



Michael Welch, CEO
Mark Patterson, CFO
Express-1 Expedited Solutions, Inc.
(amex: XPO)

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The following interview was conducted by
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Knobias

This interview is being recorded on Thursday, November 16, 2006. My name is Greg Ballard and I am Chief Operating Officer and Co-Founder of Knobias. Today, I'll be speaking with Michael Welch, CEO, and Mark Patterson, CFO, of Express-1 Expedited Solutions, Inc., ticker symbol XPO on the American Stock Exchange. Good morning gentlemen.

Michael Welch & Mark Patterson (XPO)

Good Morning.

Knobias

Thanks for taking the time to talk to us today. Let me first give you the opportunity to give us a brief overview of your business, Express-1 Expedited Solutions.

Michael Welch (XPO)

OK Greg. Thank you and good morning. Express-1 Expedited Solutions, what we do, we are a just-in-time expedited ground delivery company. Most of our shipments are time sensitive, and what that means is, that if we don't deliver on time, we could possibly shut-down manufacturing lines, or even supply chains that would cost the shipper thousands, or sometimes, hundreds of thousands of dollars per hour. So it is imperative that we deliver on time.

By doing this type of service we are also paid a premium which helps our company grow and it gives us the ability to attract quality owner-operators because we can also pay them more. So it's basically an ambulance service for the shipping industry. Anything that needs to be there and has to be there right away we can do it.

Somebody used to say, "Well boy, you guys must be just like UPS or you get there first thing in the morning." Its like, that's not what we do; we get there first thing the same day or we get there at 5 in the morning or whatever the customer requests. So that's the big difference maker from what we do to even next day delivery by some of the bigger guys.

Knobias

I understand you have two different operations, the Express-1 operations and your Dedicated operations, which are in Evansville. Explain the difference between the two, you know, what's the business model of each, and how do you serve the typical customer on a daily basis in those two operations?

Michael Welch (XPO)

Well the Express-1 model, which is about 88% of our revenue, that is all, all the work, is done by owner-operators. In using owner-operators, we have the ability to have them strategically located throughout the United States. All the work through the owner-operators is done by satellite; we have immediate contact with them, also because of the satellite units and our software, we can also tell the customers exactly where their freight is at any given moment. So it's a real specialized type of business.

Our Evansville operation is more or less a "milk run" daily deliveries to auto dealerships, so the consumer can get the parts to get their car fixed right away. They run the same route, its company type trucks, it is important because they expect the deliveries to be made on time, but it's not as time critical as what we do over in Express-1.

Knobias

The Evansville operation is based on a contract, is that right?

Michael Welch (XPO)

Yes. We have a contract running through Spring of 2007 and right now we are in negotiations to see if we can continue that contract.

Knobias

Do you see a pursuit for more dedicated services, after the Evansville contract expires, you suggested that you...

Michael Welch (XPO)

We are trying to renew the Evansville contract as we speak. We've mentioned in previous conference calls that we have put in an increase in price, we want to make that a little bit more profitable. That being said, if there is some that fit within our geographic area, or if there management team, we have a strong management team in Evansville, where we have the availability to probably bring on one or two of those dedicated type contracts, if it works well for us and if the pricing works well for us also.

Knobias

I understand that Express-1 was a long-time, family run business prior to being acquired by Segmentz in August of 2004. Give me a brief history of your original Express-1 business.

Michael Welch (XPO)

Well we started in 1989, Keith Avery and I, partner, we started out with two trucks, we were very aware of the business, as far as from the driving angle and the accounting system, typing out bills and doing all the things you have to do to get the in's-and-out's of the business. From 89, we gradually increased our fleets from two trucks to four trucks to six trucks, basically year by year.

In 1996, we brought on two of my brothers, Jim Welch, who runs our operations, and John Welch, who is our Controller presently. And they helped us with some of the management steps that really helped us go to the next level. As I stated, both still work with us, they do a great job and we still do have a family atmosphere here at Express-1.

I also have another brother, Bill, who has been with us since 1996, and he is in charge of driver relations, and does a great job working with any driver issues or driver opportunities that come forth.

Knobias

Let's talk about drivers. Tell me about your growing base of owner-operators. How does adding more owner-operators help the business, and how is this different from a financial perspective from so-called brokering, and why would an owner-operator deal with XPO?

Michael Welch (XPO)

I'm gonna have Jeff Curry, our VP of Business Development answer that.

Jeff Curry (XPO)

Greg, there's really a lot of little things that add up to something pretty big, when it comes to growing our base of owner-operators. You know as the economies of scale increase the benefits we are able to garner from that help us grow the fleet. You know, we are able to develop a more robust and full size recruiting department. We are able to spend more money on the drivers to make them feel at home, in terms of a new lounge and training center that we just put in place here just a few weeks ago. We can spend more money on advertising. We have more decals on trucks out on the road that help just perpetuate the Express-1 name out in the marketplace.

We know though that as we grow the fleet, we feel the expedite market itself is growing, and that there's more expedite freight for us to garner. We estimate that we handle about 4 to 5% of domestic automotive expedited transportation for example. All those runs are available for us if we have the capacity to handle them. So we could go from 4 to 5% to something greater if we had more capacity.

We feel that the same opportunities are available with the domestic foreign automotive as well. And with the growing fleet that we've had this year it actually gave us the opportunity and ability to gain the business of a major appliance manufacturer this year.

When we can put something on our truck and handle the load ourselves our margin is better than paying another carrier to handle the load for us, which is what we do when we broker.

Why would an owner-operator want to work with us? One way I would answer that is I think we're blessed here in Southwest Michigan to have, with a tremendous labor pool. The folks that are very committed to Express-1 and have been here since 1989. We've been able to add to that workforce with some real good people. We're very committed to training, and I think that helps separate us from our competitors. That our owner operators can trust that the folks we've put in place have been screened and we've hired a very qualified, competent person who has learned a lot and will continue to be trained. And we're committed to training the owner-operator as well, and I think those are all things that draw an owner-operator to Express-1.

Knobias

After becoming part of Segmentz in 2004, the combined company went through a significant restructuring period where most, if not all, of the old Segmentz business and management are no longer part of the company. Tell us a little about this transition.

Michael Welch (XPO)

I think the transition phase, at the time, it seemed very difficult, but it was also very clear, to us as a management team, what we needed to do. I have to commend the Board of Directors for seeing the needle in the haystack that, yes; Express-1 was a very profitable piece of the Segmentz business. With their blessing, we were able to go through and systematically sell back or shut down these other operations. Once that was done, and it was done very quickly, we could see that, yes Express-1 was very, very viable; our shareholders could see that, certainly our Board of Directors was very happy with that transition. So it was almost a blessing in one way, where some of the other business units were fairly weak, that we could strip them quickly and see what we had which was a very, very profitable Express-1. And then also keeping the Evansville operation, which was also profitable, running those two together turned out to be a very solid company.

Now we did strip away a lot of the revenue, but that revenue was revenue that was losing money and not making money. So it was a very, very easy decision for us. That's probably one of the reasons it happened real quickly.

Knobias

You touched on this next question in that last answer, but I think it's very important for our listeners to hear and understand how this transition is reflected on your historical financial statements. For starters, the company's trailing twelve months revenue of about \$41.2 million is more or less "in-line" with the last two fiscal years. In other words there seems to be no apparent top line growth. And secondly, as revenues look flat to the casual observer, the losses of the past have now disappeared and the company is reporting strong net income and positive cash flow. You touched on it already, but explain that.

Michael Welch (XPO)

Mark, you want to handle that? Mark Patterson, our CFO.

Mark Patterson (XPO)

As Mike touched on, we had several businesses. Express-1 was one of those businesses, and when I say we, that's the Segmentz operating model. Evansville was one of those businesses. Along with that were a lot of other businesses, pick-up and delivery and other forms of transportation. When we carved Express-1 and Evansville out and restructured by selling off or closing down those other operations, effectively what we did is discontinue what amounted to about \$5 million of revenue in 2005 and amounted to probably closer to \$10 or \$15 million of revenue in 2004. So, effectively, we collapsed or eliminated what amounted to in 2004, about 50% of our revenue and 2005 it represented about 20% of our revenue and we have grown now to that same level or beyond it with the core business, which we retained.

Knobias

So in other words, Express-1 by itself has replaced all of that revenue.

Mark Patterson (XPO)

Correct.

Knobias

Through growth.

Mark Patterson (XPO)

Correct.

Knobias

Typically, my weekly research profile includes a valuation comparison to four “profitable” public peers. Currently, I have chosen the following four: FedEx (FDX), CH Robinson Worldwide (CHRW), Landstar System (LSTR), and Dynamex (DDMX). Which profitable public companies would you advise investors to use when comparing valuation multiples?

Michael Welch (XPO)

They’re all very, very successful, and definitely much larger than Express-1. What we appreciate about those companies is they are profitable and they are well run. Many of the smaller public companies that you would like to have comparables with Express-1, we can’t because you are looking for a profitable company. So that sort of separates us from the smaller publicly held companies. We see Landstar as a company that we model after strongly because of use of owner-operators. As we’ve mentioned before, we are primarily an owner-operator based company, with the exception of Evansville, which runs the company dedicated fleet. So we look at their success with using owner-operators and also with possibly from time to time working with a strong agency agreement to help foster our growth. Mark, do you have any comments?

Mark Patterson (XPO)

All those companies are much, much larger, and Landstar has an owner-operator model which is very, very similar to ours. CH Robinson is primarily a broker, that kind of equates to that 20% or so of our business where we were using other peoples equipment. You know, FedEx has got a custom critical division that is a very large expeditor, but it’s so small in the whole universe of FedEx that it’s just completely lost. I think that you have to look at those guys with the exception of FedEx, they are non-asset based, and I think that’s kind of where the comparable exists.

Knobias

You talked about CH Robinson being primarily in the brokerage business, but that is something that you are really trying to get away from as you add more owner-operators.

Mark Patterson (XPO)

It's not something that we're trying to get away from, it is something that has somewhat gone away. Certainly it's more profitable if we run it on our own piece of equipment, but brokerage is something that compliments our service to our customers very, very well and probably will always continue to. But it's not something we're running away from, it's just something that when it exists and when the opportunity is there and we need it to fulfill a need of our customer we use it, but obviously we would love to grow our own fleet and put all those loads on our trucks because we make a little bit better margins on those.

Knobias

For the last eleven quarters, you have not recorded any income tax. During 2004, you actually recorded \$1.9 million in tax benefits. In your most recent financial statement refers to a \$1.2 million valuation allowance for deferred tax assets and a gross federal net operating loss carry forward of approximately \$7.7 million. How do you see this effecting your financial reporting going forward, especially in this last quarter, fourth quarter of 06?

Mark Patterson (XPO)

The reason we haven't recorded a tax provision is because the historical losses were so great there was a lack of confidence in the model that had been created at Segmentz by the auditors that no one was comfortable continuing to build a tax asset that the company may not grow out of and be able to use. With the restructuring and return to profitability, or Express-1 was always profitable, but with the profitability of the entire company it is apparent that we're going to be able to use that tax asset in the future.

So at the end of this year, fourth quarter 2006, we will record a one time adjustment to the valuation allowance and that will result in an increase in earnings per share of approximately 4 to 5 cents per share, based on \$1.2 million of valuation allowance adjustment.

For 2007, and thereafter the company will begin to record a current tax provision which will be at a rate of approximately 37%. That will be an accrual for taxes that we should pay as we earn our way, as we increase our earnings over the next few years will eat into the \$7.7 million worth of net operating loss carry forwards. When those are gone, we will actually start paying cash for tax. So, we will record a one time adjustment in fourth quarter of 2006 of approximately \$1.2 million.

Knobias

After your third quarter, you reiterated the company's full year guidance for 2006, expecting \$39 to \$42 million in revenues, and net income of 10 to 12 cents per share. Let me ask specifically about that 10 to 12 cents per share for net income, is that on a fully diluted basis, and does that include the effect of the tax benefit that you just mentioned?

Mark Patterson (XPO)

The 10 to 12 cents is on a fully diluted basis. Right now there's not a very significant difference between our diluted share count and our basic share count. As more stock options come into the money in the future, there may be a difference between basic and diluted earnings per share.

The 10 to 12 cents that we've announced in our guidance as a range for earnings per share, does not include the effects of valuation allowance adjustment which was just mentioned. We will earn an additional 4 to 5 cents per share approximately, on top of what we anticipate earning in the fourth quarter.

Knobias

In the same 2006 guidance statement, you suggest that the \$39 to \$42 million in revenues will represent approximately a 17 to 18% growth in the company's remaining operations. For the whole company, my model only suggests that that's a 5.4% year-over-year revenue growth rate if you hit the top end of guidance. So what do you mean when you suggest 17 to 18% revenue growth?

Michael Welch (XPO)

We talked earlier about closing down the unprofitable operations in 2005, the last of the operations we closed in August of 2005 and most of them ran through the first two quarters of 2005 and I think revenue approximately, close to \$5 million of revenue that the closed operations contributed to our revenue of 2005. In reality, Express-1 made up that difference and also grew on top of that.

Knobias

The company currently reports only \$129,000 in cash and \$2.4 million in debt. Working capital has been stated around \$3.7 million and you have approximately \$2.7 million available under a line of credit. I know the company has strong positive cash flow now, but it's not showing up in the cash-on-hand category on the balance sheet. Where are you applying your current cash flow and why? Secondly, do you expect to meet cash requirements over the next twelve months under current circumstances?

Mark Patterson (XPO)

The operating model that we have in place right now generates a significant amount of cash. When the restructuring was completed, we had debt, we also, in the first quarter of 2006, recorded about \$1.7 million worth of earn out payments for the acquisitions of Dasher Express and Express-1, so we absorbed that on top of the debt that we had at the end of the year which would put total debt at about \$5 million. Through the course of the first nine months of this year, we've paid that down to the approximate \$2 million range, and we will continue to pay that down through the fourth quarter and through most of the first quarter of 2007.

In the first quarter of 2007 we'll have a earn-out payment of about \$1.9 million, in the first quarter of 2008, we'll have a final earn-out payment of about \$2.1 million. Again, those earn-outs are going to people that are predominately still involved in our business.

Our philosophy has been to pay down debt. We have plenty of borrowing capacity. We have indications from our primary lending bank that they have a willingness to lend us significantly larger amounts should we need it for any purpose. But we have a model that, over the next 12 to 24 months, will make us debt free and a generator of cash, as opposed to a consumer of cash. So we haven't felt a need to try to keep a significant amount of cash on our balance sheet. Certainly it doesn't make financial sense to build a cash asset and pay interest on it from a debt standpoint.

Knobias

In monitoring your progress going forward, what should XPO investors look toward as your quote, "business metrics"? In other words, what are the best financial line items or news announcements, or whatever, to watch out for in order to measure XPO's progress and business plan execution?

Michael Welch (XPO)

Really our history, since the restructuring, we've always tried to continue to increase our top-line growth, but by doing that, we don't do that at expense of the bottom line. So what you've seen is just a real good consistent business model. We expect to continue to do that, we expect to continue to grow and that's what you should expect from Express-1. We believe our model that we have built is more or less intact and ready to expand. So you are not going to see a lot of different things, or different initiatives, that "Oh boy, we decided to get into this piece of the transportation market all of the sudden 'cause that's where the pastures are greener." We are focused. We know what we want to do. We are an expeditor. We do a great job at it. We have a model that works with the owner-

operator plan; we should continue to build on that. So that's what the investors should look for.

Knobias

Since June of 2006, Insiders have purchased at least 46,000 shares at an average of \$1.04 per share. This includes 45,000 shares purchased by you, Mr. Welch. Please explain your thinking regarding the recent buy-ins.

Michael Welch (XPO)

Sort of dove-tails back to the last question. We believe in our model. We believe in our company. Personally, I think we have nowhere to go but up, and that's the primary reason I'm buying some of the stock. As a private investor, you're looking for ways to grow your portfolio, and I believe in the company, and I believe in what we are doing, and I certainly believe in our management, our people and our owner-operators.

Knobias

I know your predecessors attempted growth through acquisition, and was not so successful. We talked a little bit about how you're using current cash flow. Is there a future situation in which you might consider starting the hunt for acquisitions to boost growth?

Michael Welch (XPO)

I think when we look at acquisitions in the future it will be, are they good companies? Does their culture match Express-1's culture? Do they make money as a stand-alone, as is? We don't want to come in and say, "You know what, this would be great, they will finally make money if these synergies work, and if this works, and if this works, it will be ok." If we do have acquisitions in the future, it's going to be already profitable, well run businesses, and who also rely primarily on the owner-operator model. So it's sort of a smaller field when you're looking for those types of acquisitions. We're looking for profitable, owner-operator and up-and-coming companies, and if we find them, and if those cultures match, and it's somewhat reasonable as far as pricing, we would certainly look at them. It's a narrow field.

Knobias

Over the past year and a half, I've written on over 70 smallcap companies like yours, and many of those I've written on have been acquired by larger companies, or by private equity groups. Do you see XPO as an acquisition target by anyone?

Michael Welch (XPO)

Not at this point. We don't believe we are. We haven't had any conversations or any talks whatsoever to that point. We believe we have a long way to go to build our company before some of the bigger people would be really seriously looking at us. So our goal is just to keep our head to the ground and continue to do the right things and hopefully we're going to grow to a size where the shoe will be on the other foot.

Knobias

After examining the four public peers we've mentioned, it seems as though your current trailing valuation multiples are at least half of your peers. Factoring in your current 2006 year end guidance, the lag factor, so to speak, may be even more. Why do you think your company's valuations are so far below peer multiples?

Michael Welch (XPO)

After the restructuring I think we're starting to develop the reputation of a profitable strong company. I think we are fighting through a little bit of the Segmentz legacy of lack of focus and obviously not making money. So I think probably the investors are lagging a little bit, they are remembering the old Segmentz.

From the Express-1 point of view, Mark hit on it earlier, as our company since 89, we've always been growing and profitable, and it's a strange position to be in, but we also know that people's memories are long. So what we've done this year of putting together, since the fourth quarter of last year, four straight profitable growing quarters. You know, we hope that investors take a second look at that and say "Wait a minute; this is who the company is. They are no longer Segmentz." And we feel once people start looking at that some of those attitudes towards the company may change and certainly will increase our stock price, hopefully, and maybe even the multiples, we'll be closer to our peers.

That being said, we know we have a lot of work to do and we have to continue to prove ourselves. Four quarters probably is good, but eight quarters is better, and so on and so on and so on. So we've got to continue to blocking and tackling.