

KNIGHT TRANSPORTATION INC
Form 10-K
March 01, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number: 0-24946

KNIGHT TRANSPORTATION, INC.
(Exact name of registrant as specified in its charter)

Arizona
(State or other jurisdiction of
incorporation or organization)
5601 West Buckeye Road, Phoenix,
Arizona
(Address of principal executive offices)

86-0649974
(I.R.S. Employer
Identification No.)
85043
(Zip Code)

(602) 269-2000
(Registrant's telephone number, including area code)

Securities registered pursuant **Common Stock, \$0.01 par value**
to Section 12(b) of the Act: **New York Stock Exchange**
Securities registered pursuant **None**
to Section 12(g) of the Act:

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
 Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
 Yes No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
 Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2006, was approximately \$1,169 million (based upon \$20.20 per share closing price on that date as reported by the New York Stock Exchange). In making this calculation the registrant has assumed, without admitting for any purpose, that all executive officers, directors, and no other persons, are affiliates.

The number of shares outstanding of the registrant's common stock as of February 10, 2007 was 86,166,076.

Materials from the registrant's Notice and Proxy Statement relating to the 2007 Annual Meeting of Shareholders to be held on May 24, 2007 have been incorporated by reference into Part III of this Form 10-K.

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PART I

Item 1. Business

This Annual Report contains certain statements that may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including without limitation: any projections of earnings, revenues, or other financial items; any statement of plans, strategies, and objectives of management for future operations; any statements concerning proposed new services or developments; any statements regarding future economic conditions or performance; and any statements of belief and any statement of assumptions underlying any of the foregoing. Such statements may be identified by their use of terms or phrases such as "believe," "may," "could," "expects," "estimates," "projects," "anticipates," "intends," and similar terms and phrases. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, which could cause future events and actual results to differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. Readers should review and consider the factors discussed in "Item 1A. Risk Factors" of this Annual Report on Form 10-K, along with various disclosures in our press releases, stockholder reports, and other filings with the Securities and Exchange Commission.

All such forward-looking statements speak only as of the date of this Annual Report. You are cautioned not to place undue reliance on such forward-looking statements. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in the events, conditions, or circumstances on which any such statement is based.

References in this Annual Report to "we," "us," "our," "Knight," or the "Company" or similar terms refer to Knight Transportation, Inc. and its consolidated subsidiaries.

General

Our headquarters are located in Phoenix, Arizona. The transportation services we provide are primarily asset-based dry van truckload and temperature controlled truckload carrier services, along with non-asset-based brokerage services. Through our asset-based and non-asset-based capabilities we are able to transport, or can arrange for the transportation of, general commodities for customers throughout the United States. We generally focus our dry van and temperature controlled operations on regional short-to-medium lengths of haul. We presently operate 24 regional dry van service centers, four regional temperature controlled service centers, and five brokerage service centers. The addition of our brokerage services in 2005 enabled us to expand our customer service offerings by providing non-asset-based capability to manage our customers' freight when the shipments do not fit our asset-based model. Our stock has been publicly traded since October 1994. Over the past five years we have achieved substantial growth from \$279.4 million in revenue, before fuel surcharge, and \$27.9 million in net income in 2002 to \$568.4 million in revenue, before fuel surcharge, and \$73.0 million in net income in 2006. The main factors that affect our results are the number of tractors we operate, our revenue per tractor (which includes primarily our revenue per total mile and our number of miles per tractor), and our ability to control our costs.

We have determined that we have two operating segments, but only one reportable segment. Our operating segments consist of (i) our truckload transportation (asset-based) segment and (ii) our brokerage segment (non-asset-based). Our truckload transportation segment includes our dry van and temperature controlled operations with service centers located throughout the United States. Each of the asset-based service centers have similar economic characteristics, as

they all provide truckload carrier services of general commodities to a similar class of customers. As a result, we have determined that it is appropriate to aggregate these service centers into one reportable segment consistent with the guidance in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." Accordingly, we have not presented separate financial information for each of these service centers. Furthermore, we have not presented separate financial information for our brokerage segment, although it qualifies as an operating segment under SFAS No. 131, because its results of operations are not material to our consolidated financial statements as a whole and it does not meet any of the quantitative tests for reportable segments set forth in SFAS No. 131, we have not presented separate financial information. For the year ended December 31, 2006, our brokerage segment accounted for 1.9% of our consolidated revenue, 1.4% of our consolidated net income, and less than 1% of our consolidated assets.

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Operations

Our operating strategy for our asset-based activities is to achieve a high level of asset utilization within a highly disciplined operating system while maintaining strict controls over our cost structure. To achieve these goals, we operate primarily in high-density, predictable freight lanes in select geographic regions, and attempt to develop and expand our customer base around each of our regional service centers. This operating strategy allows us to take advantage of the large amount of freight transported in regional markets, realize the operating efficiencies associated with regional hauls, and offer more flexible service to our customers than rail, intermodal, and smaller regional competitors. In addition, short-to-medium lengths of haul provide an attractive alternative to drivers in the truckload sector by reducing the amount of time spent away from home. We believe this improves driver retention, decreases recruitment and training costs, and reduces insurance claims and other costs. We operate a modern fleet to appeal to drivers and customers, decrease maintenance expenses and downtime, and enhance our operating efficiencies. We employ technology in a cost-effective manner to assist us in controlling operating costs and enhancing revenue. Our operating strategy for our non-asset-based activities is to match quality capacity with the shipping needs of our customers. Our goal is to increase our market presence significantly, both in existing operating regions and in other areas where we believe the freight environment meets our operating strategy, while seeking to achieve industry-leading operating margins and returns on investment.

Our operating strategy includes the following important elements:

Regional Operations. At December 31, 2006, we operated 24 regional dry van service centers, three regional temperature controlled service centers, and four brokerage service centers. We concentrate our asset-based freight operations in an approximately 1,000 mile radius of our service centers, with an average length of haul in 2006 of approximately 561 miles. We believe that regional operations offer several advantages, including:

- obtaining greater freight volumes, because approximately 80% of all truckload freight moves in short-to-medium lengths of haul;
- achieving higher revenue per mile by focusing on high-density freight lanes to minimize non-revenue miles and offer our customers a high level of service and consistent capacity;
- enhancing safety and driver recruitment and retention by allowing our drivers to travel familiar routes and return home more frequently; and
- enhancing our ability to provide a high level of service to our customers.

Operating Efficiencies. Our company was founded on a philosophy of maintaining operating efficiencies and controlling costs. We maintain a simplified operation that focuses on operating in particular geographical and shipping markets. This approach allows us to concentrate our marketing efforts to achieve higher penetration of our targeted service areas and to achieve higher equipment utilization in dense freight lanes. We maintain a modern tractor and trailer fleet in order to obtain operating efficiencies and attract and retain drivers. A generally compatible fleet of tractors and trailers simplifies our maintenance procedures, reduces parts supplies, and facilitates our ability to serve a broad range of customer needs, thereby maximizing equipment utilization and available freight capacity. We also regulate vehicle speed in order to maximize fuel efficiency, reduce wear and tear, and minimize claims expenses.

Customer Service. We offer a high level of service to our customers, and we seek to establish ourselves as a preferred provider for many of our customers. For our asset-based services we allocate revenue equipment close to customers in high-density lanes and regions where we can provide them with a consistent supply of capacity and match our equipment to their needs. Our services include multiple pick-ups and deliveries, dedicated equipment and personnel, on-time pickups and deliveries within narrow time frames, specialized driver training, and other services. Brokerage services are tailored to meet our customers' needs. We price our services commensurately with the level of service our customers require and the conditions in market demand. By providing customers a high level of service, we believe

we avoid competing solely on the basis of price.

Using Technology that Enhances Our Business. We purchase and deploy technology when we believe that it will allow us to operate more efficiently and the investment is cost-justified. We use a satellite-based tracking and communication system to communicate with our drivers, to obtain load position updates, and to provide our customers with freight visibility. We have installed Qualcomm's satellite-based tracking technology in substantially all of our tractors, which allows us to rapidly respond to customer needs and allows our drivers efficient communications with our regional service centers. Our trailers are equipped with Terion trailer-tracking technology that allows us to more effectively manage our trailers, reduce the number of trailers per tractor in our fleet, and minimize cargo loss. We have automated many of our back-office functions, and we continue to invest in technology where it allows us to better serve our customers and reduce our costs.

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Growth Strategy

We believe that industry trends, our strong operating results and financial position, and the proven operating model replicated in our regional service centers create significant opportunities for us to grow. We intend to take advantage of these growth opportunities by continuing to focus on four key areas:

Opening new regions and expanding existing regional service centers. Over the past several years, a substantial portion of our revenue growth has been generated by our expansion into new geographic regions through the opening of additional service centers. We believe there are significant opportunities to further increase our business in the short-to-medium haul market by opening additional regional service centers, both asset-based and non-asset based, while expanding our existing regional service centers. To take advantage of these opportunities, we are developing relationships with existing and new customers in regions that we believe will permit us to develop transportation lanes that allow us to achieve high equipment utilization and result in operating efficiency.

Strengthening our customer relationships. We market our services to both existing and new customers in freight lanes that complement our existing operations and that support high equipment utilization. We seek customers who will diversify our freight base; and our marketing targets include financially stable customers for whom we are not currently providing all of our service offerings.

Opportunities to make selected acquisitions. We are continuously evaluating acquisition opportunities. Since 1998, we have acquired four short-to-medium haul truckload carriers or have acquired substantially all of the trucking assets of such carriers, including: Phoenix, Arizona-based Roads West Transportation, Inc. acquired in 2006; Idaho Falls, Idaho-based Edwards Bros., Inc., acquired in 2005; Gulfport, Mississippi-based John Fayard Fast Freight, Inc., acquired in 2000; and Corsicana, Texas-based Action Delivery Service, Inc., acquired in 1999. We continue to evaluate and consider acquisition opportunities that meet our financial and operating criteria.

Diversifying our service offerings. We provide truckload transportation services, both dry van and temperature controlled, with our fleet of tractors and trailers. In 2005, we expanded our service offering to include brokerage services. We will continue to leverage our nationwide footprint and expertise of providing synergies and adding value to our customers through our service offerings.

Marketing and Customers

Our sales and marketing functions are led by members of our senior management team, who are assisted by other sales professionals. Our sales team emphasizes our high level of service and ability to accommodate a variety of customer needs. Our marketing efforts are designed to match the shipping needs of our current and potential customers with our capacity in markets throughout the country.

We try to maintain a diversified customer base. For the year ended December 31, 2006, our top 25 customers represented 41% of revenue; our top 10 customers represented 26% of revenue; and our top 5 customers represented 16% of revenue. No single customer represented more than 10% of revenue in 2006. Most of our truckload carriage contracts are cancelable on 30 days notice.

We seek to offer the service, value, and flexibility of a local provider, while possessing the capacity, strength, and dependability of a large company. Our objective is to develop and service specified freight lanes for customers who ship on a consistent basis, thereby providing a sustained, predictable freight flow and ensuring high equipment utilization. The short-to-medium haul segment of the truckload carrier market demands timely pickup and delivery and, in some cases, response on short notice. We try to obtain a competitive advantage by providing high quality services and consistent capacity to customers. To be responsive to customers' and drivers' needs, we often assign

particular drivers and equipment to prescribed routes, providing better service to customers, while obtaining higher equipment utilization.

Our dedicated fleet services also may provide a significant part of a customer's transportation requirements. Under a dedicated carriage service agreement, we can provide drivers, equipment and maintenance, and, in some instances, transportation management services that supplement the customer's in-house transportation department. We furnish these services through our company-provided revenue equipment and employees as well as through independent contractors.

Each of our regional service centers is linked to our IBM I-Series computer system in our Phoenix headquarters. The capabilities of this system enhance our operating efficiency by providing cost effective access to detailed information concerning equipment, shipment status, and specific customer requirements. The system also enables us to respond promptly and accurately to customer requests and assists us in matching available equipment with customer loads. We also provide electronic data interchange ("EDI") services to shippers desiring such service.

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Drivers, Other Employees, and Independent Contractors

As of December 31, 2006, we employed 4,176 persons, of which 3,521 were drivers. None of our employees are subject to a union contract. It is our policy to comply with applicable equal employment opportunity laws and we periodically review our policies and practices for equal employment opportunity compliance.

The recruitment, training, and retention of safe and qualified drivers is essential to support our continued growth and to meet the service requirements of our customers. We hire only experienced drivers who meet our objective guidelines relating primarily to their safety history, driving experience, road test evaluations, and other personal evaluations, including physical examinations and mandatory drug and alcohol testing. In order to attract and retain safe, experienced drivers who are committed to the highest level of customer service, we build our operations for drivers around a team environment that pays competitive wages. We provide attractive and comfortable equipment, direct communication with senior management, competitive wages and benefits, and other incentives designed to encourage driver safety, retention, and long-term employment. Many drivers are assigned to dedicated or semi-dedicated fleet operations, enhancing job predictability. Drivers are recognized for providing superior service and developing good safety records.

Our drivers generally are compensated on the basis of miles driven and length of haul. Drivers also are compensated for additional flexible services provided to our customers. During 2006, we increased our driver compensation rates approximately two cents per mile. Drivers and other employees are invited to participate in our 401(k) program and in our company-sponsored health, life, and dental plans. Our drivers and other employees who meet eligibility criteria also participate in our stock option plan. We have a broad-based stock option program with more than eleven hundred participants at December 31, 2006.

We also maintain an independent contractor program. Because independent contractors provide their own tractors, the independent contractor program provides us an alternate method of obtaining additional revenue equipment. We intend to continue our use of independent contractors. As of December 31, 2006, we had agreements covering 249 tractors operated by independent contractors. Each independent contractor enters into a contract with us pursuant to which the independent contractor is required to furnish a tractor and a driver to load, transport, and unload goods we haul. Competition for independent contractors among transportation companies is strong. We pay our independent contractors a fixed level of compensation based on the total of trip-loaded and empty miles. We incur no liability to independent contractors unless services are provided. Independent contractors are obligated to maintain their own tractors and pay for their own fuel. We provide trailers for each independent contractor. We also provide maintenance services, for a charge, for our independent contractors who desire such services. In certain instances, we provide financing to independent contractors to assist them in acquiring revenue equipment. Our loans to independent contractors are secured by a lien on the independent contractor's revenue equipment. As of December 31, 2006, we had outstanding loans of \$689,736 (net of allowance for doubtful accounts of \$140,340) to independent contractors.

Revenue Equipment

As of December 31, 2006, we operated 3,412 company-owned tractors with an average age of 1.4 years. We also had under contract 249 tractors owned and operated by independent contractors. Our trailer fleet consisted of 8,761, 53-foot long, high cube trailers, including 626 temperature controlled trailers, with an average age of four years.

Growth of our tractor and trailer fleet is determined by market conditions and our experience and expectations regarding equipment utilization. In acquiring revenue equipment, we consider a number of factors, including economy, price, rate, environment, technology, warranty terms, manufacturer support, driver comfort, and resale value.

Our fleet configuration allows us to move freight on a "drop-and-hook" basis, increasing asset utilization and providing better service to customers. Our goal is to maintain a trailer to tractor ratio of approximately 2.5 to 1, which we believe promotes efficiency and allows us to serve a large variety of customers' needs without significantly changing or modifying equipment.

We have adopted an equipment configuration that meets a wide variety of customer needs and facilitates customer shipping flexibility. Standardization of our fleet allows us to operate with a smaller spare parts inventory and simplifies driver training and equipment maintenance. We adhere to a comprehensive maintenance program that minimizes downtime and enhances the resale value of our equipment. We perform routine servicing and maintenance of our equipment at most of our service centers, thus avoiding costly on-road repairs and out-of-route trips. Our current policy is to replace most of our tractors within 36 to 48 months after purchase and to replace our trailers over a six to ten year period. We believe this replacement policy enhances our ability to attract drivers, stabilizes maintenance expense, and maximizes equipment utilization. Changes in the current market for used tractors, regulatory changes, and difficult market conditions faced by tractor manufacturers, may result in price increases that may effect the period of time we operate our equipment.

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In 2002, the Environmental Protection Agency (the "EPA") implemented regulations limiting exhaust emissions. These regulations become progressively more restrictive in 2007 and 2010. In part to offset the costs of compliance with these requirements, some manufacturers have significantly increased new equipment prices and further increases may result in connection with the implementation of the 2007 and 2010 requirements. If new equipment prices increase more than anticipated, we may be required to increase our depreciation and financing costs and/or retain some of our equipment longer, with a resulting increase in maintenance expenses. To the extent we are unable to offset any such increases in expenses with rate increases or cost savings, our results of operations would be adversely affected. In addition to increases in equipment costs, new engines generally produce lower fuel mileage compared with older models and compliance with the new standards could result in further declines in fuel economy. If we are unable to offset resulting increases in fuel expenses with higher rates or surcharge revenue, our results of operations would be adversely affected.

We have Qualcomm's satellite-based mobile communication and position-tracking system in our tractors and we have Terion's trailer-tracking system in our trailers. We believe that this technology has helped us generate operating efficiencies and allowed us to improve fleet control while maintaining a high level of customer service.

Safety and Risk Management

We are committed to ensuring the safety of our operations. We regularly communicate with drivers to promote safety and instill safe work habits through media and safety review sessions. We also regularly conduct safety training meetings for our drivers, independent contractors, and non-driving personnel. We dedicate personnel and resources to ensure safe operation and regulatory compliance. We employ safety personnel at every operating location who are responsible for administering our safety programs. We employ technology to assist us in managing risks associated with our business. In addition, we have an innovative recognition program for driver safety performance and emphasize safety through our equipment specifications and maintenance programs. Our Vice President of Safety is involved in the review of all accidents.

We require prospective drivers to meet higher qualification standards than those required by the United States Department of Transportation ("DOT"). The DOT requires drivers to obtain commercial drivers' licenses and also requires that we maintain a drug and alcohol testing program in accordance with DOT regulations. Our program includes pre-employment, random, and post-accident drug testing. We are authorized by the DOT to haul hazardous materials. We require any driver who transports hazardous materials to have the proper endorsement and to be regularly trained as prescribed by DOT regulations. We also monitor our driver's compliance with the Department of Homeland Security's new "Security Threat Assessment" regulation, which took effect in 2005, when applying for or renewing a hazardous material endorsement. Drivers who do not possess a hazardous material endorsement are subjected to a secondary background check.

Our President, Chief Financial Officer, and Vice President of Safety are responsible for securing appropriate insurance coverage at competitive rates. The primary claims arising in our business consist of cargo loss and physical damage and auto liability (personal injury and property damage). For 2006 we were self-insured for these claims, including general liability claims, with a maximum limit of \$1.5 million per occurrence, and we were self-insured for workers' compensation up to a maximum limit of \$500,000 per occurrence. The same self-insurance retentions were secured in early 2007 effective until February 1, 2008.

Our insurance policies for 2006 provided for excess liability coverage up to a total of \$50.0 million per occurrence. We also maintain primary and excess coverage for employee medical expenses, hospitalization, and damage to physical properties. Our self retention level for employee medical health was \$200,000 per claimant in 2006 and was raised to \$225,000 per claimant for 2007. We carefully monitor claims and participate actively in claims estimates and adjustments. The estimated costs of our self-insured claims, which include estimates for incurred but unreported

claims, are accrued as liabilities on our balance sheet.

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Competition

The trucking industry is highly competitive and fragmented. We compete primarily with other regional short-to-medium haul truckload carriers, logistics providers, and national carriers. Railroads and air freight also provide competition, but to a lesser degree. Competition for the freight transported by us is based on freight rates, service, efficiency, size, and technology. We also compete with other motor carriers for the services of drivers, independent contractors, and management employees. A number of our competitors have greater financial resources, own more equipment, and carry a larger volume of freight than we do. We believe that the principal competitive factors in our business are service, pricing (rates), and the availability and configuration of equipment that meets a variety of customers' needs. In addressing our markets, we believe that our principal competitive strength is our ability to provide timely, flexible and cost-efficient service to customers.

We believe that the cost and complexity of operating trucking fleets are increasing and that economic and competitive pressures are likely to force many smaller competitors and private fleets to consolidate or exit the industry over time. As a result, we believe that larger, better-capitalized companies, like us, will have opportunities to gain market share while maintaining high profit margins. In the market for dedicated services, we believe that truckload carriers, like us, have a competitive advantage over truck lessors, who are the other major participants in the market, because we can offer lower prices by utilizing back-haul freight within our network that traditional lessors may not have.

Over the past three years our industry generally has enjoyed an improved pricing environment compared with our historical experience. We believe that stronger freight demand and industry-wide capacity constraints caused by a shortage of truck drivers and a lack of capital investment in additional revenue equipment by many carriers contributed to the pricing environment. In addition, many customers have recognized that the costs of operating in our industry have increased significantly, particularly in the areas of driver compensation, revenue equipment, fuel, and insurance and claims. During the second half of 2006, the pricing environment became less favorable. Although we believe the medium to longer term outlook for achieving pricing increases remains favorable, the timing and consistency of achieving pricing increases will be subject to economic and competitive forces over which we have little control.

Regulation

Our operations are regulated and licensed by various U.S. agencies. Our company drivers and independent contractors also must comply with the safety and fitness regulations of the United States Department of Transportation ("DOT"), including those relating to drug and alcohol testing and hours-of-service. Such matters as weight and equipment dimensions are also subject to U.S. regulations. We also may become subject to new or more restrictive regulations relating to fuel emissions, drivers' hours-of-service, ergonomics, or other matters affecting safety or operating methods. Other agencies, such as the EPA and the Department of Homeland Security ("DHS"), also regulate our equipment, operations, and drivers.

The DOT, through the Federal Motor Carrier Safety Administration ("FMCSA"), imposes safety and fitness regulations on us and our drivers. New rules that limit driver hours-of-service were adopted effective January 4, 2004, and then modified effective October 1, 2005. The rules effective October 1, 2005, did not substantially change the existing rules but did result in a reduction in equipment productivity. The FMCSA is studying rules relating to braking distance and on-board data recorders that could result in new rules being proposed. We are unable to predict the effect of any rules that might be proposed, but we expect that any such proposed rules would increase costs in our industry, and the on-board recorders potentially could decrease productivity and the number of people interested in being drivers.

The Transportation Security Administration ("TSA") has adopted regulations that require determination by the TSA that each driver who applies for or renews his or her license for carrying hazardous materials is not a security threat. This could reduce the pool of qualified drivers, which could require us to increase driver compensation, limit our fleet growth, or let trucks sit idle. These regulations also could complicate the matching of available equipment with hazardous material shipments, thereby increasing our response time on customer orders and our non-revenue miles. As a result, it is possible we may fail to meet the needs of our customers or may incur increased expenses to do so.

Some states and municipalities have begun to restrict the locations and amount of time where diesel-powered tractors, such as ours, may idle, in order to reduce exhaust emissions. These restrictions could force us to alter our drivers' behavior, purchase on-board power units that do not require the engine to idle, or face a decrease in productivity.

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We are subject to various environmental laws and regulations dealing with the hauling and handling of hazardous materials, fuel storage tanks, air emissions from our vehicles and facilities, engine idling, discharge and retention of storm water, and other environmental matters that import inherent environmental risks. We maintain bulk fuel storage and fuel islands at several of our service centers. Our operations involve the risks of fuel spillage or seepage, environmental damage, and hazardous waste disposal, among others. We have instituted programs to monitor and control environmental risks and assure compliance with applicable environmental laws. As part of our safety and risk management program, we periodically perform internal environmental reviews so we can achieve environmental compliance and avoid environmental risk. We design our service centers, after consultation with environmental advisors, to contain and properly dispose of hazardous substances and petroleum products used in connection with our business. We transport a small amount of environmentally hazardous materials and, to date, have experienced no significant claims for hazardous materials shipments. If we are found to be in violation of applicable laws or regulations, we could be subject to liabilities, including substantial fines or penalties or civil and criminal liability, any of which could have a materially adverse effect on our business and operating results.

Regulations further limiting exhaust emissions became effective in 2002 and on January 1, 2007 and become progressively more restrictive in 2010. Newer engines generally cost more, produce lower fuel mileage, and require additional maintenance compared with older models. We expect additional cost increases and possibly degradation in fuel mileage from the 2007 and 2010 engines. These adverse effects, combined with the uncertainty as to the reliability of the newly designed diesel engines and the residual values of these vehicles, could materially increase our costs or otherwise adversely affect our business or operations.

Seasonality

Results of operations in the transportation industry frequently show a seasonal pattern, with lower revenue and higher operating expenses being common in the winter months. Continued expansion of our operations throughout the United States could expose us to greater operating variances due to periodic seasonal weather in various regions, which variance could have a materially adverse effect on our operations.

Acquisitions, Investments, and Dispositions

We periodically examine investment opportunities in areas related to the transportation industry. Our investment strategy is to invest in industry related businesses that will strengthen our overall position in the transportation industry, minimize our exposure to start-up risk, and provide us with an opportunity to realize a substantial return on our investment.

On October 23, 2006, we purchased most of the trucking assets of Roads West Transportation, Inc. (“Roads West”), an Arizona-based temperature controlled carrier. Under the asset purchase agreement, we purchased 133 tractors, 280 trailers, and certain miscellaneous other assets. We did not purchase cash or accounts receivable and did not assume any debts or liabilities of Roads West. The purchase price for the assets was approximately \$15.6 million, not including potential earn-outs that could increase the price to \$16.0 million. The total purchase price has been allocated to tangible and intangible assets acquired based on their fair market values as of the acquisition date. The acquisition has been accounted for in our results of operations since the acquisition date. The pro forma effect of the acquisition on our results of operations is immaterial.

On August 12, 2005, we acquired 100% of the stock of Edwards Bros., Inc., an Idaho based temperature controlled truckload carrier. In addition to the purchase price, the purchase agreement set forth certain conditions upon which we would be required to pay certain earn-out adjustments. During 2006, we paid \$320,000 as an earn-out, which represented the final earn-out under the purchase agreement.

In 2003, we signed a partnership agreement with Transportation Resource Partners ("TRP"), a company that makes privately negotiated equity investments. Per the original partnership agreement, we committed to pledge \$5.0 million out of approximately \$260.0 million, for a 1.9% ownership interest. In early 2006, we increased the commitment amount to \$5.5 million. In 2006, we contributed approximately \$1.8 million in working capital to TRP, which leaves an approximately \$1.5 million outstanding commitment at December 31, 2006. Due to portfolio losses within the TRP Fund, we recorded a \$712,500 pre-tax impairment charge in the fourth quarter of 2006 to reflect the fair value of the portfolio. The carrying book balance of our TRP investment was approximately \$3.2 million at December 31, 2006.

Other Information

We were incorporated in 1989 and our headquarters are located at 5601 West Buckeye Road, Phoenix, Arizona 85043. This Annual Report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and all other reports filed with the Securities and Exchange Commission ("SEC") pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") can be obtained free of charge by visiting our website at www.knighttrans.com. Information contained on our website is not incorporated into this Annual Report on Form 10-K, and you should not consider information contained on our website to be part of this report.

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Additionally, you may read all of the materials that we file with the SEC by visiting the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. If you would like information about the operation of the Public Reference Room, you may call the SEC at 1-800-SEC-0330. You may also visit the SEC's website at www.sec.gov. This site contains reports, proxy and information statements, and other information regarding our company and other companies that file electronically with the SEC.

Item 1A. Risk Factors

Our future results may be affected by a number of factors over which we have little or no control. The following issues, uncertainties, and risks, among others, should be considered in evaluating our business and growth outlook.

Our business is subject to general economic and business factors that are largely out of our control.