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Werner Enterprises (WERN)
Baird analyst: Ben Hartford
Werner Enterprises: Derek Leathers, President and CEO. John Steele, EVP and CFO.

Ben Hartford: Great. It looks like we've got everybody connected successfully, so we'll go ahead and get started. Obviously, thank you for joining us in this virtual setting, different than in years past, but it'll be the same in terms of format, for all intents and purposes. And as always, a pleasure to have Werner Enterprises here, represented by Derek and John.

I'm going to turn it over to them on the outset to a broad level overview of the company for a couple of minutes. And then we'll jump into Q&A. I have my email up here off to my left. So, if any questions come in from the audience, feel free to send them in and I'll be sure to get them addressed.

But with that, Derek and John, thank you again for joining us. I'll turn it over to you guys. I'll cut my video and then once you stop, I'll jump back in.

Derek Leathers: John, I'm unable to hear.

John Steele: Oh, OK. Well, I'll go ahead and get started. This is John Steele, CFO at Werner. And Werner is one of the five largest truckload carriers in the country. We have a strong TTS truckload presence with 61% of our trucks in Dedicated, and 39% of our trucks in One-Way Truckload. We're about two and a half billion in revenues, and have a market cap of about \$2.8 billion.

Been in business for 64 years, transitioning from our founder who started the company with one man, one truck to 7,600 trucks today. Derek Leathers, who's our CEO, he's with me here today, and he has been our CEO for the last three years and will become our chairman next May. So, with that, Derek, anything you'd like to add?

Derek Leathers: No, just happy to be here. Look forward to speaking with everybody today about the company and answer questions. I apologize, I had a little audio glitch there to start off, but I think you covered it well, John.

Ben Hartford: Great. So, we got that sorted and thanks for those remarks. Derek, let's just start from the top as it relates to the cycle. As I told you, you did a really good job describing the reality of where we are in the cycle. I think that's a dominant focal point among investors as it stands today.

I'm interested in your perspective on where we sit in relation to prior cycles, whether it's '17, '18, or '14, or 2010 or even mid-2000s. You touched on some elements in the third quarter call from a supply perspective and from an inventory standpoint that I think lends credence to the idea that we're close to the start, as

opposed to the end, of this cycle. So, a lot of topics in there, but interested in your updated thoughts as it relates to that topic.

Derek Leathers:

Yes, sure Ben. I appreciate the question. I do think the cycle is different. It's different for a lot of reasons. Let's start on the supply side, as you mentioned. This tightening that happened this time around, first off was kicked off by different market forces than really any of the prior cycles you spoke about. When you think about COVID and when it hit, and the impact that it had, right out of the gate, there was an impact to new entrants into the marketplace, obviously.

Schools were essentially all but shut down during the start of COVID. And then, after that point, as we move forward, they've been socially distanced ever since, and probably will remain so for some time. We found ourselves in a world where the production rate of school networks nationwide is probably 60% in aggregate of what it was pre-COVID. Schools that are open are operating at 70, maybe 72% or so, community colleges are still predominantly closed. And so, the impact on an aggregate is about a 60% induction rate compared to what it would have been pre-COVID.

Coupled with that, you have an acceleration of retirements. Some people that are at the end of their career are also older in age, and so they're more in a higher risk category. And we've seen an uptake in retirements around the industry. You have the Drug and Alcohol Clearinghouse that's certainly played a role, with 40,000 people entering that database thus far this year, and 90% of them not even really starting in earnest any kind of return to work process. And then lastly, a more metric-driven way to think about it is, 100,000 less CDLs, was FMCSA's estimate in the first six months of the year, were issued to new drivers coming in.

So, this is real, the constraints on the supply side are real. And yet on the demand side, I think the American consumer has come through this stronger than most any of us expected, especially if you're aligned with the right type of customers. We're heavy in discount retail, we're heavy in home improvement, we're heavy with people that are either the small footprint, brick and mortar, close to home, still accessible through COVID. Or they're really leaning into e-commerce and have accelerated that ability to execute in an e-commerce environment with COVID. And so, what all that's done is set up a tightening much earlier in the year than any of those prior cycles we talked about.

So, to my recollection, I can't remember a cycle that kicked off in earnest eight months prior to the start of the following contract season. So yes, we've seen spot rates getting to very elevated levels, but contract rates have been reworked around the edges. We, and others have yielded off the bottom, with underperforming pieces of the portfolio. But our ability to really engage on contract renegotiation starts now, accelerates in the first quarter, and really hits its stride in the latter part of Q1, early part of Q2. And there's no real indication in my mind that there's any capacity coming online.

The one data point that people point to is two months of elevated truck orders, but that elevation is slightly above replacement level. And if you factor in aging fleets, I would argue it's not even that. But if you take the aggregate over the last several months and compare it to the '18 run up, truck orders are 54% lower over the last five months compared to the 2018 run-up when truck orders really exploded in the first part of '18, the first eight months of '18, on a per month basis. There's still legs to this. We're down 4% as an industry on overall capacity pre-COVID to today. So even with some adds, you're just building back to where you once were, and yet demand has continued to elevate.

Ben Hartford:

I want to build on that supply point because someone pointed out some of the recent hours of service changes, and you highlighted some of the productivity improvements that came on the heels of it. You mentioned that 4% reduction in supply since all this began. The hours of service change, how do you quell some of the concerns that, as it represents, is going to make incremental supply growth that can help restore us toward equilibrium?

Derek Leathers:

Well, I think, again, it gets back to gauges for me, right? That's one gauge. We don't drive our car with one gauge on the dash. We use all of them. One gauge would say hours of service added a percent back. I think that's about right. I think it added about a percent back.

But there's a lot of other gauges to think about. So, one of those that is not being talked about at all is, we've had five months of clear highways. The roads have been de-congested. People have stayed at home. It's really been our highways to operate on. That's changing and changing fairly rapidly. People are back on the roads. People are back engaging. And that 1% gain from hours of service, in my view, is countered almost completely by the effect of that re-congestion of America's roadways.

And especially as people are starting to engage in limited regional travel, they're not flying, they're driving. Even business travel that's beyond regional, five to six hour drives, people are more comfortable often driving than flying. So, there's going to be counters to that 1% help.

But even with that 1% help, that's driving time impacts. That's when you're on the road, exercising your rights under the new hours of service rules, but we still see ongoing delays in shipper and consignees. Nothing extravagant, nothing exorbitant, but just COVID protocols cause loadings and unloadings to take a little bit longer.

They take longer to check in. So, something not traditionally captured very well, is all of the time to the in gate and out gate. People are good at measuring their dock. We don't get to teleport to the dock. We have to go through an engaging security process. And so, you chew through a lot of that capacity. The net of it all is, I don't think that 1% is real. Even if it was, you're at negative three and so negative four.

Ben Hartford: Okay. From a top line demand perspective, I mean. Kind of knock on wood, we have an effective vaccine, and we get through some state of normality at some point in time during 2021. But you look back at 2020, an unforeseeable environment, but in retrospect it clearly broke in your favor in terms of the end market profile, right? The shift toward goods away from services.

And then within that shift toward essential goods, and we know your dedicated profile and how that fits. So, any concern at all, or anything that you're doing proactively to prepare for what could be the inverse of that, we do return to some degree of normality over the next several quarters, if not during full year 2021?

Derek Leathers: Yes. I mean, there's a few things we have on our radar that we think about. One of them is there's a wallet share issue, right? During COVID services have all been shut down. The percent of wallet share, just went to product versus services, has certainly been higher than normal. As services start opening back up, restaurants, concerts, sporting events, and those things, some of that wallet share will be consumed by people spending money on those things.

But at the same time, I think it's not like you're going to see a rush of people to fill a 50,000 seat or a 100,000 seat stadium anytime soon. I don't think you're going to see people slowing down some of the momentum that they've already made on e-commerce. Once they make those e-commerce gains and they become comfortable ordering and buying in that manner, seldom do they go back to saying, I want to go stand in the line in a brick and mortar store, and unnecessarily go through that process when I can just do it from home.

That's a good thing for us. We're 61% Dedicated. So, by being 61% Dedicated, it means we lean into e-commerce very well. We're set up structurally to support that growth. As the supply chain gets shortened, as inventories get forward deployed, as people buy more and expect more service and higher service levels, that lends itself to Dedicated. And that's the strength of our portfolio and something we're proud of. And that's why we think we're structured really well, really either way this goes.

If we shelter back in place and e-commerce finds another step level change as a result, that's good for us with Dedicated. If we can return to normalcy and everybody can fully engage in the economy and consumer confidence can get a little more wind in its sails, that's certainly good for us from a demand perspective. We've scenario-planned a variety of outcomes, but we feel pretty good in all of them that our portfolio is going to serve us very well with where we're at in the cycle.

Ben Hartford: Okay. I wouldn't be doing my job if I didn't ask you a question on pricing and your expectations for 2021. I'm not going to stick you to a defined number, but obviously we can all look at the spot rate growth metrics, explore year over year, kind of record levels on a year over year growth basis. Even into the fourth quarter close, there's momentum from a contractual rate standpoint. But just

curious about how you will approach the coming quarters when clearly momentum is on, on the carrier side. It's been a volatile past five years or so, right, for the industry. So, just maybe talk about how the organization is approaching, what is clearly a healthy rate environment next year. And if you want to put parameters around what you think that that range can look like, that'd be great as well.

Derek Leathers:

Yes. I mean, there's a little we'll stop short of full guidance on pricing for 21, at least at this point. But I will tell you that obviously the setup is strong. It's a multi-month tightness leading into bid season, really eight months straight of tightness and a spot market that's continued to elevate, and prices continue to go up. That's a really good structural setup.

The driver shortage is real and very well-documented. And I think more so than even the lead up to some of the past cycles, because some of the other things that I didn't talk about. But it's also above and beyond all of those social distancing and other issues. It's just a tough sell to get somebody to go into a job that's 100% travel. I mean, at a time when the pandemic and the vaccine and all of that is not widely distributed, we have to take care of those drivers. And we're doing a good job to do that, and make insurance stay in front of it.

All of that lends itself, and our customers understand that capacity's tight. We're having those conversations on a regular basis. They know where our results are, and they know that we have guided to move those forward, that we're going to improve upon those operating margins. The only way to do that is with rate. There's some cost headwinds that are real, driver pay, the insurance, are real items out there in the marketplace and we're going to need to be compensated for that to reinvest back in the fleet. Where does it lead us? I think you're somewhere in that high single digit range to low double digits, is where I think we'll end up being as an industry.

For us, 61% dedicated. We can expand our margins. It doesn't necessarily need to be double digit rate increases to do it. We can find ways to operate that fleet more efficiently. We can keep filling backhaul lanes. So, it's not all about the price, right? It's about revenue per truck per week. And that's one component of how we get there. But utilization is another one. Backhaul fill rates are another one. And in a robust market like this, the ability to fill backhaul lanes is better than it would be otherwise. So, we have a lot of ways to increase yield.

That's why we expanded our long-term margin goal through the cycle from 11% to 13%, and established a little bit of a goalpost around it to give people kind of line of sight, that next year we expect that margin to be at the high end of that range and, or certainly materially better than 13%. And then as the cycle progresses, there'll be times where we might be closer to the mid-point or lower end. But we think our portfolio sets up to be much more stable through the cycle now than it ever has been traditionally.

Ben Hartford: So, I want to put the cycle discussion aside and talk about the enterprise. And obviously there was a big event this year with CL's transition and sale of stock, and so on and so forth. You've been in charge so to speak for some time now, though, so maybe just frame up for investors, what's different? What are changes that are afoot that have been made, what's still to come and really what isn't different, what's still the same. About Werner, put 2020 from an organizational perspective into perspective for us?

Derek Leathers: Yes. I mean, I think... So, let's start with what's the same, right? I mean, we're going to stay true to our roots. We're going to take care of our drivers. We're going to be very consistent on our commitment to the professional men and women that drive the trucks, that maintain the trucks, that really keep us and allow us to provide service. We're going to really focus on trying to hire the best people, not just in the trucks, but in the office and throughout the organization. We're going to have a commitment to integrity and service above all else, making sure that we do that safely at all times. Those things aren't going to change. What will change in an iterative way, but it already has been since 2016. If you look at us in 16, going into 17, which was the first year really under kind of a new approach, there's been an expectation of excellence in everything we do.

There's been an ongoing expansion of margins we've set. I don't know how many quarterly new records during that period, but last quarter was another all-time high third quarter earnings report from Werner in the history of our company. Our expectation is to continue to find and drive costs out. If someone's been long to the Werner story, they know we've always been at the very top of the list as it relates to revenue per truck per week, and on the revenue side of the equation and utilization and productivity. We hadn't always been as good and committed and culturally entrenched around costs and maintaining a diligence around cost and internal productivity measures.

That's changing. We're going to... We've driven out over \$20 million of cost this year in 2020, we're going to continue to look to drive more cost out next year. We believe we can do that combination of technology improvements and enhancements that we're making in, investing in, just expecting more of people and excellence around us, and a pretty structural shift over the last three years to a more pay for performance model where people are really paid to produce and paid to expect that same excellence of themselves and their teams.

All of those things I think still are, have, have runway. We still have work to do to get better. But again, that's why we changed that longer term guidance on margins. CL is still going to be around. He's an ambassador, he's a living legend. Really, if you think about starting a company with one truck, I was with him yesterday, but he's equally excited about the future. And one of the things he said to me yesterday was, hey, it's for you to now do and your team to now do what I used to do when we started this thing, and take it to another level. That's the kind of expectation we have around here as well.

Ben Hartford: I've got several topics I still want to cover. So, I'm going to do quick hitters here, just put a bow on the TTS segment. You mentioned a few times the increase in the longer-term through-cycle, even margin targets, combination of price cost focus. In terms of the composition of that portfolio, you mentioned Dedicated 60 plus percent. Maybe talk a little bit about just the general strategy and formula for growth in that segment from a fleet growth perspective, where's it going to go? And yes, we are going to put that to the side.

Derek Leathers: Sure. So, I mean, we don't expect, and we're not planning for tremendous growth over the coming year. The reality of all of the driver challenges that I've already mentioned are real. And so, we will add, we think we can add some capacity next year, but it'll be in the Dedicated portfolio most likely. The reality is, that's something that's more cycle proof. We think the margins have opportunity to further enhance the overall TTS results in Dedicated and on the One-Way side, we're going to continue to lean into three basic franchises of that, which is Team Expedited, Mexico cross-border and then our engineered lanes. We're building out engineered lanes, drivers like that work. They like to get home every night. We can do that work, and it doesn't have to always be at a premium price because the cost basis of that work is lower.

It's engineered. It's very low cost, very efficient use of the assets. We got to get better at sweating the assets. And so, we're always finding ways to engineer more slip seat opportunities, and chances to, and opportunities to use that truck better. Revenue growth is going to come through rate, revenue growth will come through some fleet growth and Dedicated, and revenue growth is going to come through Logistics.

We got caught in the third quarter. We're not happy with our results in the third quarter, our entire team and our Logistics team would feel the same way. But we've already repriced some of those contracts and got fixes in place to improve in the fourth. But going forward, those rates are going to be going up, that market opportunity to gain more share. And for some of the tech that we've been investing in and the Werner Edge platform to really show its wares, is in front of us. So, there's really a multitude of ways for revenue to go the right direction. And we look out next year at very confidently as a revenue growth year for us.

Ben Hartford: Okay. Yes. You mentioned technology. I want to stay on that topic here and maybe talk about the hiring of Daragh Mahon earlier in the year and what he brings to the organization, because technology is clearly the thread on the TTS side and logistics as well, in terms of accomplishing many of your goals. You touched on Edge, so I want to come back to that. But maybe just start a little bit from an enterprise perspective where you do sit, from a technology point of view with new leadership there. And maybe with that, you can incorporate what you mentioned on Edge and how it does affect the asset-based side of the equation. And I'd like you to touch on Platform Science. I think you struck an agreement with them of late as well. So, I'd be interested in all of those elements as it relates to the TTS business first.

Derek Leathers:

I mean, we, so we brought on Daragh Mahon in June of this year. He's been a breath of fresh air. He comes from a very hyper competitive industry in the telecom world, very tech forward industry. He's really brought a commitment to our organization to move at a faster pace. We are leaning completely into the agile processes we've had been doing for some time. But now fully committed to it, a cloud first cloud now philosophy, on what we're doing. Really looking at a build versus buy strategy more seriously than ever before. Historically, Werner's wanted to build everything. We always had this mindset around here that we would hire more and more IT people and keep trying to build everything ourselves. We're going to build the stuff that we think is a differentiator, make no mistake about that.

And there's a lot of things in places we think we can differentiate, but there's a ton of opportunity for us on the buy side to make smarter decisions, to bring stuff to bear quicker and really focus our build efforts on differentiators like Edge Connect, which is the Platform Science product that we're putting in. And we're now 85% installed in our trucks. But it's not just the product that they bring to the table, it's all the add-ons that we built into it, that give our drivers more mobility, give them the same access in the palm of their hand, both in the tablet form, but at their cell phone level. Give them the ability to check and do pre-trip and post-trip inspections mobily, use machine learning and geofencing of customers for arrive and depart connectivity, and better information exchange with our customers on the Logistics side. Building in a lot of machine learning and AI around where trucks are, based on a truck's historical patterns and what load they just took, where are they most likely to want to go tomorrow?

How do we continue to capture that capacity and keep it in a continuous loop? How do we do that increasingly, by taking friction out of the system, i.e. people, and ingesting that freight more automatically. Being able to dispatch and assign that freight, and have auto-accept features embedded in it and the advancements in those areas that are moving quickly, we're really excited about it. But make no mistake. We've got a lot of work to do like everybody else.

There's not a product out there today that I look at, or that we've interacted with, that causes us a belief that we're way behind. In most cases, we feel we're either at par or starting to lead, but there are areas that we've got to continue that investment, or you'll quickly be behind. And so Daragh has been great. If I defined him in one word, it'd be pace. Sometimes it's nice to bring somebody from the outside to just bring a fresh perspective on what real pace looks like. And he keeps a pretty frenetic one around here.

Ben Hartford:

So, on the Logistics side, specifically, how satisfied are you with regard to where it sits in the marketplace? I know there's been... and we've talked over the past few years about having this hybrid approach with customers. It does resonate particularly when the market's tight, what we're clearly there now. And the gross margin compression in the third quarter is pretty straightforward, right? We saw that across the industry, but just strategically, how satisfied are you with regard

to the scale, to the effectiveness of it, in what he does help amplify that. And as you think about growth in Logistics over the next several years, what should that trajectory look like?

Derek Leathers:

Well, we clearly need to do a few things. First thing we need to do is get margins right. I'm not a believer, we're just not in, many of these brokerages that have started up, can live in a world of cash burn and live in a world of negative margins and still find, attract new investors that are attracted to that story. I don't think that's the world I'm lucky enough to live in. It's part of a mature business. We're not going to reap those rewards and we're not looking to reap those rewards. We're going to build it the old fashioned way. Margins will be back profitable in the fourth quarter, we've got a line of sight to a pipeline that looks good, and opportunities to really leverage the portfolio as a portfolio with our customers.

I would tell you, as we built it out, we built it out a lot more with small to mid-sized shippers and not a lot of synergies, if you will, with the asset business and the asset customer base. Because we had to prove ourselves and show what our capabilities were. Now that those capabilities are more on display, we're having much more success cross sell and penetrating across larger scale shippers. And I think that's the inflection point that matters. As I think about Logistics going forward, clearly growth has got to be part of the equation. We've got to push the scale up and make that more relevant.

And that's where we're going to be putting a lot of effort. But at the same time, I think we need to do it profitably. Some of the tech rollouts as of late, really are starting to give us a clearer line of sight to how that productivity happens at the seat level. So loads shipments per day, per seat, revenue per truck or revenue per seat per day. Some of those measurements that we track are going in the right direction. And we're pretty excited about what we think they look like as we get full implementation of some of the more recent roll-outs that Daragh and his team are working on.

Ben Hartford:

What do you envision the competitive positioning better advantage to be? Is it still being able to backstop customers with assets? Is it something again on the technology side? Is it the combination of, is it something aside from that? When you go to market and you compete with some of these providers that are beholden to the different profitability standards, what is the competitive differentiation that you see? Has it changed at all?

Derek Leathers:

Yes, so I think the cross selling and integration with a full portfolio solution is a competitive advantage. I think customers, it usually takes a tight market for that to come to bear, and for them to really focus in and recognize and digest the importance of that. They're seeing that right now. We're starting to see more traction in that area as we speak. Tech's a big part of it. I would tell you that when you asked the question about how do we stack up on Tech? I feel really good about how our Logistics tech stacks up, as it, because that's where we've been spending a lot of the money. And yet with that statement, we've got some things

in the pipeline that we feel even more excited about, kind of some step level changes coming, where we think we can position ourselves to take the existing resources we already have, really focus them on differentiators, and where appropriate, plug in outside products and other products that make sense. So, Logistics tech is going to play a big role, cross selling is going to play a big role. And then frankly, just having a more seasoned group. I mean, as we were growing into this, we have a lot of new bodies in there. It's building a company from the ground up inside of a broader company. And we, like many others, probably over relied on internal resources during that build-out phase, in terms of customer interactions, customer interfacing roles. And it is a different business. It takes a different mindset. It takes people that have kind of that logistics in their blood. And we're doing a lot more of new blood into the building over the last six months, than where we had been prior.

Ben Hartford:

Okay. So, we've got about 90 seconds here. So, I want to give credit or credit that's due on the ESG front. I know you guys have put a lot of effort in it. You had the report released last night, but maybe it's just a couple of conceptual questions. One, how do you envision holding yourself to account for some of the standards that you've introduced. And then two, maybe speak to why it's more than just an in vogue thing to talk about? Why it's something that's not just good for society and for the environment and so on and so forth, but it's good for the business from a holistic level to have such a prominent now focus on these standards?

Derek Leathers:

Yes. Well, the first thing I can guarantee you is it's not going to be an event; it's going to become part of the culture. I think if you make an event and you make it a release and you move on, that's a mistake. And that's not what we're going to do. How are we going to hold ourselves accountable the same way we do on everything else? We're going to measure it, we're going to publish results, we're going to talk about where the gaps are and we're going to fix them. And so, we have a plan and a line of sight toward how we're going to do that as it relates to ESG.

I'll take them individually, but on the environmental front, we've put a big line in the side. We are going to reduce our carbon footprint by 55% by 2035. That's not going to be easy. That's both known and then developing technologies. There are no TBDs in there, meaning the technologies that don't exist at all that we just plugged in. Meaning we hope to exceed that goal because there will be technologies that'll come along in that timeframe.

On the social side we've been very active for a long time. I mean, I'm very proud of what we do here at Werner and the communities in which we work, the diversity, that efforts that we've made, but we have more to do. And I think it makes us better.

And on governance, I think you could speak to how strong our governance has been for a long time around here. This is not a company that takes governance

lightly, and nor will it be going forward. Why does it make us better? It's pretty simple to me. I think different opinions, people who have different views. They just simply create a better debate. I talk to my team all the time about, we have two ears and one mouth, so that we use them in that proportion. Well, that only works if you've got people that are willing and able to engage in, and give diverse thoughts and views. And so, to do that, you've got to really want to hear it. And so, we want to hear it. We're going to work on it. We're going to get better. But I'm also pretty proud as you saw in the ESG report that we just put out, of where we stand currently, and yet we're pretty open about how far we have to go.

Ben Hartford: Sure. Well, great. That's a great summary report and we're out of time. But I appreciate you guys' leadership in the industry. I appreciate you coming to the conference and in supporting us as well. Hope the event is beneficial to you guys and we'll see you again soon.

Derek Leathers: Thanks for having us Ben, we appreciate it.