

# Werner Enterprises

## Q3 2022 Earnings Conference Call

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### CORPORATE PARTICIPANTS

**Derek Leathers** - *Chairman, President, Chief Executive Officer*

**John Steele** – *Executive Vice President and Chief Financial Officer*

**Chris Neil** – *Senior Vice President of Pricing and Strategic Planning*

## **PRESENTATION**

### **Operator**

Good afternoon, and welcome to the Werner Enterprises Third Quarter 2022 Earnings Conference Call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the call over to Chris Neil, Werner's Senior Vice President of Pricing and Strategic Planning. Please go ahead.

### **Chris Neil**

Earlier this afternoon, we issued our earnings release with our third quarter results. The release, along with a slide presentation, are available in the investor section of our website at [werner.com](http://werner.com). Today's webcast is being recorded and will be available for replay beginning later this evening.

Before we begin, please direct your attention to the disclosure statement on slide two of the presentation as well as the disclaimers in our earnings release related to forward-looking statements. Today's remarks contain forward-looking statements that may involve risks, uncertainties and other factors that could cause actual results to differ materially.

Additionally, the company reports results using non-GAAP measures, which we believe provide additional information for investors to help facilitate the comparison of past and present performance. A reconciliation of the most directly comparable GAAP measures is included in the tables attached to the earnings release and in the appendix of the slide presentation.

Now, I will turn the conference over to Derek Leathers, our Chairman, President and CEO.

### **Derek Leathers**

Thank you, Chris, and good afternoon.

Despite rising macroeconomic headwinds, I'm pleased to report that we achieved year-over-year growth in our quarterly adjusted earnings per share for the ninth consecutive quarter. Our large and resilient Dedicated fleet performed very well.

While we experienced moderating performance in One-way Truckload, Logistics and our driving school network given more challenging operating conditions, third quarter produced the third highest ever adjusted earnings per share in a quarter in our history.

I would like to sincerely thank our talented Werner team for their meaningful contributions to our performance, and also welcome the elite driving and nondriving professionals of the Baylor Trucking team to our Werner family. As a reminder, we acquired Baylor on October 1.

Now let's move to slide four. During the quarter, we added 180 trucks in TTS, with most of the increase in Dedicated. Just after quarter end, we added 200 high-performing Baylor trucks and professional drivers in our One-Way Truckload fleet.

In light of the softening freight market and including the acquired trucks, we expect our fleet count to be up 100 to 200 trucks in fourth quarter.

Peak season freight opportunities in One-Way Truckload and Logistics are more subdued this fourth quarter, compared to a record freight market during peak in the fourth quarter a year ago.

While inflationary cost pressures continue to be challenging, particularly for labor, equipment maintenance and insurance, we have begun to see some easing in the competitive driver recruiting and retention markets. In addition, within the consumer staples vertical, shoppers are increasingly trading down for value.

By design, nearly three-quarters of our revenues are in necessity-based retail and food and beverage, with our freight weighted to winning customers that ship recurring and repeatable consumer staples.

Let's move to slide five for a summary of our financial highlights. For third quarter: revenues increased 18% to \$828 million. Adjusted operating income increased 8% to \$79.5 million and adjusted EPS increased 14% to 90 cents per share.

Dedicated ended the quarter with 5,430 trucks, adding 110 during the quarter and 310 year-over-year. Dedicated continues to experience strong demand from the majority of our long-term customers and the pipeline of new opportunities remain strong. At quarter end, One-way Truckload had 3,150 trucks, plus 70% for the quarter and up 50 year-over-year.

A year ago, a bottlenecked supply chain and three rounds of stimulus checks produced peak season shipping that started earlier than normal in August of 2021. In the current freight market, there are far fewer project and surge freight opportunities in One-Way Truckload and Logistics.

Werner Logistics achieved lower operating income in third quarter compared to a very strong performance in the second quarter, due to fewer premium pop-up freight opportunities, Intermodal customer and market challenges, and softening demand and startup costs in Final Mile.

While it remains difficult to obtain new trucks and trailers, our deliveries of new trucks continued to show improvement during third quarter. Finally, much lower spot freight rates, record cost inflation and rapidly rising interest rates are quickly eroding small carrier cash flow.

Very strong used truck pricing softened in the third quarter due to the severe challenges facing small carriers. Our equipment gains in third quarter were comparable to second quarter as we sold more trucks at a lower average gain per truck, and we sold a similar

number of trailers.

Now I'd like to turn the call over to John to discuss our financial results in more detail. John?

### **John Steele**

Thank you, Derek. Beginning on slide seven, third quarter revenues increased \$125 million year-over-year and declined by \$9 million sequentially. Revenues grew 18%, driven by 4% more trucks, 5% higher revenue per truck, a \$50 million increase in fuel surcharges and \$29 million of logistics revenue growth.

Adjusted operating income increased 8% or \$5.6 million. For adjusted operating income by segment, TTS grew \$11 million, Logistics declined \$2 million; and Corporate and Other, which includes our driving schools, declined \$3.8 million. The year-over-year decrease was due to substantial growth in our driver training school locations and temporary issues affecting two school locations this quarter.

Here on slide eight are the results for TTS. TTS revenues increased 18%, due to 4% more trucks, 8% higher rates, higher fuel surcharges, partially offset by 3% lower miles per truck, due to a 3% shorter loaded length of haul and a softer freight market.

The TTS adjusted operating ratio, net of fuel was 85.1%, a 90 basis point improvement year-over-year and 150 basis point improvement sequentially.

Now let's move ahead to TTS fleet metrics for Dedicated and One-Way Truckload on Slide nine. Dedicated revenues, net of fuel increased 16%, average trucks increased 6%, revenue per truck per week increased 9.2%. One-way Truckload revenues, net of fuel, declined slightly as average trucks increased 1%, rate per mile increased nearly 3% and miles per truck declined 4%. The year-over-year increase in driver pay per company mile for the TTS fleet increased 8%, consistent with the 8% increase in TTS revenues per total mile.

The average fleet age of our truck fleet held flat sequentially and increased two-tenths of a year compared to third quarter a year ago. Operating a slightly older fleet than we would like in an inflationary market, increases our supplies and maintenance costs, which were up 19% year-over-year.

On slide 10, let me provide an update on our durable and resilient Dedicated fleet. In Dedicated, we provide trucks, trailers and drivers exclusively for specific customers, typically for a retail distribution center or a manufacturing plant. Werner is one of the four largest Dedicated fleets in the U.S.

Werner Dedicated serves customers with extremely high service and safety requirements, typically executing shorter length of haul shipments in local and regional markets. The superior consistency and reliability of our Dedicated on-time service, provides our customers with high predictability for their inventory, to help them avoid out-of-stock surprises for their customers.

Our Dedicated fleet has steadily grown over the last 10 years with a customer retention rate of over 95%. Four of our five largest customers have been in our top five for the last 10 years, highlighting the long-term relationship nature of Werner Dedicated. Nearly two-thirds of our Dedicated business is in retail, and two-thirds of that business is with discount and dollar store retailers.

Historically, these discount retail customers performed much better than their retail competitors in slower-growth economies, when shoppers have less discretionary income to spend, and as they look to trade down for value to get the most for their money. Another one-sixth of our Dedicated revenues are with food and beverage companies that ship consumable staples with high on-time service requirements. Historically, food, soft drinks and alcohol products are much more recession-proof than discretionary products.

Our Dedicated business is more stable and predictable. Because of the high service requirements and relatively consistent freight volumes, Dedicated revenue per truck has less variability and this metric has increased seven of the last eight years.

As a result of these factors, Werner Dedicated operates with more attractive and less variable operating margins in good and bad economies. During the last trucking freight recession in 2019 compared to 2018, our Dedicated revenue per truck per week growth remained positive. Regardless of where the freight market goes from here, the size, strength and customer base of our Dedicated fleet is durable and resilient and places us in a strong competitive position.

Moving to Werner Logistics on slide 11. In third quarter, Logistics revenues grew 18% and compared to 44% growth in second quarter. Truckload Logistics revenues increased 4%, driven by a 6% increase in shipments, partially offset by a 3% decrease in revenues per shipment. As a result of the softening freight market, premium priced pop-up loads declined 50% year-over-year and 37% sequentially. At the same time, our domestic power-only solution continues to gain traction and achieved revenue growth of 118% year-over-year and 13% sequentially.

Contract loads increased 21% year-over-year and 17% sequentially. Year-over-year, transactional loads were up 5%, while revenue per load declined 8%, due principally to the reduction in pop-up transactional volume. The decline in pop-up business is expected to have a larger impact on Logistics revenues and operating income in fourth quarter compared to third quarter.

Intermodal revenues grew 10%, supported by a 37% increase in revenues per shipment, offset by a 23% decline in shipments. Declines at customer awarded business and lower volumes with existing customers caused the decrease.

Final Mile revenues increased \$21 million. Slowing demand for discretionary products and start-up costs for new business implementation weighed on our Final Mile operating income sequentially.

Logistics produced adjusted operating income of \$5.6 million, down \$2 million year-over-

year and \$7.4 million sequentially.

On slide 12 is a summary of our cash flow from operations, net capital expenditures and free cash flow over the past five years. Expanded operating margins and less variable net CapEx, resulted in higher free cash flow over the last five years, compared to the previous five years. Year-to-date, net CapEx is \$254 million.

On slide 13 is our capital allocation update. Our first priority for capital continues to be reinvesting in our fleet. During third quarter, we purchased 215,000 shares for \$8.3 million. We remain committed to maintaining a strong and flexible financial position and ended the quarter with a net debt-to-EBITDA ratio of 0.7 times. And, we continue to evaluate acquisitions in North America truckload and logistics that are both additive to our business and accretive to our earnings.

That concludes my remarks, and now I'll turn it back over to Derek to talk more about our acquisitions.

### **Derek Leathers**

Thank you, John. Moving to slide 15. Over the last 16 months, we carefully researched, analyzed, negotiated and executed three strategic acquisitions within our core business units. We have stringent criteria for what we are looking for in acquisition candidates.

It must be additive to our business, and therefore, must be complementary to our existing portfolio, either in geography or services. It needs to have superior service and a safety culture, similar to our own and it must be accretive to our earnings.

We are remaining disciplined, and we are searching for companies with strong management teams that we expect to retain with a company culture that has demonstrated a high focus for valuing its professional drivers, carriers, associates and customers.

Turning to recent transactions, we are pleased to share that both the ECM regional truckload acquisition and the NEHDS Final Mile acquisition that we acquired last year have exceeded our expectations. ECM is very profitable, serving the challenging and densely populated Northeast freight markets with a superior driver base. NEHDS has integrated seamlessly with our existing Final Mile network to produce a compelling home delivery model that is resonating with our customers. We are beginning to grow with new dedicated Final Mile business with both existing customers and new customers alike.

And we are extremely proud and excited to bring the 76-year history of impeccable service and safety of Baylor Trucking to Werner. Baylor met all our strategic touchpoints. Great service, outstanding drivers and associates, similar company cultures and an experienced leadership team that we wanted to retain.

Baylor brings additional freight diversity with its many years of experience and customer base in the specialized markets of pharmaceuticals and expedited deliveries. One month in, we are already identifying and implementing opportunities to make Werner and Baylor better together.

We have strengthened and further refined our acquisition process, from qualifying and researching acquisition candidates to quickly integrating the company with Werner to realize synergies. We will continue to carefully search and remain disciplined to identify additive acquisitions in truckload and logistics that make us better and are accretive to earnings.

Now on slide 16, I wanted to spend some time on our ESG developments. In September, we issued our CSR update report to show our progress for our ESG goals and initiatives. The report is available at [werner.com](http://werner.com) in the investors section under ESG.

We announced a pilot project with Kodiak Robotics to test their autonomous truck technology. We signed a letter of intent to purchase up to 500 Cummins 15-liter hydrogen engines when they become commercially available. During the quarter, we finalized an agreement with Remora to install and test the decarbonization cell on a Werner truck. And to strengthen and better formalized our ESG data and reporting, we subscribed to a Salesforce/Workiva tech solution.

Now let's move ahead to slide 17 and a review of our performance compared to our 2022 guidance.

Year-to-date, our TTS truck fleet increased 3%, primarily in Dedicated. With the Baylor acquisition of 200 trucks on October 1, this raises our year-to-date truck growth to 5%. Including the acquired trucks, we expect our end-of-year truck count to be 100 to 200 trucks higher than the 8,580 at the end of third quarter. Therefore, we anticipate our full year truck growth will be in the range of 3% to 5%.

Net capital expenditures for the first nine months were \$254 million. We narrowed our guidance range for full year net CapEx to a range of \$300 million to \$325 million.

Dedicated revenue per truck per week increased 8.6% year-to-date resulting from higher customer rates to offset inflationary pressures. For fourth quarter, we expect this metric will grow in the range of 6% to 8%, noting we have more difficult comps in the fourth quarter.

One-Way Truckload revenue per total mile for third quarter increased 2.5% as we lapped the ECM acquisition in July last year. For fourth quarter, we expect our One-Way Truckload revenues per total mile to be in a range of negative 3% to flat compared to fourth quarter a year ago. This expected range is due to moderating One-Way freight market and difficult comps with much fewer premium pricing opportunities in the fourth quarter this year compared to the same period a year ago.

Our income tax rate in the third quarter and year-to-date was 24.3%. For the full year, we expect to be in the range of 24% to 24.5%. During fourth quarter, we expect the average age of our truck and trailer fleet at year-end to be 2.3 years and 5 years, respectively.

One-way Truckload freight demand moderated further from second quarter to third quarter, and this trend has continued into October.

Over the last few months, concern about the direction of the economy and the truckload freight market has increased. Our current market view for the remainder of the year is as follows:

We are expecting a subdued peak season in fourth quarter compared to a very strong peak season in fourth quarter a year ago. This means that project, surge and premium transactional pricing opportunities are much more limited this peak season.

We expect that industry truckload freight demand continues to moderate, more for discretionary goods and less for consumer staples.

Pressure on small truckload carriers continues to intensify with lower spot rates, inflationary cost increases with older equipment, high fuel prices and rising interest rates.

Pricing for industry used trucks continues to ease resulting in lower gains per truck.

Inflationary cost pressures for labor, equipment and maintenance are likely to continue.

Truckload capacity remains constrained as new truck build challenges continue and the driver market remains under control. And FMCSA carrier registration and deactivation data has shown net deactivations for 19 of the last 24 weeks.

Lastly, I wanted to provide an update on our CFO transition plan that we discussed during our second quarter call. John remains fully engaged with his responsibilities. Our search process is progressing well. We have several strong candidates we are considering, and we will provide an update when appropriate.

We are confident in our positioning with the stability of our Dedicated and One-Way Truckload freight base and our Logistics segment; the proven resilience of our durable business model; our strong driver and nondriver associate team; and the superior value we provide to our customers.

With that, I would now like to turn the call over to our operator to begin the Q&A.

## **QUESTIONS AND ANSWERS**

### **Operator**

(Operator Instructions) Our first question is from Bert Subin with Stifel.

### **Bert Subin**

Derek, maybe the first question for you. We've heard a lot this earnings season about smaller carriers and the inevitable exits, but we haven't really seen spot rates rebound yet, which I think, would indicate those exits are probably not happening fast enough.

How do you think the next six months play out? And what's your viewpoint on whether or not new order activity will ultimately resume and start helping freight despite some of the concerns on the inventory side?



**Derek Leathers**

Yes. So great question. First off, I'll point you back to some of the comments in the opening remarks. 19 out of the last 24 weeks, we've seen net deactivations, meaning more companies turning in their DOT number versus new registrants coming on board. More importantly, I'd say, over the last four weeks, we've seen a very sudden and noticeable increase in the quantity of those deactivations, especially at the truck count level. So you're seeing 3,500 to 4,000 trucks a week, net coming out of the market, and so we think that is really starting to gain momentum.

There's also two primary months in the year where, every year, there's always a big uptick in it, and one is June, and one is December. And so, as we look into fourth quarter and you think about the nearly unanimous commentary on a muted peak season with the backdrop of high fuel, high insurance, high labor and rising interest rates, I think you're going to see an increase that will kind of accelerate the process that's already underway.

It's hard to exactly predict when we think that reaches equilibrium. But if you look back over the last several cycles in a row, we look back four or five cycles, and you see kind of a trend line that spot from peak to trough is, call it, 15 to 17 months, and we're kind of at that time now as it relates to what we're seeing in the market. So, I think we're close to bottom, if not at bottom currently.

And that's only going to exacerbate the problem because it's clearly below many people's operating costs. And the last comment, I guess, I would make is in conversations I've had across fuel networks in America, they're certainly seeing a rise in delinquencies. And when it starts showing up at the fuel pump level, which is something obviously you have to have to run that next load, it's real. And I think that is only going to grow as we go forward as well.

**Bert Subin**

Super helpful commentary, Derek. And maybe just a follow-up, more sort of relevant to your business. Dedicated seems to be holding up really well despite all of this commentary around softening of freight. What do you think is the bear case for Dedicated? Do you see sort of revenue per truck per week trend more in the flattish instead of growing and then volumes soften? I know that's not what you're guiding to. I'm just curious what you think sort of, if things went poorly, how would Dedicated hold up?

**Derek Leathers**

Yes. I mean, again, looking back at a couple of prior cycles and really looking at the last eight years, I mean, Dedicated, based on the type of business we do, how difficult it is to accomplish, how defensible it is because of its complexity; we've seen an environment where the type of customers we work with, that are winning in their space, is continuing to grow even during recessionary times; they need those fleets.

And so, they've been supportive of the inflationary pressures that are out there. I'm not guiding that we're going to see major increases to use your question, or to frame it in the terms of your question; bear case, I think we slow the growth in Dedicated and we become more prudent and more picky on what gets through. And you don't see the momentum perhaps on truck growth that you've seen in recent years. But I think from an overall profile

and how it runs, the ability in Dedicated to have those one-on-one relationships with long-term customers with four out of the top five being with us for greater than 10 years, we've been through some cycles together.

And there's history there on trust, and we'll work with them diligently to continue to deliver the high service expectations they have. And as you started the question, I'll just reiterate, you're right; Dedicated has performed very well and continues to perform very well. Our expectation is that it will continue to be the core of this portfolio as we go forward, and we think that positions us well during this turn.

### **Operator**

The next question is from Brian Ossenbeck with JPMorgan.

### **Brian Ossenbeck**

Maybe a strategic one for you, Derek, just as we get into more bid season and that sort of cycle coming up. I think a couple of quarters ago, you mentioned about these partnerships you're looking to do longer-term, maybe the third tier between One-Way and Dedicated. Can you give us an update on that in terms of how those are progressing, if any, this year? And what your expectations are for next year as well?

### **Derek Leathers**

Yes. So, we've been working on this for several years. It wasn't just a couple of quarter initiative. You're right, we brought it up recently and I would tell you it's progressing nicely. If you look at our Dedicated business, by and large, in its entirety, it's kind of a multiyear longer-term relationship with stickier characteristics, etc.

On the One-Way side, we're up to approximately a quarter of our One-Way business is now tied up into kind of LTAs or long-term agreements with a variety of different mechanisms and guardrails put in place around those. Those are again, alignment with strategic customers that we believe we have long-term futures with, and they believe the same. We will continue to fulfill our end of those bargains. We will expect that they do the same and have conversations if there's variances. But I'm pretty excited, to be frank, going into what is clearly a slowing economy, because we haven't been set up like that previously. We haven't had this percentage of our fleet, 63% now in Dedicated in prior turns.

We haven't had the amount of our One-Way fleet as engineered as it is today, and we certainly haven't had key agreements with key customers winning in their verticals that add up to kind of 25% roughly of that entire One-Way network. So, it's still going to be a tougher time as we look forward. We know the economy is slowing and there's some pressure out there on inventory levels and other items. But I like our positioning to get through this and come out the other end even stronger for it.

### **Brian Ossenbeck**

Great. John, maybe a quick follow-up. As you look at the fourth quarter typically seasonally stronger, obviously, not the case this year for all the comments that you mentioned. I wanted to see if you can give us some context on how to think about this quarterly progression relative to seasonality? And if you expect any sort of gains in there as well or if that's going

to tail off because it looks like expectations might be a little bit too high, given all what you said here today.

### **John Steele**

Yes, Brian. Typically, third to fourth quarter, there is an improvement in earnings that occurs. Last year, there was a very sizable increase, it was up 43% from third to fourth quarter because we had a significant number of projects, surge and special pricing opportunities that occurred during the quarter last year. And it's a very subdued, more muted peak season this year.

We expect some peak season opportunities, but not nearly at the level that we saw last year. We expect premium pricing opportunities to be down 60% to 70% in fourth quarter compared to where they were a year ago. So as a result, we're not expecting a significant improvement from third to fourth quarter because of that environment, but the strength of our Dedicated business should help us there. It's too difficult to predict from a guidance standpoint on how it will trend, but we don't expect a typical increase from third to fourth quarter.

### **Operator**

Next question is from Jack Atkins with Stephens.

### **Jack Atkins**

Okay. Great. So I guess, Derek, going back to your earlier comments around the longer-term sort of nature of a lot of your business, whether it's Dedicated or some of these longer-term commitments, how do you think about being able to get inflationary sort of cost increases through with that? Do you have mechanisms in those contracts to be able to do that? Because I would imagine over the next several quarters, it's going to be pretty tough from a cost perspective.

### **Derek Leathers**

Yes. Clearly, Jack, there will be cost pressures as we go through the next several quarters. We know that inflation is kind of something that every company in America is dealing with up and down the P&L. We won't be sheltered from some of those pressures. Our goal is to work with our customers, which we are already doing in Dedicated and have seen good responsiveness from them around the reality that, in order to deliver the kind of service we do, and at the levels that we have delivered at. that we need their support. They've signed up for that through prior trends. We expect it to have similar consistency through this one and be able to offset those pressures on One-Way.

It's a little different, but there are some tailwinds mixed in with all of this other news. Mexico, we are seeing some resilience out of Mexico right now and some growth in that Mexico cross-border business. That's more productive, longer length of haul opportunities that allow us to gain back some things that maybe doesn't always come through rate.

We are increasing the percentage of our fleet that's operating in a team environment. We always do that this time of year going into peak, but we're doing that and looking to hold that as it relates to an offset to production. We're going to continue to work with our customers, and we're seeing some decongestion as they get more normalized in their operation that we

hope to be able to leverage into some help on the P&L from a production standpoint as well.

So, there's going to be puts and takes. It's going to be difficult. We are very confident that we'll be well within the ranges we've been guiding to relative to overall margins. Certainly, One-Way, we'll have more pressure on it than Dedicated.

And it's going to be something we just kind of labor through customer by customer, agreement by agreement. And we're going to be prudent and rational about the size of the fleet. I mean, I should point that out as well. We know with the market that we're going into that it's not a time that you're going to see us leaning in heavy on truck growth. And instead, we're going to be very prudent on who we do business with and under what terms.

### **Jack Atkins**

Okay. Okay. Got it. And then I guess maybe, John, a question for you on the issues you guys had with the driver schools in the third quarter. Are those issues behind you? Can you maybe give a little bit more color on what exactly was sort of the challenge there? And I would just kind of appreciate some additional color there.

### **John Steele**

Okay. Thanks, Jack. Yes. On previous calls, we've talked about the investments that we've made in facilities and personnel and equipment at the driving schools. If you remember back to the end of 2020, we had 13 schools. And by the time we got to the end of first quarter '22, we were up to 22 schools. We felt like we needed to vertically integrate our school network to help with a very, very difficult driver market and so we accomplished that. Our driver training school team did a really great job establishing the new schools to produce high-quality driver training in markets that are targeted to expand our capacity, so the right geography.

Our school network is really one of the crown jewels at Werner. We're really proud of what they've achieved. During the first, typically 12 to 18 months of developing a new school location, they're typically not profitable and they gradually improve their financial results over time. And lastly, I'd say we had a couple of school locations this quarter that had some temporary issues that we're working through, about a penny a share impact. Those are nonrecurring and don't expect will occur going forward.

### **Derek Leathers**

The only thing I'd add to that, it's to a much lesser extent, but we did have, in total, five schools impacted for days, not weeks, so it's not a major issue, but nonetheless, impacted in the quarter as it related to Hurricane Ian.

### **Operator**

The next question is from Scott Group with Wolfe Research.

### **Scott Group**

Just want to clarify, any commentary around gains for Q4? And then Derek, your comments about capacity exiting the market. Any numbers you can share on the brokerage side about, we had x number of carriers in the broker network in Q2 and now it's down to x number in

Q3, or anything like that?

**Derek Leathers**

Yes. So I mean, I'll start on the gains side. Gains are clearly moderating, but at the same time, OEM deliveries are starting to arrive with a little more consistency. So, we're not giving a gain guidance for Q4. But I think directionally, what you'll see is the opportunity for us to perhaps have slightly higher volume with slightly lower gains that may approximate about the run rate we've been at, and that would probably be best case. The OEM thing is way too much to bet on just at this point. I can't commit that we're going to see all of those trucks arrive and so therefore, I can't commit to a gain number still. But I can tell you that the process is still functioning well.

We're still moving equipment as we receive, and we still have buyers that are interested and available. The other reality is we get this new equipment in as it gives us an opportunity on the maintenance line to start to get the fleet operating both from an uptime perspective but also, just overall maintenance costs, by getting the fleet over the next several quarters refreshed. So that would be my thoughts on gains. Scott, I apologize, the second part of the question?

**Scott Group**

Yes. You were just talking about capacity...

**Derek Leathers**

Yes, I remember. Yes. So on the brokerage count, I mean, that's a tough metric to track for us, because the combination of the growth we're seeing in Power Only, as well as the overall the strategy that we're taking within our carrier network, we're adding carriers all the time. And so yes, we can see carriers that perhaps were in the network that now are not, but aggregate numbers are still growing because of the level of recruitment that we're putting into setting ourselves up for long-term. I mean I do believe that regardless of where we are at with the subdued fourth quarter, it's my belief this cycle is shorter in duration and less severe than what we've seen in others. And so, we want to be prepared and ready coming out the other end with to hit the ground running.

**Scott Group**

Okay. And then just one big picture question. In a typical downturn in trucking, we don't see much cost inflation. It feels like we will see continued cost inflation into next year. So, is there just a risk that from a, if costs are up and rates are down, it ends up being, just more of a severe correction in margin than we typically see? Or is that just too negative of an outcome?

**Derek Leathers**

Well, I think it's a matter of perspective, right? So from my perspective, especially at the small carrier level, you've got a larger swath than normal who purchased equipment at higher cost than any time in history, who are faced with rising interest rates at a more rapid rate than any recent history for sure. And a volatile fuel environment as a backdrop with a spot market that is 37% off its peak. So, for that population of folks, it's not a great time to be a trucker. And I think that's where I have some confidence that this correction happens more rapidly.

Now on a large carrier level, we'll still have inflationary pressures, and we're still going to try to manage costs out of the system to help offset them, as well as work with our customers, especially in these longer-term relationships, which is the bulk of our asset portfolio. And I think the outcome of all of that on a net basis, is we come out the other end looking better, stronger and with the potential deeper, entrenched relationship with our customers and within our network. So, I'm not trying to make lemonades out of lemons, but I am trying to express that this turn is an opportunity for high-performing fleets to really distance themselves further, and that is certainly my expectation here.

### **Operator**

Next question is from Todd Fowler with KeyBanc Capital Markets.

### **Todd Fowler**

Derek, maybe if you could talk philosophically how you plan to address contract renewals in One-Way Truckload. I don't know if you want to share a range because there's many constituents on the call, but in this environment where it feels like spot rates have come down significantly, contract pricing has held in. In the same context where spot rates may start to strengthen later in '23, just how do you think about the bid season? Or what are some of the things you can share with us about the approach to bids as they come up in One-Way Truckload?

### **Derek Leathers**

Sure. I mean the first word that comes to mind is discipline. We're going to be very disciplined as we go through this process. We have a strong and robust Dedicated pipeline, and I've already intimated that it is not my goal for us to be leaning into fleet growth.

So, with a strong pipeline of Dedicated opportunities, and not looking to grow the core fleet, at least until we have better line of sight of how the cycle is shaping up. What it naturally means is the opportunity to move trucks through the bid process from One-Way to Dedicated as appropriate. Now every time we have those conversations with our One-Way customers who we want to stand by and stay committed to if the opportunity isn't afforded to us to do that at a rate that's reasonable, we have choices.

And so it's all about keeping discipline through the bid process and then having the backdrop of 25% of that business tied up in a long-term agreement gives us further resilience that perhaps others wouldn't have. So, I feel like we're set up as well as we can be in this environment to perform well and continue to execute, and that's certainly the expectation I have as we move forward into the bid season in late Q4 and into early Q1.

### **Todd Fowler**

Yes. Okay. That's helpful context. And just for my follow-up, on the Logistics operating margins here in the third quarter, I certainly understand the nuances with less transactional opportunities. But I was a little bit surprised at kind of the negative operating leverage that we saw and John, I think you had some comments around trends into the fourth quarter.

Can you maybe just help us think about a normalized range for Logistics margins and any ability to kind of correct the margins here in the third quarter, either into early '23, if not

sooner?

### **Derek Leathers**

Sure, I'll take that. Let's start with this. So Q2 was sort of an outsized quarter for us in Logistics. We had a tremendous amount of project pop-up type freight going on within Logistics, specifically in our Power Only unit. Those opportunities are difficult to do but can also be more lucrative from a margin perspective. As we got into Q3 and continuing into Q4, there's a far lesser degree of that type of work. So that's a big piece of it.

The next piece is the mix of transactional to contractual, although transactional I'm sorry, contractual business as a percent of total has continued to grow, even sequentially from Q2 to Q3, it's still not yet at the percentage we'd like to see. And so we're at 44% today, contractual. We'd like that number to be 50% or north of that. We're on our way and have made several percentage points of gains in just one quarter, but that plays into it as well.

And then the last piece that's mixed in there is honestly, good news that in the short-term doesn't look so great, and that's about \$1 million of start-up costs in Final Mile because of the success of that dedicated Final Mile product that we have and the number of implementations that we endured in the third quarter that start to reap benefit in Q4 and then certainly going forward.

So, there's a little bit of a lot of things that make up the answer. But globally, yes, we have line of sight to stabilizing that Logistics unit. The comp in Q4, I must point out, is also tough because of the peak and project opportunities that existed in Q4 a year ago, that Logistics played a major part in. Those will be much more subdued this year. But sequentially, I feel better about our opportunity to make improvements Q3 to Q4 in Logistics, but the comp year-over-year is probably a hill too high based on the lack of project opportunities.

### **Operator**

The next question is from Jon Chappell with Evercore ISI.

### **Jon Chappell**

Derek, on the question around capacity leaving the market and the owner operators who are struggling under insurance and fuel and buying equipment for incredibly higher prices, I think everyone just expects that some of the older capacity is in the market. But I have to expect that some bought relatively modern equipment at elevated prices as well, and there may be some discounts to be had.

I know you're not leaning into fleet growth, but as you think of opportunities, is there newer equipment that may be in the hands of owners that are struggling a lot worse than some of the bigger players, and that's an opportunity for you to get relative bargains? Or do you just stick with your OEMs and wait in a queue for that?

### **Derek Leathers**

Yes. Our model has always been based on buying new under our spec, with our setup, the way our drivers expect and like it to be delivered, the benefits of the extended warranties and the way we operate our trucks. To be frank, I hope what you just outlined isn't something

that presents itself as an opportunity because it puts pressure on our own used truck sales.

We do expect used trucks to moderate, but still the opportunity for gains is there, and the market is actually relatively stabilized as of late. How long that holds up, it is yet to be determined. It really comes down to the question that all of us want to have better clarity on, which is how quickly this capacity cleanse takes place. It's my belief for the reasons previously stated, it's going to happen a little more rapidly than people expect.

### **Jon Chappell**

Okay. My follow-up might be a bit off the reservation a bit, but you've done some transactions, you leaned into Final Mile, obviously, in the dedicated. Now where does Intermodal fit with your portfolio? Is there a lot of cross-selling opportunities? Is there a scale to be had there? It seems like there's been some transactions in Intermodal where maybe there's some decent prices. Does that fit your portfolio longer-term? Or is that an opportunity to maybe really focus on where you do at scale?

### **Derek Leathers**

Yes. We're committed to Intermodal as we go forward, and you're astute in the reality that, that is one path by which we might be able to make up some ground. Our Intermodal product today is....it does perform well from a customer perspective, it has performed well from a growth and margin perspective, but it is a more difficult space right now.

The rails have had more than their share of disruptions and service interruptions and being a smaller player out of the larger field, which is where we are today, does put us at certain competitive disadvantages. So we're in the process right now of working through a longer-term Intermodal strategy. I think it's fair to say that we've got to gain share and relevancy in order to shore up some of the issues that we face, as well as continue to grow, or increase our operational efficiencies.

We're growing our dray fleet and our percent of dray continues to increase, which helps our ability to deliver more efficiently. But that is a challenged space, not just for us, for everybody right now from a service perspective. If you think about our portfolio and how retail-oriented it is and how service-oriented it is, Intermodal and the challenges that exist within that delivery mode, and have existed now for way too long, is incongruent at times with the kind of customer portfolio and the kind of mix that we have. But where it fits and where we can cross-sell, we certainly do.

### **Operator**

The next question is from Ken Hoexter with Bank of America.

### **Ken Hoexter**

John, best of luck whenever that date does come soon. In the past downturn, Derek, I know you were talking about this on inflation, driver inflation, but I think in the past, we've seen driver rates come down when rates came down. Is that just I mean, deflation in spot rates, is that ever a reality given what's in the backdrop now or no chance?



And then John, you talked a bit about the earnings on a sequential basis. Maybe can you throw out your thoughts on operating ratio, typically you have an improvement of about 200 basis points over the last couple of years. Given the backdrop you talked about, is it possible to be flattish? Or do you see continued improvement? I guess, maybe if you can give us your high low thoughts on the OR.

### **Derek Leathers**

Yes, I'll start on the driver question. Look, taking wages down in a market with unemployment as low as it is and inflationary pressures at the household level, what they are is going to be very difficult, if not impossible. It's certainly not part of our plans at this time.

There are opportunities, as we continue to create better lifestyle jobs. Often there is a compensation trade-off that goes along with that, as you get people home more often and more consistently and especially if you can find engineered opportunities to get people home daily. But I think a better way to think about driver wages is the inflationary environment and the upward slope that we've seen for so many quarters in a row have really started to moderate. And we think the opportunity to hold the line or tow the line there for a bit is in front of us.

So, we're going to continue to focus more heavily on the lifestyle side of the equation, the equipment side of the equation. Our fleet is aged far less than many other fleets across the country, including many major trucking companies. And so, the desirability factor is there. We've turned the corner on some turnover issues within the fleet. And as we create these better jobs, the driving experiences are more sticky and they tend to stay.

So, we think the better way to think about it is that the worst is behind us. We think it moderates from here and the opportunity as it relates to driver applications is certainly up for the very reasons, we've been talking about with capacity exiting. Now within that opportunity, we have to be very selective and very careful about who we let through the door, and we're going to continue to have our standards stay high. And so, it's just a matter of picking to a larger pile of applications that is.

### **John Steele**

Okay. And Ken, on the operating margin, we did an 85.1% in TTS net of fuel in third quarter. Last year, we did an 81.8% in fourth quarter net of fuel. I don't think that's very likely. That was a stellar performance a year ago with all the project and surge and premium pricing opportunities we had last year.

My expectation is that an 85.1%, it's achievable to match that or slightly improve that from third to fourth quarter. But on the Logistics side, the level of income we saw last year was pretty strong in fourth quarter. And I would think we'll probably be closer to the level that we're at currently, maybe slightly better in fourth quarter for Logistics operating income than third, but I wouldn't probably approach what we achieved last year.

### **Ken Hoexter**

That's real helpful. Yes, I was specifically talking to TTS. So that's real helpful. And your thoughts there. And Derek, just on the 3% One-Way run rate decline or 3% down to flat. Do

you think that's more stable than the market given your mix of business on the Dedicated and your end-user customers? You talked about more is it's not as bad in the staples. So I guess, is there more stability there?

### **Derek Leathers**

I think the biggest way to think about it is the lack of project in peak. It's less to do with rate renewals at all. As a matter of fact, it's almost completely nothing to do with rate renewals and even and it's immaterial relative to spot. It's literally the comp issue year-over-year relative to the subdued peak this year.

Our core customers and our core agreements are holding up extremely well at this point. We're going to continue to hold up and stand by them from a service perspective. And so it's just the lack of opportunity....to put some framework around it, it's our expectation that our peak opportunity this year is somewhere in the neighborhood of about 60% less than what it was a year ago.

So that portion of that rate per mile that was specifically attributable to peak in project is about 60% lower Q4 this year versus Q4 a year ago. The other thing I'd point you to is that we do expect Dedicated revenue per truck per week year-over-year to still, despite all of this backdrop we've been talking about, the largest portion of our fleet, it's still our expectation will be up 6% to 8% fourth quarter this year versus a year ago.

### **Operator**

The next question is from Ariel Rosa with Credit Suisse.

### **Ariel Rosa**

So, I kind of want to stay on that theme. So, you had mentioned you think from a cost inflation standpoint, the worst of the conditions are kind of behind you. And you just mentioned Dedicated pricing up 6% to 8%, which I think is still pretty robust, maybe lags inflation a little bit, but still pretty robust. Typically, in a down cycle, we do see earnings turn negative. Here, you're still posting double-digit adjusted earnings growth.

Do we have to go through a period, do you think where we see earnings turn negative, maybe even meaningfully negative before we start to see that pick up? And if so, kind of what's the mechanism by which that happens? Is it higher cost, continued cost pressure or do rates come down or what's your view on kind of the puts and takes there of how that plays out?

### **Derek Leathers**

Yes. I mean, so first, I'll start with this, it's the industry, right, that's going to be more relevant on when this thing turns, not just one company. And I think the industry is certainly going to see some negative earnings turns, especially the more exposed they are to One-Way and furthermore the more that they're exposed to spot.

And so that's already happening where 90% of this industry is made up of carriers of 20 trucks or less and they were negative as we speak and not just year-over-year, but just flat negative in many cases. So as that washout continues, I think our job is to hold the line and

continue to allow Dedicated to perform the way it does and continue to embrace what we have in that portion of our portfolio and hold the line in One-Way and guard against that big negative turn that you're talking about.

If you go back to '18 to '19, we were up 1% year-over-year at a time that most everybody was down. If you go back further than that, it was a case where our portfolio was just fundamentally different. I'm not guiding that there won't be an EPS decline in '22 or '23 versus '22. What I am saying is that the traditional decline, if you were to look back over four or five cycles is absolutely not in the cards this time around, at least from our perspective. Our portfolio is different, our defensibility is stronger, our long-term agreements are more robust and Dedicated is simply a much larger portion of the pie. So, we will continue to chip away at it. We're not going to guide to '23, specially not on a Q3 call. But at this point, there's just too much uncertainty to be able to give you much more color than that.

### **Ariel Rosa**

No, no. That's terrific color. And certainly impressed with the results so far, especially the resiliency of Dedicated. It's just been impressive to watch. Just for a quick follow-up. On the M&A point, you mentioned Intermodal. Is there anything outside of Intermodal? We've seen some of your truckload peers looking at LTL, looking at maybe expanding in Logistics and other areas or do you think it's mostly asset based that you guys are really thinking about as kind of an M&A opportunity?

### **Derek Leathers**

Yes. I would start by saying there's, it's not mostly anything, and that's important to note. We really believe, I really believe, that to do M&A appropriately, at least within our network and our business, we've got to be eyes wide open to all opportunities. So, if you look at the three we've done so far on paper, they look very different, but they all fit a piece of the puzzle that mattered and was important to us.

The ECM acquisition really solidified the Northeast region for us in a way that was uniquely capable of being done through acquisition. NEHDS was a dedicated Final Mile, not just Final Mile, but dedicated Final Mile provider that really fits hand in glove with our current Dedicated offerings and our philosophical bend toward Dedicated and longer-term, tougher to do type of freight.

And then Baylor is a pharmaceutical, expedited sort of expert in their field, and although it isn't a large acquisition by any means, it still brings a skill set and a management team, a leadership philosophy into this building that I think makes us better.

As we look forward, we're going to have that kind of same broad net as we think about things. I didn't bring up Intermodal. I answered a question about Intermodal. So I don't want anybody to believe that that's some heavy focus or any kind of narrow band that we're looking at as it relates to acquisitions. Logistics is certainly in play as it relates to that and as are other opportunities.

And lastly, I just want to remind everyone that our first and foremost objective is to grow this thing organically, to invest in ourselves, invest in the quality, in men and women across

Werner Enterprises because I believe that's where our best return will be found. But when we find the right opportunity that we think makes us better, we're not going to be so proud as to pass up on it.

### **Operator**

And the last question will be from Amit Mehrotra with Deutsche Bank.

### **Amit Mehrotra**

Derek, John, I wanted to ask on the One-Way side if you've seen any shipper inflections in terms of bid compliance or the amount of volume they're tendering relative to the contracts? I'm just trying to sniff out if there's anything going on, either because of lower demand, or the spot market opportunities maybe move that. Anything to note there on that front?

### **Derek Leathers**

Yes. Sure, Amit. I mean first off, we have really sophisticated tools to manage customer commitments and customer compliance. And it's difficult, it's easy to measure, it's harder to understand the why. And so, I say that because clearly, there is an economic backdrop that is causing shippers volumes to decrease, the combined impact of, in some cases, excess inventory, and in other cases, just simply consumer sentiment.

But what we try to manage is when it's clearly greater than the impact of those two items. And so when that happens, we have mechanisms to address it. We bring it to their attention. We have dialogues about it, and the response has been pretty positive.

I would tell you that the majority of the folks we work with -- we've chosen to work with over a long history because of their commitment, integrity and approach to how they manage their business. And occasionally, somewhere in people's networks, somebody might run a little astray of that. And when that happens, we have to have those conversations.

So, we'll continue to manage it. I feel good about our ability to catch it if it's happening. I'm very comfortable with our ability to have that conversation when it needs to be had, and our team will continue to address and resolve them as we see them. I think you're going to see that going forward. That's always part of the process. It's always part of the cycle turn.

And our job is to out manage it relative to others and make sure our customers understand, just like we stood by them during COVID, and our spot market at its peak in One-Way was still low, low double digits, which is virtually no exposure, and showing our commitment to them. I have every confidence that we will voice and converse on that with any customer that we feel is behaving differently than that now that the market may have loosened some.

### **Amit Mehrotra**

Okay. And then just for my follow-up. You guys put out this book-ended range for margins in TTS. I think you even raised the bottom end of it last year. I forget what it was, was 13% to 17% or 14% to 17%, I forget what it was. Maybe you can remind us.

But as we think about 2023, the environment, it sounds like you still feel very comfortable that you're going to operate within that range next year in a potential downturn. I'm just

wondering with the freight selection opportunities, maybe you guys were at the high-end last year of that range, even exceeded, I think, in the quarter or so. Do you think kind of the low end of that range makes more sense, not necessarily due to price, but just the freight selection and surge opportunities?

### **Derek Leathers**

So, our range is 12% to 17%. We stress tested that range in many ways and even against economic backdrops, far worse than the one we're in right now, and we are comfortable sticking with that range and comfortable with our ability to perform within that range. It would not be my expectation to find us at the low end of that range in the ensuing quarters but certainly for the year.

It's my belief that by the middle of next year, this thing is corrected, and we've started to enter in a period of equilibrium if not tightening. And that sets itself up well for the back half of '23 and so for a yearly range, the low end would not be something that I would be expecting or accepting is probably a better word. Q1, depending on how Q4 plays out, obviously, could be tougher.

But even in that scenario, it's our belief, especially, again, I know I sound like a broken record, but I have to point you back to the strong execution, long-term history and the longevity of the relationships in Dedicated and the defensibility of what that freight looks like.

That will only increase in its importance and increase probably in its scale as we go through bid season. because the combination of a strong pipeline in Dedicated with a market going through its normal cycle change on One-Way, lends itself to rather than growing, simply migrating and I think you can expect more migration from One-Way to Dedicated depending on how this bid season goes.

### **Operator**

This concludes our question-and-answer session. I'll now turn the call over to Mr. Derek Leathers, who will provide closing comments. Please go ahead.

### **Derek Leathers**

Yes. I just want to thank everybody for joining our call today. And although we're entering the time of increasing uncertainty relative to the direction of the overall economy, our business model and our customer mix is designed to execute well. At the macro level, the industry dealt with a shifting Logistics landscape, and we face cost challenges with our investments in schools, while at the same time, our steady and durable Dedicated business continued to perform as advertised.

We added to our portfolio in other pieces of the puzzle this quarter with the acquisition of the high-performance team at Baylor. And despite its relatively small size, I'm super excited about the capabilities and industry verticals that allows us to further develop.

Our Dedicated pipeline remains strong, and our less asset-intensive Power-Only offering continues to show promise as we go forward. Deactivations of carriers are on the rise, and capacity constraints remain, lending confidence to our view that cycle duration will be

shortened and less severe. And while peak season this year is underwhelming thus far, it will only hasten the capacity correction that is already underway.

I remain confident in this team's ability to execute as we work through this correction and come out even stronger on the other side. And finally, and perhaps most importantly, I just want to thank the entire Werner team for their tireless dedication and commitment to excellence that makes me proud to be part of this team every day. Thank you for listening and thank you for spending your time with us today.

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.