Cowen 15th Annual Global Transportation & Sustainable Mobility Conference
Werner Enterprises, Inc. (WERN) September 7, 2022, 11:20 a.m. EST
Cowen Analyst: Jason Seidl
Werner Enterprises: Derek Leathers, Chairman, President & CEO. John Steele, EVP and CFO

Jason Seidl

Hi everyone and welcome back to Cowen's 15th Annual Global Transportation & Sustainability Mobility Conference. I'm one of your hosts, Jason Seidl, Cowen's Senior Transportation Analyst. With us today, Cowen and myself are honored and pleased to have Werner Enterprises. Representing Werner Enterprises is CEO, Derek Leathers, and John Steele, CFO. It's probably John's last time with us because of his pending retirement if you will, but it's always been a pleasure to have John and his insights at our conference.

So, we're going to jump right into it gentlemen. Much has been said about the sharp drop in spot prices most of this year. Derek, you always give a great sort of overview of how you see the market on your earnings calls. In your view, what's really to blame for that? Is it too much capacity that came into the market or there's not enough demand or is it sort of a combination of both?

Derek Leathers

Yes, I mean, I certainly think it's a combination of both. But I think it's important to kind of level set on what we're talking about, when we talk about that spot market and the price drop. You had two straight years of an incredible amount of entrants into the marketplace chasing a very historically elevated spot market. So they came in at higher pricing structures. They came in with maybe less experience and especially experience through any kind of economic downturn and added capacity into that spot market.

Now, when I say added, I don't know that it was industry adds, as much as it was migration out of owner operator models or company driver models into these new registrants that were chasing this robust market. You've had two now cycles of bid periods where customers have been able, through bids, to kind of re-gather a lot of that freight back into contract terms. And so now you have a very decreasing level of spot market volume being chased by an increasing level of spot market participants. And you're going to see it crater like we've seen as of late.

I think that's all kind of important background because it's not necessarily relevant to what's happened in contract. And so if you look across the contract space, contract negotiations have held up very well thus far this year. That's a more stable place obviously to be. That's what our model's built on both in Dedicated, but also even on the One-Way side of our business. We've actually decreased our spot exposure through the summer as a percent of total miles in One-Way. And it's a very, very small percentage, less than 5% of total miles when you put Dedicated into the mix.

So, it's a troubling place to be. And if that's where your business is operating is predominantly in the spot market, you've got a shrinking pool of freight with a large level of participants. Some of the supply side I think is self-correcting right now. So, we monitor very closely sort of net activation; so people closing up shop as well as people opening up under new DOT authorities. We've had 13 straight weeks of net decreases from an activation perspective and 15 out of 16. And that volume of net deactivations is now north of 40,000 units and growing.

So, I think a lot of folks have woken up to the reality that you simply can't pay what was being paid for used equipment, trucks, trailers, driver pay, et cetera, and then go chase spot rates that have declined 40% year-to-date. And you're not going to last very long in that environment.

Jason Seidl

I want to get a point of clarification and then jump into something that's related to this. You mentioned less than 5% once you throw in your Dedicated exposure. Where was that percentage last year?

Derek Leathers

So last year, it would've been slightly higher, obviously. What we did through the pandemic and we're proud of it, is we stayed true to our customer base. Now, we moved our spot percentage a little, so call it 11% of One-Way as a normalized run rate; might have achieved 13.5% at its peak. But we were never up in the 16%, 17%, and certainly nowhere near 25%, like a lot of fleets were. Today it's back to that more normalized 11% rate and that's One-Way miles. So when you take that across to all miles, you end up a lot closer to about 5% of all miles.

We're able to do that because of our contract renewals and the strength of those renewals and that our network is holding up well. Despite everything you read, we're still arriving to work every day and our network is overbooked. And it's overbooked in a more normalized way. So it's not like 2021 and 2020; you have to be fair. But it's still more shipments than trucks as we arrive each morning and then we build on that from there as the day plays out.

Jason Seidl

And this sort of leads into some of the outlook if you will. You talked about how contract, different discussion versus spot. And that's clearly been the case from the feedback we've received from not only yourself, but other carriers, both public and private. But historically spot prices, at least directionally, have indicated where contract rates are going. It's always been our view that contract rates are going to stay positive due to sort of the inflationary pressures that we have out there in the marketplace. We haven't seen this type of inflation my entire career as an analyst.

Do you think that even if we do see a downturn that contract rates can stay positive because of a lot of inflationary pressures that yourself and other carriers you're seeing?

Derek Leathers

Yes, I think you're right directionally with what – how you're thinking about it. I mean, there is incredible inflationary pressures across the industry right now. Now large, well-capitalized carriers are going to manage that better than maybe somebody who's smaller or less sophisticated. But it's sort of irrefutable. I mean, you can't fight gravity and truck, trailer, tire, fuel, labor; those prices all have upward pressure on them. Fuel is - we've seen a little bit of a reprieve as of late, but there's no fundamentals underneath that, that lead me to believe that we should count on fuel being some kind of tailwind into 2023.

So given that backdrop and given the exodus that we're already seeing happening at the small carrier level, and given that, that when spot markets in prior cycles predict kind of some directional change in contract, the lag is still about nine months, six to nine months depending. And so that puts us right around next year's bid season.

Well, if we keep seeing attrition in this net activation level that we've been seeing over the next several months, if you see the consumer kind of, come back off the couch and get more engaged in the economy, because they still have dry powder, they still have savings rates that are still in excess of pre-pandemic levels and you get through the midterm; I think political concerns that cause people to hunker down a little bit more, I think there is a lot of different ways you could end up positive next year.

Now, it could also end up obviously more muted and we're preparing for kind of an all of the above strategy. We're working on cost controls right now. We're aggressively addressing yield within the network. So even in a market where you can't go get a rate increase, you might increase yield by simply working your mix. And so we're going to work through that mix profile everywhere we can, as we go through next bid-season. Make sure we're aligning and further aligning with people winning in their space. Make sure we're growing with folks that are net beneficiaries of recessionary times. And lots of those folks are in our top 10. So, we're pretty excited about the setup going into this, even if this downturn becomes more meaningful.

Jason Seidl

That's great color. Before I jump to my next question, I want to remind investors they can ask questions over the chat or alternatively, they could email me at jason.seidl@cowen.com. So, let's talk a little bit about your customer base, because you've always touted over your history that you are a little bit better positioned on the retail side, that a lot of your higher end customers have a more, I guess a more sheltered exposure if you will. Can you talk about that a little bit and how have they been trending in this current downturn?

Derek Leathers

Yes. So early returns look as we expected. They're doing better than most, and that's what we expect of them. We went back and John did some really valuable work and analyzed prior recessions and looked across our top 10, top 15 customers, those folks that we know really kind of carry the day. And 60% of them actually improved

performance during prior downturns, 20% kind of held serve and did, sort of better than market or equal to market and then the other 20% maybe didn't do as well.

So then the next step is digging through that data to understand, okay, out of those 20% that didn't do as well, what have they changed? Where are they at in the mix? Where are they at in the pecking order? And really focusing on setting the ship up for what could be a slowdown. And so look, we can't, I used the term earlier, but we can't fight gravity on economic conditions. So, if the economy starts to slow, our job as we see it, is to just make sure, like any captain would and prepare the ship for the weather that's coming. And so we think we're there. We think we've prepared well. We've got further moves to make relative to mix.

But the exposure of Dedicated is greater than it was in any prior cycle. Logistics is a larger presence than it was in any prior cycle and One-Way has more engineered components within it, than it has in any prior cycle. That doesn't mean you get through it, like a recession didn't happen. It just means that it's not nearly as cyclical here as it might be elsewhere within this industry. And I know we all get painted with a broad brush, but we feel there are very few operators that operate at the level that we do. And we feel ours is one of the more defensive, if not the most defensive of that trucking bunch.

Jason Seidl

You mentioned a little bit about your different exposures and the types of businesses that you're in. The supply chain issues that we've seen over the past 24 months, I think, have really brought to the forefront, sort of, the importance of the relationship with your carriers and shippers, as well as the importance of a Dedicated deal.

So, how do you think an economic slowdown is going to impact people pushing more and more for the Dedicated side? Or do you think you'll see a slowdown on that growth? Or an increase or sort of steady state?

Derek Leathers

Yes, I mean, I think, whether it's the hyper demand environment that we saw over the last two years, or a slowing demand environment like we may be finding our self in over the next six to nine months, it really shows people's true colors; either one of those scenarios. And so you had carriers behaving in certain ways during the hyper demanded areas and then you'll have customers that'll behave a certain way if this thing were to flip more aggressively.

What we like is the stability of Dedicated because what doesn't change in Dedicated, if you're doing Dedicated properly, and you're only pursuing true Dedicated arrangements is, they weren't, we were not pursuing Dedicated that was really One-Way freight looking for shelter during the storm of the last two years. As those came in the building, you can kind of easily identify them. This is really going to return to One-Way as soon as it can. It's not going to hold up over time. It's not actually Dedicated.

By contrast, harder to do business, multi-stop, driver involvement, high service expectation, product placement above all else, meaning it's got to be there on-time and in full every time; that's true Dedicated. That's the stuff in the pipeline during the pandemic, that's the stuff in our pipeline currently. We feel really good about that type of Dedicated weathering a downturn. Because even though the economy may be slowing, I'm fairly certain as a retailer, what you wouldn't want to do, is take those key supply channels that source the most important products on your shelves and disrupt those to the end consumer when they're – when they may have more choices all of a sudden to make.

Jason Seidl

Fair enough. Let me shift gears a little bit here. Talk about acquisitions. It's been a while now, since you dipped your toe in. Can you talk a little bit about your first experience acquiring a truckload carrier and then talk about the current market and what we might see going forward from Werner in the current acquisition market?

Derek Leathers

Sure. So obviously we've been a conservative company for a long time. I do always like to point out that our first acquisition was actually the driver school network; the vertically integrated driver school network that we think provides us with a real competitive advantage. It just wasn't looked as much as an acquisition because it wasn't trucking logistics, it wasn't revenue based, it was strategic in nature. That's gone very well. We're very proud of that.

ECM has gone very, very well. So, we've lapped an anniversary, that one year mark. We've kept that team intact, we've kept that driver fleet intact, and we've actually grown that fleet slightly. As you well know, that's very unique in M&A in the trucking space.

We think it has a lot to do with all the diligence we did on the front end. We think it speaks highly of the team they have there and our culture. So, we're real excited about what that ECM acquisition has done thus far and what its potential is moving forward.

NEHDS, which was done later in the year; we have not yet lapsed that one-year mark. But we rebranded that as Werner Final Mile. We think that was better from a brand perspective, from a customer facing perspective. And that acquisition is also going well.

That one is, that's a longer tail pipeline just like Dedicated is in general, because, to remind everyone we're not just doing Final Mile, our focus is Dedicated Final Mile. And so that's really what that NEHDS acquisition was all about. So it's us owning a building, single sourcing the region and handling all Final Mile deliveries for a specific customer.

We've seen great receptivity from our incumbent customers. We've grown already with their incumbent customers, the pre-acquisition customers that is, and we think the pipeline there looks especially strong. The equipment challenges in that Final Mile space are real. They're real across every class of truck, but they're very pronounced in that Final Mile space. So that will be one of the limiting factors of that growth in the short-term, but the medium-to long-term prospects look outstanding.

As we think about the market overall, right now, it's active. There's lots of opportunities out there. Anytime you see the, a little bit of a turn, obviously people all are looking to sell, looking at rear facing earnings to establish valuations. We're going to be the same prudent, conservative, careful folks we've always been, but the store is open, and we are looking at things. If the right opportunity comes along, that clears the hurdles that matter to us, we will act again on further acquisitions. But we will be very methodical in our approach.

Jason Seidl

So, with the active market, Derek, would you say that sellers are getting more reasonable in their asking price?

Derek Leathers

Yes, I think it's a mixed bag, right? I mean, there's folks that are less reasonable and the conversations last less long. And then there's other folks that are more reasonable about how to think about the future, and frankly, the ones that really interest us are ones that see the same thing we see relative to the synergies between their business and our business. And the folks that truly get excited about being part of this brand and where this brand is headed and what we stand for, that conversation's going to last longer and we're going to get to a reasonable outcome. It's just going to take more time.

If it's only about the money, then we probably aren't the right buyer to be perfectly blunt. And so, we're looking for synergies well beyond that. We want to do things that are additive to the portfolio. We want to do things that are additive to geography or coverage rates in a particular area of the country.

But probably most importantly, we want the right culture. And so that's going to drive the bus more than probably anything else, making sure those cultures fit, so that we have an opportunity like we've done in ECM and like we will do, and we're on track to do with NEHDS, and that is lap that first year with increased revenues and, kind of wind in our sails relative to future growth.

Jason Seidl

John, are you trying to jump in on a comment there?

John Steele

Yes, Derek brought it up later, the additive and the accretive are fundamental requirements for anything we consider and we're continuing to do our homework on opportunities.

Jason Seidl

So in other words, if you guys announce another transaction, whether it be next month or six months from now, investors should have comfort that it will be accretive?

John Steele

Yes, correct.

Jason Seidl

Perfect. Let's talk a little bit more on sort of CapEx outlook. I'm assuming for 2022 it's largely set. How should we think about it for 2023, at least from a directional standpoint?

Derek Leathers

Yes, so 2023, we haven't fully baked the cake, so to speak, in terms of where we're at on equipment. That's predominantly because we're not – we don't have total clarity on where they're at with the ability to make it. I think in general; we've said 11% to 13% of revenues is what we think it takes roughly to run this business. At some point, and it could be as early as 2023, just depending on their ability to get back up to pre pandemic production. But at some point, we're going to need to increase CapEx a little bit because our fleet has aged a couple of tenths during the pandemic.

It's not to go grow the fleet into a bad market or bad economy or anything like that. It's because we want to freshen our truck fleet in particular a little bit. And so it's too early to predict that, and we haven't put out a CapEx range for 2023 just yet. But if you were asking me, best guess, we just don't see that fluidity in their production schedules coming back until middle of next year or maybe later. So it's more likely to be a late 2023 or even 2024 year where you might have to have a bit of an uptick in CapEx.

Jason Seidl

And you mentioned age of the fleet. Derek, where's that at versus sort of optimal points?

Derek Leathers

Optimal is tough to put an exact number on. But we're, let's say at 2.2 today roughly. I'd like to see us closer to 2.0. It's going to take some work to get there. And that means a little bit of outsized purchasing for maybe one or two years to get back to that 2.0 level. We just feel better there. We like the way the experience from a total cost of ownership is.

We sell all of our own trucks. We've got a lot of data and knowledge on what that looks like. And that's, really where we'd like to see the fleet. So the great news is 2.2 is still a young fleet. It's still very fresh by industry standards. It's not a driver deterrent in any way. But I would like to see it just a little newer than it is today.

Jason Seidl

Sounds fair. I'm going to give you sort of a broad question here for yourself. So, what are your shippers telling you about peak season and what is your overall economic outlook?

Derek Leathers

Yes. So peak season I think is still coming together for them and us. They're trying to read all the tea leaves just like you and, you are, and we are, and everyone else. And I don't think it's quite as clear as any of us would like to – like it to be. I think there are several shippers in our top 10 that we know are net beneficiaries, as things get a little tougher, because you do see people migrating down the value chain into the products that they sell. And so they're more bullish, of course.

There are others, that maybe it's just a little early and they're still maybe weaning off some out of period inventory and some things that are caught up in this whole inventory discussion that are getting maybe misunderstood. Yes, the inventory dollar levels are up, but it includes capitalized transportation cost. It includes higher acquisition cost, i.e. inflation in that number. So it's hard to get unit counts and to understand where they're at.

I think what's safe to say at this point is that peak season this year is not going to shape up with the amount of project opportunities as it did in 2021 and 2020. And I think it's too early to say that it won't replicate kind of pre-pandemic peak season levels. We just don't have quite enough closure yet to know. And we're kind of getting used to being back on a pre-pandemic kind of schedule of closing out those projects.

So pre-pandemic, it wouldn't be abnormal to be sitting in September kind of finalizing and working through projections. But for the last two years, we had the benefit of it being kind of finalized in August and moving even by late August, early September. And that's not the case this year. So, I think we, that would be my outlook on that.

Overall economic outlook, I'm probably not as doom and gloom as some. I still look at, if you kind of zoom out a little bit and you look at savings rates and what's going on with the consumer, what their debt levels were like

pre-pandemic versus today, the midterm elections, not that far away, so the daily onslaught of negativity, hopefully being in the rear-view mirror. Inflation is starting to taper a bit, the fed may be moderating their stance a bit going forward. I think, moderating GDP, flat GDP, that type of outlook is where we're going to use as our base case. Not a hardcore recession base case. Even if it is a recession, it's our belief that it'll be shorter in duration and more mild than what we've seen in some past cycles and particularly in the trucking aspect of it.

I think the math is just clear. We've got multiple years of sub replacement level builds. So, we know that at a most, at the most macro level of all, you haven't seen massive capacity adds. Now, we have tons of mix change; owner operators becoming their own authority, and now showing backup as company drivers and therefore employee counts looking like they're rising. But did that actually add to the actual rolling stock? It's hard to say it did with the production levels we've been making over the last couple years as an industry.

So, I think if you see this net registrations continue to decline, if you see spot market continue to be under duress, I think this thing resolves itself faster than prior cycles as do I believe that the overall economy gets better, quicker than in prior cycles. And so as we look out to back half of 2023, as an example, we feel pretty good that this correction that we're going through will have a totally different outlook by that time.

Jason Seidl

Well, that's great color Derek and I'm, fingers crossed. I'm hoping you're right on that one, because you're right, there is a lot of doom and gloom out there. I wanted to jump to some of the client questions here that are coming in. So, let me go into it right now. You mentioned reselling trucks. What are you getting right now for a used truck and how should we think about gains on sale in 2H 2022?

Derek Leathers

Sure. So, we've stopped giving guidance on gains, not because we're trying to be evasive, but because that market has just been so volatile over the last several quarters. We've seen similar to what you see in publicly available data that used truck pricing has come down over the, from Q1 into Q2. Now, that we get into Q3, we've seen some more stabilization of that. And that demand is supporting a more stabilized price that does include a gain still. And I would say really still an outsized gain by historical standards, not as strong as what it was at its peak, but stronger than historical standards.

So, we're going to continue to plow through that. We're moving the equipment at the pace we need to. So we can offset as new comes in, we're moving the old out. We're not sitting on it, and we're not having trouble getting it out in the market. Time will tell, I mean, as those smaller fleets come under more duress and perhaps find themselves less inclined to want to add equipment, we've – it's not unrealistic to think that that gain number comes down. But at the same time, if that's true, what that means is, you're seeing that flushing happen, that we're talking about, which gets us quicker to when this thing gets, it gets strong again. So, we'll take that trade off, if that were to happen.

Jason Seidl

Perfect. Another one here, you haven't talked a lot about driver pay or availability. What's your outlook on that?

Derek Leathers

Yes, right now driver pay seems to have found also kind of a stabilization point. We're seeing better success as of late from a hiring perspective. Applications are up quite a bit, but quality applications are really what we're interested in. It's tougher and tougher to kind of sift through the pile and find folks that meet our criteria and our expectation to join this fleet. But we are able to have a little bit more success. And I think a lot of that is exactly these deactivations and other things we've been talking about. Folks that went out there on their own, thought it was going to be great forever, realized that's not how this business works, and now they're looking for shelter. And so our experienced hire count is up as a percentage of total hires, because we're able to kind of pick through that, that pile every week and try to find those hidden gems.

It's not easy to hire drivers. We're always going to take care of our drivers. There is places where the Dedicated business we do is difficult enough to do, both in geography as well as expectation, that there are pay raises that have still gone on through Q2. But those are offset by customer support. And so we go to the customer, and we work those through with them and we make those decisions jointly. So you will see a rising driver pay line, but where that's taking place almost exclusively is on that Dedicated side. And that is offset by customer support of that pay raise.

Jason Seidl

Perfect. Well, gentlemen, that's it for the questions. On behalf of myself, my team, and all of Cowen, I want to thank you. It's been an honor to have you again and I want to wish you and the rest of the Werner family all the best. Be safe out there.

Derek Leathers

Thank you, Jason. Thanks everyone for attending.