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**Bank of America analyst: Ken Hoexter**

**Werner Enterprises: Derek Leathers, Chairman, President and CEO. John Steele, EVP and CFO.**

Ken Hoexter:

All right, great. I'm Ken Hoexter and welcome to the next session of our 28th annual Global Transport Conference. Next up, we welcome Werner Enterprises, with-- start off with Derek Leathers, Chairman, President, and CEO-- newly appointed chairman, so congratulations on that, Derek. We welcome him for the third time here at our conference and John Steele, EVP Treasurer and CFO, for the ninth time at the B of A conference. And John, if you're able to attend next year you'd become the fourth member of our 10-timers club.

So thank you for your and Werner's commitment to our conference over the years. Derek you've been CEO since 2016 and COO since 2008, so understand the market extremely well. John, same with you, CFO since 1996, on the job for more than our two decades of coverage of Werner. So happy to have you both here this morning.

Derek, I guess, let me just start it off with you, just given the market. I mean, we're here in a-- it seems like a perfect storm of tight inventories, government stimulus, constrained driver market, OEM supply issues. So you talked about the market lasting until 2022. What gives you the confidence in that duration versus the market sometimes corrects itself quicker? Maybe just talk about your thoughts on the market here.

Derek Leathers:

Sure, Ken. Well first off, thanks for having us. We're excited to spend time with you today and at the B of A event. So appreciate the invite. You mentioned and touched on several of the items, to be frank, in the question itself. I mean, I think we've got a lot of things that are a little different this cycle than what we've traditionally seen. I mean, you're looking at inventory levels, retail inventories at really 30-year lows, not a market that's very supportive of trying to rebuild those inventories in any kind of a hurry, due to capacity constraints across multiple modes, whether it's ocean, air or road; they're all under some version of duress.

You've still got manufacturing capabilities that are impeded globally, and the ability to play catch-up on those inventories is tough. The backdrop against all of that is a consumer that's heavily engaged. I mean, they're out there buying. And we're seeing record same store sales growth across winning customers, who we've worked hard to align ourselves with. We think GDP growth looks strong through the year and into next year. And then on the supply side you've got a significant driver shortage, a much more structural one than what we've seen in prior cycles, combined with an OEM network, trucks and trailers, that are in a variety of constraints that are real, they're meaningful, and we don't see them clearing in '21 and even into part of '22, potentially. And so there's no new net capacity being added. I mean, ATA's data just came out for the first quarter, of the survey of small and large carriers. And usually, when one is shrinking the other is growing.

So, if large is shrinking some, you see small carrier growth or vice versa. And in both categories, they were down, 3% to 5%, depending on whatever, small or large.

And so the last piece of that would be, I'll just-- we are a conservative company. When we give guidance, we gave guidance about 1% to 3% truck growth, and we went negative 1 in the first quarter. We're not proud of being off our projection. We're working our tails off every day. But that's just how tough it is out there. And I view us as one of the best in class as it relates to recruitment, retention, training, and development. And despite all of the above, it's a hard market to grow into right now. And I don't see the typical lack of discipline that impacts this industry even being an option on the menu right now because nobody would be able to grow, even if they were trying to, in any great, meaningful way.

Ken Hoexter:

It's an amazing set up and kind of fits the stronger for longer theme we revisited a couple of months ago. It just seems to really be holding firm. Are there-- the port of LA, yesterday, talked a little bit about getting things cleared up by the docks by July 1. Does that start to ease some of the congestion issues you're talking about? Or is that right into peak shipping season? And that's when things are going to get tougher. And so we don't see it loose-- even easing up on the backlog clearing.

Derek Leathers:

Yes, I think a few things-- one, I think it's an aspirational goal. They've been talking about trying to clear the port for several quarters now. So, we wish them luck on that. I hope that they do see some progress made with clearing those port backlogs. But even if they were to hit those aspirational goals, you're really sitting on the doorstep of peak then, at that point. You're starting to think about fall surge, fall peak, fall growth in purchasing. And so I think even under that best case scenario, you either have something that you believe that is going to bring a bunch of capacity to bear between now and then domestically-- because getting it off the boat and on the dock and ready to move is one thing, actually moving it is another thing. And I don't see that capacity coming online.

And there's no-- we were very vocal earlier in the cycle about-- during COVID about people potentially having a wallet share shift, once the economy opened back up, and getting a larger percentage of wallet that shifts back to services versus products. And yet we're largely open. It doesn't feel that way, probably, on the East Coast, but largely open in the middle and southern portions of the country. And people are still actively engaged in product-based purchasing as well as, now, a reintroduction of services in certain places. Ken, I lost you.

Ken Hoexter:

I was-- thank you. I don't know how it muted itself. But looking at the Yankees no hitter yesterday. Certainly with the full stadium in Texas, it tells you that people are out and about. So maybe let me take it near term for a second. It seems like you've historically posted 200 to 300 basis points of improvement in operating

margin from 1Q to 2Q. Given the weather impacts in the first quarter, the strength in demand and pricing that you're talking about, is there anything that constrains or enhances that level, from the 85 and 1/2 or so range you're at on the trucking side, your TTS side, as you move forward into the second quarter?

Derek Leathers:

Well, as you know, we don't give guidance. And we're not going to back into it through the back door on this call. But our expectation is to continue to execute. We're going to-- we've raised our guidance on the rate side, and we feel we're well on our way in Q2 toward strong rate performance. We believe that we've got opportunities to continue to further engineer our network, due to the tight capacity constraints and the abundance of freight that's out there that allow us to structurally continue to make the improvements we've been working on. We've been managing driver pay very well, I think, in a tight driver market. We'll continue to stay focused on that.

We had a lot of headwinds in the first quarter that won't be repeated in the second quarter. So that's beneficial. We also had tailwinds in terms of freight demand in the first quarter. And it was historically unseen before. And so the balance of all those things will flush themselves out as we report Q2.

What is intact is our long-term guidance range of 10% to 16% margins and our expectation that this year would be at the high end of that range or even potentially above the range. So that gives you some indication of how we think about the margin opportunity going forward.

Ken Hoexter:

Yes. No, that's certainly a great statement, in terms of that potential. So let me just follow on that with my next one, which would be, you've-- I guess we've talked for years about does the trucking market make-- what can potentially structurally change the market, when we talk about the ability to get margins that are reinvestable? You talked about your range of 10% to 16% long-term margins and now moving to the top end of that. We've always talked about, I don't know, whether it's insurance or things that impact some of the smaller carriers, are you starting to see that, given this environment? Or is it-- we'll look back and this is a cyclical-- I don't want to say peak right now because of that stronger for longer theme. But is something really underlying in changing that theme?

Derek Leathers:

Yes, I think there's some structural things that'll take a few years to play out and to continue to give us increased confidence that they're real. But if you think about the flaw in the trucking industry over time, it's the barriers to entry were always too low. It's a fragmented industry with fairly low barriers to entry. If you think about the current version of the trucking industry, those barriers are quite a bit higher.

Technology is playing a much larger role. And to be able to operate and compete efficiently, you've got to invest significant amounts of capital into technology. And many small- to medium-sized fleets are just unable to keep up with that.

Electrification and some of the automation and some of the safety-enhancing equipment all have one thing in common-- they're very expensive. And you've got to really think about how you're going to generate the cash. First off, we invest the cash properly, and then reap the benefits of those investments through proper modeling assumptions. Those things are barriers to entry to a less sophisticated carrier population out there.

Insurance rates are rising, and there seems to be no end in sight. And now you've got some momentum, and I think appropriate momentum, around raising insurance standards. So rates were going through the roof with the old standards. If the standards themselves get raised, that's just a further tightening, if you will, of who's able to play in this space. But it's one that's appropriate and needed because they haven't changed insurance levels in over 25, 30 years.

And so there's a lot of structural stuff. The drivers themselves have expectations that are hard for a small-to medium-sized carrier to meet. They expect now, in a tight driver market, to have best in class equipment, get home multiple times a week, have telecommunications and connectivity to take as much workflow approach to the work as you possibly can, and eliminate papers and paperwork and record keeping that is administrative in nature. All of those things are difficult to do if you're not well capitalized and with a strong bent toward technology.

Ken Hoexter:

No, that's definitely what we're seeing. So let's talk about, then, what's going on now. So utilization was down, which-- particularly in the One-Way fleet, which is about 35%, 40% of your fleet, given the parked tractors, the tight driver market. So talk a couple of things here. Talk driver pay, what's going on with driver pay, how much it's increased, maybe, year-over-year or two-year run rate. We're seeing a lot of driver pay announcements last two, three weeks. And then the second part of that question is inflation. We've heard a lot about inflation in the last couple of days. You've seen many cycles through the trucking market. Historically, what does an inflationary environment mean for truckers in a larger scale? Well, let's start with driver pay, and then we'll get to inflation.

Derek Leathers:

Well, I want to back up to the beginning of the question then I'll get to driver pay. But you talked about utilization in the first quarter. I just want to be clear that the primary driver of our utilization impact in the first quarter was weather. I mean, it was-- those parked trucks that you speak about were parked intentionally. They had drivers in them. We parked them intentionally, aggressively, and with an eye toward safety above all else. We know that that had a significant impact on our Q1 results and we talked about, in the quarter. So as those trucks, and as we get through that weather and get back to normalized environments, we have an opportunity to make up some of that. Driver pay has been going up, which has gone up in our fleet. It'll probably go up further before the end of the year. But we have a very competitive pay package. And retention is actually performing very well year over year.

So even in this market our ability to retain drivers is very strong. The impact, really, is on that sort of bubble that had to work its way through the whole industry, that still to a lesser degree exists today, which was all of the lesser entrants coming into trucking, driving school closures, socially distant schools, all of those things. And we're not back to pre-COVID levels. Total transportation employment's off almost 3% year over year, pre-COVID to present. And it's hard to envision getting those jobs back in a very tight labor market overall. Driver pay will be one way you get some of them back. But frankly, these jobs already pay more than college graduates get first year out of college, without any debt load to go along with it. They already get drivers home. And lifestyle enhancements have been made. And yet you're not seeing a ground swell of people coming back in. Stimulus running out will certainly help. But it's my belief that if you look at the average truck driver, and the folks that drive trucks, they're real salt of the Earth, hardworking, nose-down type individuals. They're not the types that are sitting on the sidelines just taking the stimulus money and waiting for it to run out. Those are other folks. And so we might get some lift from that. But I don't think it's materially going to change the game.

Ken Hoexter:

So you mentioned the fleet being down 1%, a little bit lower than you thought. So do you see, if we look at your breakdown of your fleet, you've got 2,800 tractors in One-Way, Dedicated, about 4,900. How do you see yourself holding the fleet going forward? You mentioned 1% to 3% growth for the year. Do you see yourself catching up to that? And then maybe talk about seating the tractors within that.

Derek Leathers:

Yes, I think for starters, we didn't change the range because we felt the range was still appropriate. But we're going to fight like heck to get into the bottom end of the range. The top end of the range is fairly out of the question at this point, just given the market that we're in. I think how we get back into that plus 1, starting from a negative 1 in Q1, is a split between both Dedicated and One-Way. We have opportunities to do engineering and further engineering our One-Way group. We think to add some trucks in One-Way, we have opportunities, as Mexico comes back online and the highly disrupted north route business, over the last year, gets a little less disruptive, to potentially add a little truck count in that area.

And then our Dedicated pipeline is very strong. And so it'll still be predominantly Dedicated, when you think about that growth. But we really are going to work aggressively to stop the shrinkage of the one way fleet and actually incrementally try to add some in the back half of the year. That'll be the toughest lift of all.

John Steele:

And Ken-- this is John-- I would add that we're also adding four driving school locations. Two of them are already in place. And the other two will be late this quarter, early next quarter. That should help us build our driver pipeline stronger compared to where we are today. It's an extremely competitive market.

About a year ago, we identified geographies where it made sense to be adding locations. And those are being implemented as we speak, which should help to get a little bit of growth in the second half.

Ken Hoexter:

And John, are those at existing network terminals? Or are you opening new physical locations? What are the-- what is the template for the new driver schools?

John Steele:

Yes, they're new physical locations. We have a few that are at our terminal locations already, the existing. But, the four that we're bringing on are new locations that are specifically targeted based on their driver recruiting potential.

Ken Hoexter:

So let's switch back to the yield side. So now you've talked about the fleet. On the yield side you talked about Dedicated pricing, 3% to 5%. Derek, is that-- given the contrast of the mid teens at One-Way Truckload, is that based on contract timing? Is that more just as you've got multi years, that's what you can get in any given year? And it takes time just to accret. Maybe just talk a little bit about your thoughts on the Dedicated targets.

Derek Leathers:

Yes, it's several things. First off, we're going to continue to push Dedicated rates where they need to be, based on driver availability, driver pay, pressures, and other inflationary costs. Because you've mentioned inflationary cost and we know there's several of those out there in our industry. Our customers understand that. We also know that as we hold onto Dedicated fleets and they mature we have natural yield improvement opportunities that take place. So the number doesn't have to be the same. It doesn't have to even approximate what the One-Way increase is. And frankly, that's one of the things that makes doing Dedicated, with one or so, attractive.

But what it can do at 3% to 5% or especially at the upper end of that range is improve consistently, from a margin expansion perspective, just like the One-Way does. And so we demonstrated that in the last cycle, in '18. The Dedicated was not an anchor. We re-demonstrated it. And this cycle, as you look at '20, the Dedicated was not an anchor.

And so our customers are paying for a product that is more stable. We receive revenues and margins and earnings that are more stable. And we adjust them as we need to, to keep pace with our margin expansion expectations. But it doesn't-- those two things are two different product lines. They need two different sets of pricing. And we're going to treat them both appropriately to make sure we meet our expectation, which is being at the high end of the range this year on our long-term guidance.

Ken Hoexter:

I'm going to switch-- we've talked about rates and capacity. Derek, in your five T's, you have a particular focus on technology. Maybe talk about what's shifting because you kind of threw out there, a little bit before, about the advantages you have in terms of eliminating paperwork and different things that aid the drivers' operation. Is that something that can improve utilization even better on the trucks? You kind of threw that out there. And obviously, you've never been focused on the easiest route with your Dedicated business. You've always focused on doing some of the tougher stuff out there, I presume. That's what you're getting paid for. Maybe talk a little bit about how the technology fits within that.

Derek Leathers:

Yes, I mean we think technology provides us a lot of opportunity to just simply do what we already do more efficiently. A lot of it is going to be on making drivers' lives better, easier, more efficient and, therefore, even further improving our retention advantage, that we think we already have. We're going to continue to make our office associates more productive through the use of technology and get more productivity per seat, both on the asset and non-asset side. We think that's work worth doing. We're seeing early returns of that in Logistics in some of the improvements we've made in the last couple of quarters. And we think there's more runway where that came from.

You've seen us get more aggressive on buy versus build and mentality around where our comfort level with buying and adding technologies, like recently, Workday, and a pretty major EDI transition to the cloud and cloud-based services. We've leaned into our relationships with Mastery on the TMS side. And we made an investment in that, to kind of co-develop that product for more suited needs for a large carrier like ourselves. We're going to continue to stay close to TuSimple and what's going on in the autonomous space as well as all of our OEM partners.

And so, yes, I think technology is a differentiator here. I think Werner Edge is something that we're gaining momentum on every day. And we're looking forward to how it will provide us yet another layer of stability through the cycle.

Ken Hoexter:

So the Mastery, use of the-- working with Jeff Silver, so you've got Schneider also doing that. Is there a conflict in terms of engaging with the Mastery too deep into the network, that your competitor is also using it? Or is it just a platform that you're able to address your customers' needs better?

Derek Leathers:

No, I think all of us are going to keep our secret sauce and some of our data science work and the things that we do with that base platform to ourselves. And we're going to do that work in-house. And that's the kind of thing we'll build. But having a base platform that's stable, that's highly efficient, that's best in class with input from best in class players, we think puts us in a better position.

It's really not different from the-- I'll use the banking analogy, but banks, all underlying software, the base core platform is really like, I think, two or three globally. And then, yet, every bank system looks dramatically different inside the bank. Same thing here. The user interface, the customer interface, the portals and connectivity, the number crunching and analytics will be done in-house. But that core base platform, of how we think about connecting more seamlessly across our divisions and to our trucks and to our customers, there's some commonality there that I think efficiencies can be gained with their large carrier platform that hasn't really existed. Most off the shelf software were built for 100 to 500 trucks and really did a very poor job of accommodating the complexity of our network.

Ken Hoexter:

So we talked about the pricing, the environment, kind of what's going on the cost side. Let's go to the future stuff. You talked about the investment you've made in TuSimple. You're a key partner now for Embark trucks as well. What's your thought on how autonomous will fit into the network and your thoughts on timing of seeing the rollout?

Derek Leathers:

Yes, I think it's a little early to know exactly how it's going to fit. That's part of why we wanted to get inside the tent versus outside looking in. We want to understand as it's developing and as it transfers from a whiteboard-type exercise to real life. We want to be in those conversations and at the table.

But I think there is going to be a role to play for autonomous over time. I think that timing, from a prototype perspective, is probably middle of this decade, call it '24 to '26, somewhere in that range. But that's just prototyping, testing, getting some initial blush reactions and understandings of what this stuff could or could not do.

In the meantime, we believe drivers are going to be needed for as far as the eye can see. We actually think there's going to be a net increase in the number of drivers needed over the next decade. But autonomous will play a role. And we're going to be part of that. We're going to understand it. We're going to try to make sure we're leading edge, not bleeding edge on it. And we're excited about what TuSimple, Embark, and again, I want to put a plug into the OEMs-- they're working diligently on this problem as well.

Ken Hoexter:

On your quarterly call, you mentioned one of your largest customers might look to expand its own fleet, which could be a positive, as they learn the struggles of what it's like to get a driver. How is that progressing? And is that something that could cause risk near-term?



Derek Leathers:

No, actually, it was a question from one of the analysts-- I don't remember which one-- that talked about having heard this rumor that they were doing this. They've been doing this for years. It's something that we-- we've always embraced our customers that want to have some version of a private fleet or some version of their own exposure to the market because we think it makes them better customers. It's very easy, if you didn't operate any trucks whatsoever, to feel as though the driver problems are exaggerated or the lifestyle issues are exaggerated or what drivers' expectations are in this day and age are exaggerated. But when you actually participate in the market, you have a much more educated understanding of the complexities and obstacles that we're faced with.

So we embrace it. We even assist them, when that's something they want to do. The simple reality is we can't grow exclusively to fill every need they have in every market anyway. And so we work with them more strategically, around what makes sense for them to do, what makes sense for us to do.

And I think the key takeaway in all of that, in my mind, is that they think enough of us to work with us on that development so that we-- so that they can get as much of Werner as they can and yet still augment what is otherwise lacking in the market, in their mind at least, with their own trucks.

Ken Hoexter:

Yes, sure. Education always, I guess, is best in that kind of a tight market. Your capex thoughts on delivery delays-- so you've targeted what, \$275 to \$300 million, John? Any thoughts or any need to push it to next year? I think you also included some new service centers, so appreciate that the Lehigh Valley one. But what are your thoughts on capex?

John Steele:

Yes, so at this point we're keeping our guidance at \$275 to \$300. But there are certainly some risks that are both in the truck and trailer side with the OEMs, that there may be some delays, that were pushed a little bit of it out into '22. They're dealing with chip issues, commodity issues, labor issues that are pretty challenging. And I would say they're more significant issues here in the second quarter than they were in first. Now, we're in the position where we have strong relationships. We're one of the larger buyers of equipment. So so far we've been pretty successful in getting the equipment that we planned on getting. But there is a risk that, as the year goes on, if these issues continue for an extended period of time, we might end up on the low side of the range or even potentially below the range. We'll update that as we go, with our next earnings release update.

Derek Leathers:

Yes. Then, Ken, the only thing I would add to that is-- and I agree with everything John said-- I would add that we keep a running list of capital projects that are needed to be done but not imminent or urgent. We're always looking at that list. And so we see some slack in equipment, our equipment capex, we might slot some other projects, that need to get done at some point anyway. Because what I want to avoid is any big bubble years for capex, in the out years. And I want to make sure we deliver on our commitment, which is, we've looked at this a lot. And we believe we will be a free cash-flow generating company in any point in the cycle looking forward. And that partly how you get there is to make sure we avoid any big bubble years on the capex side. And we think we've got a good handle on being able to do that.

Ken Hoexter:

So Derek, with that, we hear a lot from some of the other companies, trucking companies out there, that they're doing more of the trailer only options for their shippers. And that's a little bit different, particularly from your Dedicated business where the worker is doing a lot of the work. Is that something that you've looked to engage in? Or is that more on the brokerage side of Werner Logistics?

Derek Leathers:

Yes, that's something we are very interested in and grew quite a bit in recent quarters and will continue to grow going forward. That will reside in our brokerage business. That's our Power Only business, where we leverage trailer pools and relationships with large shippers. We bring in outside and aggregate capacity on their behalf. They like having one trailer pool to work with, not multiple rainbow fleets. And we're going to continue to grow that. You'll see that revenue run predominately through that brokerage line via our Power Only results. And it's up quite a bit year over year. And it'll continue to grow as we look forward. We think it's a great differentiator from some of the non-asset players that can't bring that kind of ease of doing business to the shipper.

Ken Hoexter:

Yes, certainly hear more and more about that. So you noted some more muted gains on gains on sale, \$7 to \$10 million in the second quarter. You moved to a quarterly target from the \$10 and 1/2 million in the first quarter. Should we expect to see that continue to fall, given the tight market through the year? What kind of leads your thoughts as you look forward on a bigger picture basis there?

Derek Leathers:

Well, I want to make sure that everybody understands. The mute-- that there was nothing muted about the gains on a per unit basis. It was simply that, given the OEM disruptions, we felt as though we couldn't commit to sell the same amount of used trucks in the second quarter as we did in the first quarter without having better visibility to the receipt of our trucks and trailers. And so we felt only-- that it was appropriate to guide to a slightly lower outcome on gains on sale.

The actual gains per unit or-- it's continued to increase from Q1 to Q2. That market is as strong as it's been at any point. That's one of the rubs we have with the OEM community, about meeting the receipt of our new equipment. And so, so far they've probably performed a little better than we were expecting in Q2. And we've been able to keep in stock, with new trucks flowing into the fleet. But we're halfway through the quarter. And I think it gets a little bumpier from here. So we wanted to guide more conservatively. But that market, on the used side, is still very hot.

Ken Hoexter:

Let me wrap up with Logistics. We've got maybe a minute, two left. You [AUDIO OUT] is before, your focus on technology. Talk about your brokerage capabilities, the end goal for you here as you scale operations there, the percent fixed versus spot, the ability to fluctuate in the rising price environment. Maybe just run through your thoughts on the brokerage side.

Derek Leathers:

Yes, we're excited. I mean, I'll start with that. We're very excited about what Brokerage looks like going forward for us. We think Power Only and that piece of it is going to play a major component. We had work to do last year. We were overly contractual. We had about 60% contractual, 40% transactional. That makes us closer to 50/50 right now. We want to hold that mix in or around that area, maybe even tilt a little further toward transactional.

But we think that gives us the best opportunity to work going forward. We're investing heavily in that side of the business, from a technology perspective. And in fact, the first phase of the rollout of our Mastery systems will be on the non-asset side. And that rollout will begin to take shape later this quarter. And we're excited about what that brings to bear there. We're going to continue to invest in the analytics and data science work internally, that I talked about earlier. And we're getting more and more sort of no touch input, or ingestion of loads, as well as no touch dispatch of loads. And we're seeing productivity at the sea level increase.

All of those things look toward a stronger Brokerage product going forward. And so we like it. We think we're well-positioned. And we think that's going to really start to see more stability than what we've been able to put forth over the last couple of years.

Ken Hoexter:

That sounds great, Derek, John. So if I were just to really quickly sum up, it sounds like a strong market at least till 2022, from your point of view-- maybe some structural things thrown in there, used market remains strong, driver pay is running up, but rates are moving ahead. Strong second quarter margin gains, I know you're not commenting specifically but just recognizes the weather impacts in the first quarter. And you'll see some nice gains sequentially because of that, in addition to the market itself. Is that-- anything else you would throw at me from kind of summation there?

Derek Leathers:

No, I think that's fair. And I think-- the last thing I would just say is, that in the event that somebody has a contrarian view, of when this market turns, I'd just remind them there's no more defensive portfolio in trucking than Werner Enterprises. If you look at our truck fleet mix in our portfolio blend, we're set up so that if we're wrong, we'll weather that storm better than anyone.

Ken Hoexter:

Wonderful. Derek, John, thank you for your time and comments. Appreciate it.

Derek Leathers:

Thank you.

John Steele:

Thanks, Ken.