Werner Enterprises

Q2 2019 Earnings Conference Call

Thursday, July 25, 2019, 5:00 PM Eastern

CORPORATE PARTICIPANTS

Derek Leathers - *President, Chief Executive Officer*

John Steele - *Chief Financial Officer*

PRESENTATION

Operator
Good afternoon and welcome to the Werner Enterprises Second Quarter 2019 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key, followed by "0." After today’s presentation, there will be an opportunity to ask questions. To ask a question, you may press "*", then "1" on your touchtone phone and to withdraw your question, please press "*", then "2."

Earlier this afternoon the company issued an earnings release for its second quarter 2019 financial results and posted a slide presentation to accompany today's discussion. These materials are available on the Investor Relations section of the company's website at werner.com. Today's webcast is being recorded and will be available for replay beginning later this evening along with the supporting slides.

Before we begin, please direct your attention to the disclosure statement on slide 2 of the presentation, as well as, the disclaimers included in the press 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. This disclaimer is a brief summary of the company's statutory forward-looking statements disclaimer, which is included in the company's filings with the SEC.

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

And I would now like to turn the conference over to Mr. Derek Leathers, President and CEO. Mr. Leathers, please go ahead with your presentation.

Derek Leathers
Thank you and good afternoon everyone. On the call today with me is our CFO, John Steele, and we are excited to speak with you about the Werner second quarter 2019 earnings results. I'll start by providing a brief overview of the company and our current positioning, followed by the financial highlights for the quarter. John will then provide additional detail on our financials. I'll finish by reviewing our business and capital allocation strategies and review our updated 2019 financial guidance, and then we will address your questions.

Now, turning to slide 4, for those of you who may be new to Werner, we've included a company snapshot. In 2018, 77% of revenue was generated in our Truckload Transportation Services segment with the remainder coming from our Werner Logistics segment.

Our customer base is focused on the consumer, for our revenue by vertical just over half is in retail, 18% is in food and beverage, 18% is in manufacturing and industrial, with the remaining 12% in logistics and other. Within our largest industry vertical, we focus on serving discount retailers that sell more necessity-based products that tend to be less economically sensitive. We have a diversified customer base with less than half of revenue coming from our top 10 customers and 74% spread across our top 50.

On slide 5, there is a timeline of key events highlighting execution over the last five years to position Werner as a best-in-class trucking and logistics provider. Our truck-and-trailer fleet are new and where we want it. This enables us to produce high quality service and attract high quality drivers. By design, our net CapEx in 2019 is lower than 2018 and has returned to normalized levels. Our revenue portfolio remains relatively balanced between dedicated, one-way truckload, and logistics. This positions Werner to increase the consistency of our financial results. Also, during the second quarter we executed our capital allocation strategy, which I will discuss in more detail in a few moments.

Next, let's move to slide 6, for a brief overview of our second quarter and year-to-date financial performance. For the quarter, revenues grew 1% to $628 million. On an adjusted basis, EPS increased 3% to $0.63 per share. This was a strong second quarter performance, considering the below average freight market this quarter compared to an unusually strong freight market in second quarter of 2018. Our second quarter 2019 adjusted EPS growth of 3% was on top of a 90% adjusted EPS increase in the second quarter of 2018. Adjusted operating income this quarter increased 1%, and our total company adjusted operating margin declined slightly by 10 basis points to 9.4%.

Results reflect freight demand that was lower than average from a seasonal standpoint and well below what we saw in the second quarter of last year. In a challenging transactional freight market, we continued our focus on maintaining a relatively low spot market exposure to maximize our trucking operating margin. As a reminder, approximately 10% of our One-Way Truckload miles are spot, or only 5% of our total miles.

Last year, the very robust freight market produced several projects and surge freight opportunities, for second quarter 2018 these events added over 2 percentage points to our rate per loaded mile in One-Way Truckload and also contributed $0.04 a share to second quarter 2018 earnings. Freight demand this quarter was lower than average with no meaningful project or surge opportunities, resulting in a tough rate and earnings comp. Despite this dynamic, we improved our second quarter 2019 adjusted EPS by 3% year-over-year and by 20% sequentially.

Year-to-date revenues increased 4%. Adjusted EPS increased 16% and adjusted operating income increased 16% versus the same period last year. We expanded our operating margin by 100 basis points year-over-year through our focus on execution and cost management in a tougher freight environment.

I'd like to sincerely thank all hard-working Werner associates for their continued efforts. Reflecting our investment in a best-in-class fleet, we ended the second quarter with 7,935 total tractors within our Truckload Transportation Services or TTS segment, an increase of 235 trucks year-over-year and down ten sequentially.

Now, I'll turn the call over to John to discuss our financial results in more detail. John.

John Steele
Thank you, Derek, and good afternoon everyone. We appreciate you joining us today. Beginning on slide 8, we provide some additional financial performance drivers in second quarter 2019 versus second quarter last year. Our revenue per truck per week declined 1% net of fuel and we increased the average number of trucks by 5.2%. In our logistic segment, revenues declined 2%.

Adjusted operating income grew 1%, and adjusted TTS operating margin declined 70 basis points. Our logistics operating margin declined by 20 basis points. Driver pay increases

moderated to nearly 5% in second quarter 2019 compared to nearly 9% in first quarter 2019, as we began to lap larger driver pay increases from the first half of 2018.

Moving to adjusted EPS; the 3% year-over-year increase was due to flat net income and 3% fewer diluted shares outstanding due primarily to share repurchases. We achieved meaningful operational improvements in the performance of our driver training schools and generated equipment leasing growth, which on a combined basis contributed $0.03 a share of EPS improvement. We believe most of these improvements are sustainable going forward.

Beginning on slide 9, let's look at our second quarter results for our TTS segment in more detail. TTS revenue grew 2% to $480 million year-over-year, primarily caused by 5% fleet growth, $5.5 million of lower fuel surcharge revenues due to lower fuel prices, and a 1% decline in revenue per truck per week.

Adjusted operating income declined 4% to $52.4 million, due to a 70 basis point reduction in adjusted operating margin. Despite the below average freight market in second quarter 2019, we achieved a solid 10.9% operating margin including fuel. Our adjusted TTS operating ratio net of fuel was a strong 87.4.

Now on slide 10. Let's look at our second quarter dedicated and One-Way Truckload metrics. For dedicated, we grew trucking revenues net of fuel by 12% to $227 million. Dedicated average tractors grew 8%, or up 339 year-over-year. Dedicated revenue per truck per week increased 4.1%.

One-Way Truckload trucking revenues net of fuel decreased 5% to $184 million. One-Way Truckload average tractors increased 2%. Revenue per truck per week decreased 6% for the quarter, due to 3.4% lower miles per truck and 2.7% lower revenues per total mile. The miles per truck decline was due to a lower than average seasonal freight market in second quarter 2019 compared to a robust freight market than second quarter 2018, fewer team driver trucks this quarter, and government-imposed delays at the southern border, which were more challenging early in the quarter, and less disruptive as the quarter progressed.

Moving to the Werner Logistics results on slide 11. In the second quarter, logistics revenue declined slightly at 2% to $130.9 million, primarily due to fewer project freight opportunities. Transactional spot pricing declines of over 20%, and lower volumes when compared to second quarter 2018.

Gross margins in logistics expanded 40 basis points as the early benefits of our new pricing analytics tools enabled more informed decisions and improved capacity generation across our brokerage network.

Our logistics operating income percentage declined 4%, down 20 basis points year-over-year. We are gaining efficiencies and productivity with our latest software enhancements. However, the operating costs of these technology investments are impacting operating margins in the short term as associates adopt these new tools and more fully realize their intended benefits.

The rollout across all of our brokerage offices will occur throughout the third quarter as users become more proficient. The benefits of the investments and digital transformation will continue to grow. I want to highlight that each new application is carefully tested and then piloted to ensure it is both effective and generates improved performance prior to widespread adoption. We're excited about what we're seeing so far, and Derek will discuss this further in a few minutes.

I would now like to turn to the final portion of our prepared remarks back over to Derek who will cover our execution against our strategy, capital allocation developments, and updated 2019 outlook. Derek.

Derek Leathers
Thank you, John. Moving to slide 13, I would like to update you on our 5T's strategy. During our prior earnings calls, I explained the steps we have taken to position Werner as a best-in-class organization, focused on enhancing our portfolio, increasing our level of service, and delivering quality earnings to our shareholders across the economic cycles.

We are creating structural and sustainable improvements with our modern and more efficiently fleet combined with high-quality professional drivers and strong management execution. We expect to be able to adapt quickly to changing market conditions and generate more consistent financial results.

Our truck and trailer fleets remain new with an average age of 1.8 and 4.1 years respectively. Despite an extremely competitive driver market, we remain committed to quality-over-quantity with our professional driver force. This is critical to delivering on our brand promise to our customers day-in and day-out.

We upgraded and expanded our terminal network to better support our customers, drivers, and lower our maintenance cost. This investment provides our drivers with the facilities and infrastructure they need and deserve, as we continue to raise our service expectations. Since 2016, we've nearly tripled our annual IT investment as part of our 5T's strategy, improving service to our customers and professional drivers alike.

During the second quarter, freight volumes were below average and below our expectations. Also, the speed of service bar was once again raised for retail companies by competitive forces. These changes, as they evolve, make on time every time freight deliveries even more critical. Our team is relentlessly focused on flawless execution. We have been raising the bar for Werner on-time service the last several years. To that end, our 2019 on time service percentage is the highest in the past five years.

Critical to being a customer-centric organization, we held our 36th Annual Werner Transportation Forum in Omaha last week, with record high customer and supplier attendance. Every year at the Transportation Forum we facilitate connections, knowledge sharing and feedback between customers, suppliers and drivers, allowing us to stay current on opportunities concerns and the freight economy from different perspectives.

Leadership in our company and our industry is one of the four pillars of our Werner core values. Our annual transportation forum is a visible example of our commitment to leadership, with our customers and suppliers. We thank them for, once again, setting a new all-time attendance record this year.

Turning to slide 14, Werner has one of the newest truck and trailer fleets in the industry. A Werner truck is less than a third as old as the industry average. All our trucks are equipped with the latest safety and training features. Our Werner fleet sales operation maximizes the remarketing value of our trucks and trailers when they are ready for sale. Our late model equipment with attractive features provides significant value to repeat customers, who appreciate the long-term reputation and integrity of Warner fleet sales.

Now, I would like to turn to slide 15. The labor market continues to be extremely difficult. And the market for professional truck drivers remains challenging. Werner offers numerous competitive advantages to the professional driver: attractive pay, a new fleet, better home time, leading industry driver training, a strong military recruiting program, and becoming the employer of choice for female drivers are all essential to our success.

In addition, our driver recruiting and retention advantages enable us to be more selective with the drivers we retain. By addressing those that do not meet our stringent performance standards, even in the difficult driver market there is a continued expectation at Werner for driver excellence. All of this leads us to our most important success factor, our culture.

Werner was founded by a driver and managed with a driver in mind. Top quality drivers produce top quality results. At Werner, no matter who you are or where you fit in our company, there is an expectation of excellence, a commitment to put team above self. It manifests itself in a desire to engage within the communities where we work. It's built on a foundation of integrity. And it supports an unwavering dedication to safety and service above all else. When you hire the right people, give them the right tools and training to do their jobs, and set expectations around safely providing a premium service, earnings and growth will follow.

On slide 16 is a visual representation of how the 5T’s are centered around supporting our customers and shareholders alike. To deliver superior customer service, we are focused on upgrading our infrastructure, improving processes and enhancing our systems while unlocking the power of data analytics to ultimately eliminate defects, improve efficiencies and lower our overall costs.

On slide 17, I would like to focus this quarter on one of the 5T’s that we haven't covered in depth in our previous calls, and that's technology. As part of our 5T’s strategy, Werner is committed to a continued investment in technology and innovation to further strengthen our customer experience, our driver experience, and market leadership.

Our investment includes a focus on: upgrading our infrastructure, investing in digitalization to improve process and systems with smart automation and leveraging innovative machine-learning technologies to provide real time data to optimize decision-making. To accomplish this, we're already leveraging innovative technologies such as IoT, automation, and machine-learning to ensure we capitalize on emerging supply chain trends and changing customer needs.

We continue to strengthen our core IT and IS services, including network upgrades and unified communication solutions to support our transformation efforts and our existing technologies. Werner's digital transformation spends enterprise-wide across TTS, logistics, human resources, and accounting and finance.

Our technology investment has already driven the following new solutions: rate matching, capacity generation, final mile platform enhancements, driver facing apps, and safety management solutions. Here are two examples: in our freight brokerage business, we internally developed capacity generation tools using machine learning technology. We combine them with public and proprietary data and align them with real time pricing support so that we can now intelligently match carrier capacity with customer freight. The combination of these innovations has enabled significant employee productivity gains by simplifying the process and has led to higher customer and carrier satisfaction, which is translated into more return bookings from our customers and carriers. This year alone we've seen the number of single-booking carriers with Werner Logistics

decline, and our bookings per carrier are up over 15%. We believe our investments have the potential to continue building loyalty to the Werner brand and return productivity gains to our shareholders.

Another example we just launched is a new Werner developed safety management workflow system that consolidates four disparate truck critical event reporting systems. This solution streamlines real time critical event and forward-facing video review. This enables our safety specialists to quickly receive and identify relevant versus non-relevant records and videos so that we can monitor, assess and address these events real time with our drivers. We expect this leading-edge safety monitoring system will increase efficiencies, including reducing time spent on following up on false alarms and ultimately help improve our management of safety to further mitigate our risks.

Let's now shift to CapEx and cash flow, on slide 18. From 2015 to 2018 we were in a heightened investment period. Focusing on strategically improving our fleet and strengthening our organization. With a significant investment in our fleet and terminals largely behind us, we are targeting net CapEx to be more consistently within the range of 11% to 13% of gross revenues over the long term. We also continue to expect to generate significant free cash flow of $100 million or more in 2019.

With increased cash generation, our capital allocation priorities on slide 19 are as follows. Our first and highest priority is to continue to reinvest in our business. We remain committed to our drivers, customers, and associates to maintain a best in class Fleet, Network, and Technology platform. We will continue to invest in IT, operational and commercial initiatives as well as our logistics technology across our company.

Our fleet age is where we want it. We are no longer spending a higher than normal amount of CapEx to lower the fleet age. We expect net Cap Ex to be in the lower end of our $275 million to $300 million range. We will continue to thoughtfully monitor and prioritize CapEx based on a goal of high return on investment in the current market environment.

Next, we will continue to return cash to shareholders. Werner has the long history of paying consistent, regular quarterly dividends across the economic cycles, as well as utilizing share repurchases and special dividends to return excess cash.

During the quarter we declared a regular quarterly cash dividend of $0.09 per share and repurchased 700,000 shares for $21.8 million. In mid May, following the extensive research and analysis of our capital structure, we announced actions consistent with our capital allocation strategy.

First, we announced a $3.75 per share special dividend, or $261 million, which was paid on June 7th. We also announced a new 5 million share repurchase authorization. Both of these initiatives are designed to enhance return to our shareholders.

In addition, we entered into new expanded credit facilities totaling $500 million with two of our existing lead banks. These facilities extend our bank credit through May of 2024 with attractive pricing terms and covenants. In the past, we maintained virtually no debt, which resulted in a more expensive weighted-average cost of capital.

By revising our long-term goal from no debt to a modest and manageable range of debt in the 0.5 times EBITDA to 1.0 times EBITDA range, we expect to lower our weighted average cost of

capital. In early July, we took advantage of historically attractive low interest rates and fixed the interest rate for $150 million of our debt at slightly above 2.3% through May of 2024. We're committed to maintaining the stronger more flexible balance sheet. Following the June special dividend, we have over $1 billion of stockholders' equity and an appropriate and still conservative net debt to EBITDA ratio of 0.7 times.

Next, on slide 20, I'd like to discuss our 2019 updated guidance. For our guidance assumptions, we expect to maintain our modern fleet at age levels at or near 1.8 for trucks and 4.1 for trailers. We expect our effective tax rate to be in the range of 25% to 26% for the year.

Next, we expect our TTS truck growth from year end 2018 to year end 2019 to be in the low end of our 3% to 5% truck growth range, with most of that growth coming in Dedicated and the remaining amount occurring in the third quarter.

In the first half of the year, we added 115 trucks. We currently expect to add about 100 more trucks in third quarter 2019 with no planned truck growth in fourth quarter 2019. On the freight side, so far in the first 3.1 half weeks of July, freight demand in our One-Way Truckload unit has remained lower than average for a typical July.

Gains on sales of equipment during second quarter were $4.5 million compared to $5.9 million in first quarter and $5.1 million in the second quarter of 2018. We have begun to see some moderation in the used truck and trailer pricing market, as the freight market has been sluggish.

Year-to-date, we realized equipment gains of $10.4 million. We continue to expect gains on sales of equipment for the full year of 2019 of $18 million to $20 million and currently expect to be in the low end of this range. For net CapEx, our guidance range remains $275 million to $300 million, and we expect to be in the low end of the range.

Now, let's discuss the 2019 guidance, we are changing. Revenue per total mile for the 42% of our trucks and our One-Way Truckload fleet, for the full year 2019 compared to 2018 is now expected to be in the range of flat to negative 3%, while year to date 2019 contract pricing increases are approximately 4% on average with recent contracts renewed in the flat to low single-digit range.

The lackluster 2019 freight market has provided few projects and surge rate opportunities, significantly lower spot rates, and higher empty miles. As such, we are assuming the current freight trend will continue in the third quarter with an expectation that there will be a normal seasonal pickup in freight and rates during the fourth quarter holiday shopping season.

Third and fourth quarter one-way Truckload revenue per total mile is expected to be lower than the same quarters in 2018, due to significant rate increases and project activity that occurred in the last two quarters last year.

Finally, we expect our interest expense to increase to a quarterly run rate in third quarter 2019 of approximately $2.7 million based on our current debt level and interest rates.

As the freight and rate markets moderated the last several months, we accelerated our cost management initiatives company-wide to lower our cost structure. To-date, we've identified over $10 million in annualized spend savings in multiple cost categories. We expect these cost savings to continue to grow moving forward.

In summary, Werner is well positioned to navigate a less robust freight market with nearly 60% of our fleet in Dedicated, a more stable and predictable business, over 20% of our revenue from our Logistics segment and less exposure to the One-Way Truckload market than many in our industry, and a continued focus on operational and digital excellence.

We are positioned to successfully operate in whatever economic environment comes our way, we have a new fleet, we have an energized and engaged team and we're producing increasingly high-quality service to our customers.

At this time, I would like to turn the call over to the operator to begin our Q&A,

QUESTION AND ANSWER

Operator
We will now begin the question-and-answer session. To ask a question, you may press "*", then "1" on your touchtone phone. If you are using a speakerphone, please pickup the handset before pressing the keys, to withdraw your question, please press "*", then "2." To allow for as many callers as possible to ask questions, we ask the callers to limit their question to one question and one follow-up. This call will end at 5 PM Central Time following the company's closing remarks.

Our first question today will come from Tom Wadewitz of UBS. Please go ahead.

Tom Wadewitz
Yes, good afternoon. Thanks for the presentation and all the detail. Wanted to see, Derek, if you could offer a view on the cycle, I guess the most recent cycle we'd look at in terms of downturn would be 2015 and 2016. So wanted to just see, if you could offer some perspective on what you think this cycle in this downturn will be pretty similar to that or are there reasons that it might be more narrow, kind of quicker down and maybe a quicker recovery, so just some thoughts to start with maybe on the cycle.

Derek Leathers
Sure Tom. Thanks for the question. So, I do think there are some differences that are important to note. If you think about 2018 or...if you think about 2019 as compared to 2018, we've had a lot more, for lack of a better term, sort of white noise or external influences on the market this year between tariff and trade talks, some of the extended winter weather, the delayed produce season, things that are not sort of macroeconomic in nature or cycle oriented per se, but more fits and starts within the larger economy that I think is very different from what we saw in some of the prior cycles, where it was true sort of widespread slowdown and overcapacity at times.

This time, I think we had a ramp up in 2018. Obviously, freight rates took a pretty sudden and pretty explosive growth rate over the course of the year followed by some capacity additions specifically at small- to mid-sized carriers followed by really, for lack of a better term, a strong economy framed with economic uncertainty nonetheless because of trade and tariffs. So, we saw the correction happen faster a year ago in terms of the market tightening. We saw some loosening earlier in the year that I think was caused by sort of a snowballing of several external factors. But the underlying economy by and large still is chugging along.

And so, yes, we do believe capacity is leading the market. If you look at order rates falling as fast as they are, if you look at cancellations of current builds taking place. And frankly, even bankruptcy trends that are out there especially at some, I would say more meaningfully sized

carriers. The opportunity for this to turnaround is before us and I think could be just...it could be quicker than what we've seen in prior cycles.

Tom Wadewitz
Okay. So instead, potentially instead of a two-year downturn like '15 and '16, maybe it happens more quickly than that.

Derek Leathers
Yes. I believe so, I believe so. There are still...we still have peak season ahead of us. We've said throughout that that our goal is to operate well in down markets as well as strong ones. And as I think about the quarter, if I was going to kind of summarize it, I really think we've delivered on that commitment that we've made. We're going to weather this and we're going to continue to weather and continue to use the defensibility of our portfolio and dedicate it to our advantage. That is performing well and we have tailwinds behind us there, as it relates to some truck growth coming out in the third quarter. So, we like our positioning.

Tom Wadewitz
Right. Okay. Thank you. And just sort of a quick follow up. How do we think about the dedicated pricing impact, your revenue per truck up 4% was pretty strong number in the quarter, against the weak freight backdrop in dedicated. Is that something, is this a matter of lag in the pricing effect there? Or would you simply expect it to be more insulated that you just wouldn't see that much of a decline in revenue per truck per week, or whatever kind of pricing related metric you want to refer to in dedicated? Thank you.

Derek Leathers
Yes. I think the way to think about it is, first off you had said, we create demand in dedicated and we really can't connect those dots. What's happening on the one-way market and what's happening in demand in one-way is one thing. And separate from that completely is customers that need high service expectation, on time every time freight delivered, with sort of premium reporting and service built around it. And that's a different animal.

And so, in good markets and bad, we've said for years, the dedicated will hold up better. Where it shows itself is in our expectation of what that means that we'll onboard. So we started the year with a 3% to 5% truck growth range. We've guided it now at lower end of the range. Because what we're not going to allow is, to provide that premium service with all of the expectations that come with it and not have a fair value for it in terms of the price. And so, we are confident with where we're at in the range. We have line of sight to where growth is coming from. But it is difficult to do dedicated well. And we think we do it very well and we're going to price accordingly. And it shows through in what you commented on, with the rates year over year.

Tom Wadewitz
Great. Thank you for the time.

Operator
Our next question comes from Ben Hartford of Baird. Please go ahead.

Andy
Hi. Thanks for taking the question. This is Andy on for Ben. I wanted to get some additional perspective on your comment about continued difficulty finding drivers. It seems that the market for drivers has loosened up a bit over the past couple quarters, particularly for the larger carriers?

Are there any specific regions where you're finding it still particularly challenging to find drivers? Thanks.

Derek Leathers
Thanks, Andy, for the question. So, I guess, my comment is framed in a larger backdrop than a quarter. The driver market and how you think about drivers, isn't quarter to quarter and if it is, I think you'll find yourself in a real trouble in a hurry. We're committed to our drivers over a much longer term than a quarter. And so, what I'm really referring to is, the market for qualified professional drivers is tight and remains tight. But more importantly, as you look forward and you think about Drug and Alcohol Clearinghouse, you think about the possibility of hair follicle testing coming into play in 2020.

We just don't want to ever lose sight of the reality that we need to leverage our driver training schools, leverage our brand, leverage the investments we're making in all of the five T's that continue to raise the bar on our expectations. So I specifically commented on that, because I don't want people to believe that suddenly, just because you have lots of applications means you have lots of drivers you would hire. There's a very big difference between the two. We're going to continue to push the envelope and expect excellence. And in that market, it's still tight.

Andy
Thank you.

Operator
Our next question comes from Amit Mehrotra of Deutsche Bank. Please go ahead.

Amit Mehrotra
Thanks. Hi, Derek. Hey, John. How are you guys.

Derek Leathers
Good, Amit.

John Steele
Hi, Amit.

Amit Mehrotra
Appreciate the time here. Derrick, I just wanted to ask a question on the truck counts and the mix between dedicated and one-way. Obviously, 60% of the tractors have been dedicated. That's up from kind of 50:50 not that long ago. Shouldn't we or should we continue to see that mix continue to shift, just given the opportunities in dedicated, the resiliency and the visibility of that business? Why not maybe make a more aggressive move there, given the volatility and lack of visibility in the one-way truckload market?

Derek Leathers
So, a couple of thoughts on that, Amit. The first one, so we're 58% today, but moving towards 60%. As we've talked about, we believe the pipeline is filling up. And our opportunities in front of us are strong enough to get us there. As we think about the overall freight market and we're right on the one-way side, we are going to continue to focus on building out our strengths, which is Mexico and team expedited. We don't want to abandon those two key franchises to what we...and we think we can do that well.

And as we think about looking forward, there is nothing magic about 60%. It could creep further than that. But that will really be dependent on what happens overall within the one-way market and our ability to continue to focus our efforts within one-way on the least commoditized end of the spectrum, which is that team expedited just-in-time world or the cross-border Mexico world that currently are the largest provider already and we believe we can continue to extend that lead.

John Steele
One thing I would add, Amit on that, just a quick thing. For our dedicated fleet, there are times when we need to surge with our customers to help them during busier times a year. And so, we use our one-way Truckload fleet at times to help with that surge capacity need.

Amit Mehrotra
Right. Okay. Yes, that makes complete sense. And just a follow-up. John, if we think about salaries, wages, and benefits, the line item on your cost structure, the growth in that expense moderated on a year-over-year basis, but actually increased as a percentage of sales ex fuel. You assume that has to do with obviously the mix of more dedicated even less reliance on PT, but hope you can just give us some sense on how should we think about salaries, wages and benefits, expense trending on a year-over-year basis in 3Q, 4Q, just given the outlook for yields?

John Steele
Okay. To start with this quarter, we increased $10 million from $196 million to $206 million and about 80% of that was due to drivers. And of that roughly $8 million increase in driver pay, about $5 million of it was due to the 5% higher rate per company mile. And then the other $3 million was due to the fact that we had 4.8 more million company miles. The balance of the increase in that line is the fringe benefits side with higher pay comes higher FICA, unemployment taxes, work comp, 401k and the medical drugs. Fringes were up about 7% year-over-year and that's the balance of the increase.

As we look at the biggest elements of that line, which is driver pay, going forward you can see that our increases have moderated from nearly 9% first quarter to nearly 5% in the second quarter. I would expect that we'll be up somewhere in the 3% to 4% range in third quarter and up in the 2% to 3% range in the fourth quarter on a year-over-year basis, because we're beginning to lap some of the larger increases we did last year. That assumes the freight market and the driver market remain fairly consistent with where they are today.

Amit Mehrotra
Okay. That's helpful. Something tells me you were anticipating that question. I appreciate the color. Thanks very much, guys.

John Steele
Thanks, Amit.

Derek Leathers
Thanks.

Operator
Next question comes from Jack Atkins of Stephens. Please go ahead.

Jack Atkins
Derek, John, good afternoon and thanks so much for taking my question.

John Steele
Hello, Jack.

Derek Leathers
Hi, Jack.

Jack Atkins
So, Derek, if I could go back to something you were commenting on a moment ago, which is sort of these upcoming regulatory changes over the next, call it, two to three quarters, whether it's AOBRD to ELD conversion like this year or the National Drug and Alcohol Clearinghouse or hair follicle testing, if you can just sort of expand on your thoughts in terms of what that could mean to industry capacity, call it over the next 12 months? Would be curious to sort of get your take on what all that means for the broader market?

Derek Leathers
Sure, I'd be happy to. Thanks for the question. On AOBRD to ELD, I think there's more there than people realize. So, we think and we've done extensive testing and then have moved our fleet and continue to move our fleet to full implementation, and we'll be done with that this month. Actually, we'll be done with that in August. I apologize. But as we've looked at that, for us it's less than 1%, but we think for the industry and there's a variety of factors that play into that thought process, it's between 1% and 3%. There are more restrictions that are more stringent and there are things that can trip folks up.

One of the things that's been lost in the news, if you will, is being ELD ready and actually ELD compliant are two different things. So, many fleets are ELD ready, but have not yet flipped the switch. We feel comfortable and confident that we are in front of that. We will be fully ready and implemented before peak season so as to stand true to our commitment to service. And we've got over 20 years of experience on electronic logs in total and approaching 19 billion miles delivered. So we like our chances there and we think we have a competitive advantage.

Drug and alcohol clearinghouse is a bigger deal than folks may realize simply because, today we have no system of record, no national database to point us to, to know that somebody has failed a drug test or alcohol test previously. Having this go into effect in January, and I do have confidence that it will happen in January and have followed up extensively to confirm that. What it really does is allows us to shine a light on past failures and understand and know exactly who we’re interviewing. And so that line earlier I talked about, driver applicants do not equal qualified professional drivers will be even further delineated, and so that has a capacity limiting effect. That was a little tougher to know because we've never had the database, right.

So we just believe it will clean up and certainly take out some capacity. Perhaps the biggest of the three would be hair follicle, when that does in fact go-live, obviously the first phase of that is simply allowing us to use it as the test of record. We've been hair follicle testing for over four years and we will continue to do so going forward. We'd like to a) save the money and not do two tests, but b) we know that hair follicle testing has a roughly 10 times failure rate over urinalysis and is much, much more accurate. If that is able to kind of gain a foothold, first it's good for safety; it's good for the industry. It's the right thing to do. That's the most important thing. But it will have an effect on limiting capacity. And I think when you combine it with drug and alcohol clearinghouse, the combined effect is far greater than even the originally ELD impact or this upcoming one that's in front of us in December.

Jack Atkins
Okay, got you. So just to sum it up, if I am hearing you correctly, over the next 12 months we could really see these regulatory changes have a pretty material impact on the underlying industry capacity?

Derek Leathers
I believe so, yes.

Jack Atkins
Okay. That's great. And then just for my follow-up if I could, Derek if I could just kind of get you to talk about, what you are hearing from your customers. You know, obviously, it's been a…was weaker than expected second quarter just from a seasonal perspective. There's overhang from excess inventory levels. What are your customers telling you about their peak season plans? And then more broadly what are they telling you about how they expect their business to perform over the next couple of quarters and how that could translate to freight volumes?

Derek Leathers
Some of the white noise I talked about earlier, obviously affects them every bit as much or in some cases more than us in terms of concerns about where the economy is headed, specifically the tariffs and trade. But at the end of it, what we've done is executed a strategy over the last several years to really try to align ourselves with winners. And so, we've worked and scrubbed and kind of gone through a pretty stringent review of our customer list and tried to make sure that we are growing with those that are growing that are financially strong and in particular, because of our retail heavy focus, making sure we have a heavy focus on discount retailers that are less economically sensitive.

With all that said, the folks that we plan to work with this fall to surge up with, to provide solutions to, they are in that winning category, they are doing well. Same-store sales look strong, inventories have been drawn down. They've kind of, chewed through what they brought in pre-tariff. And so, we feel pretty good about what we see in front of us relative to peak. Now, we still have to balance that with the reality that we felt great a year ago, last year was a year that comes along once in a career perhaps. But as a core carrier providing premium service, when it comes to things like Black Friday and the service sensitivity around the holidays, you know, carriers like Werner are going to be in high demand and all of the conversations have led me to believe that will be…that's the case this year as it was a year ago.

Jack Atkins
Okay, guys. Thanks again for the time. Really appreciate it.

Derek Leathers
Thank you.

Operator
Our next question comes from Todd Fowler of KeyBanc Capital Markets. Please go ahead.

Todd Fowler
Great. Thanks and good evening. Derek in your prepared comments, you mentioned that in the second quarter of 2018 that the surge in the project business was about $0.04 and was 200 basis points of the improvement in revenue per mile. Do you have similar numbers that you can share with us as to what that would have contributed in both the third and fourth quarter of 2018?

John Steele
No, I don't have that information in front of me, Todd. I can work to get it offline, but that may be something that we will need to update in our call next quarter.

Todd Fowler
Okay. And John, I mean, maybe just from order of magnitude, I mean, was the second quarter the biggest from a surge and project standpoint or you know, do you just have kind of sense of how that trended in the back half of the year, and obviously what I am getting at, is just trying to think about the comparisons that you guys face in the second part of this year?

John Steele
I would say third quarter was probably a little bit larger than second quarter from a project surge standpoint in terms of being an outlier in 2018. Then we had our normal pickup in project surge in fourth quarter due to the holiday season.

Todd Fowler
Okay, got it. So fourth quarter was, what you would kind of expect from kind of a more typical seasonality last year?

John Steele
Yes.

Todd Fowler
Okay, great. And then just to follow-up, there were some comments I think Derek that you made about cost saving initiatives, and I think you said you targeted $10 million. Can you give us a sense of the timing of that? Was that something that you've identified here in this second quarter that's going to start to flow through the numbers in the back half of the year or is that something that's kind of been in process and you're seeing that the numbers right now? Thanks.

Derek Leathers
Yes, I'm going to have John walk you through that, because he's been very involved in this. But go ahead, John.

John Steele
Yes. So we were at…through the end of the second quarter, we're at about 80% implemented. We expect to be about 90% implemented by the end of third quarter. So we are pretty far along in the process. The initiatives started, for the most part, with effective dates at the beginning of this year and then have continued. I think there's like 70 different items on the list that we've initiated thus far, and we expect growth in that number, both in volume and amount as we move forward.

Derek Leathers
And the only thing I would add is, you know our nature, we're conservative in nature, and so the dollar figures we are talking about there is really on true cost control. It doesn't take into account the progress we've made on maintenance. And as you've seen year-over-year the progress we're making in risk and insurance. And the last one is kind of the effects in working the way it was designed to work on non-driver salaries year-over-year, be it…you know, those are down considerably based on our incentive packages and the way we've structured pay for performance types of metrics. So this is really a true kind of cost or spend to control project, and we are ramping those goals, and we'll continue to be aggressive to look for further savings.

Todd Fowler
Okay, good. Got it. That's helpful. Thanks for the time. Thanks, guys.

John Steele
Thanks, Todd.

Derek Leathers
Thank you.

Operator
Our next question comes from Scott Group of Wolfe Research. Please go ahead.

Scott Group
Hi, thanks guys. So sometimes we have third quarter better than second, sometimes worse than second from an earnings standpoint. Maybe can you just walk us through the puts and takes as you see it for third. And then Derek, your views about hopefully a shorter down cycle than normal. Do you think we get back to a positive pricing next year?

Derek Leathers
Yes, I'll start. So the pricing dynamic obviously is going to be tied very closely to how much continuation, discipline, and commitment folks have to their order rates. Their build rates even, because we've seen cancellations rising and then carrier health. If you think about the majority of our industry, the vast majority of our industry being under 50 trucks and spot pricing being down 20% year-over-year. Nobody was making 20% or anything near that a year ago. And so we know, there's a lot of duress out there. That portion of the marketplace…a portion we don't play in much, but nonetheless that exists is really having a rough go and it's going to cleanse out any of your less efficient operators, and I think pretty quickly.

I really believe and we've talked about this a lot internally, Scott, that this marketplace we're in today will react both up and down more rapidly than what we've seen in prior cycles. And if you think about '17 and '18 and now what we saw in the first half and '19 that certainly has played out. So that's kind of my thoughts on the pricing question. I think '20 would then set up if you follow that logic it would certainly be my expectation when you think about driver pay isn't going to go down. Equipment comes increasingly with better and more advanced technologies and those coming at a price.

Oil and thus diesel and IMO hitting in 2020, there's no reason to believe diesel pricing isn't going up next year. The question is by how much. And so, there's going to be activity in the pricing market. And we're going to go and asked to be paid our fair share. We just got out of the all-time record attendance at our forum and we put in our comments because in a time when market…when the market is more loose, customers obviously have even more choice on whether they want to take valuable time to attend and spend time to understand where the market's headed and why and what our views are on it. And we had the record all time attendance. So there's clearly an interest level.

John Steele
And on the third quarter and the second quarter question, we don't provide guidance. It's difficult to predict how the freight market is going to trend from here and then other factors like fuel and the used truck market, insurance claims, how they will develop. As we look forward that makes it difficult to predict. Over a long, long period of almost 20 years, typically, second quarter and

third quarter have averaged out to a fairly consistent level of earnings. But we're going to work as hard as we can to produce at least as strong earnings in the third quarter as we did in second.

Scott Group
Okay. Thanks. And then if I can just ask the dedicated versus over the road breakouts really helpful. We don't have a lot of history. Do you by any chance can you share what the dedicated revenue per truck did in 2016? I think it might be helpful just to understand like how well that held up last cycle so we can think about it going forward?

John Steele
Dedicated revenue per truck in the four quarters of 2016, I just have the absolute numbers here. First quarter was $3,500; second quarter was $3,445; third quarter was $3,435; fourth quarter was $3,445; these are each quarter of 2016 revenue per truck per week average in dedicated.

Derek Leathers
And there is a history on our website of that data and other data that we've made available once we did the break out the way we did it.

Scott Group
Did you also…on the website, do we have the year before, so we can see the year-over-years?

John Steele
I think '16 was the first year that we show we have '16, '17 and '18 and also two quarters of '19 that are out there. So you've got 14 quarters of data.

Scott Group
Okay. But so...do you know if the year-over-years were, how much they were up or down, I am just…I guess, it’s sort of a follow-up to, I guess, was Tom's question earlier, just understanding clearly very good revenue per truck and dedicated right now. we just want to understand if this is lagging the one way or if it's going to show strong?

Derek Leathers
Well, Scott, I would just say this rather than just trying to calculate it on the call, it is on the website. So it's easily calculable. But I will tell you that if you think back to '16 and think about where we were at in our transition and think about the fact that we were…it’s still what I would call sort of an aggressive shift mode, meaning moving aggressively to get more trucks into dedicated versus where we are at today which is basically where we want to be plus roughly 100 trucks that we know and have guided to happening in the third quarter.

Our selectivity and our ability to be selective today post kind of turnaround, post revamping of the fleet is higher than it was in 2016.

So yes, there's some information to be gleaned. And I haven't even done the calculation and may look very positive. I'm just saying the market is different. The state of Werner today versus '16 is two fundamentally different things.

Scott Group
Okay. That makes a lot of sense. Okay. Thank you guys.

Derek Leathers
Thank you.

John Steele
Thanks Scott.

Operator
Our next question comes from David Ross of Stifel. Please go ahead.

David Ross
Yes. Good afternoon, gentlemen.

John Steele
Hi, Dave.

Derek Leathers
How are you doing?

David Ross
I'm great. First question is on the comments you made about, I guess, the spot exposure, you said 10% of one way, 5% of total in 2Q. What was it in the year ago quarter?

Derek Leathers
It would have been...so I was just looking at that, actually, and a year ago for the quarter it was roughly…it fluctuated between seven and eight, but it's always going be somewhere in that neighborhood in the best of times, because there is a portion of that you need to simply fill or rebalance your fleet. No matter how much freight is out there, you don't want to make commitments on it; you want to use it to be fluid with your fleet. And so yes, it is up year-over-year and it's something that actually is a major focus item of ours right now.

David Ross
7% to 8% of one-way last year?

John Steele
Yes.

Derek Leathers
Yes. Yes, of one way. So…

David Ross
Okay.

Derek Leathers
And dedicated was a slightly smaller percentage. So I would have to back end of that math, but it's 7%...call it 7% to 8% a year ago versus 10% this year, and if anybody is wondering how that is 5% of your miles with 58% of your fleet and dedicated is because dedicated is lower productivity and higher revenue per mile.

David Ross
I get that. And then just real quick on the used truck market, you said that pricing is moderating. Approximately how much more or less is the truck selling for today than it was a year ago?

Derek Leathers

That's a....I don't dodge very many questions, but that one is a tough one to answer in the best of times, because it seldom isn't so much what is price doing, as it is just what are your trends. If you think about us as a retail seller I should be clear here, when I'm talking about our secular story that's different than many others. It's really...there are times when freight uncertainty takes hold and shippers…I'm sorry carriers who are looking to buy trucks, simply choose to take a time out. So volume has been more depressed than it has been with the price, and although you may think lowering the price would certainly solve that, if those small- to mid-size carriers simply not in the market for a truck. They're not in the market for a truck.

As we look forward, that's why we wanted to guide to the low end of the range. We feel comfortable doing so. We've got some work ahead of us. And then, the last thing on that would just be to remind everyone that our trucks and trailers that we are selling and in particular on the truck side, are pretty dramatically newer than the population at large, with more safety technology on it that has become much more in demand. And there are now fully automated manual transmissions that are in our used truck inventory. And those are also in high demand. So we'll weather that storm better than many. We think our retail outlet is holding up well, but we are cautioning toward the low end of the range, just based on current trends.

David Ross
There may be just be an inventory issue rather than a pricing issue, if you can hold the pricing firm you'll…keep them on the line and wait till they sell.

Derek Leathers
Correct, we might see some inventory that rises between now and into the year under over the ideal level. But I can assure you we're not going to let it pile up either.

David Ross
Understood. Thank you.

John Steele
Thank you, Dave.

Operator
Our next question comes from Jason Seidl of Cowen & Co. Please go ahead.

Jason Seidl
Thank you, operator and afternoon everyone. You talked about reducing your fleet growth a little bit to low end of the range. How did you go about doing that, did you cancel the orders or did you push the orders out into maybe 2019?

Derek Leathers
Yes, I'll probably steer clear of how our contracts and negotiations work with OEMs, but I will just say that when we have that fleet goal range, it's safe to assume that also translates to a range of orders. How they process those on their end is really somewhat unknown to me, meaning do they publish at the high end of the order range or the low end of the order range. I'm not really sure.

We're very careful to be compliant with our...with our truck partners. And stay within the ranges that we've established with them for the year. And so, in real time what it means like…means is that often there may be a midpoint that we agree on. And if that was the case in this particular year, we might have to take something away from the midpoint, depending on how the year plays

out. But at this point, we're comfortable with adding the 100 trucks, we said exclusively in the third quarter. Obviously, any time you are talking about dedicated, there could be some leakage into the fourth quarter. But by and large, we view it as a third quarter truck add and some, and you could see more growth than that and dedicated with slightly…slight shrinkage in one way to further kind of diversify and set us up for the market in case that turn doesn't happen as quickly as we believe.

Jason Seidl
Derek, let me ask you a different way, because I'm not coming at it from the OEM angle, I am actually coming out from a truckload industry angle. So the number of trucks you've taken it down by doesn't mean you're going up by that amount in 2020 necessarily?

Derek Leathers
That is correct. Sorry, I didn't understand that was the angle you're looking probably. Yes, that's correct. We will not be going up by that because we went down by X this year.

Jason Seidl
Okay perfect. I guess, I want to touch on dedicated for my follow-up, you know, you described a good pipeline. And that's been a great source of growth for you over the years. Can you talk a little bit about sort of the ideal customer that you guys are landing in dedicated and what they look like?

Derek Leathers
Sure, I mean, so first and foremost, it's about starting with a winner. So we do a lot of work and spend a lot of time trying to identify what we believe to be up and coming sustainable stories or sort of blue chip, long term winners in their space. Once we've done that, we want to make sure that it's dedicated through the cycle, meaning it is truly hard to service and high service sensitivity, 99.5% or better kind of service levels. We want to make sure it's geographically layered over where our strength is in terms of driver domiciles and network. And we frankly want to make sure that the economics work and that it's something that we can deliver upon. So there is a tremendous amount of activity in the pipeline to get a much smaller amount out the other end. But if we sign-up for it, we want to make sure that we deliver what we said kind of on-time every time. It meets our economic return levels and our expectations, and it fits our driver lifestyle issues that we are continuously trying to address with home nightly and weekly good paying jobs in markets where we can hire.

Jason Seidl
Okay. Appreciate your time as always.

John Steele
Thank you, Jason.

Derek Leathers
Thank you.

Operator
I will now turn the call over to Mr. Derek Leathers, who will provide closing comments. Please go ahead.

CONCLUSION

Derek Leathers
Thank you. Before we conclude the call today, I wanted to leave you with some final thoughts which are outlined on slide 22. We've spent the last three years strategically investing in and diversifying our company to perform better across various economic conditions. Our heavy investments are behind us and the resulting benefits to our free cash flow are ahead. The high customer service levels that Werner provides are expected to strengthen with our new fleet, increasingly experienced team of associates, and commitment to industry leading technology.

Looking ahead, our long term margin and return expectations are higher than what they've been in the past. We've begun to implement changes to our capital allocation strategy to optimize our capital structure and deliver enhanced returns to our shareholders. We're better positioned today than we have been in our recent past and we're firmly committed to delivering superior shareholder value across the cycle.

So to close, I just want to thank everyone for participating in our earnings call today and for your interest in Werner. If you have any follow-up questions at all, please don't hesitate to reach out to us.

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