

Werner Enterprises, Inc.

Q1 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Derek Leathers - *President, Chief Executive Officer*

John Steele - *Chief Financial Officer*

PRESENTATION

Operator

Good afternoon and welcome to the Werner Enterprises First 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 telephone keypad, to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Derek Leathers, President and Chief Executive Officer. Please go ahead.

Derek Leathers

Thank you, and good afternoon, everyone. On the call today, I'm joined by our CFO, John Steele and we're excited to welcome you to the Werner first quarter 2019 earnings call.

I'd like to start by providing a brief overview of the company and our current positioning, followed by a summary of financial highlights for the quarter. John will then provide additional details on our financials. I'll finish by reviewing our business and capital allocation strategies and review our 2019 financial guidance and then we'll address your questions.

Now, turning to slide four, we included some background information on Werner for those who may be new to our story. Let me just highlight a few key items. In 2018, 77% of revenue was generated in our primary segment, Truckload Transportation Services, with the remainder coming from our Werner Logistics unit. 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. We also have a diversified customer base with less than half of revenue coming from our top 10 customers and 74% spread across our top 50. We remain committed to supporting our core customers and their growth, while mitigating the outside exposure to any single customer, vertical, or seasonal revenue stream.

On slide five, you can see the timeline of key events that have occurred over the last five years to position Werner as a best-in-class carrier and logistics provider. We covered this slide in some detail during our fourth quarter call, so I'll focus on 2019. Our truck and trailer fleet age is where we want it, at very new average age levels that enable us to produce high quality service and attract high quality drivers.

Our net CapEx in 2019 is declining and returned to normalized levels. And our revenue portfolio is more balanced between dedicated One-Way Truckload and Logistics. This positions Werner to improve the consistency of our financial results, which I'll discuss in greater detail in a few moments.

Next, let's move to slide six for a brief overview of our first quarter financial performance. Revenues grew 6% to \$596 million. On an adjusted basis, EPS increased 37% to \$0.52 per share. This was a strong first quarter and on top of a 73% EPS increase in first quarter a year ago. Adjusted operating income increased \$14 million, or 40%, and we expanded our total company adjusted operating margin by 200 basis points. This significant earnings improvement

was achieved due to our revenue increases, strong operational execution, and effective cost management, including solid driver retention.

Results for the first quarter 2019 reflect freight demand that was stronger than normal from a seasonal standpoint, but not nearly as robust as what we saw in first quarter 2018, which was unusually strong following the December 2017 mandates for tax reform, which strengthened demand and the electronic logging devices regulation change, which limited supply. In first quarter 2019, our freight demand, as measured by our daily pre-books of loads to trucks in One-Way Truckload ranked the third highest in the last 10 years.

Demand in One-Way Truckload moderated in the last three weeks of March relative to our expectations, and that trend has continued so far in April. Reflecting our investment in a newer best-in-class fleet, we ended first quarter with 7,945 total tractors within our Truckload Transportation Services, or TTS segment, an increase of 560 year-over-year and 125, sequentially.

I'd like to take a moment to sincerely thank our team for their unwavering commitment to serving our customers and our drivers during a very difficult and challenging time. In mid-March, several communities in Eastern Nebraska, near Omaha, were severely impacted by record flooding in the Midwest. Many of our associates and their families were directly affected. However, they demonstrated their resolve by continuing to do their jobs well during this difficult period.

Our Werner Blue Brigade of employee volunteers provided needed help to those impacted and Werner contributed numerous trailers for relief supplies and provided financial assistance to Nebraskans in the affected communities. I'm extremely proud of what our team has accomplished during this time period.

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 on the call today.

Beginning on slide eight, we provide some additional financial performance drivers in first quarter versus the same period a year ago, including a few significant items in the TTS segment. Our revenue per truck per week increased 2.8% net of fuel and we increased the average number of trucks by 6.2%. In our Logistics segment, revenues were flat.

Adjusted operating income grew 40% and adjusted TTS operating margin expanded 180 basis points. Our logistics operating margin percentage expanded by 170 basis points. At the same time, we continued to invest in our professional drivers by increasing average driver pay per company mile by nearly 9%.

Moving to adjusted EPS, the 37% year-over-year increase consisted of TTS growth that contributed \$0.11 a share and logistics growth that contributed \$0.02 a share. Other EPS factors were 3% fewer shares outstanding and the results of our other business units.

Beginning on slide nine, let's look at the results for our TTS segment in more detail. In first quarter, TTS revenue grew 7% versus the prior year quarter to \$462.9 million, primarily driven by an increase in revenue per truck per week of 2.8%, which includes our One-Way Truckload

revenue per total mile increase of 6.5%. Adjusted operating income rose 32% to \$44.1 million, which was driven by an increase in adjusted operating margin of 180 basis points to 9.5%. The chart in the lower right demonstrates that we achieved eight consecutive quarters of adjusted TTS operating margin expansion, including 190 basis points of expansion in first quarter 2019.

Now on slide 10, let's look at our first quarter Dedicated and One-Way Truckload metrics. For Dedicated, we grew trucking revenues net of fuel by 17% to \$218 million. Dedicated average tractors grew 13% for the quarter and dedicated revenue per truck per week increased 3.6%. One-Way Truckload trucking revenues net of fuel for the quarter increased 1% to \$180 million. One-Way Truckload average tractors declined 1%.

Revenue per truck per week increased 2.8% for the quarter due primarily to improved revenue per total mile. Miles per truck declined 3.5% in the quarter due to: one, an extended cold and disruptive winter, as well as a less robust freight market in first quarter 2019 compared to an unusually strong freight market in first quarter 2018; and two, due to fewer team trucks in first quarter 2019; and three, due to one less business day in first quarter 2019.

Moving to the Werner Logistics results on slide 11, in the first quarter, Logistics revenue was flat at \$117 million, primarily due to fewer project freight opportunities, lower year-over-year spot pricing trends, and winter weather challenges. Operating income increased 71% to \$4.7 million, driven by an expanding gross margin, caused by contractual pricing increases, improved capacity procurement, and improved operational execution, all contributing to the expansion of our operating margin by 170 basis points to 4.0%.

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

Derek Leathers

Thank you, John. Moving to slide 13, I would like to update you on our Five T strategy. We reinvented ourselves as a best-in-class carrier by putting forth a compelling value proposition that would be in high demand in any market. We are succeeding by creating improvements that are structural and sustainable and with our new and more efficient fleet, combined with high-quality professional drivers, we expect to generate more consistent financial results.

Our truck and trailer fleets are new with an average age of 1.8 years and 4.1 years, respectively. We intend to maintain our fleet at these age levels going forward. We raised the bar on driver quality and retention, despite the lowest national unemployment rate in the last 50 years. We upgraded and expanded our terminal network in multiple strategic locations to improve our driver training and equipment maintenance capabilities. This investment provides our drivers with the facilities and infrastructure they need and deserve to keep America moving every day.

Since 2016, we've nearly tripled our annual IT investment as part of our Five T strategy, improving service to our customers and professional drivers alike. During 2019, we are expanding driver mobility by strengthening our Drive Werner app and developing a new in-cab technology solution.

I said this last quarter, but it is very important and bears repeating. In truckload transportation and logistics, you earn and keep the trust of your customers with each and every shipment. In simple terms, they vote with their freight every day and we sincerely thank our customers for each and every vote for Werner.

On slide 14, I'd like to focus this quarter on two of our five T's, Tractors and Trailers. Modern driver-preferred operating equipment helps us attract and retain better drivers and produce superior on time service. Werner has one of the newest truck and trailer fleets in the industry, and we partner with Tier 1 OEMs. The average age of a Werner truck is less than a third of the industry average.

All of our trucks are equipped with collision mitigation systems to remote safety, and are equipped with auto manual transmissions to improve driver training and fuel efficiency. We are aggressively adding forward facing cameras to our fleet with the goal of substantial fleet completion by year end 2019. We upgraded and modernized our trailer fleet the last few years.

Starting in 2015, we transitioned to buying white trailers, and we also strengthened our branding to improve our ultimate resale value. We are nearly two-thirds complete with this transition. We also made significant investments to upgrade our trailers with GPS tracking with cargo sensors, trailer skirts for fuel management, and automated tire inflation systems.

Finally, we are extremely proud of our Werner fleet sales operation with over 27 years of credible experience remarketing our trucks and trailers. Our late model equipment provides significant value to our repeat customers who appreciate the long -term reputation and integrity of Werner fleet sales. When we buy new trucks, we are thinking ahead to when we will be selling them three and a half years later. This forward view is benefiting us now, as we are currently selling used trucks with low miles and collision mitigation and auto manual transmission features not readily available in the market.

From an IT standpoint, in the last year, we significantly upgraded the search engine and mobile device applications for our Werner fleet sales website to expand and simplify our equipment remarketing program.

Now I would like to turn to slide 15. As you know, the labor market is extremely competitive, and the market for professional truck drivers is even more challenging. Despite these factors, Werner achieved its second lowest first quarter driver turnover rate in the last 20 years. How are we achieving these impressive results? You must do a lot of things well in this market to attract and retain the best drivers, attractive pay, a new fleet, better home time, leading industry driver training, a strong military recruiting program, and to becoming the employer of choice for female drivers are all essential to our success.

But the most important success factor is our culture. Werner is a company founded by CL Werner, our first driver, and we are managed with our drivers in mind. Top quality drivers produce top quality on time service for our customers. To truly understand and listen face-to-face to the issues and concerns of our Werner drivers our management regularly holds events such as our spring driver appreciation event shown in this photo. Earlier this month, we held driver appreciation events at all of our terminal locations throughout the U.S.

Let's now shift to cash performance and management on slide 16. From 2015 to 2018, we were in a relatively high 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 now 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 in 2019 of \$100 million or more.

Slide 17 shows the critical success factors of the Werner business model that we relentlessly focus on every day to create and sustain operational excellence. Truckload transportation is not extremely complicated, however, safely providing on time every time truckload shipments for our customers is very complex. We carefully designed and optimize the geography of our freight network with our driver home locations. We focus on customers that value superior on time service that provides them a high level of predictability and reliability from Werner, which in turn takes costs out of their supply chain. We invest in leading edge technology that improves our service, operational efficiencies, and driver mobility.

Here we provide three examples that reflect our business model this quarter. The first example is when we faced unplanned operational challenges due to unusually cold weather, multiple extended winter storms, and flooding throughout the Midwest. Despite these challenges, we proactively adjusted and adapted. For example, when the winter weather conditions were not safe, we temporarily parked our trucks. These actions helped to minimize expensive safety and maintenance cost, which reduced our estimated winter weather operating cost in first quarter 2019 by \$1.7 million, below what we experienced in first quarter '18.

A second example is increasingly complex border regulations. In late March and early April, when government staffing actions at the southern borders increased the time it took to cross equipment for northbound freight, we quickly took steps to maximize throughput of our equipment and minimized driver layovers while at the same time maximizing customer service.

The third example is the rapidly changing industry dynamics in logistics. As the spot pricing market declined in first quarter 2019, our logistics team used their skills and technology tools to accomplish more with less. We focused on obtaining better revenue shipments and carefully managing capacity procurement to significantly expand our gross margin and operating margin. So while our logistics volumes declined due to normal seasonality and market conditions, we increased our logistics operating income by over 70%. These three examples demonstrate Werner's ability to produce operational excellence, despite new and different challenges.

With increased cash generation, our capital allocation priorities on slide 18 are as follows. Our first priority is to continue to reinvest in our business. We will not deviate from our commitment to our drivers, customers, and associates to maintain a best-in-class fleet, network, and technology platform. We will continue to invest in our IT operational and commercial initiatives as well as logistics technology across our fleet. But as noted, net CapEx has moderated from 2018 and is expected to be in the \$275 million to \$300 million range in 2019.

Second, we will continue to return cash to shareholders. Werner has a 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 600,000 shares for \$20.5 million.

We will continue to evaluate all viable options to increase shareholder value, including buybacks and dividends. Finally, we're committed to maintaining a flexible balance sheet with \$125 million of debt outstanding, nearly \$1.3 billion of stockholders' equity, and a low debt-to-EBITDA ratio of 0.3 times, our financial position remains strong and flexible to deliver shareholder value.

Next, on slide 19, I'd like to update our 2019 guidance now that we are almost one-third of the way through the year. Truck growth from year-end 2018 of 3% to 5% is expected to be primarily in our dedicated fleet and occur in the first three quarters of 2019. This growth is predicated on

new business, meeting our margin and return expectations. Revenue per total mile on our One-Way Truckload fleet for the full year 2019 is expected to increase in the range of 4% to 8% compared to 2018. Based on what we know at this point, we expect the full-year percentage increase will be in the lower end of this range. The percentage increase will likely moderate during each remaining quarter of 2019 due to significant rate per total mile percentage increases achieved in the last three quarters of 2018.

Gains on sale of equipment in first quarter 2019 were \$5.9 million, slightly higher than expected due to increased trailers sold as we gain efficiencies with our trailer-to-tractor ratio. We expect full year 2019 gains on equipment sales to remain in our guidance range of \$18 million to \$20 million.

We continue to expect our effective tax rate to be in the range of 25% to 26% for the year. We continue to expect capital expenditures in the range of \$275 million to \$300 million. So far, in the first three and one-half weeks of April, freight demand in our One-Way Truckload unit has moderated and is lower than the unusually strong freight demand during the same period in April 2018.

In summary, Werner is well positioned 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 of our large competitors. I'm confident that we are positioned for success and our ability to effectively navigate whatever economic environment comes our way. Our fleet is refreshed, our team is rebuilt, and our commitment to excellence is unwavering.

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 your handset before pressing the keys, to withdraw your question please press "*", then "2."

The first question comes from Ken Hoexter with Bank of America Merrill Lynch. Please go ahead.

Ken Hoexter

Hi, great. Good afternoon, Derek and John. Just...I guess, you just gave some thoughts as you went through bid season. You noted it was early April, but any thoughts on pricing in terms of...we've obviously seen the spot market pull back pretty solidly. Any thoughts on how contracts are faring as you go through your negotiations on the Dedicated side as well?

Derek Leathers

Sure, Ken. Thanks for calling in. So we're 40% through and implemented with our bid season on One-Way and that includes obviously some Dedicated in the mix. And as we go through that so far, we're still seeing, and that's why we've kind reiterated our guidance, but those bids have been renewed and implemented at kind of mid to better than mid single-digit levels on average. We have got about another 40% in the works as we speak that will be implemented in the second and third quarter but are not yet finalized.

Dedicated pipeline, as previously indicated, is stayed fairly robust. We still feel good about our ability to meet the growth that we've talked about, but it will be primarily in Dedicated. Spot market represents very small portion of our total TTS miles, and even in one-way truck load is on average 7% or less of our miles for most of the quarter. So although, we have seen some spot markets, volatility, we expect our volatility to go both directions overtime. Second quarter has produced and other things kick in, we know the spot market tends to liven up a bit more and we will be prepared in that market to participate. But, it's a small portion of what we do.

Ken Hoexter

And Derek, if I can get a follow-up on, I guess, on a different subject. You mentioned all the things use of capital wise, you didn't mention kind of M&A, and I just want to know that, you know, if you start seeing a loosening market that gets some of these businesses in trouble in terms of where they renewed their fleet. Is that something...I know it's historically not been Werner's way, but given the change of management just want to see if you had any thoughts on if that could be a potential as you move forward?

Derek Leathers

As we've worked to turn over the last couple of years, I mean, we're focused on returning to operational excellence in everything we do. M&A is never off the board. It's something we would look at, but factually, as we think about our business, we think the opportunity and runways in front of us...continue to make improvements. We're going to continue to invest in our core business.

We look at opportunities as they arise. But as to use your question or the phrasing in your question around troubled businesses or businesses that find themselves in trouble, we've got a lot of work to do to continue to improve what we're proud of...while we are proud of the progress we've made, there is still more to be done. So we'll look at them, but finding the business that's got the right profile at the right price, with the right equipment mix that we feel has been properly maintained with the right customer base is a pretty difficult hurdle, but we will look at them.

Ken Hoexter

Great, Derek, John, appreciate your thoughts and outlook.

John Steele

Thanks, Ken.

Derek Leathers

Thank you.

Operator

The next question comes from Brandon Oglenski with Barclays. Please go ahead.

Matt

Hi, good evening. This is Matt on for Brandon. I was just looking away from the trucking business more on logistics. I'm interested what the opportunity is there for cross selling with more of Werner's traditional customers?

Derek Leathers

Yes, good question, Matt. As we think about our business, so as we launched logistics and really started growing rampant over the last couple of years, much of that was done with sort of green field customers or new business coming into the organization as we developed scale and

repetitions and build out the technology. But now as we find ourselves in a much more relevant player in the space, we are seeing opportunities with our core customer base and our core relationships, if you will to sell into those relationships and be able to expand what that means in terms of our viability for brokerage intermodal and across the logistics portfolio. So, we think the best times are still ahead of us in logistics. The ability to add business at sort of larger levels and in individual bid level is really there. And we've seen and accomplished that over the last year in several bid opportunities. The asset-backed nature of our logistics business is something that we think is an inherit advantage especially in a market that has seen the kind of volatility we've been through in 2018 and even with the fluctuations that we're experiencing now in 2019.

Matt

Thank you. And if I could just ask one more question. Looking...as you mentioned about the tight driver market, could you just kind of help us think about how that is impacting your ability to grow the business? Obviously the first three quarters, you've talked about elevated growth, but what's sort of keeping that confined to more of the early part of 2019?

Derek Leathers

Well, a couple of things. One, we like to stay true to our roots and we're a pretty conservative credible company when we talk about what we see in front of us. And so, when we are talking about our growth expectations for the year, that's dedicated driven, it's pipeline known freight and opportunities, and in many cases it's business that is really already kind of going towards implementation. We will be opportunistic as it relates to growth. But, frankly in the market we're in today, we believe putting our assets in Dedicated, continuing to grow that part of portfolio makes the most sense. We've got visibility that we feel comfortable speaking about through the second and into the third quarter and above and beyond that, the growth would be limited in my mind, more by margin and return expectations and discipline that we want to apply across our portfolio, then the driver market.

The driver market remains very tough, but our vertically integrated school network and our ability, we think, to leverage the branding in the sort of remodeling we've done of this organization to our driver force is working, our driver referrals and our ability to gain new drivers into the fleet through our existing driver network is strong. And so, the driver market is going to stay tough, as far as, the eye can see. We think we're navigating it better than most. And really I...if I was to guess or not guess, but try to give you some visibility into limitations, we are going to be disciplined. And it's going to be margin return focused. If we find the right opportunity, I'm confident that our team can go out and we can find the drivers despite the difficult market that we are operating in.

Matt

Okay, thank you.

Operator

The next question comes from Chris Wetherbee with Citigroup. Please go ahead.

James

Hi, guys, James on for Chris. Wanted to follow-up on the question about drivers, what do you expect the pay increase to be for the quarter, and how might you think about what the net increase will be for the full year?

Derek Leathers

So this is Derek. Year-over-year...for the quarter, we were up about 9% in driver pay. Now we've seen...feel as though the work we've done on driver pay and driver compensation overall. At this time, it seems to be adequate to retain the drivers we have. We will still do targeted increases at very targeted levels, so it's very small subsets within the fleet where appropriate. But, we do not sense the type of pressure currently that we went through over the last couple of years. And if you think about that three-year period, we really went sort of three consecutive years with double-digit type pay increases with our driver force. Today, we like our positioning. We like our recruiting machine. We like our school network. And retention is at the second lowest here in 20 years. So, the culture is paying off and paying dividends. Our drivers believe in where we are headed and why, and we are going to stay connected to them. But driver pay amongst other pressures that may be out there is not the pressure that it was in 2018 and 2017.

James

Got it. Also, wanted to ask about truck utilization in terms of miles per tractor, what's the outlook for 2019 and how much did weather impact the quarter?

John Steele

I would say, there is three factors that impacted our productivity this quarter. We were down 3.5% in our miles per truck in One-Way Truckload. And they were all about equal factors. One is the overall freight market and weather hurt our production. The second is that we had one less business day than we did a year ago. And the third is we had fewer team trucks than we did at this time last year.

As we look out and compare ourselves to many of the other companies that have already reported, negative 3.5% is stacking up as above average right now. And so, that does reflect the market conditions and the weather impacts that we had in first quarter. We anticipate keeping utilization as close to flat as we possibly can once we get back to the same number of business days in a normal weather environment.

James

Got it. Thank you.

Operator

The next question comes from Ravi Shanker with Morgan Stanley. Please go ahead.

Ravi Shanker

Thanks. Good evening, gentlemen. Derek just wanted to understand the current state of the market. Is there a contradiction in shippers wanting to tie-up more dedicated capacity to guarantee supply and yet want to take advantage of loosening spot market and loosening truck capacity in general? I was trying to get a sense of, if you had a sense of where the shippers head is at right now in terms of being opportunistic versus being safe, if you will?

Derek Leathers

So great...that's a good question, Ravi, and I think it really takes two...two sides of that coin. The kind of shippers that we've really aligned ourselves with and the type of work that we've been pursuing in our dedicated pipeline is really trying to put a lot of effort toward ferreting out those that are actually contracting dedicated because they need the high level of service, the high level of reliability, very specific operating characteristics, and repeatable volumes with shippers that are experiencing success in their own business. So if you take all of that and you

focus on those kinds of shippers, those are not the folks that were in 2018 trying to opportunistically move into dedicated to kind of shelter themselves from what may have been happening in the one-way or spot markets. They were doing it for their own business purposes and they needed to do it, to be able to be...to make sure they had their freight on the shelf on time, every time. That's who we want to do business with.

So when I look out into our pipeline, I feel pretty comfortable that the folks that are coming and getting into the final stages of negotiations are not folks that started those negotiations back in 2018 under duress, but rather folks that are forward-looking and trying to improve their business models and realize that the supply chain is a big part of it and having a quality partner is a critical portion of their own success. So on the other side of the coin, absolutely, there were shippers out that were putting, what I would call, designated fleets together, that are not truly dedicated, that probably won't stand the test of time if the spot market was to deteriorate further. But we are confident in the kinds of fleets we've added, that we did a good job of trying to make sure that wasn't the freight that was getting into our dedicated fleet.

Ravi Shanker

Got it. That's really helpful. And just as a follow-up, you said that April was understandably trending below last year's levels, but how does April compare to normal seasonality or maybe the long-term trend?

Derek Leathers

Over the long-term in the quarter, it was the third highest in the last 10 years and so we put that in there to try to provide some color too. I think emotionally and otherwise, everybody is tied to 2018 comparables. It didn't catch us off-guard, but it wasn't going to be 2018. 2018 is a once in a career type of year and we spent the latter part of 2018 preparing for what we thought would be a 2019 that would be more challenging. As we look at the quarter and look through the months and into April, we commented that freight is moderating and that's probably the word I'd still use.

What's more difficult to tell is how much of the moderation in the quarter was tariff related, weather related and just overall economic concern related versus....and how much of it's still going to happen now that weather is behind us, the tariff issues at least to the inventory destocking portion has been going on throughout the quarter and we still think, remarkably, spring is coming. Spring will finally come. And as spring starts to happen and mower and blower and patio and beverage starts to crank up, we like our positioning in those spaces, we like our ability to serve difficult to serve markets that do require the large amounts of capacity in relatively short time frames. And so it's just too early to give you any kind of crystal ball, but contractual rates are holding up. Spot market has been obviously erratic. It's a smaller population of freight than it's been in a long, long time, because so many people moved freight from the spot into contractual relationships and so it's going to be inherently more volatile, because there's less demand and supply in that spot market basket of goods.

Ravi Shanker

Very good. Thank you.

Operator

The next question comes from Allison Landry with Credit Suisse. Please go ahead.

Allison Landry

Thanks. Good afternoon. I was hoping you could offer some thoughts on recent trends in the used equipment market and if there's anything to glean with respect to the health of smaller carriers and their fleet condition? Thank you.

Derek Leathers

Allison, another good question. I think over the course of the year, we're going to obviously have better visibility into that, but right now, what we know is that the trucks we're selling are pretty unique. We're not the only one selling them, but the list is pretty short that are selling late model, low mileage, collision mitigation, auto manual transmission type of equipment into the marketplace. There's just not a lot of folks that have that available to be purchased. And so, we like our positioning and so what I would caution the group on as it relates to the question is even to the extent we see used pricing starting to decline, which we have not yet seen, but if that was to start taking place, we feel as though there is an insulation effect that won't carry on forever. But certainly for 2019 and we think into 2020, we will still be one of the few carriers that are remarketing equipment that basically have all of the safety, efficiency, and auto manual transmission features included in the spec. And so, we're not necessarily a great read through for the broader industry because we think we've got a bit of a secular story on what's happening. You combine all of that with the fact that we've got our own sales force and our own fleet sales group that actually retails these trucks versus relying on wholesale package deals or trades, and we think we're uniquely positioned.

John Steele

Plus Allison, I would add that we also have significantly upgraded our website to remarket our equipment, and that's generated a lot of marketing interest. And we believe we're better positioned than most, based on the auto manual transmissions and collision mitigation systems that Derek referred to. And the fact that we're selling more trucks at retail and wholesale than we did a year ago and two years ago, puts us in a better position to get the best value out of the trucks we sell.

Allison Landry

Thank you, guys.

John Steele

Thanks, Allison.

Operator

The next question comes from Matt Brooklier with Buckingham Research. Please go ahead.

Matt Brooklier

Hi, Derek, John, good evening. So I just wanted to turn back to kind of the line of questioning on the pricing side of things. Maybe if you could talk to this cycle. It seems like contract pricing is holding up relatively better versus spot looking back over history. Maybe you can talk to some of the components that you think is allowing for that to happen. What's contributing to maybe the market being a little bit more contractual here and shippers potentially willing to pay a little bit more this go around versus prior cycles?

Derek Leathers

Sure, I'll take that. And appreciate you being with us this afternoon. So for one thing, I talked about it earlier, and I'll try to touch on it again. But I think in 2018, couple of things happened

that we can't overestimate. As rates increased at the level they did industry-wide and people kind of reset rates to where returns needed to be, to be able to continue to reinvest in their fleets, a large population of sophisticated shippers and capitalized carriers really exited in many cases the spot market, and entered into contractual relationships at rates that made sense, that work for reinvestment that allow for assets to come into the market to support their growth.

When you do that, what's left in the spot market is a much smaller basket of goods, a much different mix of both carriers and shippers. And those carriers that exited remember why they exited. I mean they...it's not like it was five years ago, it's still one year in arrears. They realize and remember that when you...we went through a period of time, multi-year period, where kind of roaming fluidly between spot and contract and moving your routing guide back and forth was relatively pain free and it became very painful in 2018 for folks. And I think they've...there's been some lessons learned. How long they last is probably a tougher question. And I think there is a willingness to reward assets if they are high-quality. So the service levels have to be there. The operational execution has to be there, the commitment has to be there and if you say you're going to haul for them, you have to honor those commitments. And we did that in 2018, despite the tight market.

Obviously, we're having conversations about where we stepped up in 2018 and asking people to make sure that those memories don't fade too quickly. Beyond that, it's...I'm not really here to try to predict what's in their mind. That's my best guess. I know this, high service levels come at a cost and 85% service levels can save a lot of money at least in the short-term, but long-term it's a recipe for disaster. And so we want to continue to hold out a premium product and expect a premium price. And if that doesn't work or that's not the right fit, then maybe we need to work with other folks that place greater value on it.

Matt Brooklier

Okay. Yes, that's great color. And then a second question, if we look at the spot market, look at the pressure on pricing, we've been hearing incrementally that maybe some of the digital brokers, this go around the cycle have been more aggressive in terms of trying to take share, more aggressive in terms of pricing and potentially have put some downward pressure...incremental downward pressure on spot pricing, just curious to hear your thoughts if you think that is something that is occurring here.

Derek Leathers

Sure, I'd be happy to. So digital brokers are obviously a hot topic and it's a conversation that's not going to go away anytime soon. And they take all kinds of shapes and forms. I would argue that what's been overlooked often within the truckload space with big well-capitalized companies like ourselves is that we're doing work in that space as well. We are developing the technology, we're developing the systems and people and processes to be able to increasingly in an automated manner match freight with carriers, dispatch it, bill for it and collect and do so in more and more... with more and more automation.

What we're faced with right now is a reality that there's going to be a lot of price competition in truly transactional spot rate that's where digital brokers are going to do their best work. They're going to continue to be able to lead or need to lead with price to be able to enter into some of these shippers that we've got decade's worth of relationships with. And our job is to continue to try to display that same service can be accomplished with a valued partner that you've known for a long, long time. So, we've talked about tripling our IT investment, those investments are paying dividends. We're continuing to see increased efficiencies.

I would point to the first quarter where we made a conscious decision not to chase rate and not to get too emotionally involved in some of what we saw happening and some of these freight bids or transactional opportunities, I should say. And instead, you leverage that productivity to expand margin. And so we increased gross margins in logistics. We increased net operating income in logistics, and yet we are not giving up on, we're still focused on growing that portfolio. But we're always going to have an eye toward returns and margin levels before we just go growing for growth sake. If you are a new entrant in the market or you are digitized freight broker, you probably don't have the ability to make that trade-off, because you need your foot in the door one way or the other.

Matt Brooklier

Okay, great. I'll pass it along.

John Steele

Thank you, Matt.

Operator

The next question comes from Brian Ossenbeck with JP Morgan. Please go ahead.

Brian Ossenbeck

Hi, guys, good evening. Thanks for taking the question.

Derek Leathers

Hi, Brian.

Brian Ossenbeck

I just want to ask a maybe different couple of questions here, then the market. Can you just give us an update on the regulatory side and what we are looking for maybe a few steps forward on hair and follicle testing right around the government shutdown last year? And I was wondering if you guys have heard anything, if that is continuing to progress or are we still a long ways away from the first steps of that being...codify the testing and then sort of moving on from there? What have you guys heard recently?

Derek Leathers

So, we are in dialog all the time on this issue and it is actually progressing. Obviously, it's been slower for our...for the expectations we have, we look forward to it happening and that can't happen soon enough, we hair follicle all of our drivers today. We know the failure rate in hair follicle is roughly 10 times greater the failure rate with urinalysis. We believe it's the right thing to do to provide safer more vetted drivers on America's roadways. I still believe you'll see hair follicle happen this year. But to try to put a bow on it and give you a quarter prediction, whether it's second quarter, third quarter, or fourth would probably be too bullish on my part, but HHS is involved. The holdup has been at HHS. They are now looking and reviewing and trying to get through some of the final issues that remain.

And then on the heels of hair follicle with or without that getting done, we have drug and alcohol clearinghouse that's currently still on schedule for January 1st, 2020. Again, not making any prediction as to whether it will be delayed or not, but what we're hearing is that we are proceeding on schedule at this point. And if you were to couple hair follicle with drug and alcohol clearinghouse, I think by comparison it makes ELD look like a speed bump in the road.

It needs to be done, it will be capacity limiting, the clearinghouse is probably more meaningful in my view, even than hair follicle, because it gives us a one-stop shopping depot, if you will, to check in with and understand what a driver's record really looks like. We are committed to putting drug-free drivers on the road, plain and simple. And we're going to stay committed to that and do everything we can to ensure that our drivers are drug free when we hire them and throughout their career here at Werner.

Brian Ossenbeck

Got it. Thanks for that, Derek. Appreciate it. Maybe just one more for you, it sounds like it's...it might be a little less of an issue than it was early in the quarter, but what's the latest on the border and the disruption there? It sounds like you just did pretty well, I believe that they...it opened up sort of a speed lane...speed fast lane, if you will, to help things increase the fluidity a little bit. But just wondering if that was really a significant impact in the quarter. Do you have some freight that's going to catch up here in 2Q and when do you see this actually resolving?

Derek Leathers

Well, third part of that's obviously the hardest of all, because when it will resolve is probably something that's outside of our control for certain. We have seen some improvement at the border crossing times, but by and large, they're still slow and freight is still crossing the border at a very slow rate by comparable standards. What we've done is worked very closely with our shippers, with our customs brokers, with the folks along the border itself to try to do and everything we can to make sure that we cross as many loads a day as we can. We've mitigated essentially all exposure to layovers for our drivers. We've kept freight moving. But it's absolutely been a dampening of overall freight demand just because on the other side of the border depending on what crossing you look at, the pent-up demand at individual border crossings had peaked at over 7,000 loads in certain cases, but on average it's safe to say that nearly every crossing had over 1,000 to 2,000 shipments pent-up on the Mexican side of the border.

Laredo has seen some relief and additional resources here lately. Our understanding is that we will see additional relief at other crossings over time, but we're going to move forward on the assumption that the border is going to be slow for the foreseeable future. We're going to continue to plan our southbound freight to match with the northbound volume that we know we can cross, and not lay our drivers over and try to move them forward. When that clears, there will be an opportunity for freight off the border that is going to need to move in large volumes and an expedited type of...transit times. And we are set up well, because it's a core strength. I mean, we're the largest cross-border carrier to and from Mexico today. And we plan to leverage that and we are adding those dialogues every day with our customers.

Brian Ossenbeck

Thanks for that, Derek and John. Was there material impact in the quarter or is it hard to estimate that?

John Steele

I think the impact was pretty minimal in the quarter. We managed through it pretty effectively, based on what we talked about in the presentation.

Brian Ossenbeck

Okay. Thanks for time guys. Appreciate it.

Derek Leathers

Thank you.

Operator

The next question comes from Bascome Majors with Susquehanna. Please go ahead.

Bascome Majors

Yes, good evening, guys. You've been very transparent about seeing some softer demand in the last six-seven weeks in your business, but certainly consistent with what we heard from pretty much everyone in surface transportation this quarter. How long could this softness continue without a real spring seasonal pickup before you start to get more concerned about the broader economy?

Derek Leathers

Bascome, you know, I would say, this, we are way too early in spring at this point to start casting broader concerns or economic concerns. If you look at so many of the economic indicators are actually still positive and certainly by contrast to some of the conversations or dialog around freight volumes, they are pretty disconnected. And so, I think what we've seen predominantly, not exclusively but predominantly, is the combined effect of some of the pull forwards, not just of December 31st tariffs, but of the threatened April 1st tariffs. And some overstocking that took place that needs to be destocked and it is destocking as we speak. The extreme winter weather, I mean, the winter weather this winter was significantly broader...more broad-based with more road mile closures with more population impact in core freight markets than one we've seen in a long, long time.

Now, we are proud of the fact that we managed it better than a year ago, and so internally we had a lot of dialogue around the economic impact of it. If you look at the dollars and cents, it was lesser this year than a year ago, but that's because of what we did and how we navigated it, not because the winter was less. And then in our case, we had the added challenge, if you will, of the flooding that took place all across the Midwest and specifically in our backyard. And that's why I was so proud of our associates for stepping up and while dealing with floodwaters and sandbags and everything else imaginable, they showed up and they performed. And so, we are really proud of the culture showing through during what's been a very, very difficult time.

Bascome Majors

Thank you for that. I appreciate it, Derek. And just to expand on the comments about growing the fleet, most of it happening by the third quarter. Is it that, you don't plan to grow, you plan to be down in the fourth quarter, is that just the bid season outcomes are uncertain and still in process at this point? Thanks.

Derek Leathers

Sure. I would say, it's closer to the latter. But in general terms, we do want to stick to our knitting. And so our plan right now is that 3% to 5% type growth range for the year, really exclusively and dedicated. We will grow by the lower or the higher end of the range based on how some of these negotiations finalize. We see very little risk to be below the range and equally low risk to being above the range, based on what we know today. So we are going to stick to our knitting. We're going to stay focused on returns and we will be opportunistic if the opportunity arise. But right now, it's a dedicated driven focus as it relates to truckload. One-Way Truckload, I don't think any of us believe, is suddenly going to have a robust rebound, but it is steady enough and the freight and customer mix, we have, we think we can weather through the remainder of the year while improving our overall returns as an organization.

Bascome Majors

Thank you and congrats on the quarter.

Derek Leathers

Thank you.

John Steele

Thanks, Bascome.

Operator

The next question comes from David Ross with Stifel. Please go ahead.

David Ross

Yes. Good afternoon, gentlemen.

John Steele

Hi, David.

David Ross

With the driver situation, you added drivers that have been all company, lost a few on our operators. Is there any reason for that trend?

Derek Leathers

Yes, I would say our focus is really company...we want to support our owner operators in our fleet today, but look, let's be frank, it's an increasingly difficult operating model and one that seems to come upon new challenges every day. And if we can improve margins, increase returns and do so with company trucks and company drivers with a much greater confidence in that model, we're going to continue to do so. We love the owner operators we have with us today. We are continuing to develop programs for them that allow them to succeed. But our focus is really, going forward, more on the company side. A lot of that is also driven by the reality that we are more dedicated, exposed in one way. And if you think about dedicated fleets, the reality of a dedicated fleet, the operating characteristics, the driver expectations, the freight characteristics themselves in terms of utilization, et cetera, they work better in a company driver scenario by and large. And so, I'm not trying to offer a read-through into the broader industry. I'm just saying here at Werner, we are not looking to purposefully lower our owner operator count, but I think over time, as you think about the growth, the growth will be predominantly in company drivers.

David Ross

Have you seen a willingness of dedicated customers to pay more for a company driver fleet versus an owner operator fleet?

Derek Leathers

Well, I don't know that I would be the best asked to be blunt, because we don't offer an owner operator fleet option when we go into the dedicated. We want to lead with our strength, which is our trucks, trailers, talent, technology, the infrastructure we give them to back that up, and our One Way assets to be able to surge and protect during times of peak need. We think our model and our sell is really what dedicated looks like. If you are truly trying to buy best-in-class service and reliability, so that's what we sell and that's what we offer. Seldom, do I find us competing with somebody that's a finalist in a bid, I am actually struggling to recall one where the other

finalist that was an owner operator model. It is just a different, dedicated is one of those words that's broadly used and broadly applied to describe a whole lot of different businesses. But ours is hard to serve, high service, with a great deal of sensitivity to 99% or better. And usually, if you are in the low 99%, you are in trouble. But we can do that with our...with the structure we have in place.

David Ross

And then you talked about raising driver pay or at least driver pay was up broadly speaking around 9% year-over-year in the first quarter. When does that lap the increases taken in 2018, you know, it sounds like it's going to be steady from here, but when does that increase go away?

John Steele

Yes, it begins to lap higher increases last year that were more in the 11% or 12% range as we look at second and third quarter of last year. We continue to expect driver pay to increase from here, but at this point, the percentage increase will likely moderate as the year goes on.

David Ross

Okay. And then last question is about length of haul trends. Last three years has been a consistent uptrend and length of haul now is about 13% higher than it was in 1Q 2016. Is that due to more team expedited business, is there something going on with the network there? What's driving the increase in length of haul?

Derek Leathers

Yes, it's really driven by us utilizing our One-Way assets to play to our strengths. Our strengths in One-Way are Mexico and team expedited. And we talked a lot about that on the last quarter's call, but over 50% of our One-Way network is made up of those two components alone. Those two components both have one thing in common which is long length of haul, high service expectations. And so, as we continue to leverage our strengths and kind of flex our muscle, if you will, in our operating model, length of haul is something that although we won't see the same kind of increase because it's really part of the story over the last couple of years that's already been implemented, I don't foresee a sudden U turn in that length of haul number or a sudden drop because we are going to continue to expand our presence in our product offerings in both team expedited in Mexico.

David Ross

Perfect. Thank you.

John Steele

Thank you, Dave.

Operator

The next question comes from Scott Group with Wolfe Research. Please go ahead.

Scott Group

Hi, thanks. Good afternoon, guys.

Derek Leathers

How are you doing, Scott?

Scott Group

Good. John, one for you. So when I look at second quarter typically we see about 3 to 4 points of margin improvement on truckload relative to the first. Help us...walk us through some of the puts and takes. It sounds like pricing is better than normal, maybe demand moderating a little bit. Is that still the right way to think about margin seasonality for this year?

John Steele

Yes, and it's hard to characterize first to second quarter with a broad brush. If you look at history, there is a fairly wide variability from year-to-year and how we performed first to second quarter. I would say that the moderating demand that we are seeing thus far in the latter part of March and April is a little bit of a headwind. And last year, we had unusually strong freight demand particularly in May and June of 2018 that we are going to be competing up against. The operational improvements that we're making, we expect will continue. So we do definitely expect improvement from first to second quarter in terms of our performance. Predicting how much improvement we will have is difficult to predict at this time.

Scott Group

Okay. And then maybe, Derek, just big picture for you, just obviously the spot market is tough. Are you starting to see any signs of capacity leaving the market? Do you think that moderating supply is going to become a tailwind to this market this year or is it more, we need to start seeing demand reaccelerate in order to get the market tighter?

Derek Leathers

Well, I mean, I said, I think some of the signs that seem to indicate some rationality are what we're seeing with truck orders and the significant drop year-over-year and I think you'll see that ongoing for some time. I think at current spot market levels and some of the effect of the transactional market or digital freight brokerage market, if you will, that those are not sustainable rates in some cases. And I don't know how these...how carriers that are participating predominantly in that market can stay around very long. So that should lead to some rationalization. I think the economy is actually doing a little better than what the general commentary seems to indicate at least specific to our industry and again I think destocking, tariff effect, and overall winter weather has played a larger role, but it seems to get lower billing in the conversation versus concerns about the economy. And then the backdrop of the regulatory stuff coming at us, I mean, with hair follicle coming around the corner and the drug and alcohol clearinghouse, there is a natural dampening that will take place there. And that's why we are kind of leaving our options open on the range for truck growth, meaning that we will drive to the lower end of the range, if we think that's where we need to be.

In terms of truck growth in order to do what's right in our contractual renewals, quality product costs a certain amount and we can't put that product forward at some of these transactional rates that you may see on the spot market, but we don't do that either. I mean, 7% or less of our One-Way Truckload assets are in that market on any given day, which means under 3.5%, or right at 3.5% of our total assets, it is not going to move the needle much in our current view here at Werner.

Scott Group

All right, thanks for the time, guys.

Derek Leathers

Thank you.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Derek Leathers for any closing remarks.

CONCLUSION**Derek Leathers**

Thank you. Before we conclude the day, I'd just want to leave you with some final thoughts, which I've outlined on slide 21. We spent the last three years strategically investing in and transforming our company. We've done it to perform across various economic cycles. The heavy investments are behind us and the benefits to 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 return expectations are higher than what they've been in the past. And we believe that we're better positioned today than we've been in our recent past. We're committed to delivering shareholder value across the cycle. So in closing, I just want to thank you to all of you for participating in our earnings call today and for your interest in Werner Enterprises. If you have any follow-up questions, 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.