

Werner Enterprises

Q2 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

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

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

PRESENTATION

Operator

Good afternoon and welcome to the Werner Enterprises Second Quarter 2021 Earnings Conference Call. [Operator instructions].

Earlier this afternoon, the company issued an earnings release for its Second Quarter 2021 results and posted a slide presentation. These materials are available at the company's website at werner.com. Today's webcast is being recorded and will be available for replay beginning later this evening. Before we begin, please direct your attention to the disclosure statement on slide two of the presentation, as well as the disclaimers in our earnings release related to forward-looking statements.

Today's remarks may contain forward-looking statements that may involve risks, uncertainties and other factors that could cause actual results to differ materially. Additionally, the company reports results using non-GAAP measures, which 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 table attached to the earnings release in the appendix of the slide presentation.

I would now like to turn the conference over to Mr. Derek Leathers, Chairman, President and CEO. Please go ahead sir.

Derek Leathers

Thank you and good afternoon everyone. With me today is our CFO, John Steele. I am pleased to report that Werner delivered record earnings in the second quarter, which was achieved through outstanding execution in a robust freight market with unprecedented driver and capacity challenges. The Werner team worked tirelessly and creatively to provide our customers with best-in-class solutions and superior on-time performance.

We continue to expect strong freight demand through the rest of this year and well into 2022. Retail inventories require significant replenishing, which will take time, and bodes well for retail freight demand going forward. Strong sales, combined with persistent supply challenges, resulted in the retail inventory to sales ratio setting another new 30-year low this quarter.

At the same time, the driver shortage is as severe as I have ever seen. Traditional industry headwinds remain, including aging demographics in recruiting for the trucking life. Werner is well-positioned to thrive in this business environment as a result of our consumer-oriented freight base, driver preferred Dedicated fleets, industry-leading cross-border Mexico business, engineered lanes in our One-Way Truckload segment, and our comprehensive capacity solutions within Werner Logistics. In addition, just after quarter-end, we added 500 trucks and skilled professional drivers to the Werner family by acquiring 80% of the regional truckload carriers of the ECM Transport Group.

Slide four provides an updated snapshot of Werner to include the addition of the ECM acquisition, which we completed on July 1st. ECM adds 500 trucks and 2,000 trailers to our combined One-Way Truckload fleet and provides us with a short-haul regional fleet presence to serve customers in the Mid-Atlantic, Ohio and Northeast geographic markets. ECM has strong safety and service performance, an outstanding leadership team and highly skilled drivers with extremely low driver turnover.

After the acquisition, Werner continues to have a consumer-centric freight base with over 70% of revenues in retail and food and beverage. Nearly half our revenues are with our top 10 customers and almost 80% from our top 50. Werner and ECM have longstanding and growing relationships with successful companies.

Let's move to slide five for a summary of our second quarter financial performance.

For the quarter, revenues increased 14% to \$650 million, adjusted EPS grew 40% to \$0.86 per share, adjusted operating income increased 37% to \$79.1 million, while our TTS adjusted operating margin, net of fuel, grew 340 basis points to 17.1%. We generated margin expansion from higher revenues per total mile, continued strong safety performance, effective expense management despite continued cost inflation, and improved gains on sales of trucks and trailers due to much better than anticipated pricing and strong sales execution.

Dedicated freight demand remained strong in second quarter, as our largest Dedicated customers in discount retail, home improvement, and beverage continued to generate robust sales. Our Dedicated team once again executed well in the second quarter.

One-Way Truckload freight demand was also strong. The rapidly growing economy, combined with several factors limiting the industry capacity, resulted in excellent second quarter freight market conditions and our One-Way Truckload team performed well.

We made further strides in our Logistics segment in the quarter, stepping up our growth in both revenues and operating income. Despite much higher capacity costs, which impacted our gross margin percentage for our contract business, improved pricing and operational efficiency led to better Logistics results.

The driver recruiting and retention markets became more challenging in the second quarter. High-quality drivers are increasingly harder to find and retain, with intense competition from other carriers in industries that are labor constrained. To address driver turnover, we implemented additional selective compensation increases. Our TTS company driver pay per mile increased nearly 11% year-over-year. In addition, we continue to deploy innovative strategies to strengthen our driver positioning, which I will discuss in a few minutes.

In the second quarter Werner Fleet Sales capitalized on a significantly improving pricing market for our premium used trucks and trailers by realizing substantially higher average gains per truck and trailer, and achieved equipment gains of \$13.5 million. Fleet sales are a core part of our business for the last 30 years, and our Werner Fleet Sales team performed well in the quarter as well.

In the first quarter, we made a strategic minority and equity investment in TuSimple, an autonomous technology company. TuSimple completed its IPO in April, and experienced stock price appreciation through June. As a result, we recognized a \$20.2 million unrealized gain on our investment or \$0.22 a share, which increased our non-operating income in second quarter 2021. We reduced our second quarter GAAP EPS for this item in our adjusted EPS reconciliation. In future quarters, we will mark-to-market this investment based on the change in TuSimple's stock-price.

We ended the quarter with 7,645 trucks in TTS, five fewer than last year and 90 fewer sequentially. The extremely difficult driver recruiting market prevented us from achieving our goal of organically growing our fleet during second quarter. At quarter-end, 66% of our TTS

truck fleet was in Dedicated and 34% was in One-Way Truckload. Following the ECM acquisition, our Dedicated and One-Way Truckload fleet percentages changed to 62% and 38%, respectively.

At this point, I will turn the call over to John to discuss our second quarter financial results in more detail...John?

John Steele

Thank you, Derek and good afternoon. Beginning on slide seven, total second quarter revenues increased \$81 million to \$650 million or plus 14%. Our TTS revenues per truck per week increased 6.7%, due to a low double-digit percentage improvement in revenues per total mile, offset by a mid-single digit decline in miles per truck caused by a greater mix of shorter length of haul Dedicated versus One-Way Truckload and fewer team drivers. And Logistics continued to strengthen growing revenues by 29%.

Adjusted operating income grew 37%, based on 33% growth in TTS, 25% growth in Logistics and improved financial performance from our driver training school network. Adjusted earnings per share were \$0.86, up 40% year-over-year.

Beginning on slide eight, let's review results for our Truckload Transportation Services segment. In second quarter, TTS revenues increased 10% on higher revenues per mile, lower miles per truck and 1% fewer average trucks. Adjusted operating income was \$74.4 million or a 33% increase driven by a 340-basis point expansion in our adjusted operating margin, net of fuel. Our adjusted operating ratio continued to show strong improvement with an 82.9% OR.

Turning to TTS fleet metrics on slide nine. For Dedicated, we grew trucking revenues, net of fuel, by 10% to \$262 million. Dedicated average trucks increased 7% and revenues per truck per week increased 2.4%. Dedicated rates increased above our guidance range of 3% to 5% and miles per truck were lower due to fleet mix changes. Our Dedicated customer pipeline remains strong.

One-Way Truckload revenues, net of fuel, decreased 1% to \$166 million. Average trucks decreased 14%, due to trucks that moved into Dedicated and the challenging driver market. Revenues per truck per week increased 14.8% as a result of higher revenues per total mile, which grew 16.7%. This was partially offset by a miles per truck decrease of 1.7% due to fewer team drivers.

Like others, we anticipate ongoing inflationary pressure for our main costs, specifically fuel, driver wages and driver sourcing. We will continue to drive operational excellence initiatives to gain greater efficiency and address cost issues, including working with our suppliers and attempting to recover these costs from customers wherever possible.

Moving to Werner Logistics on slide 10. In second quarter, Logistics revenues of \$142 million grew 29%. Adjusting for the sale of Werner Global Logistics in the prior quarter, total Logistics revenues grew 52%. Truckload Logistics revenues increased 49%, driven by a 37% increase in revenues per shipment and a 10% increase in shipments. Power only and project business continued to generate strong revenue growth, more than doubling from second quarter a year ago. Intermodal revenues grew 52% supported by a 17% increase in revenues per shipment and a 30% increase in shipments.

Our Logistics gross margin percentage decreased 350 basis points year-over-year, due to the much higher cost of truckload capacity for contractual brokerage and intermodal shipments. To address the increasing cost of truck capacity, we reduced our contractual Truckload Logistics shipments from 58% to 48%. Also, Intermodal dwell time increased at customer and rail locations during second quarter, which impacted profitability. As we move forward, we expect to see continued performance improvement from Werner Logistics through revenue growth and margin expansion.

On slide 11 is a summary of Cash Flow from Operations, net Capital Expenditures and our growing free cash flow over the past five years. Expanded operating margins and less variable net CAPEX resulted in higher free cash flow during the last four years. We expect to generate continued meaningful free cash flow going forward.

For 2021, we continue to expect net CapEx to be comparable to the last two years in a range of \$275 million to \$300 million. This guidance range assumes we maintain our new truck and trailer fleet and we continue to invest in Werner EDGE, the innovation arm of Werner, by building out our technology platform with solutions that are more advanced, more productive and with enhanced safety and security. Our net CapEx guidance assumes no significant delays in delivery of new trucks and trailers in the second half.

On slide 12 is a summary of our disciplined strategy for capital allocation. The first priority is reinvestment in our new fleet with feature-rich trucks and trailers with the latest safety, driver-friendly and fuel-efficient capabilities. Earlier this month, we opened our second new terminal facility of 2021. This terminal is strategically located in Lehigh Valley, Pennsylvania and replaces a smaller leased facility. We are making meaningful and sustainable progress enhancing Werner EDGE, our technology initiative and platform. And during the quarter, we raised our quarterly dividend by 20%.

In prior quarters, we said we would consider strategic acquisitions that are additive and accretive. Just after quarter-end, we were excited to announce the acquisition of the elite regional truckload carriers of the ECM Transport Group. ECM operates with industry-leading operating margins and its accomplished and experienced leadership team remains in place as a stand-alone business unit. We will leverage our collective strengths and generate synergies to serve our existing and new customers at even higher levels.

We are committed to maintaining a strong and flexible financial position. Our long-term leverage goal is a net debt to annual EBITDA ratio of one half to one turn. We added a \$100 million fixed rate loan on June 30 at an interest rate of 1.3% to partially fund the ECM acquisition the following day. Since the acquisition did not occur until the beginning of third quarter, our net debt to EBITDA ratio was 0.2 times at quarter end and increased to a pro forma 0.4 times the following day.

On slide 13 is a summary of the benefits of the ECM acquisition. ECM strategically expands our operations in the Mid-Atlantic, Ohio and Northeast regions by adding eight terminals and 18 drop yards to our footprint, as shown on the map. Our companies shares similar cultures based on the highest standards of safety and on-time service, and the combination will boost our fleet size by nearly 7%. The integration is going smoothly, and the transaction is expected to be accretive to adjusted EPS in year one.

I will now turn the final portion of our prepared remarks back to Derek. Derek?

Derek Leathers

Thank you, John. Over the past five years, we implemented structural and sustainable upgrades to our TTS segment with a modern, safer and more efficient fleet; raised our hiring and retention standards for high-quality, safe, professional drivers and delivered on our commitment to best-in-class customer service. Our trucks and trailers continue to have young average fleet ages of 2 and 4.1 years, respectively. Every Werner truck is equipped with advanced collision mitigation safety systems, industry-leading emissions and fuel mileage technology, automated manual transmissions, forward-facing cameras and an untethered tablet-based telematics solution.

The driver market is very competitive and dynamic. In addition to implementing attractive and competitive driver pay increases, we are expanding and leveraging the strategic advantage of our industry-leading driver training school network. This year, we have grown our locations from 13 to 16 and have three more planned openings for 2021 and an additional three in 2022. Our goal is to achieve a total of 22 strategic driver training school locations by the end of March 2022.

We also took another strategic action to achieve our fleet growth goal. Similar to our IT software strategy of buying rather than building when it makes sense, our ECM truckload acquisition enabled us to acquire 500 trucks and over 500 highly-skilled regional drivers who have daily home time.

In addition to attractive driver compensation, Werner strives to be the truckload employer of choice, by providing a modern truck and trailer fleet with the latest safety equipment and technology, a wide variety of driving positions including daily and weekly home time opportunities and an industry-leading driver training program. Despite the tight driver recruiting market, we are maintaining our stringent hiring standards and we remain focused on attracting and retaining the best professional drivers.

This year, we opened two new flagship terminals in Lake City, Florida and Lehigh Valley, Pennsylvania. Our strength in our terminal network is an integral part of our ability to attract and retain the best drivers and minimize fleet downtime for maintenance issues.

On the technology front, we continue to execute on our Cloud First, Cloud Now strategy by developing innovative products and combining them with third-party SaaS solutions, to work in ways that provide competitive advantages.

For example, Werner rolled out new technology to streamline our connectivity with existing and new preferred maintenance vendors. This allows us to optimize costs for over-the-road maintenance program as well decrease truck maintenance downtime to keep our trucks and drivers rolling. With this new technology, we accomplished a 67% reduction in call time and a 52% reduction in driver dwell time for each maintenance event. We also rolled out a new simplified equipment warranty recovery process that is projected to realize an additional 25 to 30% savings in warranty dollars by the end of this year.

Werner Logistics recently launched our Carrier's EDGE digital freight platform. This provides our carriers with a self-service portal that enables them to view and book loads real-time.

For our drivers, we launched our Drive Werner Pro mobile app which offers enhanced features to improve our drivers' lives on the road.

We continue to modernize and update our core IT systems with SaaS applications. One exciting second quarter milestone is that we are 100% migrated to a cloud-based EDI solution that easily connects and provides more accurate and timely information to our shippers and carriers.

We are committed to the modernization of our financial and accounting systems with the selection of Workday Finance which dovetails with our existing Workday HRM platform.

And we are also thrilled to rollout MasterMind, our new Transportation Management Software platform with Mastery. We began testing with our Logistics teams, and this is the first of many incremental roll outs. This is the first step on our four-year strategy to have our Truckload and Logistic systems on one combined SaaS platform, with the same, but enhanced secret sauce features and applications that make Werner successful. We will continue to provide status updates as we progress.

And last year, we added sustainability as a key element of our strategy.

On slide 16, I am excited to announce that we published our inaugural Corporate Social Responsibility report this week with a significant amount of new information and specific E, S and G goals. Some important actions we have taken that I would like to highlight, because they demonstrate our commitment to becoming an ESG leader in our industry, are:

In November, we formally and publicly launched our ESG Program including adding “Sustainability” as a strategic pillar and as we embed sustainability organization-wide into our business decisions.

In March, we hired an Associate Vice President of Sustainability and in January, we created a new position, and appointed an Associate Vice President of Diversity, Inclusion and Learning. We are now a signatory of the UN Global Compact and have aligned with specific Sustainability Development Goals that most support Werner values, our strategy and aspirations. The specific SDGs are good health and well-being, decent work and economic growth, reduced inequalities and climate action.

This week, we published our inaugural CSR report, which was a milestone we outlined back in November. You can find a report on our website at werner.com.

We adopted the Sustainability Accounting Standards Board or SASB Disclosure Framework.

We have formally branded our sustainability program as WernerBlue, and we will be working to develop a more comprehensive strategy and will communicate our progress.

I am proud of our team for all the hard work that went into our progress over the past eight months and achieving these important ESG journey milestones. It's a great foundation on which to build, and we will keep building from here.

Next on slide 17, are the new ESG goals and milestones that we announced earlier this week. For Environmental, we will disclose Scope 1 and Scope 2 greenhouse gas emissions by 2025, we will double our Intermodal usage by 2030 and we will reaffirm our aggressive goal to achieve a 55% reduction in greenhouse gas emissions by 2035.

For Social, we are creating an advancement and retention plan to increase and elevate women and diverse talent in our management team pipeline. We are instituting an employee volunteer hours program by 2022, and we will add greater impact to the communities we serve by doubling the volunteer hours of our successful WernerBlue Brigade program by 2025. We are also doubling training hours devoted to human trafficking awareness.

For Governance, by next year, we will establish a standalone ESG committee for our Board of Directors. Also, we will establish a task force of leaders, associates and board members to further the goals of our Werner Blue ESG strategy.

While we are still in the early stages of the positive impact we will have, I am inspired by the excitement and engagement of our associates and drivers. And like everything we do at Werner, we are committed to leading by example.

Moving to slide 18 and a review of our 2021 guidance framework, how we are progressing against that guidance and updates to our outlook.

During the second quarter, our truck fleet declined 1% and we are down 2% year-to-date due to the extremely challenging driver recruiting market. We believe this challenge will persist and taking this dynamic into account, we are updating our expectations for the Werner fleet for the remainder of the year. We now expect truckload growth for the full year to be in a range of 1 to 4%, including the ECM fleet.

Pricing in the used truck and trailer sales market was stronger than expected in second quarter, resulting in higher equipment gains of \$13.5 million. For third quarter, we expect continued strong pricing with fewer units sold resulting in expected gains in the range of \$9 million to \$13 million.

Net capital expenditures were \$103 million for the first half of 2021. We continue to expect full year net CAPEX in the range of \$275 million to \$300 million, which will maintain our truck and trailer fleet ages subject to the timing of OEM new truck and trailer deliveries.

Dedicated revenue per truck per week increased 2.4% in second quarter, due to higher rates partially offset by lower miles per truck. Dedicated rates in 2Q21 versus 2Q20 were above our guidance range, however miles per truck were lower due to changes in fleet mix. We continue to expect annual growth of revenue per truck per week in the 3% to 5% range, but more likely at the bottom end of the range.

One-Way Truckload revenues per total mile for the second quarter increased 16.7%, which was above our guidance range of 13 to 16% as a result of strong execution with our core customers. For the second half, we are now expecting One-Way Truckload revenues per total mile to increase 16 to 19%, due to higher contract rates, and including the favorable impact of the ECM acquisition. Going forward, we will report ECM within our One-Way Truckload results and metrics.

In the first four weeks of July, freight demand trends in our One-Way Truckload unit have remained strong. So far, we are about 80% through our annual contract bid season negotiations in One-Way Truckload. Contract rate increases year-to-date are tracking in the low double-digit percentage range. More recently, contract rate increases have further strengthened to the mid to high-double digit percentage range. Dedicated contract rates are also tracking favorably.

We are reaffirming our effective tax rate assumption of 24.5 to 25.5%, and average age of our truck fleet of two years, consistent with what we guided to in the beginning of the year.

Werner remains well positioned with a superior team and an active talent pipeline that will continue to yield strong and sustainable results. We continue to believe the runway for freight demand looks very good for 2021 and well into 2022.

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

QUESTION AND ANSWER

Operator

Thank you and we will now begin the question-and-answer session. [Operator Instructions] To allow as many callers as possible to ask questions, we ask that callers limit their questions to one question and one follow-up. This call will end at 5:00 pm Central Standard Time following the company's closing remarks.

And our first question today will come from Ken Hoexter with Bank of America. Please go ahead.

Ken Hoexter

Hey Derek and John, thanks for the detailed overview. Just a.... good afternoon. I guess we're looking at demand. I want to follow up on that last comment of continuing. I guess, what signs do you look for, I mean, in terms of that acceleration or continuation? Railcar loads have kind of flattened out, it looks like Amazon had some weak sales data. I'm just trying to gather what we've looked for to see that peak. Looks like your CAPEX is going to really accelerate in the second half, I guess, is that more just timing? Those are my two questions. So just one, on what you look for it in terms of that continued strength? And then the CAPEX, to your confidence on being able to get those trucks in the second half?

Derek Leathers

Yes Ken, thanks for joining us today. Great question. So, a few things. So, on the demand side, I guess we'll start with the conversations we're having with actual customers about their actual expectations relative to the next six months. So, it's both a combination of macro data that everybody can see, and then it's private data based on conversations we're having with our retailers, in particular, where we have a heavy retail base with successful retailers that are sort of having outsized results inside of the overall macro-economy. The economy itself is still doing well, even with the 6.5% GDP growth that was maybe below what some had expected, it's still significant growth. You can couple that with your inventories to sales ratios that are now at a new 30 year low. So, there's certainly some replenishment that has to take place.

And then the last thing, I think that might just get overlooked, is where does supply play into all of this? And on the supply side, you've got a.... out of those that are publicly reported so far; you've got a net fleet decline of 7% versus a Werner net decline of 1%. So, we're holding the line better on our fleet. Not something we're proud of, of ever being negative, but on a relative basis certainly sort of winning the battle. But my point being there isn't capacity flooding in or coming into the market. OEM production schedules have been negatively impacted and continue to be as we look forward, and I think it's a combination of supply and demand that makes us bullish on the back half.

As it relates to CAPEX, yes, some of it is just timing, it's as simple as that. When things are received versus maybe when we originally expected to get them, we have seen some delays, both on truck and trailer. The truck side has done better than the trailer side, clearly. And we know as we think through the back half that based on what we now expect that we will end up somewhere in that range. It's also impacted by our stated remarks in the prepared section around the intent to sell less equipment at the back half; two reasons there. One is to provide a hedge for what may continue to be supply chain disruptions and the receipt of our equipment. But also, it's based on our belief that with the additional schools that are coming online, with the demand profile of our customer base, that if the opportunity is there to grow that fleet a little bit during peak and better support what is going to be a very supply-constrained market, we're going to do so.

Operator

And our next question will come from Scott Group with Wolfe Research. Please go ahead.

Scott Group

Hey, thanks, good afternoon. So maybe can you give us some thoughts on just how to think about the margin progression in the back half of the year? We're at such a great starting level. Can we sort of keep up the normal seasonality or does that get tougher? Any thoughts or perspective there?

Derek Leathers

Yes, I mean, I think the seasonality question, Scott, is tougher than really any period I can recall because what happened...the moment we say that it may not be normal seasonality, people read into that or react to that in ways that are not intended. The seasonality is affected by the starting point, which I appreciate you pointing that out. I mean, we've never really had a second quarter that looked an awful lot like peak to begin with. So, as you go forward, you won't have normal seasonality simply based on starting in such an oversold environment.

But our job and what our expectation is, is to continue to get creative around capacity creation through brokerage, intermodal, the ECM acquisition itself, as well as doing a better job of increasing our team count, and our seated tractor count in the back half. If we can get more throughput through the existing infrastructure, then it gives us the opportunity to further expand margins, we're about 80% through the contract rates; we talked about that earlier. But there's still 20% you have to go and some of that 80% it was only implemented in July. So, it's not in the Q2 numbers, but it's now being implemented, and we'll start to see the results of it.

So, we think there's, top line opportunity in the back half, bottom line opportunity in the back half, both; but the normal sequential incremental gains that you might see in prior years will be tougher to come by, not because people won't be as strong, not because we won't have as robust of a project opportunity, but more because of the strength of the second quarter.

Scott Group

Right, that makes sense. And then just from when we think about our model, the ECM I think helps the rate per mile. Can you just help us think about the implications what that means for utilization in the back half of the year?

John Steele

I can jump in Scott. How're you doing?

Scott Group

Good, hey John.

John Steele

On the ECM acquisition, it's about 16% of our One-Way Truckload fleet and that's where it will be reported going forward. So, because the length of haul is substantially lower than our existing One-Way fleet; their length of haul is in the mid-200s. As a result, the miles per truck will be lower; the deadhead percentage will be higher. The revenue per truck per week is pretty comparable to what we are realizing in our One-Way fleet, and then the rate per mile, it will be a help. So, there's a few percentage points of help that the ECM fleet will give to our percentage increase in One-Way Truckload rate per mile.

Operator

And our next question will come from Jack Atkins with Stephens. Please go ahead.

Jack Atkins

Great. Good evening. Thank you for taking my questions. I guess Derek, if you want to take this or this is more for John, but, I'd be curious if you guys could maybe help us think through the impact that the lower-than-expected tractor count this year, because of the driver recruiting challenges, the impact that that's having on your efficiency within the TTS segment. I'm just thinking forward to next year; hopefully we're in a we're in a position to see some acceleration on the fleet next year, and is that perhaps a tailwind for margins as we go into 2022? Any thoughts on that would be very helpful.

Derek Leathers

It's difficult Jack to predict all the way out into '22 at this point with so many unknowns, but clearly, we have a portion of our costs that are fixed in their nature. We've actually added some fixed costs and absorbed those costs despite putting up an 82.9, net of fuel, in TTS, in the form of new terminals and other investments we're making. We would like to see more throughput through all of that fixed cost infrastructure and truck count is certainly a great way to get there. Utilization is another way.

We know there's things working against us on that front relative to congestion of the general motoring public which is continuing to pick up. But on the flip side of that, the addition of the schools, the expiration of the additional unemployment benefits, the hopeful expiration over time of some of the cautious feelings around being out over the road during COVID as vaccine rates go up, could and should give us an opportunity to, at a minimum, stop the attrition and ideally have some incremental adds as we look in the back half.

The caveat to all of that is the production impact of what's happening at the OEM level. So, at a macro level, we've...I've said starting in Q1 this year that I thought 285,000 builds was about where they would be. At that time, most experts had the number in the 325 or even higher in some cases. I think we won't get to 285 when the dust settles on the year, I really don't. And so, it's difficult to fight for trucks, fight for drivers and fight to overcome some of the COVID hesitancy that still exists out there. And so, it's just too early to say that about '22, but in terms of, where's our mind's at right now in the building? Yes, that's the type of mindset that we have. We want to look to kind of do more for our customers, grow a little bit in the back half if feasible, but with all those stated obstacles I've talked about, and then work to enhance margins through both yield exercises that will be ongoing I believe through '22 that we're going to need to continue to do, as well as some of the cost take-outs that we continue to chip away at every day.

Jack Atkins

Okay, okay. That makes sense and I guess for my follow-up question Derek, I mean, obviously a lot of investments going into the Logistics business. I think a lot of the opportunity there is on the come when we think about the payoff from those investments particularly around your partnership with Mastery and Werner Edge. How are you thinking strategically about the Logistics business as a revenue and profit driver over the next several years? What portion of your revenue do you think that could represent if we were to look out, call it three to five years from now?

Derek Leathers

Yes, so on the macro level, Jack, I would say that we are certainly looking to be more aggressive with our growth in our Logistics group. At the same time, we want to make sure they're properly tooled with the right systems, right infrastructure, and right processes to be able to handle the growth while enhancing margins. We've seen some, in this recent quarter, kind of the impact of our ability to now start really moving the needle on revenue, but I'm actually more interested and more excited about the fact that we're seeing volumes going in the right direction and increased volumes taking place with it. That's with a lot of effort that has to be taken away from the day-to-day to work on the strategic relative to the implementation of a new TMS that's really companywide, but Logistics is kind of the tip of the spear of where we're implementing.

And so, as those things, you get through that knothole, a couple of things happen; the expense rate or the investment rate that we're having to make on the front end with little or no productivity gains until you start getting to rollout phases starts to kind of ease a little.

And then, the second thing is as we get more comfortable with our ability to utilizing those tools as well as our internally developed kind of secret sauce if you will, we think we can grow that further. So, if I look out three to five years, I certainly expect Logistics to be a larger percent of the total. I'm not yet ready to predict exactly how big that would be, but all expectations internally are to more aggressively grow that as we look forward.

Operator

And our next question will come from Ravi Shanker with Morgan Stanley. Please go ahead.

Ravi Shanker

Great. Thanks, good afternoon gentlemen. Derek, can you give us some color on the Dedicated side of the business in terms of what the pipeline looks like, what customer interest is like? I mean clearly, at least a couple of quarters ago, there was a lot of momentum in customers trying to shift their Dedicated to guaranteed capacity. Are you still seeing that, kind of what's the organic kind of truck count going to look like in the next couple of quarters?

Derek Leathers

Yes, sure Ravi. Thank you for the question. So first off, I'm going to start with this. I'm extremely excited about what Dedicated was able to accomplish in the quarter. If you think about the 2.4% revenue per truck per week number, that's muted, to say the least, right? I mean, that's not where we want to see a number like that and yet, with it being the predominance of our fleet with only 2.4% revenue per truck per week gains, we were able to still post a TTS OR of 82.9. I point that out because it once again proves that even in strong markets, Dedicated can perform very well and not act like the anchor that so many people were fearful of.

As I look forward, the pipeline in Dedicated is as strong today as it's been on any of the prior multiple quarters of calls. As a matter of fact, those bids already landed that we're looking to source and looking to find drivers and fill open seats, is actually greater as of this moment than it was on the prior two calls. The obstacle is that although those jobs are better and are more easy to fill than a One-Way Truckload job, they're still very, very difficult to fill, nonetheless. So the battlefield is clearly on the driver, and we must continue to gain traction with how we treat our drivers, how we pay our drivers and then the tools we give them to equip themselves to do their jobs effectively. And we're seeing a momentum, so that's the good news.

I know I've said it before, but I'll say it again; the additional schools coming online, we are very excited about because we've already seen the impact from those schools we opened earlier in the year. So, we think that gives us some lift. We grew 300 trucks plus in Dedicated year-over-year in the quarter. That's something to be excited about. Because in a market that's this tough, it's hard to grow at all, so that shows the ability to land, fill and then operate profitably those new fleets as they start up. So, there's a lot to like there and we're going to continue to lean into it as we go into '22.

Ravi Shanker

Great, and just a follow-up on the ECM acquisition. When you look at the recent history of TL M&A, in most cases, you see an exodus of drivers either voluntary or involuntary from the acquired asset. Clearly, kind of, part of the reason you made this acquisition is to get those 500 drivers on board. Are you pretty confident that you can retain them?

Derek Leathers

Yes, it's a great question and I would tell you something I'm probably most happy with thus far as it relates to the ECM acquisition is that the due diligence in the work and frankly the very cautious nature of Werner, in terms of how.... getting something across the finish line and then deciding that this was the right one, has been proven true thus far.

The driver morale, the driver retention, has been very strong. Same on the customer front. In fact, I would say at the moment we feel like we have some momentum with ECM and conversations we're having are about growth, not retention or not attrition at all. And we think in the back half because of the high desirability of the types of jobs they have; home nightly, stable pay, regional repeatable work, that we actually have an opportunity with this acquisition to grow that One-Way Truckload group, but that a lot of that growth may end up residing within ECM based on the early returns and conversations we've been having with their leadership, and their fleet directly. So far so good, and if anything, a little better than good, so we're pretty excited.

Operator

And our next question will come from Jon Chappell with Evercore. Please go ahead.

Jon Chappell

Thank you. Derek, just a follow-up on the Dedicated. I think maybe John mentioned that some of the trucks from One-Way, were shifted to Dedicated because of the business there. How do you go about making that decision just given the strength in One-Way today? Do you take a long-term view that you want to service a customer and get them on board for a long-term, and give up some of the torque, so to speak, and how do you think about that in the back half of year? I know you sound more optimistic about the seating trucks, but it's still a pretty decent trade-off between long-term and short-term.

Derek Leathers

Yes, I guess a couple of things. Jon, I mean first off in our network, the trade-off isn't what some might expect. I mean, both of those divisions operate very well and we have a model that has been able to produce results in Dedicated that replicate One-Way more closely than evidently many others. And so, we're going to continue to focus on operating that Dedicated fleet as efficiently as we can.

As to how we make the decision? Obviously, it is going to be based with a little bit of a longer-term view. But the bigger deciding factor is the defensive nature of it. The fact that we think those Dedicated returns can stabilize through the cycle at a premier level, if you compare it to other truckload players out there. It's pretty exciting stuff if I can give that driver that level of stability, give the investor community the same level of stability, and do so over a multi-year cycle versus just one year bid-to-bid. And then, the last piece is back to the driver. Frankly, even if I wanted to keep a truck in One-Way, and that driver's preference is clearly to be in Dedicated, I'm not going to risk losing that driver, when I have an opening in Dedicated that fits that driver's needs and provides the return profile that our investors would expect. So, if that's the case, we're going to do what we can to build a bubble around each and every driver in this fleet because that's how important they are right now.

Jon Chappell

Got it. That makes sense and I'm glad you brought up the defensive part of it as well, I know is a big focus of yours and you just brought it up; how we can still have upside even in the up markets, maybe some people will think that way. I know ECM showing up in One-Way, however, just given the length of haul, it sounds like it's a more defensive business as well, so as you think about still being levered at 0.4 times pro forma, and any other acquisitions you'd look to make in the future, do you look to get out of the traditional long haul truckload market and get into other businesses that may not be as defensive per se as Dedicated, but a little stickier, little less cyclical, like what ECM is?

Derek Leathers

In short, the answer would be yes. I mean, we're not going to run from long haul and we have drivers in our fleet and customers in our fleet that are important to us that are profitable, that make sense in that long haul business, but we are always looking across to every one of our businesses for more sustainable, defensible, repeatable work. And so, those are the things that we want to go after. We think the ECM business, if you look at their contracts, their customer relationships, we're talking multi- multi-year and, in many cases, actually multiple decade-type relationships and it has proved to be very sticky because what they do is very difficult.

If you look at our One-Way business, we do a tremendous amount of engineered lanes within our One-Way business, we do a tremendous amount of cross-border Mexico, which is also more complex, more difficult, and more defensible. And then, we have a decent component of Team Expedited that works for very high expectation customers on business that is not for the faint of heart.

The business we have the least interest in is that stuff that's in the farthest end of the commoditized spectrum. And so, yes, there are times when that business is highly fruitful and we know that and understand that, but it comes at a price when the market turns, and so even with this quarter's results that we just talked through, I am probably most proud of the fact that that type of result was put forth with only about a 10% exposure to the spot market and that's in the side of our One-Way network which means our total spot exposure of all miles is well under 5%. And so it's not a.... we didn't get there that way and we're not going to get penalized that

way when the spot market turns because quite frankly, we have very limited exposure in that space.

Operator

And our next question will come from Amit Mehrotra with Deutsche Bank. Please go ahead.

Amit Mehrotra

Thanks operator. Hi Derek, hi John. The 82.9 OR performance in trucking was obviously very impressive. You kind of answered this Derek in the last question but I was hoping you can deconstruct that for us. What is the level that One-Way is performing at and...versus Dedicated? And the Dedicated business we have heard from some other trucking companies has been impacted a bit as the cost inflation has come on faster than the contract re-pricings. Wondering if you guys saw that at all and if there is opportunity for a step up in profitability in Dedicated as some of those contracts are revisited in light of some of the cost inflation?

John Steele

Yes, hi Amit. This is John. As you know, we don't report Dedicated in One-Way margins separately. So, I am going to give you general answers as opposed to a specific one, but margins in both Dedicated and One-Way were strong that enabled us to achieve that 82.9 OR and we didn't see deterioration in margins in Dedicated as a result of the driver pay market. We have good relationships with our customers and when the driver challenge is big in a certain geography for a specific customer, we're able to go out and get rate increases to compensate us for the needed driver pay before it happens or as it happens. So that has not been a problem for us. The One-Way margins obviously improved from last year because of the strength of the freight market. Dedicated has been solid both years.

Derek Leathers

The only thing I would add to that answer is that when you think about our Dedicated I don't want you to have the impression that as our costs go up we simply tell our customers to pay us more and they just do it. It is a combination of that. They certainly need to support us because the business is defensible and our performance warrants it, but we also look aggressively at increased creativity to eliminate empty miles, better backhaul fill percentages of each of those Dedicated fleets, work with those customers to better optimize what freight they need to ship, when, where and what mode and so all these things come into play. And that's how you retain that business at 96% or north of that in many cases as it does come up for renewal. So, it is a collaborative effort but the outcome from a profit profile perspective for us is one that serves us well in very strong markets like this one and we think serves us even better when and if this market turns, although we don't see it turning in the foreseeable future.

Amit Mehrotra

Okay. That's helpful and then just for my follow-up. I fully understand the dynamic of One-Way Truckload counts coming down; I think we are seeing that across the industry, but the magnitude of the decline was pretty significant. I think you have to go back to 2016 to see this type of sequential decline in average tractor counts, and I was wondering, John, you usually have been pretty helpful in trying to understand the forward outlook for that. I know ECM will add 500 trucks in the back half of the year but if we were to just put that to the side for a second, have we seen the worst of the organic decline in truckload counts. Maybe, they continue to go down but at a lower level in the third quarter, what's the right expectation there?

John Steele

Well, if you take out ECM from our guidance as we said at the end of June, we're on the upper end of the range or we're flat at the bottom end of the range we're down about 200 trucks. So, it really depends on, does the driver market get more difficult from here or not? We are taking steps with the addition of the new driving school locations to counter that and to give us better recruiting numbers for drivers entering the fleet, but, there is risk of other factors in the marketplace like the infrastructure bill for example. If that comes to bear and that starts to change the market conditions, that may make it harder to get drivers than easier to get drivers. It is the most difficult market I've seen for drivers in my career, Amit.

Operator

And our next question will come from Bert Subin with Stifel. Please go ahead.

Bert Subin

Hey, good afternoon and thank you for the time. Derek, I appreciate your supply comments, John as well. Have those views changed at all over the last 90 days. Seems like truck deliveries are clearly slipping a little over to the right, but that's probably going to be transitory. Drivers, however, aren't getting any easier to find, as you highlighted. That may be more structural in nature. Do you agree with that? Just curious to know how you are thinking about this and sort of how it's changed maybe since earlier in the year.

Derek Leathers

I would say on the supply side, the only change over the course of the year that's become more pessimistic in terms of what's going to happen with supply as the year has progressed. I think the driver market has become worse as the year has played out. Now, we may see some relief as I mentioned earlier from the expiration of some of the additional unemployment benefits although we think that is going to be more impactful for our customers at the loading dock levels and jobs of that nature. We really hope it will be impactful there because we have seen increased delays at customer locations because of the lack of staffing that exists and so that's a problem.

But on the truck OEMs front, yes, transitory is probably a good word for it, but I don't think people realize how long that transitory period might last. I think we are going to be in a disrupted state through the end of the year and frankly all eyes at this point...all of my opinions at this point would point toward further disruption as we get into the early parts of next year. It is far beyond the chip shortage. It is far more robust of a list of issues than that and I think it is going to be a tough hole to dig out of and so I don't see a lot of good news on the horizon on the capacity front. And again, I think the thing that we are proud of here is on a relative basis, being negative one versus negative seven in the public group and then if you look at ATA's most recent data, they have large carrier fleet shrinkage of north of 6% and small carrier fleet shrinkage now approaching 4% and you almost never see through prior cycles both large and small shrink at the same time. And right now we are seeing that and that's very unique and there is no real end in sight that I can see.

Bert Subin

Yes, I appreciate that. Maybe, sort of in a similar vein, you mentioned infrastructure that looks like it could be becoming a little more tangible. How do you from an operator perspective, how do you plan for that? It seems like the effect would be more supply side for you just on the job competition side, probably less so on the demand side, just based on your exposure, but curious to know maybe how you guys are thinking about that if that becomes a real vision. Thank you.

Derek Leathers

Yes, I think in terms of weighting, you're right, Bert, that it's more of a supply side issue than a demand side, but there is demand effect even for us because trucks have wheels and they move to where the market is. And so it doesn't mean our trucks do, but it means other trucks that have the flexibility or maybe are more transitory in the type of work life they live, will flow to those infrastructure projects which further constrains capacity. Or said differently, further increases net demand to us. So, we think there is a demand impact but certainly on the supply side, both on net drivers available, drivers leaving the industry to pursue construction jobs and then just drivers being tied up actually hauling freight, but tied up now with new freight that was not...that we were not previously competing with from an overall demand perspective.

So, I do think infrastructure is gaining some momentum. I suspect something will take place sometime this year. But as we all know, that's a multiyear rollout. The last piece of all of that we spend time thinking about, both in driver training but also just in projections and thinking about our business is, it will increase congestion, which is already increasing from cars returning to the road. When you start doing massive infrastructure projects, we all know what that looks like and the one thing it doesn't look like is efficient. And so there will be some slowdowns in network velocity that we have got a plan for and price for as think about 2022.

Operator

And our next question will come from Jordan Alliger with Goldman Sachs. Please go ahead.

Jordan Alliger

Yes, hi. Just a quick question. I'm curious with the tightness in supply chains and drivers and trucks, but from the Dedicated perspective, are you actually seeing when customers come to you or potential customers, a desire for larger contracts or more fleet outsourced?

Derek Leathers

Yes, Jordan, I think both the frequency by which we are seeing Dedicated bid opportunities, the number I should say of Dedicated opportunities is increasing because of the capacity constrained market we are in, as well as, in some cases, the size of those opportunities. When things are thin in the pipeline, you might be looking at 5 and 10 truck opportunities. Right now, we look at everything and if it fits right, and it fits a need, it forms an important piece in the puzzle that we are trying to build every day, then it may work its way through the pipeline and into implementation.

But the propensity for these larger Dedicated fleets are certainly greater right now and our biggest filter, if you will, that we run things through is relative to the profile. We want stuff that is defensible, difficult to do, that we think is true Dedicated. It is not a designated type fleet or a One-Way replacement fleet, but it has work characteristics that can only really be accomplished long-term through Dedicated service levels. That's the stuff we want to pursue and really try to avoid just capacity fleets when we can. Because those are...those opportunities blow up on you when the cycle turns and suddenly that defensive position doesn't look so defensive after all. So, we have a very critical eye as we look through those opportunities and try to sift through those that we can seat, those that we can serve and those that we can sustain through the cycle.

Jordan Alliger

Okay, great. Thank you.

Derek Leathers

Thank you.

Operator

And our next question will come from Chris Wetherbee with Citi. Please go ahead.

Chris Wetherbee

Yes, thanks. Good afternoon, Derek and John. Maybe I could just ask quickly on the Dedicated mix issue obviously impacted that revenue per tractor. Can you just give us a little bit more detail on what was driving that? And I think you said maybe it was at the lower end of the range is the right way to think about the full year outlook there?

Derek Leathers

Yes. So, we just wanted to make it clear that what's driving it is fleet mix more than any other factor. And so as we bring on new Dedicated fleets or we grow with the existing Dedicated fleets, depending on where that incremental truck count ends up, it can have a negative effect on revenue per truck per week that may not be negative at all to our overall profitability, because it could be a low mileage fleet that simply doesn't produce the same amounts of revenue, but nor does it have nearly the same cost structure.

And so, it just so happened that in the second quarter, both incremental growth of existing fleets as well as a couple fleets that were seated, landed and implemented, just had impacts that were greater than originally projected on that revenue per truck per week metric. It may not be the perfect metric going forward, we are actually having discussions about that, we think it's still the best metric to use for now to try to give you guys some sort of visibility to how the business is running. But there are anomalies from quarter-to-quarter based on fleet mix that can play into it and certainly the 2nd quarter was one of those quarters.

Chris Wetherbee

Got it. That's super helpful. And then, just a follow-up on the driver pay side of it, you mentioned in the neighborhood of 10% wage increase; if you think of the back half of the year, do you need to see more of those continue to sort of hold the line on the organic fleet count?

Derek Leathers

Yes. So, we are about 11% I think year-over-year TTS driver wages were up; that's accelerated from the first quarter to the second quarter. As we look at the back half of the year, we still have some targeted strategic driver pay raises that are going into effect, both in Dedicated and in One-Way. We are somewhat insulated in that in the Dedicated side; those are funded increases that are worked out collaboratively with the customer and that's going to be our approach as we continue to battle through the back half.

On the One-Way side, we'll be very cognizant of where we are at from a rate per mile perspective and what's going on with our overall yield efforts as well as what does our peak agreements end up landing as...as we think about rolling out target of pay increases, some could be very, very fleet specific, some could be seasonal specific, peak kind of run bonuses and things of that nature. So, we will be very thoughtful in the back half, but certainly there will be some more pressure on the wage line, that we currently believe based on all information we have as well as bids that we know landed in July, will be offset through rate increase and overall yield initiatives.

Operator

And our next question will come from Jeff Kauffman with Vertical Research Partners. Please go ahead.

Jeff Kauffman

Thank you very much and thank you for squeezing me in. Just a broader picture question and follow-up; your insurance and claims expense look fantastic, and I know it was...fell a little bit anomalous a year ago. And then, purchased transportation surprised me. If I back out the PT related to Logistics, it looked like for the trucking business purchase transportation was down about 5% and that's kind of stood out to me relative to other truckers. How did you manage both of those so well in the quarter?

Derek Leathers

So, on the insurance line, the simplest of answers would be we had a very strong first half of the year. We have been working aggressively on much revamped training programs, we have been using and learning and evolving in our use of simulation training, our onboarding procedures, the way we think about our driver leaders interacting with our placement drivers as they come into the fleet, and it's paying dividends. We've seen a significant reduction in major accidents.

Technology also plays a part in that, all of this tech that I know we're redundant on in our prepared remarks quarter-after-quarter, I realize, but it's because we are trying to message things that we think are very important and that one is one that's very important. And so, those are some of the dividends that gets paid.

Now, I want to be clear as we go forward, insurance renewals still look ugly. The market is still a very, very tough market to deal with. We're going through that process as we speak right now, there will be headwinds as it relates to the cost of insurance as we go forward, that obviously we have to work to make sure are offset through actual performance of the portion of that risk, that we hold in-house. So, that's going to be an ongoing evolution.

As far as the purchase trans. thing, that's an owner operator issue; that's all that is. We know that the market for drivers is tough, it's also tough for owner operators. We probably have a more cautious view than some of our competitors on that owner operator model overall. We want to stand by those that we have, we want to provide opportunities for company drivers to be able to make that conversion and become a fleet owner, if they so desire. But we are not actively out there trying to increase our exposure in that owner operator environment given the current regulatory environment that we live in and the current administration. We believe that's going to be a tougher part of the capacity framework as we go forward over the next several years. And so, it's not one we are looking to grow and therefore that PT line will probably decrease further as we go forward.

John Steele

Yes. So, Jeff our owner operator count went from 485 a year ago to 340. So, Derek's right. The reason for the decline in the TTS side of rent and purchased transportation is the reduction in owner operator costs due to fewer owner operators.

Jeff Kauffman

Okay. So, it's going up pretty much in line with the industry outside of the owner operator shift. And just a follow-up, it was really interesting this quarter; a lot of other truckers out there were recording pretty healthy margin improvements in their OTR businesses, but most folks running a Dedicated operation had a decline in their reported ORs. I guess I was just reading into your

commentary about how OTR just had a terrific quarter and Dedicated kind of really hung in there. Did you buck that trend I mean, if we look at the Dedicated business on an OR basis, did it not go down? Was it up on a year-on-year basis? I've just been surprised how most folks running Dedicated fleets have struggled with drivers and PT costs this quarter?

Derek Leathers

Yes, again we don't disclose the breakout and I know you are not specifically asking for that. But I will say that in general terms, yes, we bucked that trend, I mean, our Dedicated group performed well this quarter. It was not a drag this quarter and I think it's a combination of the top-quality execution, the top-quality customers that we work with and the very difficult to do business that we are in, that's not easily replaceable. So, it gives you the opportunity to have a lot more rational discussions with your customers and we need...we have to be good about asking for what we need to continue to provide that service and I think we did that this quarter. So, I don't know if that fully answers your question, but I read the same comments and have heard some of the same calls and our results in the quarter certainly seem to differ from many of our competitors in that particular aspect.

Operator

This will conclude the question-and-answer session; I would like to turn the conference over to Mr. Derek Leathers for any closing remarks.

CONCLUSION

Derek Leathers

Yes, thank you. So, I just want to thank everybody for being on the call again this quarter. We appreciate it and we appreciate you tuning in. I want to thank Werner associates for all they did to make the quarter possible. We are very proud of what we view is a very strong quarter in an extremely challenging labor market. As I have said several times, we are very proud of our ability to hold the line on our fleet in that market. It proves the kind of differentiation we have been speaking of. Dedicated performed well and it will continue to perform well through the cycle and so that's something that we look forward to being able to put on a display when and if the cycle turn takes place, although we think that is well into '22 if not further out than that, based on current supply constraints and the current demand indicators that we follow.

We are happy with the ECM acquisition, we are probably more happy with how that integration has been going at this point. It's still in the early innings, we have a lot to prove, but we will work hard to make sure we do that.

I also want to mention this week; we had our 2,000th million-mile driver.....accident-free driver. So, the 2,000th person at Werner Enterprises to achieve 1 million miles accident-free and we are looking forward to some celebrations around that fact as the week progresses.

Lastly, we are committed to generating free cash flow through the cycle. We have been talking about it for some time. We remain committed to do that. I think more importantly, we are committed to utilizing that free cash flow to return value to our shareholders but doing so in the same capital allocation discipline that we have been demonstrating up till now. Investing back in our fleet, growing our business organically, looking for the appropriate time and place for M&A when we think something special exists, that can add...that can be additive and accretive. And we will continue to look to do that going forward. And our commitment to ESG has never been stronger. We are going to continue this journey and that's what it is, it's a journey not a short trip, but we are going to work hard at it, and I think you are going to continue to see results

that can make the investment community proud of the work going on here at Werner Enterprises, so thanks again. Thanks for joining us.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time.