

Werner Enterprises

Q1 2021 Earnings Conference Call

Wednesday, April 28, 2021, 5:00 PM Eastern

**CORPORATE PARTICIPANTS**

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

**John Steele** - *Chief Financial Officer*

## **PRESENTATION**

### **Operator**

Good afternoon and welcome to the Werner Enterprises' First Quarter 2021 Earnings Conference call. [Operator instructions].

Earlier this afternoon, the company issued an earnings release for its First Quarter 2021 results and posted a slide presentation. These materials are available in the Investors section of the company's website at werner.com. Today's webcast is being recorded and will be available for replay beginning later this evening. 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 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, and in the appendix of the slide presentation.

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

### **Derek Leathers**

Thank you and good afternoon. With me on the call today is our CFO, John Steele. I am pleased to report that Werner produced record earnings in the first quarter, achieved by outstanding operational execution, while we maintain a laser focus on the health and safety of our associates. I sincerely appreciate the significant contributions of our entire Werner team to meet and exceed the needs of our customers.

Today, I'll start by sharing our perspective on the current market dynamics, followed by an overview of our first quarter financial results. Then I'll discuss the latest developments from our "5 T's plus S" strategy and wrap up with an update on our 2021 guidance metrics and assumptions. We continue to expect strong truckload freight demand through this year and into 2022. Retail inventories need replenishing, as their strong sales, combined with multiple supply-chain challenges, produced a 30-year low retail inventory-to-sales ratio in January. \$5.7 trillion in cumulative COVID stimulus relief payments over the last year has helped triple the amount of U.S. household personal savings to nearly \$4 trillion.

At the same time, as the freight demand pump has been primed, the supply of truckload capacity is constrained due to a tight driver market. Werner is well-positioned to thrive in this business environment as a result of our retail-oriented freight base, driver preferred Dedicated fleets, industry-leading cross-border Mexico business and engineered lanes in our One-Way segment. These offerings are further supported by comprehensive capacity solutions in our Werner Logistics segment.

Slide four provides an update of our key market size and fleet size metrics, as well as our revenues by segment, industry vertical and customer. Over three-quarters of our revenues are generated by Truckload Transportation Services, with the remainder primarily coming from Werner Logistics. By design, Werner has 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. We have longstanding and growing relationships with successful companies.

Let's move to Slide five for a summary of our first quarter financial performance.

For the quarter, revenues increased 4% to \$616 million; adjusted EPS grew 72% to \$0.68 per share; adjusted operating income increased 68% to \$62.7 million, while our TTS adjusted operating margin, net of fuel, grew 570 basis points to 14.2%.

We generated margin expansion from higher revenues per total mile, strong safety performance, effective cost management and improved gains on sales of trucks and trailers. As we communicated last quarter, we implemented driver pay increases in January that increased driver pay per company mile by nearly 7%.

Driver pay in TTS was flat year-over-year, due to a 6% decrease in company truck miles, resulting from a few factors, including the proactive steps we took to avoid safety risks during times of severe winter weather, fewer team drivers, and a higher percentage of our total truck fleet in Dedicated with an increased mix of shorter-haul, lower-mileage trucks. Despite the more difficult driver market, our retention efforts are paying off and we are holding the line on turnover.

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.

Dedicated freight demand remained strong in first quarter, as our largest Dedicated customers in discount retail, home improvement retail and beverage continued to generate robust sales. One-Way Truckload freight demand was also seasonally strong. The recovering economy, combined with several factors limiting capacity, resulted in a very good first quarter freight market.

We made further strides in our Logistics segment in first quarter, stepping up our growth in both revenues and operating income. Improved pricing and operational efficiency led to better Logistics results.

The abnormally severe winter weather events in February and March were disruptive to operations. As each event developed, we made safety the highest priority by working with our drivers to park their trucks until it was safe to resume operations. These actions lowered our miles per truck and we experienced increased weather-related maintenance, driver pay, and other costs. However, we were pleased that our safety-first focus resulted in a 10% decline in our chargeable DOT reportable accident rate per million miles in first quarter. The unusually cold mid-February weather and resulting power outages also temporarily closed certain driving schools and terminal locations. We estimate that severe winter weather negatively impacted our first quarter earnings by \$0.07 per share.

We ended the quarter with 7,735 total trucks in TTS, a decrease of 100 year-over-year and a decrease of 95 sequentially. At quarter end, 64% of our TTS truck fleet was in Dedicated and 36% in One-Way Truckload.

Werner fleet sales capitalized on an improved market for our premium used trucks and trailers by achieving substantially higher average gains for truck and trailer, and higher unit sales, which resulted in equipment gains of \$10.5 million in the first quarter, an increase of \$8 million.

At this point, I'll turn the call over to John to discuss our first quarter financial results in more detail. John...

**John Steele**

Thank you, Derek, and good afternoon.

Beginning on Slide seven, total first quarter revenues increased \$23 million to \$616 million or plus 4%. Our TTS revenues per truck per week increased 1.3% due to a high-single-digit percentage improvement in revenues per total mile offset by a high-single-digit percentage decline in miles per truck, which was caused by the adverse winter weather, 17% fewer driver teams, and an increased mix of Dedicated.

COVID and social distancing protocols reduced the number of our driver teams. We expect improvement in our team count going forward as the number of vaccinated Americans increases, and Logistics continue to strengthen, growing revenues by 23%. Adjusted operating income grew 68%, due to our strong performance in TTS and improving Logistics results. Adjusted earnings per share were \$0.68, or a 72% increase year-over-year.

Beginning on Slide eight, let's review results for our Truckload Transportation Services segment. In first quarter, TTS revenues were flat due to higher revenues per mile, lower miles per truck, and 1% fewer trucks. Adjusted operating income was \$58.9 million, or 67% increase due to a 570 basis point expansion of our adjusted operating margin net of fuel. Our adjusted operating ratio net of fuel continues to show strong improvement with an 85.8% OR.

Turning to TTS fleet metrics on Slide nine. For Dedicated, we grew revenues net of fuel by 10% to \$254 million. Dedicated average trucks increased 7.5% and revenues per truck per week increased 2.1%. Year-over-year, strong rate growth was partially offset by lower miles per truck, due to winter weather challenges. Our Dedicated customer bid pipeline remains strong.

One-Way Truckload revenues net of fuel decreased 12% to \$157 million. Average trucks decreased 12.7% due to trucks that moved into Dedicated and the challenging driver market. Revenues per truck per week increased 1.0%, due to strengthening revenues per total mile, which grew 9.5% and a miles per truck decrease of 7.7%, due to winter weather and fewer teams.

Moving to Werner Logistics on Slide 10. In first quarter, Logistics revenues grew 23% to \$138 million. Truckload Logistics revenues increased 20%, due to a 22% increase in revenues per load offset by a 1% decline in volume. Loads handled by our power-only solutions increased nearly 50% in the quarter. Intermodal revenues grew 24%, due to a 6% increase in revenues per load and a 23% increase in volume.

Our Logistics gross margin percentage decreased 190 basis points year-over-year, due to the 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 55% to 49% of total shipments.

The previously announced sale of our global logistics freight forwarding business, WGL, closed at the end of February. We remain focused on expanding and enhancing our North American logistics capabilities in truck brokerage, freight management, intermodal, and final mile.

WGL had annual revenues of \$53 million in 2020, and the sale resulted in a gain of \$0.01 per share in first quarter 2021. 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. Expanding operating margins and less variable net CapEx enabled us to improve our free cash flow during the last four years. We expect to generate meaningful free cash flow going forward.

For 2021, we expect net CapEx to be comparable to last two years in a range of \$275 million to \$300 million. This guidance range assumes we maintain our new truck and trailer fleet, modestly grow our truck fleet primarily in Dedicated, 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 security.

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. In February, we opened a state-of-the-art terminal in Lake City, Florida, replacing a smaller leased facility in the Florida market. In June, we will open another newly built terminal in Lehigh Valley, Pennsylvania, also replacing a smaller leased facility.

We are making meaningful and sustainable progress enhancing Werner Edge, our IT initiative and platform.

During the quarter, we repurchased 130,000 shares and raised our quarterly dividend rate by 11%. And we will consider strategic acquisitions that are both additive and accretive. The increase in our quarterly dividend, share repurchases, and ongoing cost containment initiatives reflect our strong earnings performance and confidence in our business plans moving forward. 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 0.5 to 1 turn. During COVID, we intentionally maintained a lower debt level and are currently at 0.2 times.

I'll now turn the final portion of our prepared remarks back to Derek. Derek...

### **Derek Leathers**

Thank you, John. Moving to Slide 14, here's our 5 T's plus S strategy. Over the past five years, we implemented structural and sustainable upgrades to our TTS segment with a modern, safer, and more efficient fleet, raising our hiring and retention standards for high quality, safe professional drivers and further strengthening our service product to our customers. As an ongoing testament to our intense focus on service, last week, we were named "2021 Carrier of the Year" by Walmart. We are extremely proud of the entire Werner team for earning this prestigious award.

Our first two T's, trucks and trailers, continue to have young average fleet ages of two and four years, respectively. All Werner trucks are 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. We continue to enjoy a strategic advantage with our driver training school network at 14 locations that will increase to 18 by third quarter.

Our strengthened terminal network is an integral part of our ability to attract and retain the best drivers and minimize fleet downtime for maintenance issues.

Our Cloud First, Cloud Now strategy is well underway and progressing at pace. During first quarter, we successfully converted our HRMS and non-driver payroll systems to the cloud solution Workday. We completed the rollout of our new telematics solution Edge Connect to the entire truck fleet. We migrated over 60% of our EDI transactional volume to a new cloud-based provider and are completing the EDI transition in second quarter. Last quarter, we communicated our four-year plan to replace our existing TMS with an integrated cloud-based leader, Mastery Logistics Systems, to improve functionality and visibility. As we make further progress, we will provide project status updates. And last year, we added sustainability as a key element of our strategy.

Moving to Slide 15, last October, we formally launched our environmental, social, and governance effort. Our ESG strategy will continue to evolve through these key themes. First, we established a formalized ESG framework and strategy. In addition, we are identifying relevant reportable metrics and goals to monitor, measure, and report on our ESG performance and progress.

For environmental, we're building on our strong foundation as a truckload industry leader by reducing our environmental impact and carbon footprint through a young, innovative, and modern truck and trailer fleet. We also announced our goal to reduce our carbon emissions by 55% by 2035. We are currently testing electric trucks and plan to expand testing with other providers in the future. While it's unknown whether one clean truck technology will emerge as the leader, we are actively participating in various technology developments and programs.

For social, we are fostering and empowering an inclusive culture that upholds our core values and provides equal opportunities for all. We added "inclusion" to our core values and adopted a Diversity, Equity and Inclusion vision statement. So far, in 2021, we established a new associate resource group for Werner veterans, and formed a DEI council to oversee the development of additional ARGs going forward. We are in the process of launching five more associate resource groups this year. During first quarter, we named Kathy Peissig as our Associate Vice President of Diversity, Inclusion, and Learning. We also named Shawntell Kroese to the position of Associate Vice President of Sustainability and Sales Operations.

Finally, for Governance, we will continue to uphold transparency, ethics, and integrity in our governance practices, with an emphasis on creating a more diverse Board of Directors with complementary skills that align with our long-term strategy. In our recently filed proxy, we nominated three new Directors with relevant experience that will further strengthen our capabilities set and enhance our diversity upon their election.

We're excited about the energy our efforts to embrace sustainability are creating at Werner. And while we have accomplished a lot, there is so much more opportunity in front of us. To that end, in third quarter, we will publish our inaugural Corporate Social Responsibility Report.

Moving to Slide 16, we have a comparison of the 2021 guidance metrics we provided last quarter against our actual results. We are also providing our updated 2021 guidance metrics and assumptions.

During the first quarter, our truck fleet declined 1% with most of the decline in One-Way Truckload, due to the challenging driver market and the impact of weather on our driver training schools. For the full year 2021, we continue to expect to modestly grow our truck fleet in the range of 1% to 3%. And consistent with our strategy, we expect this growth will be in Dedicated.

Pricing in the used truck and trailer sales market accelerated in first quarter amid very strong demand, which resulted in sequentially improved equipment gains of \$10.5 million. For second quarter, we expect equipment gains in the range of \$7 million to \$10 million. We are pivoting to quarterly guidance, given trends in the used and new equipment markets that are difficult to predict.

Net capital expenditures for first quarter were \$38 million. We continue to expect 2021 net CapEx in the range of \$275 million to \$300 million, which will maintain our truck and trailer fleet ages and allow for modest fleet growth.

Dedicated revenue per truck per week increased 2.1% in first quarter and was impacted by lower miles per truck due to winter weather. For the full year, we continue to expect growth of 3% to 5% for this metric.

One-Way Truckload revenues per total mile for first quarter increased 9.5%, which was in the upper-end of our guidance range of 7% to 10% due to a strengthening pricing market. For second quarter, we expect this metric to increase in a range of 13% to 16%. We're also pivoting to quarterly guidance, due to the strong pricing changes we have seen so far this quarter.

Our effective tax rate in first quarter was 24.9%, in line with our guidance range, and our full-year guidance is unchanged.

The average age of our truck and trailer fleet held constant and our guidance remains the same for the rest of the year.

In the first four weeks of April, freight demand trends in our One-Way Truckload unit have continued to be strong. So far, we are about halfway through our annual contract bid season negotiations in One-Way Truckload and Logistics. Contract rate increase percentages have trended higher each month this quarter and are tracking in the high-single-digits to low-double-digits percentage range. Dedicated contract rate increases are also tracking favorably, consistent with our revenue per truck per week guidance.

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 into 2022. Inventory restocking will likely continue to occur for the next few quarters. And we also expect the economy to continue to strengthen as the national vaccine program expands and government stimulus dollars are spent.

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

## QUESTION AND ANSWER SESSION

### Operator

We will now begin the question-and-answer session. [Operator Instructions] To allow for as many callers as possible to ask questions, we ask the 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. At this time, we will pause momentarily to assemble our roster.

Our first question will come from Chris Wetherbee with Citigroup. Please go ahead.

### Chris Wetherbee

Hi, thanks, and good afternoon, guys. So...

### John Steele

Hi, Chris.

### Chris Wetherbee

Hi, maybe we can start just on rate. And I understand that the market is volatile. So, I guess, it makes sense to move towards quarterly guidance. And obviously, 13% to 16% is quite robust, I guess. Could you maybe though, frame up sort of how you might think that the...sort of this cadence could play out as the year goes on? Do you feel like 2Q is actually the top of the rate growth dynamic, and it'll stay strong, but maybe a little bit of the lower growth rate as we move forward? Or are there other nuances that we might expect, particularly as we start to head towards the peak season, because it doesn't look like this, sort of capacity is going to let up anytime soon?

### Derek Leathers

Sure, Chris, I'll take that and thanks for the question. So, the thinking we had was, right now we've got obviously good visibility. We know how tight this market is. We know where we're at in the current bid season and the progress we're making. As you look out in the third and fourth, I see nothing that changes my view on capacity, nothing that changes my confidence and how tight this market would be. You do have, however, tougher comps. And rather than blending some kind of three quarters worth of data, and losing sight of what's happening in the market today and being clear on what success we're having, it made more sense in this unique point that we're in today to be specific about what's happening on the contract side, where we see strength in the spot rate continuing through the end of the year.

And as I'm looking forward, I guess my main message would be, I have a strong degree of confidence that rates are going to continue to stay elevated, that spot market will far outpace contract rates for the foreseeable future through the end of the year, and frankly, into 2022. But we felt it was better to give a specific guidance about Q2 specifically, when it came to rates.

### Chris Wetherbee

Okay, okay, that's helpful. I appreciate that color. And then, maybe if we could talk a little bit about the fleet, I think I asked this question most quarters, but just so as you think about the mix of Dedicated versus the One-Way Truckload, and obviously you're expecting to grow as the year goes on, but you're down a little bit from I think where you finished the fourth quarter. So, can you just give us a sense of...now, obviously, it seems like the growth is going to come on the Dedicated side, but maybe when you think about the One-Way Truckload, do you think you



actually can grow that? Or can you stabilize that fleet size and maybe that stays flat, while you add to the Dedicated?

### **Derek Leathers**

Yes, I think the way to think about it would be...I'll start on the One-Way side, right, we want to stabilize that. And we've seen signs of stabilization. It's a very tight driver market out there. I think everybody's well aware of that. We are making moves as appropriate to build jobs that drivers want in that One-Way group, and really package and engineer freight through the first half of the bid season that we feel can both retain drivers at a higher level as well as attract drivers into the mix. It would be my expectation that from now moving into the year that we would see some growth on the One-Way side.

But the predominance of the growth is still expected to be in Dedicated. Frankly, that's driven as much as anything by just how strong that pipeline is. And what that return profile is of Dedicated through the cycle. So, we'll still see growth on Dedicated. That'll be the majority that will get us across the threshold of 1% to 3% fleet growth, but some of it, sequentially, will come in One-Way as the expectation as we go forward.

### **Operator**

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

### **Jack Atkins**

Great. Good evening and thanks for taking my questions. So, I guess, we could maybe start and I'd love to John or Derek, whoever wants to take this, get your thought on customer inventories. I know you guys do a lot of work around this particular subject. And I think it's a critical topic as we think through the end of the year and into next year. How much further do you think your customers have to go? And how long do you think it's going to take them to get back to where they want to be from an inventory perspective? It seems like there is...we're still at very low levels on an absolute basis.

### **John Steele**

Yes, I know I sound like a broken record on this, Jack. But for the last few quarters, and what we see going forward, we think inventory levels will be challenged. If you look at our overall economy, inventories are low in lots of areas, retail, lumber, steel, housing, chips, new trucks. This V-shaped recovery that we've got going on is really challenging suppliers to be able to restock, especially at the very strong sales levels that the large retail customers who are part of our customer base are achieving. So, we expect it to be a few more quarters. And it's really difficult to predict when it's going to end. We think that restocking is going to take a while with all the different things that happened this quarter that made restocking even more challenging, with the weather, the port delays, the Suez Canal issue. I mean, there's been just a lot of issues thrown at retailers, making it challenging to rebuild their inventory levels. 9 of 10, in their most recent quarter had a higher same-store sales growth than they did inventory per store growth. So, the challenge continues for them.

### **Derek Leathers**

Jack, all I would add...all I would add to that, Jack, is that, best case scenario, they begin to make any traction at all, it probably lands them right in the middle of peak, if they're able to make traction between now and peak. And with the amount of stimulus money coming in and \$4 trillion in savings sitting out in dry powder, we just don't see a way you claw back anytime this year and it's probably pushed into sometime in 2022.

**Jack Atkins**

Okay. All right. That makes a lot of sense. And I appreciate that insight. I guess my second question, I would love to get your thoughts on your cross-border business. You guys have a really unique asset in terms of your cross-border Mexico/U.S. franchise. That's becoming more and more a topic for folks, just given all the news from a rail-perspective and the interest in KSU.

How are you guys thinking about investing in your cross-border business? Can you just remind folks, what that represents today in terms of either fleet or revenue? And where do you see that going over the next couple of years?

**Derek Leathers**

Yes, so I'll start with this. In the quarter, our cross-border business actually was under some pressure. The reality is we do a lot of southbound business with truck OEMs and other auto or auto-related-type businesses. Those have all been under duress, as it relates to some of the shortages that people are well aware of. And so, you feed your northbound business, which is really where the money is made through southbound activity. And so, we're real proud of the first quarter results and the record earnings and some of the things we've talked about, given that that particular franchise was under what I believe to be kind of temporary duress. And so, there's upside from here. We're excited about what that looks like.

As it relates to the merger and other thing, I think it really speaks to the reality that Mexico/U.S. trade isn't going away. There is a certain component of that that will naturally move rail. Intermodal will certainly play a role in that and we do some of that business today ourselves. But truck is going to still play its position. And so, we're going to continue to invest in that business. We understand it well. Even with the volume pressures that we had in the quarter, the profitability and earnings of that segment continues to be at or above our network averages. So, we like the business. We're going to continue to stay with it. And I think it's one place that has some unlocked potential right now, as we look forward over the next several quarters if we can get some of these shortages behind us.

**Operator**

Our next question will come from Jon Chappell with Evercore ISI. Please go ahead.

**Jon Chappell**

Thank you. Good afternoon. Derek, just to start with logistics, the comment I have from the call on February, so less of a headline in first half 2021, more of a recovery story in second half. They had a pretty big first quarter, at least as it relates to revenue and operating margin. So, did Logistics business get a lot better a lot sooner than you thought? Or was this the natural progression that you envisioned? And there's even a bigger step up that you envision for the second half of the year?

**Derek Leathers**

Yes, great question. A couple of things, one, I think it's important to recognize the work they put in to turn that thing around and get it go in the right direction. We've seen, I would say, a lot of smaller levers pulled. There's no silver bullet in it. But we've seen some of the productivity gains we were hoping to get and some more focus on the cost line. If you look at productivity in that division, it certainly played a role as it relates to load per seat, et cetera. We moved to a more transactional model, which we expected to do. The market certainly is one that allowed us to do that more aggressively. We worked with our contractual customers, would have loved to have retained all of them, if we could have, but in some cases, that wasn't the case.

And so, underlying those strong first quarter results is a reality that we're lapping as we get through the second quarter some larger scale businesses that we had to walk away from and then replace that with much smaller volumes across many multitude of shippers, but more in a transactional space, and it's paying dividends. So, yes, I'm happy that we're seeing progress. We've got a lot more to go. I'm not at all pleased with where we stand today. But I don't know that I'll ever be completely satisfied. But the trajectory is certainly one that's good. And I think there is upside from here, as we look out through the remainder of the year.

### **Jon Chappell**

That's great. And then, for my follow-up on the Dedicated side, I mean, clearly, the quality of life is a little bit better than the One-Way. But you mentioned that the driver issue is across the entire business. I know you're opening more schools in the second half of the year. Are you turning away any new potential business from the Dedicated side just because you don't have the drivers to service that right now? Or maybe even another way to ask it is, are you not pursuing as much new business as you think that you can attain with your network because of the labor shortage?

### **Derek Leathers**

Yes, so few comments on that. First off, those schools are predominantly going to open in the first half of the year. So, we'll have some relief coming sooner than later. That will be helpful. Dedicated is more attractive. And although the driver shortage affects us across the business, it's clearly more acute on the One-Way side. So, Dedicated gives a shelter through cycles from an economic perspective that also gives shelter through tight driver markets. And we do have benefits that come along with running that business. As far as the pipeline is concerned, I think the way I would think about it is we know that we can be more selective.

And so, we're not at a point where from our lens I would call it turning away business. But we are certainly being very selective with the type of business that we're looking for, the geographic location of that business, the industry or vertical that they may represent, what are their surge patterns versus existing surges in the geographic area. So, that you're fitting these pieces of a puzzle together to make Dedicated be able to operate very well as it just did once again, in a strong market where others may choose to chase spot or chase One-Way, we can put these kinds of numbers up with the predominance of our fleet being in Dedicated by taking a more strategic view.

One of the things throughout this quarter that was a major emphasis for us, is not just the rate, it's how do you engineer more freight in your One-Way market, how do you engineer more Dedicated fleets that fit a purpose and fit a part of the overall Dedicated strategy versus just landing a fleet, because it's there to be taken on. And then, how do you make sure you price it and build driver salaries and lifestyles around it, so that you know, you can fill those seats. And at this point we're able to fill those seats. We're able to get drivers to go into those fleets. And we don't get to that final round, because these things have six month tails on them usually; by the time you're in that month four or five, you've pretty much figured out where you're going to get the drivers, how you're going to get them, and what that pay is going to look like if you're doing it right.

### **Operator**

Our next question will come from Brandon Oglenski with Barclays. Please go ahead.

**Brandon Oglenski**

Hi, good evening, everyone. Thanks for taking my question. So Derek, can you just speak to the outlook on your long-term profitability targets? And maybe what you can do to reduce volatility, because I think the issue what investors have with trucking equities right now is how to mark the peak and trough in the cycle. And whether the stocks are fairly valued or not, because I think through that perspective, there could be a lot of upside there?

**Derek Leathers**

Yes, I mean, so when we reissued our new TTS guidance of 13% to 16% through the cycle, we talked about the...I'm sorry, 10% to 16% through the cycle. We talked about the reality that we think we can squeeze some of that volatility out. We talked about how we'd be at the upper-end or lower-end of the range at times. Right now, we're clearly in a market that we need to be driven by a laser focus to be at the upper-end of the range, and frankly, beyond it. And that's what all of our efforts are going toward right now.

As we do that, and as I talked about this engineered approach in the first quarter, a heavy amount of that work is really actually focusing on, how do we tighten up that bottom end of that range? How do we make sure through analytics to think about the freight we put in at the time when we have choices, to know that that freight provides density and lifestyle, and choices for our drivers, so that our costs and pressures from a driver hiring and pay perspective, perhaps weather that storm better than others, and really try to limit the risk to that downside number. I think, it bears pointing out, however, that that downside number, that 10% number is the same number that the majority of the industry strives to get to in the best of times. And we are basically putting a line in the sand and saying we think that's as bad as it could get, and actively working to make sure it never comes into play.

**Brandon Oglenski**

Yes, I appreciate that. I guess, what's your broader view on industry supply later this year, especially as vaccinations go through the population, is there potentially a lot more folks wanting to get back on the road, then?

**Derek Leathers**

I don't think so. So, if you think about the American truck driver, they didn't wither at all, during the early stages of COVID, there was no vaccine, little understanding, a lot of fear, and they got in the truck, put the key in the ignition, and drove. So, they're not the crowd that is waiting for a vaccine to somehow then have the courage to reenter the workforce. That crowd stayed out there and worked. What did happen, however is COVID limited through social distancing, and throughput at schools and all of a variety of other factors, new entrants into the market. What did happen is we had an aging demographic that we're not replacing on a one-to-one basis now, because of a year of lost sleep of throughput.

And as you look forward, any lift you might get from vaccines also goes into lift from economic activity from retail sales, it lifts up the overall consumer, we're 53% retail, so we benefit from that lift, and it puts further pressure on demand. You've got infrastructure out there ahead of us that is certainly some version of which I believe will pass, which will be a pull from capacity as it relates to drivers pursuing jobs that are like and perhaps lifestyle-wise in certain areas viewed more preferentially. The Drug and Alcohol Clearinghouse is continuing to gain steam with very little return to work taking place within it.

And frankly, just work-life balance is a reality, not just in trucking but across the entire workforce of the United States. And so, one of the reasons that we think about Dedicated, we think about

engineered, we think about a lot of the things we're doing is really taken a multiyear out view on building jobs that are sustainable where, with an eye toward retention at all cost, because ultimately, that's how we provide our customers, the capacity they need. But I don't think though the recovery is coming from a capacity perspective. I talked about that last call; nothing has changed in my view. As a matter of fact, I feel probably more strongly about that today.

The last one I'd mention is the known and very public reality now of what's going on from an OEM production capability perspective. And yes, the order boards are full, and yes, the backlog is long, but if they don't translate into builds, and builds don't get seated, it doesn't mean capacity comes online. And I don't think that you're going to see any capacity relief coming in 2021.

### **Operator**

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

### **Scott Group**

Hi, thanks. Good afternoon guys.

### **Derek Leathers**

Good afternoon, Scott.

### **Scott Group**

Derek, John, how should we think about utilization in the One-Way fleet going forward? Now that we're through winter, do we get back to positive year-over-year utilization?

### **John Steele**

The challenge on One-Way utilization is team count. We talked about how we're down 17% on teams and most of that occurs in One-Way. And so, as we get vaccinated throughout the country and it's easier to put teams back together again, I think we got a better opportunity for that in the second half than probably in second quarter. From a freight standpoint, however, I do think that, that will help. So, I expect to see improvement as we get farther and farther through the year on miles per truck. I wouldn't predict right now that it will be positive, but I do think that it'll be less negative and closer to flat as we get to third quarter.

### **Derek Leathers**

The other thing I would tell you relative to the utilization, Scott, is in the first quarter, if you think about our network, everybody's strengths are geographically slightly different, but we are very dense from, call it, Dallas to the East Coast and then, down through to Florida, and then up the lower East Coast as well. And we just, frankly, got hit pretty hard by the storm, and that storm was more widespread, longer lasting, with more significant road closures and impacts than any that we've seen in a couple of decades.

So I wouldn't read...I wouldn't over-read into the utilization decline in the first quarter. It hurt us in Dedicated, it hurt us in One-Way, but that storm-related impact here at Werner was larger than some and perhaps maybe not as large as others. I don't know all of their networks as well. But all that John said is true.

And on the team count, we took a stance. You've got a chance during things like a pandemic to really let your culture lead. And our culture has always been built around safety first, and our drivers, if they were at all uncomfortable, there was no pushback on our part. We want to retain them for the long haul, not just for a pandemic period. And if they split into solos and wanted to

go and not be comfortable in that environment, we were more than happy to support that. We are seeing a return, as John indicated, to folks going back to teaming, and we're going to encourage that as we go forward.

### **Scott Group**

Okay. Thanks. And then, Derek, as you're about to take over as sole Chairman of the Board, what changes, if any, do you think we should expect in terms of balance sheet and leverage, more aggressive buybacks M&A? Any meaningful changes you think we should anticipate?

### **Derek Leathers**

Yes, I mean, what I would say first is, look, we've been making changes for the last several years, and I think they've been consistent and progressing quarter-over-quarter for now, really the better part of the last, call it, four almost five years. Those changes and those...that aggressiveness will continue, we're going to continue to expect excellence from ourselves at all times. I've already indicated that there is a comfort level relative to leverage that is perhaps higher than where it's been historically.

But at the same time, if you're thinking Werner is going to wake up and be three times EBITDA, probably not in terms of the debt that we'd be comfortable with. We indicated and talked about the things that we think about relative to the reality of ongoing free cash flow generation. And yes, we're going to look at dividends, and we're going to look at buybacks, and we're going to look at M&A. And so, those things are on the table, and they're real, and we're going to take an analytical critical eye to each of those and be opportunistic when the opportunities present themselves. But the biggest takeaway would be staying true to our roots evolving our culture, holding on to something that, for 65 years, has worked pretty darn well. But at the same time, the world around us is changing, and we'll change with it.

### **Operator**

Our next question will come from Ken Hoexter with Bank of America Merrill Lynch. Please go ahead.

### **Ken Hoexter**

Hi, Derek and John. Nice job on the quarter. Good afternoon. Can you talk a little bit about the Dedicated contracts a little bit further? I know, maybe just delve into the percentage you can touch this year, obviously, multiple...multiyear contracts. Derek, you threw in your...that's why you thought the 3% to 5% rate increase is a good starting point. Maybe just talk about the cadence of the renewals. And does that mean you got any chance to...or is there any chance to get any better given the current rate structure and environment?

### **Derek Leathers**

Yes. Our Dedicated unit, first off, is performing very well and it's margin enhancing to the overall business. And I want to be clear, it is not a drag nor did it perform as a drag in the quarter. In a tight market that, again, I know the spot market can become so intriguing to some, but in our business through the cycle, we think we can continue to enhance margins. That 3% to 5% is a revenue per truck per week number. It's impacted to both utilization and rate. As it relates to the contracts themselves, they're generally three to five year type contracts with one-year activity that takes place from a rate perspective. Some are fixed or indexed, I should say. The majority are negotiated. Those negotiations are ongoing. And obviously, in the current driver market we're in today, there's more eligible and available for conversations than there are that aren't.

And so, the majority of those contracts and those customers either have had or will be having conversations shortly, because we have to continue to enhance driver pay. We also have to continue and enhance returns, so we can continue to invest and grow with that customer. So, so far, it's been good. I know, I didn't give you a percentage, but if I was to throw one out there, I mean, 75% of those at some point this year, whether it's driver pay-specific or overall rate increase would be touched or...and the majority of that's already happened as the year progresses. That number likely will be higher than that simply because of the pressures out there with attracting and retaining quality drivers.

### **Ken Hoexter**

And...thanks for that, Derek. And then maybe just a little bit more on your thought on, I guess, two parts, wage increases as we move through the year. You noted a 7% increase you put out there. Are you seeing maybe accelerated pressure from that, I guess, I asked that, because your gains on sale, you noted at \$10.5 million this quarter? I think you said \$7 million to \$10 million, so that means a deceleration. Does that mean we're at the peak in terms of that pressure or I just want maybe some insight on that? Thanks.

### **Derek Leathers**

Well, I'll take it in reverse order. I think it's a great question. The deceleration of gains is volume related. So, I just want to be clear about that. We are really focused on trying to manage through and be in constant communication with our OEM partners. And so, given that what we were able to secure in the first quarter as it relates to equipment and given where the market was at, we sold higher volume in the first quarter. The second quarter will probably be a little more prudent about those sales numbers and a little more cautious, so conservative perhaps is a way to think about it, because we need to make sure we've got incoming trucks and trucks are arriving on time, on schedule. And so, it's almost exclusively driven by volume. It's the only reason that's going down. And that's driven much more by production disruptions or the concern potentially for production disruptions than it is any other factor. So, that's not a slowing issue or any kind of peak indicator in my mind.

As it relates to wages, we do have a benefit; I mean, 64% of our fleet is in Dedicated. Those are much higher paying jobs in general. They also happen to have better lifestyles as it relates to time at home. We're managing those pressures and working with customers where we have and need their support. We're getting their support to offset those. But by and large, that provides a degree of insulation from this market that wouldn't be there if they were all on the One-Way side.

On the One-Way side, we enhanced wages going into the year. We've held the line on turnover. That new entrant into the market is artificially constrained in the short term with lower throughput through schools and lower new CDL issuances throughout 2020. And we will, in all likelihood, apply more wage increases, but they will be very geographically focused even in the One-Way market. Very little...a very small portion of our fleet is over the road, go anywhere type trucks. They're regional; they're designed engineered lanes; they are local in some cases.

And so, we'll hand...and the pay is all reflective of the type of work. So, as needed, we'll make additional adjustments. We do not think that's going to have any opportunity to outpace where rates are going. And in fact, that's part of the confidence of our ability to enhance margins as we go forward. First quarter is always the worst operating quarter of the year for us and many others. And yet this first quarter was the best one we've ever posted. So, we've got room to run, and we're going to try to execute as we go forward to the best of our abilities.

**Operator**

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

**Amit Mehrotra**

Thanks, operator. Hi, Derek, hi, John. Hope you guys are well. I guess, on the utilization question for One-Way, I wanted to ask how you think comp wages and benefit costs are going to trend. Are they going to trend with utilization plus a little bit more given the raises that you implemented at the beginning of the year? It's obviously a very big part of the cost structure I just want to make sure we're thinking about in the context of limited utilization.

**Derek Leathers**

Yes. I'll start and let John jump in. But I would say this, to start, they're not going to be...they're not going to track exactly with utilization gains simply because, in the first quarter, we have the double whammy of the miles not being there, but us standing by our drivers. So, we spent a considerable amount of money paying drivers for not moving in the first quarter. That pay would be the same pay they would have received had they been moving, but we were the ones taking the decision to shut them down or hold them up. We made the decision to go ahead and pay for that downtime. I think it's a right decision, it's no fault of their own that those storms hit. But as we now gain those miles back, those paid....at those payments are already in the number.

Now we will have wage pressure, I talked about that. We think it'll be less than some of the commentary we've heard thus far. We think that really has a lot to do with the starting point on where turnover is and where fleet morale is. We're going to pay our guys fairly, though, I'm telling you that. And so, as we have those needs, we'll address them. But I think that's a misunderstood thing about the quarter would be how much driver pay was actually dispersed for no miles being ran, and the opportunity to now fill that gap with miles. And the same pay that was already taking place anyway.

**Amit Mehrotra**

Got it, okay. That's helpful. And then, I just wanted to also revert back to the question, I guess, you're going to be obviously appointed a Chairman at the end of next month. So, congratulations for that. I think you guys made this acquisition or equity stake in TuSimple, which obviously, I don't think was financially motivated, rather just from a development of new product perspective; but, obviously, Derek, the Werner profitability trajectory has dramatically improved under your leadership and the senior managers' leadership. It doesn't seem like you guys are getting that much...as much credit as you should for the improvement. And I was just wondering, if that given your elevation to Chairman of the company, whether that changes the M&A strategy, I mean, Werner has been incredibly conservative from an M&A perspective. Does it at all incentivize you want...strategically want you to pivot into a little bit more of an M&A that gets you away from this truckload and diversify a little bit away from....so, you don't have to deal with this peak debate that continuously happens?

**Derek Leathers**

Yes, well, I don't know, if you could ever find us a formula to not deal with the peak debate. I'd be happy to be. I'd be all ears, because it doesn't seem to matter that our portfolio is arguably the most defensible portfolio in trucking, and yet it doesn't underperform during very strong robust markets. And so, it wasn't an anchor during good times, it's clearly been demonstrated to be a support structure as markets turn. As it relates to me as Chairman, first off, I appreciate your comments. I think I'd be remiss if I didn't point out that CL, his guidance, his leadership, as part of the last several years have been integral to this. But he and I both agree that it's time for Werner to take that next step to evolve and continue to push boundaries on what is possible



to have the energy and the focus and the technology to do it, to invest in the business consistently like we have been doing, and have really focused on free cash flow, which then provides opportunities for things like M&A, share repurchase and dividends. Those are all on the table.

I want to be clear. We will continue to look at all of those. We've talked about all of those for some time. But, yes, there's probably a shift in our tolerance to be aggressive. There's a shift in our tolerance to look to return value to shareholders in all forms. And that is something that I think over time you'll see play out.

### **Operator**

Our next question will come from Brian Ossenbeck with JP Morgan. Please go ahead.

### **Brian Ossenbeck**

Hi, good afternoon, guys. Thanks for taking the question. Derek, maybe we can just get you to expand a little bit more on M&A. Clearly, you've invested a lot in the business through the 5 T's, you've made some of those equity investments or partnerships that we've been seeing in the news and some of that you've been getting some benefit from things like Mastery. What is kind of the medium to long term? Are you looking for things to develop externally? And then put your chips down in a bigger way when you feel like there's a bigger need, or do you think that you can just get to where you want to go through partnerships alone? So, how do you think, I guess, about the partner versus acquire even in some cases, the build versus buy, when it comes to technology?

### **Derek Leathers**

Well, thank you for the question. So, build versus buyout, I will start there. We believe there's a lot more that we can buy versus build as it relates to technology, focus our efforts on integrating the connective tissue that makes those systems work well together. There will always be proprietary things that we think are secret sauce to our business, that create an opportunity for us to differentiate and we'll build those things. But we're certainly open minded to go out and partner with folks if we think that's the right approach and we have demonstrated that, as you mentioned, with both Mastery and TuSimple. We think we can add value to the development of those products and make those products not only more robust, but actually better fit our needs through that process, and that's something that we're excited about.

As it relates to M&A, we've looked at these deals for a long time. The appetite is probably more there than maybe it has traditionally been. And frankly, the need is probably there more than it has been traditionally. This is a driver market like one I've never seen; I've been doing this now for 30 years. If you're going to try to do something on the asset side, the idea of adding geographic capabilities, adding drivers into the mix that we think fit culturally or otherwise would be attractive to us. On the non-asset side, clearly, there's folks out there that are winning in their space, that are generally maybe early in their development that, we think we can add a catalyst to, and both to our own business, but to the underlying model that they're building and working on. And if the opportunity presents itself and the price is right, that's something we're going to look at more seriously.

So yes, there's a shift, subtle as it may be, as it relates to that. But at the same time, we're not going to be a serial acquirer, and we're not going to be going out to buy things just to buy it. I'm not looking to stake my 30-year reputation on making some move overnight, just for the point of doing it. But I think, you've seen a commitment from myself, and this entire leadership team to

make whatever moves are necessary to continue to enhance value for our shareholders, and that's one of those that's on the table.

### **Brian Ossenbeck**

Alright, great. Thanks for all the context there. Just a real quick follow-up on the Class 8 orders. It sounded like with the gains, I'm assuming, you're getting the trucks that you need to at least here for the first quarter. But it sounded like there's still some uncertainty whether or not you're going to face some delays throughout the year. So, maybe you can just give us an update in terms of what you're hearing from the OEMs, and what you expect to see in the rest of the year, when you look at the fleet that you have on order so far?

### **Derek Leathers**

Yes. Thank you for the question. I'm going to be a little careful here and let the OEMs focus on speaking for themselves, as it relates to their specifics. But in general, this market and where we're at in the market and with our focus on service, I simply don't, regardless of what I'm hearing, I don't want to put our customers or our customers freight at risk through a lack of supply of new equipment. And as a result, we're going to be very careful and conservative as it relates with what we sell in Q2. At the same time, we're clearly projecting a large sales number. So, it's not like we're going to shut down the process. Right now, we feel like we're in great shape. Our OEMs have been great partners. They've stepped up. We've worked with them and the communication has been outstanding. We'll continue to be laser-focused on that communication and on their deliverables. But, yes, I think it would be a shortsighted move on our part or on my part to chase quarterly gains at the expense of long-term customer opportunities. And so, that's really the primary driver of that.

And as it relates to gains, I just want to say this, while I have the opportunity, I know tomorrow people will be quick to point out that somehow gains don't count as or take some stance as to whether our gains are part of co-operations. But I haven't changed my view on this, and I never will. How you buy a truck, the negotiated price that you...and time and effort you put into specing that truck, how you maintain it during its entire life and how you sell it is about as core to running a quality trucking company as anything I can think of. So, I view it as absolutely a core part of our business and critical to our success. We'll be opportunistic about when we sell, when we buy and what we buy. But it's always going to be with an eye towards a longer-term strategy, not just the quarter.

### **Operator**

Our next question will come from Bascome Majors with Susquehanna. Please go ahead.

### **Bascome Majors**

Yes, thanks for taking my questions here. Your largest customer was recently talking pretty publicly about expanding their private fleet on their earnings call and in the press. I know they've done this before, but can you give us a fresh look on whether or not these efforts will or won't impact your broader growth and Dedicated truck count over the next call it, one, two, three years? And you may be more broadly above and beyond that, anything you like to add on the Dedicated pipeline and sales cycle, just putting that in historical context today versus where that's been historically?

### **Derek Leathers**

Yes, great question. So for starters, our largest customer is highly successful and runs a very good business and has continued to win through the cycle. And that's got a lot to do with why we have such a strategic relationship with them. I'm always excited, if a customer wants to take

on some transportation on their own, to help offset the needs that they're going to have, as they grow. It does several very valuable things. It instructs them on just how difficult this business is to do. It allows them to learn and appreciate the challenges that their freight may present. And it makes them, frankly, much better customers over time. So no, I don't think it's a drag on our opportunities. As we look forward, we actually participate in those discussions with them on a regular basis, help and even support some of the launch of that fleet in various locations. And yet, there's plenty of opportunity for us to continue to perform at the level we're performing and grow our business with them.

So, it's not something that I would be concerned about, as I think about what Werner's Dedicated footprint looks like. And frankly, we have a huge pipeline currently of opportunities that are predominantly outside of that very customer. And it's a broad mix and it's part of that puzzle I referenced earlier in the call, where we're out right now being very selective and thoughtful about the type of business, the geography it exists in, and the cyclical nature of it as it relates to intra-year cyclical nature, when do they surge and what do they need during that time, and fitting more pieces of this puzzle together, that I think is going to pay dividends as we go forward. So, that's my best answer to that.

### **Bascome Majors**

Thank you for the thoughtful answer.

### **Operator**

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

## **CONCLUSION**

### **Derek Leathers**

Thank you, Matt. I'd like to thank everyone for joining us today for our first quarter earnings call. It's an exciting time at Werner as we continue our journey towards sustainable best-in-class earnings through the cycle. Our consistent operational execution of our "5Ts plus S" strategy has resulted in structural and durable improvements across the business. Consistent free cash flow generation and ongoing margin expansion are the outputs of the strategy, but it's the passionate driver, office, and maintenance associates that provide the creativity and energy that makes it all possible. Our commitment to continuous improvement and safety and on-time service and sustainability is unwavering, as is our focus on achieving Diversity, Equity, and Inclusion throughout the organization. This commitment is backed by our balanced portfolio and it positions us well to succeed and create long term sustainable shareholder value.

In two weeks, CL Werner, our Founder and Chairman, first driver, and my dear friend will be retiring from our board of directors. He's had an incredible career and built a lasting legacy over 65 years in this industry. His foresight, wisdom, entrepreneurial talent and drive has cemented him as a legend in the trucking industry. Starting as one man with one truck and growing to nearly 8,000 trucks and 13,000 associates is something to be proud of. But more important than that, he did it the right way, focusing on premium service and safety; taking care of his customers, drivers, and associates above all else, and trusting that the profits will follow. We all owe CL a debt of gratitude for what he created. And I'm humbled, honored and excited to help move Werner forward from here. This story isn't complete, but it's been a great read so far. And on behalf of all of us here at Werner, we firmly believe the best is yet to come.

Thank you CL from all the Werner team, our Board, our shareholders and our customers.