

Company Name: Werner Enterprises, Inc. (WERN)  
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<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Great. We'll go ahead and get started. Thanks for joining us. My pleasure to have Werner Enterprises here and long-time CFO, John Steele, representing the company, Standard procedure here. I've got the device up here. Any questions from the floor? Send them up, I'll welcome them in. But I think we'll just dive right into Q&A.

I will ask John to give just a high-level overview of what Werner is and does, and then we'll get into the questions here. So, John, I'll turn over to you for a minute.

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Thank you, Ben. Werner is based in Omaha. WERN is our ticker symbol. We're a trucking and logistics company. About 57% of our trucks, or about 4,600 trucks, are in dedicated contract services, where we have trucks exclusive for a specific customer. And then 43% of our trucks are in one way truckload, that's point-to-point freight throughout the U.S. that's about 3,400 trucks.

We have a growing logistics division that's on a run rate of roughly a \$600 million per year. That's increasingly focused on improving the service experience for carriers and customers through investment in IT. And we're about \$2.6 billion in revenues annualized and one of the five largest truckload carriers in the country.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Great. So, let's start with the topic of truckload and the core business, and maybe, just kind of bringing everybody up to speed in terms of what's happened here over the past three, six months. So, freight standpoint and what the lean is as you look into the start of peak season. We'll start with that.

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Okay. It's been a challenging 2019 on the heels of the best freight rate market in my career in 2018. And that's a 31-year career at Werner. The freight market this year was definitely challenging in the middle of the year. We had – what's turned out to be an increased supply of trucks in the market. The industry is not altogether that disciplined in a fragmented market with a lot of small and medium-sized carriers.

When tax reform hit in 2018 and the electronic log conversion change mandate went into effect in April, we saw an environment where small truckers decided to add capacity in what was a very attractive rate market. And so now, we're living with that increased capacity here in 2019 and that made for a pretty difficult market in July and August. We did not see project, surge or

special business opportunities with our customers that we normally would see in July and August, in our one-way truckload division, where that impacts us the most. That pressured rates. Our spot miles were higher than normal, about 13% for the quarter. We did start to see improvement – slight seasonal improvement in the month of September and that has continued now in October and early November.

And when I say slight seasonal improvement, that means that normal improvement and freight that occurs as you get closer to the holiday season that is beginning to occur. It's not quite at the level of normal, but it's moving in that direction. We are seeing some project and surge opportunities that we would expect to see this time of the year. The premiums for that business are substantially lower than last year, which was a very strong period, but we're encouraged by the improvement trend relative to what we were seeing in July and August.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

So that seasonal spot project opportunity in this fourth quarter, I know it's below a year ago, how does it seem like compared to 2017 or 2016, where does it fall?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Well, I'd say from a volume standpoint, it's fairly comparable, but probably is still a little bit light on the rate side, or the premium side.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Okay. What are your thoughts and experiences on bid season, it seems like the commentary is a little bit mixed, but unbalanced. We are starting to see shippers pull forward some bids here in the fourth quarter. I don't know if you're seeing that same type of dynamic?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Yes. We haven't experienced that. Fourth quarter is normally the lowest bid season count of the quarter, of any quarter of the year. So, not a lot of activity right now, especially with our concentration in retail. The retailers are busy getting ready for the holiday season, they're not working on bids right now during their highest volume time of year. So very little bid activity currently.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

With the retail customer base, is there a read on where inventories with – sit at the moment, where they might be biased as you look into the early part of 2020?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

There's been some mixed developments on retail inventories this year. The last real factual update we received was in August when the retailers reported their results through the end of

July. And there were probably four out of our top 11 retailers that substantially increased their inventories and made reference to that as being the result of uncertainty regarding trade and tariffs. I mean, it's a business, where 10% margins are considered pretty good and when you're facing potentially, a 25% or 30% tariff on the goods you buy, that's a big, big deal. And they needed to take steps to try to temporarily minimize the impact and it is still unsure as to how that's all going to play out. But we'll get more of an update here, the quarter ended October results will start coming out probably later next week and the following week, we'll get more visibility into what their inventory developments have been.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Do you have any sense based on initial conversations with shippers as they look toward 2020, what their overall transportation budgets, how they're going to be set relative to 2019 or they assumed to have decreases in 2020 relative to 2019?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

I don't have a sense for that now. As we talked about in our second – our third quarter call, a heavier portion of our retail business is in dedicated. So, as a company, we're 52% retail and dedicated we're 62% retail. So, we have customers that demand very, very high levels of service with repeat consistent business within dedicated. And those contracts renew throughout the year on an annual basis. Many of them have indexes that are built into the contract rates. So, I don't have a good feel for what their expectations are for spend, for next year. I think somewhat it is dependent on how this peak season ends up playing out and how the tariff trade issue is ultimately resolved.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Okay. Last question, on the One-Way Truckload side. As you do think about 2020's bid season, is there any thought as to the direction of rates, what's the probability that rates are in fact down as we moved through for the industry as we move through 2020's bid season?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Yes. My boss was asked that question during the earnings call and I think I'll follow a similar procedure. I mean, the things that we expect to happen that influences the market are on the supply side. So, there's a number of developments that are going to begin to happen in the early part of the year.

The requirement that carriers convert from AOBRD to ELD starts in mid-December. For us, that had a negative 1% impact on productivity. I expect for some other companies that may be slightly larger than that. The drug and alcohol clearing house goes into effect in January. That will be a national database of drivers that have failed either an alcohol test or a drug test that doesn't identify anybody who's failed in the past. It's a go-forward database. And so, you'll begin to see over time, drivers ending up going into the database that are not really hireable. And over time that will shrink capacity in the market.

Hair follicle testing has been proposed. The latest proposal is to allow it to be an alternative test to urinalysis testing. And we are big believers that hair follicle testing is a better, more comprehensive test. We see 10 times the failure rate with hair follicle testing than we do with urinalysis testing, because with hair follicle testing, you're testing what's in a person's system for a much longer period of time. We think that would be the first good step toward improving safety as it relates to drug testing.

And then the last 10 months up until October, truck order numbers came down. Truck orders have been well below replacement level. The October number that came out earlier this week is basically at replacement level. I am not particularly concerned about that 22,000 number that came out, because October is traditionally a bigger order month. I suspect that our order replacement is in the month of October, or in that number. And so I would be concerned if it stayed at 22,000 or higher for several months. But the month of October, which is traditionally an order month for the upcoming year, is not a concern.

So, I think all those factors will gradually lead to less supply in the market next year and will help to better balance supply and demand. The demand side is harder to predict.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Of course, from the floor and into the vein about supply side pressure is about insurance and some of the jury awards. And to what extent, let me talk about what has happened in the market from an underwriting perspective over the past year or more, that's what to some of the inflation that we've seen already from a premium perspective. Talk a little bit about the awards and then as you think about 2020, could you talk about what you're expecting from an insurance related premium et cetera cost point of view and perhaps what the industry could be realizing as well?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Okay. The insurance market is definitely hardening. There are fewer large insurance companies that are as willing to write truck liability insurance in the past. So, the supply side capacity is declining. Jury verdicts are increasing and these large jury verdicts that are hard to comprehend are occurring with a greater rate of frequency at a higher amount, and we've been included in that group. So, we felt the impact of that. I've heard from people in the industry that insurance rates for liability renewals going forward for smaller carriers, are maybe 50%, 75%, or 100% increases, which would be very challenging for a small carrier to deal with that. That could be a couple of points, maybe three points on their operating margin depending on how low their deductible is, and how much of the insurance they cede to the insurance company is compared to what they assume themselves.

In our case, over 90% of our insurance and claims expense in our P&L is self-insured. So, it's our claims and our own claims experience. We renewed our catastrophic coverage in August with an 11% increase, but that basically took us from \$6.3 million to \$7 million roughly and our total expense annually is probably more an \$85 million to \$90 million kind of run rate. So, we feel like with the safety programs that we've initiated, we have a higher quality driver base. We

have collision mitigation systems in the trucks. We're at about 75% of our trucks having forward-facing cameras moving to 100% in the first half of next year. We believe that we are a safer company and ultimately, the insurance cost should be based on our own experience as opposed to insuring with a third party for most of that coverage.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Okay. Let's focus on the dedicated side of the TTS segment and talk if you want a little bit about the changes that have been made from a portfolio constitution perspective within the dedicated business and as we think about a more difficult, perhaps pricing environment in 2020, what gives you confidence that that business can be a little bit more margin resilient than it has in the past. Let's start with those two points.

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Well, I mean 4,600 trucks over 150 fleets. We had a couple of slides in our earnings call this quarter specifically to talk about dedicated, to give people a better understanding of what it is we do and how we do it and it's very, very demanding service business. Not quite two-thirds of it is in the retail sector, with a heavy emphasis on discount retail. So, it's customers that truly value the on-time, every time, safety-free service that we provide, so that that product will be on the shelf when it needs to be on the shelf. So, their end customer won't have a bad experience and decide to go somewhere else. And these are brick-and-mortar companies that are competing in a world, where Amazon has thrown down the gauntlet and said two-day service has now become one-day service, and these are companies that are trying to compete effectively with that.

So, new equipment, better drivers, sophisticated technology systems, all the things we do to deliver 99% plus on-time service consistently for the dedicated customer base is what helps us to continue to produce positive revenue per truck. We were up 4% in third quarter even in a softer freight market and it's because our customers who support us value that, and it's based on the fact that we're able to produce that very high level of service.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

On the final mile component in particular, can you talk a little bit about that strategy and returns have been for the industry, somewhat mixed, we've seen some exits. How pleased are you with the development? What's the five-year view on that?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Well, we've been at it for a couple of years and it hasn't grown yet as much as we anticipated. We have an agency model. So, it's a variable cost structure using agents throughout the country. We have a very sophisticated technology platform that we think is leading in the industry, just our business development efforts have not yet been significant enough for us to have a meaningful amount of final mile business.

Now, we also, because of our variable cost structure, we haven't had, we don't have terminals and drivers and equipment that we've got to cover that nut every month, because it's a fixed cost that would eat our lunch.

So, final mile is slightly unprofitable at the present time. The business developments are improving and getting better. It's difficult to predict how significant it will be in five years, but clearly, there are some others leaving the market. We're confident in our product and solution and we'll be able to grow that business pretty significantly going forward.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

You expected to remain an agency type business?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

The way we have it structured, yes. We expect to do that until it becomes much more sizable than it is right now. We can always reevaluate to give the best product, but we don't want to have a large fixed cost structure that is difficult to cover in a final mile arrangement and we believe we have a service solution that is very strong in the market with our agency-based network.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Okay. The TTS business in total both one way and dedicated, what's a long-term kind of five-year reasonable fleet growth number target for you guys? Is there a strong appetite to grow that business period? Is there going to be some mixed, where you go dedicated, but you shrink a One-Way Truckload and so that the size of that portfolio is flat. I mean, how do you think about the size of that, that business over the next five years? Kind of put the cycle aside for a minute.

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Well, we would like to grow, but we're not grow for growth's sake and the current challenges of today's market make it less likely that we will grow meaningfully going into next year. Well, we'll discuss that more in fourth quarter when we have more information on the peak season and the market conditions at that time, but we have moderated our growth as we've ended 2019 and I expect we'll be pretty cautious, especially in the One-Way Truckload segment of the business, because it's still a pretty challenging market from a freight and rate standpoint.

Dedicated opportunities when they come along, if they fit our service and value profile. We may grow in dedicated where there is a good fit, both Werner could be an existing customer that is expanding or a new customer opportunity. We do have a fair amount of opportunities in the pipeline, but we're going to keep our service standards and our margin expectation standards high, if we decide to expand in dedicated.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Question from the audience who are back to dedicated. How do you guys think about counterparty risk on the dedicated side, specifically in the context of retailers that compete with Walmart and Amazon?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Counterparty risk meaning in terms of the financial risk with our customers or do you mean the impact that other companies like Amazon are having in the market compared to brick-and-mortar...

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Let's go with the latter.

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Okay. We do some business with Amazon, but not a significant amount of business at the present time. We've aligned ourselves with brick-and-mortar retailers, who as Derek referred to in the call, are the more successful winners within the retail space. They're seeing some level of store growth or same-store sales growth or inventory per store growth that translates into freight growth, and that growth creates opportunity for us. We would rather not invest our eggs in the dedicated retail basket with companies that are shrinking and are struggling to compete in a market that's gradually requiring transit times to shrink. So, we're trying to align ourselves with the winners in retail.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Okay. Let's jump over to logistics and maybe, provide some context to that strategy would start with some of the IT-related investments, leadership position appointments that have been made over the past couple of years. Where does it bring you today?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Yes. So, we talked a fair amount about logistics in our second quarter call. So, to get some more information, that'd be good to refer back to that.

But yes, we've invested more heavily in logistics over the last 18 months to 24 months to improve service and responsiveness to our carrier base, to optimize the execution of the assignment to loads to carriers on the load planning side to improve cost efficiencies on a real-time basis for the decision-making process. We have real measurable results that we've been generating for each project that we've identified and assigned as a cost benefit analysis that goes along with it, and we've been meeting our objectives as we go along. So, we're making sustainable improvements and quite frankly, that's probably what's required to be competitive in the current logistics marketplace. We're looking at it long-term and continuing to provide better value for our carrier base as well as our customer base.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Can you talk about the position that you can walk into a customer and talk about your portfolio? You got a relatively a young logistics entity in a relatively short history there, but you've got the assets and you've got the history on the truckloads side. This notion of coming in with an asset backstop in a hybrid model against, are there incumbent brokers that have scale or some of the startups with the technology that they market, how does that conversation go? And if they choose to do business with Werner Logistics, why are they doing so? They're doing so, because of price. So, they're doing so, because of the security of the capacity or they're doing so, because they do business with you on the asset-based side. Can you talk a little bit about what that competitive advantage might be?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Well, we think our capabilities stack up very well with the competition. We have a presence in all major modes of transportation whether that'd be true truckload, truckload brokerage, intermodal, global logistics, final mile. So, we've got a complete suite of services that we can offer. Our focus is on small to medium-sized customers that don't have the level of IT expertise and spend capabilities to provide solutions that, that meets their service and pricing needs.

So, we've been able to grow. We had double-digit growth in volume, in logistics in third quarter, in quite frankly, a really competitive market. So, we think we don't take a back seat to anybody. We're over 10 years in the business now, \$600 million of annual revenues, we think we're pretty relevant. We're not one of the biggest of the big boys in the market, but we think we offer a great product and a full suite of services.

Getting back to the asset back part of your question, we see probably more benefit from being an asset-backed solution in a tight market, where our assets are available to support their needs from a capacity standpoint when they're having difficulty finding high service trucks in the market. It's not as much of a benefit in a looser market like we have been going through here in 2019.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Sure. The double-digit growth that you highlighted in the third quarter or it did stand out in a very weak spot market. So, can you talk a little bit about the sources of that growth and given the answer to the last question, can we start to budget for 10% plus type load growth going forward. If you can do that in a weak market, then is that a good number to think about on an annualized basis?

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Yes. That was growth on the contractual brokerage side of the business with a customer that we've cultivated over time, that wasn't a customer in third quarter of 2018 and was a customer in third quarter of 2019. That was the biggest single factor, but our goal is to continue to grow the small and medium-sized contractual accounts to be able to help them better manage their freight



spend. And to the extent that we can continue to be successful in our business development efforts, we expect continued growth in logistics as a result.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

Okay, great. Thank you. Please join me in thanking John Steele and Werner Enterprises.

<<John J. Steele, Executive Vice President, Treasurer and Chief Financial Officer>>

Thank you, Ben.

<<Benjamin Hartford, Analyst, Robert W. Baird & Co.>>

We'll do a breakout here outside of the room. Up next in this room, we have Barnes Group.