

Werner Enterprises, Inc.

Q3 2019 Earnings Conference Call

Thursday, October 24, 2019, 5:00 PM  
Eastern

**CORPORATE PARTICIPANTS**

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

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

## **PRESENTATION**

### **Operator**

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

Earlier this afternoon, the company issued an earnings release for its third quarter 2019 financial results and posted an accompanying presentation. These materials are available at the company's website at [werner.com](http://werner.com), by clicking on Investors, then News and Events, and then Webcast and Presentations. 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 included in the press release related to forward-looking statements. Today's remarks contain forward-looking statements that may involve risks, uncertainties and other factors that could cause actual results to differ materially.

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

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

### **Derek Leathers**

Thank you, and good afternoon, everyone. On the call today with me is John Steele, our CFO.

Turning to slide four in our company's snapshot, in 2018, 77% of revenue was generated in Truckload Transportation Services, or TTS, with the remainder coming from Werner Logistics. TTS is made up of Dedicated, which comprises 57% of our fleet, and One-Way Truckload, which is 43% of our fleet. Over half our revenue is retail, 18% is food and beverage, 18% is manufacturing and industrial with the remaining 12% Logistics and other.

We focus on serving discount retailers that sell more necessity-based products that tend to be less economically sensitive and historically perform well in slower growth or recessionary economic periods. We have a diversified customer base with less than half of our revenue coming from our top 10 customers and 74% spread across our top 50.

Next, let's move to slide five for a brief overview of our third quarter and year-to-date financial performance. Overall, the trucking freight market in the third quarter 2019 was meaningfully softer than the same period a year ago, with slight seasonal improvement in September that thus far has carried forward into October.

For reference, a year ago in third quarter 2018, we had an extremely strong freight market and we produced a record 16% rate per total mile increase year-over-year in One-Way Truckload. The strong third quarter 2018 freight market, and our outstanding execution in that market, resulted in record high third quarter earnings a year ago. For this year's third quarter, it made for

a challenging comparison. Despite the tough comp, our team performed well, and we produced the second highest third quarter earnings in our history.

For the quarter, revenues declined 2% to \$618 million. On an adjusted basis, EPS decreased 11% to \$0.57 a share. Adjusted operating income decreased 12%, and our total company adjusted operating margin declined by 90 basis points to 8.8%. The adjusted operating margin and earnings decline were due to lower results in One-Way Truckload and Logistics, while Dedicated improved its performance. The softer freight market and small sequential fleet growth in One-Way Truckload in the quarter contributed to spot miles of 13%, up sequentially from 10% and up from 9% year-over-year.

Spot market miles in One-Way Truckload were higher in July and August and were lower in September. Last year, the very robust freight market produced several project and surge rate opportunities. In the year ago period, these events added over 2 percentage points to our rate per loaded mile in One-Way Truckload and contributed \$0.04 a share to our third quarter 2018 earnings. In third quarter 2019, a few smaller scale projects and surge opportunities began to occur in the latter part of the quarter. Currently, we expect freight to seasonally strengthen sequentially in fourth quarter 2019, and we expect a peak season that is solid, but not as strong as the 2018 peak season.

Werner Dedicated again performed well, delivering a strong operating margin that was better than third quarter 2018 and achieving continued revenue per truck growth, despite the softer year-over-year freight market.

Year-to-date, revenues increased 2%, adjusted EPS increased 6% and adjusted operating income increased 5%.

We expanded our adjusted operating margin by 20 basis points through our focus on execution and cost management in a tougher freight environment. I'd like to sincerely thank all our hard-working Werner associates for their continued efforts.

Reflecting our investment in the best-in-class fleet, we ended the third quarter with 8,055 total trucks in TTS, an increase of 305 trucks year-over-year and up 120 trucks sequentially, just slightly above our guidance.

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

### **John Steele**

Thank you, Derek, and good afternoon. On slide seven are additional financial performance drivers. Total revenues declined 2%. Our TTS revenues per truck per week, net of fuel, declined 1.5%, due primarily to tough comps and higher spot miles in One-Way Truckload, while TTS average trucks grew by nearly 4%. Revenues in our Logistics segment declined 6%.

The operating income reduction was due to a 140 basis point decrease in TTS adjusted operating margin and 120 basis point decrease in Logistics operating margin. These operating margin declines were due to comparing to a very strong freight and rate market in third quarter 2018, which negatively impacted margins in One-Way Truckload and Logistics.

In addition, our sequential truck growth of 120 trucks in third quarter 2019 was more weighted to One-Way Truckload than expected, largely due to certain planned Dedicated fleets that were

temporarily delayed. In the last few weeks, we are beginning to see these trucks shift from One-Way into Dedicated.

Moving to adjusted EPS, the decrease was due to 14% lower adjusted net income offset by 3% fewer diluted shares outstanding.

Beginning on slide eight, let's look at our third quarter results for our TTS segment in more detail. TTS revenue declined 1% to \$480 million, primarily caused by \$11.2 million of lower fuel surcharge revenues due to lower fuel prices, a 1.5% decline in revenues per truck per week, which was due to lower miles per truck, and partially offset by 4% fleet growth.

Adjusted operating income declined 13% to \$49.7 million, primarily due to a lower operating margin percentage. Despite the less robust freight market in third quarter 2019, we achieved a solid 10.3% TTS adjusted operating margin, including fuel. Our adjusted TTS operating margin net of fuel was 11.7%.

Now on slide nine, let's look at our third quarter Dedicated and One-Way Truckload metrics. For Dedicated, we once again grew trucking revenues, net of fuel, by 9% to \$232 million. Dedicated average trucks grew 4%, or up 191 year-over-year. Dedicated revenues per truck per week increased 4.1%.

One-Way Truckload trucking revenues net of fuel decreased 5% to \$186 million. One-Way Truckload average tractors increased 3%. Revenues per truck per week decreased 7.6% for the quarter due to 2.0% lower miles per truck and 5.6% lower revenues per total mile, which was in line with our prior full year 2019 guidance range.

Higher spot miles and less project and surge business in third quarter 2019 contributed to the revenue per total mile decline. We continue to take additional steps to enhance our cost structure. Last quarter, we identified \$10 million in expense savings and we have now expanded that to over \$15 million this quarter. Nearly \$10 million of these savings are expected to be realized in calendar year 2019. We grew the cumulative number of expense savings items from 70 last quarter to 130 this quarter. We expect these savings to continue to grow in the future.

In addition, our performance-based compensation systems are intentionally structured to adjust payouts based on company performance relative to our business plan. At this time, we expect these annual incentive payouts for 2019 to be several million dollars lower than 2018.

We lowered our trailer-to-tractor ratio in trucking by 6% year-over-year and improved our tractor to non-driver ratio, a key measure of operating efficiency, to the highest level in over a decade.

There is one other item I wanted to mention in the TTS side of our business. Earlier this month, we received a large unfavorable jury verdict for a truck accident that occurred in 2017 in New Mexico. Our excess liability insurance and previously established reserves covered the amount of this tragic accident. This tragic fatality accident was a result of a brief moment of operator error by a Werner driver. We continue to express our sincere condolences to the Armijo family.

Moving to the Werner Logistics results on slide 10, in the third quarter Logistics revenues declined 6% to \$121 million, primarily due to intermodal volumes, which were significantly lower. Truckload Logistics, which consists of transactional and contractual brokerage, had double-digit volume increases offset by double-digit price decreases. A transactional spot pricing decline of nearly

20%, combined with few project freight opportunities in the third quarter, led to lower Truckload Logistics pricing.

Logistics gross margin was 70 basis points lower due to our softer freight market and a more competitive brokerage market. Logistics operating income declined 37%, and the operating margin percentage was 120 basis points lower year-over-year. Other operating expenses declined \$0.4 million, as we are beginning to gain efficiencies from our Logistics technology, which optimizes and automates freight and carrier selection.

I would now like to turn over to Derek, the final portion of our prepared remarks. Derek...

### **Derek Leathers**

Thank you, John. Moving to slide 12, let me update you on our 5T's strategy. During our prior earnings calls, I explained the steps we have and continue to take to position Werner as a best-in-class organization focused on enhancing our portfolio, attracting top talent, increasing customer service levels and delivering quality earnings to our shareholders across economic cycles. We're creating structural and sustainable improvements with our modern and more efficient fleet, combined with high quality professional drivers and strong management execution, we expect to generate more consistent financial results.

Our truck and trailer fleets remain new with an average age of 1.8 and 4.0 years, respectively. Despite an extremely competitive driver market with a 50-year low national unemployment rate, we remain committed to quality over quantity with our professional driver force. This is critical to delivering on our brand promise to our customers.

We're continuing to upgrade and expand our terminal network to better support our customers and drivers and lower our maintenance costs. This investment provides our drivers with the facilities and infrastructure they need and deserve as we continue to raise our service expectations.

And as I discussed last quarter, we significantly increased our annual IT investment as part of our 5T's strategy to improve service to our customers and professional drivers. Our 5T's investment combined with strong operational execution is paying off. Our on-time service percentage is the highest in the last five years.

In August, Werner was one of only a few large Dry Van Truckload carriers to be named a Quest for Quality award winner. Over 4,500 shippers participated in the 36<sup>th</sup> Annual Logistics Management Survey where they rated carriers for on-time performance, value, information technology, customer service and equipment and operations. In addition, we're equally proud that for the first time, Werner Logistics was a Quest for Quality winner in the TMS category.

Turning to slide 13, we have provided a network map to help you understand the carefully designed infrastructure supporting Werner's Dedicated fleet. Our Werner Dedicated fleet network is strategically positioned with our terminal locations and driving schools, helping us optimize our driver recruiting, driver training, and equipment maintenance. Over 90% of the U.S. population resides within 150 miles of a Werner Dedicated fleet, terminal or driving school location.

Next on slide 14, we highlight some of the key elements of Werner's Dedicated business, which was established 28 years ago. In Dedicated, we generally provide trucks, trailers, and drivers exclusively for a specific customer, typically for a distribution center or manufacturing plant.

Dedicated has steadily grown over the years to more than 4,600 trucks and 150 plus individual fleets, making it one of the five largest Dedicated fleet providers in the U.S.

Dedicated serves customers with their shorter-haul freight, who have very high service and safety requirements. The extremely high predictability and reliability of our Dedicated on-time service product extracts unnecessary cost from our customers' supply chains. Since the large portion of these driving jobs are typically in shorter-haul operations, they are attractive for recruiting and retaining the best drivers because they are able to return home more frequently.

The upper left pie chart shows our intentional focus in the retail sector, noting our discount retail emphasis. By design, we focus on the brick-and-mortar winners in retail who are growing and producing strong financial metrics. They require, and we deliver, extremely high on-time service as they compete in a retail marketplace that is increasingly online, with their customers expecting ever shorter order-to-delivery windows. Almost two-thirds of Werner Dedicated is retail DC to store, and about two-thirds of that retail business is discount.

Frequently, discount retail customers require specialized driver training, multi-stop deliveries, and driver assistance with the unloading process. Historically, our large discount retailers performed very well during slower growth economies or recessions as consumers gravitate to their attractive pricing and merchandise. This was evident in 2009 and 2010, following the great recession, when our larger discount retail customers produced superior same-store sales and operating margins.

Werner Dedicated is the stable middle of our revenue portfolio of One-Way Truckload, Dedicated and Logistics. Over the years, Dedicated has grown to over 57% of our truck fleet, because of the high service, driver and capacity requirements in Dedicated, and we have far less relevant competition than we see in One-Way Truckload. Driver home time is more frequent in Dedicated as drivers work in closer proximity to their home. This strengthens driver satisfaction and helps lower driver turnover. Each of our Dedicated fleets has their own P&L that is closely managed and monitored.

In summary, our Dedicated revenue metrics and operating margins provide more relative consistency in all types of economic conditions. As a result, Dedicated has traditionally been a strong margin performer in good freight markets and a solid margin performer during softer freight conditions.

Next on slide 15, I would like to discuss our 2019 updated guidance. We're reaffirming our prior guidance for TTS truck growth, gains on sales of equipment, net capital expenditures, and One-Way Truckload revenue per total mile for the full year 2019 versus 2018.

Continuing our previous guidance, we do not plan to grow our truck fleet in fourth quarter 2019. For our guidance assumptions, we expect our effective tax rate to be in the low end of the 25% to 26% range for the year. We expect to maintain our fleet age levels at approximately 1.8 for trucks and 4.0 for trailers.

Finally, our expectation for fourth quarter 2019 interest expense is \$2.2 million, based on current debt levels and interest rates.

This concludes our formal remarks, and at this time, I'd like to turn the call over to our operator to begin our Q&A.

## **QUESTION AND ANSWER**

**Operator**

We will now begin the question-and-answer session. To ask a question, you may press "\*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the key. To withdraw your question, please press "\*", then "2." 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 PM Central following the company's closing remarks. At this time, we will pause momentarily to assemble our roster.

And our first question will come from Chris Wetherbee of Citi. Please go ahead.

**Chris Wetherbee**

Hi, guys, thanks and good afternoon guys.

**Derek Leathers**

Good afternoon, Chris.

**Chris Wetherbee**

I wanted to pick up on the peak season comments that you made, they seemed a bit more optimistic than maybe some of your peers have made so far during earnings season. I wanted to get a sense of maybe what you're seeing, some color in the market. How much maybe has to do with some of your exposures, whether it'd be Dedicated or maybe just retail in general? But if you could elaborate a bit on that, that would be helpful.

**Derek Leathers**

Sure. So in our remarks, we talked about freight throughout the third quarter being meaningfully softer than it was a year ago with slight improvements in September that have continued into October. I would sort of double-down on what the previously stated statements which is we're seeing slight improvements. But make no mistake, it is not 2018 and so I wouldn't want you to read through something overly bullish by any of that commentary.

We feel good, we have a peak season that's shaping up, that is coming together nicely. We've got commitments in place and projects in place that give us some comfort, but this is still a market that is filled with uncertainty as on the demand side especially with all of the tariff and trade backdrop and macroeconomic uncertainty. But overall, the quarter and the peak is shaping up more traditionally like you would have seen in '17 or '16, certainly not like '18.

**Chris Wetherbee**

Okay. That's actually very helpful. So I appreciate that commentary. Maybe just as a follow-up here on pricing, obviously expect the One-Way Truckload revenue per total mile to...it sounds like decelerate towards the drive...sort of the full year towards...into the range or maybe towards the lower end of the range. But can you give us a sense of maybe what your expectations are as you sort of stretch that out a little bit, maybe take a little bit of a glimpse into the first half of the next year to get a sense of maybe how you sort of set up into bid season might look like. I know you probably don't want to give too much guidance for 2020, but just want to get a sense of maybe how you are feeling about how the rate dynamics playing out right now?

**Derek Leathers**

Sure, I thought we might get asked the first question before that came up. But look, there is a lot of uncertainty in the market place right now. We know the economy is sending mixed signals. We see a lot of trade and tariff uncertainty and question marks that are still out there. Without

better resolution on some of those items, it would be increasingly difficult to try to predict what the first half looks like. We don't give rate guidance, especially not that far out to begin with. Our focus, to be honest, is going to be on execution. It's going to be on continuing to deliver on what we've committed to shareholders and customers alike, which is providing more stable returns and stable results. We think we've done that in the third quarter. As we approach next year, we'll attack it based on the environment at that time, but I need more visibility than I have right now to be trying to prognosticate what first half of next year would look like.

**Chris Wetherbee**

Okay. That's fair. I appreciate the time. Thank you.

**Operator**

Our next question comes from Ken Hoexter of Bank of America Merrill Lynch. Please go ahead.

**Ken Hoexter**

Hi, great good afternoon. Derek or John, great opportunity there on the cost side, sounds like you're making some great strides. Can you maybe provide some additional details to see maybe the scale of those 130 projects, John, that you walked us through?

**John Steele**

Yes. The scale is an annual run rate of \$15 million; that's up from an annual run rate of \$10 million that we identified at the end of second quarter. We expect to have for the full year '19 implemented \$10 million of savings this year. And we've got various programs throughout the company that are in place to identify more opportunities as we move forward. The types of opportunities run through the P&L, through the salary wages line, the maintenance line, the taxes and licenses line, insurance line, the rent and PT line, communications line. So these initiatives affect multiple categories of expenses throughout the company's P&L.

**Ken Hoexter**

So it's not like there is one big one, it's just a multiple different...many opportunities.

**Derek Leathers**

There is no silver bullet. This is grinding every day across the P&L and really we're trying to leave no stone unturned. And we're not done. We're going to continue to do so as we go forward challenging everything.

**Ken Hoexter**

All right. And just on my follow-up. We've seen some other shifts away from home delivery, are you seeing increased competition in the Dedicated as you kind of prove the sustainability of the returns in that segment, particularly to the discount retailers? Are you seeing others switchover to compete in that field against you?

**Derek Leathers**

Yes, I think there is always an ebb and flow and as people find additional struggles in the One-Way market, they tend to try to gravitate toward what others may be doing successfully. We like our positioning. We like the product that we put forth. It's difficult to do. It's hard to replicate and it's well entrenched. And so we're going to stay with that.

We will see people show up at the table. The question is how long can they last? And I think with the businesses we do, with the types of companies we do it with, their proven track records in good times and bad and the relationships we built in the product and the service we deliver, it's



hard to unseat us. It doesn't mean there won't be people showing up. It's our job to make that decision exceedingly difficult for a customer to ever want to entertain a change.

**Ken Hoexter**

Thanks, Derek. Thanks, John.

**Derek Leathers**

Thank you.

**Operator**

Our next question comes from Kevin Sterling of Seaport Global Securities. Please go ahead.

**Kevin Sterling**

Thank you. Good evening, gentlemen.

**John Steele**

Hi, Kevin.

**Kevin Sterling**

Derek, you've obviously been at this and John, too. You guys been at this long time, it's not your first rodeo. Can you just kind of share your general thoughts on what we're seeing on the supply side? We continue to hear about bankruptcies and insurance costs going up particularly for some of the smaller carriers and some of these nuclear verdicts. And unfortunately, you have been exposed to nuclear verdicts before. But kind of what you're seeing on the supply side of the equation as it relates to One-Way Truckload business?

**Derek Leathers**

Sure. I'll take a stab at it and John feel free to jump in and weigh in. Look, essentially we had a long, detailed discussion about this over the last several days here even. And the term I'd used with my team multiple times is it's just math. Like, we got to do the math, we got to stay close to the math and we got to watch it. You see 10 months consecutive of order rates dropping and then dropping below replacement levels. You see year-over-year changes that, depending on the month, were negative 50 to negative 70. You see bankruptcies at 780, half way through the year versus, I think, it was 159 for the full year 2018. So if you project that out, it's not unreasonable to believe that number will cross 900 before the end of the year and maybe further north of that.

You touched on yourself, the impact of insurance rates, the nuclear verdicts. I think one thing that's maybe sometimes missed in that is, you have these large verdicts at large carrier levels, but that cost structure change impacts every carrier in America, because it's passed through in insurance rates and insurance renewals, as well as obviously those that have to actually absorb the blow of the actual verdict.

You put all that together, you couple it with Drug & Alcohol Clearinghouse in January, the final ELD conversion in December, and I think it's extremely reasonable for anybody to look at that and say, "It's coming out." And it's coming out now. The question is how much needs to come out and against what economic backdrop before we get back into a more tight kind of market. And my best guess at this point is still we've got a couple of quarters of uphill climbing to do where we've got to focus and put our heads down on costs. We got to not take our eye off of the ball on service. We have to make sure and watch expenses, but not under invest in our fleet. And if we do all that and execute and keep delivering the kind of quality that we're doing with our customers,

we'll be around when it turns, and we'll be ready and prepared to ask to be paid appropriately when that time comes. But it's still a couple of quarters away where we're going to have to kind of win the old-fashioned way. There is no silver bullet, it's going to be X operational excellence, and we've got to outperform our competitors.

### **Kevin Sterling**

Thank you, Derek. That was just some great color and perspective. One last question here is kind of switching gears a little bit, how do you...are you concerned about IMO 2020 and the impact on diesel fuel prices? Does that thought factor into your thinking at all?

### **Derek Leathers**

Yes. Concern, you have to be concerned when you have a shift of this magnitude coming at us and we have to make sure and stay cognizant of it. We've looked at it throughout the year. We've studied it. I don't know that anybody agrees on what that outcome is going to look like. I think it's somewhere in the middle of where the goalposts have been set. I've seen people say they think it's a relatively nonevent, I don't agree with that. I've also seen people talk about \$0.70 to \$1 type spikes in diesel. I think that's a bit overstated. I think somewhere in that goalpost is where it falls out. What we've got to do is keep working on MPG improvements at every turn making sure we burn less of whatever it is...whatever it costs. We've got to make sure our surcharges are adequate and appropriate, based on the work we do for our customers. And we've got to make sure and think about places it can creep in.

If we don't have our eye on the ball like anywhere that we have all-in rates or anywhere in our Logistics group where that type of activity may exist and be thinking well in advance of the change to make sure our rating and our rating engines are prepared for it. We think we are; I feel confident we're looking at the right things the right way. And I think it's going to happen. I don't think there is going to be some last-minute save that's going to save the day. We're going to see rate...we're going to see diesel go up, but I don't believe it's the \$0.70-type number that some have talked about. We'll focus on operationally trying to make improvements in deadhead and elimination of any and all empty miles in preparation of it as well, and we need freight to do that obviously. But there are other things we can do execution-wise to make that better.

### **Kevin Sterling**

Got you. Okay. Thank you so much for your time, giving all the color and candor. Really appreciate it. Take care.

### **Derek Leathers**

Yes. Thank you.

### **Operator**

Our next question comes from Brandon Oglenski of Barclays. Please go ahead.

### **John Steele**

Hello, Brandon.

### **Brandon Oglenski**

Hi guys, sorry my phone is on mute, I am talking to myself. Hi, guys, so I think you mentioned that it feels there's a couple of quarters away here from market balance, and I apologize, because I just jumped off of another call. But what is the driver here of the weakness that we're seeing or the continuing weakness in the freight market, is it more demand-driven or more supply-driven from your perspective?

### **Derek Leathers**

From my perspective, more is a relative term. But I think I would put a little more in the supply side than I would on the demand side. If you look overall at demand trends in terms of macro tonnage, macroeconomic activity, et cetera, it's still relatively strong, it's not as strong as it was a year ago, but overall tonnage is still up by most metrics. It's been softening some as of late. I think supply has really been the issue, and we've kind of covered it in an earlier answer what we think is happening with supply.

You mentioned a couple of quarters to get the balance, what I meant to say if I didn't say it this way is, I said a couple of quarters is when I think you start to see tightening reenter. I think we're in a relatively balanced market today. And for the most part, we've hit the bottom. The question is how long we drag across the bottom in terms of the current supply and demand balance. And the tough part is, and I don't think this is limited to our industry, I think it's industries across America, is there is still this trade and tariff uncertainty out there with a little bit of an economic overhang that causes consumers at some point to start to become a little more hesitant in their thought process and spending habits that we have to factor in.

So that's why you've heard me reiterate so many times that we're going to keep focusing on delivering the highest possible product we can, product quality, focusing on operational excellence and absolutely trying to turn over every stone on the cost side in the meantime, because we're not going to just sit around and wait for the market to turn. We're going to continue to try to make a series of steps, regardless of how small some of them incrementally they may be, to just make this company a little leaner and a little more prepared as we wait this out.

### **Brandon Oglenski**

Well, I appreciate that, and I think you did allude to previously at a conference, you know, some of your Dedicated contracts might not be delivering maybe what you thought they would. Is that a fair statement? And then, does that make you rethink the Dedicated business, because we've definitely seen some of your competitors have a different strategy there and definitely delivering better margins. Is that something you guys think about looking forward?

### **Derek Leathers**

We don't...so the quote you attributed to me, I'm not sure what conference that would have been at, but that's not how I feel about Dedicated all. The only hesitancy we've had on Dedicated this year at all has been delayed implementations that we've struggled through as we work to get trucks in place or I should say, get the green light to put trucks in place that caused in the quarter from some trucks to land in One-Way that were really destined to be in Dedicated. That caused disruption, because you're over-trucked on one side. And while you await for final implementation, our confidence in our Dedicated returns are as strong as they've ever been. My confidence in Dedicated weathering well in a tight market and an upturn is equally strong.

We feel very good about the Dedicated model that we've built. We're going to continue to push the envelope in Dedicated, we're at 57% of the fleet Dedicated today. I have repeatedly stated that we would be comfortable with that number going up to 60%, if it gets to 60%, we'll revisit and re-guide, but it's got to be at the right return. So part of the third quarter impact was delayed implementation. The other part, honestly, was exiting or downsizing the businesses that we're not meeting the profit profile that we feel the work demands and requires. So we're going to just stay disciplined, do our job, focus on the long-term portfolio blend, but only do it if the returns are there to justify our participation.

**Brandon Oglenski**

Appreciate it. Didn't mean to miss characterize it there.

**John Steele**

Thank you, Brandon.

**Operator**

Our next question comes from Ravi Shanker of Morgan Stanley. Please go ahead.

**Ravi Shanker**

Thanks. Good afternoon, gentlemen. You were one of the first among your peers to identify the emerging competitive landscape in Logistics from the new digital entrance, I'd say, three or four years ago. How would you characterize that today, to what extent does that having an impact on your ability to go-to-market or other numbers in your Logistics division?

**Derek Leathers**

Yes. So the digital freight brokers, I think, are here and here to stay. We have to recognize the reality that there is all kinds of marketing out there and when anytime you talk about startups, the one thing they get right in a hurry is how they market and how they sell the bells and whistles that they commit to the customers. Actually executing and operating that and delivering on that same level of service that the customers become accustomed to is a much more difficult hurdle. I think we're still in the white noise phase and I don't mean that dismissively, it's real and we have to react to it. But we do a lot more talking to customers and having to work through benchmark rates or target rates that are often in our view below re-investable levels from folks that are openly admitting that they're not making a profit. And what we have to do, obviously is to deliver service and return a profit to our shareholders all at the same time. We're going to stay committed to that. So you saw our revenues after several quarters in a row of growth have cooled and now actually been negative. We're going to make sure that we add business that we think we can do profitability.

We're also spending money on tech to make sure we're relevant in that space, in that competition. We are seeing dividends from that tech investment we're making. We need to continue to roll it out more system wide to reap the full benefit. So it's a tough one to answer. I think some of these folks will survive, some won't. In the meantime, they're going to continue to push the spot market to the low levels that we've seen. It seems to have stabilized as of late, and with peak around the corner, I think, there'll be some relief in that area. Our job is to get our trucks out of the spot market altogether or as close to it as we can, and then make sure our brokerage capability is as nimble as any of theirs.

**Ravi Shanker**

Understood. And I just wanted to follow-up on your comments earlier on peak season, where you said that this year is not going to be as good as last year. If I remember right, last year's peak season was actually pretty bad. So are you referring to 3Q or are you referring to 4Q peak season?

**Derek Leathers**

Yes, we had a strong peak season last year by historical standards. So perhaps you're referring to more...a mix of other carriers' results. Our peak season last year was strong. The third quarter in particular, as you mentioned, we were up 16% in the third quarter in the One-Way Truckload side in terms of revenue per mile. In the fourth quarter, we were up 11% for revenue per total mile. That is a combination of packaged...prepackaged agreements made well in advance of

peak, as well as, spot market opportunities when people see some particular SKU or product line selling aggressively and needing to restock and then get it to the store. We're going to...we have a similar combination of those opportunities this year and volume is actually up, but the problem is rate in the market like the one we're in today is where you won't see the same kind of packaging or surcharges available in '19 versus '18.

**Ravi Shanker**

Very helpful. Thank you.

**John Steele**

Thank you, Ravi.

**Operator**

Our next question comes from Brian Ossenbeck of JP Morgan. Please go ahead.

**Brian Ossenbeck**

Hi, guys. Good evening. Thanks for taking my question. John, just a quick one for you on used vehicle market and the pricing. It looks like you're calling out that's been moderating a bit in the 2Q and then to 3Q here. I know you had purchased a lot of tractors off cycle not too long ago. So I just wanted to see if that was more of a Werner comment or if that was something more broad-based that you're seeing in the industry and if you have any early thoughts on next year?

**John Steele**

No, that's more of an industry comment and how it's impacting us in the marketplace. As carriers are facing more challenges in the market, their appetite for buying used trucks is lower than it has been. We think from a product standpoint, we're the good house in a not so good neighborhood because we've got a newer truck with lower miles, has features that others don't have--AMTs and collision mitigation systems. But regardless, the fact that with less demand for purchasing used trucks in today's market, that does have a negative impact on pricing. We expect that will continue for at least the near term until supply side begins to get more corrected.

**Brian Ossenbeck**

Okay. And then maybe a quick follow-up on the insurance market. I know you can give some color to the types of rates that you are expecting for renewals for this coming period. But maybe from an industry wide perspective, Derek, what are your thoughts on what needs to change in terms of just focus on safety, I'm sure from the driver side as well, but how do you think the industry can kind of deal with this and maybe limit some of the risks and exposure that have been cropping up here in the last couple of years?

**Derek Leathers**

So our renewal is in the rear view, and we've done that and got through that, and it was not nearly as large of an increase of what you've heard of from many other people. It was low...very low double-digits, you know, really between 10% and 11%.

In terms of the bigger question, what do we need to be doing? I think what we're doing is we need to continue to invest in technology, wherever it's available, to make our trucks as safe as possible. We need to continue our commitment to forward-facing cameras to be able to provide visual evidence of what actually happened versus what's been alleged to have happened. We need to continue our focus on safety above all else and the internal motto of nothing we do is worth getting hurt or hurting others.

We are seeing progress across all of the above. The problem is the nuclear verdict that you talked about. You can make all kinds of headway across multiple categories in the risk arena, and it takes one day, one minute, one accident combined with the right jury to wake up to a world where you are faced with a very high cost of doing business. That then leads into everybody's insurance rates over the market. When any of us are attacked, it's really an attack on all of us and we're going to have to continue to fight the good fight.

ATA has also made the public statement that it is a Tier 1 issue for them to focus on tort reform and work at a state-by-state level to get some of these sort of unfair realities corrected in how the laws are written. We have to keep America moving every day. It's our job, it's what we do, and... but there can't be sort of this outsized risk at a time when our safety results continue to actually improve as an industry, and we continue to focus on delivering safer and safer year-over-year. We just see outsized verdicts. And I think that's a reflection of other issues that are pervasive across our culture in terms of how money that one group has suddenly transferred to other groups at outsized proportions to try to level the playing field or send a message versus having to be more reflective of the facts of the individual cases.

#### **Brian Ossenbeck**

Do you think hair follicle testing, if that were to be approved, would be helpful or do you see the problem on, like you mentioned the tort reform and just the broader societal challenges of these accidents?

#### **Derek Leathers**

I mean, I think if you look at the stats and you look at the progress being made across safety and safety initiatives, there is progress being made and yet nuclear verdicts continue to pop up at a more increasing level. So I don't think it's indicative of...the nuclear verdicts are not indicative of a sudden disregard for safety by the industry. They're more indicative of where courts and court systems and outcomes are going.

Hair follicle, we do already. We have been doing for years and we will continue to stay committed to that. I think if we have an opportunity to do anything in our power to make sure that a driver is not under any influence within our truck, we're going to do that. And we're going to continue to focus on collision mitigation, active breaking, lane-keeping technology, forward-facing cameras and the list goes on and on, but you will still have accidents.

I mean, when you have millions of miles delivered by 3:00 p.m. every day, you...it takes a brief moment on any one of those miles to find yourself in a situation that could be troublesome. We've done everything we can and we'll continue to do to eliminate everyone of them, but I can never predict that will...future where there will be never an accident, because I just think that's not the reality of vehicles moving down the road.

#### **Brian Ossenbeck**

Right. Okay. Thanks Derek. Appreciate your thoughts.

#### **Operator**

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

#### **David Ross**

Yes, good afternoon, gentlemen. John, can you talk a little bit about any fleet plans for 2020 and how you think about the CapEx range for next year. Derek mentioned not willing to under invest

in the fleet. So is there a floor you're thinking of for CapEx and then an upward range if the market improves more quickly than expected?

**John Steele**

With the macro uncertainty and the lack of clarity on trade and tariffs, we've decided not to put out our 2020 CapEx number until we release earnings in fourth quarter. Fleet plans for next year are dependent on how things trend over the next couple of three months here and we will also talk about our fleet growth plans when we do our fourth quarter call.

**David Ross**

And Derek...

**Derek Leathers**

The only thing I would add to that is that we have opportunities, based on the year we've been through in '18, to shift assets as new opportunities come available and we will do so where those returns warrant it. So, said differently, until we address underperforming or units or areas that have become under duress, there would be no incentive to add to the fleet versus shifting those assets from that portion of the fleet to a better performing unit.

**David Ross**

That's helpful. And then, any changes to thinking regarding the driver training school or any changes made at the training school in light of the most recent verdict?

**Derek Leathers**

The short answer would be, the driver training schools that we operate already produce measurably better results. We know the accident rate is better by 15%. We know that turnover is better in that group of drivers than the population at large. This was not an issue relative to the driver training school. That simply is part of the noise that's been created in the media.

This driver was a person who had an accident, plain and simple. He was properly trained. He did very well in his program, and he had an accident. And beyond that, I probably won't talk about the case much more. We have confidence in our schools, we will continuously look to improve them, but that would've happened with or without a verdict, because we're always going to strive to be as safe as we can be.

**David Ross**

Excellent, thanks.

**Derek Leathers**

Thank you.

**Operator**

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

**Scott Group**

Thanks. Good afternoon, guys. So Derek, Dedicated revenue per truck up 4%. Curious how do you think about that, is that a sustainable run rate going forward or perhaps is there a bit of a natural lag here relative to the over-the-road business?

**Derek Leathers**

Well, I'm not going to try to predict or give guidance on the future of Dedicated revenue per truck. What I can tell you is that, those agreements we have in place are stickier than they are in One-Way. They're longer-term than they are in One-Way. Our delivery on what we promise on our end is at or above expectations and we're going to stay committed to doing so. Revenue per truck per week is something that we are going to stay hyper focused on, because Dedicated comes in so many varieties, that's why we shy away altogether from rate per total mile. It really depends on the miles, the productivity of the fleet and the designs that we're looking at any given time. What I can tell you is, as previously commented, we're not going to be looking to push growth for growth's sake. We're going to make sure, and the win rates will probably fall, the bid rates or the amount of bid activity has to stay active, the pipeline has to stay full. So we can earn our way into businesses that work for both us and the customer. Right now we feel good about how all of the above looks, and so we'll continue to take that kind of focus into 2020.

### **Scott Group**

Okay. That makes sense. And then Derek, I'm just curious, you made the comment earlier that we've already troughed in terms of the cycle. I'm just curious, what metrics do you look at that tells you that?

### **Derek Leathers**

I think what I said is, I think we've hit bottom and I don't know how long we're going to stay here. The predominance of that statement is driven by the reality of peak being around the corner sort of regardless of the market you're in. So when we go back and look at prior markets...or prior peaks and prior valleys and prior cycles, even in bad markets from third to fourth quarter, you see demand increases, simply because Christmas is coming. I think that's an impetus to start to set the stage as we go into 2020 for a more balanced conversation.

I think when you look at the number of bankruptcies and more importantly probably the number of large bankruptcies, it's starting to become apparent that these trucks are leaving and these rate structures are not sustainable. Sustainability is more visual, based on the quantity of bankruptcies, and capacity actually leaving is more visible when you talk about some of the larger ones. When you put all that together and I think we still got a fight ahead of us. We're going to have a market that's going to be tough for the fourth quarter. It's going to be tough for the first quarter, and we're not seeing anything different than that. What we believe we need to do is just out execute in the tough market and we think we're taking the steps to do so. It will come a lot more in clear picture over the next three-to-four months, Scott, but until we have that visibility, that's about the best picture I can paint.

### **Scott Group**

Okay. Thank you, guys. Appreciate it.

### **Derek Leathers**

Thank you.

### **Operator**

Our next question comes from Tom Wadewitz of UBS. Please go ahead.

### **Tom Wadewitz**

Yes. Good afternoon, I wanted to ask you a little bit about customer inventories, I think you look at that reasonably closely. And just wanted to see if you have a view on that whether that's kind of a risk, if there was pre-shipping activity and maybe the inventories are a bit full, or if you think inventories are at a level that's going to be favorable and helpful to the improvement in freight?



**John Steele**

Tom, this is John. We did see some of our larger customers increase their inventory levels in the most recent quarter, but it wasn't across the board, it did vary from company-to-company. The expectation is that part of it was driven by concerns they had with trade and tariffs getting...in a few cases, getting more inventory in place in advance of the increases that were coming to try to delay the cost of those tariffs as long as they could. It feels like inventory levels are at fair, reasonable levels currently, based on conversations with customers and are not excessive. But I wouldn't say they're lean levels either at this point in time. So I think a lot of it will depend on how the peak season plays out and how the consumer is for spending this holiday season that will determine where retail inventories end up. Most retail customers will be reporting their numbers the end of...based on the number...based on the end of October, which they'll report in third week of November. So we'll get an update here in about three weeks.

**Tom Wadewitz**

Right, okay. And then a second question just on inflation in 2020, it seems like it might work in your favor that in addition to the cost actions you're taking maybe the kind of natural inflation you face, whether it's driver pay or other factors, you might use. Do you have any thoughts on how...what inflation might look like and whether that's maybe helpful next year?

**Derek Leathers**

So when you think about the big factors that impact us the driver market is still tough, but clearly, not as tough as it may have been a year ago. We make it tougher in terms of expecting quality above quantity and we're going to stay committed to that. We're going to make sure we hire the best drivers we possibly can, but we don't foresee the kind of pressure on wages that we went through in '18. So that's relatively speaking, we're going to be through the comps of a lot of the driver wage pressure. If the market were to suddenly change and the economy were suddenly to take off, obviously that could change, but so would rate along with it. So there is a natural hedge there. Trucks, trailers all these other things that are big components of...tires and fuel. We talked about fuel earlier on the equipment side, it's going to be a little bit better market than it has been to try to work through what those purchases look like. The only caution I would give you is we're going to stay committed to the safety tech and the more tech-enabled trucks that we've been buying and those do come at a cost. And so, that's a lot to do with why our focus is so heavily on the "everything else" category. There is no silver bullet, there is no one tailwind coming. It's going to have to be fought out the old-fashioned way and we're going to continue to look for ways to lower our cost going into '20.

**Tom Wadewitz**

Okay, great. Thanks for the time.

**John Steele**

Thank you, Tom.

**Derek Leathers**

Thank you.

**Operator**

Our next question comes from Jack Atkins of Stephens. Please go ahead.

**Jack Atkins**

Hi, guys, good evening. Just a couple of quick questions, I guess, when we think about the nice continued growth in terms of revenue per tractor per week within the Dedicated business, it was up 4.1%, which was in line with the same type of growth you saw in the second quarter on a harder year-over-year comparison. So, I guess, as we sort of think about the components of that, and I know you don't want to get too granular there, but the components of that nice growth on a year-over-year basis, is that a function of more miles per truck or is that a function of are you seeing some increased rate momentum there? Just kind of help us think about the directionality of those, if that's possible.

**John Steele**

Yes, without being too specific, Jack, I'll say its more rate than miles.

**Derek Leathers**

A lot of has to do with mix...Dedicated mix changes, as you add new fleets in and that does have an impact as well.

**Jack Atkins**

Okay, understood. Understood and then just in terms of tractor count sequentially between One-Way and Dedicated, it sounds like One-Way is coming down but Dedicated is going to be growing up sequentially. Can you help us think through that, John, if it's possible to kind of put a finer point on it?

**John Steele**

Well, overall, we don't expect any fleet growth sequentially from third to fourth quarter.

**Jack Atkins**

Okay.

**John Steele**

But, you're right; we ended up expecting more Dedicated growth in third quarter than we had. I think we were up 40 trucks and our plan was to be up closer to 100. We're beginning to see that come back here as we implement some new Dedicated fleets this quarter. So, I think we will see a little bit of a shift from One-Way Truckload into Dedicated in fourth quarter if things play out, based on where we think they will as of today.

**Jack Atkins**

Okay. Thank you for the time.

**John Steele**

Thank you, Jack.

**Operator**

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

**Ben Hartford**

Hi, good evening, guys. Derek, just wanted to focus on the double-digit volume growth in the Truckload Logistics portion. What are the sources of that growth? Obviously, it's been a tough third quarter from a volume standpoint. So, maybe could you talk a little bit about the drivers or the sources of the volume there? And as you think about 2020 without being too specific, could you just provide us some context about where the organization sits from a brokerage capacity standpoint, some of the tech investments that you've made, and maybe what the posturing is

going to be as you look into 2020 to use your words kind of the tough 4Q, 1Q, where does that unit sit?

### **Derek Leathers**

Yes. So, this year, just as a broad brush kind of overview, we came into the year more bullish in brokerage and more bullish in Logistics and adapted as the year played out. We've seen double-digit volume growth offset by double-digit rate decrease especially in the transactional part of our brokerage business. We made the decision that we're not going to pursue growth for growth's sake, but we did stay true to the early decision to continue to invest in tech. So, we see margin compression that comes across the variety of fronts, but we feel that the steps we're taking are the right ones to prepare us to be ready and able when that market change takes place to shift back into more of a growth mode. With double-digit growth in volume offset by double-digit declines in rate, it naturally sets itself up, when you see spot rates rebound to start to see revenue growth both in volume and rate, and therefore have kind of more noticeable more meaningful upside.

The tech investment we're making is not dissimilar from what you hear from others. It's really trying to automate all the parts of the process that we think we can. It's the ability to deliver to the desktop and handheld, if you will, to our associates, all the information relevant to be able to make the right decision and make it faster. We're seeing that play out. We're seeing productivity increases that are double-digit and growing at the seat level in terms of loads covered per day and the ability for them to transact on their decisions more quickly. We're going to continue to invest in that, but we're not going to get to that bleeding edge level, because we don't believe we need to. We think we can make the types of steps and the incremental gains happen without needing to sacrifice margins altogether, and we're going to deploy kind of tech in pockets and then expand nationally, once proven, versus expand nationally and try to fix where the errors may be after the fact. That's been prudent and thus far we're going to continue on that path.

I think as we look into next year, our focus on small-to-midsize customers that expand our visibility into other and new supply chains is going to remain intact, but we're also now starting to gain more acceptance at some of our core customer levels, which allows or sets the stage for us to be able to accelerate that growth.

I think asset-backed brokerage still matters to customers and they see viability in it. And as you see supply corrections taking place and what happens to folks that work exclusively with non-asset brokers in terms of their financial stability, customers take note of that as well. And so we will continue to push forward. And as you indicated, it's too early for me to be putting a line in the sand on what I think 2020 looks like in terms of revenue growth on the brokerage unit.

### **Ben Hartford**

Great. A follow-up on that, is there a specific driver on the volume growth in that unit? Is it coming from what you talked about the asset-backed solution, is it coming from the competition? Is it a conversion either internally or from a private fleet? Is there a source of that volume growth?

### **Derek Leathers**

It's a little of all of the above, but we're gaining reps and gaining abilities both tech capabilities as well as experience with our transactional brokerage unit and we certainly see a lot of upside there. We've seen some small-to-midsize contractual Logistics agreements come to fruition offsetting some businesses that we've exited, that we have chosen to exit this year in that space as well, where we felt the margins and the returns didn't justify our ongoing relationship.

We'll continue to kind of do that as we go forward where it makes sense, but I think it's transactional brokerage and getting better reps with better tech. It's contractual brokerage across small-to-midsize shippers and it's the entry point now into some of our larger relationships that makes me feel good about the future of our Logistics product.

**Ben Hartford**

Great. Thank you.

**Operator**

This concludes our question-and-answer session. I will now turn the call over to Mr. Derek Leathers, who will provide closing comments. Please go ahead.

**CONCLUSION**

**Derek Leathers**

Thank you. On slide 17, we have an overview of in our view why invest with us. But I'd like to take a minute and just talk about the quarter, and how we feel from a closing perspective or closing thoughts. At the end of the day, we told you that we would go out and build a portfolio and a process and have the operational execution to perform better in good or bad markets. The third quarter was certainly a tough one. Despite that, we delivered an 88.3% OR net of fuel for the quarter, which I think is an indication or a window into how we operate and how we think.

As we look forward, we're going to stay disciplined on the cost side; we're going to continue to be consumer-driven and service-focused. We're going to double down on our commitment to working with winning companies and be a part of their growth as they continue to win. There is a lot of economic uncertainty, there is trade and tariff clouds around us, but we think that the commitment to our cost controls, our operational focus and our commitment to excellence above all else will help us endure and continue to set us apart.

I appreciate you being with us on the call today. We thank you for your time, and we look forward to your further interest in Werner. Thank you.

**Operator**

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