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Wolfe Analyst: Scott Group

Werner Enterprises: John Steele, EVP and CFO. Chris Neil, SVP Pricing and Strategic Planning

John Steele

We're excited to be here in person. It's the first in-person conference we've done -- we did one in Miami earlier this year, but it's great to be back in the city. We'd like to take this opportunity to give you our view of the current market and how Werner is positioned in that market.

So over the last three months, following the invasion of Ukraine and the Fed's action to increase interest rates to control inflation, spot rates are down about 35% from the peak. One-way Truckload freight demand has moderated from really superior levels to what we would characterize as very strong. Truckload supply continues to be challenged by a very competitive driver market and persistent OEM new truck build delays.

We're one of the five largest carriers with a fleet of 8,200 trucks. Nearly two-thirds of our trucks reside in Dedicated, or about 5,200. The Dedicated operation has extremely high on-time service requirements with our customers. The fleets are sized based on our customers' more consistent year-round volumes of freight, and our Dedicated freight demand remains strong at this time with no slowdown to date. We have hundreds of Dedicated driver openings and a robust customer bid pipeline.

We're paid in Dedicated on an all-miles basis. Our contracts are three to five years, annual pricing adjustments, and we have a stable revenue stream in Dedicated. Our revenue per truck in Dedicated has increased each of the last five years and seven of the last eight.

In One-Way, about a third of our business is multi-year customer contracts. We specialize in the harder-to-serve Mexico cross-border business, engineered home nightly, and the ECM regional fleet home nightly operation. So overall, our trucking business is 95% contract, 5% spot, and 75% of our total trucking business is under multi-year contracts. We have a growing and increasingly profitable Logistics operation in Brokerage, Intermodal, and Final Mile.

Three of our top five customers are discount or dollar store retailers that perform well in economic markets when consumers place even more emphasis on value. And the other two customers in our top five are industry-leading home improvement and beverage companies. Five of our top 11 are discount retailers or food and beverage; they ship consumer non-durable goods with a repeatable freight that's less sensitive to changes in the business cycle. So regardless of where the direction of the freight economy goes from here, we think we're really built to perform and thrive.

And so, with that Scott, I'll turn it back over to you for the Q&A.

Scott Group

Fantastic. Thank you, John. So maybe let's just start on the macro. You talked about on the first-quarter call, March was very good, relative to strong previously. I guess is there a new adjective you'd use right now? And then, obviously lots of news last week about Target and Walmart and we’ve seen some other retailers talk about inventories this week. What's your perspective, or what are you hearing from your customers as it relates to inventories and demand?

John Steele

Yes, we're still seeing a strong environment on the One-Way side. It's a little more balanced than it has been in past. Last year was certainly aided by the government stimulus, and we were tremendously overbooked at times last year, where it's more manageable overbooking levels this year.

As it relates to the retailers, we're 60% retail, so that's important to us. Nine out of our top 14 retail companies have reported thus far. We get two of our top five that report tomorrow, so we'll get more information tomorrow on how they're doing.

And I think really the best way to quote it is to quote it based on what they're saying, as opposed to what we're seeing. They're saying their inventory levels -- they're still operating with less inventory than they did pre-pandemic. Another said, their in-store inventories are where we want them to be. Their in-stocks are not back to pre-pandemic levels, said another retailer.

Now one said, we're in a short period of needing to right size our inventory; that would be Walmart. And another retailer said, our inventory was up 10% with inflation being up 13 and volume down three. So we would characterize it based on our own conversations with them, that inventory levels have caught back up to close to, or equal to, where it was pre-pandemic, where last year, they had significant shortfalls.

So, it's not that, in most cases, they're overbooked with inventory compared to the level of demand that they see in the marketplace. But they've had some pretty severe supply chain challenges they've had to deal with in the last year. And as a result, they've had to adjust their inventory levels accordingly.

They're lapping stimulus from last year, demand is not quite as strong as it was a year ago. But relative to most markets, it's still a pretty good market, especially for the consumer nondurable goods, the household items, the food, the beverage, the consumable products that we haul for customers consistently year-round. We think we're in a pretty good place.

Audience

I just have this one [question] when I think on the inventory. John, when you said it's caught up to pre-pandemic, is that on a relative to sales basis or in absolute terms?

John Steele

I'd say on a relative to sales basis because inflation is built in, probably 10% in the last year in terms of the value of inventory. So, it's more of an inventory to sales. And so clearly, there is risk that the sales side could slow from here and their inventory would need to adjust accordingly. But based on where we're at, especially with our Dedicated freight mix, we feel pretty good about where we sit today.

Scott Group

Okay. So let's talk a little bit about spot pricing. So are you seeing any signs of uptick in spot pricing, and I'm guessing there was some noise last week of Road Check. But overall, what's the trend you're seeing in spot rates? And then where are spot rates today relative to contract rates?

Chris Neil

Yes, I'll take that one. So, first of all, I guess I'd level set and say that from a spot perspective, what we do at Werner is fairly minimal. We have a big -- Dedicated is 63% of our TTS fleet. In our One-Way fleet, we don't do a ton of spot; we are exposed a little bit. So as spot rates have come down, we've certainly seen that both internally and from the market in total.

We have seen some stabilization, I'd say, in the last couple of weeks in the spot market. Part of that probably was Road Check. I think we've seen some improvement in some of the spring seasonal shipments from home improvement companies and others. So, I think we're seeing some stabilization. Whether or not that will continue or not, hard to say, but we have seen some strength in the last couple of weeks.

As it relates to how spot compares to contract, I mean, it's getting close. Again, we do such a little sliver of that market, that in our world spot still exceeds contract by some measure. But we'll continue to monitor and see how it goes.

Scott Group

And so, Chris or John, what does that mean from a contractual pricing standpoint? Are we still getting -- I think we talked about high single digit, maybe low double-digit increases at the start of bid season. As we're now in the middle part of bid season, are we still getting -- what kind of increases are we getting as you look out to the tail end of bid season in third quarter? Do you think we'll still be getting increases? Is there any risk of starting to see contractual decreases? How do you think about that?

Chris Neil

Well, I'd start by saying that in terms of our progress with bid season, as I look at our One-Way trucking progress, we're probably 60% of the way through, maybe a little more than that. And we're in relatively later-stage conversations as we're kind of winding toward the end of bid season.

So far, our renewals have been as planned. They have been in the lower double-digits early in the year. As we lap last year's increases, which started to escalate into the double digits last year at this time, the rate of change will certainly moderate a little bit throughout the rest of the year. But nonetheless, we feel like from a contractual perspective, shippers still want to work with carriers who have a stable and financially strong balance sheet.

And so, I think with all the volatility that we've seen, whether it's the Ukraine thing, whether it's the increase in fuel prices, the inventory disruptions, the ongoing supply chain disruptions, we continue to feel like folks want to have a solid partner in their transportation carrier. And we feel like our service product has been very good, our capacity has been stable and strong throughout the course of the year. And so, we feel like we're in a really good position to continue to be that partner for shippers out there trying to traverse this really volatile environment.

Scott Group

Okay. John, I'll try and to turn into maybe a guidance question for you, right? So, you guided One-Way yield growth, second quarter, 14% to 17%. A month later, how are we feeling on that guidance?

John Steele

Yes, we're still feeling confident based on that guidance. Now remember, we added the ECM acquisition in July last year. And so that helps our rate numbers. It hurts our utilization, but it helps our rate numbers a little bit, and we'll lap that in third quarter.

When we gave the guidance for the first half, and I think it was 17% to 19% or 16% to 19%, something like that, for the first half, we assumed that first quarter was going to be a little bit stronger than second quarter. So that 14% to 17% based on how things have progressed, noting that we're only 5% spot overall and 10% spot in One-Way, we feel very comfortable with that 14% to 17% range at this point.

Scott Group

Now that higher first quarter, that's a year-over-year comp?

John Steele

Yes.

Scott Group

So we're still seeing -- like revenue per mile is increasing sequentially 2Q versus first quarter?

John Steele

Yes, a little bit. Our comps get tougher as the year goes on. So clearly, the rate comps will be more challenging in the second half than the first half. So it depends on how the demand environment continues from here.

Scott Group

Yes, I was thinking just more of the absolute still rising.

John Steele

Yes, the absolute number is still rising. Correct.

Scott Group

Okay. Now one thing that can -- the comps get tougher on year-over-year yield, but one thing that can certainly get better is utilization, right? So, what's the trend you're seeing in utilization so far in second quarter? And then when is it -- when realistically do you think that utilization can turn positive year over year?

John Steele

Yes, it's a little bit better in second quarter mostly because we had Omicron in January that challenged first quarter for the first month, and we didn't have that impact in second quarter. I wouldn't say it's meaningfully better because some of the challenges that we're dealing with, with accessing team drivers, driver turnover, are still there with us. And I believe your question is more geared towards the One-Way side of the business. So slight improvement from first to second quarter, but still challenged by the driver market.

Scott Group

Are you seeing any signs of driver market getting better?

John Steele

It's easing a little bit, and I think some of it is self-imposed. We've expanded our school network from 13 to 22 locations over the last 15 months. And so that's helping. I mean, there is certainly some costs that went along with building up those schools. But we're in a better place now for recruiting and retaining drivers than we were.

I'd say the market has improved slightly, but it's still really, really competitive. It's the home-every-night jobs that we're competing with, not just in trucking, but in general industry. And with the low unemployment rate, it's still hard to get and keep good drivers.

Scott Group

Okay, let's talk margins. So, I think you said on the first quarter call that Truckload margins may not improve as much as normal sequentially in second quarter. Any more color you can give there? I'm still confident we'd get some degree of margin improvement sequentially.

John Steele

Yes, we expect margin improvement sequentially. But the drop-off from our strongest seasonal quarter, which is fourth quarter to first quarter, was only 15%, 2021 to 2022. And normally, it's more of a 30% decline. So, we're comparing to a higher base in first quarter. And Ukraine happened, then fuel prices happened in the middle of first quarter, and that's put a little bit of pressure on the demand side. So, I wouldn't expect as much improvement as normal, second quarter of 2022 compared to the first quarter of 2022.

Scott Group

How is fuel impacting you guys right now?

John Steele

It was a little bit of a pain point, but we're fortunate that we're paid on an all-miles basis in Dedicated, so our surcharges adjust weekly. We were up about $0.80 a gallon from the end of February to the end of March, and it's about another $0.40 a gallon since the first of April. So, there are empty miles and truck idle time, it's a little bit of pressure, but the surcharge programs are working well to minimize that. So, I'd say a small negative impact.

Scott Group

And then what about the sphere around diesel shortages in East Coast? Are you seeing that? Are you worried about that? Can you do anything to prepare for that?

John Steele

There is a lot of talk about it. We've kept very close to our fuel suppliers, and we have not experienced any shortages. But, with all the attention this issue is getting, we get a daily update of the markets, particularly in the East, and we have not had any shortages to date.

Scott Group

Okay. Dedicated, maybe give an update on Dedicated revenue per truck per week. How are things trending relative to that 4% to 6% guidance you guys gave? Let's just -- we'll start there. Yes.

Chris Neil

Yes, so guidance, there is 4% to 6% on a year-over-year look back. And I think in the first quarter, we posted 7.3% year-over-year change in Dedicated revenue per truck per week. That's a metric that measures both miles and revenue. So, our revenues have been a little higher than that; miles, as we already talked in terms of utility, have been a little less than that. But we continue to feel like we're in a good position with Dedicated. Renewals, have been strong. As we've eased into more of a balanced market, we feel like utility will continue to improve, as John already mentioned. So, we're -- we feel good about that guidance moving forward.

Scott Group

Chris, how is that pipeline for new Dedicated?

Chris Neil

Yes, pipeline is very good. We would have said that a year ago, and it continues to be good. We've seen no drop-off in demand from a Dedicated perspective. And I think it really gets back to this thought around this volatility in the unchartered waters that we're in and people wanting a consistent, reliable, safety and service-based provider in this environment.

So, I think with all the unknowns coming up, I think people will continue -- shippers will continue to look for carriers to provide that Dedicated service. We work in a very high service-oriented field. Much of our customers have 98%-plus on time kind of demands. In many cases, there are fleets where the driver is involved in unloading and some of the other things involved with that beyond just the driving. So, it's -- we have over 95% retention rates on our Dedicated renewals. All those contracts are three to five years, and so we feel like it's a real solid place to be.

Scott Group

Ideally, that mix of Dedicated versus One-Way, do we go even more Dedicated over the next year or two percentage of the mix? Do we start to grow truck little bit more?

Chris Neil

Yes, I don't think we're opposed at all to increasing the Dedicated percentage as a total of TTS. Right now, it's at 63%. Years ago, five years ago or so, it was probably mid-50s. So, we've grown that over the course of the last few years. That's been our plan to grow more in that stable middle Dedicated, where the volatility is just much less than the One-Way environment.

We have the ability now to supplement and complement our Dedicated service with Logistics. That Logistics piece in our world is a much bigger piece than it once was. And so as customers need flex capacity, we're able to do that now with Logistics. We used to rely more on our One-Way side for that. We're doing that less. And so as a result, I think we can grow Dedicated a little bit more and continue to build on that durable, resilient kind of model that we're building.

Scott Group

John, you guys have talked about double-digit annual revenue growth going forward. If we assume a softer trucking market next year, is that -- would you still target double-digit growth next year? How do you think about that through a cycle, the double digit?

John Steele

Yes, and that's a five-year growth goal with average growth of 10% over that five-year period. It was about 5% to maybe 6% truck growth with the balance being rate and a little bit faster rate of growth in Logistics. It really depends on the Dedicated market, probably. I would say a heavier focus on Dedicated growth than on One-Way Truckload.

Mostly organic, it could be supplemented by a small acquisition. We did a couple in the last nine months that added to our portfolio and are accretive to earnings. So, it's possible that small part of it could be due to acquisition. So, I'd say just expect a little bit more growth from Werner over the longer term than what we've done in the past, but it's not growth at the expense of margin. We intend to stay in that 12% to 17% TTS margin range and as high on that end of the range as possible.

Scott Group

So, let's talk about that range, so that 12%, the low end. What would have to happen to -- be it price or gains with the combination of the two? Those are probably the two biggest tailwinds to margins right now: pricing, and then to a lesser extent, gains. What has to happen to see you go back to that low end of that margin range? How much would rates have to fall?

John Steele

It would be a much more difficult macro environment, where rates are meaningfully negative in One-Way and probably flat to slightly positive on a Dedicated revenue per truck basis. We don't anticipate getting all the way to 12%. I mean, Chris has forecasted this a lot of different ways based on a lot of historical environments that we've dealt with in the past, and we don't really see us getting to 12%. We think we'll stay above 12%. And so that's -- maybe worst case is kind of like 25% off of our current earnings level is our expectation.

And we considered the 2008 to 2009 environments. We lived through that and that was pretty difficult. But with where we're at today, with almost two-thirds Dedicated and then a more specialized One-Way network than we've ever had, we think we're in a less competitive, more durable environment than we've ever been.

Scott Group

So, we have a year next year -- my scenario, right, not yours -- where trucking rate is down, but in One-Way. But we still have Dedicated still up a little bit, Dedicated fleet's growing, utilization may be getting better. Do you think can truck -- trucking earnings grow next year in an environment where rate's down?

John Steele

If rate's down in One-Way, but it's still holding up well in Dedicated, yes, that's certainly in the realm of possibility. I mean, there's a lot of other variables like how's the OEM new truck availability been, where we're challenged right now by our fleet getting a little bit older. The last three quarters, it's increased a tenth. We'd rather not see it get much higher than this. And so we are really working hard to get the new equipment in as quickly as we can

to put less pressure on the maintenance side and the driver turnover side of the business. So there are some unknowns that would influence how our costs play out in 2023 in that kind of a scenario. But we certainly think there is a possibility of getting there, but it's not a lay-up by any stretch.

Scott Group

Okay.

Chris Neil

Scott, and also to add to that. I mean, we spent a lot of time being very selective in terms of the number of -- in the quality of customers that are getting into our Dedicated fleet. I mean, we're making sure that as customers come in with fleets that these are true Dedicated fleets. They're not fleets that can be easily transitioned over to the One-Way environment in a weaker environment.

And so our customer mix; we've spent a lot of time in the last five years improving that customer mix. We're working with very solid customers. Many of them even had some same-store growth here recently. And so, I think that's another thing that would enable us to continue to have that positive year-over-year change in Dedicated rate per mile like we've had seven over the last eight years.

Scott Group

You mentioned OEM deliveries, so what -- maybe just give an update. Are we seeing any signs of production rates improve and any signs of the deliveries improving?

John Steele

Not at this point. It's still a pretty significant struggle. The semiconductor chip problem got more difficult with Ukraine in February. The parts shortages are real. The OEMs are doing their best in a difficult environment to produce as many trucks as they can, and we're trying to make sure we stay at the front of the line. But it's still challenged and it's difficult to get what we want.

Scott Group

So we talked about this with a few of the other carriers yesterday, but it was interesting. How many trucks are you taking this year?

John Steele

Well, it depends on how many we can get. But I mean, with a four-year average age goal, I mean, that's on -- just a little bit shy of 8,000 trucks. That's over 2,000 is the plan. But I don't know if we'll get over 2,000 trucks this year.

Scott Group

And if we woke up and the OEM said for 2023, there is no limit, you can order whatever you want, no limits, we'll deliver it, relative that 2,000, what would you want to do next year?

John Steele

That's pretty unrealistic. In this environment, I'm not sure what's going to turn that upside down and make that happen. I mean, we would like to get back to a two-year average age, if we could. But I don't know what price would be charged for that. There are a tremendous amount of variables that go into that that would influence our decision making. But we would like to get back to a more normalized age for our fleet to put less pressure on the maintenance and the driver turnover line.

Scott Group

Well, you don't -- you think that they will again limit orders for 2023?

John Steele

Well, they've got a 10-month backlog now. So, to dig out of that backlog is going to take a lot. And they have a limited amount of plant capacity, they have labor challenges. So, it's unrealistic to think that they could do that and turn it on a dime quickly.

Chris Neil

On the parts shortages, on the component parts and the chips and all that are still creating problems. And I think we expect that to continue at least for the near term.

Scott Group

Used truck pricing, given what you're saying, is that holding firm? Any signs of that starting to moderate?

Chris Neil

Yes, I think it's probably plateaued to some degree. But again, with the challenges on the used truck side, inventories continue to be low. And so, I think as spot rates decline, it's unlikely that they will go higher. But I think at the same time, we feel like used truck prices are -- will probably decline moderately from here; I don't think it's going to be a cliff moment at all throughout the course of the rest of the year.

John Steele

It depends on new -- I mean, if the new production increases and that probably softens the used truck market. But it's still at record levels right now. And it's really the demand side of freight that's probably causing it to plateau at this point.

Scott Group

Given fuel prices, spot rates, any signs of change in owner operators versus company drivers and what people want right now?

John Steele

We're increasingly a company truck fleet compared to owner operator. It's been pretty competitive market for owner operators, and I would expect you'll see our company mix continue to increase.

Scott Group

How is -- maybe an update on the Brokerage business and how it's performing and with that, an update on Power Only.

John Steele

Chris, do you want to take that?

Chris Neil

Yes. Brokerage demand continues to be good, including Power-Only. So Power-Only is probably our biggest, fastest-growing part in Logistics right now. And with some of the smaller carriers or independent operators that are challenged now with higher used equipment cost, higher fuel cost, higher inflation in general, we think there is probably going to be a little bit better availability as some of those folks move over to work with bigger carriers who have a stronger carrier base -- or shipper base and aren't reliant on the spot rate.

And so, we think that our continued investments in technology, the platform that we have in Logistics with Brokerage and Intermodal and Final Mile; we just purchased and acquired NEHDS, the Final-Mile provider back in the fourth quarter. So we're on a nice growth trajectory there. We've strung together several really good quarters in Logistics, and we feel like again, demand continues to be good.

On the Power-Only side, we think customers really have accepted that, and it's really seamless now to them with a trailer pool that's a Werner trailer pool and using that trailer pool for Power-Only to come in and hook up to. So, we think that's resilient and then that's got some good growth potential moving forward.

Scott Group

So, in a slower -- even in a slower market that you think Power-Only still has a very good growth driver.

Chris Neil

Yes, I think so. I mean, it's more in the contract side of the business. So, it's not in the live load, live unload, true Brokerage end of it that's probably going to see some -- I mean, in a slower economy, that would be the first that would see some weakness. And so on the contract side, we think that will be resilient and continue to be a growing part of our portfolio.

Scott Group

John, we're doing 5% Logistics margins in Q1. You give us a range now for truckload margins. What do you think is the right range for Logistics margins for you guys?

John Steele

Over time, our goal would probably be in the 4% to 6% range, and that's a combination of Intermodal, Final Mile and Brokerage in there. Intermodal is challenged right now based on the rail service issues in the marketplace. Final Mile is doing well. Brokerage is doing really well in light of the fact that spot capacity costs are declining. Rates are holding up pretty well on the contractual side of the business. So margin growth is pretty strong there.

Scott Group

Okay. I want to wrap here, John. Very little differentiation, valuations for truckload stocks. And you guys all have different strategies that you're working on to sort of diversify beyond just the cycle. What are the company-specific growth, costs, anything that you want to highlight for us as we try and differentiate among the different trucking companies?

John Steele

Yes, that's what I attempted to do in the first three minutes was to kind of tell the story of how we're different. I mean, we're 75% multi-year contracts; we are almost two-thirds Dedicated. We worked hard to build a portfolio that can then protect us. And if we need to play defense, we're ready to play defense. We can't predict the market, but we've got a position in the market that is less volatile and more stable than it's ever been. So, I think that positions us well for whatever the macro kind of brings.

Scott Group

And do you think about balance sheets under levered relative your target? Is this more acquisitions, more likely a big buyback; you could buy back a lot of the stock over the next few years, if you want to?

John Steele

Well, we purchased stock the last couple of quarters at higher prices that what we're trading at now. So we certainly see opportunities in the stock. We'll be very selective about acquisition opportunities that come our way. But we've shown with two acquisitions in the last nine months, that we have an interest level when the right situation comes along at the right price that's additive and accretive to our business. So we'll continue to look at that. I don't think you'll see any huge market-moving acquisitions from Werner, but smaller fits that make us better are certainly something that we'll continue to consider.

Scott Group

Okay. We're going to wrap there. Thank you, guys, so much. This was great.