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Ryder System, Inc. (R)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

Robert S. Brunn
Vice President-Investor Relations, Corporate Strategy & New Product Strategy, Ryder System, Inc.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

John J. Diez
Chief Financial Officer & Executive Vice President, Ryder System, Inc.

J. Steven Sensing
President-Global Supply Chain Solutions, Ryder System, Inc.

Tom Havens
President, Fleet Management Solutions, Ryder System, Inc.

OTHER PARTICIPANTS

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Scott H. Group
Analyst, Wolfe Research LLC

Stephanie Moore
Analyst, Truist Securities, Inc.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Todd Fowler
Analyst, KeyBanc Capital Markets, Inc.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Justin Long
Analyst, Stephens, Inc.

Bert Subin
Analyst, Stifel, Nicolaus & Co., Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Ryder System Third Quarter 2021 Earnings Release Conference Call. All lines are in a listen-only mode until after the presentation. Today's call is being recorded. If you have any objections, please disconnect at this time.

I would now like to introduce the call to Mr. Bob Brunn, Senior Vice President, Investor Relations, Corporate Strategy and New Product Strategy for Ryder. Mr. Brunn, you may now begin.

Robert S. Brunn

Vice President-Investor Relations, Corporate Strategy & New Product Strategy, Ryder System, Inc.

Thanks very much. Good morning and welcome to Ryder's third quarter 2021 earnings conference call. I'd like to remind you that during this presentation, you'll hear some forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to changes in economic, business, competitive, market, political and regulatory factors.

More detailed information about these factors and a reconciliation of each non-GAAP financial measure to the nearest GAAP measure is contained in this morning's earnings release, earnings call presentation, and in Ryder's filings with the Securities and Exchange Commission, which are available on Ryder's website.

Presenting on today's call are Robert Sanchez, Chairman and Chief Executive Officer; and John Diez, Executive Vice President and Chief Financial Officer. Additionally, Tom Havens, President of Global Fleet Management Solutions; and Steve Sensing, President of Global Supply Chain Solutions and Dedicated Transportation, are on the call today and available for questions following the presentation.

At this time, I'll turn the call over to Robert.

Robert E. Sanchez

Chairman & Chief Executive Officer, Ryder System, Inc.

Good morning, everyone, and thanks for joining us. On today's call, I'll begin with the strategic update and then cover the investments that we're making in innovative technologies to accelerate growth in our Supply Chain and Dedicated businesses.

I'll also discuss today's announcement of our plan to acquire Midwest Warehouse & Distribution System. John will take you through our third quarter results, which exceeded our expectation again this quarter and review our disciplined capital allocation strategy focused on returns. I'll then discuss our updated 2021 outlook.

Let me start with some key highlights about the market and our results. Long-term transportation and logistics outsourcing trends continue to support our growth strategy and investments. Trends in warehousing and distribution as well as in e-commerce fulfillment and last mile delivery of big and bulky items have continued to accelerate since the pandemic began. Our strategic investments remain focused on leveraging these favorable outsourcing trends.

Unprecedented challenges impacting labor, supply chains and truck production are providing us with additional growth opportunities because they help drive companies to make long-term outsourcing decisions. We're seeing record new contract wins in Supply Chain and Dedicated, which we fully expect will contribute to long-term profitable growth.

FMS is also benefiting as companies are looking to source truck capacity in this extremely tight market. Consistent with our disciplined capital allocation strategy, we're investing in our higher return logistics businesses through our planned acquisition of Midwest Warehouse & Distribution System, which adds multi-client warehousing capabilities and supply chain and accelerates growth.

We also announced plans to return capital to shareholders over time through discretionary and anti-dilutive share repurchase programs. Use of the new discretionary program is anticipated to occur over time, dependent on several factors including balance sheet leverage, the availability of quality acquisitions and the stock price.

We now expect to achieve ROE in the range of 18% to 19% for the full year. The team has done an excellent job of leveraging favorable pricing trends in used vehicles sales and rental, resulting in outperformance in both these areas. In addition, we've continued to increase lease pricing, resulting in improved portfolio returns and a 4% increase in revenue per average active lease vehicle.

We expect additional benefits going forward as leases are renewed and repriced, and as we utilize data analytics to further segment customer pricing based on application, equipment type and other key drivers of lease returns.

Moving to cash flow, we generated strong year-to-date free cash flow of over $800 million and have increased our full year free cash flow forecast to $1 billion to $1.1 billion, up from our prior forecast of $650 million to $750 million. Our full-year forecast reflects an estimated cash flow benefit of $400 million from deferred capital expenditures due to OEM delivery delays as well as a record proceeds from the sale of our used vehicles. With balance sheet leverage currently well below our target range, we have additional capacity to enhance shareholder value by deploying capital consistent with our disciplined capital allocation strategy.

Slide 5 provides an overview of the investments we're making to drive accelerated growth in Supply Chain and Dedicated, a key element of our strategy to generate higher returns. Developing new and enhanced products such as Ryder Last Mile, e-commerce fulfillment and freight brokerage provides opportunities to leverage profitable growth areas.

Innovative technology enables us to deliver value-added logistics solutions that are in high demand. Last quarter, I highlighted Ryder Last Mile offering. This quarter, I'll discuss RyderShare, our real-time freight visibility and collaboration tool that has proven to be a key differentiator in winning new business.

Sales and marketing are key to our brand awareness and ensuring customers are aware of our full array of supply chain capabilities. Our Ever better campaign and the increased digital marketing presence have driven a significant increase in qualified sales leads. We're also expanding our sales force and investing in their capabilities to drive additional growth opportunities.

Strategic M&A opportunities, such as our planned acquisition of Midwest, are focused on adding new capabilities, geographies and/or industry verticals. These opportunities are an important way to accelerate growth, especially in Supply Chain and Dedicated.

RyderVentures, our corporate venture capital fund, aims to invest $50 million over five years through direct investment in startups. Our investments here advanced strategic relationships where we typically are working together to develop new products and capabilities that benefit our customers and solidify our position as an industry leader. We've made investments in numerous exciting areas such as e-commerce micro fulfillment and digital driver staffing, and are working with these startups to address important customer needs.

We also recently announced strategic alliances with several autonomous technology firms, which enables us to leverage our expertise in asset management, maintenance and transportation, positioning us as an innovative leader in this emerging space.

Slide 6 takes a closer look at RyderShare, an innovative digital product that combines Ryder's nearly 90 years of logistics experience with best-in-class technology. RyderShare provides users with real-time freight visibility throughout the lifecycle of an order as well as the opportunity to share information between suppliers, carriers and shippers on one platform with Ryder's team of supply chain experts managing exceptions.

RyderShare users benefit from improved service for their – for their customers, increased employee productivity and the ability to readily access information from one source for decision-making. Almost 70% of Ryder's transportation volume in Supply Chain and Dedicated now runs through RyderShare. The platform has processed over 4.4 million transactions and has over 5,300 users to date.

We're also excited about our recent launch of RyderShare for warehousing. This enhancement makes RyderShare the only visibility platform that connects transportation with warehousing. We expect this will be a key differentiator in winning new business.

I'll turn the call over to John now to briefly cover our third quarter results and review our capital allocation strategy.

John J. Diez

Chief Financial Officer & Executive Vice President, Ryder System, Inc.

Thanks, Robert. Total company results for the third quarter on page 7.

Operating revenue of $2 billion in the third quarter increased 11% from the prior year, reflecting revenue growth across all three of our business segments. Comparable earnings per share from continuing operations was $2.55 in the third quarter as compared to $1.21 in the prior year. Higher earnings reflect improved performance in FMS from higher rental, used vehicle sales and lease results as well as a declining depreciation expense impact related to prior residual value estimate changes.

Return on equity, our primary financial metric, reached 15.7% for the trailing 12-month period. ROE reflects higher earnings from rental, used vehicle sales and declining depreciation expense impact. Improved lease performance also contributed to higher ROE and reflects the impact of our pricing initiatives.

Year-to-date free cash flow was strong at $829 million, although down from a prior year when capital expenditures were unusually low due to COVID.

Turning to FMS results on page 8, Fleet Management Solutions operating revenue increased 8%, reflecting 37% higher rental revenue, driven by strong demand and higher pricing. Rental pricing increased 9%, primarily due to higher rates across all vehicle classes. FMS realized pre-tax earnings of $186 million, up by $170 million from the prior year. $93 million of this improvement is from higher gains on used vehicles sold and a lower depreciation expense related to prior residual value estimate changes.

Improved rental and lease results also significantly contributed to increased FMS earnings. Rental utilization on the power fleet was a record 83% in the quarter and well above the prior year's 71%. Results also benefited from ongoing momentum from lease pricing initiatives, partially offset by a 3% smaller average active lease fleet.

FMS EBT as a percentage of operating revenue was 14.9% in the third quarter and surpassed the company's long-term target of high single digits. For the trailing 12-month period, it was in line with the target at 9.7%.

Page 9 highlights global used vehicle sales results for the quarter. Used vehicle market conditions remain robust due to strong freight activity and [ph] tightening (00:11:38) supply from truck production constraints. Higher sales proceeds reflect significantly improved market pricing.

Globally, year-over-year proceeds more than doubled for both tractors and trucks, while sequentially, tractor proceeds were up 32% and truck proceeds were up 27% versus the second quarter 2021.

As you may recall, last year, we provided a sensitivity noting that a 10% price increase for trucks and a 30% price increase for tractors in the US would be needed by 2022 in order to maintain current residual value estimates. Our current tractor and truck proceeds significantly exceed these levels.

Average current pricing in the US for tractors and trucks is well above our residual value estimates used for depreciation purposes. As such, we are comfortable with our residual value estimates and we do not anticipate the need for any significant adjustments at this time.

During the quarter, we sold 4,900 used vehicles, down 44% versus the prior year and down 18% sequential, reflecting lower inventory levels. Used vehicle inventory was 3,500 vehicles at quarter end, below our target range of 7,000 to 9,000 vehicles.

Turning to supply chain on page 10, operating revenue versus the prior year increased 14% due to new business, higher volumes and increased pricing. Growth was partially offset by the impact of supply chain disruptions and automotive production activity. We expect this disruption to continue to impact our automotive customers until global supply chains normalize, and we continue to work with our customers to mitigate the impact. We have included an estimated impact from potential shutdowns in our balance-of-year forecast as the situation remains fluid.

SCS pre-tax earnings decreased 62% and trailing SCS EBT as a percent of op revenue of 6.2% was below target. This reflects lower automotive earnings, higher labor costs and strategic investments, partially offset by positive earnings from new business.

We anticipate the pricing adjustments we're implementing to improve SCS EBT percentages in the first half of 2022, and to move around the target range or move to around the target range in the second half of next year.

Moving to dedicated on page 11, operating revenue increased 16% due to new business, higher volumes and increased pricing. New contract wins in DTS continue to be robust with year-to-date sales results already reaching full-year record levels.

New contract wins are driven by ongoing secular outsourcing trends as well as current labor and supply chain challenges that are driving companies to make long-term outsourcing decisions. We're signing larger deals across a diversified industry base and new contract wins are also benefiting from cross-selling opportunities from FMS and SCS.

DTS pre-tax earnings decreased 54% and trailing DTS EBT as a percent of op revenue was below target at 5.3%. This reflects increased labor and insurance costs, partially offset by positive earnings from new business.

Although unprecedented labor challenges are affecting current results in DTS and SCS, we're increasing our recruiting efforts and successfully working with our customers to implement price adjustments to address higher market costs. We're encouraged by the early progress we're making on these price adjustments as we continue to deliver the superior service our customers expect.

We're confident that our new and expanded customer base and pricing adjustments will improve DTS EBT percentages in the first half of 2022, [ph] with it (00:15:54) moving to around our target range in the second half.

Turning to slide 12, lease capital spending of $807 million was above prior year's plan due to increased lease sales activity in the year. Lease returns are benefiting from pricing initiatives and support a more normalized lease capital investment. Rental capital spending of $583 million increased significantly year-over-year, reflecting a higher planned investment in the rental fleet. We plan to grow the rental fleet by approximately 15% in 2021 in order to capture the increased demand we've seen from strong e-commerce and overall freight activity.

Our full-year 2021 forecast for gross capital expenditures of $1.9 billion to $2 billion is below our initial forecast range. This reflects an estimated impact of $400 million from deferred vehicle purchases due to OEM delivery delays that Robert highlighted earlier.

Turning to slide 13, our 2021 free cash flow forecast has increased to a range of $1 billion to $1.1 billion, up from our previous forecast of $650 million to $750 million. The full-year forecast reflects our strategy to balance moderate growth in the capital-intensive FMS business, while generating positive free cash flow over the cycle. It also reflects the impact from delayed OEM deliveries and record proceeds from used vehicles sold as noted earlier.

Balance sheet leverage declined due to higher earnings and cash flow and is expected to remain below the low end of our target range this year. Importantly, we now expect to achieve ROE of 18% to 19% this year due to stronger-than-expected performance in FMS and a declining depreciation impact. Higher year-to-date comparable EBITDA, which excludes the impact of gains and losses on used vehicle sales, reflects revenue growth and improved operating performance.

Turning to slide 14, I'd like to review our capital allocation priorities, which are focused on creating long-term shareholder value by investing in high-return opportunities that generate positive free cash flow over the cycle. Our first priority for capital is investing in high-return organic growth opportunities, which includes moderate FMS lease fleet growth and accelerating growth in SCS and DTS.

In our FMS business, we estimate investments of between $1.8 billion to $2.1 billion annually, and that is the amount needed to replace leased vehicles as contracts are renewed and to refresh the existing rental fleet. We also estimate investing between $200 million to $500 million in annual fleet growth, which represents lease fleet growth of approximately 2,000 to 4,000 vehicles with commensurate growth in rental. Returns in both lease and rental are expected to continue to benefit from ongoing pricing initiatives.

Investments to accelerate growth in our higher return and less capital-intensive Supply Chain and Dedicated businesses as well as technology investments that expand or enhance our capabilities are also key priorities for organic growth capital.

Targeted acquisitions, such as our planned acquisition of Midwest, are focused on adding new services, capabilities or industry verticals and provide us with important opportunities for the long-term profitable growth. Accretive tuck-in acquisitions that supplement our base business as well as investments by RyderVentures provide additional opportunities for us.

Our capital allocation strategy is also focused on returning capital to shareholders through dividends and share repurchases. Ryder has made an uninterrupted quarterly dividend payments for more than 45 years. Our dividend growth rate over the past 10 years is 7% and our current dividend yield is around 3%. The new share repurchase programs discussed earlier allow for both anti-dilutive and discretionary share repurchases.

We remain committed to offsetting dilution through the use of the anti-dilutive program. The discretionary program is planned to be utilized over time to manage leverage and its usage will be dependent on several factors, including balance sheet leverage, the availability of quality acquisitions and stock price. Our capital allocation priorities are focused on achieving ROE of 15% or higher over the cycle while generating positive free cash flow and maintaining target leverage.

I'll now turn the call back over to Robert to discuss our outlook.

Robert E. Sanchez

Chairman & Chief Executive Officer, Ryder System, Inc.

Thanks, John.

Turning now to our EPS outlook on page 15. We're raising our full-year comparable EPS forecast to $8.40 to $8.50, up from our prior forecast of $7.20 to $7.50, and well above a loss of $0.27 in the prior year. We're also providing a fourth quarter comparable EPS forecast of $2.36 to $2.46, significantly above the prior year of $0.83.

Used vehicle sales, rental and lease are the key drivers of higher expected full-year results. Gains are expected to be down slightly in the fourth quarter compared to the third quarter, reflecting strong pricing, partially offset by fewer vehicles sold due to low inventory levels.

Looking ahead to 2022, we expect both higher revenue and earnings. Record new contract wins in 2021 in Supply Chain and Dedicated are expected to benefit 2022 revenue growth. Supply Chain and Dedicated margins are expected to improve in the first half of next year and move towards the target range in the second half, reflecting price increases to address higher labor costs, barring any further market disruptions.

We expect strong freight conditions and truck production challenges to continue into 2022, benefiting FMS results. Declining depreciation expense impact is expected to benefit year-over-year earnings comparisons by $85 million. However, this is expected to be fully offset by higher book values on vehicles being sold next year.

Used vehicle sales volumes are expected to be flat to modestly higher. Used truck pricing for the year is expected to be flat to modestly higher in 2022, remaining strong through at least the middle of the year and potentially declining in the second half if new truck production ramps up and used vehicle inventories and the overall market begin to normalize.

Free cash flow next year is expected to decline, largely reflecting the $400 million capital expenditure deferral from 2021 into 2022 due to OEM delivery delays. Given the unusual OEM production situation, it would be appropriate to look at combined free cash flows in 2021 and 2022.

Overall, we're pleased with the trends that favor outsourcing and our efforts in sales, marketing and new product development. We're confident in the actions we're taking to increase returns, including higher pricing to offset labor challenges, positioning us well for 2022.

That concludes our prepared remarks this morning. Before we go to questions, please note that we expect to file our 10-Q later today. We had a lot of material to cover today, so please limit yourself to one question each. If you have additional questions, you're welcome to get back in the queue and we'll take as many as we can.

At this time, I'll turn it over to the operator.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we'll take our first question from Allison Poliniak with Wells Fargo. Please go ahead.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. Just want to ask about Supply Chain Solutions, obviously, some margin pressure there. Is there a way to kind of dissect that a little bit more for us in terms of what was due to the automotive versus the higher labor cost? Certainly, you expect some improvement into next year, but I just want to try to see kind of where those buckets are at this point.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. If you just look at supply chain, a lot of the challenges really come from the auto group. And it's primarily the semiconductor shortages that are impacting production, therefore, impacting the amount of revenue that we're getting from that side of the business, and also some of the driver turnover and the driver shortage challenges that really are affecting all of the transportation-related verticals, but significantly, I would say, around the automotive. So, Steve, anything else that you want to add there?

J. Steven Sensing
President-Global Supply Chain Solutions, Ryder System, Inc.

A

No. I think those two, Robert, and then we did increase our investment both in RyderShare, the Ever better campaign and a couple of other areas. So I think those three kind of sum it up.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

And I would just add, Alison, the goal is for us to – through the price increases that we're putting through to offset the labor cost increases and a supply chain within automotive starts to hopefully stabilize as we get into the back half of next year. We do expect margins to improve in the first half and then get back towards our target ranges of high single digits in both Supply Chain and Dedicated in the back half of next year.

Allison Poliniak-Cusic
Analyst, Wells Fargo Securities LLC

Q

Got it. Helpful. Thanks you.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Okay.

Operator: Thank you. [Operator Instructions] We'll take our next question from Scott Group with Wolfe Research.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Hey. Thanks. Good morning, guys.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Good morning, Scott.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Robert, you said that there was an $85 million benefit from lower depreciation next year, but there was an offset. I missed what that offset was, if you could just help us.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. The offset is the rising residual values. If you remember, this year, the residual values that we have in place are at the accelerated level, which was much lower and we made those changes back in 2019 and 2020. As we go to next year, it goes back to the policy levels, which will be higher residual values.

So what we're saying is that that – it's about $85 million, which is the offset that we see with the roll-off of depreciation. So, really, when you think about year-over-year, the real impact is going to be from what happens with pricing and volume within used vehicle sales. And we think that's going to be flat to up as we look at next year, certainly strong in the first half and then maybe pricing coming down in the second half, as more inventory begins to get into the market, especially the truck – really if the truck OEMs can get their production levels back.

Scott H. Group
Analyst, Wolfe Research LLC

Q

And just so I understand that, so the higher residual value, so that shows up in – even if used prices stay the same, gains on sales would just be lower next year by $85 million. Is that what you're trying to say?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

Correct, correct. If pricing stays the same, gains will be less by $85 million, but then you'll have a benefit in depreciation of $85 million.

Scott H. Group
Analyst, Wolfe Research LLC
Q

Okay. And your view, though, on the market is that – maybe just talk about your view on OE production for next year. And it sounds like you think used pricing stays firm through the first half and then maybe starts to moderate a little bit in the second half.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

Yeah. It's still pretty early in the process, but, yes, our view right now is that, from what we're hearing from the OEMs, the semiconductor challenge and production challenge still sticks around through the first half of the year, and then really improves in the second half. So if truck production is limited, it's going to be hard to get used truck inventory into the market, right, because the inventory is created by a replacement. When a new truck comes in, the used truck goes into the market and it's replacing. So without new trucks coming into the market, you're going to have a constrained used truck market at least for a period of time.

I mean there could be some seasonal adjustments in the first quarter. We may see a little bit to come in, but I think, overall, we'll continue to be pretty constrained. And we get into the second half then, if production ramps up, you'll see – certainly, the year-over-year comps get a lot tougher, but you'll also see maybe some of the pricing coming down.

Operator: Thank you. We'll take our next question from Stephanie Moore -

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

But I would tell you the net of that – I'm sorry, let me just add to that. The net of that, I would say, since prices have risen so much this year and are at much higher levels now, the net of all that is, on average, we think pricing will be flat to up because it's coming from a very high level right now.

Operator: Thank you. We'll now take our next question from Stephanie Moore with Truist.

Stephanie Moore
Analyst, Truist Securities, Inc.
Q

Hi. Good afternoon. Thank you for the questions.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

Hi, Stephanie.

Stephanie Moore
Analyst, Truist Securities, Inc.
Q

I wanted to talk a little bit more longer term focused than the pricing opportunity within FMS. I believe your pricing initiatives successfully began really several years ago during admittedly some – a weaker freight environment. So we could assume Ryder kind of had historically been under-pricing based on its level of services.

So, fast forward now and just given this freight environment where we're seeing really strong pricing as well. So it's kind of a long-winded way of asking is Ryder catching up for maybe under-pricing in the past, or is this just a function of the current environment? And really, what is the opportunity in pricing as we get out of this current environment whenever that might be?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

Yeah. Stephanie, thanks for the question. Look, I think when you look at when did we start raising prices and leases was in 2018. As we started to see the used truck market really take a pretty significant decline, starting in the end of 2015 through [indiscernible] (00:30:41) that lasted through 2020. So really to account for that additional risk, we realized we've got to get the pricing up.

So we've had some good success with that. I think customers in the market has recognized the importance of this and the value that we bring. So the good news is that each year, when a vehicle turns out, it's being repriced at the higher prices. We're about halfway through that. If you think back in 2018, 2019, 2020, we're in the fourth year now, maybe a six-year cycle, but we're also continuing to evaluate and look for opportunities to adjust pricing, especially as we implement more data analytics around understanding which applications, which vehicle types really are costing us maybe more money than we thought, and we need to adjust the pricing there.

So I think it's an ongoing benefit to the returns and it's something that we still have – just on what we've done so far, we still have a couple more years of benefit to go, and I think there's ongoing process. But let me hand it over to Tom and he can give you a little more color about kind of what we're seeing in the market and the acceptance of that – of those price increases.

Tom Havens
President, Fleet Management Solutions, Ryder System, Inc.
A

Yeah. We do continue to have more opportunity in the pricing segmentation that Robert mentioned. So that has been ongoing since 2018 and we've continued to refine that process. And I would tell you that, you have seen a nice increase in the rates in the lease fleet on a per unit basis thus far, that's reflected in the P&L and the numbers you're seeing today, but we have had also a very strong sales year this year at the new pricing levels. And because of the OEM delays, the majority of that equipment hasn't yet arrived and that new pricing isn't reflected in the P&L yet. So we're really encouraged with what that's going to look like in future years.

And as Robert mentioned, we're still about halfway through it and working through an entire lease replacement cycle. So we would expect to continue to see expansion in the margins as we work through the entire replacement of that fleet.

And we have – from an acceptance standpoint, like I said, we have seen solid sales results this year. So we haven't seen customers leaving us through this cycle and through the pricing increases. So we expect to retain that business and add new business at the new pricing as we move forward.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

So this environment is certainly helping, but we don't think that this pricing is dependent on this robust environment. We see the pricing acceptance really began prior to us getting into this environment that we're in this year. So we see this as an opportunity going forward.

Operator: Thank you. We'll now move on to our next question from Jordan Alliger with Goldman Sachs.

Jordan Alliger
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Hi. Just a question. You gave some color on SCS and DTS and the margins progression. Obviously, FMS has had fantastic margins. I'm just sort of curious, all things considered with your outlook for used trucks and the depreciation impact, et cetera, I mean, how do you think about FMS margin as we look forward from here? Thanks.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah, Jordan, we've targeted FMS margins at high single digits. Obviously, we're going to exceed that this year with the strong performance on the gains on rental side. And longer term, do we think that that – that the high single-digit really target can go up? Absolutely. It's just – if you recall, we still have a lot of depreciation going through the P&L as a result of the residual value changes that we made a couple of years ago and last year. And that's going to put a little bit more pressure on margins than we would normally expect. But once we get over the next year or two, that normalizes completely and certainly, I see an opportunity for us to revisit those target margins. But in the short-term, definitely, the environment of strong gains and strong rental is going to keep us above that high single-digit target.

Operator: Thank you. We'll take our next question from Jeff Kauffman with Vertical Research Partners.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Thank you very much. Good morning and congratulations.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

[ph] Thanks, Jeff. (00:35:25)

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Just a quick – thank you. Just want to clarify, I should know this, but it's escaping me right now. You're looking like you're generating about 26% higher revenue per vehicle in rental, but the rate change your broadcasting is 9.3%. So can you help me kind of disaggregate what's driving that differential?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. I think what you're missing there is the improvement in utilization, right. So utilization is up from the low 70s to the low 80s. So that's obviously given us higher revenue per unit beyond just the pricing.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

All right. So there's no mix differential now that you're largely sold out or any kind of changes in services or fees that's driving that is just strictly utilization?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Let me ask Tom that, but I don't believe so. Tom?

Tom Havens
President, Fleet Management Solutions, Ryder System, Inc.

A

No, I don't think so, Robert, I'd say. I think it's the utilization driver. I think going into next year, we may see a mix in the fleet chain, so more trucks, less tractors, but we haven't seen that yet.

Jeffrey Kauffman
Analyst, Vertical Research Partners LLC

Q

Just a quick follow-up. Autonomous seems to be the hot word these days. You've got a lot public, some of which you're partnering with. And I just wanted to take a step back and understand Ryder's opportunity here, and kind of where – let's say, autonomous catches on it, it's a few years out, but let's say it's going to happen. You're committing the partnerships with a lot of companies. Where can that come to benefit Ryder? And are there any new business opportunities that might arise as autonomous vehicles become more established on the highway?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah, Jeff, look, that's a great question. I think we're certainly early days in this technology. So there isn't full clarity yet on exactly how this is going to evolve, but I do believe that Ryder is well-positioned in many ways to participate in this market as an asset management company that knows how to own and manage and maintain trucks. And as a transportation provider with our dedicated and supply chain businesses that does final mile delivery, most of the autonomous technology that's being tested today is really on highway kind of hub-to-hub, which the final mile would actually be done by a driver. So Ryder has the capability to handle that very well, just even within our current network. You think about the facility of networks that we have. We have 800 facilities across North America, some of which could be used as hubs for this type of activity.

So we're in the R&D phase, I would tell you. We're excited about it, though, because we see the technology beginning to evolve, and we think that we certainly are well positioned to play a part in that.

Operator: Thank you. We'll take our next question from Todd Fowler with KeyBanc Capital Markets.

Todd Fowler
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. Thanks and good morning. Robert, I just wanted to first follow up on your response to an earlier question. So based on your fourth quarter comments, it seems like that gains are going to be about $200 million this year. Is your expectation for 2022 that gains will be at that same $200 million level, but the cadence will be different, starting off stronger and then slowing towards the back half of the year, or is that $200 million a different number for 2022?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

No, the gains – if you just look at gains alone, they'll probably be down by $85 million because our [ph] – by at least (00:39:14) $85 million because our – the book value of our vehicles is going to be up $85 million. So if you just only look at gains, they're probably going to be down about $85 million. However, that $85 million will be offset by lower depreciation expense as more of that – those vehicles that we had to adjust residual values for, as those have rolled off, our disproportionate depreciation expense rolls off.

So net-net, it's – what we're saying is flat. Assuming flat to up pricing and flat to up volume, your gains would be down not more than $85 million, but offset by a benefit of $85 million in depreciation expense.

Operator: Thank you. We'll take our next question from Brian Ossenbeck with JPMorgan.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

Hey. Thanks for taking the question. I hope that you can hear me okay. Just wanted to ask about the just overall pace of outsourcing new business wins you're seeing in SCS and DTS. We often hear that this might be the peak of those decisions, but I would tend to think that events like we're seeing that would actually create a longer tail for some of those opportunities.

So maybe you can just elaborate on that and then your confidence in getting some of these projects back to profitability, I guess, more broadly in the entire segment? And you're talking about improving in the first half, getting back to target in the second half, but that assumes no further disruption. So maybe you can also elaborate on flexibility to kind of move along with any other disruptions you might see to try to keep those closer to where you expect them to be? Thank you.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah, Brian, listen, I'll just hand it over to Steve in a minute to give you more color, but I'll just tell you this. Whenever we hear on the news supply chain disruption and people talking about the importance of supply chain, that's really good news for Ryder, because that means companies are really focusing on this capability and this function, and they're looking for companies that can help them, not just with the immediate issues that they they're facing today but how do they avoid that in the future, right? How do they design their supply chains and run them differently so they don't run into these issues two years from now. And those are the – a lot of the conversations that we're having with companies that are redesigning their supply chains and relooking at this.

So I do think I agree with you. I think it is a longer tail issue and we're certainly seeing the benefits of that in some of the sales. These are – again, these are contracts that are multiyear contracts. So all the contracts we're signing now – they're signing now are going to pay dividends for a long period of time. So, Steve, why don't you give him a little more color?

J. Steven Sensing
President-Global Supply Chain Solutions, Ryder System, Inc.

A

Yeah, Brian, thanks for the question. On the growth side of it, we're seeing historical pipelines and I think those are attributed to a couple of things. Like, our continued investment in the Ever better campaign. We started that, I guess it was mid-year last year, and we've run it through Q4 of this year. So that's continuing to help us assist not only in the top of the funnel but also converting new wins and profitable wins.

The investment in RyderShare, it is a differentiator in the market. As Robert said, the DTS sales, we've already hit our full year plan at the end of Q3. So that continues to allow us not only to win but to win larger deals as well, and we're seeing that on the SCS side. I expect SCS by the end of the year to be at a record level as well. Don't see anything slowing down at this point and comfortable there.

I think on your question on the profitability, just one reminder, Q3 of last year was really a record EBT percentage for both DTS and SCS, really hitting on all full cylinders, low turnover lower open spots, volume was steady. And then, conversely, this year, it's kind of the opposite of that. So we're having really good discussions with the customers, both on DTS and SCS on the rate issues, and we expect to start solving that Q4, but really in the back half of next year.

Brian P. Ossenbeck
Analyst, JPMorgan Securities LLC

Q

All right. Thanks very much.

Operator: Thank you. We'll take our next question from Justin Long with Stephens.

Justin Long
Analyst, Stephens, Inc.

Q

Thanks. I wanted to follow up on the rental market. Obviously, the utilization rate in the third quarter was at an extremely high level. Any updated thoughts around utilization in the fourth quarter? Curious what's getting baked into the guidance there? And then, Robert, as you talk about earnings growth in 2022, what's the assumption for rental?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

All right. Let me hand over the first part of that question to Tom and then we can talk about the second.

Tom Havens
President, Fleet Management Solutions, Ryder System, Inc.

A

Yeah. We're – like we said, we delivered a record utilization in Q3 and we're expecting similar performance in Q4. So we're expecting utilization in the mid-80s again going into Q4, which will be at or near another record quarter.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah, so continued strong. Now, I'm almost willing to say we are red lined. I mean, our utilization is about as high as it's – it is as high as it's ever been and I would expect that to continue certainly through the fourth quarter.

As we look at next year, I think you can assume, especially in the first half of the year, but I would say even most likely still even the second half, a very robust rental market. We are – we do plan on adding vehicles. We're going to be adding vehicles to the fleet to take advantage of some of that. But we expect still a very tight truck market as OEM production still continues to be somewhat hampered, and not really seeing relief of that until the second half of the year. So even as they begin to ramp up in the second half, I would expect rental to continue to be – rental demand continue to be very strong.

Remember also, we are shifting some of our investments there to more straight trucks to be able to take advantage of the e-commerce demand, which is really strong. So some of that, I would say, is even outside of the unusual truck tightness right now. I think demand for straight trucks for the rise in e-commerce is a longer term secular trend that we plan on being able to capitalize on.

Justin Long
Analyst, Stephens, Inc.

Q

And just to follow up on that, Robert, I know rental growth this year is expected to be around 15%. Any initial thoughts on what the growth in the fleet could look like next year? I'm sure you're having to plan ahead a little bit more, given the OE constraints.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. I don't have a – I can't give you a number, Justin, because we haven't finalized that yet, but certainly expect it to be up from these levels.

Justin Long
Analyst, Stephens, Inc.

Q

Understood. I appreciate the time.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Thanks, Justin.

Operator: Thank you. We'll take our next question from Bert Subin with Stifel.

Bert Subin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey, good morning.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Good morning, Bert.

Bert Subin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

A question on supply chain side of things. Was operating income in supply chain in line with your expectations for the quarter or was auto ultimately softer and inflation higher than expected? And maybe just to add on to that, what should we expect the long-term trajectory for supply chain to be? Is this the largest segment five years from now?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. Well, I'll let – let me – let Steve answer the first questions on versus expectation because it was slightly below what we had expected. So go ahead, Steve. Why don't you give him some color on that?

J. Steven Sensing
President-Global Supply Chain Solutions, Ryder System, Inc.

A

Yeah. Bert, it was really in the quarter, there were more chip shortages than we expected earlier in the year, certainly, and that continued to linger, and then you had the driver kind of turnover pay issue that continue to go through the quarter. So we've seen that kind of flatten out a little bit, but still cautious as we go through the back half of the year.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

So to the second part of your question, yeah, we do expect Supply Chain and Dedicated, certainly, at this accelerated growth rate to continue to become a larger part of the overall Ryder story. If you – depending on what acquisitions we're able to do and how much organic growth we get over time, yes, it could become more than 50% of the overall revenues. But that's we're probably looking at least five years out before we start to see that. But higher return businesses, we want to make sure we're doing the right acquisitions and we're growing it and getting the right returns, which we've got line of sight to getting our margins back to where they need to be in both of those segments and feel really good about the prospects for it going forward.

Bert Subin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks for that. Just a clarification question. Is the Midwest acquisition contemplated in your 4Q guidance, I didn't know, with some uncertainty around when that gets completed?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

No. Yeah, it's not. Remember, we're going to close it – the plan here is to close it here at the beginning of November. So you've only got a couple of months anyway. But no, it's not built in.

Bert Subin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks for the time.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Okay.

Operator: Thanks you. Your next is from Scott Group with Wolfe Research.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Hey, guys. Thanks for the follow-ups. Apologies if I missed this. Did you give the margin or expected earnings accretion from the acquisition for next year?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

No, we have not. We have not. We expect it to be accretive certainly, but we have not fully flushed that out yet or given it.

Scott H. Group
Analyst, Wolfe Research LLC
Q

Or some sense of what the margin that they're operating at now is?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

Yeah. No, we haven't given it that. But clearly, in alignment with what we see in supply chain.

Scott H. Group
Analyst, Wolfe Research LLC
Q

Okay. And then, just I want to make sure I've got some of the pieces right for depreciation. The $85 million next year reduction, is that just from the accelerated rolling off? Is there any incremental tailwind from depreciation just from the annual studies that you guys do every year?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

Yeah. No, that's just from accelerated and some of the policy rolling off there. We don't expect to make any changes to residual value estimates this year.

Scott H. Group
Analyst, Wolfe Research LLC
Q

Okay. And then, just as we go forward the next few years, I think you said there's still a bunch of excess depreciation. As that rolls off the next few years, do we see the same sort of offset with the fair values getting reset higher where sort of the net impact going forward is a push or is there still some net benefit in the out years?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.
A

Yeah. No, I believe – let me hand it over to John, but I believe that the residual values from next year on are set at policy. So they're not – there is no increase in residual values going forward after next year. So any benefit that we get from depreciation policy does not have that offset. John, is that correct?

John J. Diez
Chief Financial Officer & Executive Vice President, Ryder System, Inc.
A

So, generally speaking, that is correct. You should expect that we're going to see a tail off of depreciation benefit continue to impact even beyond 2022. And then, as Robert mentioned, we do expect that network values will kind of settle into kind of where we expect them to rise to next year over time because the accelerated impact is largely behind us in 2022. So that should give you an indication of what we expect going forward.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Okay. So next year is a push, but we could get back to a tailwind in 2023?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yes.

John J. Diez
Chief Financial Officer & Executive Vice President, Ryder System, Inc.

A

It won't be significant, though, Scott, just to set expectations.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. The $85 million will be much less in the following year.

Scott H. Group
Analyst, Wolfe Research LLC

Q

Got it, got it, got it. Okay. Thank you, guys. Appreciate it.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Thanks, Scott.

Operator: Thank you. We'll hear next from Stephanie Moore with Truist.

Stephanie Moore
Analyst, Truist Securities, Inc.

Q

Hi. Thanks for the follow-up. On the Supply Chain and Dedicated segments and in terms of being able to pass through higher labor costs, is this just based on those contracts, something that's a function of done annually or it's contract-by-contract or is it based on regional inflation levels, with maybe true-ups? Just any color you can provide on passing those through would be helpful.

J. Steven Sensing
President-Global Supply Chain Solutions, Ryder System, Inc.

A

Yeah. Stephanie, let me...

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

[ph] Steve, why don't you give an (00:52:13) update on it?

J. Steven Sensing
President-Global Supply Chain Solutions, Ryder System, Inc.

A

Yeah. Well, Stephanie, let me talk, first of all, in our dedicated business, we have annual CPI increases. What we're seeing right now is those wage increases are higher than what's priced in. We are having those conversations and we've – we're going to ink, I'd say, the majority of our customers within DTS by the end of the year.

On our SCS business, I think it's kind of a mix. A large percentage of our warehousing business, about half of that is cost plus. So that is kind of real time. When those things happen, we just get with the customers and make those adjustments. And then, in some of the other segments and our dedicated that's in the supply chain, we do that both annually. And in some of our new contracts – well, really, all of our new contracts going forward, we have put a more frequent opener in those contracts so that we can deal with any future changes that come up on us very quickly.

Stephanie Moore
Analyst, Truist Securities, Inc. Q

Great. Thank you.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc. A

Thanks, Stephanie.

Operator: Thank you. We'll hear next from Todd Fowler with KeyBanc Capital Markets.

Todd Fowler
Analyst, KeyBanc Capital Markets, Inc. Q

Great. Thanks for the follow-up. Robert, on the asset management update slide, lease extensions are up pretty significantly, which makes sense, given some of the delivery delays, I think, in the past, as the lease fleet has aged, the warranty – or the maintenance expense, excuse me, starts to ramp up. Can you talk a little bit about the repricing that you're doing on the extensions or your ability to kind of buffer any higher costs with running an older lease fleet at this point?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc. A

Yeah. I'll hand it over to Tom, but let me just say that some of that spike in extensions is driven by a couple of large trailer fleets that we extended that really disproportionately impact the count. But let me hand it over to Tom so he can talk about what that means for rate and cost.

Tom Havens
President, Fleet Management Solutions, Ryder System, Inc. A

Yeah. If I were to kind of split that bar up into power and trailers, the vast majority of it is actually in trailers, but you're right, our running costs do go up. And if you look at the lease fleet, I think our average fleet age is up five or six months. That does drive cost. But I can tell you that on our extensions, we are more than recovering that cost in the new rate to customers. So we absolutely have that, I guess, running cost risk covered in the new rate extensions as we go forward.

Todd Fowler
Analyst, KeyBanc Capital Markets, Inc. Q

Okay.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Todd, I know you've been following the company for a while, so I would also add that, remember, we changed – with a change in lease accounting, we changed our revenue recognition on maintenance cost. So that impact that we used to see as the fleet aged that margins would deteriorate, we don't expect to see that as the fleet ages any – in this go around because the way revenue recognition works is, as the fleet ages, you get to recognize more revenue to offset those costs.

Todd Fowler
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay, Robert. [indiscernible] (00:55:18)

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

And we should have more of a stable margin. Yeah.

Todd Fowler
Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah. Okay. So then just to kind of follow it through, as we think about some of the lumpiness in the deliveries as you go into next year, the trade-off would maybe be that we can see the lease fleet actually move up a little bit. My guess is that rental utilization, though, has benefited from people renting if they don't have a truck. So as you kind of push some of the delay this year and kind of balance that into next year, how does that kind of come through from a margin standpoint? It seems like it's maybe a net neutral or not a big negative or positive one way or another.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. I mean if you think about it, on rental, it should be a positive because we still expect strong rental demand next year. Lease – as a lease fleet, if you think about margin being relatively stable, margin percent, because of the way revenue recognition works on the maintenance revenue, even if the fleet ages, the margin stays the same.

So to the extent we grow the lease fleet, you should see a benefit in the overall lease margin dollars for lease. And then on the used truck side, we said we expect to be flat to up on pricing for the year. Again, strong in the first half, potentially pricing slowing down in the second half, but net, for the full year, certainly flat to up because we're at such a high level now even relative to the average of where we were this year.

Todd Fowler
Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah. Okay. All of that helps. Now, we just need to see the year coming together the way you've got it mapped out, so unlike the last couple [indiscernible] (00:56:53) right. So, okay, thanks a lot for the follow-up. Appreciate it.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

All right. Thanks, Todd.

Operator: Thank you. We'll hear next from Bert Subin with Stifel.

Bert Subin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey. Thanks for the follow-up. Outside of the commercial side of things, it seems like FMS revenues sort of moderated this quarter. How much of that is just limited ability to get new trucks versus the strategy you guys have put in place to improve profitability there?

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

A

Yeah. I'd say it's a combination of the two. But, Tom, why don't you give him some color on that?

Tom Havens
President, Fleet Management Solutions, Ryder System, Inc.

A

Yeah. I think if you look at both the lease fleet and the rental fleet, both – underpinning both, are the supply chain disruption. So even then if you look at our rental fleet, there's still about 1,000 units that had not been delivered from our initial order. So as good as the results were, they could have been better. And it's a similar story with lease. We typically have a lag from when a deal is signed to when a new unit arrives. And certainly, that has been elongated. So I think underpinning both of those fleets are the supply chain disruptions.

Bert Subin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks. Thanks for the color.

Operator: Thank you. And at this time, there are no additional questions. I'd like to turn the call back over to Mr. Robert Sanchez for closing remarks.

Robert E. Sanchez
Chairman & Chief Executive Officer, Ryder System, Inc.

Okay. Thank you. Listen, thank you, thanks, everyone, for your continued interest in Ryder and the great questions. And we look forward to seeing you in the coming weeks. Have a safe day.

Operator: Thank you. That does conclude today's conference. We do thank you all for your participation. You may now disconnect.