# Werner Enterprises

## Q1 2023 Earnings Conference Call

Wednesday, May 3, 5:00 PM ET

CORPORATE PARTICIPANTS

**Derek Leathers** – *Chairman, President and CEO*

**Chris Wikoff** – *Executive Vice President, Treasurer & CFO*

**John Steele** – *Executive Vice President – Finance*

**Chris Neil** – *Senior Vice President of Pricing and Strategic Planning*

P R E S E N T A T I O N

**Operator**

Good afternoon, and welcome to the Werner Enterprises First Quarter 2023 Earnings Conference Call.

(Operator Instructions)

The speakers for today are Derek Leathers, Chairman, President and CEO; John Steele, Executive Vice President - Finance; Chris Wikoff, EVP, Treasurer and CFO; and Chris Neil, SVP of Pricing and Strategic Planning.

(Operator Instructions) Please note, this event is being recorded. I would now like to turn the call over to Chris Neil.

Please go ahead.

**Chris Neil**

Earlier today, we issued our earnings release with our first quarter results. The release and a supplemental presentation are available in the Investors section of our website at werner.com. Today's webcast is being recorded and will be available for replay later this evening.

Please see the disclosure statement on Slide 2 of the presentation as well as the disclaimers in our earnings release related to forward-looking statements. Today's remarks contain forward-looking statements that may involve risks, uncertainties and other factors that could cause actual results to differ materially.

The company reports results using non-GAAP measures, which we believe 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 to the earnings release and in the appendix of the slide presentation.

Now, I would like to turn the conference over to Derek.

**Derek Leathers**

Thank you, Chris, and good afternoon.

On our fourth quarter earnings call, we shared our expectation that freight conditions in the first half of 2023 would be challenging and competitive. We anticipated first quarter freight would be soft due to seasonality, inventory destocking and the impact of the Fed's monetary policies to control cost inflation.

Freight in January was soft, but better than expected. As February progressed, freight began to moderate. And in March, it took a step down in contrast to the strengthening we typically see during the month.

Our primary focus entering first quarter was operational execution. We leaned into the strength of our dedicated fleet, which performed well through superior customer service and fleet efficiency resulting in solid financial results.

As anticipated, the One-way Truckload and Logistics were challenged by overall market conditions with less freight available and increased price competition. This was in contrast to the first quarter a year ago, when we benefited from an unusually strong freight market with consistent project opportunities.

In addition, we faced broader industry issues, including higher insurance and claims, and supplies and maintenance. Higher driver and nondriver pay in a moderating freight and rate market also pressured first quarter earnings.

Over the last several years, we've built a business model design to perform better in both good and less desirable freight markets. Our large and durable dedicated fleet in our diversified One-Way Truckload business and our growing and increasingly diversified Logistics segment provide us with a more resilient portfolio of complementary services and industry verticals.

Over this period, we grew our Dedicated and One-Way business in a very difficult operating environment, which, along with contributions from recent acquisitions, contributed to 9% year-over-year revenue growth.

I want to sincerely thank the 14,000-plus talented Werner team members for staying true to our core values and delivering on our unrelenting strategy to safely provide superior service to our customers.

Now let's move to slide three.

I'm delighted to formally introduce and welcome our new CFO, Chris Wikoff. After an extensive search process over the last several months, we hired our top candidate. Chris joined Werner two weeks ago and has hit the ground running.

Chris is the right CFO for Werner at this exciting time in our history. He's an accomplished and strategic financial leader with over 20 years of corporate finance and business transformation experience with large public and private companies in the technology and telecommunications industries.

Chris shares our company values, and he brings to Werner our growth mindset and a deep skill set in technology, operational processes, treasury, capital markets, M&A and investor relations.

We expect a smooth CFO transition as our retiring CFO, John Steele, Chris Neil, and our entire leadership team are working closely with Chris in his new role. Welcome aboard, Chris.

**Chris Wikoff**

Thank you, Derek. It's great to be here and to be part of the Werner team.

Coming into the role, I was highly optimistic about the strengths of Werner, including deep management experience, significant reach and a scale of one of the largest truckload carriers in North America. Werner has a history of operational excellence, a strong balance sheet and steady growth and results such as a double-digit annual revenue and adjusted earnings growth over the last three years, combined with adjusted operating margin expansion that nearly doubled in the last six years. In addition to these competitive strengths, Werner also has an outstanding and diverse culture.

While that is a very compelling combination as an outsider, I have to say I'm even more excited now after being part of this great company for two weeks. Werner is well positioned for the future, and I look forward to building upon past success as a premier trucking and logistics business and partnering with Derek and the leadership team towards continued shareholder value.

I also want to take the opportunity to thank John for all the work that he has done over his long and amazing tenure at Werner as CFO. It has been a very smooth transition so far, and that's a testament to the great organization that is in place. I'm enjoying working with John during this time, and I appreciate his commitment and partnership in the final mile of his legendary career.

Over the past two weeks of assimilating into Werner I have been listening, learning and meeting with associates and leadership across the organization. I'm gaining greater understanding of the business operations, industry and clients as well as increasing familiarity with the financial performance, outlook of the business and opportunities in the markets and verticals where we compete.

I look forward in the coming weeks and months to engage with many of you in the investor community, while further establishing a rapport and cadence with the Werner associates and business leaders.

With that, I'll turn the presentation back to Derek to cover our first quarter financial highlights.

**Derek Leathers**

Thanks. Let's move to slide five.

In the first quarter, revenues increased 9%, adjusted EPS decreased 37% to $0.60. Adjusted TTS operating margin for the quarter was 10.7%. For the last twelve months, our adjusted TTS operating margin was 13.8%.

Dedicated freight demand in the first quarter was solid and steady, in line with our expectations.

Sequentially, our Dedicated fleet declined by 105 trucks. A few Dedicated customers adapted to lower demand this quarter by slightly reducing fleet size within the parameters of our contract terms, and implementation for a few expected new Dedicated fleets have been extended, which slowed our Dedicated fleet additions during the quarter.

A year ago, freight was unusually strong for both One-Way Truckload and Logistics. At that time, we benefited from a strong pricing environment and numerous project freight opportunities that typically do not occur in the first quarter.

This year in first quarter, freight trends were weak, and pricing was more competitive. Despite spot freight rates that declined nearly 40% year-over-year, the diversification and minimal spot exposure of our One-Way Truckload fleet enabled us to limit the decline in revenue per mile to 3%, which is at the upper end of our guidance range.

The experienced driver market showed signs of improvement in a historically low unemployment market, enabling us to be more selective as we hire and retain drivers.

Next on slide seven is our revenue snapshot.

We ended the quarter with 8,475 trucks, down 125 sequentially and up 250 year-over-year. Revenues were $833 million, with 71% in TTS and 27% in Logistics. Three-quarters of our revenue base comes from retail and food and beverage with customers winning in their verticals. We intentionally focus on growing companies that ship recurring and repeatable consumer essential products, who have rigorous on-time delivery requirements. We do not plan to grow our fleet in the second quarter. We plan to grow Dedicated in the second half of the year.

Turning to slide eight.

Werner is one of the four largest Dedicated providers in the U.S. We serve customers with extremely high service and safety requirements, which are not easily replicated by our competition. Our typical Dedicated fleet consists of shorter length of haul freight, serving local and regional geographic markets.

The superior consistency and reliability of our Dedicated on-time service product provides our customers with high predictability for their inventory to help them avoid out-of-stock surprises. Dedicated has steadily grown over the last 13 plus years with a customer annual retention rate of over 95%. During this period, we added over 2,200 trucks growing our Dedicated share of total TTS trucks by 17 percentage points.

Nearly two-thirds of Dedicated is retail and two-thirds of that business is with discount retailers. Discount retail performs better in recessionary economies when shoppers have less discretionary income to spend and as they look to trade down for value. Conversations with customers and consumer confidence numbers indicate we are seeing a more focused approach to discretionary spending.

Another 16% of Dedicated revenues are with food and beverage companies that ship consumer staples. Historically, this segment is more recession-proof than discretionary products. Because of the high service requirements and relatively consistent freight volumes, Dedicated revenue per truck has less variability. Revenue per truck has increased eight of the last nine years. During first quarter, Dedicated revenue per truck increased 4.6% year-over-year.

Turning to slide nine for an update on our growing Logistics segment.

With the acquisition of ReedTMS Logistics last November, our asset-light Logistics freight revenues grew in the first quarter by $40 million to $229 million and has a combined pro forma annual revenue run rate of nearly $1 billion.

ReedTMS has expertise in the food and beverage verticals. The addition of this business in our Logistics segment expanded our diversity for temperature-controlled freight and aided in growing our refrigerated Truckload Logistics business from 7% of revenues in 2022 to 21% of revenues in Q1.

The integration of ReedTMS and Werner Brokerage is on track. We are making significant progress with systems integration, automation and procurement savings, and we remain on pace to meet our synergy and savings goals that we identified prior to making the acquisition. These synergies were offset in Q1 as early integration costs were absorbed.

Turning to slide 10 for a deeper dive on our first quarter results.

Total revenues grew 9%, driven by 4% growth in average trucks, slightly higher revenue per truck, an $8 million dollar increase in fuel surcharges and Logistics revenue growth. As mentioned earlier, the soft freight market in first quarter was a significant headwind compared to an unusually strong market in the same period a year ago.

At this time, I'd like to turn the presentation over to John, who will discuss our segment results. John?

**John Steele**

Thank you, Derek.

On slide 11 are the Truckload Transportation Services results.

TTS revenues increased 5% and adjusted operating income decreased 31%. The TTS adjusted operating margin declined 570 basis points year-over-year due to increased operating expenses. Our adjusted operating expenses per mile net of fuel increased 7.2%, compared to our TTS rate per mile net of fuel, which increased 0.4%.

Inflationary pressure is having a more pronounced impact on our margins. The largest operating expense increases within TTS were in driver pay, supplies and maintenance, and insurance and claims.

Driver pay per mile increases continue to moderate and were up 6% for first quarter.

Supplies and maintenance expense increased $11 million or 20%. This was caused by higher-than-expected over-the-road truck and trailer maintenance and increased tire costs. While these costs continue to be inflationary, we have actively taken steps to control our spend and we continue to see signs of cost moderation thus far in second quarter.

Insurance and claims expense increased $9 million or 33%. We continue to be encouraged by our recent quarterly low in both the number and frequency of claims and our 10-year record low last year for DOT preventable accidents. This is driven by our focus on safety, our highly trained and experienced drivers, combined with our investment in the industry's best technology and equipment.

That said, we are seeing an elevated cost per claim. We are holding firm on our commitment to safety by continuing to reduce the frequency of claims and being laser-focused on claims resolution and claims cost.

In first quarter, we sold significantly more tractors and trailers at a lower average gain per unit. Gains on sales of revenue equipment were $18 million, a decline of $2 million year-over-year.

With the continued decline in spot rates, the shortfall between small carrier operating costs and spot freight rates has grown to over 15%. This is leading to carrier failures in greater numbers and will result in an opportunity to focus on yield improvement. Conversely, for the used truck and trailer market, we anticipate these trends will gradually lower used truck demand, pricing and equipment gains.

We are committed to controlling costs and performing within our annual TTS operating margin range of 12% to 17%. We have implemented ongoing and specific company-wide cost savings initiatives. These initiatives include driver recruiting expense, savings from lower driver turnover and SG&A, as well as cost-saving opportunities for fuel efficiency, equipment maintenance and supplies.

Now let's move to first quarter TTS fleet metrics for Dedicated and One-Way Truckload on slide 12.

Dedicated revenues, net of fuel increased 9%, average trucks increased 4%, revenue per truck increased 5%. One-way Truckload revenues net of fuel declined 2% due to 3% lower rates in a much softer freight market. Average trucks grew 4% due to the Baylor acquisition, and miles per truck declined 3%.

Moving to Werner Logistics on slide 13.

In first quarter, Logistics revenues grew 21% as growth from the November ReedTMS acquisition offset lower brokerage pricing and intermodal revenues. Truckload Logistics revenues increased 41%, driven by an increase in shipments due to the ReedTMS acquisition and growth in our organic volumes, partially offset by a decline in revenue per shipment. Despite a weak freight market in first quarter 2023 compared to the strong market in first quarter 2022, both our Werner and ReedTMS Truckload Logistics units grew shipment volume year-over-year.

Intermodal revenues declined 33% due primarily to a decline in shipments. Final Mile revenues increased 12%. First quarter shipments and revenue per shipment were negatively impacted by a more challenging macro for the sale of discretionary products.

In total, Logistics achieved adjusted operating income of $6.4 million with a 2.8% adjusted operating margin, down $2.8 million year-over-year.

Moving to slide 14.

We ended first quarter in a strong financial position following the closing of our new syndicated credit facility last December.

We are well positioned with over $500 million of liquidity and a low net debt-to-EBITDA ratio of 0.9 times.

The six large commercial banks in our syndicated credit facility all have strong tier-one capital ratios and healthy loan-to-deposit ratios.

On slide 15 is a summary of our cash flow from operations, net capital expenditures and free cash flow over the past five years. Expanded operating margins and less variable net CapEx resulted in ongoing robust free cash flow generation. And in first quarter, we generated $167 million of cash flow from operations and $64 million of free cash flow.

Turning to slide 16 and our capital allocation framework.

Our first capital priority continues to be reinvesting in our truck and trailer fleet and enhanced technology. New truck deliveries from our OEMs are improving, which helps lower our average truck age. Reducing our average age back to two years is a priority, as it reduces our trucks out of warranty and related expense, improves our on-time service and strengthens driver
recruiting and retention.

With our fourth quarter acquisitions of Baylor Trucking and ReedTMS Logistics, we are currently focused on integration and capturing revenue and cost synergies but remain open for business for the right acquisition opportunity that fits within our strategic, financial and cultural criteria.

We will take a balanced capital allocation strategy by maintaining low leverage, returning value to our shareholders and providing financial flexibility to invest in growth and initiatives to expand our operating margin.

Next, on slide 17, we continue to execute our Drive strategy as we are building on our durable, resilient and balanced revenue portfolio.

We are committed to a relentless focus on exceptional on-time service that drives long-term value for all stakeholders. Werner is a leader in the logistics industry, focusing on innovation and technology, investing in our associates and progressing on our sustainability journey.

Here are a few updates.

We've deployed our new Werner EDGE TMS in Truckload Logistics with more of our Logistics business units currently in development, and we are fine-tuning the platform to leverage real-time insights that drive operational improvements.
We have also continued to invest in our new tech stack by deploying and integrating back-office CRM and API platforms that improve operations and enhance the customer experience.

As evidence of our commitment to safety, in first quarter, we achieved record low accident frequency in addition to the 10-year low accident frequency rate we achieved last year. And

we also accomplished a record low work injury rate in first quarter with 30% improvement year-over-year.

We invested in our associates by establishing the inaugural cohort of PACE, our rotational development leadership program.

As we work to be good stewards of our environment, auxiliary power units were installed on half of the new tractors placed in service during first quarter, reducing truck engine idle fuel consumption.

As we search for new technologies, we received our first 15-liter renewable natural gas truck in April in connection with our partnership with Cummins. And this week, we began transporting freight with two battery electric vehicles in the Southern California market.

That concludes my remarks. I will now turn it back over to Derek.

**Derek Leathers**

Thank you, John.

Next on slide 18 is a review of our first quarter performance compared to our guidance and our updated guidance metrics.

During first quarter, our truck fleet declined 1% as we adapted our fleet size to adjust to freight market conditions. As a result, we lowered our truck growth guidance for the year to (2%) to 1%.

We are maintaining our net CapEx guidance for the year at $350 to $400 million.

Dedicated revenue per truck increased 4.6% in the first quarter, slightly ahead of our full year guidance range that we are retaining. One-Way Truckload revenue per total mile for the first quarter decreased 3.2% at the upper end of our first half guidance range. Our guidance range for the first half remains down 3% to down 6%.

Our tax rate in first quarter was 24.3%, in line with our guidance range for the full year.

The average age of our truck and trailer fleet in first quarter was 2.2 and 5.1, respectively.

Now let's move to slide 19 and discuss our updated market outlook for 2023 and our modeling assumptions.

The freight market and spot rates in One-Way Truckload and Logistics did not experience typical seasonal improvement in March and in fact, declined. Freight demand in April remained challenging and consistent with March. The March freight lull occurred concurrent with the timing of the banking system failures, which has resulted in tighter lending standards.

On last quarter's earnings call, we expected that 2023 would have a relatively muted economic backdrop. At that time, we forecasted a better second half of the year with inventory replenishment resuming, trucking capacity exiting and a more normal peak shipping season in fourth quarter. Our outlook has not changed, but improvement may be delayed a few months due the uncertainty caused by the recent banking failures.

We continue to expect freight and One-Way Truckload and Logistics will remain challenging and second and potentially third quarter as retail inventory destocking runs its course, and the Fed completes monetary tightening.

We expect spot freight rates will bottom in the second quarter, and then begin to improve in the second half. Smaller carriers that rely on the spot market are facing tremendous financial challenges given the shortfall between revenues and costs and tighter bank lending standards with much higher interest rates. Trucking company failures are increasing.

FMCSA data backs this up. Starting last September for 31 consecutive weeks, interstate truck deactivations exceeded truck activations with net deactivations of over 80,000 trucks over the seven-month period.

By fourth quarter, we expect the freight market will begin to show improvement for the holiday shipping season. This is driven more by inventory and capacity trends than confidence in a macroeconomic acceleration.

For the used truck market, we expect gradually declining demand in a difficult freight and financing market, which should moderate pricing and equipment gains as the year progresses. We continue to expect that our equipment gains for the full year will be in the range of $30 to $50 million.

Due to higher interest rates and a higher debt level, we continue to expect net interest expense this year will be $20 million higher than last year.

We anticipate that OEM truck and trailer production will continue to show improvement the rest of this year. This should enable us to gradually decrease the age of our truck fleet, which in turn will help with maintenance expenses, on-time service and driver retention.

We have a powerful business model with a large and durable dedicated fleet, a diversified One-Way Truckload fleet and a growing Logistics segment.

As nearshoring expands, we have the largest Mexico cross-border franchise in truckload and deep experience operating in this complex market.

We are building a Werner-branded premier Final Mile solution to service a rapidly growing customer need for high service home delivery.

We continue to prioritize and invest in our Cloud First, Cloud Now technology strategy through Werner EDGE. We are streamlining operations and are enhancing the experience of our stakeholders.

Three-quarters of our freight base is aligned with winning retail food and beverage customers with a focus on transporting necessity-based goods.

And most importantly, we are continuously improving our superior safety record and award-winning service.

Now I would like to turn the call over to our operator to begin the Q&A.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

And the first question will be from Jack Atkins from Stephens.

**Jack Atkins**

Okay. Great. Chris, welcome to Werner. And John, congratulations on your retirement. Legendary was a great way to put it. So enjoy your retirement.

So I guess, Derek, if we could maybe start with what you're seeing right now? I mean it feels like April was sort of a tale of two halves, very challenging first half. Easter was in the first half of April. And then things maybe picked up a bit in the second half of the month.

Are you seeing anything in your business in the last couple of weeks that would make you a little bit more encouraged about whether it's the spring peak or maybe just capacity rationalizing somewhat?

**Derek Leathers**

Yes, Jack, thanks for the question.

I might stop a little short of the tale of two halves approach, but I would say this. We have definitely seen, as, we had a delayed spring, especially relative to produce and other products that were impacted by weather. As that starts to work its way through, that does draw capacity, both from the obvious refrigerated market, but capacity in general, that then finds its way into that market. And I think that explains part of it. We know that our customers are getting further through their inventory destocking and starting to think and prepare differently.

We also know as it warms, with 15% of our business in food and beverage, that has positive impacts on the freight flows in that part of our market as well. So yes, we are encouraged by some of what we've seen in the last couple of weeks of April. But I certainly don't want to be too optimistic at this point. I'd rather cautiously continue to observe it and see if we can continue to see this trend develop.

**Jack Atkins**

Okay. No. Understood. I know we have a lot of wood to chop here, both from a macro perspective and from a supply-demand perspective, but I appreciate that.

And then I guess maybe for my follow-up question, John reiterated that the longer-term TTS margin range of 12% to 17%, I believe, is the range. Last quarter, you guys said you expect to be able to stay within that range this year, even despite the market challenges.

I know it's one quarter, but it's a seasonally soft quarter, we were below that, in the first quarter. How are you thinking about what you need to do to be able to make sure you can stay within that range this year? I'm sure the entire organization is focused on that. But are there cost out opportunities, efficiency opportunities? Like what needs to happen to make sure you can stay in the bottom end of that range.

**Derek Leathers**

Yes, Jack, I mean, you summed it up pretty well. I mean we are laser-focused right now on the cost side of the equation. I would say the passion for taking cost out of the business right now is as heightened as it's been in a long time. We are not celebrating Q1 results. We certainly know that we've got work to do ahead of us.

But we've maintained the guidance because of the confidence that we have as we look forward and think about what happened within supplies and maintenance, some of the integration costs that we know were just a reality during the first 90 days of digesting two acquisitions that took place kind of in middle of Q4. The ongoing success we're having on the insurance and claims as it relates to both frequency, severity and work comp as well, that’s the toughest one to ever predict, because it always takes just one bad outcome for

that to move differently.

But over time, the thing that we can most control in that line is simply being safer. And we continuously are setting new 10-year, 11-year, now 11-year record in Q1, and we're going to continue to drive lower. I would say I'm also encouraged because the work we're doing within One-Way, to further engineer that network, has started to reap benefits as it relates to production. And if you can't get rate, the next best thing is to make sure we're actively utilizing our assets and doing the best possible job we can to keep them busy. That has certainly been encouraging.

And we've seen some encouraging signs on the turnover front as I think the overall economic backdrop becomes more and more real, it allows us to continue to present a compelling story to our drivers as to why Werner is a great place to work. So you put all that together and you add the large caveat, which is there is a lot of work to be done to make sure that we deliver on that long-term guidance range relative to 12% to 17%. But at this point, we feel that is still something that we can deliver on.

**Operator**

And the next question will come from Scott Group from Wolfe Research.

**Scott Group**

Thanks, good afternoon guys and best of luck John, and congrats, Chris.

So we've talked about the resiliency of Dedicated margins through the cycle. But if I look this quarter, I get one quarter, but Dedicated 60% of the revenue and overall margins were down 570 basis points. Maybe it would be helpful, can you just give some directional color on how One-Way and Dedicated margins performed in the quarter? I just want to understand where we're seeing the margin pressure.

**Derek Leathers**

Yes, Scott. Great question.

Let me start with this. Our premise on Dedicated remains intact. We do believe it will continue to perform well through the cycle in both good and softer freight markets. It performed largely as expected in Q1. But if you think about a couple of the caveats that we held out there are some of the largest headwinds, both supplies and maintenance as well as insurance and claims, those are impacts to both Dedicated and One-Way. And so we did have outsized costs that we've got our arms around, and we've made progress on already and have seen the impact of some of the progress specifically on the supplies and maintenance line.

On the revenue per truck per week, it did exactly what we thought it would do. It continued to find increased efficiencies and increase the opportunity to improve that metric. It was a cost issue, clearly.

As far as where the OR in TTS, the degradation obviously, was much more severe in One-Way than it was in Dedicated. Obviously, we've got to put the lion's share of our focus there to make sure that we get that turned around, and that is where our focus is at this time.

And then lastly, I'll just say again, I'm not trying to point the quarter toward this issue, but there was clearly no ability, although synergies are being realized on the acquisitions, they're being offset by the integration costs that take place predominantly early on, as we had to quickly mobilize and work toward getting fleet standards to where we wanted to see them, getting that equipment maintained and upgraded where appropriate. And then some significant work on the system side to make sure we secure those networks and made sure that we did not have any vulnerabilities post integration.

So, some of that stuff is behind us, as we look forward, and we have kind of a cleaner quarter to work with. We're encouraged by what we see so far, but it's still tough out there. Make no mistake. We know that we recognize that from an overall market perspective, and we're going to adapt accordingly.

**Scott Group**

So maybe to that point, Derek, any way to just think about how much sequential margin or earnings improvement you'd expect trucking in the second quarter? And then the cost opportunity you talked about, is there any way to just put numbers around how much cost you potentially could take out?

**Derek Leathers**

Yes. So I'll start with the first question. I mean if you look historically over a multi-year period, Werner's earnings from Q1 to Q2 normally go up somewhere in the neighborhood of, call it, 25% to 30%. We do not believe that is the case this quarter given the economic backdrop that we're faced with right now. So that's not something that we think is in the cards. We don't give quarterly guidance, as you know, but I do want to frame up very clearly, the 30% improvement in Q2 is not the way we are thinking about that.

We have made headwinds, as I've indicated already, on supplies and maintenance and feel very good that some of the moves we took in the first quarter, although they increased cost in that quarter, they set up for a better Q2, 3 and 4.

The insurance and claims line. Again, I will reiterate what we can do is continue to be safer and safer and safer. And at some point, we need to see some of this prior period stuff kind of work itself through and hopefully put it behind us, but that's clearly the most volatile and least predictable line in the entire P&L. And so I just want to be cautious about trying to give anything too specific there.

The market itself has shown a couple of weeks, and so I want to be careful with how much credence we put on that, a couple of weeks of stabilizing and it appears as though spot rates have found the bottom, but they're still going to be off significantly year-over-year and down sequentially both. So if that's true, and we start to see any lift from here, that certainly is a positive.

On the overall cost savings initiatives, I mean, we've up till now, kind of shied away from talking about specific numbers, but I think we owe it to you and the investor community to say, we've identified at this point and started implementation and have already started to see some of these come through, cost savings in the neighborhood of about $34 million dollars. Those are annualized numbers. And obviously, some of those have not yet started, so you only get partial year impacts. We're going to continue to dig, and we think there's more that we can find. But as we sit here, it's already May, many of those are just being implemented as we speak. But we're going to stay aggressive in that category.

**Operator**

And the next question is from Tom Wadewitz from UBS.

**Mike Triano**

This is Mike Triano on for Tom. So you maintain that down 3% to down 6% for revenue per mile and One-Way for the first half after posting down 3.2% in 1Q. That implies a pretty wide range for pricing in 2Q, could be anywhere between down 3% to down 9%. So just wondering what you're assuming would drive the lower and the higher end of the guide for revenue per mile?

**Chris Neil**

Mike, this is Chris Neil.

So yes, you're right on the One-Way Trucking rate per total mile decline, we were at 3.2%. That was at the higher end of our guidance, down 3.2%. And it is definitely choppy waters out there. We've built the One-Way portfolio with winning customers and volumes really held in there pretty good in January and February. And as mentioned, by us and others, I think, there was some weakness in second half of March and then a little bit in the first half of April, and now we've seen a little improvement.

In terms of what we're thinking, I mean, we've got some bid rates that are going to be implemented, and we've had some rate renewals that have been negative. Some of those are in place now, but more of them will be in the second quarter. We expect about 30% of our rates, I'm talking One-Way trucking specifically, to be effective in Q2, a little more than 30%, a little less than 30% were in Q1. In Q3, we have about 23% exposure and then the rest in Q4.

So as some of those negative rate renewals are implemented and effective, we'll see some

increased pressure on the One-Way trucking metric. We've also had to increase spot exposure a little bit as we've maintained discipline with our pricing. So I think as you look at, most likely, we would expect that our One-Way trucking rate per total mile would decline sequentially, mainly because of those negative rate renewals. But there are some opportunities to continue to perform in that area.

We could see spot that has bottomed. It feels like we're close, if not there. We could see a little bit of improvement there. We could see the market pick up a little bit as it relates to spring produce and just contractual volumes in general. And that would decrease our exposure to spot, which would help, as you talked, improve that number towards the upper end of the range in the second quarter.

But it's a tough environment out there, and we're just going to continue to do the best we can, at this point, bid season has kind of gone as expected.

**Mike Triano**

Right. Then the other question I have is on the demand side, just to go back to that. Some of your biggest customers are the largest retailers out there, so just curious how they're viewing demand in their businesses. Has their outlook and inventory replenishment changed at all? And how much advance notice would you ordinarily get from those customers if there was an inflection or change in the demand forecasts?

**John Steele**

Mike, this is John. As it relates to our retail inventory customers, that's a big lion's share of our business. Clearly, their demand has been declining, but we are concentrated with discount retailers that are really more attractive to the value-conscious consumer, a high percentage of what they sell is consumer staples and that's definitely seeing less pressure than what discretionary goods are seeing.

Every one of our large retailers when they reported in late February and early March, reported that they achieved a reduction in their inventory dollars per store from November to January, all 13. Seven of the thirteen had stronger growth in same-store sales than they did in inventory per store growth.

We think that they're well along the way in destocking of inventory as a group, and they're getting closer back to normal replenishment of inventory, which would increase freight shipments compared to a destocking environment.

A few of the comments are, inventory levels moderated significantly after the first half of 2022. We took bold actions last summer to quickly take action to right size our inventory. Inventory growth is still elevated, but the pace is moderating as we expected. Units per store are at a similar level to pre-pandemic periods. We've had a strong execution of inventory rebalancing. And finally, the last one is, our inventory is in good shape.

So overall, we think we're in the latter stages of destocking. Obviously, demand is hard to predict, but we think things are getting closer to a normalization at levels that we'll see with this recessionary type of economy.

**Derek Leathers**

The only thing I would add to that. I would also just add that part of the battle here is in a market like the one we're in today, it's about execution. It's about putting your best foot forward in front of your customer and showing that we can simply outperform. And so there is the obvious question about how their sales doing. There's the equally important one, which is where they're at the inventory cycle. And then the last one is what are we doing relative to their share.

And so, we have continued to both be able to, and if you ask me what I think some of the bright spots in the quarter are, one of those is keeping pricing discipline and expecting and being paid appropriately for the type of work we do. It's hard to do, hard to serve, difficult work, especially on the Dedicated side with the service expectations, and taking wallet share from others through that service. And so that's something I'm proud of. It also positions us well when this turns to be able to grow further with winning customers.

**Operator**

The next question will be from Ken Hoexter from Bank of America.

**Ken Hoexter**

Good afternoon, of course, John, best of luck in retirement, and Chris, welcome. I look forward to working with you going forward. Derek, Scott Group and I just boarded a plane and he said he's going to kick my chair the longer I ask a question. So let me dig into the state of the market following Jack's question.

Did you say there was a 15% spread between spot rates and I guess, cost above spot right now? And maybe, Derek, just given your historical experience, maybe talk a bit about what you've seen in peak to trough kind of markets and how we should look at that spread indicative of what the time frame you've seen in the past?

**Derek Leathers**

Sure, Ken. Well, I'll start by saying don't get into any fights on the plane. They don't like that these days anymore. So be nice. It’s our strong belief that if you look at where spot rates are today, they are 15% to 17%, maybe even as high as 20% below carrier operating costs. There are several ways you could look at that. You could think about average carrying operating across the publicly traded group, ATA, or ATRI, I should say, puts out really strong operational cost of trucking. And then, of course, we work with and talk to lots of carriers in our brokerage and power-only groups.

So on many different ways of looking at it, these spot rates are simply unsustainable. These folks are not going to make it. They bought high-cost equipment during the peak of the market. And if they're fully exposed to that spot market today with both high driver pay, high-cost equipment, high cost of capital, and in many cases, kind of variable lending arrangements that are now becoming much more expensive, almost overnight and inclusive of today, it just is going to be a very tough time. So yes, we do believe that it's only so low it can go. And I said it a quarter ago, the cure for low prices is low prices. Eventually, they go too low, and they have to bounce back.

So that's part of the confidence that some of the lesser efficient operators are going to continue to exit and that exit is now 31 straight weeks of net deactivations. Sure, some of those are ending up as those experienced drivers we spoke of, and they are ending up in company fleets, but it isn't like large company fleets are growing either right now.

It's simply an opportunity to raise the bar on quality to make sure you're getting the very best drivers behind the wheel in every possible truck to take this further step down in accident frequency and work comp frequency and kind of a step up in service. So these are all kind of foreshadowing better performance as we go forward, while we wait for this market to turn.

Another reality is when you have these markets that are slow and been slow like they've been kind of year-to-date, it presents opportunities that, to take care of necessary things and sometimes you pay a little bit of a price for it, like maintaining equipment and getting equipment completely up to snuff, if you will. And when drivers have more time and we have more time, you can find more things to fix. And we've got to watch that. We've got to get our arms around that, and we're doing that actively as we speak.

The last part of your question was about peak to trough. If you look through historically in cycles, when we start seeing spot rates going negative, 18 months kind of on the outer end before they bounce and start to come up. We're certainly over twelve and working our way further, but it's our belief there's no six months more to go. You just can't go lower from here. I think April, when the dust settles, will represent the bottom.

The question is how long does it drag on the bottom before you see some improvement. And we still have conviction that, that happens in the second half. But we're going to see sequential Q1 to Q2 spot is going to be worse in Q2 than it was in Q1. And our exposure is slightly up. We're still very low spot exposed on a total mile basis, somewhere south of 7% of total miles. But that's still north of where we'd like to be, but it's about discipline, right? So I'd rather be disciplined in Q1 and take a little pain than to inherit or digest really bad contractual terms into this business that I have to live with for quarters to come. So that was our stance. That was our strategy. It presents a tough spot relative to Q1 results. But I think it's the right play as it relates to 2023 and beyond.

**Ken Hoexter**

Really helpful perspective. And just if I can do my follow on then, Derek, on what you just left off with, which is the cost side, right? What happens is the driver pay when you get this rate reduction market? I guess, for John, is there integration potential from the Baylor and ReedTMS acquisitions? Or was that built into your cost, kind of focused commentary there?

**Derek Leathers**

Yes. So driver pay is certainly moderating. I mean what's happened with driver pay over the last couple of years, both here and across the industry was really significant. And you're looking at driver pay really for the industry but certainly here where we have daily home time jobs, dedicated jobs that give people really, really upgraded lifestyles and yet year one wages that can, in many cases surpassed $70,000 and really with opportunity to make quite a bit more than that as you go forward. And many of our accounts, especially in certain geographic areas, are north of $90,000 and several are north of $100,000.

There is a point by which you can't just pay your way up to try to solve that problem any further. We've got to continue to focus on lifestyle. And we think most of that pay pressure is behind us, especially with the macro backdrop of what is more likely to be a tougher labor market for employment itself. I mean more unemployment and other things on its way.

We've aggressively been working, especially in Q1 through some further engineering for lifestyle in our One-Way fleet and the expansion of some of the legs of the stool around team-expedited and cross-border, we think that positions us really well moving forward as well. But yes, I think we've seen the worst of spot. And now the question is just how long it goes sideways before it goes up.

**Operator**

And the next question will come from Chris Wetherbee from Citigroup.

**Rob Salmon**

It's Rob Salmon on for Chris. John, congrats on the upcoming retirement and Chris looking forward to working with you.

I guess to follow up on Scott's question with regard to the cost inflation. Can you give us a sense how much integration costs you guys incurred in the first quarter? And how you're thinking about that for the back half of the year?

**Derek Leathers**

Yes. I don't have a firm number to be able to give you on integration costs. What I can tell you is that it more than outweighed the synergies that we experienced thus far. We think the largest portion of that is really behind us. If you think about the world we live in today, one of the large upfront integration costs that we attack very aggressively here is on the

cyber side. And so there's a lot of work we do and a lot of expense we make to make sure and bring everything that we touch immediately, and at whatever cost that may represent up to the standards that we have from a cybersecurity perspective here at Werner. That was part of it.

There's the obvious integration costs as it relates to maintaining and improving upon the equipment allotment that some of those companies may have had because of how difficult it was to get equipment during the pandemic.

There's travel costs related to the integration teams and the work that they do. And most of the synergies, there's a few things you get right away. You can get some synergies right away on fuel and other items. But a lot of it is a larger kind of journey that we have to take.

As we look forward, I guess all I would say is I'm encouraged by where we're at and getting better each time we've had one of these acquisitions at integrating more rapidly, getting some of the synergies realized and measured more quickly and then mostly, improving upon the score carding we're doing with those businesses.

The last thing I'd say on this is it's also tough, like to be fair to these acquired companies, who we think so highly of their leadership teams, they too are operating in this very, very difficult market.

So, I'll point back to a highlight we mentioned earlier in the call. One of the highlights for me of the quarter, is that unique to really only a few players in the space, in our Logistics business, both on our organic truckload brokerage as well as on the acquired ReedTMS business, both of those individually and then obviously, collectively, were up year-over-year in shipments. So the product they're putting out there in the market is winning. We are gaining share.

We were fairly close from a gross margin perspective year-over-year. Everybody has seen some compression there. But most importantly, we're getting deeper footholds into very key customers that we feel strongly about their future. So I'm excited. I realize I didn't give you a numeric answer to your question, but that's some philosophical views on where we sit with those integrations.

**Rob Salmon**

That's helpful. And just following up on the $34 million of kind of annualized cost opportunity, how much has already started? How much did you guys see in the first quarter? How much do you plan on doing in the second quarter? And then obviously, the remainder would come in at some point in the back half of the year.

**Derek Leathers**

Yes. I would say first quarter was mid-single digits, so call it, three to five, because it takes a while to get it ramped up, get it identified and get it going. That obviously starts to ramp as we move forward. Some of those items still don't really start to gain any momentum until kind of end of Q2. But we're actively working the list every day.

That $34 million, I'm still hopeful we're going to identify more and dig deeper. But certainly, maybe a safe way to think about it is, half a year of that number because it's going to be a tough lift to get a lot of it done quickly here in Q2, and then it will build from there.

**Operator**

And our next question is from Jon Chappell from Evercore.

**Jon Chappell**

Thank you, good afternoon. Derek, just wondering how the dedicated pipeline has changed at all in this kind of weaker environment, especially as you transition from maybe a more optimistic start to the year to a little bit more of a difficult March, April. I know you said you're not going to really grow your fleet until the second half. Is it going to be an incredibly back-end loaded kind of 4Q fleet growth as you kind of laid out the differences in the spot between a weak 2Q, 3Q and then a more optimistic 4Q?

**Derek Leathers**

Yes. I'm not signing up today for kind of a hockey stick type growth in the back half. But what I can tell you is the Dedicated pipeline is really robust. And we will actually be implementing some new dedicated business in Q2. Some of that will be offset by either attrition and/or some things that we've made decisions to separate and/or downsize.

So, you could see slight Dedicated growth even in Q2, but we wanted to be more prescriptive and talk about that being in the second half. There's really no line of sight right now at this point for us growing our One-Way fleet through the back half of the year. And so we really thought the safer thing was to talk about kind of flat fleet in Q2 with growth in the second half, but if there was growth, it would be in Dedicated.

And I'd remind you that, one area that has continued to grow, and we really haven't spoke about it on the call yet, is Power Only. And so Power Only operates in conjunction with our One-Way network, and that has had tremendous success. It continues to sort of improve month-over-month, both in volumes, but also in efficiency.

And so we’re gaining further excitement about the future of what Power Only could look like. And it obviously helps us take some of the capital intensity out of the business as we think about going forward. We’re still going to be an asset player because Dedicated is still going to be a major part of our portfolio. But as we go forward, we’ll continue to find ways

to do more with focusing on a less asset-intensive footprint and Power Only in the mix as part of that solution.

**Jon Chappell**

Great. And my follow-up is actually going to be on Power Only. Just really quickly, I mean, with the logistics margin pressure, if you didn't have the growing Power Only, was it something where it could have been closer to breakeven? Has the Power Only proven to be less cyclical and a little bit more stickier through this really weak broker environment?

**Derek Leathers**

Yes, I would certainly say that we view Power Only as stickier for sure. It's still going to operate predominantly inside of, obviously, the Logistics business and in conjunction with our One-Way Truckload business. Therefore, it is part of a more secular end of the spectrum, but it's stickier.

It behaves and operates in drop trailer configurations that are tougher to compete with, with pure brokerage. It behaves and operates with more sophisticated customers that tend to have a longer-term view because their expectations around service are more elevated than your typical spot load type shipper.

So I'm not trying to be evasive, but somewhere between where Dedicated sits and where your transactional One-Way market sits is kind of where Power Only resides. A little stickier, a little more resilient, a little better through the cycle. But certainly, I'm not trying to portray it to be the same as Dedicated.

**Operator**

And our final question for today will come from Bert Subin from Stifel.

**Bert Subin**

Thank you and good afternoon. Congratulations to John on an incredible career and welcome to Chris.

Derek, you talked a lot about sort of the setup today. If we think about maybe past the current backdrop, it seems fair to think eventually, imports and spot rates are going to rebound quite a bit.

Are you looking at the setup as 2H '23 is going to be tough, '24 is going to be the first stage of the rebound and then potentially 2025 is going to be really good. And if that is your view, what can you do to get ahead of that, so you're prepared for the upswing?

**Derek Leathers**

Yes. Great question, Bert.

So first off, let me talk about second half '23. Let me start with what we don't think it is. We don't think there's some big economic recovery right around the corner and suddenly, all of this sort of background noise is going to go away and subside. We don't think that suddenly the banking industry looks strong and resilient and consumer confidence goes through the roof. What we do believe is that what's happening from a capacity perspective is real, and it's accelerating, meaning what's taking place relative to the cleansing of less efficient or less capable operators is happening all around us, and if that will continue.

We think our model, our execution, our service, our commitment to our customer, will continue to pay dividends, and we will continue to take share both with existing and new customers. We think the inventory destocking is in the later innings. And so, we think, as that continues to run its course and, in some cases, has run its course with some key customers within our network, you start to see normal replenishment cycles.

We think living in the neighborhood that we live in, in discount retail, where folks can continue to have the opportunity to trade down as they are becoming more frugal with those discretionary dollars is a good place for our portfolio to sit. We think the share gains that we've made in Logistics and our ongoing ability to not only hold and retain volumes, but increase volumes sets us up very well for when this thing turns.

So, the back half, we think, has got opportunities to outperform and really be stronger and see some normal return to seasonality. We think Christmas is still going to be on December 25, and people are still going to buy and participate in that. And unlike a year ago, where inventory gluts were profound, that will cause and necessitate the movements of goods for some of that stock and inventory to move.

You put all of that together, that's our outlook, and that's why we have more optimism still for back half, but perhaps with a month or two delayed from our original expectation.

As you get into '24 and '25, yes, we think it sets up much better. I don't foresee this. I mean, it's my personal view that this economic recession is not long lived. I think people will get through this, not only you start to see a better environment in '24. You see the strong have survived.

We continue to execute against our DRIVE strategy to set up for that. And even in the short term, as we sit around and make decisions here, it's always tough to be a publicly traded company, thinking about a quarter, but having to run a business based on a strategy and a long-term vision.

And so when in doubt, we're going to focus on long-term vision strategy and where we see this business in two to three years over a month-to-month decision-making tree.

So that's kind of the course we're on. That's the course, we'll stay on. As long as I'm here, that's how I believe strongly in taking that longer-term view. And I think our portfolio is set up really, really well for when this turns.

**Bert Subin**

That's great. Thanks so much for the great answer there, Derek. Maybe a follow-up on maybe a brighter spot of things. Can you just give us an update on what you're seeing on your cross-border service? I imagine that's remained quite a bit stronger than other parts of the business. And is there a way to continue growing that to capture potentially some near-shoring demand?

**Derek Leathers**

The short answer is yes. We are very bullish on Mexico and on our cross-border business. We've continued to invest down there and spend money down there to expand our capabilities. We've enhanced and expanded our ability to crossdock and be able to do both temperature controlled as well as dry van cross-docking, so that we can use our assets and/or others.

We now have all of our major components playing in the Mexico market, if you will. So we do both Power Only into and out of, standard brokerage, truckload asset and intermodal. So that's exciting. Our customers are absolutely telling us that they are interested in doing more near-shoring and many of them have been trusted partners with us for over 20 years. We've worked with some of these companies since the days I came to Werner, 24 years ago. So we're excited as we look forward to Mexico.

There are some constraints. And if we've stayed only in the asset lane, there's only so much North-South business you can do on asset only without impacting your network. And that's where power only and brokerage and intermodal and other solutions are being brought to bear.

There are still disruptions with cross-border Mexico. So we're not out of the woods yet. I mean, some of the stuff happening with the issues of immigration and other things at the border have caused some fits and starts as of related to El Paso. In particular, where major international trade bridges were closed for periods of time. We don't like to see that. We'd like to see that be set aside for international trade, but we don't always get everything we want.

But as I look at the medium to long term, and I think about Mexico, I think about a seasoned team with over two decades of experience, most of the management group having been here for that entire run. Partnerships with carriers across Mexico that have the same

amount of longevity. Customers, really the same thing and yet some very robust new customers coming into the fold as of late.

So I'm pretty excited about what that business looks like going forward. And its profile has maintained to be one that has premium returns because of its complexity, less competition because of its complexity and one that we think we can continue to excel at.

**Operator**

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

**Derek Leathers**

Yes, I'd like to just thank everybody for joining us on our first quarter earnings call today.

While we recognize Q1 certainly had its share of challenges, I remain confident in our ability to deliver as we move through the cycle.

We're positioned well for strong performance with a robust dedicated pipeline to further enhance our stable and growing Dedicated fleet.

We've remained disciplined on price across our organization while still being able to grow volumes and logistics, both organically and with our recent acquisition.

Power Only and Truckload Brokerage growth continues to add solutions for our customers while lowering the capital intensity of our business, and that's exciting.

We remain committed to operational excellence and expect superior performance from our team and have an unwavering focus on sustainability as demonstrated by the meaningful progress, we made achieving our ESG goals.

We remain well positioned to generate superior earnings and free cash flow to weather the storm and drive long-term shareholder value.

And I'd like to end by one last time thanking John Steele for, again, to use the word, legendary career. Thank you for all that you've done and all that you've contributed. It's been an honor to work with you.

**John Steele**

Thank you, Derek.

**Derek Leathers**

And with that, we conclude our call today. Thank you, everyone.

**Operator**

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