Werner Enterprises

Q4 and Full Year 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Derek Leathers - *President, Chief Executive Officer*

John Steele - *Executive Vice President, Treasurer, and Chief Financial Officer*

PRESENTATION

Operator
Good afternoon and welcome to the Werner Enterprises Fourth Quarter and Full Year 2019 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*", then "1" on your telephone keypad, to withdraw your question, please press "*", then "2." Please note, this event is being recorded.

Earlier this afternoon, the company issued an earnings press release for its fourth quarter and full year 2019 results, as well as, posted a slide presentation to accompany today's discussion. These materials are available on the investor section of the company's website at werner.com, by clicking on investors, then news and events, and then webcast and presentations. Today's webcast is being recorded and will be available for replay beginning later this evening.

Before we begin, please direct your attention to the disclosure statement on slide two of the presentation, as well as the disclaimers included in the press release related to forward-looking statements. Today's remarks contain forward-looking statements that may involve risks, uncertainties, and other factors that could cause actual results to differ materially. Additionally, the company reports results using non-GAAP measures, which it believes provide 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.

I would now like to turn the conference over to Mr. Derek Leathers, President and CEO. Please go ahead.

Derek Leathers
Thank you, and good afternoon, everyone. With me is our CFO, John Steele. Turning to Slide four, we've included some updated background information for those who may be new to our story, and I'll highlight a few key items. For 2019, over three quarters of revenues were generated in our primary segment, truckload transportation services, with the remainder coming from Werner logistics.

Looking at revenues by vertical for our top 50 customers, just over half is in the retail category, which reflects the continued strength of North American consumers, and about 30% of these revenues are with discount retailers that focus more on selling necessity-based products. Twenty percent of our revenues were in manufacturing and industrial, 17% were in food and beverage, and the remaining 12% in the logistics and other category.

We have a diversified customer base with nearly 60% of revenues coming from outside our top 10 customers and about two-thirds spread across our top 50. We remain committed to supporting our core customers and the growth, while mitigating outsized exposure to any single customer, vertical, or seasonal revenue stream.

Next, let's move to Slide five for a brief overview of our financial performance. In the fourth quarter, revenues decreased 4% to $622 million. Adjusted EPS was 11% lower at $0.67 per share. Adjusted operating income decreased 14% to $63.4 million, and our adjusted operating margin declined 120 basis points to 10.2%. Considering the more challenging market conditions, we are proud to have delivered a total company double-digit operating margin in fourth quarter '19.

For 2019, in total, revenues increased by $6 million to nearly $2.5 billion. Adjusted EPS increased $0.01 to $2.39 per share. Adjusted operating income declined 1% to $225.9 million, and our adjusted operating margin was nearly flat at 9.2%.

2019 was a below average freight and rate year, compared to a stellar freight and rate year in 2018. We are pleased that in 2019, our exceptional execution, effective cost management, and balanced revenue model enabled us to successfully weather the storm and generate strong financial results. Adjusted earnings per share were the second highest we've ever reported in the fourth quarter, and our full-year 2019 adjusted earnings per share established a new record high. Our diversified revenue base and operational strengths place us in an excellent position to perform well in different markets and truckload freight cycles.

Results for the fourth quarter reflect freight demand that improved sequentially from the third quarter due to seasonality, and volume was comparable to fourth quarter 2018. The fourth quarter of 2019 was operationally more difficult than the fourth quarter 2018, due to a compressed holiday shipping period as a result of the later timing of Thanksgiving and the mid-week timing of Christmas and New Year's. Pricing was challenging as One-Way Truckload and Logistics project and surge pricing in fourth quarter 2019 was significantly lower than fourth quarter 2018.

In January 2020, one of our trucks was involved in a serious accident. The company is still investigating the accident, but it is probable that it will adversely impact first quarter 2020 earnings. The company self insures for the first $10 million of liability coverage for this policy period and has appropriate excess liability insurance coverage with insurance carriers above this amount. Additional insurance and claims expense of $10 million in first quarter 2020 would result in a charge of $0.10 per diluted share. As a company, we constantly emphasize that nothing we do is worth getting hurt or hurting others. We will continue to live by those words as we strive to reduce and eliminate accidents.

Reflecting our investments in a newer best-in-class fleet, we ended the year with 8,000 total trucks within our Truckload Transportation Services or TTS segment, an increase of 180 trucks year-over-year and down 55 sequentially. Most of our 2019 fleet growth came in Dedicated.

I'm extremely proud of Werner's performance and execution in 2019 amid the challenges we faced. Our team and our business model are well positioned to quickly adjust to whatever conditions present themselves in 2020. We have a flexible and adaptable revenue portfolio, and we are continuing to more effectively manage a broad base of our controllable costs.

I'd like to sincerely thank all of our associates--our professional drivers, mechanics and office employees, who contributed to this strong performance for all their hard work, dedication commitment to safety and superior service.

At this point, I'll turn the call over to John to discuss the financial results in more detail. John.

John Steele

Thank you, Derek, and good afternoon. Beginning on Slide seven, we provide some additional financial performance drivers for fourth quarter. Starting with our TTS segment, revenues per truck per week decreased 1.8% net of fuel due to lower miles per truck and partially offset by slightly higher revenues per total mile.

A soft and lackluster One-Way Truckload pricing market was more than offset by relative strength in dedicated pricing. Year-over-year, we increased the average number of TTS trucks by 3.3% and then deliberately tapered off our truck count during fourth quarter '19 by design.

In our Logistics segment, revenues were 12% lower. Our adjusted operating income declined 14%, primarily due to a 120-basis point decline in our adjusted operating margin due to the more challenging freight and pricing market conditions. Our adjusted earnings per share were $0.67, or 11% lower than the record $0.75 a share we earned in fourth quarter a year ago.

Turning to Slide eight, let's look at our full year data. In TTS, revenues per truck per week net of fuel was nearly flat. We had an average of 347 more trucks, which was a 4.6% increase. Logistics revenues declined 5% in a softer freight market with increased competition. Our adjusted operating income for the year declined slightly by 1% and our adjusted consolidated operating margin decreased slightly. Our adjusted earnings per share increased $0.01 to $2.39.

Beginning on Slide nine, let's look specifically at results for our Truckload Transportation Services Segment. In the fourth quarter, TTS revenues declined 2% versus the prior year quarter to $487 million, primarily driven by a 1.8% decrease in revenue per truck per week. Adjusted operating income was $60.4 million, declining 11% due primarily to the decrease in adjusted operating margin of 130 basis points to 12.4%. Despite the challenges, our fourth quarter 2019 adjusted operating ratio net of fuel surcharge was a strong 86.0%.

For the full year, TTS revenues increased 2% to $1.9 billion. Adjusted operating income declined 3% to $206.6 million, due to 50 basis points of operating margin contraction to a solid 10.8% for the full year, despite challenging trucking industry market conditions in 2019. And our full year adjusted operating ratio net of fuel was 87.7%.

Turning to fleet metrics on Slide 10. For Dedicated, we grew full year 2019 trucking revenues net of fuel by 12% to $914 million. Fourth quarter 2019 Dedicated revenues net of fuel increased 10% to $237 million. Dedicated average trucks grew 7% for the year and 5% for the quarter. Fourth quarter 2019 average Dedicated trucks of 4,693 exceeded year-end Dedicated trucks of 4,630 by 63 trucks due to the typical post holiday retail truck decline in the latter part of December. Dedicated revenues per truck per week increased 4% for the year and 5% for the quarter.

One-Way Truckload trucking revenues net of fuel for the full year decreased 4% to $739 million. Fourth quarter '19 One-Way Truckload trucking revenues net of fuel decreased 8% to $188 million. One-Way Truckload average trucks increased 1% for the year and for the quarter. One-Way Truckload revenue per truck per week declined 5% for the year and 9% for the quarter. Further breaking out the components of the revenue per truck per week changes, One-Way Truckload revenue per total mile declined 2.1% for the year and 5.4% for the quarter. One-Way Truckload miles per truck declined 3.1% for the year and 3.5% for the quarter.

During November 2019, our fleet experienced a temporary unplanned outage for our trucks and drivers caused by our GPS satellite communications provider that was subsequently rectified in December. This industry-wide outage affected tens of thousands of trucks in the market and negatively impacted our One-Way Truckload miles per truck by approximately 1% in the quarter. We estimate the incurred cost for this issue reduced our fourth quarter 2019 earnings per share by $0.01 to $0.02 per share.

Moving to Werner Logistics results on Slide 11. In the fourth quarter, logistics revenues declined 12% to $120 million, primarily driven by a 12% decline in Truckload Logistics revenues. We had fewer transactional opportunities, less attractive contract and transactional pricing and increased competition from logistics competitors, including digital brokers.

Our gross margin percentage declined 150 basis points, driven by significantly less project and surge opportunities. While we achieved a 5% reduction in our other operating expenses, gross profits declined by 20%, and resulted in a 250-basis point decline in our operating margin percentage to 2.8%. We are continuing to invest in Logistics IT, which is clearly improving our decision-making and employee productivity.

Logistics operating income decreased 54% to $3.4 million. For the full year, logistics revenues were 5% lower, gross profit was 4% lower, and operating income declined 20%. Our logistics operating margin declined 60 basis points to 3.3%.

I'd now like to turn the final portion of our prepared remarks back to Derek, who will cover our strategy, CapEx and free cash flow generation, and 2020 guidance. Derek.

Derek Leathers
Thank you, John. Moving to Slide 13, I wanted to update you on our Five T's strategy. Over the past few years we created structural and sustainable improvements with our modern and more efficient fleet, high-quality professional drivers, and strong management execution. We expect to generate more consistent results, and that's exactly what we delivered in a challenging year.

Our truck and trailer fleet ages remain new, with an average of 1.9 and 4.0 years, respectively. Despite the very competitive labor market, we continue to achieve one of the highest driver retention rates in the last 20 years. We significantly upgraded and expanded our terminal network in multiple strategic locations to improve our driver training and equipment maintenance capabilities. This investment also provides our drivers with the facilities and infrastructure they need and deserve to keep America moving every day.

We are upgrading and modernizing our IT infrastructure and data security as part of our Five T’s strategy, while continually strengthening service to both our customers and drivers. We value the business of IT and prioritize, rank, and measure our technology initiatives to ensure they align to the operational priorities, support business strategies and generate strong ROIs. The ultimate goal of our Five T’s strategy is safely delivering superior service to our customers on time every time.

Last August, we were recognized by Logistics Management as a Quest for Quality Award winner in both the dry van truckload and logistics categories. This independent recognition from thousands of shippers that participate in this long-standing annual award survey, along with our solid financial results, further validates that our Five T’s strategy is working.

On Slide 14 is a summary of cash flow from operations, net capital expenditures, and the resulting free cash flow over the past five years. From 2015 to 2018, we were in a relatively high investment period focusing on strategically improving our fleet and strengthening our organization.

With the significant investment in our fleet and terminals behind us, in 2019 our net CapEx normalized to $284 million and we generated free cash flow of $143 million, or a $74 million increase in free cash flow generation year-over-year. We are continuing to reinvest in a new fleet for the future and are targeting net CapEx to be more consistently in the range of 11% to 13% of gross revenues over the long term. We also expect to once again generate significant free cash flow in 2020.

Looking ahead to our 2020 guidance on Slide 15, we do not plan to grow our truck fleet until market conditions improve. Our fleet count will likely be flat to slightly lower in the first half of 2020. From year-end 2019, we expect the change in our fleet count to be in the range of negative 3% to positive 1% for the year.

Gains on sales of equipment are expected to decline from $18 million in 2019, to a range of $6 million to $12 million in 2020 due to decelerating used truck demand and pricing and fewer trailers expected to be sold. We expect net capital expenditures to be in the range of $260 million to $300 million.

One-Way Truckload revenue per total mile for the first half of 2020 is expected to decrease in a range of 5% to 7% compared to the same six-month period in 2019 similar to the One-Way Truckload year-over-year rate trend we've experienced in the last two quarters. We expect our effective tax rate will be in the range of 25% to 26%. We expect to maintain the average age of our truck and trailer fleet at or near current levels.

So far in the first five weeks of 2020, freight volumes in our One-Way Truckload unit have been seasonally normal and slightly lower than the same period in 2019. Pricing remains challenging. The rate market remains difficult, based on challenging customer contract rate negotiations so far in the 2020 bid season and lower year-over-year spot pricing.

Year-over-year comparisons of rates and earnings in the first half of 2020 are more difficult. Currently, we expect industry dynamics to improve in the second half of 2020, although it is difficult to predict the exact timing of the turn.

Werner is well positioned with nearly 60% of our fleet in Dedicated, a more stable and predictable business, 20% of revenue from our logistics segment, and less exposure to the One-Way Truckload market. Depending on how the year develops, there could be fleet growth opportunities in the second half of 2020 following expected truckload industry supply contraction in the first half. Lower industry new truck production, fewer available industry drivers as a result of the build-up of the drug and alcohol clearinghouse, accelerating trucking company failures, and other factors are expected to constrain truck supply as 2020 develops.

I'm confident that we're positioned for success and to effectively navigate whatever economic environment comes our way in the future. Our fleet is refreshed, our team is rebuilt, and our commitment to excellence is unwavering.

At this time I'd like to turn the call over to the operator to begin our Q&A.

QUESTION AND ANSWER

Operator
We will now begin the question-and-answer session. To ask a question, you may press "*", then "1" on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press "*", then "2." To allow for as many callers as possible to ask questions, we ask the callers limit their questions to one question and one follow-up. This call will end at 5 PM Central Time following the company's closing remarks. At this time, we will pause momentarily to assemble our roster.

And our first question comes from Todd Fowler of Keybanc Capital Markets. Please go ahead.

Todd Fowler
Great. Good evening. Thanks for taking my question. Derek, just to the comments on what you are expecting for fleet growth, playing around with the numbers a little bit you know, to get to that flat level in the first half of the year, it seems like Dedicated fleet growth might decelerate from the mid single-digits that you've seen in the fourth quarter. Can you talk a little bit about the dedicated pipeline and maybe why you are seeing a little bit of slower growth in Dedicated in the first part of 2020 versus what you saw in the back half of '19?

Derek Leathers
Yes. So first off, thanks for the question, Todd. The assumption, maybe a little bit off in the sense that Dedicated...the pipeline looks good right now, actually, as we think about what we have in the pipeline and even as we think about it from a year-over-year perspective, it's fairly robust. The hesitance on fleet growth in our mind or my mind right now really has more to do with where we are at in the bid cycle, what's going on in the overall market, and our willingness, if needed, to move additional trucks from One-Way over to Dedicated to supply that demand that we believe is there, and we will be adding as we go forward. I'd rather not, I'd rather have the opportunity to keep our One-Way products out there and available to our customers, but as capacity still needs to bleed-off, and if there is an expectation of rate that we don't believe is really tenable in our network, we may be in a situation where we'll simply move more trucks from One-Way into Dedicated and end up netting either flat to slightly down in the quarter.

Todd Fowler
Okay. So, it sounds like it's a little bit more of reluctancy to lock in to where the contract market is right now versus anything on the pipeline side?

Derek Leathers
Yes, I think that's a fair way of thinking about it. I mean, thinking about it really is just sort of execution discipline. We are going to be disciplined in this bid season. We know what's happening with our cost structure. We know where we need to be from a rate perspective, and if we find ourselves in situations where we have to chase a rate, I'd rather move the truck to Dedicated than to find myself doing that.

Todd Fowler
Okay, understood. And then just a follow-up, you know, the commentary is helpful and the expected comparisons, pressure on the revenue per total mile. You did a good job this year of kind of controlling the margin and controlling costs and the challenging environment, particularly in the back half. As you look to 2020, what leverage do you have on the cost side and what would your expectation be for you know where margins, can you still be kind of in the high-80s with the pressure that you are seeing right now on rates and how do you think about controlling margins in the environment that we are in right now? Thanks.

John Steele
Thanks, Todd. This is John. We're continuing to expand our cost saving programs throughout the company. The cost saving items that we've initiated are widespread, they are broad-based. We've made meaningful improvements to our cost savings culture over the last year. And the categories range from labor efficiency, both on the non-driver and driver side; maintenance; supplies; benefits; to communications; to insurance and claims. I will say that when you get into year two of the cost savings, it's a little bit more difficult than the low hanging fruit that you start

with in year one, but we expect to make improvement on the cost side. The biggest variable to the margins is where does the rate side shake out.

And we expect the negotiations to be difficult in the first half. We expect the freight market and the rate market to be challenging in the first half and then begin to improve in the second half, partially due to relatively easier comps in the second half compared to the first half.

If you remember last year, we had a 6.5% increase in One-Way Truckload revenue per total mile in the first quarter. And then that gradually deteriorated down to negative 2.7%, negative 5.6% and negative 5.4% the next three quarters. So, we're going to work hard to continue to make improvements as we can, but it will be a challenging first half.

Operator
Our next question comes from Amit Mehrotra of Deutsche Bank. Please go ahead.

Analyst
This is Sal on for Amit. As it relates to your guidance of…rate guidance of down 5% to 7% in the first half of 2020, obviously it implies a bit of a step down from 4Q and comps do get easier as you move into 2Q. What does this assume, just from a supply / demand perspective for the market overall?

Derek Leathers
I mean, our thoughts on supply and demand is that we think capacity is coming out of the market right now, we are seeing signs of that in a variety of ways. The obvious being the truck orders are now translating into lower builds, finally bankruptcies are up. The Drug and Alcohol Clearinghouse has clearly taken an effect and clearly going to make it more difficult, or more supply constrained.

The bulk of that rate commentary in the first half is really just a lapping effect of what took place over the course of last year. And it's kind of a continuation of where current rate levels are, as well as, spot exposure and where the spot market is currently at. We like to be conservative in our guidance. We think that's a number that we feel comfortable with the guidance that we've given. That's not where we're seeing rate renewals take place at, but it's bigger than that. It's what's the spot opportunity.? What are project opportunities looking like? What's our exposure to spot year-over-year…and when you put all of that in the mix, rates, we think, are going to be down for the…in that negative 5% to negative 7% range. It could be better than that if the turn happened sooner than midyear, and I think that's really going to be determined on what we see in the accelerated bankruptcy environment with where rates have been for as prolonged as they've been. I think you are going to continue to see pressure on people trying to make it through the other end of the tunnel.

Analyst
Okay. And maybe just a little bit of different way, because we don't have the actual rate per mile anymore. What does this kind of assume on an absolute basis relative to…as we move from Q4 to Q1 to Q2?

John Steele
Well, traditionally rates are lower when you move from the strongest seasonal quarter to the weakest seasonal quarter of the year, and we fully expect that this year. We did have some project and surge opportunities, not at the rate that we had hoped for and not at the rate that we saw in fourth quarter of '18. But yes, we expect a traditional step down, based on the fact that

freight that we are seeing thus far in the month of January is a little bit below where it was at the same time last year.

Analyst
Okay. So just kind of assumes normal seasonality?

Derek Leathers
Correct.

Analyst
Got it. Okay. Appreciate the questions. Thanks guys.

Operator
Our next question comes from Jason Seidl of Cowen & Company. Please go ahead.

Adam
Hi guys. This is Adam on for Jason. Just wanted to try and dig a little bit deeper on the current environment right now. You mentioned a little bit about the contract increases you're getting now and how things are still challenged obviously. I just wanted to ask if you'd be able to kind of give us a little bit more color, maybe a number around what contract increases…what contracts that you are getting right now, what those numbers look like?

Derek Leathers
So first off, thanks for the question, Adam. We're early in the process. So, we've probably got about 20% to 25% of bids that are either in-house or in-process. Those are finishing in a variety of outcomes. Not very many of those are completely settled and finished yet. We'll have over roughly 70% of our business in the first half of '20. And as we sit here today, we've seen renewals from flat to down a few points. We're going to continue to work hard to be in that range. There will be exceptions to that, based on network fits and efficiencies of the freight.

One of the things I think we're doing a much better job of over the last year to two years is understanding the operational cost of the individual freight lanes and individual customers. And so that does weigh into the bid process. There's no one size fits all answer. But the net of it…of the bid outcomes as well as the spot market is where we come up with the guidance that we've issued.

John Steele
And one thing I want to add Adam was remember, One-Way Truckload is 42% of our trucks, and the commentary relates to One-Way Truckload and not to Dedicated.

Adam
The rate number there, the flat to down a few points, was One-Way Truckload?

John Steele
Yes, all the commentary we just covered relates to One-Way Truckload.

Adam
Okay.

John Steele
Our guidance is down 5% to down 7%. And the comments that Derek just made also relate to One-Way Truckload.

Derek Leathers
As does the guidance.

Adam
Understood. Yes, thank you for the color. Just as a quick follow-up. When you're thinking about the back-half recovery, it seems like everyone's kind of pricing that in. You mentioned some of the catalysts earlier, the insurance bankruptcy, et cetera. What do you kind of think about the timing as we get into that, right, do you anticipate that second quarter will kind of continue to be challenged, I guess, kind of how do you see the breakdown between the first quarter and second quarter as we get to the recovery in the second half?

Derek Leathers
Sure. Well, I would start with this. The first quarters are challenged in general. Normal seasonality takes hold. It's a challenging quarter even in the best of times, and this will be no different. We're still are in a situation today where although I think we're closer to equilibrium than we've been in a while, you've got kind of negotiation headwinds, if you will, from where capacity has been looser over the last couple of quarters than we saw in '18.

With that said, orders are way-off. Builds are coming off and below replacement levels now. As I already mentioned, bankruptcies are rising in a meaningful way. I mean, we're not talking of going up by 20%. We're talking bankruptcies up five-fold over '18 to '19 and some larger players now being affected as well. It's not just small shops that are going out of business. It's larger. The two big ones that I think are…you mentioned one of the two was insurance. The hardening of the insurance market and what we're continuing to see in insurance cost is really pushing a lot of people over the edge, because they can't take 50% to 70% insurance renewal increases when it's 5% to 6% of cost line item and they're operating on razor-thin margins to begin with.

And the other ones are the Drug and Alcohol Clearinghouse. I mean, we know with reliable data that that Drug and Alcohol Clearinghouse has been receiving 250 to 275 new names a day into the clearinghouse. And so, if you just think about that over the course of the year, you're talking about a pace that would project out to be over 60,000 drivers entering the Drug and Alcohol Clearinghouse this year. That's a good thing for safety. It's something we fully support, and that's why we have been hair follicle testing for many years to make sure our fleet is drug-free. But it will cast some capacity constraints over the industry that will take more hold as we move forward.

On the outside, I think it's fully felt in the latter part of the second quarter. On the inside, I think we could start feeling it late Q1, early Q2. But for right now, we've got choppy times ahead of us and we're going to continue to keep our head down and focus on what we can control, which is our cost and our execution and the service we provide our customers.

Adam
Got it. Thank you for the color. Appreciate it.

John Steele
Thank you, Adam.

Derek Leathers
Thank you.

Operator
Our next question comes from Alison Landry of Credit Suisse. Please go ahead.

Allison Landry
Good afternoon. Thanks. Sorry, I just jumped on from another call. But my question is, how do you see the progression of the upcoming bid season? Would you expect contract rates to perhaps start out on the weaker side and then strengthen toward the latter part? Maybe if you could just delineate how you are thinking about that.

Derek Leathers
Yes. Thanks, Allison. Clearly, we view the market as one that's going to tighten as the year goes on. At a high level that's going to change outcomes on bids as the year progresses as well. At a more tactical level, the fact is, we can't afford to go backwards right now. I mean, the fact there may be a little bit of overcapacity out there in the market is a relevant fact. But what's happening with overall cost and all of the things we're discussing in terms of the industry headwinds. And frankly, the undersized margins that the vast majority of the industry is faced with, mean to me that we've got to hold the line on rates and we're going to have very open, frank, professional discussions with our customers on that. Hopefully, they're going to look to a longer-term horizon than just a quarter, because to save money or to be overly aggressive in a contract, knowing that the market is turning 30 days, 60 days, maybe 90 days out, to me would be short sighted versus a more long-term approach. We have customers that take that view and we have others that will be more transactional and that's where some of the commentary you missed earlier in the call comes into play and that we could see more movement from one way to Dedicated, because our pipeline there is pretty strong and we have the opportunity to move more trucks to Dedicated versus taking bad outcomes out of bids if that's the only other option.

Allison Landry
Okay, that's really helpful. And then, just in terms of some of the trends that you're seeing across your retail customer base, maybe specifically low-end versus high-end retail. Could you talk about what you're seeing in each of those end markets relative to historical trends?

Derek Leathers
Yes. We don't talk about individual customers, but I will talk about it in general terms. You know, we've aligned ourselves over the last several years with winners and we've worked hard to do that, so we follow our retailers very, very closely to see kind of who is winning and gaining share and who is losing and maybe losing out to the e-commerce reality that's around us. And by aligning with folks that have successful stories and successful products, it's given us the opportunity to grow with them. At the discount retail level and the home improvement retailers in particular, they've continued to put up strong solid results through their own execution models that we think are winning strategies.

We're going to continue to align with them and continue to grow with them and be ready as they continue to expand their footprint. That end of the market looks real good. Some of the other ends of the market, frankly, we don't plan as much and it's by design and in particular folks that are maybe caught in the squeeze of what's happening with e-commerce and we see that squeeze occurring and not see the sufficient strategy on their business model or their approach to the market. To keep up with that, we've minimized our exposure over the last several years for precisely the market that we're now in, and that's what helped us weather the storm this year.

Allison Landry
Got it, that's great color. Thank you, guys.

John Steele
Thanks, Allison**.**

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

Ken Hoexter
Hi, great, good afternoon. Derek, maybe you could just keep going on some of the pricing discussion. You focused a lot on One-Way? And maybe just talk to us about Dedicated and your thoughts on how that rolls through on revenue per mile through the year, you've given a lot of specifics on the One-Way. Maybe Dedicated slower to ramp or does the pain that you're feeling now kind of come through maybe a little bit longer through 2020 than obviously in the One-Way.

Derek Leathers
Ken, first off, the best news about Dedicated, especially the Dedicated that we do, is it's difficult to serve, it's high expectation, and it's well beyond just the movement of freight. I mean, it's the design, optimization, implementation, with a heavy focus on the utilization across the fleet. To do that, you have to have a certain amount of sophistication. We think we do that and do it well. That has not come under the same pressure in 2019 as One-Way did. It certainly doesn't resemble anything that's going on in spot.

And had this cycle carried out longer, like if we still thought that we were going to be in an overcapacity situation for another year or another two years, it could have had adverse effects at some point on Dedicated. But having the belief currently that we are closer to equilibrium than not that you're seeing some relief in the spot market, and you're seeing exits of capacity kind of across the multitude of reasons we've already given, we feel pretty good about where we sit with Dedicated. As we talk to those customers, and they look for us to grow, there is not a lot of folks that can do what we do for them. We're going to be fair with them and charge them appropriately, based on the services that we're asked to provide. But the risk for that to decline or that story to worsen is largely behind us. We're pretty confident in how we think about the future of our Dedicated model.

Ken Hoexter
So, I think the expectation of One-Way was kind of built-in, in terms of the minus 5%, minus 7%, but you're not turning negative is what you're saying in terms of the dedicated side?

Derek Leathers
That's correct. The pipeline is plenty robust that there isn't a reason or need to think about turning negative in Dedicated right now at this point.

Ken Hoexter
Alright. If I can get a follow-up on the outage, you mentioned the cyber or, was the outage a cyber-attack on this supplier? And I know you said you're beefing up your own IT. Is there anything that you've done differently now that you've gone through that? John, you were talking about that experience in the quarter and the EPS impact. Anything to ensure backup? Or was it the drivers kept driving; they just went out of route? It was a little bit longer on mileage. I just want to understand maybe that impact a little bit on what you're doing?

Derek Leathers
Yes, this impact was not a cyber-attack or anything like that. It was a global GPS rollover event that took place that affected more than just our supplier to be fair. And it had to do with a scheduled GPS update/rollover that frankly just went afoul. It affected a variety of different tech devices around the world that relied on that information. We were affected as well. What it meant for us is we had to revert to the old-fashion days. We had to from one day to the next, over the course of an evening revert to paper logs, paper routing, atlases and trip planning, and that is a pretty big undertaking.

I would be remiss if I don't specifically thank all of the folks here at Werner because the amount of work and effort they put into it, the amount of extra hours and overtime and effort to keep that fleet moving was nothing short of incredible. It really proved to me what they are really made of. But we got through it. It took several weeks to get through it completely and to come back online, and we've kind of commented already on what we think the EPS impact of the delayed dispatch, delayed ability to have visibility, not being able to use our optimization software, because you don't have clear visibility to the fleet. And it was pretty major. As to what we can do differently than when it is the telecommunication link between us and our fleet. It isn't something that you would have redundancy on. It’s hard to explain why, but it's just kind of how that works.

And so, when we went dark, we were all the way dark. We do have, one of the things I'm most proud of is we've built driver apps, not for this reason but for other reasons, that allowed us to stay in constant communication with our drivers and still send and receive dispatch information. We had already kind of built technical solutions or workarounds without even specifically this kind of outage in mind, but it worked and provided an avenue for us to continue to move goods for our customers. There were impacts across the service spectrum and other places, but it was widespread, not just at Werner. We just were more impacted than most because it was the entirety of our fleet, whereas others had pockets of their fleet impacted.

Ken Hoexter
Okay, Derek, John, a great job on the quote on the tough environment. Appreciate the time.

Derek Leathers
Thanks, Ken.

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

Scott Group
Hi, thanks, good afternoon, guys. Derek, are we, in the first half, are we seeing the same sorts of headwinds from lower project business, lower spot rates than what you saw in the second half of '19? I'm just trying to bridge to that down 5% to 7%. And then, if the market turns, as you expect, what do you think is a realistic second half rate recovery? Is it low-single, mid-single, what do you think?

Derek Leathers
So, the environment has not dramatically changed from currently in the first quarter from what we were seeing in the latter part of '19, to answer the first part of your question. Now I will tell you there are fundamentally less projects and surge opportunities even in a good year in the first quarter and most of the second quarter than there would be in the third or fourth quarter. The impact, if you will, of that environment isn't as great. We will have to continue to battle through

the fact that we're in the bid season and the turn is not completely upon us, but at least it's visible from where we're standing.

And I think that's generally recognized across the shipper, carrier, and investor community. And as it relates to the back half, rates are going to really be heavily dependent on what happens with project, surge, and those type of opportunities, because we built a lot of product lines around that, and we do it very well. We need that stuff to come…to be available back half, and it's just too early to try to give you a prediction on what that looks like.

I like where the consumer stands right now, they're staying engaged and consumer confidence looks good. We've got a trade deal in USMCA, that makes me feel pretty good, given our presence in Mexico. Phase 1, China, certainly better news than what we were dealing with throughout all of '19. But…but on the flip side, you've got an election coming, and so who knows what that does relative to confidence one way or the other. It’s a bit early. We'll update quarter-to-quarter. But I can assure you that rates need to recover. And when it's time for them to recover, we'll be out there doing our part.

Scott Group
Okay, thanks. And then if I can ask one to John. The salaries costs were down, I think, 4% or 5% sequentially. Is that fourth quarter a good run rate? And I get you didn't want to answer the question about full-year margin that someone else asked earlier. But at least, in the first half, if rates are down similar first half as they were in back half of '19, do you think the margin impact should be similar as well?

John Steele
Yes, salary, wages improvements came from the non-driver and the logistics payroll side, helped sequentially as we gained some productivity and efficiency improvements. We had 3.3 million fewer company miles in fourth quarter compared to third quarter, partially because of the GPS outage, partially because we got two holidays in fourth quarter and one in third. And we had a little bit more dedicated shorter haul in fourth quarter.

We also had improved work comp and health insurance in the fourth quarter. Those are a little harder to predict as to how much that's going to be sustainable going forward. We like the changes that we've made to make improvements there, but you're always somewhat subject to your claims experience for those costs. I would expect salary, wages to continue to trend favorably, based on what we know right now. But our claims experience was pretty good in the fourth quarter for work comp and health insurance. I wouldn't want to predict that we'll keep all of that.

Derek Leathers
The only thing I would add to that is that all of the things John said and then the other factor to keep in mind is we did have some tailwinds in the fourth quarter from incentive comp. Although this was great news in some respects for the quarter in terms of how we performed, it certainly did not meet our expectation. Our internal goals were higher and incentive comp will reflect that. And so, there will be some headwinds that will exist as it relates to that going into next year as we hope to exceed our goals and exceed our expectations.

Scott Group
Okay. Thank you, guys.

Derek Leathers
Thanks, Scott.

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

Jack Atkins
Derek, John, good afternoon. Thanks for taking my questions.

Derek Leathers
Good afternoon.

Jack Atkins
To go back to the rate expectations in One-Way Truckload, just for a moment, not to belabor the point, but I'm just trying to bridge to it. I think the other folks are as well. The downside 5% to 7%, you've got less of a headwind year-over-year from special project business. The spot market rates appear to be roughly flattish at just the public published rates and contract rates are flat to down slightly. On an easier year-over-year comparison, it seems like a pretty steep decline in that One-Way business in the first half. Could you just kind of maybe put a little bit more context around sort of how you're getting to the down 5% to 7%, I think that would be helpful for folks?

Derek Leathers
Yes. Well, I think the first thing that might be getting overlooked is we were up over 6% for QI last year. And so, if you do nothing on contracts and you don't renew anything, just the effect that we've already been experiencing throughout the year, both in spot. And spot has two effects, right, higher spot miles exposure and a much lower spot rate. You compound that with a normal seasonally slow first quarter, which has happened. It's like most first quarters right now, you're going to be negative right out of the gate. Those contracts that then renewed that may end up renewing flat to slightly down still only add to that issue, although they may be better than what you're experiencing in spot. And so, we are being conservative with our estimate, it's probably has upside in the second half perhaps or the second quarter perhaps, but that will really get back to an earlier question around project and spot and surge opportunities.

The only time they really come to fruition in the first half of the year, even in good years, is at the end of the second quarter. And it's just too early to be looking into a crystal ball right now and predicting what happens in June. We're going to assume, and plan based on what we know, and what we're lapping. And what we're lapping is a reality of being in that range for One-Way Truckload, not total company as we start this year. So that's our best view on it right now.

Jack Atkins
Okay. That makes sense. And I appreciate the extra color there. For a follow-up question, I'm sorry, for two relatively short-term questions, but I just think it's important for everyone to have their expectations calibrated correctly. When you think about OR trends within the TTS segment, John, if I'm hearing everything that you guys are saying correctly, you had some health care and other sort of workers' comp tailwinds in the fourth quarter. Incentive comp was a good guy. But conversely, you had the disruptions from the supplier there, which negatively impacted the fourth quarter. How should we think about sequential OR trends? Typically you see about a 400-basis points, maybe a little bit more than a 400-basis point degradation, fourth quarter to first quarter. Is that the right way to think about that this year? Or are there puts and takes on either side?

John Steele
Well, I think the biggest variable is the rate challenges that Derek had talked about and being down 5% to 7% in One-Way. I think it's still going to be pretty tough sledding at least in first quarter and more than likely in second quarter. We're not forecasting significant project and surge business in second quarter at this point. It could show up in June. But at this point, we're thinking it's going to be a fairly difficult environment when you combine spot rates, which we're forecasting to be down in the range of 15% first quarter, 5% second quarter. And contract rates that Derek talked about, flat to slightly negative, and we're not planning on special project business at this time. So those factors all enter into the thought process as it relates to margins.

Jack Atkins
Okay. That's helpful. Thanks very much.

Operator
Our next question comes from Jordan Alliger of Goldman Sachs. Please go ahead.

Jordan Alliger
Yes, hi. Just a quick question. Obviously, most of the conversation, rightly so, was on Truckload. But can you maybe talk a little bit about the Logistics business and Brokerage? And is there any thought that the improved environment for Truckload, you start to see a trickle-down to the Brokerage side of the equation later this year?

Derek Leathers
Yes. Jordan, thanks for the question. Logistics has got challenges, both sort of market-based, if you will, in terms of supply and demand right now, and what we've seen happen with rates and some of the rate pressure. And then additional, as it relates to new entrants into the market that are making that market more competitive than even the underlying supply and demand would warrant, in my view. We're going to continue to try to be disciplined. We believe in that product.

Volumes were actually up despite revenues being down, and that's just a reflection of rate and where rates went. We are going to stick to our knitting on walking from business that we think is putting ourselves in a position to leave our customer in a bad spot when the market turns, i.e., we're not going to enter contracts where we're going to have to go back and rip them up and tell them here's new deals. We're going to try to make sure on price with sustainable pricing. And we hope customers will understand that.

And frankly, I think it will be a little bit of a test to see how long they can lose this much in some of the digital brokers that have entered the space and how much staying power they have. In the meantime, what we're going to focus on instead is continuing to build our tech, continue to gain efficiencies, and continuing to build products that we think can compete head-to-head with any of them, regardless of where they might want to price the business. We have to be able to execute and operationalize it every bit as well as what they do and then back all that up with our assets. When we put that together, that value prop, I think, makes sense for our customers. The response has been positive. But it's going to come down to us being pretty defensive around where we're willing to go with rate. And I think the story is yet to be written on how much more aggressive some of these folks get.

Jordan Alliger
Thank you. Very helpful.

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

David Ross
Yes, good afternoon, gentlemen.

Derek Leathers
Good afternoon, Dave.

David Ross
I got some questions on some of the T's. First, the expanded terminal network that you talked about, how much did that grow in 2020 over 2019? Do you plan for any more expansion of that this year? And is that to support mainly the One-Way operation, the dedicated operation or both?

Derek Leathers
Yes, it's a multiyear plan to continue to expand terminals where we think they make sense and support our business and lower our overall cost structure. It's all in the CapEx numbers, and we can do this multiyear plan and still stay within the ranges that we've guided to. I only point that out because I don't want people to be worried or thinking that we're unnecessarily expanding. Yes, there's terminal expansion happening this year. We are expanding and building the terminal in Pennsylvania. We are continuing to expand existing terminals where appropriate. In almost every case, they support both. Actually, in every case, they support both. In some cases, it might be a terminal that's 80% Dedicated focused and 20% One-Way, and the inverse is true on other terminals in the network. And it really has to do with the difference between incumbent terminals that we've had for a long, long time and new terminals that we're building to better support a more widespread fleet that is more regionally concentrated than it has traditionally been.

David Ross
So how many terminals did you end 2019 with? And how does that compare to a year earlier?

Derek Leathers
So, in '19, we would have added to, it's difficult, I'm not trying to be evasive, but we have Tier 1, Tier 2, and Tier 3 terminals. There are a multitude of stats around each of those. I can just tell you that at the Tier 1 level, we've added a terminal in each of the last two years. We're adding a terminal this year. But there are also takeaways. There's terminals that are either being downsized or removed from the network. And net effect is we'll probably be plus 3 at the end of the process, net. And that net number would be about 13 of the large Tier 1 terminals, a similar number of Tier 2 and Tier 3.

David Ross
Excellent. Thank you.

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

Mike Triano
Hi, guys. This is Mike Triano on for Tom. I was wondering if you could provide an update on customer inventory levels. Are customers looking to build inventory at this point? Or do we need to see some more drawdown before activity picks up?

Derek Leathers
So, John is the expert on that. I'm going to be quick and turn it to him because he follows this closer than anybody I know. I just would say this, I think, on a very, very macro level, we have to continue to contemplate e-commerce when we think about inventory, and we know that it takes more inventory for people to go to this omni-channel model and to continue to grow and have a more robust e-commerce fulfillment strategy. They've been pulled down some in recent reports. And by historical standards, they probably still look a little elevated. I think they have to stay somewhat elevated as it relates to having a best-in-class e-commerce strategy. With that, I'll turn it over to John for more color.

John Steele
So, with the quarter ended October for our retail customer base, in general, inventory levels got a little bit better. But it does vary from retail customer to retail customer, depending on their strategy. Our customer base had a pretty solid quarter in October. From a margin standpoint, they're in slow growth mode. I'm not saying they're expanding their sales significantly. But they are keeping a close eye on inventory and now that they have a little more clarity on the tariff situation, I think that has helped them to manage their inventories more effectively. I think we're in a good position from an inventory standpoint--not excess, not significantly lean either. I think we're in a fairly balanced inventory situation.

Mike Triano
Okay. Yes, thanks for that. And with the recent ratification of USMCA, are you guys expecting any impact or change to your Mexico business within One-Way truck for a longer term?

Derek Leathers
Yes. We're still bullish on Mexico, both for our own story network and what we've built down there and having what we believe to be the industry-leading position already. You couple that with the fact that we've had multiple exits over the last 12 months of carriers that have decided to exit the market, which bodes well for us. USMCA gives folks confidence now that they can go and put back on the front burner plans they had for expansion. And so, all of those things are positives. The other question, Mike, I would say, is Mexico GDP for this year looks to have come in at either flat to maybe slightly negative for 2019. And the expectations for '20 is growth of 0% to 1%. We have to keep our eyes on what happens overall with their general economy. But, in general terms, I'm bullish on our ability to continue to leverage our Mexico footprint.

Mike Triano
Okay. Thanks, appreciate it.

Operator
Our next question comes from Chris Wetherbee of Citi. Please go ahead.

Chris Wetherbee
I wanted to maybe see, Derek, if you could elaborate on some of your comments around sort of early 1Q? I know January is always difficult to get a read on to what true demand kind of looks like. But when you think about it versus what you saw in the fourth quarter, is this sort of where we would expect to be sequentially? Any signs of improvement or maybe stagnation? Just kind of want to dig into a little bit more color around the January comments.

Derek Leathers
Sure. So, we saw the freight environment improve sequentially from Q3 to Q4, not surprising, obviously, with surge and other opportunities that exist. But it started to give us strength beyond

that in terms of what we're seeing in the overall non-surge network. I would say, in Q1, that trend line has continued. It's still seasonally, obviously, lower than what we had seen in Q4, but compares favorably to most of the prior years. I think it's way too early to say we're out of the woods yet, but we've commented that it's still a lesser environment than what Q1 of '19 looked like. And the next few weeks is really when things become a lot clearer. We think assets are going to matter again and they're going to matter again very soon, and we'll continue to try to position those assets where we think they make the most sense for our core customers and our shareholders.

Chris Wetherbee
Okay. I know that's very helpful. I appreciate that. And that kind of leads into the second question, just sort of conceptually, when we think about sort of coming out of '19, which was a challenging year, particularly for One-Way Truckload, and maybe there will be a recovery coming in the back half of '20 or maybe 2021. How do you think about sort of the real flexibility of the fleet to go back and forth a bit between Dedicated and One-Way Truckload? How much capacity can you really swing back and forth in any given cycle or should we assume that sort of the 60-40-ish type of split is maybe where the run rate is going to be going forward?

Derek Leathers
I think it's relatively easy to move fleet, move trucks from One-Way to Dedicated and to do that in a fairly fluid way, just depending on how bid outcomes are progressing and bid negotiations are taking place. It's a little more difficult to move from Dedicated to One-Way, simply because Dedicated contracts, the very reason they're sticky for us, they're also sticky for our customers. They are three years deals, usually or sometimes longer. Our commitments have been made, and those trucks generally are going to remain. As far as the mix, we really do believe that 60-40 is about where we want to be. But ultimately, people are going to compete for assets internally. The belief I have is that when we think about what it takes from a CapEx perspective to continue to operate a best-in-class fleet, those are expensive assets, and there ought to be competition for their service.

Our van division folks, One-Way Truckload, Mexico, Dedicated, they're all going to be arguing over why those assets should be in their area, and the returns will dictate where they end up. But 60-40 as a guideline, general guide would be where I'd tell you to think about our fleet as we go forward. Good drivers help us to be able to achieve that goal and having high expectations of our fleet and fleet discipline has really been rewarded with high retention rates. That serves us well if we were to have to grow and to boost up One-Way Truckload from the outside. That's why we commented on being in a market we're open to if the market supports it in the back half to thinking about fleet growth. But, right now, we're going to stay disciplined.

Chris Wetherbee
Got it. Thanks for the time, appreciate it.

John Steele
Thank you, Chris.

Operator
Our next question comes from Brandon O'glenski of Barclays. Please go ahead.

David Zazula
This is David Zazula on for Brandon. I apologize I do not have a question on Q1 rates, if that's okay?

Derek Leathers
Perfect.

David Zazula
So, when you guys started the 5 T's strategy in 2015. I think the goal was to try to outperform in all rate environments. And judging by the results of 2019, it seems to be bearing fruit. Can you maybe pick out one of those elements of the strategy you think was most critical in the declining rate environment in 2019? And maybe contrast that as investors try to evaluate the strategy with what you think will be most critical in a recovering rate environment in 2020?

Derek Leathers
Yes. I think in the early decline of the market, the clear commitment that we made starting with our Chairman, CL Werner, and delivered upon and kind of throughout our culture to our drivers. The talent T really carried the day. But that will carry you and allow you to change momentum and change culture in an organization, but you have to back it up with some of the other Ts. And so, tech has and our investment in technology has started to really kind of pay dividends, and we've got a lot more to do there and a lot more money will be spent. But it will be spent based on tangible returns and tangible timelines. And so, that is one that we think, as we look forward, has more opportunity. The terminal and infrastructure and trucks and trailers, honestly, are really a way to envelop the driver in the type of tools that he and she need to do their job.

We think we have some of the best drivers in the industry, but we had to up our game on the kind of tools that enabled them to really achieve what we knew they were capable of. That was what '19 was about. And as we go into '20, it's continuing that culture and focus, but backing it up with better tech and finding a more frictionless environment with how we interact with customers, drivers, mechanics, and throughout our organization, even internally. And we have some runway left ahead of us, to improve some of those productivity measures, and I'm excited about what that looks like as we continue to invest in tech as we go forward.

David Zazula
Thanks Derek. Just a quick follow-up judging by the performance in margins this year, is it time to revisit the 11% or better average through the cycle? And if not, now what would spur kind of that internal conversation for you?

Derek Leathers
Well, I think you should look for updates on that maybe as the year progresses. We want to make sure we're, in fact, through the turn and that we understand how we've performed kind of through a full cycle with this new culture and new environment and new operational focus. But certainly, my expectations and those of my leadership team are to continue to improve, and we have to continue to find ways to create this evolution at Werner towards a better future. I think we're on our way. I think the fourth quarter shows that, I think, posting year-over-year EPS earnings increase is pretty remarkable. And yet we, I'm excited about the number of things that we have in front of us to continue to execute even better on. Not looking to change that goal just yet, but I can tell you that it's on our mind.

David Zazula
Well, thanks Derek. Congrats on the quarter and the year.

Derek Leathers
Well, thank you.

John Steele
Thank you, David.

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

CONCLUSION

Derek Leathers
Yes, first off, I just want to thank everybody for being on the call with us today and for taking the time to spend time to understand our story. Appreciate those that have had the faith for some time and those that are coming to us more recently. If I was going to leave you with comments, it would be really that we're going to stay committed to what we've been doing over the last several years.

We're going to put a best-in-class product out there. We're going to expect best-in-class returns. And we're going to work with best-in-class customers. Assets will matter again, and that turn is upon us as we sit here today, but we are going to continue to keep disciplined through the last few innings or last inning perhaps of what was a tough rate environment. The first half will be challenged. The second half looks more promising. And in the meantime, we're going to find ways to execute and continue to put up results that we can be proud of. Again, thank you for attending our call. We look forward to talking to you all more in the future.

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