

Company Name: Werner Enterprises, Inc. (WERN)
Event: Stifel 2020 Transportation & Logistics Conference
Date: February 11, 2020

<<Analyst, Stifel Nicolaus & Company>>

Welcome back. Continuing with the trucking theme, just off the trucking panel, back to some more truckers, we've got with us Derek Leathers and John Steele from Werner Enterprises. So, Derek, maybe you just want to give a quick intro on Werner and then we can get into Q&A from there.

<<Derek J. Leathers, President & Chief Executive Officer>>

Yes, sure. So, I guess I'll start with today's presentation. We'll include some forward-looking statements and we would recommend you take a look at our forward-looking disclosure statement on our website.

With that said, a little bit about Werner. So, we are publicly traded on NASDAQ, \$2.6 billion roughly market cap. Our business model is a pretty diversified portfolio with about three quarters of it coming through a variety of Truckload Transportation services offerings. And within that TTS segment, we're a little more heavily Dedicated than we are in One-Way. In the One-Way segment, our focus and our niche is really team expedited and Mexico as specialties within our One-Way network, about 20% of our revenues are through logistics. And in that logistics portfolio, that's where brokerage, intermodal, freight management, our global business is all housed. And that's been an area that we're focusing on as we continue diversify out our portfolio.

2019 from a highlight perspective, I would just say the thing we're probably most proud of is that following one of the most epic years in trucking in 2018 in terms of what the market looked like and the tightness of the market, we followed that up in 2019 by increasing EPS on a full year basis. And so we're pretty proud of what our team was able to achieve, but we've got a lot more still to work on as we go forward.

<<Analyst, Stifel Nicolaus & Company>>

Now you're talking about the change in environment from 2018 to 2019. I remember hearing a lot of shipper of choice language that was used in 2018 as shippers learned to be good partners. Did that hold true in 2019?

<<Derek J. Leathers, President & Chief Executive Officer>>

Yes, I think, sweeping statements or generalizations can be dangerous. And so, there's exceptions to this rule. Certainly, there were shippers that behaved in a variety of ways. I'm sure they would argue the carriers behaved in a variety of ways in 2018. But in 2019, the majority of the core shippers that we do business with, that we work with and have for a long time, really

kind of upheld their end of the bargain by and large. They're facing internal pressures relative to a market that was looser, they may have asked for help or concessions at various points during the year for various projects. The only place it really showed through in a very, very tough comp year-over-year was in project and surge business, because we saw volumes in both project and surge that were similar to 2018, but pricing that was dramatically lower on anything that was priced within the year.

But contractual stuff held up pretty well. Our shippers really kind of stood by us for the most part. And one of the things we've done at Werner and really focused on, and it's something I believe strongly in, is working with winning models. And so, we, three or four years ago, came out with a very overt, very intentional message about aligning ourselves with winners. And winners don't look at their supply chain as a place to make their quarterly profits. They look at their supply chain as a competitive advantage. They want high quality carriers and they're delivering high quality service so that the stuff they make is on the shelf and can sell. People who have losing models or models that are not as robust try to find profits in their vendor base. And that's why we don't really want to work in those environments anymore than we absolutely have to. And whenever there's a choice, we're going to align with people that we believe in their story, just like hopefully they believe in ours.

<<Analyst, Stifel Nicolaus & Company>>

And so, to that end, how do you differentiate Werner and their minds when you're trying to win their business and be partnered with these companies when they're looking across at some other very good competitors of yours? What's the Werner sell or what are you pitching to them?

<<Derek J. Leathers, President & Chief Executive Officer>>

I think there are several things. I mean, one is that we're a portfolio company at this point, meaning that there's less calls you need to make to get a variety of services provided under one roof. If you're working with Werner, than is the case with many of our – many others in the industry. Probably preceding that is a dedication to service, a commitment to excellence. In 2016 when I became the CEO, one of the things we talked heavily about is an absolute, deep-seated cultural shift toward excellence in everything we do.

Shippers, they are willing to pay a fair price, but they expect and demand exemplary service. And we weren't always doing that. There were periods in our history where we have drifted from that principle. That is something we have doubled down on and committed to now more than ever before. And when you do that in 2018, which was a very tough year and it was tight for them and it was very tight, but you stand by your commitments, you deliver excellent service and you do what you say you're going to do, it's only fair to expect that that gets reciprocated in 2019. And we were able to gain share with some of those shippers from 2018 to 2019 because they understood and realized that we were serious about what we were doing. And getting their product to the store on time, every time was important to us.

<<Analyst, Stifel Nicolaus & Company>>

And then when you think specifically about the Dedicated model, because there's been just a continued shift at Werner Dedicated growing faster than the over the road fleet. And a lot of folks in 2018 were talking about building Dedicated businesses because that's what the shippers wanted because the spot market was out of control. Was that temporary dedicated freight? Did that bring an increased competition? How are you dealing with that? And is the Dedicated business still a growth area going forward?

<<Derek J. Leathers, President & Chief Executive Officer>>

Sure. I mean there's a lot to unbundle in that question. So temporary dedicated freight, I mean that's the camel in the tent, you just can't let it in. So, in 2018, we had all kinds of opportunities to bid on, what I would call, designated freight. It was One-Way freight that they were repackaging and trying to bid it as Dedicated to get guaranteed capacity and you have to be diligent. And we were very diligent about not letting that in the building, because that will go back to One-Way. As soon as the market softens, that story has been told throughout cycles and that story was retold again in 2019. So, if you are not diligent about not letting it in the tent, you're going to suffer the consequences when the One-Way market softens.

What we were growing in 2018, and what we continue to grow in 2019 and what we're going to focus on in 2020, is real Dedicated. 99% on time and 98% gets you fired. It's designed, optimized work that can't be replicated by One-Way, it can't be replicated by brokerage, it's not going to be displaced by digital or anything, it's real men and women doing real work, that's real hard to do that has to be designed and delivered with the best-in-class assets. That's what we want to do. And if we do that and do it well, we'll continue to grow. Our pipeline in 2019 is – I'm sorry, 2020, first quarter 2020 our dedicated pipeline right now looks better than it did a year ago.

Now the bad news is you talked about new entrants, there are a lot of people flooding to Dedicated. I mean if your One-Way is hemorrhaging, you're going to look for a safe haven. And that safe haven seems to be Dedicated, because those that are doing it well seem to be doing well. So, everybody goes and tries to replicate it. Some can, most can't. And they create white noise on pricing and other things. And so, what that means for us is that we have to have a stronger, fuller pipeline and a lower win rate in order to keep discipline high. And that's what our strategy is going to be.

We want a bigger, thicker pipeline with more opportunities coming at us every day. And we just know that a normalized run rate is 10%, to 11%, to 12%; a 2020 run rate might be 5%, to 6%, to 7%. And we're just going to have to live with that because we can't, we know what it costs to do these hard to deliver businesses in Dedicated. We know what the service expectations are, and we know how to price it though some new entrants are not fully grasping some of those complexities yet and so some of that pricing can create some friction in the process.

<<Analyst, Stifel Nicolaus & Company>>

And then as you look at the 2020 what's your expectation for Dedicated growth, because, I think, the One-Way you said it might be up a little, might be down a few percent?

<<Derek J. Leathers, President & Chief Executive Officer>>

Yes, it all depends on this win rate issue, but we have a pretty strong pipeline. We feel pretty good about where we're at. We've got several of those in the latter innings. And even assuming a less than normal win rate, there's opportunity for us to grow Dedicated this year. We will continue to fund that growth if you will, out of One-Way assets because the One-Way market, although we think it's at the bottom and maybe even near in a turn. We're not going to wait for that turn. If it's not here yet, we're going to move those assets and fund it through Dedicated.

So, we're not expecting total fleet growth in the first half at all. And in all likelihood, our range was negative three to positive one, but all likelihood, it'd be flat to slightly down on a total fleet basis with more trucks being shifted to Dedicated out of One-Way. Obviously if this market turns more quickly than that, we'll revisit it. But I think we all have to be careful about going out and buying trucks for the same load. The same incremental load cannot justify five different people buying the truck forward.

<<Analyst, Stifel Nicolaus & Company>>

And back to the turning and what's going on the spot market on the earnings call last week you said you expect the One-Way truckload rate per mile to be down about 5% to 7% in the first half of the year. And then you mentioned your forecast for spot rates for the market to be down 15% in the first quarter and then 5% in the second quarter. How do you kind of understand all the dynamics that are going on in the market and how it attracts?

<<Derek J. Leathers, President & Chief Executive Officer>>

Do you want to take that John?

<<John J. Steele, Executive Vice President, Treasurer & Chief Financial Officer>>

Yes. I'll take that one. So, in first quarter of 2019, our spot miles were lower than normal. They were about 7% of our total One-Way truckload miles. And therefore, our spot rate was higher than DAT, about seven percentage points higher than DAT, because we were able to be more selective.

In first quarter of 2020, our spot miles are running higher than normal in the 13% range. And our spot rate is comparable to DAT. So, as we negotiate bids in first quarter of 2020, we're being disciplined and walking away from business that doesn't make sense for our network and where the rate structure is unacceptable. We do have an example of an account that declined 20 million annual in January and its being replaced by another piece of business, its 20 million annual here in February. In that temporary time period, we have a little bit more spot as we make that transition. It creates network disruption for us, but it's absolutely the right thing to do for our company for the long-term.

So, our guidance of negative 5% to negative 7% in One-Way truckload rate per total mile is based on several factors. We expect flat to slightly lower contract rates. We have the impact of more spot miles in the first half of 2020 than we did in the first half of 2019. We're not assuming any project or surge business in the first half of 2020 at this point. And we've experienced slightly lower freight volumes in the first quarter of 2020 for the first five weeks that we did for the same period last year. It's obviously early in the bid season, so our guidance could end up being conservative. Time will tell.

<<Derek J. Leathers, President & Chief Executive Officer>>

And the only thing I would add is that you started the question by asking about our view on the market or spot rates. And I think what we confused on the call – we didn't confuse, but it was understood to be our commentary on broader market, and we were actually trying to comment on the spot market in our business.

And so, our business was behaving a little differently than the broader spot market. And I think something got lost in translation and we ran down that rabbit hole for the next eight questions on the earnings call.

<<Analyst, Stifel Nicolaus & Company>>

When you think about your customers, you're trying to grow business, you're trying to get new customers all the time, on apples-to-apples basis, are they saying they're going to be shipping more stuff this year than they did a year ago?

<<Derek J. Leathers, President & Chief Executive Officer>>

Yes. Again, it depends on the customer, but I think if you're aligned with winning strategies and winning companies, those people are bullish on their prospects for good reason. There's a lot of positivity out there relative to the economy, certainly there's plenty of concerns and potential headwinds. But on a net basis just year-over-year, a year ago we have trade conflicts with Mexico and China, today we have USMCA and a Phase 1 deal. We had housing fits and starts, but overall housing is strong and growing and looking good.

Consumer confidence continues to improve and people have more money in their wallet. You have to then of course, balance that with the coronavirus issue going on over in China and an increasing way or across the world. Election year, issues that are just inherently going to cause certain levels of uncertainty, especially given some people that may end up being candidates. And so net of all of that, winning retailers are being pretty bullish on their outlook and so we want to be there for them and be prepared with all our freight.

<<Analyst, Stifel Nicolaus & Company>>

I mean, how do you view the competition versus intermodal?

<<Derek J. Leathers, President & Chief Executive Officer>>

It's interesting. I think truck and intermodal competition is – the dynamics are changing around those, more than people are really, I think at times are grasping. Intermodal has gone to obviously PSR, they're doing a really good job, their service levels are good. So, none of what I'm about to say is anti-rail or anti-intermodal. However, the backdrop is, you have increasingly core diversion for it, instead of coming in on the West coast and being a natural fit, for the rail is now filling up East coast forward and landing within 500 miles of its final destination.

You have e-commerce that's shortening length-haul on an ongoing year-over-year basis. And that's been going on for multiple years, which takes freight off the rail and back to truck. When those segments get shortened sufficiently, you have service expectations on everybody in the world, wanting everything no matter what it is tomorrow at a click of a button, which works in favor of truck, not against it.

And so, I think there are some, some broad-based market conditions that are increasingly favorable for a high-quality service truck model. But rail's clearly going to still win their share of stuff, that's relevant. The last piece of all of that is that, I think if you go back five years to 10 years on bids, you had clear truck freight, clear rail freight and this jump ball stuff in the middle could have been 20% or 30% of a bid.

Now when you fast forward the clear truck and clear rail makes up 90% plus of the bid and there's a small little sliver in the middle of it can go, it's kind of a jump ball and could go either way. That clearly puts us in a better position to protect our backdoor, because we're not having as much stuff that's leaking or converting as what was once the case as they were making early pushes into intermodal and really improving the service product.

<<Analyst, Stifel Nicolaus & Company>>

And besides intermodal competition, the other competition in theory and bid of some of these 3PLs that are offering the services of many small trucking companies and when you, – I guess in the current bid process, the last couple of quarters, have you been running into more of 3PLs as a legitimate competitor for your lanes?

<<Derek J. Leathers, President & Chief Executive Officer>>

We run into them, yes. Whether they're legitimate, time will tell. They certainly create their share of white noise today in the process. I think a lot of that bids and a lot of that market share gain that's taken place is sustainable, I don't think you can continue to deliver and offer, and secure pieces of people's network at 20% below market and transact that business when and if as this market starts to turn, I think there's going to be some shippers really pinched.

I think they also know that. So again, best-in-class shippers view supply chain as a competitive advantage, they don't test their future on startups. They stay with what they know, and they work with incumbent carriers that do really good jobs and assets matter. But in the meantime, we're going to have a lot of – it's funny for a business built on the concept of frictionless loads and frictionless interaction with carriers. They're creating a hell of a lot of friction right now and we

just have to do what we do, stay disciplined and have enough opportunities to win the ones we want and walk from those that don't work.

<<Analyst, Stifel Nicolaus & Company>>

And you have an in-house brokerage as well...

<<Derek J. Leathers, President & Chief Executive Officer>>

We do.

<<Analyst, Stifel Nicolaus & Company>>

In Werner logistics, how do you see that evolving over the next few years?

<<Derek J. Leathers, President & Chief Executive Officer>>

I think asset-backed brokerage is a big part of our future. I mean, I think if you think one or five years from now, increasingly we're an asset-backed logistics company with clearly the bulk of revenues in that asset or area. But customers want to be consulted, not sold.

They want us to come in and talk to them about the portfolio and ask them what the problems are they need to be solved, they want us design solutions to present to them, that fix issues that they have on their supply chain, they don't want us to come and show the truck route or truck rate down their route from A to B. And so if you believe that, which we strongly do, then it only makes sense for over time the lead of ourselves, the tip of the spear is walking in and being more of a consultation led with being more agnostic, which means you have to lead with logistics as your entry point and then, but the difference is we've got 24,000 soldiers we can come bring to bear in moments of peak or moments of project or moments of pressure in their network, where a non-asset aggregator or small carriers is not going to be able to respond in those situations the way an asset player can.

A to B commoditized freight, you call we haul, they're going to own that space over time as we are in our brokerage area. We will be appropriately in that. We're building tech to be able to participate head-to-head with anybody, but our assets are not going to be in that business. Our assets are going to be in harder to haul, difficult to serve, more defensible, dedicated preferably lines of work that can stand the test of time to digital brokers and others.

<<Analyst, Stifel Nicolaus & Company>>

You mentioned Werner in five years. How do you think about 2025 and you're back up here on the stage, talking about what the company has recently done, what do you think would surprise most people?

<<Derek J. Leathers, President & Chief Executive Officer>>

I think the surprise will be the relevancy they'll have in their space of all of this digital tech and they will be relevant, and they will have a role, but that the assets will still matter in 2025. The asset players will still be sitting here, this whole disintermediation concept and thinking about trucking, like the Medallion service and taxis in New York City, is I think fatally flawed. And you had an inefficient operation with high barriers to entries with low technology being applied and you had people come in and intermediate that.

In trucking, we have tremendous amounts of tech, one in roughly five of all non-driver associates at Werner are tech people. And we're building tech, and building out information systems on a regular basis. The 40% empty mile, I'd love to know who that trucker is, because everybody talks about trucking runs around at 40% empty miles. If you're still alive and you're here today and you have 40% empty miles, congratulations, because I know you won't be here the next year. That just doesn't exist. It's a leaner, meaner industry than people realize.

<<Analyst, Stifel Nicolaus & Company>>

And specifically on the technology side, what, I guess, have been the – either your favorite investments, the most productive investments where has your focus been on the IT front?

<<Derek J. Leathers, President & Chief Executive Officer>>

Yeah. So, our focus has been – it's a great question. The first thing you got to do if you're going to really build tech and you're going to build out something that's sustainable long-term is we had to do a major in 2016, 2017, even a big part of 2018 investment in everything that is not sexy and not visible and seems not that important, which was infrastructure, databases, architectural design and all of this other work.

And so, you've got both customers and associates feeling like a lot of money is going out the door and I'm not getting much for it. In 2019, actually mid-2018, all of 2019, and now into 2020 that's converted and the focus throughout most of 2019 was inward-facing tech to make frictionless orders, more reality, to make people more productive, to take the average broker and increase their productivity by 2030 and in some cases 40%, but that's not as visible to the customers.

And so one of the things, I think, the advent of the digital brokers that are buying share and going out and making noise at the customer level was it taught us to make sure that we never lose sight of our customer and that we've got to focus and redouble our efforts now on outward-facing, customer-centric, frictionless experiences and make that part of our tech better. And so, we're shifting from an inward-focused to an outward-focused approach to a lot of this tech stack we're building. We have a lot of work to do, but I can tell you with confidence, three, four years ago, we'd go to a conference and every other person you met with who had something new that they were building or developing sounded all inspiring and impressive. And now for the most part, every time we have those same interactions or those same conversations, I walk away thinking, yes, we have that or we're ahead of that.

And I feel emboldened by what I hear as they sell a stuff or try to sell a stuff because I know what we're building our self, and/or plugging in from others, we're plugging, and it makes more sense. It took us a while to get to the buy versus build mentality around certain things and we're going to build what we think is a differentiator and we're going to buy what we think is commoditized.

<<Analyst, Stifel Nicolaus & Company>>

Right. I'm going to open up the floor for questions now. Yeah. Berry?

Q&A

<Q>: [Question Inaudible]

<Q>: Yes. So, the question, just to repeat for the transcript or whatever, is the carrier base, so within Werner logistics the number of carriers used, is that shrunk given all the cost pressures and other things going on in the industry?

<A – Derek J. Leathers>: Yes, we're certainly having conversations with carriers all the time and we were hearing stories of carriers having to dramatically shrink their fleet right now because of the cost of insurance or some of the effect of what's happening on the used truck market and their inability to be able to transact enough used sales to fund buying new, or even newish trucks out of our own network for instance.

Insurance renewals have been very devastating for a lot of these small to midsize carriers, just like nuclear verdicts have been very devastating for the large carriers. So, we all pay for it, we just pay for it in different ways. And there's absolutely been some attrition. So, we're seeing them shrinking their fleets. We've seen some that have closed their doors. One of our big focus items has been to work with repeatable carriers. So rather than just transacting with thousands and thousands of carriers, how do you get repetitive business in the hands of core carrier groups by region, by zone, by lane, so that they have business they can count on from us.

And I think one of the things about being an asset-backed broker is we understand assets and asset management and so we can help them help themselves. Because unfortunately, I want to be clear, I'm not blaming it all on brokers because we've even done some of the buy it now, and book it now and some of those types of features with our carriers. And sometimes they have raised to the bottom and a while that may look good for the quarter, it may help us in the short term, they won't be around in a quarter or two if we don't try to be a little more reasonable about how that transaction looks.

<Q>: Got to ask about the insurance side of things, because you guys have been in the headlines more than most over the past 18 months with some of these nuclear verdicts. What went wrong? What have you done? What was the outlook for 2020?

<A – Derek J. Leathers>: So, I'll start with the positive. I mean, our accident rate continues to drop. Our accident frequency both on small, mid, and large accidents is down and continuing to

go down further. We're extremely proud of our safety record overall. None of which matters when you find yourself in a courtroom in litigation where somebody crossed over three lanes of traffic through a divided median and hit you head on in your own lane of travel, we came to a complete stop without leaving our lane of travel and a jury decide that's worth \$89 million.

That's, I can't do much about that other than appeal it. That's costing us about \$400,000 a month in interest as we appeal it. And we will appeal it until we have our last \$400,000 because it's not going to stand, it's not right, it's not right for this industry. These big verdicts you've heard of or these big accidents were separated by three years, three years and then three years later. So, I just need to put in perspective the two verdicts that are public knowledge that are out there. Were three years apart. Those accidents took place three years apart and then we announced on a call last week or whenever our call was, I think, it was last week, that we had accident in the first quarter of this year that we are going to reserve at the \$10 million self insured retention level. But they are three years apart. No, nothing we do is worth getting hurt or hurting others. We preach that every day.

But when you deliver 3.5 million miles a day over open roads with mechanical equipment and distracted drivers all around you, things happen. It is not okay. We are going to continue to work and be more diligent to lower it. I think that our record speaks for itself over the long haul. But yes, we have been hit with a couple of verdicts that were pretty nasty overall.

<Q>: And any last questions from the audience, otherwise, I'll wrap up with one more. All right. Drivers...

<A – Derek J. Leathers>: Tons of them, easy to find.

<Q>: Okay.

<A – Derek J. Leathers>: Not true.

<A – Derek J. Leathers>: They're everywhere. The driver market is going to be tough. And what I tell people all the time as it's really the qualified driver market. There are tons of people out there that have CDLs. I mean many, many, many more CDL holders than there are driving jobs. That's not the issue. The issue is qualified drivers that can actually meet your hiring criteria that you can put into your truck and be confident in this safe operation. That's the obstacle.

The Drug and Alcohol Clearinghouse is going to appropriately exacerbate that much, much more. In the first three weeks of operation of the Drug and Alcohol Clearinghouse, over 4,000 names were put into that database. Once they're in that database, it's pretty tough to get out of it and they've got a lot of things they've got to do to ever be qualified again to drive. That projects out to well over 60,000 drivers on the course of this year, they will be put on the sideline that will make drivers even tougher to get.

We have hair follicle tests and have done it for over five years. We are very confident that when it went from 25% random to 50% random, that actually is a net positive for us because we know our fleet is clean or cleaner than most anyone and so we say bring all of that on. That's all good

stuff. It cleans up the road, it makes the road safer for everyone, but it will make drivers tougher. That could put pressure on driver wages late in the year or mid-year. But if it does, there will also be rate pressure to go along with that because we can't afford as an industry to pay drivers more and not be paid more by our shippers because the margins simply don't justify it.

I think a third of the truck haul group either lost money or made 1% or less last quarter. So, if a third of the publicly traded group is in that kind of shape, imagine what small to midsize carriers or customers look like today. We need to do better. We need to be paid to do what is very difficult work. That is very important for the future of the economy. And it's our job to ask for appropriate compensation for very tough work to do.

<<Analyst, Stifel Nicolaus & Company>>

Excellent. Well, with that, I'd like to thank Derek, thank John for joining us from Werner and we will be back up in a few minutes with Old Dominion.