Werner Enterprises

Q4 2022 and Full Year Earnings Conference Call

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CORPORATE PARTICIPANTS

Derek Leathers - *Chairman, President and Chief Executive Officer*

John Steele – *Executive Vice President and Chief Financial Officer*

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

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

Operator

Good afternoon, and welcome to the Werner Enterprises Fourth Quarter and Annual 2022 Earnings Conference Call.

(Operator Instructions)

The speakers for today will be Derek Leathers, Chairman, President and CEO; John Steele, CFO; and Chris Neil, Senior Vice President of Pricing and Strategic Planning. Please note, this event is being recorded. I would now like to turn the call over to Chris Neil. Please go ahead.

Chris Neil

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

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

The company reports results using non-GAAP measures, which we believe provides additional information for investors to help facilitate the comparison of past and present performance. A reconciliation to the most directly comparable GAAP measures is included in the tables attached to the earnings release and in the appendix of the slide presentation.

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

Derek Leathers

Thank you, Chris, and good afternoon.

2022 was another successful year at Werner. Revenues ex-fuel grew by double-digit percentages in both TTS and Logistics, and we also set a new record for adjusted earnings per share. My sincere thanks go out to the talented Werner team who remain resolutely committed to our values by providing superior safety and service to our customers.

As we look back on the fourth quarter, freight in our large Dedicated fleet was steady and performed well. One-Way Truckload and Logistics were challenged by a seasonally weaker-than-normal freight market in contrast to the very strong conditions a year ago.

We expect that the 2023 freight market will be challenging in the first half and then gradually begin to show improvement in the second half, as capacity exits the market and retail inventory resets to normalized levels.

Over the last several years, we intentionally built a powerful business model that performs well in both strong and challenging freight markets. Our large and durable Dedicated fleet, our diversified One-Way Truckload fleet and our growing Logistics segment, provide us with a resilient portfolio of complementary services and industry verticals.

This business model, coupled with our seasoned leadership team, who averages 26 years of Werner experience, gives us confidence in our ability to weather any economic environment and positions Werner for success.

Now let's move to slide three.

Werner is one of the nation's five largest truckload carriers, safely delivering over three million miles each business day with an experienced and increasingly diverse workforce of professional drivers.

During 2022, we were proud to achieve the lowest DOT preventable accident rate per million miles in the last 10 years, a testament to our continued focus on improving safety and service across our fleet.

During the quarter, our strong balance sheet provided the flexibility to add two stellar companies to the Werner family, premier truckload carrier, Baylor Trucking and the elite freight brokerage and dedicated carrier, ReedTMS.

Werner is a growing logistics provider with an annual revenue run rate exceeding $1 billion with a large and growing base of over 70,000 qualified carriers and a pool of 30,000 trailers. This large trailer pool and our growing domestic and cross-border Mexico power-only capabilities, provide Werner customers with additional solutions and flexibility to effectively manage their supply chain in rapidly changing market conditions.

Let's move to slide four for a summary of our fourth quarter and full year financial highlights. In the fourth quarter, revenues increased 13% to $861 million. Adjusted EPS decreased 13% to $0.99. Adjusted TTS operating margin for the quarter was 15.8%. For the year, revenues increased 20% to $3.3 billion. Adjusted EPS rose 7% to a record $3.70. Adjusted TTS operating margin for the year was 15.1%.

Dedicated freight demand in the fourth quarter was solid and steady. The normal seasonal freight spike for certain Dedicated retail customers didn't occur this year, given the

increasingly challenging macro environment and relatively muted consumer spending. Fourth quarter freight was seasonally soft in One-Way Truckload and Logistics with fewer project surge and peak opportunities compared to the record high levels a year ago.

On October 1, we acquired Baylor, a high-performing truckload carrier based in Milan, Indiana with 200 trucks. Baylor is a 75-year-old company with outstanding leadership, elite drivers and impeccable customer service.

The first week of November, we acquired ReedTMS Logistics, a rapidly growing Tampa-based freight broker and dedicated carrier with a skilled and knowledgeable leadership team. ReedTMS has a 26-year history of developing and expanding long-term customer relationships, supported by a large and growing carrier network, with two thirds of their revenue coming from the stable food and beverage verticals, including a heavy focus on temperature-controlled freight. We are very pleased to retain the strong management teams and talented associates of Baylor and ReedTMS.

Both companies maintain cultures similar to ours, with an intense focus on superior safety and service. Our implementation team is rapidly integrating these businesses with ours, to capitalize on the synergies and mutual learnings between our companies.

Together, our durable Dedicated fleet, which includes 63% of TTS trucks, and our growing Logistics business, account for 69% of fourth quarter revenues and is expected to exceed 70% in 2023.

Next on slide six, I would like to discuss Werner Drive. Last August, we introduced Drive, which is the next evolution of our business strategy that delivers our future. Drive incorporates sustainability, capital allocation and outcome-oriented approach to operations, innovation and a culture that supports and values our team members.

Our intentionally designed durable portfolio of asset and asset-lite solutions serves a diversified client base of industry leading customers with an emphasis on the transport of necessity-based goods. We relentlessly focus on our results with the company culture immersed in safety and service. Since 2019, we have received 27 unique customer Carrier of the Year awards.

Werner is committed to innovation through our investment in technology and our Werner EDGE cloud-based platform, which is improving the experience of our customers, drivers, non-drivers, carriers and suppliers.

Our core values of safety, service and integrity are based on an unwavering commitment to inclusion, community, innovation and leadership.

And we embrace ESG and specifically our impact on the environment, through the continuous exploration and development of alternative fuels and equipment, executing on our aggressive carbon reduction plan and expanding partnerships through WernerBlue, our company-wide sustainability initiative.

Next on slide seven is our revenue snapshot. For the year, revenues were $3.3 billion, with 74% in TTS and 24% in Logistics. Baylor and ReedTMS added $71 million of revenues to the fourth quarter and the year. Including these acquisitions, we forecast Logistics revenues in 2023 will grow to over 30% of the total.

Three-quarters of our revenue base this past year came from retail and food and beverage, with customers winning in their verticals. We intentionally focus on growing companies that ship recurring and repeatable consumer essential products who have rigorous on-time delivery requirements.

We ended the quarter with 8,600 trucks, up 3% for the year, or 260. In the fourth quarter, we held our TTS fleet size flat, to adapt to the changing freight market. We intend to limit TTS fleet growth until we see signs of freight improvement, which we expect in the second half of the year.

Turning to slide eight and the consolidated fourth quarter results. Revenues grew 13% due to 5% growth in average trucks, 1% higher revenues per truck, a $41 million increase in fuel surcharges and Logistics revenues growth of $29 million, which includes eight weeks of the acquired ReedTMS business. A seasonally soft freight market in fourth quarter compared to a seasonally strong market a year ago was a significant headwind. Despite this freight challenge, strong Dedicated performance limited the adjusted operating income decline to 11%.

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

John Steele

Thank you, Derek. On slide nine are the fourth quarter TTS results. TTS revenues increased 13% and adjusted operating income decreased 8%. Sequentially, TTS adjusted operating income increased 9% quarter-over-quarter. TTS adjusted operating margin declined 240 basis points year-over-year, compared to last year's record fourth quarter operating margin.

Our adjusted operating expenses per mile, net of fuel, increased 6.6% compared to our TTS rate per mile, net of fuel, of 3.5%. The largest per mile operating expense increases were supplies and maintenance at 18% and insurance and claims at 53%, while driver pay increased 4%.

During fourth quarter, we incurred $11 million higher insurance and claims expense, or an unusual charge of $0.13 a share, and $8.5 million lower workers' compensation in salaries, wages and benefits expense, or an unusual benefit of $0.10 a share. For insurance and claims, a limited number of prior year incidents have developed beyond what we had expected. For workers' compensation, prior year claims are developing lower than what we previously experienced.

Over the longer term, we expect our accident per million miles performance will improve our insurance and claims experience. While we can't ignore the increasing trend of nuclear verdicts and settlements, we expect our 2023 insurance and claims expense to moderate from 2022.

In fourth quarter, we sold more tractors and trailers at a lower average gain per unit. Gains on sales of revenue equipment were $22.5 million and we had a gain on sale of property of $3.4 million.

As we expect small carriers to exit in greater numbers in 2023, we anticipate the used truck and trailer market will weaken. We expect our gains on sales of equipment in 2023 will moderate from record highs in 2022. For 2023, we expect annual equipment gains in the range of $30 million to $50 million.

In an effort to partially offset the headwind of lower equipment gains in a more challenging freight market, we are implementing company-wide measures to reduce controllable expenses.

Now let's move to fourth quarter TTS fleet metrics for Dedicated and One-Way Truckload on slide 10. Dedicated revenues, net of fuel increased 9%. Average trucks increased 4%. Revenue per truck increased 5%. One-way Truckload revenues, net of fuel, increased 2%, as average trucks increased 7% from the Baylor acquisition.

Miles per truck declined 5% and rate per mile increased slightly, despite far fewer peak and transactional pricing opportunities. We expect One-way Truckload miles per truck will flatten out on a year-over-year basis in 2023, and we expect a gradually improving pricing environment during the second half.

Moving to Werner Logistics on slide 11. In the fourth quarter, Logistics revenues grew 15%, due to eight weeks of ReedTMS, offset by less peak and transactional freight opportunities. Truckload Logistics revenues, including ReedTMS, increased 20%, driven by a 34% increase in shipments, partially offset by an 11% decrease in revenues per shipment caused by fewer premium pricing opportunities.

Despite the challenging freight market, Logistics shipments, excluding ReedTMS, were flat year-over-year and down 5% sequentially. Contract shipments increased 89% year-over-

year and 62% sequentially, with the addition of ReedTMS. Transactional shipments were up 2%. Contractual mix versus transactional was 55% in fourth quarter. Intermodal revenues declined 23%, supported by a 3% increase in revenues per shipment, offset by a 25% decline in shipments. And Final Mile revenues increased $14 million.

In total, Logistics achieved adjusted operating income of $8 million with a 3.8% adjusted operating margin, down $3.9 million year-over-year, and an improvement from third quarter of $2.4 million, or an 80-basis point sequential increase.

Next, on slide 12, let me spend a moment on our innovation. Our IT team accomplished a great deal this past year as we continue to adapt to a dynamic supply chain through our enterprise-wide technology transformation. A few of the notable achievements include: we completed the first phase of our Cloud First, Cloud Now implementation of Mastery in December with the conversion of our Werner Truckload Logistics brokerage business to our EDGE TMS platform. We successfully expanded the deployment of Workday across Human Capital Management and Accounting applications. We strengthened our data and system security with zero trust security practices. And we continue to invest in and pilot new technologies to reduce our carbon footprint, including hydrogen fuel cells and EVs.

We continue to live and build on our values in 2022. I'm on slide 13. As evidence of our commitment to safety, in 2022, we achieved the lowest DOT preventable accident rate per million miles in the last 10 years, and the lowest work injury rate in the last 17 years.

Over the last two years, we significantly strengthened and diversified the leadership of our board as we carefully selected five new board members with unique backgrounds and skill sets. This has resulted in a more diverse board that bolsters our expertise in transportation and logistics, finance and sustainability, leading to a wider variety of perspectives.

On slide 14, we continue to make progress and receive recognition on our ESG journey. In 2022, we were recognized as a “Top Company for Women to Work For” by Women and Trucking, a Top Food Chain provider by Food Chain Digest, and a Top Green Fleet by Heavy-Duty Trucking. We are focused on creating a safe and inclusive culture for our associates, while operating efficiently to reduce our impact on the environment.

On slide 15, we ended the year at a strong financial position, with net debt of $587 million and equity of over $1.4 billion. Approximately one-third of our debt is fixed rate and two-thirds is variable rate. In December, we finalized a new $1.075 billion five-year unsecured syndicated credit facility with six banks, to expand our credit capacity and extend most of our debt maturities out to 2027. Following the acquisitions of Baylor and ReedTMS, our net debt-to-EBITDA ended the year at one, within our long-term range goal of 0.5 to one.

On slide 16 is a summary of our cash flow from operations, net capital expenditures and free cash flow over the past five years. Expanded operating margins and less variable net CapEx resulted in significant free cash flow generation. In 2022, we had net CapEx of $318

million and generated free cash flow of $131 million.

Turning to slide 17 and our capital allocation framework. Our first capital priority continues to be reinvesting in our fleet. We are investing in the latest safety and equipment technology, and we are growing and modernizing our terminal and driver school network. In 2023, we expect to slightly lower the average age of our truck fleet.

Turning to acquisitions, we will remain disciplined in our approach by evaluating candidates against our strategic filters. In 2023, our focus is the integration, synergy implementation and cross-selling opportunities for our recent acquisitions. We will also continue to enhance shareholder value through dividends and share repurchases, while maintaining a strong and flexible financial position.

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

Derek Leathers

Thank you, John.

Moving to slide 18, here, you see that over the last 18 months, we executed on four additive and accretive acquisitions, ECM, NEHDS, Baylor and ReedTMS. All four strengthened the durability of the Werner portfolio and expanded our capabilities. Our growing and diverse business provides additional solutions for the increasingly complex needs of our customers. To date, we have been successfully integrating these companies into the Werner portfolio and our synergy implementation process is running ahead of schedule.

Next on slide 19 is a review of our performance compared to our 2022 guidance, as well as the introduction of our 2023 guidance metrics. For the year, our truck fleet increased 3%, primarily in Dedicated. For 2023, we plan to keep the fleet flattish in the first half, with plans in the second half to grow primarily in Dedicated in the range of 1% to 4%.

For 2023, we are planning net CapEx of $350 million to $400 million. For revenue equipment, most of this CapEx is to refresh our existing fleet, with a small share to fund fleet growth in the second half.

Dedicated revenue per truck increased 5% in the fourth quarter, as we had far fewer projects and surge opportunities this year compared to last. For the year, Dedicated revenue per truck increased 7.6%. Noting the freight market outlook and tougher comps, in 2023, we expect Dedicated revenue per truck to increase in a range of 0% to 3%.

One-way Truckload revenues per total mile for the fourth quarter increased slightly, just above our guidance range. In the first half of 2023 in a challenging freight market with more difficult comps, we expect One-Way rates to decline year-over-year in the range of 3% to

6%.

Our full year income tax rate was 24.4%. In 2023, we expect our tax rate to be in the range of 24% to 25%. The average age of our truck and trailer fleet in fourth quarter was 2.3 and 5.0, respectively. For 2023, with increased CapEx, we expect to slightly lower the age of our truck fleet. One-way Truckload freight demand in January was softer than the strong freight market a year ago.

Next, let's move to slide 20 and discuss our view of the market this year and our modeling assumptions. Over the last several years, we carefully designed and prepared our business to outperform in a slowing economy. The last two quarters, we've adapted to retail inventory rightsizing as consumer demand moderated and supply chain bottlenecks began to ease.

Over 60% of our trucks are in our durable Dedicated fleet and one-third of that business is with large and successful discount retailers that are gaining share, as consumers are becoming more value-conscious for their household spending. With the acquisition of ReedTMS, our mix of revenues increased for contractual food and beverage shipments, which complements the seasonality of our existing logistics business.

For our TTS segment, spot freight is less than 5% of our revenues. Small truckload carriers are being whipsawed by 35% lower spot rates, while also dealing with much higher operating costs for drivers, equipment, fuel, maintenance and capital. As the year plays out, and there's a large shortfall between spot rates and carrier operating costs, we expect carrier failures will increase. This trend has already started. FMCSA data shows that truck deactivations exceeded truck activations for every one of the last 19 weeks with net deactivations of 53,000 trucks over this period.

We expect interest expense this year will be $20 million higher than last year, due principally to higher interest rates, as well as maintaining a higher debt level. We anticipate that OEM new truck and trailer production will show modest improvements in 2023.

Before opening up for Q&A, I want to give a brief update on two executive transitions. First, as of December 31st, Marty Nordlund stepped down as COO to assume a new role focused on fostering and developing strong relationships with some of our largest customers. Eric Downing became COO in January, following his outstanding leadership of our Dedicated fleet since 2016. During the last seven years, Eric and his team grew our Dedicated fleet by 50%, while nearly doubling revenue. I want to thank Marty for his continued hard work and loyalty at Werner, and I'm excited to work alongside Eric to grow our business.

Second, as you know, John Steele will be retiring as CFO and has been flexible with his end date, as we continue our search for his successor. The search process is going well, and we look forward to providing an update when appropriate. With that, I'll turn the call over to our operator to begin the Q&A.

Q U E S T I O N S A N D A N S W E R S

Operator

(Operator Instructions) Our first question is from Chris Wetherbee with Citigroup.

Christian Wetherbee

I guess I wanted to start maybe on some thoughts around the sort of way to think about earnings power as we go into 2023. So, I think you guys outlined both the gains as well as insurance, potentially providing somewhat meaningful of a headwind to EPS. And I wanted to get a sense of how you think you can offset that with core results.

Obviously, the Dedicated business looks like it's more stable. One-Way Truckload is going to be more volatile. So, I just want to get a sense of as you start to think about some of those headwinds that you've outlined to EPS, what you think you can do with the core business to potentially offset?

Derek Leathers

Yes, Chris, this is Derek. Thanks for the question and good afternoon. Yes, you're right. There are some headwinds as we start and go into the year. We wanted to be clear about them, and that's why we included them in the opening remarks. When you think about the gain at the midrange, it's a $40 million type headwind at the midpoint of the range.

We know interest expense is going to be more significant. At the same time, we've got the benefit of the integration that's ongoing with both Reed and Baylor. Those integrations are going well. We feel good about that. We believe that the very successful trends that have been going on within our DOT accident preventable frequency is going to lead to an opportunity to at least moderate insurance and take some of the noise out of that line.

We've also been pretty clear internally on the need for us to go out, and not just look for synergies relative to the integration efforts, but also around the building. And so, we've launched an internal effort several months ago actually, to prep for what we knew was coming, and we're going to continue to chip away at trying to neutralize those headwinds. It's going to be a work in progress.

We also obviously have pretty clearly signaled; we think it's a year that's going to be made up of two halves. And the second half has opportunity for us to continue to improve those results. Lastly, I'll just tell you that one of the upsides, I know people don't like increased CapEx ranges. But as we've seen OEMs start to kind of be able to get through some of the bottlenecks they've been faced with, we're encouraged by early returns in terms of equipment receipts, as well as the quality of that equipment and specifically the impact we think it can have on the maintenance line.

Christian Wetherbee

Okay. That's helpful. I appreciate that color. And I guess maybe a follow-up, you guys have been helpful in terms of giving us some sense of the sequential earnings power of the company. This has been a unique fourth quarter, with sort of less project business than we would normally have seen. So any thoughts on sort of normal seasonality as you cross over into the first quarter? Should we see the typical step down in earnings power that you normally, see or would it potentially be a little bit more muted, given what was going on, or sort of the weakness that you saw in the fourth quarter?

Derek Leathers

Yes. So that's a little tougher to put a finger on. But clearly, fourth quarter was muted. You're right. But obviously, mostly as it relates to comparing to some very outsized comps in the prior couple of years, driven by COVID and supply chain disruptions. We still had some activity in the fourth quarter on the peak and project side, just not nearly what we thought it would have been in a normal year. That sets up for possibly a little more muted drop.

But realistically, the market we're in today is still a tough market. One-Way is holding up, I would say, better at this point than I would have expected -- if this same call had existed 60 days ago. But make no mistake, it's tough out there. I think if you look historically, that drop off fourth quarter to first quarter is somewhere around 24%. And I would tell you that this year, we're going to work our tails off to make it be less than that perhaps. But I certainly expect it's going to be somewhere in that 20% plus range.

Operator

Your next question is from Jason Seidl with Cowen.

Jason Seidl

I wanted to touch a little bit on your outlook. You seem to think the market is going to moderate a little bit and then gradually recover. Can you put some meat on that and talk a little bit about what your retail customers are telling you about inventories and how long they expect to work through?

Derek Leathers

Yes. Sure, Jason. Thanks for the question. Look, retail inventories are tough because, holistically, there are still issues out there and there are still people rightsizing their inventories, that's a fact. But we've been very intentional about who we do business with. We've talked about it for years about being more of a rifle shot versus a shotgun when we go out and pursue new business and try to pursue those we want to grow with. And those better ran, more successful retailers, especially folks that work in that discount retail space, they’ve got through the knothole predominantly.

So, as we talk to those folks, they're in the latter innings. I would say the network overall, across all customers, is not necessarily in the latter, but it's certainly middle to late innings. And so, we're encouraged by the opportunity to work -- for that to burn off. We couple that and probably were more bullish on what we track and some of the things we've built to track internally on deactivations. If you look at deactivations over that 19-week period, and you talk about 53,000 net deactivations, that's a big number. And that's only gaining steam. And not only is it nineteen consecutive weeks, I think it's 35 of 37 in total, have been negative. And there's nothing on the horizon that leads me to believe that that doesn't accelerate as we move forward from here.

So, you put all that together, we still assume a relatively muted economic backdrop in all the modeling we're doing. So, we're not banking on some sudden rebound in the economy. And we think the back half setup is for us to get back to a world of inventory replenishment, peak freight movements, et cetera, in the back half, all of which will support our portfolio well based on the type of business we do and the people that we do it with.

Operator

The next question is from Scott Group with Wolfe Research.

Scott Group

Derek, if I look, length of haul is down, I don't know, almost 30% from a couple of years ago, deadhead is up a couple of hundred basis points. Is this just the mix of the acquisitions or is there something else going on here? And I guess, ultimately, I'm trying to figure out how is this impacting your rate per mile, your utilization? And ultimately, is this a good thing or a bad thing for margins and earnings, this mix shift?

Derek Leathers

Yes, Scott, great question. I'll attempt to be as clear as I can here. I think it's a mix of several items. So, acquisitions certainly play a role. In nearly every case, the acquired company was operating in a more regional footprint, with a shorter length of haul. And as you continue to blend that in, it's going to bring it down. I think the ongoing forward deployment of inventories and the ongoing growth of, sort of the smaller regional DC model, is going to continue to impact that. I think the ongoing, although much lesser now, conversion opportunities for intermodal, where longer length of haul stuff goes more by train plays a role.

Another one that I think is probably a little more pertinent to Werner than others, is our very large Mexico franchise -- in all of the robust COVID freight activity, one place that was impacted negatively was really cross-border during that time frame, because you had two different governments with disparate approaches to COVID and you had openings and closures seemingly twice a day in some cases, but certainly multiple times a week. And that's long length of haul freight that really kind of went the other direction.

So, I tell you that because as we look at it and we look forward, we think that the bulk of that length of haul erosion is behind us, and we think that moderates. I'm not yet prepared to say it gets longer again, but Mexico early returns so far in the last few months, we've seen the growth come back there. The early innings of nearshoring is real. Net direct investment was up $30 billion, I believe, last year already, and we think that number continues to rise. And so those loads tend to have a longer length of haul profile.

And so, I think you'll end up, in our network, with kind of a tale two cities. Some of the expedited and Mexico cross-border will be longer and longer, will have a longer profile, I should say. And then, an increased focus on regional, and our regional footprint is going to be something that's going to be ongoing as we continue to engineer more time at home and lifestyle jobs for drivers with high service requirements.

John Steele

Scott, I'll add one thing to that. Consistent with our expectation that our One-Way Truckload length of haul will begin to flatten out, we also think that our miles per truck in One-way Truckload will flatten out going forward as well.

Scott Group

Okay, so this has been a headwind to utilization, probably a tailwind to rates, I guess. The second question, you talked about insurance and maintenance. Any way to just sort of put some numbers around how big of a tailwind that could be this year? And then what does that mean with puts and takes for the OR? Do we think we stay within the long-term guidance on operating ratio?

Derek Leathers

I'll take the guidance one and then John can weigh in with some specifics. But yes, the answer is yes. We've established that guidance. We've stressed tested that guidance. I want to encourage everybody to remember that that's annual guidance. And so, we believe as we look into 2023 with all the puts and takes, we can stay within that guidance as we go forward.

Insurance is moderating. We believe, we're very encouraged by the most important thing, which is having less accidents, and especially having less serious ones. With new trucks coming in, we think there's opportunities and parts availability, I would actually probably put in front of new trucks coming in, for maintenance to be less disruptive. And I'll turn it over to John for any specifics he might want to add.

John Steele

Yes. so, for insurance and claims, it was a $44 million insurance and claims quarter, $11 million of that was the year-end charge as we went through the actuarial process at the end of the year. So adjusting for that, that puts it down to $33 million. While we'd like to be back at that $25 million a quarter level we were in the past, that's probably unlikely with the

growth in the fleet and with the environment that we operate in. But we'd like to be closer to the $30 million a quarter range depending on how our experience on severity of claims plays out.

On the maintenance side, our maintenance costs were up 18%. That has been gradually coming down on a year-over-year basis as the supply chain improves. We expect that as we move throughout the year, that increases in maintenance costs will move into the single digits.

Operator

And our next question comes from Jack Atkins with Stephens.

Jack Atkins

Okay. Great. So I guess, Derek, you referenced stable Dedicated demand in the fourth quarter. Would just be curious if maybe you could talk about the Dedicated pipeline more broadly as you go into 2023? And are you seeing some of your Dedicated customers looking to either push trucks back or want more trucks, kind of in a one-off or onesie, twosie kind of way? Just any kind of color around that and the broader pipeline would be helpful.

Derek Leathers

Yes, Jack. And when we think about Dedicated, first off, the pipeline remains strong in Dedicated right now. We're -- that will be tempered somewhat with the reality that in certain Dedicated fleets, you might see some shrinkage just due to their business being under duress. We know that there are certain businesses that are going to be more impacted by the economic backdrop than others. And so, there'll be some offset to what that pipeline is able to bring to fruition. We're also going to be pretty disciplined. Dedicated is hard to do business with very high service expectations. We know what it costs to do that. And so we're going to stay disciplined relative to price. Our customers have been supportive thus far.

And so, it's hard to dictate exactly where that fleet goes over the next, call it, quarter or two. We've guided to kind of flat because we know there are some puts and takes. Right now, I'm encouraged by the conversations we're having. I'm also encouraged that one-third of that Dedicated book of business is actually set up on index. It's indexed business. So, the rate noise on some of that will be less. And we'll have the ability to focus on the two-thirds where there could be activity.

You put all that into the blender, and here's what I would say. I think we're a premier Dedicated player. I think the service we provide for our customers is second to none. And I think they understand that. We also understand they're under a lot of pressure, and so there's going to be some interesting conversations to be had. But most -- I guess, in closing, I would say I'm encouraged by the pipeline. I'm encouraged by the ongoing bid activities in Dedicated. And I'm probably most encouraged by the fact that we've been able to test the

model relative to not letting a designated fleet into our Dedicated business and therefore, having the kind of hemorrhaging that may have happened in past cycles where the business was not set up with a true dedicated construct.

Jack Atkins

Okay. that's very helpful. I appreciate that. And then I guess, maybe for a longer-term question, Derek, if I go back to, I think, last year in the fourth quarter call, you outlined a plan to grow Werner's revenue by 10% a year, on a CAGR basis for the next five years. We're now a year into it. You had a good revenue year in 2022, partially driven by M&A. Could you maybe update us on that longer-term vision for the company? And do you feel like you're on schedule, ahead of schedule, as you sort of think about those longer-term plans?

Derek Leathers

Sure. I mean, clearly, at this point, we're ahead of schedule based on what we -- the two years that have played out since we first started having that conversation. We're encouraged on the revenue front. We want to continue to always keep an eye on the bottom line, because I've always said that it's not going to be an or proposition, it's an and. We need to grow and maintain our discipline relative to margins and expectations around performance. But right now, we're ahead of that schedule. We also indicated at the time, and I'll reiterate today, there's going to be years that don't fall into that 10%-plus type revenue growth, because you've got to be smart and disciplined and kind of read the market that you're in.

This year, obviously, expectations at this point, just doing the math on the recent acquisitions, we've got a really good head start to that 10%-plus number. But we're going to have our eye this year on cost control, synergies through the implementation, that's through the integration, probably most importantly, product and portfolio enhancement through these additive acquisitions that we've done, and continuing our larger strategy of just building out yet another layer of defense for some of the economic ups and downs and then proving it out. Look, at the end of the day, what matters is what's on the scoreboard. And you don't get credit for first downs. We've got a lot of those, but I'm looking forward to working our way through this downturn, so we can show what this company is capable of.

Operator

Your next question is from Ken Hoexter with Bank of America.

Ken Hoexter

Great. Derek, John, can you -- maybe your thoughts on acquisitions? Your leverage is at the top end of your target, but typically, in a downturn, you kind of want to take more opportunities. You just swallowed the four over the last two years as you highlighted. So can you be more aggressive in this market? Do you calm down if we're in a slowdown in and step back, maybe just talk about your thoughts and then how discussions are going?

Derek Leathers

Yes. So, there's obviously going to be a lot of opportunity out there over the next 12 months. There's a lot of folks looking for an exit, a lot of it is demographic-based as much as anything. But we've stated, even in the prepared remarks, our focus right now, because of doing four in 18 months, because of the early returns being as positive as they are on those four, and because, in each case, I think we've learned, we've gotten better, and we've set ourselves up for even further success in the future, I want to see these things integrated. I want to see them all functioning as one.

I want to make sure that our cross-selling capabilities are where they need to be. We just came out of our annual sales meeting that I was personally in attendance at, and meeting with all of the sales teams from each of the organizations. And I think we've made large strides to what this looks like going forward. But there's work to be done. So that's -- I guess my way of saying, there's nothing is off the table. We're not -- we've got room with the credit facility to be able to do more. We've got an open mind to look at opportunities as they become available. But in the meantime, our focus will be on integration, on synergies and on execution.

Ken Hoexter

And then maybe just a little bit -- we've heard a lot of shifting in contracts, right? Everything used to be a year long when you talk contracts. I know your Dedicated business, a little bit different multi-year, but if the retailers are now talking less than one year, what is your thoughts on the pricing paradigm in that market given your kind of mid-single-digit downtick on One-Way and slowing and Dedicated? What -- how does that change the market dynamics in this environment?

Derek Leathers

Yes, great question. The -- first off, I just want to point out the guidance we gave on One-Way is a first half guidance. So, we believe it will end up being a tale of two halves, and we're just not comfortable yet talking about the second half, so I think that's important. As it relates to people going to shorter bid durations right now, I mean, normally, under almost every cycle, I can recall and every time frame, we're always pushing for stability in our network over any short-term type pricing. But if somebody wants to price short right now, we're going to be all ears. I mean, we'll have that conversation because we have conviction that this thing is turning quicker than people realize.

And I'd rather not be saddled with that price for 12 months if six months will do. So we'll be open-minded. We'll have those dialogues, and we'll figure it out. We're also going to hold people accountable just like they held us accountable and should hold us accountable to the agreements we made during COVID. The same thing is true now. If we have agreements in place, we're going to look for that to hold up, and we'll have those dialogues. And lastly, I'll just point to something you mentioned in the question. So, I know you know, but 63% of our businesses in TTS -- and TTS is in that Dedicated arena, and that is almost entirely made up of long-term contracts.

Ken Hoexter

But you did talk about decelerating pricing even on the Dedicated write-down, I guess, flattish, right, in terms of your pricing now?

John Steele

Flat to up 3% and that's comping up against 7.6% that we achieved for revenue per truck increases in Dedicated in 2022.

Derek Leathers

Yes. I mean, not to be cheeky, but look, it is raining out there. Dedicated is a pretty darn good raincoat, but it's still raining. So we're going to have to perform. We're going to have to execute in Dedicated, and we're going to have to ask for what we feel is fair and appropriate. But it's not going to be in the first half, the rate environment that we've seen over the last couple of years, and we hope to outperform that. But you know us, we're going to be conservative with our guidance, and we're going to try to make sure that what we put out there is achievable and exceed it where we can.

Operator

The next question is from Tom Wadewitz with UBS.

Tom Wadewitz

I know you've talked a bit about rates, but wanted to see if you could offer just a thought on what we end up with in terms of the bid season and truckload contract rates. It seems like the comment in the first half, down 3% to 6% is maybe not exactly what you think the rates could be. I mean, I guess if you think of the timing being that the contracts get implemented and partially 2Q more in 3Q, do we also expect that the rates would be down more in second half than that 3 to 6? So just, I guess, some commentary on kind of how to think about contract rates relative to the guidance?

Derek Leathers

Yes, sure. So first, let's talk about what that cadence looks like. You really got kind of 60% of the revenues are done in the first two quarters, then 20% and 20% thereafter in Q3 and Q4. We've got a decent feel for Q1 implementations, and those are progressing. At this point, even just this point in Q1, our mindset is already starting to shift relative to how we think about rating business based on when we believe the turn is happening and the recent acceleration of some of these deactivations we've been speaking of.

So, we're giving first half guidance. We think spot rates have gone about as low as it can go, and it's well below people's operating cost. We're fortunate that less than 5% of our

revenues are in the spot market. But we think that flush happens quicker than maybe it has in past cycles. So I mean that's more color and context maybe than an exact answer. But certainly, I'm encouraged. Lastly, I'll just tell you, the comps in the first half are significantly tougher than the comps in the second half just based on how 2022 played out. So -- that's as much the issue as really anything.

John Steele

And when we're talking about bid season, Tom, we're talking about the 39% of our revenues in TTS that's One-Way Truckload. The biggest share of it is in Dedicated, and we think that's going to be positive, up 0% to 3% in revenue per truck per week.

Tom Wadewitz

Yes. I mean that makes sense, and I understand that. I guess maybe one follow-up on this topic. I think generally, people are kind of thinking high single-digit decline in contract rates, irregular route truckload. Are you more optimistic than that? You think it's better? And then I guess in terms of the kind of quicker tightening, do you think maybe this really tightens meaningfully in second half or it's more just like kind of a gradual improvement?

Derek Leathers

Well, I don't know that I'm more optimistic because that sounds an awful lot like hoping. We put guidance out based on analyzing it. And we talked for several quarters about our One-Way network being more engineered than ever before, we've talked about LTAs being part of our One-Way network at a larger percentage than ever before. And so I'm not trying to refute what others may be saying about what may or may not happen in their networks. I just feel strongly that in our network, based on both bids completed, LTAs in place and ongoing engineering within that One-Way network, that our ability to perform where we've guided to is, at this point, what we feel will take place.

Tom Wadewitz

Okay. Great. Yes. I mean, I think it's quite clear that you've positioned the portfolio to be resilient, which is great.

Operator

The next question is from Todd Fowler with KeyBanc Capital Markets.

Todd Fowler

There's been a couple of comments on the cost side, and it sounds like that there's some opportunity and some things that can help and also some headwinds. I'm just curious, Derek, if you've got a comment on, driver pay being one of your biggest cost buckets, I know that that's moved up substantially in the last couple of years. Is that something that moderates into '23? And then how do we think about maybe, I think, John, you shared that total operating expense in the fourth quarter was maybe up 6% or so. Does that -- what

sort of run rate are you expecting in '23 on the total side for all the buckets?

Derek Leathers

Yes. So I'll have John take the second part of that. But on the driver pay question, yes, we think there's going to be moderation. That market is still going to be tough. We're still going to hold our expectations high, and only hire the best of the best. That does come at a premium cost. But nonetheless, in that market, the pressure has moderated some. We also remind you, especially on the One-Way side, pay is a reflection of both pay rate and miles. And so, as we've endured the last couple of years and some of the disruptions that were going on, and you saw miles degrading, you had to make that up at times with the pay rate.

As we start to stabilize miles and start to see some of that congestion or disruption, if you will, evaporate, it provides us an opportunity for our drivers to still be paid very well, still make a very good living and actually have less disruption in their life as well. And so, all those things factored in, yes, that's a line that we envision moderating this year compared to what you've seen over the past couple of years as we continue to focus on other items.

Look holistically, there's still a lot of pressure. Trucks, trailers, tires, fuel, most likely, and a moderating driver wage, but still not going down, clearly, are all going to put pressures on the P&L. So our job is to go find every other line item in there that we think we can extract savings from and then execute on it.

At the same time, it's going to be having those tough conversations with our customers about what we need to have sustainable pricing to be able to support their future growth and their needs. Those customers that aren't growing or are struggling, obviously, that conversation has a different tone. That's why we try to align ourselves with folks that win and what they do.

John Steele

And Todd, the year-over-year increase in driver pay has tracked from quarter-to-quarter throughout '22. First quarter was up 15%, second quarter up 15%, third quarter up 9%, fourth quarter, up 4%. So, the year-over-year increase is moderating and the cost, while it's not flat, it's moving to lower single digits. We expect it will stay in the low single digits as we move forward in 2023.

Todd Fowler

Okay. Good. That helps. And maybe just for a quick follow-up. On the Logistics side, with kind of the change in the portfolio and the acquisitions, the margins in the last two years on a full year basis have kind of been in the mid-single-digit range. Is that kind of the right longer-term range, not looking for 2023 guidance, but just kind of a general range to think about the logistics margins at this point? Or is there something that makes the margin stronger or weaker for any reason?

Derek Leathers

Sure. I mean, first off, I'll point out, Logistics is now greater than 30% of revenues, and we have eyes to growing that at an outsized pace over the more incumbent book of business in Dedicated and One-Way. So I think you see that becoming a larger portion over time. We're super excited about how the integration is going with ReedTMS and the opportunities that stand in front of us.

That integration, in particular,especially as it relates to the real productivity gains and system enhancements when you bring people together on one platform, is a back half of '23 initiative. It takes a while to get there. We operate predominantly in different verticals today with different customer makeups. They do what they do very well, but we are actively working toward that integration date. So, at this point, I'm not looking to change any kind of guidance on mid-single-digit Logistics expectations. But we will certainly be updating as we get further along in that integration as to what we think that potential could look like when you get all the freight into one network with one central kind of visibility platform.

Operator

The next question is from Jon Chappell with Evercore ISI.

Jon Chappell

Derek, you mentioned Mexico earlier, and it sounds like the nearshoring thematic is starting to gain some momentum again. Can you just give a little bit more insight as to the trends you're seeing there from a volume perspective? And then also from pricing, how does that compare relative to some of the trends you're seeing in the U.S. and from a competitive landscape as well?

Derek Leathers

Yes, sure Jon. I mean, first off, yes, its early innings, but we are seeing sort of the refutable proof that nearshoring is taking place. Obviously, it starts with expansion of existing plants and facilities, because that's easier to do than to build new plants and facilities, although those are also starting to come out of the ground. I think it plays out over many years, not just a couple of quarters. So this is not a short-term thing, but we are reaping benefits as we speak from the increased activity to and from Mexico.

Our franchise is one of the strongest, if not the strongest that exists on the southern border. Our sales team is very tenured and high quality, and we are seeing volumes picking up there. That's higher priced freight with longer length of haul, that has lots of positives for our drivers, so we love it kind of all the way across the board. As it relates to longer term, the magnitude of that, I think it's too early to tell, but we're certainly encouraged by what we see at this point.

Jon Chappell

Okay. Great. And then just a clarification, trying to match up the $30 million to $50 million of expected gains this year with the 1% to 4% total TTS truck growth from the beginning of the year to end of the year. Should we think about those ranges as kind of overlapping. So, if you have only $30 million of gains, you're going to grow the fleet 4% and if it's $50 million, 1%.

And I guess really the reason I'm asking is, if the used truck market really does continue to roll over, is there a chance that you either would have to not grow the fleet or contract the fleet on a net basis to get to that range or that, that range of gains comes in lower than the $30 million to $50 million?

Derek Leathers

Yes. So that's a tougher one to predict. I think there's -- if someone was to ask what's the most speculative, or what's the most difficult to pin down aspect of the assumptions that we put forth, it would be gains. But I think a way to think about it is, we think 1% to 4% based on pipeline alone is pretty realistic, and that's likely to happen sort of regardless. What will happen relative to the gain line – or what the gain line will dictate is how much work we get done on refreshing the fleet. If we can continue to move equipment and move it at a high velocity, then we will get on with the business of lowering our fleet age more quickly. If that used market were to roll over and we felt like that rollover was short term enough that we might let that refreshing of the fleet take a little longer, then we'd go that route.

But I think, sort of regardless of what happens in the used market, we've got too strong of a pipeline to not see some back half growth, specifically in Dedicated at this point. And the gains and gain per unit, I should be more specific, the gain per unit will dictate how aggressively we can refresh the fleet this year. We do want to bring the fleet age down. That is something that is important, but we're not going to do it at all cost.

Operator

The next question is from Bert Subin with Stifel.

Bert Subin

Derek, you've made a lot of comments on the contract market, which I imagine you anticipated coming into this call. We've heard from some of your peers that the focus on trailer capacity is maybe changing the shape of the cycle with rates generally not falling as much for large carriers, at least those with large bases of trailers.

How do you assess that with regards to your One-Way segment? Could the focus on trailer capacity help those asset-based discussions such that rates maybe don't fall as much as they otherwise would have?

Derek Leathers

Yes. I certainly think that trailer pools and the efficiencies that are incumbent with those that have large trailer pools and a robust power-only offering like we do, are better positioned through downturns to be able to have more rational conversations because there's less folks that can replace you. You can't replace the efficiencies we bring with a blended solution of our assets in power only, with a large trailer pool presence, with a non-asset broker. You can't really do it with somebody that's asset only that doesn't have the ability to assign lanes based on differentiated strengths, meaning we'll take the stuff that works on our assets, the broker carrier that may be better at particular lanes takes those lanes. And so trailer pools and the inherent efficiencies that come with them are a competitive advantage.

Even within our power-only solution, as an example, they predominantly play within the contract market. Very little of that is even done in the spot market, and so it gives those partner carriers better opportunities to build the future around stable rate levels and stable experiences. So I think both for the carriers that do business with us, the customers that participate in this product offering and for our shareholders, it truly is a win. That is also relatively speaking, in the early innings. So all early returns are positive. We're excited about it. We're growing it very rapidly. But I think there's a lot of runway ahead of us.

John Steele

We've had five straight quarters of sequential growth in our power-only business, and that's during a period of time when the freight market is moderating. So, there's some real staying power with power only.

Bert Subin

Yes. that's great. Maybe just a follow-up then on the Logistics side. How does growth in that platform play out from here? In '22, as you noted, John, you're expanding the presence of power only, and that's been a success. And then you acquired ReedTMS and that significantly grew your top line footprint. As we progress, maybe a longer-term question, we progress through the decade, what's the vision for that platform? Is it to be trailer centric? Is it to be a digital automated broker? Is it all of the above?

Derek Leathers

Yes. So as we go -- first off, giving guidance out a decade is tough to do. But clearly, power only is something that's gaining traction at a pace that's unique compared to traditional brokerage. And so we do anticipate that, that will grow at a faster pace. The majority of what we do in Brokerage is still traditional Brokerage and yet power only is quickly making that gap up.

I think over time, the simple reality from a product offering standpoint is that power only is tough to compete with. It's very difficult to recreate that in a traditional brokerage format. I think as we brought Reed into the Werner family, even they were very excited about having that opportunity to complement the exceptional sales force and the customer relationships that they have, coupled with, obviously, our ability to add trailing capacity at rates that would

have been difficult to do for them as a stand-alone. So, I'm encouraged by it. I'm not going to try to predict a 10-year-old percentage or ratio at this point, but I think it's going to be a larger and larger player.

Bert Subin

Just to clarify, Derek, I meant more like what is your strategic vision for Logistics, I wasn't looking for long-term guidance or anything like that, but I think you answered that.

Operator

The next question is from Brian Ossenbeck with JPMorgan.

Brian Ossenbeck

Maybe just two quick follow-ups on Dedicated. Looking at the revenue per truck per week and, I said it's off a tough comp from last year, but 0% to 3% seems like it's going to be tough to exceed, inflation this year when you talk about driver pay as part of that. So maybe you can elaborate on that a little bit. Is there the ability to go back, it seems like you might be having some conversations to possibly move that up. Is this something we should look at more in a multiyear period, one strongly offset by a bit weaker one. Maybe you can offer some thoughts around that.

Derek Leathers

Yes, Brian. So, the multiyear approach is certainly one lens that I think does matter. When you're coming off of some of the comps over the last couple of years and we were able to shore up driver pay and other things at a rate that, A, the market would support, but B, we felt it was appropriate for our drivers. It is certainly -- that line item will moderate as we look into 2023.

The other reality of Dedicated agreements that we have in place, is that driver pay is always set aside as a stand-alone item. So, if we see pressure there and we feel as though the market has tightened sometime during the course of the year relative to driver availability, there's always the opportunity in Dedicated to go back and have that conversation. It's not as easy as just asking and getting it, of course, but that it will be a data-driven analytical discussion.

0% to 3% growth has a lot to do also with a year ago. There was a lot of project-type work or incremental trucks on many of these Dedicated accounts. So, you've got a base contract and then you have incremental trucks that are playing a role. This year, you've got a base contract and you might have some incremental shrinkage in that same fleet just based on their shipping volumes. And so you got to put all that into the mix. The comps are probably one of the toughest things about that 0% to 3%, not looking as impressive as you might have hoped for.

The last thing I'll point out is Dedicated revenue per truck per week has grown eight out of the last nine years. And I think that really covers multiple different swings in the market, then it really kind of gives you a better insight to just how stable that business can be. If and only if you execute and so we always start and end with that concept. We've got to be absolutely best-in-class on our execution, and we are. And so, when we look back at 2022, over the course of the entire year for all of those trucks operating in Dedicated, and you look across the entire fleet, that fleet operated north of 99% on time throughout the entirety of the year. And that's something that I want to thank all of our folks once again for making possible.

Brian Ossenbeck

All right. John, just a quick one for you then on the cost side. You mentioned going after some controllable costs. I don't know if you can elaborate on that. I know you've got a few things on maintenance; it sounds like parts could be a big deal even more so than the, getting the new trucks in place, which obviously have an effect on maintenance and other line items. But maybe you can elaborate a little bit on where you have line of sight to that's controllable over the next year, you're looking to deliver on.

John Steele

Yes. Thank you, Brian. Yes, we definitely have a cost focus across the entire business, and we're realizing savings in several categories such as driver hiring and advertising, lower driver guaranteed pay, synergies related to the acquisitions that we've done, actually, all four acquisitions. And then IT savings to implement our Cloud First Cloud Now strategy that are helping with both efficiencies and productivity, and we're taking aggressive actions to improve our cost structure. We know we have a big headwind with the reduction in gains in '23 compared to '22, but we're confident that we can make a meaningful dent in that with the cost improvements that I just elaborated on.

Operator

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

Derek Leathers

I just want to thank you for joining us today on the call. We're proud of our results in 2022 and encouraged by the durability of our business as we enter a weaker setup, at least in the first half of '23. Dedicated is going to remain the lead horse on our wagon, but One-Way, and Logistics now surpassing $1 billion in freight with increased customer and industry diversity is exciting.

I believe this year will be a story told in 2 halves. Capacity is already exiting, inventories are coming into balance, and while there remains macro uncertainties, the one thing I feel strongly about is this: strong well-capitalized carriers, focused on operational execution will have an opportunity to shine, and we look forward to that challenge. I want to thank you for spending your afternoon with us today.

Operator

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