Morgan Stanley Virtual 9th Annual Laguna Conference

Fireside chat with Mario Harik and Matt Fassler of XPO Logistics

Conducted by Ravi Shanker, Equity Analyst

September 13, 2021*

1. **Ravi Shanker, Morgan Stanley:** I'm very excited to kick off this session with XPO Logistics. I would like to welcome XPO's chief information officer and chief customer officer, Mario Harik, as well as XPO's chief strategy officer, Matt Fassler. Gentlemen, thanks so much for joining us this morning. Congratulations to XPO for celebrating your 10-year anniversary. It's been an absolutely incredible 10 years. Mario, I believe you were a member of the original crew here. Maybe you could start with some thoughts on what the last 10 years have been like?

2. **Mario Harik, XPO:** The last 10 years have been fantastic. When we look back, we started with a couple hundred employees. Over the decade, we've grown to become one of the top innovators in our industry. We're now a top-three player in truck brokerage and in LTL in North America. We have a highly effective technology platform that's focused on innovation and will allow us to continue to succeed in the years to come.

3. When we look forward, we have great people, strong momentum from both a sales and a profit growth perspective, and powerful technology to back it up. So, it's been a rewarding 10 years, and we look forward to the years to come.

4. **Ravi Shanker, Morgan Stanley:** On the macro, what is the growth environment looking like right now? How have your new business conversations with customers been going? Is the pipeline looking strong? Are you seeing any trends related to new business coming online? And, what are the biggest growth engines you see over the next three to five years for XPO as a pure-play transportation provider?

* Edited for clarity

5. **Mario Harik, XPO:** Our conversations with customers have been going very well. We're growing the existing share we have with some of our larger customers, while also winning new accounts. So, we're growing our pipeline and also our footprint.

6. When we think of customers, we break them down into three categories: strategic accounts, which are some of the top companies in the world; national accounts, which are companies with multiple locations; and local accounts, which are small, mom-and-pop shippers.

7. Within our strategic account base, we serve more than two-thirds of Fortune 100 companies. A lot of our focus is on growing these existing accounts. With some of these accounts, we already have a large share of the spend, and with others, we have a significant opportunity to expand the share of wallet.

8. Our focus is to grow our LTL and truck brokerage businesses across the optimal mix of channels — strategic, national and local. On the LTL side, the local channel is very profitable for us. Growing our share in local target geographies has been a big focus for us since we acquired Con-way in 2015.

9. As for our capabilities, we have access to massive capacity, we have powerful technology — including XPO Connect — and we provide easy, simple-to-use capabilities for our customers.

10. **Ravi Shanker, Morgan Stanley:** The LTL business is clearly a focus area for investors right now. How have you seen the pricing environment evolve throughout the quarter? Are you surprised by the strength you've seen so far this year, and do you expect that opportunity to continue as we move into 2022?

11. **Matt Fassler, XPO:** The pricing environment today is rational and favorable. Remember that we've increased yield in North American LTL every year since we acquired Con-way.

Today, we're obviously operating in a very tight transportation market. Capacity is at a premium and we're pricing appropriately for that environment.

12. **Mario Harik: XPO:** LTL pricing is a big area of focus for us, where we see huge potential. We're leveraging data science and new technology to improve how we price for our customers. Right now, we're working on price elasticity and how that's affected by the type of freight and type of customer. We're in the early stages of being able to generate meaningful increases in overall margins with this technology.

13. We've spent a lot of time automating the entire process. When a salesperson is working with a customer to respond to an RFP, for example, we've increased the role of automation to cover about 90% of that process. Looking forward, these algorithms will be getting smarter and smarter, allowing us to have even better pricing capabilities and expand margins in our LTL business.

14. **Ravi Shanker, Morgan Stanley:** Is it fair to say that your focus with that pricing algorithm is with margins and productivity, and less so on just driving that pricing number higher?

15. **Mario Harik, XPO:** You're spot on, Ravi. It's about maximizing margin for the types of freight that we want. In LTL, we operate a network business. When we think about balancing that network and having freight in backhaul lanes to balance headhaul lanes, all of that can be driven by our algorithms looking not only at what the profitability of a certain shipment is, but also at things like market imbalance. It all goes back to maximizing the profitability of the network. In some cases, that might mean having a slightly lower yield to be able to fill a backhaul. It's all about finding the right price where the customer is willing to move the shipment with us while maximizing overall profitability and return on capital.

16. **Ravi Shanker, Morgan Stanley:** Where do you think North American LTL margins can go in the long run? Do you think a sub-80% operating ratio number is possible at some point?

17. **Matt Fassler, XPO:** I think it is. In the second quarter, we were at an 81% adjusted operating ratio, excluding real estate gains. And on an LTM basis, we were at an 83% adjusted operating ration, excluding real estate gains. We mentioned in our new investor deck that posted last week that we expect hundreds of basis points of improvement in LTL adjusted operating ratio over time. So, yes, we think we can get below 80%.

18. **Ravi Shanker, Morgan Stanley:** Mario, can you talk about your main focus areas for technology investment going forward? How much of this can shrink operating costs versus driving upside? And do you anticipate these savings getting passed on to the customer, or do you expect them to flow down to the bottom line?

19. **Mario Harik, XPO:** Our focus in technology is on our two largest profit drivers in the business: LTL and truck brokerage. In LTL, I mentioned the focus on pricing and price elasticity, with the goal of being able to get that goldilocks price that makes sense for the customer and makes sense for us. That would allow us to grow top-line revenue and be able to have higher margins that flow to the bottom line, as well.

20. Our other focus area in LTL is on our cost drivers. These include optimizing our linehaul network — how we organize the movement of freight between our terminals. The second category relates to optimizing our pickup and delivery operations. The third category is optimizing dock productivity across the board.

21. Our LTL platform consists of very strong, proprietary technology that leverages machine learning and data science. In linehaul, for example, we already have proprietary linehaul optimization models that allow us to organize how our systems group freight together to move it through terminals. We’re working to make these models operate even more

efficiently — for example, we have technology in the field that helps our operators utilize the optimization models in real-life scenarios. In terms of the size of opportunity, that part of the cost is over a billion dollars, and it hits the P&L. So, for a category like this, it's about what we save on this cost by becoming more efficient.

22. With pickup and delivery, this refers to how we optimize routes to be able to get the highest number of stops per hour on a given driver's route using machine learning and data science. Our platforms are super easy to use, and allow our drivers and dispatchers to operate more efficiently. There's about $650 million worth of cost we're optimizing through that technology.

23. Finally, on the cross-dock side, we launched XPO Smart, which is a tool that we initially launched with our supply chain business to help determine the optimal use of workforce hours. And, we now employ that tool on our LTL docks, where we're seeing 5% to 7% improvement in productivity.

24. Now, in truck brokerage our XPO Connect platform is seeing gangbuster growth. It's on fire. When we think about the number of overall downloads we've had for our app, that number has roughly tripled from a year ago, to more than 500,000 cumulative downloads this quarter. Our customer usage on the platform has roughly doubled from a year ago. We have more than 87,000 carriers on the platform, so far. Our focus has been on automation, on making it easy for carriers to work with us digitally through capabilities like automated counteroffers and negotiations driven by machine learning.

25. **Ravi Shanker, Morgan Stanley:** I remember the tech day you hosted in Boston in 2019. That was pretty mind-blowing. You used the words 'data science' then and you're using them now, as well. Who owns the data? Is it you or is it the customer? Maybe you could elaborate more on the shared productivity and economics. How do you figure out how much of the gains here you get to keep, versus how much you share with your customers, and what's the payback like on some of these projects?

26. **Mario Harik, XPO:** Let's start, first, with the data science. We have a fantastic team of data scientists. You saw some of their work at the tech session we had here in Boston. Our focus, with data science, is on leveraging the troves of data that we have, to be able to make better decisions about how we operate for a given customer, and also how we run our operations overall.

27. To give you an example from our LTL business — we have more than 10,000 handheld devices that have proprietary technology on them. We use those devices to capture data on how our operations are working, and we couple that with customer shipment data. So, let's say you're a dockworker and you're scanning pallets as you move them around on the dock. We collect thousands of data points in a given day from your activities. If you're a driver in a truck — let's say in an urban area doing pickups and deliveries — similarly, we capture thousands of data points from your activities: where you're driving; how long the dwell time is at a given customer stop. We take all of that data and store it in our technology infrastructure; then we use proprietary systems to mine that data for ways to optimize the operation.

28. I'll give you a couple of examples of what these technologies look like. I mentioned XPO Smart earlier. We can marry time data and activity data to predict productivity. We can also predict — based on customer volumes and historical knowledge, including seasonality — how much work we're going to get at a certain dock. The result is a much more accurate workforce plan that prescribes how many dockworkers we need for the work that we expect will need to be performed.

29. Similarly, we use data science to optimize routes in our pickup and delivery operations. We can even predict on a per-customer basis what the length of the stop will be — 20 minutes, 15 minutes, 18 minutes. We use this information to better sequence our routes and make sure we're accounting for how much time individual drivers typically need to spend at a given stop.

30. You've heard me talk about Freight Optimizer, and how we use it to tap into a massive amount of capacity from a carrier perspective, and how we match carriers to customers — all of that is machine learning. All of that uses data science in how we look at historical and current information to come up with the best predictions possible.

31. In terms of returns on these investments, they tend to be very fast. Our XPO Smart platform's actual return —what we spent on the platform versus how quickly we capitalized on the return — was measured in months, not years. Now, in terms of where that profit goes, some could go back to the customer through price elasticity, so we can give them a more desirable placement for a backhaul lane, for example. Predominately, though, the profits would typically stay with the company.

32. **Ravi Shanker, Morgan Stanley:** Fascinating. No technology discussion would be complete without talking about the potential for autonomous and electric trucks. We've seen several developments in the last few months, with companies looking to commercialize this technology. I know you guys have been an early leader in terms of doing the research and staying on top of what you're seeing out there. Can you just give us an update on what you see right now? What's the timeline? What's the horizon? What's the path to XPO using the next generation of trucks?

33. **Mario Harik, XPO:** We're really interested in both technologies for different parts of the business. In LTL, where we're an asset-heavy business, obviously we're very interested in both EV and AV capabilities. We have multiple EV pilots going on today. In Europe, we have pilots in London, Rome, Florence and Madrid. A lot of them are inner-city short hauls, as opposed to longer hauls. Here in North America, we just launched a pilot in Oakland, California of an Freightliner eCascadia truck with our long-term partner, Daimler.

34. With EV, overall, the issue is more about the efficiency of these trucks. Today, they still don't have the range that diesel trucks have, and they're much more expensive than

diesel trucks. They also have roughly 9,000 to 10,000 additional pounds of weight that's associated with the batteries in the cabs. These attributes make EV trucks, today, not as commercially beneficial as diesel trucks. We're working closely with the OEMs through these pilots, to make sure that we can easily convert to EV technology for our trucks as it becomes more efficient and practical to operate. AV has a longer runway. Where EV's runway is in the short-to-medium term, AV's runway is in the medium-plus term.

35. Going back to your question on the roadblocks, we still believe the number one roadblock will be policy. Will it be acceptable for a Class 8 truck to be driving down the highway with no driver in it? The technology itself is impressive. I've been on ride-alongs in AV trucks, and the technology is almost there. Again, the question is more about the safety of these vehicles and the regulatory hurdles associated with getting them on the roads.

36. **Ravi Shanker, Morgan Stanley:** Switching gears to the asset-light brokerage business, you mentioned on the Q2 2021 conference call that you're gaining share within brokerage, and I think you guys have been for a while, given how quickly your brokerage business has been growing. Can you give us more color on this? Where is it coming from? Are you confident that this is sustainable and can continue? How do you feel about the competitive environment right now? Especially regarding large digital entrants, who may have been very aggressive when they started out and now, as they've grown bigger, they've stabilized a bit. How do you see the brokerage environment?

37. **Matt Fassler, XPO:** I'll talk about the numbers, and then Mario can touch on the competitive backdrop for digital. In the second quarter, we grew our loads in North American truck brokerage by 38% year-over-year. That's substantially stronger than the average of the public companies that we track, and substantially stronger than any gauge of the market that we've seen.

38. **Mario Harik, XPO:** It's a competitive market, but we believe the players that have the best technology coupled with great people will be able to continue to grow the business over time. As Matt said, we grew our volumes 38% year-over-year in terms of truck brokerage load count in Q2 2021, and we roughly doubled our brokerage revenue, with what we believe were best-in-class margins, too. A big component of that, again, is talented operators and effective technology with very rapid adoption. When you combine all of these things together, you get strong growth, good profitability and fantastic relationships with customers, where we can help them access massive amounts of capacity.

39. **Ravi Shanker, Morgan Stanley:** Taking that same top-line question and directing it at the bottom line, or the gross margin line — I think it was on the Q2 2021 call that Brad said that he thinks brokerage margins could come down over time, but the overall dollar profitability could go up as you gain share. Can you unpack that a little bit more? What is that trajectory? What is that balance between percentage margin coming down, but dollar EBIT going up? What does that look like in the next couple of years?

40. **Matt Fassler, XPO:** Ravi, we think that mix will work well for us. We've said all along that we're prepared for an environment in which net revenue margins decline, and that we could maintain or grow our adjusted EBITDA margin in that environment by using XPO Connect, our digital platform, to drive share, productivity and margins. That remains our view. Our gross profit per load has been excellent, and we've been generating some of the strongest load growth in the industry. That's been very good news for us. We haven't seen a material change on a competitive front from any single competitor, or group of competitors, that would change that dynamic.

41. **Ravi Shanker, Morgan Stanley:** Switching gears again, you've all had a notable and busy few months as you worked on the spin-off transaction and the breakup of XPO into XPO and GXO. Can you talk about what the customer reception has been to the new XPO,

and what the investor reception has been? Within XPO, right now, you have this mix of asset-heavy businesses and asset-light businesses. I think it was Brad Jacobs who coined the term 'asset-right' about five or six years ago. Is that the right answer for you? Do you still see room for adjusting the portfolio? What is XPO going to look like three years from now?

42. **Matt Fassler, XPO:** We like our mix today. Over 90% of our operating income emanates from LTL and truck brokerage. Our single biggest source of profit in the company is North American LTL. It's asset-based, and it's high-ROI — significantly in excess of our cost of capital. Asset-right, to us, is about generating sustainably strong returns, and both LTL and truck brokerage deliver on this for us.

43. As to investor reception, the spin-off is around five weeks old at this point, and the reception has been positive. We've been very engaged. We have new, streamlined investor materials that speak to our newly streamlined organization, wholly focused on freight transportation. Investors understand that we have high-ROI businesses with strong, secular tailwinds, that we bring massive capacity, that we have a leading technology platform, that we have a raft of initiatives to drive above-industry-average revenue and profit growth, and that we're committed to deleveraging the balance sheet.

44. We're pursuing an investment-grade credit rating and expect to get to one to two turns of leverage by the first half of 2023. That's down from 2.7x pro forma net leverage, as of our June 30 balance sheet.

45. **Mario Harik, XPO:** Customer reception has also been good. Customers appreciate that we're now more focused on transportation, from both a management team perspective and from an investment perspective.

46. **Ravi Shanker, Morgan Stanley:** I have a few investor questions that I'll roll into one big question. What are your views on when the supply chain issues (port congestion, etc.) will be resolved? Is this something that can be achieved this year? Will it be resolved in the first half of 2022? The second half of 2022? Also, what are your thoughts on how peak season in 2021 is shaping up? Also, can you share any thoughts on the current labor environment and the general cost inflation you're seeing? How tough is it for you guys? How are you managing it? Sorry, there are a few things in there.

47. **Matt Fassler, XPO:** I'll address labor first. Labor's in tight supply. This is true for any service business. We're making moves internally — for example, to increase the graduation rates at our LTL driver schools. We've also invested in LTL recruiting upgrades to address the driver shortage, which is endemic to the current labor backdrop. That's an ongoing effort, and we're definitely making progress on that front.

48. Capacity is going to be tight industry-wide for the peak season. We know that the economy is in good shape and there's a shortage of capacity out there. We bring massive capacity to bear in both LTL and in full truckload brokerage, so we're optimistic about the support we can provide to customers during peak. It could be a slightly more predictable peak than it was last year. Think about the unprecedented challenges that the world faced last year in managing peak — it started early and ended late. This year will, we think, be a good peak season.

49. Finally, regarding the resolution of the supply challenges at the ports and in other areas, we don't know. That's not in our crystal ball. As the challenges begin to resolve, there should be tailwinds for freight transportation. There are industries that aren't operating to their full potential this year because the raw materials or unfinished goods aren't there. Those industries aren't moving goods at the rates dictated by end-market demand. The goods will move, and we'll be there to move them. Some of the labor constraints, as well, are likely to abate. All of these issues help set the industry up for a strong 2022. That's what we envision.

50. **Ravi Shanker, Morgan Stanley:** That's an excellent, bullish tone on which we can wrap up the session, because we're out of time. Mario and Matt, thanks so much for joining us and kicking off the transportation track of this conference.

Non-GAAP Financial Measures

As required by the rules of the Securities and Exchange Commission ("SEC"), we provide reconciliations of the non-GAAP financial measures contained in this transcript to the most directly comparable measure under GAAP or a pro forma measure prepared and presented in accordance with Article 11 of Regulation S-X, as applicable, which are set forth in the tables posted in the September 2021 Investor Presentation posted in the investor relations section of our website.

XPO's non-GAAP financial measures used in this transcript include: adjusted earnings before interest, taxes, depreciation and amortization ("adjusted EBITDA"), adjusted operating ratio for XPO's North American less-than -truckload business, and pro-forma net leverage.

We believe that the above adjusted financial measures facilitate analysis of our ongoing business operations because they exclude items that may not be reflective of, or are unrelated to, XPO and its business segments' core operating performance, and may assist investors with comparisons to prior periods and assessing trends in our underlying businesses. Other companies may calculate these non-GAAP financial measures differently, and therefore our measures may not be comparable to similarly titled measures of other companies. These non-GAAP financial measures should only be used as supplemental measures of our operating performance.

Adjusted EBITDA includes adjustments for transaction and integration costs, as well as restructuring costs and other adjustments as set forth in the attached tables. Transaction and integration adjustments are generally incremental costs that result from an actual or planned acquisition, divestiture or spin-off and may include transaction costs, consulting fees, retention awards, and internal salaries and wages (to the extent the individuals are assigned full-time to integration and transformation activities) and certain costs related to integrating and converging IT systems. Restructuring costs primarily relate to severance costs associated with business optimization initiatives. Management uses this non-GAAP financial measure in making financial, operating and planning decisions and evaluating XPO's ongoing performance.

We believe that adjusted EBITDA improves comparability from period to period by removing the impact of our capital structure (interest and financing expenses), asset base (depreciation and amortization), tax impacts and other adjustments as set out in the tables on our website that *management has determined are not reflective of core operating activities and thereby assist investors with assessing trends in our underlying businesses. We believe adjusted operating ratio (including and excluding real estate) for our North American less-than-truckload business improve the comparability of our operating results from period to period by (i) removing the impact of certain transaction, integration and rebranding costs and restructuring costs, as well as amortization expenses; and (ii) including the impact of pension income incurred in the reporting period as set out in the attached tables. We believe that pro forma net debt and pro forma net leverage are important measures of our overall liquidity position. Pro forma net debt is calculated as total debt for XPO pre-spin; less cash and cash equivalents; less debt, primarily in the form of finance leases, attributed to GXO Logistics, Inc. ("GXO") which we spun-off on August 2, 2021; less net proceeds from GXO debt offering and XPO stock offering described in our September 2021 Investor Presentation (which is available on our investor relations page of our website); plus cash provided to GXO in connection with the spin-off. Pro forma net leverage is calculated as pro forma net debt divided by pro forma adjusted EBITDA for the trailing twelve months.*

With respect to our projected net leverage, a reconciliation of this non-GAAP measure to the corresponding GAAP measure is not available without unreasonable effort due to the variability and complexity of the reconciling items described above that we exclude from this non-GAAP target measure. The variability of these items may have a significant impact on our future GAAP financial results and, as a result, we are unable to prepare the forward-looking statement of income and statement of cash flows prepared in accordance with GAAP that would be required to produce such a reconciliation.

Forward-looking Statements

This transcript includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including our revenue and profit growth, improvements in LTL adjusted operating ratio, our ability to maintain or grow adjusted EBITDA margin in an environment in which net revenue margins decline, our projected net leverage, and our plan to achieve an investment grade credit rating. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. In some cases, forward-looking statements can be identified by the use of forward-looking terms such as “anticipate,” “estimate,” “believe,” “continue,” “could,” “intend,” “may,” “plan,” “potential,” “predict,” “should,” “will,” “expect,” “objective,” “projection,” “forecast,” “goal,” “guidance,” “outlook,” “effort,” “target,” “trajectory” or the negative of these terms or other comparable terms. However, the absence of these words does not mean that the statements are not forward-looking. These forward-looking statements are based on certain assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances.

These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions that may cause actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements *expressed or implied by such forward-looking statements. Factors that might cause or contribute to a material difference include the risks discussed in our filings with the SEC and the following: economic conditions generally; the severity, magnitude, duration and aftereffects of the COVID-19 pandemic and government responses to the COVID-19 pandemic; our ability to align our investments in capital assets, including equipment, service centers and warehouses, to our customers' demands; our ability to implement our cost and revenue initiatives; our ability to successfully integrate and realize anticipated synergies, cost savings and profit improvement opportunities with respect to acquired companies; matters related to our intellectual property rights; fluctuations in currency exchange rates; fuel price and fuel surcharge changes; natural disasters, terrorist attacks or similar incidents; risks and uncertainties regarding the expected benefits of the spin-off of our logistics segment; the impact of the spin-off on the size and business diversity of our company; the ability of the spin-off to qualify for tax-free treatment for U.S. federal income tax purposes; our ability to develop and implement suitable information technology systems and prevent failures in or breaches of such systems; our substantial indebtedness; our ability to raise debt and equity capital; fluctuations in fixed and floating interest rates; our ability to maintain positive relationships with our network of third-party transportation providers; our ability to attract and retain qualified drivers; labor matters, including our ability to manage our subcontractors, and risks associated with labor disputes at our customers and efforts by labor organizations to organize our employees; litigation, including litigation related to alleged misclassification of independent contractors and securities class actions; risks associated with our self-insured claims; risks associated with defined benefit plans for our current and former employees; and governmental regulation, including trade compliance laws, as well as changes in international trade policies and tax regimes; governmental or political actions, including the United Kingdom's exit from the European Union; and competition and pricing pressures.*

All forward-looking statements set forth in this transcript are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to or effects on us or our business or operations. Forward-looking statements set forth in this transcript speak only as of the date hereof, and we do not undertake any obligation to update forward-looking statements to reflect subsequent events or circumstances, changes in expectations or the occurrence of unanticipated events, except to the extent required by law.