Q4 2020 XPO Logistics Inc Earnings Call

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PRESENTATION

Operator

Welcome to the XPO Logistics Fourth Quarter 2020 Earnings Conference Call and Webcast. My name is Melissa, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

Before the call begins, let me read a brief statement on behalf of the company regarding forward-looking statements and the use of non-GAAP financial measures. During this call, the company will be making certain forward-looking statements within the meaning of applicable securities laws, which, by their nature, involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those projected in the forward-looking statements. For instance, there can be no assurance that the company's planned spinoff of its logistics business will occur as currently contemplated or at all. A discussion of factors that could cause actual results to differ materially is contained in the company's SEC filings.

Forward-looking statements in the company's earnings release or made on this call are made only as of today, and the company has no obligation to update any of these forward-looking statements, except to the extent required by law.

During the call, the company also may refer to certain non-GAAP financial measures as defined under the applicable SEC rules. Reconciliations of such non-GAAP financial measures to the most comparable GAAP measures are contained in the company's earnings release and the related financial tables on its website. You can find a copy of the company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures, in the Investors section on the company's website.

I'll now turn the call over to Brad Jacobs. Mr. Jacobs, you may begin.

Brad Jacobs, XPO Logistics, Inc. - Chairman & CEO

Thank you, Melissa, and good morning, everybody, and welcome to our fourth quarter and full year 2020 earnings call.

Joining me on the call today are Malcolm Wilson, our CEO of XPO Europe; David Wyshner, our CFO; and Matt Fassler, our Chief Strategy Officer.

I'm very pleased with our fourth quarter results. We reported much better-than-expected revenue, adjusted EBITDA, adjusted EPS and free cash flow. Year-over-year, revenue was up 13% and strengthened across every business unit in logistics and transportation. In fact, revenue in both segments showed increases in the double digits.

Adjusted EBITDA was a fourth quarter record. We also generated solid free cash flow that brought us to over $0.5 billion for the full year.

Within transportation, in our LTL business, our fourth quarter adjusted operating ratio, excluding real estate, was also a record. And our truck brokerage results were simply stellar.

Within logistics, our growth accelerated in both North America and Europe, and these higher volumes are increasingly being handled by robots.

We're off to a great start in Q1. Across our key regions, the consumer-led recovery remains robust, and the industrial economy is starting to catch up. Demand for our expertise has never been greater, driven by the shift to outsourcing, e-commerce growth and customer interest in our technology.

We're seeing strong momentum in our 3 largest lines of business: truck brokerage, LTL and logistics. And we expect both of our segments to generate year-over-year EBITDA growth in the range of 24% to 29%. We issued higher-than-expected guidance for full year adjusted EBITDA of $1.725 billion to $1.8 billion.

We're also making good progress on the planned spinoff of our logistics segment. We've named a world-class management team from our own ranks, and we're excited about the impressive talent we're recruiting. We're still targeting a completion date in the second half of this year. We remain confident that the spin, if completed as planned, would enhance the growth prospects of both companies, giving them greater flexibility to tailor strategies and capital allocations to their end markets. We believe that the planned spin-off is an effective way to unlock significant value for our customers, employees and shareholders.

Now I'll turn the call over to Malcolm Wilson to update you on our European business. Malcolm runs our European operations and upon the completion of the planned spin, will become CEO of the global logistics business. Malcolm has been managing multinational 3PLs for 3 decades in Europe, North America and Asia. He joined us in 2015 when we acquired Norbert Dentressangle, where he grew the logistics division into its largest revenue-producing unit. Then he came to XPO and led our logistics business to unprecedented growth and efficiencies. He's ideally suited for this next opportunity. Malcolm?

Malcolm Wilson, XPO Logistics, Inc. - CEO of Europe

Thank you, Brad, and good morning to everyone. I'm very excited about our momentum in Europe. Our logistics business has fully recovered from COVID, and our transportation business is most of the way back. Our European logistics business operates in 15 countries, and we're a leader in many important verticals. Foremost among these is e-commerce, where we are the first European outsourced provider of logistics.

Across e-commerce and all of our verticals, we're helping our customers accelerate their adoption of new technology. We have a large and growing population of robots in our warehouses and the benefit of our XPO Smart productivity tools. We believe we'll see large upside to productivity when XPO Smart is fully utilized in all our logistics sites.

To give you an idea of our operating landscape in Europe, we have the bluest of blue-chip customer bases, with an average customer relationship of between 5 and 10 years. Some of these relationships go back 30 years or more. As we infuse more technology into our operations, the tenure is growing. 10-year contracts are becoming quite normal now.

As is the case in the U.S., COVID has created a real appreciation for the critical importance of supply chains throughout Europe. During the past 4 years, our senior management team have delivered 12% CAGR in logistics gross margin while tackling big projects in a variety of market environments. The company has been very resilient through the pandemic.

We stood up our highly automated Nestlé facility in the U.K. during the height of COVID last year, while maintaining stringent safety measures. This brought the facility online in time to deliver an excellent peak season performance. We also stood up new operations for several omnichannel retailers, including the luxury brand, Kering, in Northern Italy, where we launched a large campus of automated warehouses also in the peak of COVID.

Although new lockdowns were implemented in many countries in the fourth quarter, governments have been much more thoughtful about how they apply these measures. The latest restrictions were designed to keep commerce moving. We've seen no material impact to our business.

As for Brexit, we've experienced only minimal impact there as well. Our logistics business in the U.K. has been unaffected by the changes in the trading relationship with the rest of Europe, as our U.K. sites largely serve customers who sell to U.K. consumers.

And with our U.K. transportation business, Brexit has actually worked in our favor. We have been able to recover costs related to border delays, and some of our competitors have exited the lanes going into the U.K. So we've picked up share.

Looking forward, we have several new high-profile projects starting in 2021. One notable logistics contract is with Nutricia, Danone's healthcare products business. This will be a fully automated facility in the Netherlands.

And finally, we're very excited to have completed the acquisition of the majority of Kuehne + Nagel's U.K. [contract logistics] business (added by company after the call), which gave us the opportunity to welcome nearly 6,000 new colleagues serving 3 strategic verticals: tech and e-commerce, foodservice and beverages. We've also onboarded many new customers with the acquisition. These blue-chip brands operate across Europe, and we are already seeing new business opportunities with them. The tech customers, in particular, include many industry leaders, such as Virgin Media and BT. All the customers are high-quality relationships.

The transaction closed on the 1st of January. The transition has gone smoothly, and all customers and key employees have been retained. We had identified significant synergy benefits prior to the acquisition, and a number of these are already in process. We expect this acquisition to add more than $600 million to our annual revenue and drive significant synergies during 2021.

All in, we have an enormous opportunity in front of us and even more so as a separate company. I've had the pleasure of meeting some of you, and I'm looking forward to spending time with more of you in the months ahead.

Now David will cover the results.

David B. Wyshner, XPO Logistics, Inc. - CFO

Thanks, Malcolm, and good morning, everyone. Today, I'd like to discuss our fourth quarter and full year results, our balance sheet and liquidity, some insights we gained during the pandemic and our outlook for 2021.

In the fourth quarter, we generated revenue of $4.7 billion and adjusted EBITDA of $449 million. Both figures reflect year-over-year increases despite the pandemic, and they are higher than we expected at the beginning of the quarter. Our adjusted EBITDA is an all-time fourth quarter record and reflects our commercial momentum and a continued strong recovery over the last 6 months.

As Brad mentioned, revenue grew 13% year-over-year in the fourth quarter. We incurred direct COVID-related costs of $9 million, and our gains on LTL real estate sales were $14 million versus $32 million last year. Excluding those 2 items, adjusted EBITDA in the quarter grew by 11%.

The holiday peak was long and strong. We saw robust consumer demand and a continuing rebound in industrial activity. As revenue increased, we began to benefit from the operating leverage inherent in our business. Matt will review our segment detail in a few minutes.

Our adjusted earnings were $1.19 per diluted share in the quarter and increased year-over-year despite higher interest expense. We generated $193 million of cash flow from operations in the fourth quarter, spent $149 million on gross CapEx and received $47 million of proceeds from asset sales. As a result, we generated free cash flow of $91 million in the quarter. We didn't repurchase any common stock in the fourth quarter, so we continue to have $500 million of authorized share buyback capacity.

For the full year, we generated revenue of $16.3 billion and adjusted EBITDA of $1.4 billion. Our adjusted earnings were $2.01 per diluted share.

For analysts who exclude amortization of acquisition-related intangible assets for comparison purposes, I'll note that our full year 2020 results include $0.96 of amortization expense related to intangibles. Going forward, we're going to add intangible asset amortization back in our calculations of adjusted EPS. We and many investors we've spoken with think that produces a more comparable and meaningful metric. With this modification, our 2020 adjusted earnings are $2.97 per diluted share.

Our gross capital expenditures were $526 million in 2020, which reflects decisions we made in the second half of the year to resume capital spending in support of key initiatives. After considering our regular course asset sales, our net capital expenditures were $331 million in 2020. And importantly, our full year 2020 free cash flow was $554 million.

Maintaining strong liquidity continues to be a top priority for us as an organization. Our cash balance at December 31 was $2.1 billion. This cash, combined with available debt capacity under committed borrowing facilities, gave us total liquidity of more than $3 billion at year-end. Our net leverage was 3.3x LTM adjusted EBITDA.

We redeemed our 6.5% senior notes due 2022 in January, which reduced our debt and cash balances by an equivalent amount. We have no significant debt maturities until September 2023, and our liquidity position is strong.

We've learned a lot over the course of the last year. The list of insights is a mile long, but here are a few key takeaways.

Our business is incredibly resilient. Both our transportation and logistics segments have an ability to operate, rebound and prosper, even when circumstances are at their most challenging. In 2020, we also proved our agility by adjusting our expenses to changes in demand even though the changes were sharp and unpredictable.

On a macro level, we're benefiting from the trends toward e-commerce, outsourcing and automation, all of which have accelerated. Transportation and logistics customers of all sizes see the advantages of working with strong partners like XPO. And in many cases, they also saw the risks associated with relying on firms that don't have the resources we do.

And lastly, once the scope of the COVID impact on our end markets took shape, we were quick to take actions that strengthened our position in the recovery, like retaining people, securing new business and investing in technology. We saw an opportunity to grow rather than retrench, and it has proven to be the right move.

Turning to our outlook. Our guidance reflects the improved operating environment we saw in the fourth quarter as well as our expectation that the effects of COVID will continue to moderate in 2021. All of our projections exclude impacts from our planned spin-off of our logistics segment.

As Brad highlighted, we expect to generate $1.725 billion to $1.8 billion of adjusted EBITDA in 2021 with growth of 24% to 29% in each of our transportation and logistics segments. Our outlook assumes ongoing COVID-related costs for at least the first 6 months of the year and lower year-over-year gains from LTL real estate sales.

We're optimistic that our base case scenario will prevail. That is that consumer demand will continue to be solid, e-commerce will continue to grow, industrial demand will continue to recover, and new business opportunities will continue to emerge.

In the first quarter, we expect that our adjusted EBITDA will be in the low 20s as a percentage of our full year adjusted EBITDA, which is consistent with our typical seasonality. On the cash flow front, we estimate that our full year free cash flow will be in the $600 million to $700 million range. We're targeting roughly $650 million of gross capital expenditures and $500 million of net CapEx, although both of these estimates could vary based on new business opportunities in our logistics segment.

We expect depreciation, excluding intangibles amortization, to be up slightly this year to $635 million to $655 million. With the repayment of our $1.2 billion of senior notes in January, we're forecasting $275 million to $285 million of interest expense in 2021, which represents a nearly $50 million year-over-year reduction. And we estimate that our effective tax rate will be in the 24% to 26% range, which is standard for us.

With nearly all of our outstanding convertible preferred stock having been converted into common stock in December, we'll have 113 million diluted common shares outstanding this year. As a result, we're projecting adjusted earnings of $5.10 to $5.85 per diluted share, representing 84% year-over-year growth at the midpoint. These figures all add back the intangibles amortization expense I mentioned.

In sum, we delivered strong results again this quarter, ahead of both Street expectations and our own. We move into 2021 with the wind at our back, with robust liquidity, growing revenues, solid results in both segments of our business and record adjusted EBITDA in each of the last 2 quarters despite the pandemic.

We remain enthusiastic about our prospects as a leader in the markets we serve. And we believe that we're proceeding toward our planned spin-off of our logistics business from a position of strength.

I'll now turn things over to Matt.

Matthew Jeremy Fassler, XPO Logistics, Inc. - Chief Strategy Officer

Thanks, David. I'll review the fourth quarter operating results, starting with our transportation segment. In North American LTL, we showed a solid progression in revenue trends throughout the quarter. Our tonnage per day accelerated to 1.6% growth, which was an improvement from the third quarter of almost 6 percentage points. Tonnage was positive in every month of the quarter.

We also saw a pickup in the trend of shipments per day, which were down 0.7% year-over-year. That's 3.3 percentage points better than Q3. Weight per shipment rose 2.6% year-over-year, which compares to flattish in Q3.

The pricing backdrop for LTL remains rational. Yield, excluding fuel, rose 1.5% year-over-year, consistent with our Q3 increase. Underlying yield trends improved quarter-to-quarter, offset by the increase in weight per shipment, which tends to impact reported yield numbers.

Growth in revenue per shipment, excluding fuel, improved to 3.8%, which is more than twice the growth rate we saw in the third quarter, and it accelerated through the fourth quarter. Growth in revenue per day, excluding fuel, also accelerated through the quarter to 3.1%. That picked up 5.7 percentage points from the third quarter.

Tonnage trends improved in all of our top 7 verticals, which together comprise 85% of our throughput. Consumer verticals remained stronger than industrial. You'll recall that we're overweight industrial in LTL, and any improvement in the industrial economy is good for our business.

Our adjusted operating ratio of 83% compared to 82.3% a year ago. Excluding real estate gains, our adjusted OR improved to 84.5%, which was 130 basis points better than the fourth quarter a year ago. We've improved this fourth quarter metric for 6 consecutive years. Both operating ratios include a 60-basis point impact from COVID-related costs.

Adjusted operating income ex real estate increased by 11%. We also saw ongoing improvements in productivity in LTL. Our load factor increased by 3.1% year-over-year, and we were 3.7% more efficient in pickup and delivery than we were last year.

Internal adoption of our XPO Smart labor management tools in our LTL facilities increased by over 50% from the first quarter to the fourth quarter in 2020, contributing to our labor efficiency. We see big upside from this technology as it becomes fully utilized.

Our North American truck brokerage business delivered tremendous results. We generated a 76% year-on-year increase in revenue and a 110% increase in net revenue. Loads per day increased by 24%, sharply outpacing the market.

Net revenue per load increased by 69%. Net revenue margin rate increased by 300 basis points year-over-year to 18.6%.

As you might imagine, earnings for this business rose substantially. It marked a continuation of the strong performance we've generated for the past several quarters in truck brokerage.

There's a great story behind our volume growth in the second half of the year. We drove that growth by making a strategic decision to hire and train people at the bottom of the market. As demand rebounded and the environment became exceptionally tight, we were in a strong position to help our customers procure capacity.

Our brokerage teams continue to leverage our XPO Connect digital platform to drive profits in tandem with our real-time pricing tools. We're also using API tools to generate quotes for some shippers. This is a relatively recent pricing channel for us. It's an efficient, touchless way to capture revenue and maintain our margin.

In the fourth quarter, we increased the number of API quotes we issued by about 45% quarter-over-quarter, which led to nearly twice the number of delivered loads negotiated through these tools. We're seeing year-over-year quarterly improvements in brokered loads per head. Even as we staff up, we're growing volume faster than headcount, again, because of XPO Connect.

And carrier adoption of the platform is on a strong upward trajectory. We've seen a 47% increase in downloads for our Drive XPO carrier app in the last 3 months, taking the cumulative total from 200,000 at the end of the third quarter to over 300,000 at year-end. We now have approximately 58,000 brokerage carriers registered on XPO Connect in North America and another 17,000 or so in Europe. And these numbers keep climbing.

Looking at our transportation segment overall, revenue increased by 13% year-over-year in the quarter, and adjusted EBITDA increased by 8%. COVID costs impacted our EBITDA growth by 2 percentage points, and lower gains from LTL real estate impacted it by 8 percentage points.

Turning to our logistics segment. We increased revenue 13% in the fourth quarter year-over-year. The biggest growth driver for contract logistics continues to be e-commerce, both in Europe and North America. There's been a lot written about the secular shift to online and omnichannel, and we're seeing it firsthand.

Demand for e-fulfillment and returns management expertise is surging at our existing sites. And it's spurring new commercial opportunities. In 2020, we shipped about 5x as many units using robotic automation than we did in the prior year.

Our European logistics business has excellent momentum. As the largest outsourced e-fulfillment platform in Europe, we're a natural place for e-commerce customers to turn. We see a lot of new business ahead as these customers seek out our scale and automation capabilities. Our European logistics revenue rose 19% in the fourth quarter year-over-year or 13% excluding the impact of FX. For the full year, consumer goods generated over 80% of the revenue in European logistics.

In North American logistics, our revenue grew 4% year-over-year. And importantly, it accelerated. While our strongest growth emanated from omnichannel retail, we also saw a big increase in consumer packaged goods.

There were also some challenges in the quarter. As e-commerce volumes surged over the course of an extended peak, warehouse employment rose 9% in December, and seasonal hourly wages spiked. The increase was sharp and sudden, with a 4% month-over-month pop in December alone. This led to higher compensation costs, particularly for seasonal labor.

In addition, COVID created some special constraints for launching new projects. We completed 11 start-ups in the fourth quarter versus 8 a year ago. These required complex installations of equipment and technology, as well as permit inspections and testing, many of which ran into delays from COVID. This added to the cost of launching these customer projects, but the issues are temporary. Seasonal labor costs are abating, and our recent start-ups are running well. These new contracts will generate significant revenue and profit over the next 5 to 10 years.

We get asked a lot about our shared distribution network in North America. Well, XPO Direct had a terrific quarter, with its fourth consecutive quarter of year-on-year profit improvement. If XPO Direct were its own vertical, it would have been our fastest-growing vertical in Q4 for the logistics business.

The benefits that are resonating most strongly with retailers and brands is that they can use the XPO Direct network to position their inventory close to end customers and to reposition it when demand patterns change. These shorten distribution times. We're onboarding numerous emerging and midsized firms who trust us to provide fulfillment services for their consumers.

Returning to our global logistics business overall, we expect year-over-year profit growth in this business of at least 15% in the first quarter and growth of 24% to 29%, in line with our guidance for the company overall, for the full year. And that's pretty much the theme of 2021 across all our lines of business. They were all off to a strong start in January.

Consumer spending growth remains strong with the shift to e-commerce persisting, and the industrial economy is beginning to regain momentum. We remain focused on driving share gains and efficiency through innovation.

In our warehouses, we plan to roughly double the number of robots in place over the course of this year, which will continue to deliver critical productivity improvements. XPO Smart is helping us drive consistent 5% to 7% productivity improvement in contract logistics labor, and it's improving dock productivity in LTL as well.

Also in LTL, our pricing algorithms are driving fully automated responses to 75% of the RFPs we receive. As you can see, automated pricing is a consistent theme throughout our transportation segment.

To give you a little color on January, in LTL, revenue growth ex fuel continued to accelerate. Both tonnage growth and yield growth picked up further from Q4 levels. We successfully executed our annual GRI, and the pricing backdrop is constructive. We expect year-over-year adjusted OR improvement in Q1 with significant OR improvement for the full year.

In truck brokerage, volume growth remains very strong in a tight market. This tightness is driven largely by the supply side with ongoing congestion at some of the major ports and a driver shortage. There has been some loosening in capacity from the seasonal peak, which helps us with procuring capacity for our customers.

Our organic revenue growth in our logistics segment in January was consistent with fourth quarter levels. And again, our outlook for Q1 earnings growth in logistics is solidly positive.

I'll close with a few of the accolades we received in the quarter. On the customer front, we received Dow's Sustainability Award for 2020 in road transportation, and we were named the GlobalTranz LTL Collaborator of the Year. We also won a Green Supply Chain Award from Supply & Demand Chain Executive magazine. Finally, we were named a World's Most Admired Company by Fortune magazine for the fourth straight year.

With that, I'll turn it over to the operator for your questions.

QUESTIONS AND ANSWERS

Answer – Operator: (Operator Instructions) Our first question comes from the line of Chris Wetherbee with Citi.

Analyst: Christian F. Wetherbee, Citigroup Inc., Research Division - MD & Lead Analyst

Question – Christian F. Wetherbee: I'd like to touch on the guidance for a moment. So you gave some pretty detailed and good guidance, particularly on the profit level. I was wondering what the outlook is on the revenue side. And maybe if you could kind of break that down into the global logistics business as well as transport business. Can you give us a sense of sort of what the revenue growth potential could be, what the backlog might look like for 2021?

Answer – Matthew Jeremy Fassler: Chris, it's Matt. So a couple of points on the revenue. Revenue moves around a lot due to exogenous factors like currency, FX, fuel, truckload rates. So we haven't guided to revenue this year, and we typically haven't guided to revenue.

We're off to a very strong start for the first quarter, and the trends that you saw in the fourth quarter are pretty good sign all in of what we're seeing in Q1. But we expect strong balanced revenue growth over the course of the year, both for transportation and for logistics.

Keep in mind, as you model revenue for the year, that we closed the Kuehne + Nagel acquisition at the outset of the year. We're thinking of that as about $600 million to revenue over the course of the year. So as you build your models, that's something to consider for the total number. All the comments I gave you about the tone of business are prior to considering the addition of K+N.

Question – Christian F. Wetherbee: Okay. That's helpful. And then maybe just as a follow-up to that in terms of the logistics side, can you talk a little bit about the pipeline in terms of the new business wins? Let's take K&N out for a moment. It sounds like there's a lot out there from a pipeline standpoint. Can you just give us a sense of what that might look like?

Answer – Matthew Jeremy Fassler: The backlog for contract logistics is very strong. There are so many tailwinds for the contract logistics business. You think about the tailwinds from outsourcing. You think about the tailwind from industrial automation and the way we deploy our technology in our warehouses. Of course, you think about the tailwind from e-commerce, which, if anything, gained momentum as we made our way through 2020.

Certainly, the demand for incremental e-commerce projects is a very substantial part of our backlog. So we have a strong backlog, both in North America and in Europe as we look forward to 2021. And we expect that to be the case for years ahead.

Question – Christian F. Wetherbee: Okay. And if I could just sneak one in on the LTL side. You mentioned year-over-year gains in the OR in the first quarter and then more substantial improvement beyond that. Can you just talk a little bit about sort of what the opportunity looks like? You have tonnage and pricing both turning positive here or at least tonnage turning positive, pricing accelerating from where we were in the fourth quarter. How should these incremental margins look in this business? I know you have a target for $1 billion of profit going out into the future. I just want to get a sense of what '21 might look like from an OR standpoint.

Answer – Matthew Jeremy Fassler: Sure. To answer the first part of your question, we do expect OR improvement in Q1, and we expect OR improvement of at least a couple of hundred basis points, excluding real estate, for the full year.

Now in addition to tonnage, which you cited, and pricing, which you cited, we have a number of company-specific initiatives: continuing to drive dock productivity through XPO Smart; continuing to drive route optimization in both pickup and delivery and linehaul. These are company-specific initiatives that will help us on the cost front in addition to the top line drivers that you cited. All of these are part of our game plan for achieving strong OR expansion this year and for achieving that LTL EBITDA target of at least $1 billion in 2022.

Answer – Operator: Our next question comes from the line of Allison Landry with Crédit Suisse.

Answer – Allison M. Landry: So just another one on LTL. I think around a couple of years ago, you guys were talking about the pricing algorithms and the automated pricing facilitating an ability to gain some share. And I think you specifically maybe talked about being able to go after some spot market freight. So wonder if you could remind us of the potential size of this opportunity. I think it was maybe challenging on this front in 2020. But any sense of if you think you can make some inroads here in 2021?

Answer – Matthew Jeremy Fassler: Allison, it's Matt. Two points to make. First of all, we're really in the early innings of optimizing pricing in LTL. We've made some good headway, but we have a lot more to go, particularly in terms of price elasticity.

Secondly, one of the skills that we've been developing in LTL is the skill of assessing the OR profile of freight as we bring it into the network. So one of the reasons we continue to drive strong OR improvement, and we had very strong incremental margins in LTL in the fourth quarter year-over-year as we think about pricing in terms not just of yield but also in terms of the OR profile of the freight we bring in. And that has certainly been helping us drive that operating income improvement. You saw that 11% EBIT increase in LTL, excluding the impact of real estate. Clearly, our pricing work is one of the drivers of that improvement.

Answer – Allison M. Landry: Okay. And then, Matt, you just sort of listed some of the different tailwinds in contract logistics. Maybe this is more of a question for Malcolm. But could you just sort of give us a sense of the nature of some of the commercial opportunities more recently because of COVID? Is it more just the sort of broad outsourcing trend? Or is there more of a trend for wanting industrial automation or warehouses of the future, fulfillment? Maybe if you could just sort of give us a sense of how those discussions have evolved over the last, I don't know, 6 to 12 months in terms of those sort of buckets of growth drivers.

Answer – Malcolm Wilson: Matt, it's Malcolm. I'll take that question, please. So Allison, what we're seeing is really we're just able to capitalize on being the largest e-fulfillment provider in Europe, our reverse logistics, returns management, the strength we have in omnichannel distribution and, of course, XPO Direct.

What we've seen through COVID is it's brought a new appreciation of just the critical nature of supply chain to our customers. And that's fueling our ability to sign longer-term contracts. So in the past, 10 years would have been a long contract. Now it's more and more the normal type of contract.

Customers are really wanting more and more technology in their operations. So with more and more robots in our warehouses, collaborative robots, larger automation sortation centers. So all of these are driving a very, very positive trend in terms of organic growth. And of course, technology brings productivity and that's enabling us also to improve EBITDA levels.

Answer – Allison M. Landry: Okay. So is it fair to think about sort of the more complex nature of the pipeline as maybe having a better margin profile versus historical?

Answer – Malcolm Wilson: I think it allows us to bring more to our relationship with our customers. It really moves us up the importance of the supply chain. So, we mentioned earlier, I think Matt mentioned about the warehouse of the future, that we successfully implemented in 2020. That project, in fact, was 2 years from the beginning to the end, involving a greenfield construction of the site, XPO deploying all of its skill set to turn a greenfield into a highly automated warehouse that was delivered on time and able to deliver an excellent performance at the peak of the season even in a COVID environment. So we're seeing really that customers are coming to XPO really because of those experiences and that reputation that we have for delivering things on time, in a reliable way, really making ourselves an integral part and assistance to their success also.

Answer – Operator: Our next question comes from the line of Scott Schneeberger with Oppenheimer & Company.

Analyst: Scott Andrew Schneeberger, Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst

Question – Scott Andrew Schneeberger: I was hoping you could address the contract logistics EBITDA margin, some headwinds in the fourth quarter you outlined. And it sounds like kind of similar to Chris's question on LTL. First quarter will be solid, but it will really be the latter quarters. So if you could just elaborate on what you see? It sounds like a lot of won business in 2020 and more in the pipeline. How are you going to become more efficient with the margin, and what type of expectations you have for that segment business over the course of the year?

Answer – Matthew Jeremy Fassler: Sure. Scott, this is Matt. I'm happy to take that question. Think about the margin pressure that we saw in contract logistics in the fourth quarter of 2020 as an isolated incident related specifically to the 2 unique idiosyncratic factors that I discussed a moment ago. One of them relates to pressure on seasonal wages that we saw in the fourth quarter. And the second relates to the challenge of starting up new business in a COVID environment.

And just to shed a little more light on that. Some of the projects that we implemented in the second half of the year had very advanced automation at their core. As we installed some of this new machinery, we needed to move tech people around the country. We needed to get sign-off from municipalities. The inspection process was sometimes delayed, and we had to provide interim solutions that were quite labor-intensive and going back to the prior issue, at a moment in time when labor was extremely expensive.

We did what we needed to do to deliver for our customers in the fourth quarter. It cost us some money. Happily, as we speak today, these issues are in the rearview mirror. We stated a moment ago that we expect adjusted EBITDA growth for contract logistics in the first quarter of at least 15%. We expect adjusted EBITDA growth for logistics in the 24% to 29% range for the year, consistent with our outlook for the broader company. So we feel very good about the earnings outlook for the logistics business.

Question – Scott Andrew Schneeberger: Great. Appreciate that. And then curious to hear about last mile logistics, given it was the peak quarter. Just a little bit more insight into how you handled the quarter and what you're expecting for the coming year.

Answer – Matthew Jeremy Fassler: Happy to take that one as well. So our last mile revenue grew 13% in the quarter. Our contribution dollars from last mile grew 15% year-over-year, and the contribution margin rate increased to 22% from 21.6%.

As you know, we're the largest outsourced provider of last mile logistics for heavy goods for most of the leading retailers and e-tailers out there - not a surprise when customers tell us that our service metrics are best-in-class. Our claims frequency is astounding, 1 out of only 600 or so deliveries results in a claim. We bought and integrated this business from 2013 to 2015, as you know, before the industry really came to a high-profile notice. We had first-mover advantage here, really starting with a one-of-a-kind platform in 3PD.

More recently, we've invested in world-class consumer-facing technology, which has really enhanced the value proposition for our customers. So a very strong close to the year for this business, to your point.

Answer – Operator: Our next question comes from the line of Tom Wadewitz with UBS.

Analyst: Thomas Richard Wadewitz, UBS Investment Bank, Research Division - MD and Senior Analyst

Question – Thomas Richard Wadewitz: I wanted to ask you a little bit about brokerage, and congratulations on the really impressive results in brokerage. Can you give us a sense of what that percentage change was in brokerage headcount year-over-year? And also how you think about the increase in automation? If you could give a sense of kind of what percent of loads were automated on one side or on both sides, just to think about kind of where you're at in that process of leveraging the kind of DFM type of approach?

Answer – Matthew Jeremy Fassler: Tom, it's Matt. Our brokerage headcount was up 20% year-over-year. To repeat a stat that I gave in my prepared remarks, our load count was up 24% year-over-year. So we achieved improvement in productivity per rep even as we staffed up. But the most important metric to integrate or synthesize with that picture are the increases that we drove in that margin per load, which were substantial. And that tied to our ability to really invest time working for our customers, procuring capacity in a very dynamic market.

On your question on digital, at this point, all of our orders are running through the XPO Connect platform in one sense or another. This is the system that our customers and our carriers use for transacting business with us. So there's a digital element to everything that we're doing in brokerage.

And one of the great changes over the past year or 2 is the way Connect has been integrated into the day-to-day of business practices of our reps. And that is contributing to their efficiency, contributing to better price discovery and contributing to the margin and profit results that we delivered in the fourth quarter.

Question – Thomas Richard Wadewitz: How would you think about -- fourth quarter seemed to be a kind of uniquely good environment for brokers. Obviously, you capitalized on that. But I guess if we go back to -- if we think of 2021 as analogous to 2018, contract rates up a lot. That's a pretty good environment for brokers as well. How do you think about the kind of pace of top line growth in 2021 for your brokerage business, just given that it was such a big step-up in activity in fourth quarter?

Answer – Matthew Jeremy Fassler: Sure. We're almost halfway through the first quarter. We're doing extremely well in truck brokerage. Q1 will be spectacular, maybe not quite as spectacular as the fourth quarter, but it will be exceptionally strong. Typically, as you know, you would see a seasonal step down from the fourth quarter to the first quarter.

One thing to keep in mind on our recent hires. As the tenure of these new hires increases, they'll be more impactful. They will be able to transact more business than they did in the past. So we think we're setting ourselves up here for a sustained period of success relative to the market.

Question – Thomas Richard Wadewitz: If I can sneak in one other quick one. Just what about intermodal within freight brokerage? Anything of note happening there?

Answer – Matthew Jeremy Fassler: Intermodal had a massive recovery in the fourth quarter. Organic revenue per day was up low double digits. That was a nice acceleration from Q3. Loads per day were up 4%. This was the first positive quarter that we had in this metric in 2020. Gross margin per load was up 8%. And you can think about the recovery there reflecting the tight truckload market, which leads to some conversion to intermodal, and incremental demand from consumer and retail customers, particularly with that extended peak later in the year.

Answer – Operator: Our next question comes from the line of Jason Seidl with Cowen & Company.

Analyst: Jason H. Seidl, Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Question – Jason H. Seidl: How should we think about tonnage growth on the LTL side, considering the industrial economy is still lagging? So that seems to be on the comp.

Answer – Matthew Jeremy Fassler: Jason, it's Matt. The industrial economy is still lagging the consumer economy, though it is beginning to recover. Our tonnage per day in January was stronger than our tonnage per day in the fourth quarter. And our expectation is that we will see improvement as the industrial economy continues to recover.

Question – Jason H. Seidl: Okay. Want to switch over to the robotics side. So it's -- you made some interesting comments about how much increase you guys have seen and what you're going to plan for 2021. The fourth quarter saw a big spike in seasonal wages for your logistics business. As you implement more and more robotics throughout your business, does that sort of buttress you a little bit away from the seasonal wage increase issues that may come and go depending upon the given year?

Answer – Matthew Jeremy Fassler: Over time, over time, it can. I mean, we're continuing to see sixfold productivity improvement with goods-to-person robotics versus manual sites. We said earlier we shipped 5x as many units using robotic automation technology. Year-on-year, we grew the number of robots in our warehouses by about 4x, so there's some productivity improvement embedded within that for us. As you can see, we plan to double the number of robots that we have in 2021.

We have a first-mover advantage in good-to-person robots. The cost of entry is high. Many customers are consequently outsourcing that, including to us. And robots are particularly critical in supporting large-scale e-commerce rollouts in tandem with our workforce.

Question – Jason H. Seidl: And what part are the robots as a percentage of your CapEx? Is it still less than 2%, 3%?

Answer – Matthew Jeremy Fassler: It's a small number in the grand scheme of the CapEx guide that David gave you a moment ago, but it will grow over time as they emerge as a bigger part of our story.

Answer – Operator: Our next question comes from the line of Amit Mehrotra with Deutsche Bank.

Analyst: Amit Singh Mehrotra, Deutsche Bank AG, Research Division - Director and Senior Research Analyst

Question – Amit Singh Mehrotra: Malcolm, congrats on the appointment as CEO of SpinCo. I guess I'd like to direct my first question to you, Malcolm, if that's okay. And that's really just regarding the structural return potential in contract logistics not just this year, but kind of over the next several years. Because we talk a lot about revenue growth in logistics, and that's clearly very compelling, but we don't talk about margin expansion or structural margin expansion. And one of the concerns out there with investors and analysts is a relatively low-margin profile of the logistics business. So in that context, Malcolm, I was just wondering, is there a structural margin expansion story at logistics as you penetrate more value-added services? And if you could just talk about in terms of what that structural return potential could be over the next 3 or 4 or 5 years?

Answer – Malcolm Wilson: Thank you, Amit. Just to remind, for quarter 1, we're already tracking for our logistics business to be above 15% in adjusted EBITDA, for quarter 1, and 24% to 29% for the full year, in line with the business.

Going forward, if I consider the experience that we have, we can see a lot of potential for margin expansion. That's coming from more and more deployment of technology into our business. So as Matt just explained, the productivity improvements that we get from the cooperative robots and autonomous robots is really quite significant. We're also seeing significant productivity improvement from our XPO Smart productivity tools. So these things combined give us great confidence that we can expand margins on the go forward.

Question – Amit Singh Mehrotra: Right. And so what is the ceiling on that? Is it high single-digit operating margins, low double-digit EBITDA margins? Like what is the opportunity from where we are today?

Answer – Malcolm Wilson: Right now, we're operating our business with [high single digit] (corrected by company after the call) EBITDA margins. And we expect that to have the ability to expand as we're rolling out these new technologies. The solutions that our customers are demanding are larger, more complex, more embracing. We're obviously seeing the benefit of this huge secular change that's coming as a consequence of e-commerce. We're all buying more and more things online, and that's driving our ability to deploy more and more technology in our warehouses.

So these things all together definitely are going to allow us to expand margins. And not to lose sight of the very leading position we have, strongest e-fulfillment provider, with strength in reverse logistics and returns management, the strength we have in omnichannel and of course, in North America, XPO Direct. So there's a lot of runway ahead for us to improve.

Question – Amit Singh Mehrotra: Yes. Okay. And then just as my follow-up, maybe for David or Matt, if I strip out the $600 million of Kuehne + Nagel U.K. logistics inorganic growth this year on the top line, it looks like -- and I could be wrong on this, but it looks like the implied incrementals on the organic growth is like low to mid-20% range. And I just would have thought it would be higher than that given, one, the split between fixed and variable costs and you're comping COVID costs, then you have this $500 million non-volume opportunity. So I'd love you to kind of help me with first of all, is that right in terms of low to mid-20% incremental on the organic growth? And why that isn't higher given all these kind of lapping of costs in the non-volume-driven cost opportunity?

Answer – Matthew Jeremy Fassler: So a couple of points on that, and some of them are going to repeat, I think, the clear premises you have in your question. We do see a strong revenue performance in Q1 and for the year. We do expect substantial operating leverage in 2021.

We talked about K&N. It is coming in most likely at a lower EBITDA margin, but we're going to build that margin up over time through synergies. Your math is pretty good. Excluding K&N, we expect to generate incremental margins into the 20s. It's early in the year. Let's see where we can take this.

Answer – Operator: Our next question comes from the line of Brandon Oglenski with Barclays.

Analyst: Brandon Robert Oglenski, Barclays Bank PLC, Research Division - VP & Senior Equity Analyst

Question – Brandon Robert Oglenski: I'll just keep it to 2 today. But, Malcolm, I guess coming off that answer, more holistically, how do you want to manage the business from a growth perspective? Would you rather get price and margin? Or would you rather see greater organic expansion looking forward? And I guess along those lines, how much of the benefits from robotics and productivity in the business do you have to give back just via your contract structures?

Answer – Malcolm Wilson: Thank you, Brandon. Going forward, we're going to use the same strategy that we've had since XPO acquired the ND legacy business. Under my leadership, that strategy has delivered a 17% CAGR in logistics gross margin while adding 6% CAGR revenue growth, all while throwing off tons of free cash flow, no acquisitions in those numbers, just good solid management. It's been achieved by us capitalizing on our leading position in omnichannel and e-fulfillment logistics.

We give superb and reliable customer service to our blue-chip customers, and everybody's seen that during the last year of the pandemic. Optimizing our operations, we utilize the technology, all the robotics, automated sortation machines. All of those help keep our business lean and efficient.

And finally, we work hard in developing a very positive engagement with all of our employees, and that's an integral part of our success. So when you put all these things together, we've got years and years ahead of us in terms of strong organic revenue and EBITDA growth. That's for the combined business.

I think the volume now and the acceleration that we see in robotic technology, in automation technology, in technology generally that we're able to deploy in the warehouse, it's a super exciting environment that we're in and really bodes very, very well for the future of our logistics business.

Question – Brandon Robert Oglenski: I understand like a big drive here with the split is to be very focused on capital deployment. Any changes there? Does M&A move up the list for you as you look forward? Or is it more internal development?

Answer – Malcolm Wilson: For our internal development, we scrutinize every project. We look at the ROI returns that we got on every project, and we're going to carry on with that very good cadence in the new spin company.

When it comes to acquisitions, I've got tons of experience of acquisitions. And in fact, we've just completed on the K&N deal. Indeed, I've been acquired myself on a couple of occasions. That gives us a great perspective and appreciation of what goes into making a very smooth and a successful integration.

But really, in the initial environment, we're just going to focus on our core business in North America, in Asia Pacific, in Europe; in our current wheelhouse - e-fulfillment, reverse logistics, omnichannel, XPO Direct. We're in the largest and fastest-growing verticals in retail and e-comm with bluest of blue-chip customers. Then on top of all of that, we've got our leading position in automation and robotics. We're driving the full deployment of XPO Smart productivities. We've got plenty of things to be getting on with. But of course, we'll always be open to projects that will be accretive to our shareholder value.

Answer – Brad Jacobs: Okay. I see it's 9:30. The market is opening up. We very much appreciate the hour we got to spend with you all.

Obviously, we had a fantastic quarter. Good job, Team XPO. We have a lot of wind to our back, especially from e-commerce, from the outsourcing trend, from the significant investments we've made in technology over the year. We need to stay focused and keep executing well. Thank you for your support. Talk to you in 3 months, everyone.

Answer – Operator: Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.
