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XPO, Inc. (XPO)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to XPO Q4 2024 Earnings Conference Call and Webcast. My name is Latonya, and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. [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 make 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. A discussion of factors that could cause actual results to differ materially is contained in the company's SEC filings as well as it is in earnings release. The 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 this call, the company also may refer to certain non-GAAP financial measures as defined under 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, or 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 will now turn the call over to XPO's Chief Executive Officer, Mario Harik. Mr. Harik, you may begin.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Good morning, everyone. Thanks for joining our call. I'm here with Kyle Wismans, our Chief Financial Officer; and Ali Faghri, our Chief Strategy Officer. This morning, we reported a strong fourth quarter with year-over-year earnings growth and LTL margin expansion that outperformed the industry. I'm pleased with the substantial progress we've made in the trough of the freight market cycle. For the full year, we grew revenue by 4% to a record \$8.1 billion company wide. We also generated \$1.3 billion of adjusted EBITDA, a 27% increase from the prior year, reflecting significant operating leverage. And we delivered a 31% increase in adjusted diluted EPS at \$3.83 for the year.

Turning to our LTL segment. We're making great strides in executing our plan and optimizing all parts of the business. The results we've delivered so far are just the beginning of our potential. You can see that in the 260 basis point improvement in our adjusted operating ratio, which was better than our targeted range. This was underpinned by record customer service levels, which translated to profitable market share gains and above-market yield growth for the year. And we have a well-defined plan to keep driving our OR toward becoming industry best.

We also seamlessly integrated 25 new service centers into our network, establishing a major competitive advantage of customer service capacity. And we operated more cost-efficiently across the board, including our line-haul operations, where we reduced outsourced miles to the best level in our history.

Now, I'll summarize the highlights of 2024 in each of these areas, starting with world-class service. This is our most important lever for growth and profitability. In the fourth quarter, we delivered a damage claims ratio of 0.2%,

which is an improvement from 0.3% last year. Importantly, we reduced damage frequency each quarter to a new company record. This metric is a real-time indicator of the service quality that our customers experience.

To put it in perspective, we've improved damage frequency by over 80% since 2021, and we have significant room to make further progress over time. We also improved our on-time performance year-over-year for the 11th consecutive quarter. This is a testament to the speed and reliability that our customers value in our network.

Next, I want to talk about a lever that touches every part of our plan, our network investments. On the real estate side, I mentioned that we brought 25 new service centers online last year and will integrate the remaining acquired sites over the next few months. When we expand our network capacity, we create more opportunity to improve service because it balances our network, adds density in strategic markets, and helps us run the business more efficiently.

We're also adding rolling stock to serve our customers and support our ongoing insourcing of line-haul transportation. Since 2021, we've produced over 15,000 trailers at our in-house manufacturing facility, and we're the only LTL carrier in North America with this capability. This is a major advantage, because trailers are the backbone of efficient LTL operations. We rely on this capacity to consolidate and move freight across our network.

We've also purchased nearly 5,000 tractors during the same period. We ended 2024 with an average fleet age of 4.1 years, giving us one of the youngest tractor fleets in the industry. As a result, we're operating our fleet at a lower cost per mile. Because we made these strategic investments throughout 2023 and 2024, we currently have nearly 30% excess door capacity and a robust fleet in the trough of the cycle. That's a major improvement from a few years ago when our excess capacity was about half of what it is today.

We're one of only a few LTL carriers in North America with this kind of capacity in hand. It allows us to respond quickly to surges in demand, and it puts us in a strong position to accelerate operating leverage and profitable growth in a freight market upcycle.

Yield is another key lever for us and the most impactful metric underlying margin improvement. For the full year, we grew yield excluding fuel by 7.8% year-over-year, directly contributing to our 260 basis points of OR improvement. Both yield and margin are being driven by our internal initiatives and proprietary technology. Here again, we see a long runway for further gains, including a double-digit pricing opportunity in the coming years, propelled by three dynamics.

First, by aligning price with the service value we deliver, we've been consistently outperforming the market in yield growth, and we expect this to continue. Second, we're committed to evolving our service offering to meet our customers' needs. The premium services we introduced last year contributed to above-market yield growth and account for an increasing share of our revenue mix. And third, investments in our sales force are generating market share gains with local customers. This is a strategic lever for margin expansion.

The final component of our strategy is cost efficiency, with our primary focus being line-haul insourcing and variable costs. In 2024, we reduced our purchased transportation costs by 32%, driven by a reduction of more than 600 basis points in line-haul miles outsourced to third-parties. We accelerated this initiative in the fourth quarter when we reduced our outsourced miles to 10.7% of total miles. That's nearly 900 basis points lower than a year ago, primarily due to the expansion of our Road Flex operation. And we expect this metric to drop into the single digits this year, which would be a new historic low.

Our reduced reliance on third-party truckload carriers will help insulate our cost structure when demand returns and truckload rates rise, generating higher incremental margins versus prior upcycles.

Importantly, we're also managing our labor costs more effectively with our proprietary technology. Our systems can forecast volume trends using predictive AI so we can quickly align labor hours at the service center level. In 2024, this resulted in consistent labor productivity improvements in a changing volume environment, and we expect our technology to continue to deliver incremental benefits to our cost structure as we grow.

Turning to Europe, we increased full year segment revenue by 3%, which outperformed the industry in a soft macro. Our most robust performance was in the UK, where we grew year-over-year organic revenue by double digits.

In summary, we delivered our strongest year of LTL margin improvement since 2016, and we achieved that in a historically soft freight environment. We also cemented our foundation for future growth, validated the opportunity ahead of us, and positioned the business to capitalize quickly in a freight market recovery. We're in our strongest position yet to unlock the potential within our network, and we expect to deliver significant margin expansion and earnings growth this year.

Now, I'm going to hand the call over to Kyle to discuss the financial results.

Kyle, over to you.

Kyle Wismans

Chief Financial Officer, XPO, Inc.

Thank you, Mario, and good morning, everyone. I'll take you through our fourth quarter financial results, balance sheet and liquidity, as well as our planning assumptions for 2025. We reported a strong fourth quarter, reflecting the continued execution of our plan. Our total revenue for the quarter was \$1.9 billion, which is 1% lower than the prior year on a company-wide basis. In our LTL segment, revenue was down 3% year-over-year, reflecting a 23% decline in fuel surcharge revenue tied to the price of diesel. Excluding fuel, we increased segment revenue by 2%.

We continue to realize new cost efficiencies in our LTL operations, including other material reduction in purchased transportation due largely to insourcing more line-haul miles. Our purchased transportation expense in the fourth quarter was 47% lower than a year ago, equating to a savings of \$39 million. We also managed LTL labor effectively, with hours per shipment improving year-over-year by 1%. This helped mitigate a fourth quarter increase of 3% in total salary, wages, and benefits, primarily due to inflation.

And we've realized continued cost efficiencies in our fleet operations, with our investments in new equipment, bringing down our maintenance costs per mile by 10% year-over-year. Depreciation expense increased by 16%, or \$11 million, reflecting the investments we're making in the business. This continues to be a key priority for capital allocation in LTL.

Next, I'll add some details to adjusted EBITDA, starting with the company as a whole. We generated adjusted EBITDA of \$303 million in the quarter, an increase of 15% from a year ago. Our adjusted EBITDA margin of 15.8% was a year-over-year improvement of 220 basis points. Looking at just the LTL segment, we grew adjusted EBITDA by 20% to \$280 million. LTL adjusted EBITDA includes the impact of \$34 million real estate gain in the fourth quarter. This primarily stemmed from the planned sale of the service center in Brooklyn as we opened a larger site we acquired in the same market.

Excluding real estate, we grew LTL adjusted EBITDA by 6% year-over-year to \$246 million. The increase is driven by yield growth and cost efficiencies, which more than offset the non-operational headwind from lower fuel surcharge revenue.

In our European Transportation segment, adjusted EBITDA was \$27 million, and corporate adjusted EBITDA was a loss of \$4 million for the quarter. Looking at the fourth quarter company-wide, we reported operating income of \$148 million, up 24% year-over-year, and we grew net income from continuing operations by 31% to \$76 million, representing diluted EPS from continuing operations of \$0.63. On an adjusted basis, diluted EPS increased by 16% year-over-year to \$0.89. And lastly, we generated \$189 million cash flow from operating activities in the quarter and deployed \$108 million of net CapEx.

Moving to the balance sheet, we ended the quarter with \$246 million of cash on hand. Combined with available capacity under our committed borrowing facility, this gave us \$757 million of liquidity. Our net debt leverage ratio at year-end was 2.5x trailing 12 months adjusted EBITDA. This is improvement from 3 times at the end of 2023.

While we remain committed to investing in our long-term growth initiatives, we expect LTL CapEx to moderate as a percent of revenue from the past two years of significant network expansion and additions to our fleet. With a lower CapEx profile and sustained earnings growth, we can generate higher levels of free cash flow, giving us greater flexibility to return capital to shareholders over time.

Before I close, I'll summarize this year's planning assumptions to help you with your models. For 2025, we expect total company gross CapEx of \$600 million to \$700 million, interest expense of \$220 million to \$230 million, pension income of approximately \$6 million, an adjusted effective tax rate of 24% to 25%, and a diluted share count of 120 million shares. These assumptions are included in our fourth quarter investor presentation.

Now, I'll turn it over to Ali, who will cover our operating results.

Ali Faghri

Chief Strategy Officer, XPO, Inc.

Thank you, Kyle. I'll start with our LTL segment, which delivered another quarter of margin improvement and earnings growth. Our results were characterized by strong underlying trends, and our volume outperformed the industry as a whole. On a year-over-year basis, our shipments per day were down 4.4% and our weight per shipment was down 1.3%, resulting in a 5.7% decline in tonnage per day. Within shipments per day, we grew volume from our local customer base year-over-year by high-single digits. This is our highest margin business and an important part of our strategy. We expect to accelerate market share gains in our local channel this year.

On a monthly basis, our October tonnage per day was down 8%, November was down 4.1%, and December was down 4.4%. Looking just at shipments per day, October was down 6.5%, November was down 4.3%, and December was down 2%. For January, tonnage was down 8.5% from the prior year, with a 3 point impact from weather disruptions throughout the month. Excluding this impact, January tonnage per day was largely in line with seasonality.

Our pricing trends remained strong throughout the quarter, reflecting our progress in aligning price with the value of our service and growing range of premium offerings. This is one of our most promising underlying trends. This enabled us to deliver another quarter of above-market pricing growth.

On a year-over-year basis, we grew fourth quarter yield ex-fuel by 6.3% and revenue per shipment by 5.8%. Importantly, we achieved sequential improvements in both yield growth and revenue per shipment from the third quarter as well as on a two-year stack basis. We've now increased revenue per shipment sequentially in every quarter for two consecutive years, and we expect to accelerate yield growth in the current quarter, reflecting the ongoing momentum of our pricing initiatives.

Turning to margin, we improved our fourth quarter adjusted operating ratio by 30 basis points year-over-year to 86.2%. Over the past two years, we've improved adjusted OR by a total of 410 basis points. Sequentially, our fourth quarter adjusted OR increased by 200 basis points, outperforming normal seasonal trends. We're driving this outsized margin expansion through a combination of yield growth, cost initiatives, and productivity gains, all facilitated by our proprietary technology.

We've now delivered year-over-year OR improvement for five consecutive quarters in a historically soft rate environment. And not only did margin come in above our target range, we were the only public LTL carrier to expand margin in 2024 in the trough of the cycle.

Moving to the European business, we made meaningful gains in the quarter against the soft macro backdrop. We increased segment revenue on a year-over-year basis for the sixth consecutive quarter, supported by strong pricing. In some key geographies, like the UK, we increased adjusted EBITDA by double digit versus the prior year, reflecting disciplined cost control. And we grew our fourth quarter sales pipeline sequentially by high-single digits, positioning our European business to accelerate results when the macro recovers.

Before we go to Q&A, I want to summarize the key drivers behind the considerable outperformance we achieved in 2024 and how that enhances our market position. Our service quality is at record levels, and we expect our pricing initiatives to continue to drive above-market yield growth. We're just beginning to capture the massive pricing opportunity ahead of us.

We're also optimizing our cost structure by reducing line-haul outsourcing to historic lows and leveraging our technology to become more productive and cost-efficient. And we remain intently focused on margin, supported by our operational initiatives, investments in network capacity, and compelling value proposition for customers. We've created a solid foundation for years of ongoing margin expansion with meaningful upside in a freight market recovery.

Now, we'll take your questions. Operator, please open the line for Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now conduct a question-and-answer session. [Operator Instructions] Our first question comes from Ken Hoexter with Bank of America. Please proceed.

Ken Hoexter

Analyst, BofA Securities

Q

Great. Good morning. Great job on the continued performance. You mentioned going to single-digits on the insourcing. Maybe can you talk about where you are in that network 2.0, what other opportunities you can still see to continue to improve that cost base? Ali, you mentioned still room to go.

And then, Mario, you've talked about the kind of different service-level improvements that lead you to get that pricing long term. Can you talk about what you still see as the opportunity there to close that margin gap versus the industry leader that you kind of talked about in terms of using that price and what's left on that margin gain? Thanks.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Thanks, Ken. I'll start with the latter part of the question. If you look at the opportunity ahead of us, a lot of it goes back to yield improvement. When we started our plan back in 2021, there was about 15 points of yield differential between us and best in class. And over the last few years, we are now, call it, in the low teens in terms of margin opportunity or pricing opportunity ahead of us. And there are three levers for us to capture that pricing opportunity. And that's going to lead to above-market yield growth like we saw here in 2024. And we expect that to be the case over the years to come.

But that margin opportunity, the three levers are, one, that continued service improvement. We're hearing more and more from our customers, they want to do more business with us, and we're being able to – about half that delta was driven by a better service for a longer period of time that we are now bridging over the years to come. And there's a 5- to 10-year runway of bridging that [pricing] gap.

The second category is around premium services. We mentioned this earlier, where last year, we launched a half a dozen or so premium services. And these are things that our customers are asking for, whether it's shipping into for a retail store rollout or shipping in and out of a trade show. And today, our assessorial as a percent of revenue, when we started the plan, we were about at 10%, best in class was 15%. In 2024, we were able to get 1 point of that delta, and we expect that the cadence to get 1 point over the next four years in terms of bridging that gap.

And the third area is around local accounts. Roughly when we started, 20-or-so-percent of our business was local accounts. These come at a higher margin and higher yielding. And we've made tremendous progress in 2024. We've added more than 10,000 new local accounts and this was based on us hiring 25% more local sellers. But that's the overall opportunity. Think of it as being in the low teens of incremental yield improvement over the next 5 to 10 years, above what we're seeing in market yield growth.

In terms of line-haul insourcing, so we delivered our 2027 target three years ahead of plan, like we said we would. And in the fourth quarter, we were at 10.7% outsource, which was nearly 900 basis points of insourcing on a year-over-year basis. We expect that to be in the single-digit territory in 2025, so we're going to continue to insource.

Long-term opportunity, there will always be some residual we're going to keep as outsource, probably in that mid-single-digit-plus range as we exit next year.

But importantly, Ken, the reason why we are very excited about the outlook on this, because usually when the cycle turns, truckload rates go up as well. And this is going to help insulate our P&L and our margin performance and get higher incremental margins in the upcoming upcycle versus compared to prior upcycles, given the lower reliance on third-party truckload.

Ken Hoexter

Analyst, BofA Securities

Great stuff. Thanks.

Q

Operator: Our next question comes from Jon Chappell with Evercore ISI. Please proceed.

Jonathan Chappell

Analyst, Evercore ISI

Thank you. Good morning. Ali, if I heard you correctly, you said expect yield to accelerate in the current quarter. So, I just wanted to be clear, that 6.3%, as someone pointed out to me today, probably the best pricing in any industrial company, let alone transport company, in this environment. Do you expect that to be better than 6.3% in the first quarter? And if so, what does that translate to as far as sequential OR guide is concerned?

Q

Ali Faghri

Chief Strategy Officer, XPO, Inc.

So, Jon, we do expect our yield growth to accelerate here in the first quarter relative to the 6.3% growth that we delivered in the fourth quarter. We would also expect our contract renewals to accelerate as well, and that's being driven by the initiatives that Mario just outlined. As our service continues to improve, that's allowing us to earn a higher price. We're also making continued progress on improving our mix of premium services and local customers, and all of that is what's translating to that acceleration that we're seeing here in the first quarter.

A

Now, in terms of OR, we do expect a strong quarter from a margin performance standpoint here in the first quarter. Normal seasonality for us is for OR to deteriorate about 50 basis points from the fourth quarter to the first quarter, and we expect to outperform seasonality. We also expect, Jon, for our OR to improve sequentially from Q4 to Q1, and that's going to be driven by the continued strength that we're seeing from both the yield side and the cost side as well. And as I noted, our baseline expectation is for yield to accelerate here in the first quarter.

Now, from a volume perspective, Q1 does tend to be a tougher quarter to predict, given the weather impact and also the fact that the quarter tends to be more heavily weighted towards the month of March. And the magnitude of how much we're going to improve our OR sequentially into the first quarter will ultimately depend on how tonnage plays out through the rest of the quarter. However, we do expect to outperform seasonality, even with that weather impact that we saw earlier in the quarter.

Jonathan Chappell

Analyst, Evercore ISI

That's great. Thanks, Ali.

Q

Operator: Our next question comes from Scott Group with Wolfe Research. Please proceed.

Scott H. Group

Analyst, Wolfe Research LLC

Q

Hey. Thanks. Morning, guys. Just want to follow up there. Rather than looking sequentially, do you guys think you'll see margin improvement in the first quarter year-over-year? And then, I know last year you gave some full year guidance on the LTL operating ratio. I'm just curious if you have any thoughts on in terms of how much improvement we can expect this year. Thank you.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Scott, so for the first quarter, as Ali said, we typically see that deterioration from Q4 to Q1, and our 50 basis points, we expect to outperform that. We expect to outperform also on a sequential basis to improve OR. Now, getting on a year-on-year basis, there's a path for that, but we'll see what the rest of the quarter has in store for us here as we execute in February and March.

In terms of full year OR expectation, we do expect to have another strong year from both an OR improvement and earnings growth perspective, and this is despite continuing to be in a soft macro environment. Our baseline expectation is for OR to improve 150 basis points for the full year. And a high level, all the things I mentioned earlier on are all contributors from a yield perspective. We continue to do a great job in terms of the service product being excellent for our customers and being able to get yield flow-through on that.

We are ramping our premium services. A lot of these things we launched through the course of the year, so we are building the pipeline and converting that pipeline. On the local channel, we have our – 24%, 25% more local sellers are now fully ramped up, and we've onboarded more than 10,000 new local accounts.

On the cost side, the team – I'm very proud of the team for their execution. We keep on doing a great job of managing labor to the volume we're seeing in the environment. We're insourcing line-haul faster than we've ever done before with our Road Flex operation. And ultimately, we have larger locations in many markets. We will end the quarter with 30% excess capacity, which is also going to help us.

So if you look at all of these things, 150 basis points is the baseline that we expect for improvement for the full year. And if we do see an inflection in demand and demand improves through the course of the year, and we start seeing the upcycle, there's upside to that number as well.

Scott H. Group

Analyst, Wolfe Research LLC

Q

Appreciate it. Thank you, guys.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Thank you.

Operator: The next question comes from Chris Wetherbee with Wells Fargo. Please proceed.

Chris Wetherbee

Analyst, Wells Fargo Securities LLC

Q

Yeah. Hey. Thanks. Good morning, guys. Wanted to pick up on the pricing. So, obviously, you guys have initiatives that are driving upside relative to what we're seeing in the market. But I guess, could you maybe walk us through kind of how these conversations are going and kind of how you think you are realizing this relative outperformance? I guess, volume obviously has been on the softer side, but pricing accelerating. I guess, as you break that down and think about the conversations with customers, what are the key points that are sort of allowing you to continue to outperform and maybe how you think about the sustainability of that through 2025?

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Yeah. So when you look, Chris, at the conversation with customers, not all of our pricing is coming in from price increases to customers. So, a lot of it is coming from the mix dynamic of having more local business, and we're being able to onboard that business and grow it. And it's also coming by giving the customers an incremental services that they are asking for. And these incremental services, obviously, come at a cost for us at higher yield and higher margin as well. And they appreciate that tremendously when you think about areas like shipping into retail stores and being able to have 1,000 shipments going to multiple retailers all at the same time and meeting those expectations, all of that is really constructive for customers.

And similarly, on the service product, keep in mind that we still have a big gap between us and the best-in-class provider, so we are bridging the difference in that gap. So, the way we think high level about pricing is that you want to price incrementally higher than cost inflation by 100 to 200 basis points, and there's always upside to that through all the things I just mentioned.

Chris Wetherbee

Analyst, Wells Fargo Securities LLC

Q

Okay. That's helpful. One quick follow-up. I think you noted 1Q tonnage in line with normal seasonality. What do you guys see as normal seasonality for 1Q tonnage?

Ali Faghri

Chief Strategy Officer, XPO, Inc.

A

So, Chris, typically, what you'll see is that tonnage is about flattish sequentially from Q4 to Q1. So if you roll forward normal seasonality here, that would imply tonnage down somewhere in that mid-single-digit-plus range on a year-over-year basis, so a few points better on a year-over-year basis relative to what we saw in the month of January. And as we noted earlier, March does have an outsized impact on the quarter overall, so we'll see how the rest of the quarter plays out. And as normal, we'll give another update on our February volume trends in early March.

Operator: Thank you. Our next question comes from Tom Wadewitz with UBS. Please proceed.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Yeah. Good morning, and great to see the continued strong execution. Wanted to see if you could give a couple of thoughts on just maybe competitive dynamic in local. I guess, I'm kind of thinking about what's going on with FedEx freight, and you're going to invest in a couple hundred salespeople. Maybe that's just an offset to is selling before. But I wonder, are you seeing other LTLs invest more in local? Is there any change in competitive dynamic, or is that kind of a clean runway for you to keep leveraging that investment you made and continuing to see that mix improve in terms of just high-single-digit growth in that area?

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Well, first, starting with a spin of a competitor. I mean, they are a competitor today. They'll be a competitor tomorrow. We do believe high level being a standalone LTL carrier only reinforces the great dynamics in our industry, because one of our most important scorecards as a carrier is margin improvement over time, which predominantly, as the LTL carrier knows this, is driven by yield performance. So, again, we don't expect things to change there drastically.

Now, when you look at the competitiveness for the local business, I mean, we compete today with all the carriers out there. Our goal is to provide the best service possible. I always tell the team, we're a customer-loving organization and every interaction we have with a customer, we want it to be an interaction of the light. And when you think of the local mom-and-pop shop, this is what they want. They want a great relationship with their local seller. They want to make sure that we're going to go through anything we can to make sure they are getting a great experience with us. And that pays dividends over time.

Similarly, we have added more salespeople to the team. It's a combination of, again, more boots on the ground and having this great service product is what is enabling us to grow in that channel.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Okay. And in terms of the – I guess, the incremental margins, you mentioned you'd expect stronger performance without the headwind of stronger – higher truckload rates when the cycle improves, right? So, maybe just refresh on what the right area is for incremental margins. And what can it be if you really see the cycle move, you see weight per shipment improve, and pricing accelerate, all that. So, thanks for your time.

Kyle Wismans

Chief Financial Officer, XPO, Inc.

A

Hey, Tom. It's Kyle. So, when you think about incremental margins, we would expect 2025 to be another strong year of incremental margins, comfortably above 40%. That's really where we've been tracking more recently. And if you think about why we can drive that, it's really – as we've talked about earlier on the call, it's a lot of the yield strength that can contribute to the top line growth. And obviously, if you're driving top line with higher yield, that'll have strong flow-through. And as Mario mentioned, you think about these yield initiatives being the early innings, whether it's growing local, driving more premium services, and strong renewals, that'll really help us drive strong incremental margins here in 2025.

And again, I think the other point, too, when you think about us is, as the demand network recovers right now, we're in a great position to really pull in more of that volume. Again, we're going to have up to 30% of additional capacity right now. That's really going to help us capture more of that volume, and that volume, coupled with a really strong pricing, will help drive strong incremental margins in 2025.

Operator: Thank you. Our next question comes from Jordan Alliger with Goldman Sachs. Please proceed.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Maybe just following a little bit. Can you give some thought – a lot of talk's been on yield and what have you. Can you give a little bit of thought on, as we roll into this year, perhaps some positive signals from ISM? Any

sense from customer sentiment perspective around demand and perhaps some optimism? And then, sort of secondly, the 150 basis points of OR improvement, any sense what sort of your base level volume expectation would be to sort of center in on that? Thanks.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Yeah, I'll first start with the customer demand outlook and then turn it over to Kyle to discuss some of the outlook through the course of the year. But on the customer side, we are hearing more positivity from customers than we have in the past. Obviously, for us, the 150 basis points does not imply a recovery through the course of 2025, but that could be a potential upside. Now, as you know, we typically survey customers on a quarterly basis, some of our top customers, to ask them what they are seeing in the overall macro. And the majority expect a gradual improvement in demand this year.

Just to give you an example, we saw a 10 point increase in the percentage of customers that expect an acceleration in demand in 2025 versus what – the survey we had done three months ago. And for the first half of the year, half the customers responded they expect an acceleration in demand, while only 15% expect a deceleration. And if you go back three months ago, it was – there was a bigger portion of flat customers, and then the acceleration versus deceleration were about even.

So we are seeing much more optimism. As you said, we are also seeing it in the ISM. Today, two-thirds of our customers are industrial companies, and we've seen the ISM here pop over 50 in the month of January. Importantly, we have seen the new orders part of that ISM index get to 55, and all of these are very good leading indicators for higher industrial demand over time. Again, obviously, we can't control the macro, and we see what the year has in store, but we are hearing more optimism from customers.

Kyle Wismans

Chief Financial Officer, XPO, Inc.

A

And Jordan, if you think about tonnage and how we think about that for 2025, our baseline expectation that we're contemplating in the OR improvement is really flattish tonnage in 2025. So, any improvement in underlying demand backdrop should be upside to that. Again, when you think about tonnage, our expectation is to outperform, thinking about our service improvements, getting the damage claims ratio 0.2% reflects that. And we're also continuing to make gains in local channels as we already talked about on the call.

When you think about that, coupled with, again, having upwards of 30% excess capacity, we're in a great position to capitalize on a demand recovery when that happens, but our baseline expectation for 2025 in the outlook is a flattish tonnage expectation.

Operator: Thank you. The next question comes from Brian Ossenbeck with JPMorgan. Please proceed.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Q

Hey. Good morning. Thanks for taking the question. So, maybe just a quick follow-up on the incremental margins. Can you talk a little bit about the ramp-up of the new facilities? It looks like you sold one in Brooklyn. But is that still above [ph] a percent (00:37:02) in how those are progressing?

And then just a separate comment, question. Obviously, the NMFTA is moving to change how some of the classes are organized and categorized. I'm assuming that you're dimensioning a lot of stuff already, but given

your high exposure to SMBs, I'm not quite sure if they're ready for such a change. So, maybe you can talk through a little bit about what that means for the shipper base and if there's going to be any sort of friction, disruption or confusion there. Thank you.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Thanks, Brian. I'll start with the latter half of the question, turn it over to Kyle to talk about the real estate side. But when you look at the changes that are coming here in the month of July, the NMFTA is implementing, effectively, changes how freight is getting classified, where it's based on subcategories of products where density could change the class by which freight is being rated. So, that's a change for customers, and a lot of customers are worried about that change.

But overall, if you look at – we analyze all of our shipment data, where some customers could have a slightly higher price, some customers could have a slightly lower price, but overall, we don't expect the change to be material in terms of how we do pricing. And our goal is to be there to support our customers through the change, and we're doing a lot of outreach, communication, training, all these kind of pieces where they will see impact.

On dimensioning, today we dimension the majority of our freight. We use a combination of overhead dimensioners. I think we have technology on the handheld devices that our drivers can dimension freight at the dock of customers, and we also obviously get dimensions from customers as well. So, we use that dimension data and work with our customers to make sure it's a smooth change for them and it doesn't impact that operation either.

Kyle Wismans

Chief Financial Officer, XPO, Inc.

A

Yeah, Brian, if you think about the real estate, in the quarter, we did have a gain. That gain was driven by the Brooklyn site. So we completed the sale of Brooklyn, and we opened a large and really better located facility in the same market. And if you think about what that means, this is part of the overall plan that we had when we acquired the sites at the end of 2023. So, a little less than half those sites we acquired are going to be net adds. So, there are going to be some service centers we're going to exit.

And from those, some are leased – leased properties, we're going to let those roll off or sublease if they have favorable terms. And then on the own property side, we're still working through a divestiture plan, starting there with Brooklyn, which was a good thing. But when you think about what that means for 2025, it's fair to assume we're going to get some level of proceeds in 2025 and gains. It's a bit early to quantify and provide a timing for those, but you'll see those as we progress through 2025.

And one point of context to give, too, when you think about what we've marketed so far, we are seeing interest from companies outside of LTL. Brooklyn is an example actually purchased by a non-LTL company. So, more to come here throughout 2025.

Operator: Next comes from Jason Seidl with TD Cowen. Please proceed.

Jason H. Seidl

Analyst, TD Cowen

Q

Thank you, operator. Mario and team, good morning. Appreciate the time. You guys have a big focus on local customers. Maybe you could help us out with some numbers. Where do they stand when you compare them to

sort of national customers in terms of profitability? And what percent of the business are they now and where do you think you can get them to?

Ali Faghri

Chief Strategy Officer, XPO, Inc.

Morning, Jason. This is Ali. So, we're looking to...

Jason H. Seidl

Analyst, TD Cowen

Hey, Ali.

Ali Faghri

Chief Strategy Officer, XPO, Inc.

...grow our local – we're looking to our channel mix from roughly about 20% of revenue to 30-plus percent over time. And this is both higher-yielding and higher-margin business for us. We're making a lot of good progress on this. You saw in the fourth quarter we grew our local shipments by high single-digits on a year-over-year basis. As Mario noted, we also onboarded over 10,000 new local customers in 2024.

If you look at our mix currently, we're somewhere in the low-20% range. So, we've closed a few points of that gap from going from 20% of revenue to 30%. And we would expect as we move out over the next few years, you'll see us claw a few hundred basis points of that revenue mix gap every single year as we move to growing our mix to that 30% target we have over the next few years and beyond.

Jason H. Seidl

Analyst, TD Cowen

No, that's good color. Quick follow-up. Mario, you said the network's at 30% excess capacity currently. Given the network that you have now versus where it was before, where do you think excess capacity sort of needs to be to be at an optimal level for your operations?

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

We are currently – so usually as an LTL carrier, Jason, you want to be at that 30% excess capacity at the trough of the cycle, because usually you need about, call it, mid teens in excess capacity for the fluctuation of volume between the beginning of the month and the end of the month or the beginning of the quarter and the end of the quarter. So, effectively, being at 30% in the trough is a very good place to be at.

Now, keep in mind, when we purchased the service centers at the end of 2023, we picked all the locations where we historically were capacity constrained. Think of markets like Nashville, Tennessee, Atlanta, Georgia, Columbus, Ohio, Indianapolis, Minneapolis, Houston, Texas, so all of these are sites that are – or areas where we needed that incremental capacity, and now we've got it. So when you think about the next upcycle, we've been positioning the business for the last few years to be able to capitalize on that very effectively.

And if you look at all the categories, in real estate, we're feeling fantastic where we are. On rolling stock, our fleet age is down to 4.1 years. We've added nearly 5,000 new trucks and more than 15,000 new trailers over that period of time. And we're feeling very good about being able to capitalize on that. You couple this with a lower reliance on purchased transportation, which usually goes up in the context of an upcycle, this gives us a ton of

confidence of getting high incremental margins, as Kyle just mentioned, in future upcycles, whenever the upcycles start, could be this year.

Operator: [indiscernible] (00:42:45) proceed. [ph] Scott (00:42:52), your line is live.

Q

Oh. Hi. Sorry, I couldn't hear that. Good morning, everyone. I guess, first question is, obviously, getting a lot of benefit in the OR from yield, but cost is contributing as well. Just, Mario, could you address some of your initiatives there? Where are you? What inning, essentially? Is there a lot more opportunity to go in areas such as dock operations, XPO Smart pickup/delivery optimization? Thanks.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

You got it, [ph] Scott (00:43:22). So, there are two primary levers for improvements in cost management that we have. One is around labor efficiency and density in our line-haul network. So it's tied to how many labor hours we're using versus the volume we have in the network. And the second area is around third-party line-haul insourcing. When it comes to labor efficiency, as you know, our technology is proprietary, and we have tools like Smart that use AI to predict what demand is going to look like, and then being able to help our operators in the field getting this real-time visibility in terms of when and where they need those labor hours to support the volume.

In our business in LTL, if you're overstaffed, it's not good, and if you're understaffed, it's not good because you won't be able to deliver the service for the customer. So being able to forecast how much people you need and how many hours you need on a dock or in the city is incredibly important, and our technology is helping us with that. Our – going back to your question on what inning we are in, we do expect on a consistent basis over the next few years as we execute on our plan to improve productivity in that low-single-digit territory on an annual basis as we keep on improving productivity as we go along.

The second area is around line-haul insourcing, and we've made tremendous progress on that. We are three years ahead of line here, exiting 2024 and going into 2025. For this year, we expect another strong year for insourcing. Our baseline expectation is that for the full year, we would be in the mid- to high-single-digit outsource, but exit the year in the mid-single-digit, call it, plus territory, and that's going to help us, again, insulate our P&L from truckload rates going up in the upcycle.

Q

Great. Thanks. Appreciate that. And just 10% of EBITDA, but still meaningful in the story. Just a little bit more elaboration on Europe. Sounds like the UK was great, but if you could just speak to what sounds like outperformance across the region with a little bit more level of detail. Thanks.

Kyle Wismans

Chief Financial Officer, XPO, Inc.

A

Yeah. So if you think about Europe, I mean, I think, as you said, Europe's outperforming the overall market, and if you think about it from a top-line perspective, we grew year-on-year revenue for the sixth consecutive quarter. That was really supported by stronger pricing. And if you think about which reasons are driving it for us, it's really the UK. I mean, the UK had organic growth of 14% year-on-year.

If you go across the market, France is a bit softer on a relative basis, and that's consistent with some of the macro indicators we've seen. You think about the PMI, that's been weaker in recent months, so there's probably slower overall manufacturing activity there. We think we're well positioned for an eventual improvement in the demand backdrop. And again, you think about our sales pipeline, right now it's at record levels at 1.2 billion. And we've also tried to focus on right-sizing the cost structure.

Now, if we kind of move forward, we do think 2025 can be a stronger year for them. We think EBITDA, if you think about it in a constant currency basis, it should be up somewhere in that low-single-digit range from 2024, and it's a good outcome given some of the pressure they're seeing right now in Europe.

Operator: Thank you. The next question comes from Daniel Imbro with Stephens. Please proceed.

Daniel Imbro

Analyst, Stephens Inc.

Q

Hey. Good morning, everybody. Thanks for taking our questions. Maybe on the LTL side, weight per shipment did decline a bit sequentially. Ali, some of your peers saw some strength there. So curious if you could talk about maybe what drove that sequential softness, what you're expecting this year from a weight per shipment standpoint, especially if we see industrial begin to recover? And then one just clarifier on the OR outlook, the 150 basis points of improvement. Is that including the gain on sale here in 4Q, or is it 150 basis points excluding that gain in 4Q 2024? Thanks.

Ali Faghri

Chief Strategy Officer, XPO, Inc.

A

So, Daniel, I'll take the second part first. So, our OR does not include real estate gains. So when you think about that 150 basis points that we're expecting for the full year, that does not assume any sort of benefit from real estate gains. Now, on the weight per shipment side, if you look at the fourth quarter, our weight per shipment was down about 1.3% on a year-over-year basis. That was a modest sequential decline, as you noted, versus the third quarter. However, that was largely in line with seasonality as well as in line with our expectations for the quarter.

Now, if you just roll forward seasonality into the first quarter, which is our baseline expectation for weight per shipment, it would imply weight per shipment being down on a year-over-year basis, a similar magnitude to what we saw in the fourth quarter. And for the full year, if you continue to assume seasonality through the balance of the year, it would imply on a full year basis that weight per shipment will be flattish for the year as a whole.

Daniel Imbro

Analyst, Stephens Inc.

Q

I understand the future OR doesn't include gains on sale, but does the base we're growing off of include the gain on sale from this past 4Q or not?

Ali Faghri

Chief Strategy Officer, XPO, Inc.

A

It does not, Daniel. When we report our OR, so you think about the 86.2% in the fourth quarter, that does not include real estate gains in it. So, it's coming off of a base that does not include real estate.

Daniel Imbro

Analyst, Stephens Inc.

Perfect. Thank you.

Q

Operator: The next question comes from Eric Morgan with Barclays. Please proceed.

Eric Morgan

Analyst, Barclays Capital, Inc.

Hey. Good morning. Thanks for taking my question. I guess, I wanted to follow up on the weight per shipment question there. Is there any way to quantify what the impact of that is on your yields that you're realizing in the business? And if we do get into an upcycle here, where do you think weight per shipment can go, and should we assume that that kind of has some moderating effect on the yields that you're able to generate here? Thanks.

Q

Ali Faghri

Chief Strategy Officer, XPO, Inc.

So, Eric, when you think about weight per shipment, we wouldn't expect it to be a swing factor as we think about our yield outlook. We do expect, as we noted, yield to accelerate here in the first quarter on a year-over-year basis, and that acceleration is being driven by an underlying improvement in core pricing that we're seeing. But we also expect contract renewals to accelerate here in the first quarter as well. So when you think about yields (sic) [we expect weight per shipment to be] largely flattish on a year-over-year basis for the full year. So as we think about our strong pricing growth that we expect this year, won't be impacted by weight per shipment, either positive or negative.

A

Operator: The next question comes from Ravi Shanker with Morgan Stanley. Please proceed.

Ravi Shanker

Analyst, Morgan Stanley & Co. LLC

Thanks. Morning, guys. Apologies if I missed this, but just on CapEx, given the run rate of CapEx in 2024 and 2025, what do we think of as a good, normalized, long-term run rate? And also for 2025, can you give us a split between real estate, rolling stock, and other, like tech?

Q

Kyle Wismans

Chief Financial Officer, XPO, Inc.

Hey, Ravi. It's Kyle. So when you think about CapEx just in general for 2025, when you think about the outlook, the LTL business for 2024, we spent 14.6% of revenue into CapEx. That's going to moderate by a few points here in 2025. There's a couple reasons for that. So, one, we brought 25 service centers online this year, and we said about a few million per to bring those online. That's not going to repeat in 2025. And then you think about our fleet additions, we're down to 4.1% – or 4.1 years on fleet age. And you think about all the work we've done in insourcing, that'll require less CapEx. So both of those will help us to contribute to drop that percent of revenue by a few points this year here in 2025.

A

And when you think about the breakdown specifically on that CapEx, for the spend, we're typically – about half of it goes to fleet. When you think about LTL specifically, half goes to fleet. About 40% is land and building, and the rest is a mix between different kinds of equipment and IT spend.

Ravi Shanker

Analyst, Morgan Stanley & Co. LLC

Very helpful. Thank you.

Q

Operator: The next question comes from Stephanie Moore with Jefferies. Please proceed.

Joseph Hafling

Analyst, Jefferies LLC

Hi. Good morning. This is Joe Hafling on for Stephanie Moore. Congrats on the good results. Maybe speaking about those 25 service centers, Mario, could you speak to maybe the ramp that you've seen or maybe the productivity improvements you've seen as you've brought those 25 service centers online and sort of what the expectations would be for what they can contribute moving into next year, I guess this year?

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

When you look overall at the ramp, so the biggest improvement for us in the near term has been around cost and cost efficiency. And it's fairly quick for us. I mean, we've added 25 service centers last year. And just to give you an idea, on the net head count, Joe, we only added 150 people to support this incremental capacity, because the lion's share of these service centers were in markets where we already had presence, and they were able to give us immediate efficiency. So starting with line-hall, where we opened up those locations, we saw an improvement in productivity, call it, in that low-single-digit territory for those sites.

A

And in the city operation, I always give the example of a place like Goodlettsville around Nashville, where we had a site southeast of Nashville, but we used to have up to 35 drivers every day drive up to an hour north and an hour south to service the customers. So by opening up a site in Goodlettsville, we were able to relocate 35 drivers and have much lower spend times on our P&D routes. And by doing it that way, we saw, in those locations, all the new locations, a mid-single-digit improvement in miles per stop, which is one of the KPIs we use for line-hall and improvement in efficiency.

So, high level, we saw a contribution in 2024, and we expect that contribution to continue in 2025 and beyond. And some of the larger locations, the biggest impact we also are seeing is in our service, because when you think about our business, whenever you have more dock space, you turn your doors less frequently, and you can build more pure trailers coming out of your location, and that reduces rehandling in your network, which improves service and reduces costs as well.

So, we've seen those – all the sites are at or above our expectations in terms of contribution at this point. In terms of volume, this has been a modest contribution in some of the markets where we were capacity-constrained in the past, but the bigger contribution is going to come in the future when you think of the upcycle, having the 30% excess capacity is going to be fantastic for us to be able to support our customers and service them in some of these markets.

Joseph Hafling

Analyst, Jefferies LLC

Thanks so much for the time and congrats again on the strong momentum.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Thank you.

A

Operator: The next question comes from Ariel Rosa with Citigroup. Please proceed.

Ariel Rosa

Analyst, Citigroup Global Markets, Inc.

Hi. Good morning. Congrats on a strong quarter here. So, I wanted to ask about the OR, and certainly some impressive OR improvement year-over-year. And I know you guys have noted that it obviously bucked the trend of the broader industry, and yet there were a couple of headwinds, and specifically I'm thinking of the macro, which has obviously been challenging, and also the costs associated with adding new service centers. I was hoping you could kind of discuss to what extent those factors have been a headwind and kind of where the OR would have been, do you think, for 2024 if you hadn't had those particular headwinds?

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Well, overall, Ari, every year is going to come with tailwinds and headwinds. But when you think for us, we obviously had both strong performance in the fourth quarter and on a full year basis as well. The headwinds – starting with the new service centers, they were actually OR – slightly OR-accretive in 2024, because despite us adding 25 service centers, the team has done an impeccable job on execution in terms of staffing those locations, moving people, and making sure we are delivering a high-quality service while improving efficiency. So, we actually have seen those being more of a tailwind through excellent operational execution across our network.

Now, in terms of the macro, if you recall, when we gave our initial outlook for 2024, we said 150 basis points to 250 basis points of OR improvement, but we were expecting higher volume contribution. Now, the full year actually came in, the first half was stronger last year, the back half was softer. And our goal is to always operate, no matter what the environment is, and execute and make sure we are managing our cost structure to match the volume environment.

Now, obviously, if it was a stronger environment, we would have seen a higher OR improvement. And our goal is, no matter what the macro throws our way, to execute and deliver great service for the customer and deliver great margin improvement and efficiency across our network.

A

Operator: Thank you. The next question comes from Bruce Chan with Stifel. Please proceed.

J. Bruce Chan

Analyst, Stifel, Nicolaus & Co., Inc.

Hey. Good morning, gents, and thanks for the question here. Wondering if you can help us to understand the local market opportunity a little bit better. Is this a customer that tends to grow in line with the broader market, or do they tend to grow faster in an upcycle? And when you think about the growth here, are these local accounts mostly new customers? Is it more freight and more shipments from existing customers, or maybe conversion from 3PL to a direct relationship? Thank you.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Yeah. So, when you think about, Bruce, about those local accounts, they typically are local, could be local manufacturers, could be local consumer packaged goods companies, but typically they're a customer that has one outbound location where they ship product out of, and it goes to multiple locations across the country, depending on where their customers are at. They are a customer that values relationships. They are a customer that values excellent service, because they don't have the volume of freight that you would see from your larger shippers. They could be doing a couple of shipments a week or a couple of shipments a day, but they are typically lower volume shippers than their larger counterparts.

Now, in an LTL network, these type of customers, they do have less density on your pickup points and your delivery points, so it's important to make sure as we onboard those customers they are in the right markets around our service centers. And again, we've grown their sales force, and the improvements in our service product are enabling us to earn more of that business with these customers. They are sticky relationships, and they stay with us for a long, long time, and it's a great source of growth and volume and improvement of overall financial performance for the company as well.

Operator: [indiscernible] (00:57:19) Kauffman with Vertical Research. Please proceed with your question.

Jeff Kauffman

Analyst, Vertical Research Partners LLC

Q

Thank you very much. And first of all, congratulations on terrific results in a difficult quarter. I want to ask about currency. This is something that's been flagged by a lot of other companies in the industry, and we do think of North American LTL as being kind of insulated, but can you talk about any currency impact that's affecting translation or results in the North American business as well as the European business? How should we think about this?

Ali Faghri

Chief Strategy Officer, XPO, Inc.

A

Sure, Jeff. This is Ali. So when we think about our European business, we did see an impact of the stronger dollar, that was a bit of a headwind for that business for the quarter as a whole. However, as Kyle noted earlier, we were still able to deliver growth in that business above the market. In the fourth quarter, we delivered the sixth consecutive quarter of year-over-year revenue growth, and that's despite an impact from a stronger dollar. So where you would see that FX impact us specifically would be primarily within our European business, and we did see a bit of that in the fourth quarter.

Jeff Kauffman

Analyst, Vertical Research Partners LLC

Q

And if I could just follow up on that, is that more of just a revenue impact, or does that affect the operating income line as well?

Ali Faghri

Chief Strategy Officer, XPO, Inc.

A

It's a little bit of both, Jeff.

Jeff Kauffman

Analyst, Vertical Research Partners LLC

Q

[indiscernible] (00:58:44) question, and thank you.

Operator: Thank you. At this time, I would like to turn the call back over to Mr. Mario Harik for closing comments.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Thank you, operator, and thank you, everyone, for joining us today. As you saw from our results, we delivered above-market results, and these are really direct result of our focus on execution as we continue to invest in customer service, network expansion, and cost efficiencies. We're confident in delivering another strong performance this year. And more importantly, we have a long runway to unlock many more years of margin expansion and earnings growth.

On that note, operator, you can end the call.

Operator: Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation. And have a great day.

***Editor's Note: Texts in brackets were added as a request by the Company to clarify the speakers' statements.

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