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XPO, Inc. (XPO)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the XPO Second Quarter 2024 Earnings Conference Call and Webcast. My name is Sachi, 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 be making certain forward-looking statements within the meaning of the 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 SEC filings as well as in its 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 may also 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 of 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 in Greenwich with Kyle Wismans, our Chief Financial Officer; and Ali Faghri, our Chief Strategy Officer. This morning, we reported a strong second quarter for both revenue and earnings in a soft market for freight transportation. Company-wide, we grew revenue year-over-year by 9% to \$2.1 billion, and we increased our adjusted EBITDA by 41% to \$343 million. Adjusted diluted EPS was 58% higher year-over-year at \$1.12.

I'll start with a strategy that's driving our above-market earnings growth and margin expansion. There are four pillars to LTL 2.0. First is to provide world-class service. This revolves around the service metrics that are most important to our customers. In the second quarter, we improved one of the most important metrics, damage claims ratio, to a company record of 0.2%. This compares with 0.3% in the first quarter and 0.7% last year. Since late 2021, when we started LTL 2.0, we've driven more than a 75% reduction in damage frequency.

We also improved our on-time performance on a year-over-year basis for the ninth consecutive quarter. We already have one of the industry's fastest networks of one- and two-day lanes. And when coupled with our strong on-time performance, this is a key differentiator for our customers. We achieved these improvements while handling higher volume across our network by prioritizing both operational excellence and network investment.

Specifically, we have two major levers with long runways to improve our service. One is the opening of 28 new service centers, and the other is our insourcing of purchased transportation. In addition, we're constantly implementing a number of shorter-term initiatives. For example, we now have a freight airbag system installed in over 95% of our service centers. We're seeing a strong return on this investment through a reduction in damage claims.

The second pillar is to invest in network capacity. Over the past three years, we've added nearly 14,000 trailers and more than 4,000 tractors to our fleet. This is a high return use of capital that allows us insource line-haul transportation, drive operational efficiencies, and improve customer service levels. So far this year, we've added over 1,900 new tractors, bringing down the average age to four years from five years at the end of 2023. These new tractors are more efficient to operate, resulting in a double-digit decline in our fleet maintenance costs in the second quarter.

We've also manufactured over 2,600 trailers year-to-date at our in-house production facility in Arkansas. As the only US freight transportation company to produce its own trailers, we can create capacity when our customers need it and at a lower cost.

In addition, we're continuing to roll out the 28 service centers we acquired in December. We've opened 14 so far and expect to open another 10 in the back half of the year. The last four will be operational by early 2025, on track with our plan. These sites are in fast-growing freight markets. Each new center will help us operate more efficiently in the near term, while giving us more capacity when the cycle recovers. Our larger footprint also reduces freight re-handling and brings us closer to our customers. And as our network continues to expand, the benefits to service will grow.

Our third area of focus is yield, which is our single biggest opportunity for margin improvement. We've been reporting strong yield growth and we're still in the early innings. In the second quarter, we grew yield excluding fuel by 9% year-over-year, which helped us deliver 440 basis points of adjusted operating ratio improvement. We have three distinct levers for yield improvement. We're aligning our price with the value we deliver, we're growing our accessorials business, and we're expanding our local customer base.

In the second quarter, our contract renewal pricing increased year-over-year by a high-single digit for the fourth consecutive quarter, driven by the service improvements we're making. And accessorials generated double-digit revenue growth in the quarter. We're rolling out premium services that our customers are asking for, like our expanded trade show service. We recently opened a new service center in Las Vegas and we're already seeing strong customer demand for this offering.

With our industrial base, we launched an expanded cross-border service called Mexico+ that adds more capacity and border crossing points that supports our customers who are shifting production to North America from overseas. We're also continuing to earn more market share from our local customer base, which is a higher margin business. In the second quarter, we increased shipments from local customers by over 9% compared to the year ago.

The final pillar of our strategy is cost efficiency. The opportunities here are in purchased transportation, variable costs, and overhead. In the second quarter, we reduced our purchased transportation costs by 22% year-over-year through a combination of insourcing line-hauls and paying lower contract rates to third-party carriers.

We ended the quarter with 15.9% of line-haul miles outsourced to third-parties, which was a reduction of 490 basis points year-over-year. This is the lowest level outsourced in our company's history and we expect to accelerate the pace as we move forward.

When we transport the freight ourselves, we have more quality control and more flexibility. Our drivers and service centers can move freight faster with less re-handling, which reduces damages. We also get better utilization of our trailers by redeploying them at their destination. We expect to have a few hundred driver teams and sleeper cab trucks on the road by year-end to support more insourcing.

Lastly, we're continuing to manage labor costs effectively in our operations. This is a direct result of the team's execution as well as our proprietary technology for labor planning. The second quarter was our sixth straight of quarterly improvement in labor productivity.

Turning to Europe, our business continued to outperform the industry in a soft macro. On a year-over-year basis, we increased segment revenue by 4%. We also delivered the highest quarterly EBITDA since 2019 with year-over-year growth of 7%, driven by a combination of top-line growth and disciplined cost control. Our strongest EBITDA growth was in the UK and France. In the UK, the increase was in the high teens and in France, it was in the high-single digits.

In summary, our strong results in the first half of the year demonstrate the disciplined progress we're making with the many initiatives we've put in place. Importantly, we're delivering record service levels with a direct connection between service and profitability. This dynamic is at the core of our strategy. It enables us to outpace the market with yield growth and profitable market share gains while operating more cost efficiently at scale.

We're also continuing to invest capital where it can sustain high returns over time. These are all inherent strengths of our company that we use to improve the business in any environment. Together, with our operating momentum, they create a powerful foundation for future growth.

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 key financial results, balance sheet, and liquidity. We reported a strong second quarter across the company, with revenue up 9% year-over-year to \$2.1 billion. This includes top-line growth of 12% in our LTL segment and 4% growth in Europe. Excluding fuel, our LTL revenue was up 13% year-over-year.

As we took on more business in LTL, we also improved our labor productivity. From the first to second quarter, we reduced our head count sequentially, while our shipments per day increased by 4%. This helped to mitigate the cost of salary, wages, and benefits, which, in total, were 11.5% higher in the quarter than a year ago. This primarily reflects wage and benefit inflation, as well as incentive compensation aligned with the segment's strong second quarter performance.

We were also more cost-efficient with purchased transportation, primarily due to our insourcing initiative. Our expense for third-party carriers was down year-over-year by 22%, which equates to a \$19 million savings in the quarter. Additionally, we continue to improve our maintenance costs, with our cost per mile down 12% year-over-year.

Depreciation expense increased by 24% year-over-year, or \$15 million, reflecting investments we're making in the business. This continues to be our top priority for capital allocation in LTL. Our second quarter CapEx is primarily allocated to purchase tractors from the OEMs and manufacture more trailers in-house.

Next, I'll add some detail to adjusted EBITDA, starting with the company as a whole. We generated adjusted EBITDA of \$343 million in the quarter, up 41% from a year ago. Our adjusted EBITDA margin was 16.5%, which was a year-over-year improvement of 380 basis points. This was supported by margin improvement in both segments and the continued rationalization of our corporate cost structure. In the second quarter, our corporate net expense was \$3 million, or a year-over-year savings of 70%.

Looking at just the LTL segment, we grew adjusted operating income by 51% year-over-year to \$214 million, and we grew adjusted EBITDA by 43% to \$297 million. This reflects the combined impacts of our pricing gains, cost efficiencies, and the increase in volume. In our European Transportation segment, adjusted operating income was \$19 million, which was a 6% increase from the prior year, and we grew adjusted EBITDA by 7% to \$49 million.

Returning to the company as a whole, we reported operating income of \$197 million for the quarter, up 84% year-over-year. And we grew net income from continuing operations by 384% to \$150 million, representing diluted earnings per share of \$1.25. The increase in net income from continuing operations includes a one-time tax benefit of \$41 million related to the reorganization of our legal entities in Europe.

We expect to receive a net cash refund of approximately \$45 million in 2025. Note that we excluded the tax benefit from adjusted net income in our second quarter reporting. On an adjusted basis, EPS increased by 58% year-over-year to \$1.12. Lastly, we generated \$210 million of cash flow from operating activities in the quarter and deployed \$184 million of net CapEx.

Moving to the balance sheet, we ended the quarter with \$250 million of cash on hand. Combined with available capacity under our committed borrowing facility, this gave us \$836 million of liquidity. We had no borrowings outstanding under our ABL facility at quarter-end.

Our net debt leverage ratio at the end of the quarter was 2.7 times trailing 12 months adjusted EBITDA. This was an improvement from 2.9 times at the end of the first quarter, and we expect to further reduce our leverage in the second half of the year. The ongoing investments we're making are enhancing our earnings growth trajectory and will support our long-term goal of achieving an investment-grade profile.

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 reported another quarter of profitable growth, reflecting strong execution by our operational teams. On a year-over-year basis, we increased our shipments per day by 4.5% in the quarter, led by more than 9% growth in our local sales channel. Notably, we grew tonnage per day by 3.4%, which is an acceleration from 2.6% in the first quarter.

Our weight per shipment was down 1.1%, with the year-over-year decline moderating from the prior quarter. This was our fourth consecutive quarter of year-over-year improvement in weight per shipment. On a monthly basis, year-over-year, our April tonnage per day was up 3.1%, May was up 2.4%, and June was up 4.6%. Looking just at shipments per day, April was up 4.7%, May was up 3.8%, and June was up 4.9%. For July, we estimated

tonnage and shipments per day to be about flat year-over-year, with both trends outperforming seasonality. On a two-year stack basis, July shipments per day and tonnage per day meaningfully accelerated versus June.

Our pricing trends remained strong, as we continue to align our pricing with our service quality and premium offerings. For the second quarter, our contract renewal pricing was up year-over-year by 8%. We also delivered another quarter of above-market yield growth. We grew yield, excluding fuel, by 9% compared with the prior year.

While our improving weight per shipment was a modest mix headwind to yield, our revenue per shipment ex-fuel increased sequentially for the sixth consecutive quarter and was up 7.4% year-over-year. We expect to continue increasing both yield and revenue per shipment quarter-over-quarter in the back half of this year, reflecting ongoing momentum with our pricing initiative.

Turning to margin, we improved our second quarter adjusted operating ratio by 440 basis points to 83.2%. We've now delivered year-over-year margin expansion of around 400 basis points for three consecutive quarters. Sequentially, our adjusted OR improved by 250 basis points, coming in at the high end of our guided range. Our robust margin performance was primarily driven by yield and volume growth, bolstered by our cost initiatives and productivity gains.

Moving to the European business, we improved volumes throughout the quarter with strong pricing that outpaced inflation. Our organic revenue growth in June was the highest year-to-date for the segment overall. And in the UK, an important market for us, organic revenue in June increased year-over-year by double digits. Our sales pipeline has grown to a record \$1.3 billion, and the team continues to earn new business from blue chip customers, strengthening our position in key European geographies.

Before we go to Q&A, I want to summarize the considerable progress we're making toward becoming the LTL service leader in North America. Our service metrics are at record levels, and there is ample runway for further improvement. This is earning us profitable market share and above-market yield growth.

We're also optimizing our network with meaningful cost efficiencies, primarily through line-haul insourcing and labor productivity. And we just reported another strong quarter of revenue and earnings growth in a soft macro. We're confident that our strategy will drive significant margin expansion over the years to come.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question is from Ken Hoexter from Bank of America. Please go ahead.

Ken Hoexter

Analyst, BofA Securities, Inc.

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Hey. Great. Good morning, and congrats on the strong results. Maybe, Ali, just to kind of wrap on that, your tonnage and shipments accelerated in June. Maybe your thoughts on the market here, is it share gains, benefits, and new facilities? And relaying that, you've always given some thoughts on the sequential move in the operating ratio, obviously, you've got a lot of seasonality that typically increases it. Maybe your thoughts as we go into the third and fourth quarter. Thanks.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

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Yeah. You got it, Ken. This is Mario. First, I'll start with the market. So, we're continuing to see a soft freight market, but it's stable. If you look at the month of June, the ISM was in the high 40s at 48, 49, and the industrial demand was relatively stable. It did pick up a bit from the month of May in the underlying demand on the industrial side, but again, not major growth there. On the retail side, retail sales came in better, and we did see the retail sector also hold up and increase a bit as well. But sequentially, we did see a pickup in the month of June compared to where we were in May.

Now, if you take a step back on the quarter, and July is starting there on tonnage, for us, July tonnage is, call it, about flattish, which outperforms seasonality by 1 to 2 points, and we expect a similar outperformance for the third quarter as a whole. Now, when we look at seasonality, we do exclude the impact of COVID, since, if you recall, Q2 to Q3 back then was a big upswing with the decline in Q2. And similarly, when you look at Yellow last year, it was outside of seasonal norms. So if you apply seasonality, it would imply tonnage in the third quarter to be down low-single digit. And we expect to do better than that, where we expect to be flattish on tonnage for the third quarter as a whole.

Now, the other moving part for OR, going to your question on margin, is on the yield front, and we expect a strong quarter for yield, ex-fuel, as our initiatives continue to gain traction. We expect to be in the mid- to high-single-digit range on year-to-year improvement for yield, even as we lap the tougher comps. Weight per shipment could be a swing factor. We've seen that improve here through the course of the year for us. And it does imply an acceleration on a two-year stack for yield, Q3 versus the first half, and it does imply a sequential increase on an absolute dollar basis from Q2 going into Q3 as well.

Ultimately, from an OR perspective, we also expect a strong quarter for margin improvement. We expect OR to increase sequentially by 100 to 150 basis points, which is in line with seasonality. But similar to my comments on volume, if you do exclude outlier quarters with COVID and the Yellow bankruptcy, typical seasonality is 200 to 250 basis point deterioration, and we expect to do much better than that, driven by volume, yield growth, and all the cost efficiencies we're implementing.

Ken Hoexter

Analyst, BofA Securities, Inc.

Q

Very helpful. Thank you, Mario.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

You got it.

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Operator: The next question is from Scott Group from Wolfe Research. Please go ahead.

Scott H. Group

Analyst, Wolfe Research LLC

Hey, thanks. Just want to follow up on operating ratio. So, thanks for the color on Q3. How are you now thinking about the full year guide in terms of full year OR? And then, I know it's early, but clearly, there's some continued good momentum on price and claims. How do you think this sets up from an OR perspective, heading into 2025?

Q

Kyle Wismans

Chief Financial Officer, XPO, Inc.

Hey, Scott. It's Kyle. So, when you think about 2024, we think it's going to be a strong year of margin improvement. Initially, we thought the year would be in the 150 to 250 basis point range for the year of improvement, and we expect to land towards the high end of that range, and that's given the momentum we've seen so far in the first half, and assuming a stable macro in the back half of the year.

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Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

And Scott, for 2025, we expect a strong year in 2025 for OR improvement and earnings growth as well. Now, obviously, we're not immune to the macro. Macro would be the biggest swing factor there, but we expect a very strong year. And if you take a step back, we are driving above-market yield growth, and that's driven by the continuous service improvements that we are doing across the network, and that's translating into us gaining profitable market share, and customers want to give us more business. And we're driving higher yields since they know that for us to provide this great service, we've got to invest in our business.

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We're also renting contributions from premium services and the growth of the local channel or the local accounts. When you look at premium services, we already launched a good number of them here through the course of the year between retail store rollouts or retail solutions to trade shows, to cross-border Mexico, expanding the service, and we're continuing to make great progress on insourcing. You saw here our results in the quarter. We got to a record level of insourcing of 15.9%, and we're ahead of our plan to get to the low-double-digit, low-teens, and we expect to continue to accelerate that.

And ultimately, we're opening up the new service centers, and these are contributing to cost efficiencies in the near term. But as the cycle starts inflecting at some point, they're going to give us more capacity as well and they will be both OR-accretive and EPS-accretive in 2025. So, overall, we expect a strong year, and we'll talk more about 2025 expectations as we report the fourth quarter results this year.

Scott H. Group

Analyst, Wolfe Research LLC

And I – did you give the pricing renewals number in the quarter?

Q

Kyle Wismans

Chief Financial Officer, XPO, Inc.

Hey, Scott. It's Kyle. So, the renewals in the quarter were up 8%.

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Scott H. Group

Analyst, Wolfe Research LLC

Helpful. Thank you, guys. Appreciate it.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

You got it. Thank you.

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Operator: The next question is from Daniel Imbro from Stephens, Inc. Please go ahead.

Daniel Imbro

Analyst, Stephens, Inc.

Yeah. Good morning, guys. Thanks for taking our questions. Maybe if we could follow up, Mario, on the pricing on the – on the accessorial side. I think there was a 5% gap when we came into this year between you and your best-in-class peer. I'm curious how much of that you think you've captured so far. And you mentioned a few of the services you've rolled out. I'm curious, have you introduced enough to close that gap fully? I guess, how long do you think it would take to maybe close that accessorial pricing gap as well? Thanks.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Yeah. You got it. So when you look at it, the difference on accessorial revenue as a percent of total from where we are today and where we want to be, where best-in-class is, there's roughly a 5 points difference. So, we have grown this last quarter accessorial revenue double-digit on a year-on-year basis, and we are making inroads towards getting to that 15%. Currently, we're still in the, call it, low-double-digit, low-teens territory. And we believe that overall, over the years to come, if we gain an incremental point of yield from accessories over the next, call it, three, four, five years, that would be a good cadence for us in terms of how we realize that.

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In terms of the services themselves, as you know, then whenever you launch a new service, a new product, you build the pipeline, you have all the – you train your sellers, and you start building that pipeline over time, and we're seeing a lot of great traction. There's still roughly, call it, about three or four services we want to be launching over the course of the next year that we're currently working on, but we already have made really great progress on launching some of these services, like I mentioned, trade shows, or retail store rollouts, or retail solutions and many of these other services.

Daniel Imbro

Analyst, Stephens, Inc.

Got it. And just to clarify, that was 1 point per year for the next few years, Mario, was your expectation?

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Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

This is how we think about it.

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Daniel Imbro

Analyst, Stephens, Inc.

Great. Thanks so much. Best of luck.

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Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

You got it.

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Operator: The next question is from Fadi Chamoun from BMO Capital Markets. Please go ahead.

Fadi Chamoun

Analyst, BMO Capital Markets Corp. (Canada)

Yes. Good morning. Thank you. Mario, so a big kind of piece of the OR improvement strategy over the medium term is kind of that revenue per shipment to outgrow the market consistently and accessorial is part of that and all of these things. I'm wondering if you can give us kind of behind-the-scene description, maybe example, of how the service improvement in the last maybe six, eight quarters that you've been going at it have changed the revenue makes, have changed how your shipment profile with your customer is changing, or your customer profile is changing.

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Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Thanks, Fadi. So if you take a step back, in our industry, customers want great service. And the reason why they want that, because that avoids disruptions in their supply chain and how they move a product from their locations to their customers' locations. And as you said, Fadi, we've made tremendous progress on that. Over the last two years, we've reduced our damage claims ratio from 1.2% to a new company record here of 0.2%. Our customers see that, even in our new service centers, we put a slogan that says, we love our customers, with three hearts next to it. And when this is the relationship we're building with the customers, they want to give you more freight. They want to give you more profitable freight.

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So in terms of the impact on the mix, we are being disciplined in terms of what we're taking on. So if we see a skid or a pallet that is non-conforming in size, doesn't fit well in an LTL network, if we see freight that is not operating at a desirable margin for whatever reason, whether it's a customer who is not willing to pay a premium price, then we are turning away that freight, or we are pricing it accordingly. And if we see a customer who wants to grow with us, whose freight fits our network, it operates at a good margin, we're onboarding that freight. So we are being selective in terms of the freight we are taking on while supporting our customers, and we're also growing.

Now, in terms of mix, it's largely unchanged between the industrial side and the retail side. We're still the same proportions. But where we are seeing faster growth is in the local channel. These are mom-and-pop shops. We have now 25% more sellers in our ranks, and we're being able to gain more profitable market share in that channel. So far, year-to-date, we've added more than 5,000 new customers in that channel, and we believe that that's going to grow with us here over the years to come.

Fadi Chamoun

Analyst, BMO Capital Markets Corp. (Canada)

Okay. Appreciate it. Thank you.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Thank you.

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Operator: The next question is from Chris Wetherbee from Wells Fargo. Please go ahead.

Chris Wetherbee

Analyst, Wells Fargo

Yeah. Hey, thanks. Good morning, guys. You guys have been opening new facilities, not all of them are net new facilities, and I think you have still some in the back half of the year. But I guess, is there a way to think about sort of the relative profitability of the new facilities this year relative to maybe what the facilities that have been open for a longer period of time are operating at? I guess, we're just trying to get a sense of maybe how things could look as we get into potentially a better tonnage environment in 2025 as those facilities ramp up.

Q

Ali Faghri

Chief Strategy Officer, XPO, Inc.

Good morning, Chris. This is Ali. So, when you think about the sites we're launching here, as we noted before, we would expect these service centers to be OR-neutral this year. As you move through the year, we're going to continue to ramp sites. We're going to have another 10 online by the end of the year. And then we'll open the remaining handful in early 2025. As these sites continue to mature, we would expect them to turn OR-accretive into 2025 and also EPS-accretive as well. And everything we've seen so far from the 14 sites we've opened already confirm our view that as we get into 2025, these service centers are going to be contributing meaningfully from a bottom line perspective.

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Chris Wetherbee

Analyst, Wells Fargo

Got it. Thank you. Appreciate it.

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Operator: The next question is from Jonathan Chappell from Evercore ISI. Please go ahead.

Jonathan Chappell

Analyst, Evercore ISI

Thank you. Good morning. Ali, you mentioned revenue per hundredweight ex-fuel continued to increase sequentially throughout the rest of the year. Is mix starting to stabilize a little bit, and is this just pure core pricing and accessorials? Because you're coming up against some very difficult year-over-year comps, and sequential increases would insinuate kind of low- to mid-single-digit year-over-year increases as well. So, can you help us think about maybe the continued headwinds of mix versus the core pricing momentum?

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Ali Faghri

Chief Strategy Officer, XPO, Inc.

Sure, Jon. So, when you think about mix, the biggest factor for us has been weight per shipment. Now, weight per shipment was down about 1% on a year-over-year basis in the second quarter. If you just roll forward seasonality from what we saw in July from a weight per shipment standpoint through the rest of the quarter, we would expect weight per shipment in Q3 to be down in that 1% range year-over-year, similar to what we saw in the second quarter, and in a similar decline also in Q4 as well as our baseline forecast. So, overall, we would expect mix from

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a weight per shipment standpoint to be relatively stable in the second half of the year relative to what we saw in the second quarter.

When you think about our revenue per shipment outlook, we do expect a strong year from a revenue per shipment standpoint. As I noted earlier, we would expect revenue per shipment to increase sequentially both in Q3 and in Q4, and also accelerate on a two-year stack basis as well in the second half of the year versus the first half of the year. And our ability to drive that sequential improvement and two-year stack acceleration really goes back to all of the company-specific pricing initiatives that we're executing on that are allowing us to drive that above-market growth.

Jonathan Chappell

Analyst, Evercore ISI

Got it. Thanks, Ali.

Q

Operator: The next question is from Stephanie Moore from Jefferies. Please go ahead.

Joseph Hafling

Analyst, Jefferies LLC

Hey. Good morning, everyone. This is Joe Hafling on for Stephanie. Congrats on the good results. I guess I wanted to ask on the terminal openings. And you mentioned the OR-neutral impact. So, I kind of wanted to ask on how are you able to mitigate these cost headwinds from new terminal openings? Is it just better revenue quality flowing through the new terminals? You mentioned from a near-term perspective, it almost sounded like it was a cost of productivity advantage, compared to some of your peers seeing some growing pains on the new terminal headwinds. I wanted to know how you're able to kind of keep that OR-neutral outlook on the new terminal openings. Thanks.

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Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Joe, this is Mario. So, when you think of the openings that we are doing, so far, we opened up 14 service centers out of the 28 that we acquired. And out of the mix of these service centers, six of them are net adds. So these are markets where we are adding an incremental terminal. And eight are relocations, where we went from a smaller service center to a larger service center. Now, keep in mind that we already have a network that covers all zip codes in North America. So for us, the openings are about adding capacity. But in the near term, it's about gaining efficiency and improving service as well.

A

So when you think of the first tier of service centers that we've opened up, we've only added 50 net head count to support these openings. And compare that to we have 23,000 people, so it has almost no impact on cost. And the team has been executing very well on these openings. To give you an example, you look at a market like Brooklyn, New York, we used to have 30, 40 doors in that market, small yards. We were tapped out on capacity. Now, we've moved into one of the larger service centers in Brooklyn, north of 80 doors, beautiful yards, gives us much more capacity.

You look at a market like Nashville, for example. We used to have a site in southeast of Nashville. And every day, we used to dispatch 30, 35 drivers north of Nashville for an hour each way to get to the customer pickup and delivery locations. Well, as soon as we opened up our Goodlettsville location north of Nashville, we relocated 35 of our drivers to that new location. And now, we can cover that market with 10 to 15 minutes drive time to get to the customer locations.

So, all of these service centers we opened up so far have been on track, on time, either meeting or exceeding our expectation on cost efficiencies. And where we've opened them up, we've seen just one line-haul alone 2 to 3 points of productivity pickup associated with the more space that we have with these service centers. So, the execution has been very well – going very well, and then we expect that to continue here through the course of the year going into early next year.

Joseph Hafling

Analyst, Jefferies LLC

Q

Great. Really impressive stuff. Thanks for the time, and congrats on the quarter.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Thank you.

Operator: The next question is from Tom Wadewitz from UBS. Please go ahead.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Yeah. Good morning. And yeah, really strong results. Wanted to see, Mario, if you could give us any thoughts on what might cause deviation versus normal seasonality in 3Q. I think you tend to give us a somewhat conservative framework and consistently give good results. What do you think might help you to do better than that 100 to 150 basis points in deterioration sequentially in OR?

And then, just a broader question as well, I think there have been concerns about pricing environment given the soft backdrop and that there might be some kind of wrinkles and a little bit of increase in competition. And just wanted to get your thoughts on whether you're seeing that at all or whether you're just kind of seeing continued, very stable, very favorable pricing backdrop. Thank you.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Yeah. Thanks, Tom. First off, to clarify, in the third quarter, we would be in line with seasonality. But when you exclude the outlier quarters of COVID or the Yellow bankruptcy, we are meaningfully doing better than seasonality on OR sequential changes from Q2 into Q3. But this said, when you look at what could allow us to outperform the high end of the range of the 150 to 250 basis point full year guide, a lot of it would be based on, one, what happens from a macro perspective, we're not assuming any improvement. We're assuming a stable macro, but no pickup in demand in the back half of the year. So, obviously, if we see stronger demand, that could lead to better results.

There are also a lot of idiosyncratic things that we are executing on when it comes to, for example, insourcing third-party line-haul. If we execute faster than we expect, the cost flow-through there would be beneficial. Similarly, when it comes to some of the new services we're launching, the premium services we're launching, we currently have a great pipeline, we're converting that pipeline, if that goes ahead of plan, we can see upside as well. So, there are many of these initiatives that we're doing. If we see upside in them, we expect to do better than where we are currently landing for the full year.

Now, when you take a step back and you think about the pricing environment, we're still seeing a very favorable pricing environment in our industry. You look at our yield numbers. As Ali mentioned earlier, we expect acceleration on a two-year stack, sequential acceleration as well on yield. Our contract renewals were, call it, 8% in the second quarter. We expect to be in the same ballpark in the third quarter as well. We continue to see a good environment out there, especially if you're providing the great service product, that we are, that is the biggest driver for being able to drive those meaningful yield improvements, and we're seeing that materialize in our business.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Okay. So, you're really not seeing a change in the competitive dynamic.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

No, we're not seeing it in terms of overall industry.

Thomas Wadewitz

Analyst, UBS Securities LLC

Q

Okay. Great. Thanks for the time.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Thank you.

Operator: The next question is from Brian Ossenbeck from JPMorgan. Please go ahead.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Q

All right. Thanks. Good morning. So, Mario, you said you're still in the early innings of the yield story at XPO, renewing at high-single digits now, I wanted to see what your confidence, what you think is driving that in the future as you look into next year. And then maybe, Kyle or Ali, you can give us a little bit more clarity details behind the different cost buckets that are getting you to that OR progression, whether it's labor productivity, additional line-haul, insurance was a decent improvement here in the quarter. So, anything more specific on those separate buckets behind the OR would be helpful.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Yeah, I'll start first with the [ph] context on (00:40:59) yield and what gives us confidence in pricing. So, we expect to outperform the market from a yield growth perspective. But we're obviously not immune to the macro. If things change from an underlying demand perspective, that could change the environment. And if things pick up, you would see massive yields improvement in our business. But there are three reasons for that.

Number one starts with service. The service improvements we're making for our customers are drastic. I mean, if you think about where we were two years ago to where we are now, and we hear it from our customers all the time when they see the level of support we're giving them, the focus on picking up on time, delivering on time,

delivering damage-free every single time, that leads to customer, again, want to give you profitable market share. And they understand that we've got to charge a price for that.

The second area is around the premium services. That's a big opportunity for us. As I mentioned earlier on, we want to go, call it, from the low-double-digit, low-teen, accessorial as a percent of revenue to the mid-teens. And that's another opportunity as we continue to roll out these premium services and build the pipeline. And that pipeline converts, we're going to see more profitable freight in that segment.

And then finally, on the local channel, we've onboarded all the local – the incremental local sellers we've wanted to add since last year. And now, as these local sellers ramp and that contribution continues to build, we're going to see higher growth in that channel, which comes at a higher yield and a higher margin as well. So, these are the three levers that we look at in terms of that yield improvement.

Kyle Wismans

Chief Financial Officer, XPO, Inc.

A

And then from a cost standpoint, Brian, if you think about salary, wage, and benefits, just labor being our largest cost element, in terms of head count for Q3, we think we're going to be up less than our shipment growth sequentially. We would expect shipments per day in the third quarter to be up modestly. But we're going to do what we did in Q2 when we were up sequentially 4% on shipments and head count was actually down. So, I think when you think about that cost area, which is our largest, you think you're probably up mid-single-digit quarter-on-quarter.

And then probably the second area I'd point to is line-haul insourcing. We're going to continue to insource more line-haul. You saw purchased transportation down 22% in the second quarter. I'd expect that improvement to continue and accelerate in the third quarter.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Q

And anything in particular on insurance? Is that just lumpy from quarter-to-quarter?

Kyle Wismans

Chief Financial Officer, XPO, Inc.

A

From a Q2 perspective, we think insurance is going to be fairly consistent when you think sequentially.

Operator: The next question is from Bruce Chan from Stifel. Please go ahead.

Jizong Bruce Chan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. Thanks, and good morning, everyone. Maybe just to follow up, Ali, on those comments around the PT reduction accelerating in the back half. Really nice to see that, I think, especially in a world with cheap spot and soft demand here. Can you maybe just remind us of what your target is for that outsourced line-haul percentage this year and long term, and then maybe help us think through any market factors that would influence the pace of reductions, whether up or down?

Ali Faghri

Chief Strategy Officer, XPO, Inc.

A

Sure, Bruce. So when you think about our progress that we made in the second quarter, we were able to bring our third-party line-haul miles as a percentage of total down to sub-16%. It came in at 15.9%, which was a company record for us and improved by nearly 500 basis points on a year-over-year basis. Now, our goal is to get that number down to the low-teens by 2027. However, given the progress that we've made so far over the last several quarters, we would expect it to get there much quicker, and our goal would be to continue insourcing even beyond that into the single digits.

More recently, we have been rolling out initiatives to accelerate that pace of insourcing, specifically team drivers and sleeper cab trucks. We'd expect to have a few hundred of these teams in our fleet by the end of the year, and that's going to allow us to accelerate that pace of insourcing even beyond what you've seen us deliver over the last several quarters.

In terms of the market factors influencing the pace of insourcing, we have a lot of confidence that we can deliver the continued insourcing in any macro environment. So our expectation is, is that as we move into the second half of the year and into 2025, you're going to continue to see both line-haul miles as a percentage of total as well as our purchased transportation expense on the P&L continue to move lower.

Jizong Bruce Chan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. That's very helpful. Thank you.

Operator: The next question is from Ravi Shanker from Morgan Stanley. Please go ahead.

Ravi Shanker

Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Morning, everyone. Mario, you said earlier that you're seeing outsized growth in small local channel mom-and-pop business versus national accounts. Can you unpack that a little bit more? Because I thought that maybe 12, 15 months ago, you had onboarded a couple of large national accounts as well. How is that mix shifting? What is the actual kind of mix difference between the local channel and the enterprise channel? And also, usually in upcycles, which part of the business accelerates faster, the national networks or the local networks?

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

A

Thanks, Ravi. When you look at our local channel, so the shipment growth in that channel here over the last quarter was above 9%. Compare that to the overall network has grown, it's almost double the rate of growth for the rest of the network. So, we're seeing meaningful progress in terms of getting more of those stickier relationships with local accounts. And the reason why that's really good business, again, it's a higher yielding business, but you also have a great local relationship with that customer that can grow with you over time as they grow their business.

Now, in terms of how they react to a macro environment, they are about the same. I mean, what you typically see with the local accounts is that in a softer macro, the weight per shipment in that channel goes down higher than in a strong macro compared to the national or the larger accounts, because usually larger accounts, they use CMS systems to optimize how they're moving the freight.

From a local perspective, you can imagine if you had a local manufacturer as an example, they might be shipping typically 2,000 pounds in a pallet in a strong economy, and in a soft economy, that might be shipping less product, it could be 1,000 pounds a pallet. So, it depends on the economy impacts weight per shipment more on the local channel. But we do expect in a cycle recovery both to grow meaningfully and be tailwinds, especially on the local side for tonnage and ultimately margins as well.

Ravi Shanker

Analyst, Morgan Stanley & Co. LLC

Understood. Thank you.

Q

Operator: The next question is from Jason Seidl from TD Cowen & Company. Please go ahead.

Jason H. Seidl

Analyst, TD Cowen

Thank you, operator. Mario, you still talked a little bit about a sluggish backdrop, but some others have noted some green shoots along the way. I was wondering if you can give us a little bit more color about the demand function and what your customers are telling you what to expect in the back half of the year. And then, just looking also for a clarification, the 8% renewal rate, what percent of the overall business did that cover?

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Yeah, I'll start first and I'll turn it over to Kyle for the renewal side. But in terms of the backdrop, Jason, we're seeing, again, stable macro, but soft demand, a continuous soft demand. So, what we're getting from customers, we usually survey our large customers every quarter. And this time for the back half of the year, about half of them said they expect things to be flattish in the back half, and the other half was split equally between folks who expected some pickup versus folks who were expecting a bit of decline as well. So on a net-net basis, we are expecting a flattish type demand environment in the back half of the year.

A

Now, in terms of green shoots, there are certain scenarios. But if you look at the retail side, the fact that retailers are largely done with destocking and their inventories are in a good place, you could see with easier comps compared to last year, peak season be slightly stronger on the retail side. And same thing on the industrial side, we are seeing some subsectors where we potentially could see strength heading into the back half of the year as well.

But I think, currently, we're not seeing a lot of green shoots that are showing a meaningful inflection point of demand. But we'll see where things go from here. I do think that the Fed lowering grades could [ph] be stimulated for (00:49:14) consumer confidence, increasing retail and stimulate spending on the industrial side as well, but we'll see what that materializes like in the fourth quarter.

Kyle Wismans

Chief Financial Officer, XPO, Inc.

And then, Jason, from the renewal [ph] standpoint (00:49:23) – sorry, and Jason, from the 8%, that covers about a quarter of our contractual book. And just a little more color on renewals, renewals have been strong now for four consecutive quarters in that high-single-digit range. Our expectation for Q3 is we should come in at a similar range we've seen so far in the first half.

A

Jason H. Seidl

Analyst, TD Cowen

Perfect. Appreciate the time, guys.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Thank you.

A

Operator: The next question is from Jordan Alliger from Goldman Sachs. Please go ahead.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Yeah. Hi. Morning. Just obviously done a real good job with LTL 2.0. I'm just curious, longer term, over the next several years, you're several quarters into this, if not more, at this point, new terminal openings. How do you think about the benefits you've derived? And when we get back to better demand footing, manufacturing and otherwise, can you maybe talk to what you're thinking in terms of incremental margin potential over the next several years? Thanks.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

If you take a step back in terms of where we are now first in the overall demand environment, if you look in our industry at all the publicly traded LTL carriers, shipment count is down from 2021 to 2023 by roughly about 12%. Now, a lot of times I hear the feedback that this was the post-COVID run-up in 2021. But in LTL specifically, 2021 was softer than pre-COVID. So when you compare 2018, 2019 to 2023 as a full year, shipment count in our industry was down in the mid-teens. And this is an industry that has historically grown in the low- to mid-single-digit range, commensurate with the [ph] IP, a bit higher than the IP (00:51:07).

A

So when you think of a cycle inflection, that's going to be a massive tailwind, both in terms of tonnage and volumes and in terms of pricing as well, because you won't have enough capacity in our industry. Now, you see a lot of those capacity additions, but here it was about 10% of the industry capacity and only half of that capacity is coming back into the market by next year. So, the next cycle is shaping up to be a very strong cycle for LTLs across the board.

Now, when you think about our execution, we've been able to execute very well on the plan, and we're going to continue to execute very well on the plan. And you look over the last three quarters, we've delivered nearly 400 basis points of OR improvement quarter-after-quarter. And you look at the next cycle, we expect also very strong performance over the years to come.

Now, in terms of incremental margins, we do expect them to change depending on what quarter it is and how much of the revenue growth is coming from yield versus volume, and how well we do on the cost side. But just to give you an example, here in the third quarter, we are expecting incremental margin, more than 60% in what is a very soft freight environment. So, again, we see massive upside here. And we're going to get to the low 80s from an OR perspective, and we're going to get to the 70s and go from there. So, that's how we think about the trajectory we're going to be on over the years to come.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Thanks.



Operator: The next question is from Eric Morgan from Barclays. Please go ahead.

Eric Morgan

Analyst, Barclays Capital, Inc.

Hey, good morning. Thanks for taking my question. I wanted to ask about CapEx. Your average fleet age is down to four years. I think in the past, you mentioned a target of four to five years. Maybe you could just clarify that. And then, just given the fleet age, I was wondering, next year, you would expect to come back into that 8% to 12% range and maybe what some of the priorities might be. I know it's kind of early, but just given that the fleet's in better shape at this point.



Kyle Wismans

Chief Financial Officer, XPO, Inc.

Yeah, Eric. So, the long-term target on fleet age is still 4.5 years. And when you think about CapEx this year as a percent of revenue, from an LTL standpoint, we're looking around 13%. I think next year, you're going to normalize and come down. So, certainly, as we bring the Yellow service centers online, that will help us reduce that number a bit. And then when you think about some of the insourcing efforts as those slow a bit, as we get through our goals there, that will help reduce the number as well. So, I think you're probably down a point or two when you think on a percent of revenue basis.



From a prioritization standpoint, when you think about our CapEx, obviously, the majority across the company goes to LTL. And then within LTL, we'll prioritize continued fleet investments and then continued investments in real estate.

Eric Morgan

Analyst, Barclays Capital, Inc.

All right. Thank you.



Operator: The next question is from Kevin Gainey from Thompson Davis & Company. Please go ahead.

Kevin Wade Gainey

Analyst, Thompson Davis & Co., Inc.

Hey, gentlemen. Good morning. Congrats on the great quarter. Maybe to take a different approach here, I was wondering if we could maybe talk through some of the internal initiatives that you guys have done from a wage perspective in employee management. And I know, Mario, previously you've talked about like employee satisfaction and stuff like that. How is that affecting like retention, labor, outlook? And as the other point, maybe if you could break out the bonus compensation, or at least percentage-wise, maybe what salaries and wages was for the quarter.



Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.



Sure. So, starting with wages, our goal is to always make sure that our employees are very well compensated. And we have given above-market wage increases here this year that were effective at the beginning of the second quarter, which were in the mid-single-digit territory for our employees, for dock workers, drivers, et cetera. And in terms of employee satisfaction, if I think about the foundation of our plan, of our strategy, a lot of it goes back to two foundational elements.

One is around customers and making sure we are providing the best customer satisfaction possible. And the second one is around making sure that we have the most satisfied employees in the industry, that they know we support them, we listen to them, whether it's myself, or Dave, or our operators in the field, or Tim and Tony, or Kyle, the whole company, we spend a lot of time in the field where we are in service centers, sitting in break rooms, talking to drivers, talking to dock workers, because they are the folks who keep the freight moving for our customers. And we take that very seriously.

Now, over the last two years, our employee satisfaction has gone up in a similar trajectory as we've seen our customer satisfaction and our service improvements, and it's been hitting company records quarter after quarter. And we're very proud of the progress we're making in overall employee engagement across the board.

In terms of incentive compensation, the way we look at it, it's based on a combination of things depending on where you are in the business. But it's a combination of OR improvement, a combination of revenue growth, and a combination of service improvements and hitting stretch goals. And we also have localized incentive plans, we call it the Gladiator program, that whenever a service center hits a stretch goal of improving quality, of reducing damages, also we give monthly incentive and we do a whole cookout for all the employees at the location to celebrate the fact that we're taking care very well of customer's freight. So, that's another foundational element of our strategy that we usually don't talk about, that we're very proud of the progress we're making there as well.

Kevin Wade Gainey

Analyst, Thompson Davis & Co., Inc.

Appreciate the color.

Q

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Thank you.

A

Operator: This concludes the question-and-answer session. I'd like to turn the floor back over to Mario Harik for closing comments.

Mario A. Harik

Chief Executive Officer & Director, XPO, Inc.

Thank you, operator, and thanks all for joining us today. We're continuing to move forward from a position of strength, following a strong first half of the year, and we'll be sharing more progress with you each quarter. Operator, you can now end the call. Thank you.

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

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