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**XPO, Inc.** (XPO)

Q1 2024 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Welcome to the XPO First Quarter 2024 Earnings Conference Call and Webcast. My name is Jessie, 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 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 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 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 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.

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### 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 financial results that were well above expectations for revenue and earnings in a soft market for freight transportation. It was a strong first quarter for us, company-wide, reflecting the momentum we carried into 2024. We grew revenue year-over-year by 6% to \$2 billion, and we improved our adjusted EBITDA by 37% to \$288 million. Adjusted diluted EPS was 45% higher year-over-year at \$0.81.

As you saw in our results, our LTL 2.0 plan is firing on all cylinders. I want to frame my comments this morning around the four pillars of our plan and the tremendous progress we're making. I'll start with the pillar that is most important to our growth and profitability, which is to provide world-class service to our customers.

Our first quarter damage claims ratio continued to be among the best in the industry at a company record of 0.3%. This was an improvement from 0.7% last year and from 1.2% when we launched LTL 2.0 just over two years ago. The underlying driver of this improvement has been a reduction of more than 70% in damage frequency.

Another key service metric is on-time performance, which has now improved on a year-over-year basis for eight consecutive quarters. In short, we're delivering meaningful service improvements while moving more volume through our network with a multiyear plan that balances operational excellence and investments in the network. This includes the freight airbag systems we introduced in the second half of last year. That equipment is now

installed in 75% of our service centers, and we expect to complete the rollout by midyear. The sites that have the airbags are seeing an improvement in damage frequency of greater than 20%.

We've also recently updated our trailer loading procedures, which will continue to enhance our service quality over time. And as we insource more miles from third-party carriers, we expect this to further reduce damages and improve on-time performance. We've made it clear to our customers and employees that service quality is our North Star, and we're well on our way to becoming the best-in-class LTL service provider.

The second pillar of LTL 2.0 is to invest in our network. Our business has historically generated a high return on invested capital. Since the launch of LTL 2.0, we've added over 12,000 trailers and 4,000 tractors to our fleet. This has allowed us to operate more efficiently and maintain strong network fluidity, while insourcing more line-haul transportation. Over two-thirds of our 2024 CapEx is allocated for fleet.

We added nearly 1,600 tractors in the first quarter, which brought down our average tractor age to 4.2 years from 5 years at the end of 2023. The new tractors are more efficient to operate, resulting in an improvement in our fleet maintenance costs.

We also manufactured nearly 1,300 trailers in the quarter, and we recently celebrated the 30th anniversary of our production facility in Arkansas. We are the only US freight transportation company to manufacture its own trailers, which puts us in a unique position to create capacity when our customers need it, and we can do it with less capital.

In terms of the 28 new service centers we acquired in December, we've now opened the first 6 on schedule in April, with another 6 planned for the second quarter. This is expanding our presence in growing freight markets like Nashville, Las Vegas, and Houston. We plan to bring another dozen sites online by the end of this year, and expect all 28 to be operational by early 2025.

The third pillar of our plan is to drive above-market yield growth. Yield is our single biggest opportunity for margin improvement, and it's the highlight of our results this morning. We grew yield, excluding fuel, by 9.8% year-over-year, which helped us deliver nearly 400 basis points of adjusted operating ratio improvement. Even with the gains we've made, we still have a significant pricing opportunity that we can capture over time through three distinct levers: by improving our service, growing our accessorial business, and expanding our local customer base.

As we continue to improve our service, we're able to align our price with the value we deliver. This was reflected in our contract renewal pricing, where we achieved year-over-year growth in the high-single digits for the third consecutive quarter. We also captured a double-digit increase in accessorial revenue, as customers took advantage of our premium services.

The fourth quarter rollout of our retail store offering went well, and we're developing a pipeline of customers specifically for this premium service. In the first quarter, we introduced another new service called Must Arrive by Date, which is already gaining strong customer traction, and we're expanding our tradeshow and cross-border services with the support of our newest service centers in Las Vegas and Nogales, Arizona.

Lastly, we're continuing to have success in growing our local customer base. From a strategic perspective, local accounts are a higher margin business for us, and we've expanded our local sales force to double down on this opportunity. In the first quarter, we earned 10% more shipments from local customers compared to the year ago.

The final pillar of LTL 2.0 is cost efficiency, specifically with purchased transportation, variable costs, and overhead. In the first quarter, we reduced our purchased transportation costs by 21% year-over-year by covering more line-haul miles in-house, while also paying lower contract rates for the miles we outsource.

We ended the quarter with 18% of line-haul miles outsourced to third-parties, which was a reduction of 370 basis points year-over-year. That puts us at the higher end of our target range for a 200-400 basis points improvement this year. We expect to accelerate the number of miles we bring in-house in 2024, which will give us greater efficiency, flexibility, and quality control.

This will be supported by our initiative to add driver teams and sleeper cab trucks for long-distance hauls. We've onboarded over 100 of these teams, and we're targeting a few hundred sleeper trucks to be in operation by the end of this year.

Lastly, as our volume growth continues to outpace our head count growth, our variable labor costs creates an ongoing margin opportunity. We managed this effectively in the first quarter through the strong execution of our operational teams and our proprietary technology.

Turning to Europe, our business continued to perform well in a soft macro environment. We increased both revenue and adjusted EBITDA versus the prior year, supported by a strong pricing environment and a robust sales pipeline. Our strongest year-over-year growth rates in adjusted EBITDA were in France and the UK, which are two key geographies for us. In France, the increase was in the mid-teens, and in the UK, it was in the high-single digits. Across the European business as a whole, our first quarter EBITDA was the highest it's been since the pandemic.

In summary, we made significant progress in executing our strategy in the first quarter, while continuing to make investments in long-term growth. Our service quality is at record levels. We're growing yield faster than the market. And we're driving cost efficiencies in areas that have the greatest impact on earnings.

The initiatives we put in place are contributing to our strong operating momentum and cementing our foundation for future growth. We've come a long way on the LTL 2.0, and we're still in the early stages of unlocking our full potential.

Now, I'm going to hand the call over to Kyle to discuss the first quarter results. Kyle, over to you.

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## 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. It was a strong first quarter across the board. Revenue for the total company was \$2 billion, up 6% year-over-year. This includes top-line growth of 9% in our LTL segment and 1% in Europe. Our LTL revenue, excluding fuel, was up a robust 12% year-over-year.

On the cost side in LTL, salary wages and benefits were 10.5% higher in the quarter than a year ago. The increase primarily reflects wage and benefit inflation, as well as incentive compensation aligned with the segment's strong first quarter performance.

We mitigated these impacts by delivering our fifth straight quarterly increase in labor productivity on a year-over-year basis. Our labor hours per day increased by 3.5% in the quarter, while our shipments per day increased by

4.7%. We were also more cost-efficient with purchased transportation through a combination of insourcing and rate negotiation.

Our expense for third-party carriers was down year-over-year by 21%, which equates to a \$21 million savings in the quarter. Depreciation expense increased by 22% year-over-year, or \$13 million, reflecting the investments we're making in the business. This continues to be our top priority for capital allocation in LTL. Our first quarter CapEx was primarily allocated to purchase new tractors from the OEMs and manufacturing 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 \$288 million in the quarter, which was up 37% from a year ago. Both our North American and European segments contributed to the increase. Our adjusted EBITDA margin was 14.2%, representing a year-over-year improvement of 320 basis points company-wide. We also continued to rationalize our corporate cost structure. Our first quarter corporate net expense was \$5 million for a year-over-year savings of 44%.

Looking at just the LTL segment, we grew our adjusted operating Income by 50% year-over-year to \$175 million, and we grew adjusted EBITDA by 40% to \$255 million. This reflects the combined impact of pricing gains, cost efficiencies, and an increase in volume. In our European Transportation segment, adjusted EBITDA was \$38 million for the quarter, up 3% over the prior year.

Company-wide, we reported operating income of \$138 million for the quarter, up 138% year-over-year. And we grew net income from continuing operations by 294% to \$67 million, representing diluted earnings per share of \$0.56. On an adjusted basis, EPS increased by 45% year-over-year to \$0.81. And lastly, we generated \$145 million of cash flow from operating activities in the quarter and deployed \$299 million of net CapEx.

Moving to the balance sheet, we ended the quarter with \$229 million of cash on hand. Combined with available capacity under our committed borrowing facility, this gave us \$793 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 2.9 times trailing 12 months adjusted EBITDA. This was an improvement from 3 times at year-end 2023, and we expect to further reduce our leverage this 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.

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## Ali Faghri

*Chief Strategy Officer, XPO, Inc.*

Thank you, Kyle. I'll start with our LTL segment, which reported another quarter of profitable growth with strong underlying trends. On a year-over-year basis, we increased our shipments per day by 4.7% in the quarter, led by 10% growth in our local sales channel. This resulted in growth in tonnage per day of 2.6%. And our weight per shipment was down 1.9%, which was less of a decline than the prior quarter. On a year-over-year basis, this was our third consecutive quarter of improvement in weight per shipment.

On a monthly basis, the trends across our operating metrics were broadly positive. Our January tonnage per day was down 1.1% year-over-year. February was up 3.5%, and March was up 5.9%. Looking just at shipments per day, January was up 1.4% year-over-year. February was up 5.8% and March was up 7.2%. In April, our

preliminary tonnage per day was up 3.1% year-over-year, while our shipment count was up 4.8%. On a two-year stack basis, April shipments per day and tonnage per day accelerated versus the month of March.

We also delivered another strong quarter of yield growth. We grew yield, excluding fuel, by a robust 9.8% compared with the prior year. While our improving weight per shipment was a modest mix headwind to yield, our revenue per shipment, ex-fuel, accelerated for the third consecutive quarter to a year-over-year increase of 7.9%. Importantly, our underlying pricing trends are strong as we continue to align our pricing with the better service and value-added offerings we provide. Our contract renewal pricing was up 8% in the quarter compared with a year ago.

Turning to margin, our first quarter adjusted operating ratio was 85.7%, which was an improvement of 390 basis points year-over-year. We've now reported nearly 400 basis points of year-over-year margin expansion in each of two consecutive quarters, and the current quarter is tracking for an improvement at the same level or better. Our strong margin performance was primarily driven by yield growth and bolstered by our cost initiatives and productivity gains. Sequentially, our adjusted OR improved by 80 basis points, which outperformed our expectations.

Moving to our European business, we delivered year-over-year revenue growth despite ongoing softness in the macro environment. As with the prior quarter, our strong pricing outpaced inflation. Volume improved month-by-month and turned positive on a year-over-year basis in March. We also grew adjusted EBITDA versus the prior year, even with fewer working days, reflecting disciplined cost control. The team continues to execute well and earn new business from high-caliber customers. This momentum is reflected in our sales pipeline, which has expanded to nearly \$1.2 billion. This should continue to strengthen our position in key European geographies.

I'll close with a summary of our strong start to the year, which lays the foundation for the significant margin improvement we expect in 2024. As you heard from us this morning, we're continuing to deliver record service levels, providing more value to our customers and earning higher returns. Our service improvements, combined with the momentum of our accessorials offering, drove another quarter of strong yield growth. And we realized meaningful cost efficiencies through our line-haul insourcing initiative and labor productivity gains.

In summary, our strategy is working. We're delivering strong revenue and earnings growth, and we're still in the early stages of realizing our margin expansion opportunity.

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



## QUESTION AND ANSWER SECTION

**Operator:** Thank you. Ladies and gentlemen, we will now be conducting our question-and-answer session. [Operator Instructions] Our first question is coming from the line of Ravi Shanker with Morgan Stanley. Please proceed with your question.

**Ravi Shanker**

*Analyst, Morgan Stanley & Co. LLC*

Q

Thanks. Good morning, everyone. So, Mario, you said that you are seeing some pretty good pricing momentum and there's a lot more to come. How much of your order book is repriced already and kind of what's the potential opportunity there as you kind of go through the year?

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Hey, Ravi. Mario. When we look at the overall contract renewals, so we were up in the high-single digits in the first quarter, and usually, on average, we renew roughly around a quarter of our contracts. And that performance for us was driven by all the service improvements that we are delivering for our customers that obviously we earn a higher price because they don't want to see disruptions in their supply chain. And they also understand we're investing in our network to be able to provide that great service.

Again, for us, it's been the third quarter of high-single digits. And we have, since the bankruptcy of Yellow, that would be – we have another quarter of the book effectively to renegotiate here in the upcoming quarter as well.

**Ravi Shanker**

*Analyst, Morgan Stanley & Co. LLC*

Q

Got it. It's helpful. And maybe as a follow-up, I think you said 2Q OR, I think, year-over-year improvement similar. Can you just unpack that a little bit more? Kind of how do we think about the evolution through the months of 2Q and kind of how much OR would improve versus seasonality? Thank you.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Yeah, you got it, Ravi. I'll actually give the color on the tonnage, yield, and OR – ultimately OR outlook, like we usually do. But on the tonnage side, for us, April was up 3% on a year-on-year basis and shipment counts were up in the same ballpark as the first quarter as well. We do expect the second quarter to be up in a similar level. For us, April was actually better than seasonality compared to March. And we'll give another update here on the May tonnage early June mid-quarter.

And on the yield side, as I said earlier, we do expect yield to be up on a year-on-year basis in a similar range as we had in the first quarter. April, for us, was also in a similar range. From the revenue per shipment perspective, we saw that accelerate from Q4 to Q1, and we expect, on a quarter-over-quarter, on an absolute dollar basis, for that to further accelerate in the second quarter.

And ultimately, from an OR perspective, we expect a strong quarter for margin improvement. Sequentially, we expect to be an improvement from Q1 to Q2 of 200 to 250 basis points going into the third (sic) [second] quarter.



That would put us, call it, in the low-to-mid 83% range for Q2, which implies more than 400 basis points of margin improvement on a year-on-year basis, which we believe would be a very good performance in this freight market.

**Operator:** Thank you. Our next question is coming from the line of Ken Hoexter with Bank of America. Please proceed with your question.

**Ken Hoexter**

*Analyst, BofA Securities, Inc.*

Q

Great. That's a great detail there, Mario. Congrats, and way to go. Just talk about the growth of local sales and what that's meant. It seems like that had outsized growth compared to your national sales in the quarter, and it seems to be accelerating. Maybe talk about the pace that you expect that to continue because that's been an important driver for the pricing that you're talking about. Thanks.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Thanks, Ken. It is a big part of our strategy to grow local account business because, Ken, these are more sticky relationships we have with those customers, and they are supported with a local relationship with one of our sellers in a local market. So, over the last 12 months, we increased the head count in our local sales force by roughly around 25% over that period of time, and we're seeing great performance. Here in the first quarter, shipment count was up 10% on a year-on-year basis.

Just to give you a stat there, we've added more than 3,000 new buying accounts in that channel so far a year-to-date. So, it is a segment of growth for us. We're investing more in it. And when customers see our focus on service and taking care of them and taking care of their freight, we're seeing very good growth associated with that.

**Ken Hoexter**

*Analyst, BofA Securities, Inc.*

Q

Great. On the future growth, we've seen some volatility in some customers kind of taking on freight and losing it. Maybe talk about the demand environment in the backdrop here. We've had mixed signals. Our indicator seems to be improving in the backdrop. Any signs that you're seeing demand improve in the backdrop?

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

We are seeing the freight markets continuing to be soft, Ken. The underlying demand from customer is soft. However, it's stable. It seems to be bouncing along the bottom from that perspective. Obviously, again, for us, April was better than seasonality. But a lot of that is based on our sales efforts, on our quality improvements, our service improvements are enabling us to drive those gains.

Now, if you break it down between industrial and retail, we saw the ISM peak over 50 for the first time in March, but then it dropped back down to 49 here in April. So, we're seeing the industrials be a bit more muted. And when we talk to our industrial customers, and we usually survey them on a quarterly basis, they do expect growth in the back half, but it seems to be muted growth.

On the retail side, inventories are largely normalized at this point. And what our customers are telling us, they do expect, again, growth in the back end, given – in the back half, given the easier comps. But it's still softer consumer demand as well. So, again, the market seems to be on the softer side in terms of the underlying

demand. But, again, for us, it's about gaining more momentum in that local account segment. And as we deliver great service numbers, our customers are rewarding us with more freight.

**Operator:** Thank you. Our next question is coming from Daniel Imbro with Stephens. Please proceed with your question.

**Daniel Imbro**

*Analyst, Stephens, Inc.*

Q

Yeah. Good morning, guys. Thanks for taking our questions. I wanted to dig in to the cost side in a little bit more detail. Obviously, better performance on the OR here in the first quarter. And you mentioned bringing line-haul in in-house, 200 to 400 basis points this year. Where could that go in 2025 and beyond? And then, Mario, on the variable cost side, what are the other levers that you and the team are targeting? So, as we kind of execute on this initiative, what's the next leg of the cost takeout you see in the model?

**Ali Faghri**

*Chief Strategy Officer, XPO, Inc.*

A

Sure, Daniel. So when you think about line-haul insourcing, obviously, an important strategic initiative for us. Here in the first quarter, we were at about 18.1% miles that were outsourced to third parties. We improved that by 370 basis points on a year-over-year basis. Also improved 150 basis points quarter-over-quarter. And that was at the higher end of our full-year target range of improving by 200 to 400 basis points annually.

In terms of our targets, we've talked about cutting third-party line-haul miles in half by 2027 relative to where we were at year-end 2021. So that would get us to somewhere in that low-teens percent range as a percentage of total miles. That's not only going to be a cost benefit for us, but it's also going to help us with service as well.

As we've talked about more recently, we've been rolling out initiatives to accelerate the pace of insourcing, specifically team drivers and sleeper cab trucks. We already have 100 of those teams onboarded, and we expect to have a few hundred of those teams in the fleet by the end of 2024. And that's going to allow us to drive efficiencies in our line-haul network, but also accelerate that pace of insourcing.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

And in terms of [ph] then (00:30:17) – Mario. In terms of variable cost levers, so Ali mentioned the insourcing of third-party line haul, which that comes, obviously – you saw it here in the first quarter our PT costs were down over 20%. Now, when you look at the other levers around variable labor costs, and the team has done a great job operationally managing labor. Here in the first quarter, we had the fifth consecutive quarter of productivity improvement. If you look at the quarter, our shipment count went up more than our head count effectively in the first quarter, and that led to benefits, obviously, to the bottom line.

Now, a lot of that is driven, again, by operational execution in the field, and it's also driven by our proprietary technology that enables us to manage labor very effectively. So if you think through the quarters and years to come, these are two big levers for us. One is the continued reduction of PT costs, and then the second one is labor productivity.

**Daniel Imbro**

*Analyst, Stephens, Inc.*

Q

I'll leave it there. One question. Best of luck, guys.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Thank you.

**Operator:** Thank you. Our next question is coming from the line of Fadi Chamoun with BMO Capital Markets. Please proceed with your question.

**Fadi Chamoun**

*Analyst, BMO Capital Markets Corp. (Canada)*

Q

Yeah. Good morning. Thanks for taking my question, and congrats on strong results. Were there any costs associated with the new terminals that you opened in Q1? Are there any dragging costs that you expect kind of as we go into the second quarter and the second half of the year as you reopen these terminals? And just to follow up, kind of on the pricing side of things, I mean, you mentioned renewals are tracking in the 8% range. Is that kind of complete, kind of the book of business that we have seen started to get renewed as service level improved last year? I'm just trying to figure, like, from a comp perspective, do we start to get into easier – I mean, harder comps in the second half of this year, or is that momentum potentially sustainable? Thanks.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Thanks, Fadi. I'll start with the Yellow site openings, or the required size opening. I'll turn it over to Kyle to discuss contract renewals. But when you look at the new service centers we're bringing online, we don't see them as having a meaningful cost headwind for us. We do expect them to be OR neutral in this year, and they will become accretive in 2025 and beyond. Now, here in the near term, in the second quarter, I mean, it's a small impact of cost, probably the 10 to 20 basis point range on OR associated with those sites as we first turn them on, and then we start getting the efficiency benefits.

Now, there's a reason why for us that's the case, because if you look at the service centers, we already cover 99% of all ZIP codes, and they fall in three categories. In some markets, we are moving from a smaller location to a larger location. And as soon as we do that, we gain all the benefits of having more space on the dock that enables us to run more productively and more efficiently for better service, but your variable cost is the same, because we just relocated the team and the rolling stock from site A to site B.

The second scenario is where we are adding a site to an existing market where we already have a service center. A good example of that is Nashville. I was in our new Goodlettsville site, which is north of Nashville, a few weeks ago. But that's the case where, you look at that site, we split the existing team in that market between two sites or more than two sites. So, in the case of Nashville, we already have 30, 35 city drivers in Goodlettsville, but these were relocated from our Nashville terminal into Goodlettsville.

So there as well, you see a small impact from the cost per door, the more space that we have, but you don't see a meaningful impact on cost. And we have two smaller markets in Eau Claire, Wisconsin, and Nogales, Arizona that are net new markets, but they are smaller terminals and they're already – Nogales is right across the border from Mexico, and it's already running ahead of expectations in terms of the demand we're seeing on the site. So, on a net-net basis, Fadi, we look at these as being OR neutral and then accretive for 2025 and beyond.

**Kyle Wismans**

*Chief Financial Officer, XPO, Inc.*

A

Hey, Fadi. When you think about renewals, so we renegotiate about 25% of the contractual book each quarter, so from the disruption last year, we've gone through about 75% of the book. And then if you think about the outlook for contract renewals, we expect to be somewhere probably in the high-single-digit range for the remainder of the year.

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**Fadi Chamoun**

*Analyst, BMO Capital Markets Corp. (Canada)*

Q

Great. Thank you.

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**Operator:** Thank you. The next question is coming from Jon Chappell with Evercore ISI. Please proceed with your question.

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**Jonathan Chappell**

*Analyst, Evercore ISI*

Q

Thank you. Good morning. Kyle, kind of a simple one for you, maybe. So in February, you gave some annual guides, low-single-digit tonnage, yield ex-fuel mid-single-digit, OR 150 to 200 points of improvement, and it feels like with the 1Q upside and the commentary that Ali and Mario have given about April so far and how 2Q is tracking that, you're off to a much better start. Is there any way to frame what the full year guide may look like, based off the first four months of the year vis-à-vis the February guide?

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**Kyle Wismans**

*Chief Financial Officer, XPO, Inc.*

A

Sure. So I think what's important to think about is if you take the Q2 guide we walked through today, so if you're in the low- to mid-83s, if you think about that and you roll through typical seasonality for both Q3 and Q4, that would imply our full year OR to be at the high end of the outlook range. Now, there's still a path, Jon, we could do better than that, given the momentum we have now and potential for a macro recovery, but it's still early in the year. We'll give you an update as the year progresses.

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**Jonathan Chappell**

*Analyst, Evercore ISI*

Q

Okay. And no change to the others, tonnage or yield as well?

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**Kyle Wismans**

*Chief Financial Officer, XPO, Inc.*

A

No change right now to the assumptions.

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**Jonathan Chappell**

*Analyst, Evercore ISI*

Q

Okay. Thanks, Kyle.

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**Operator:** Thank you. Our next question is coming from Stephanie Moore with Jefferies. Pleased proceed with your question.

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**Stephanie Moore**

*Analyst, Jefferies LLC*

Q

Hi. Good morning. Thank you. I wanted to actually follow up on the prior question or – two questions ago on just the ramp of terminals. Any change in the timeline of the ramp of service – the ramp of these service centers, just given what is a weaker macro?

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Well, Stephanie, we will expect to change the timeline because we think of these opening as being an investment for the next 10-plus years. And we are prioritizing markets that are capacity constrained for us today. I mean, you hear us talk about the markets like Las Vegas, for example, or Brooklyn, New York, or Houston, Texas, these are markets where we don't have enough doors as things stand. So, they get OR accretive very, very quickly.

And the second area is around cost efficiency. I mentioned earlier on the Goodlettsville site as an example. It's not that we are ramping variable costs associated with that. Just to give you an example, for the first phase of a dozen terminals we're opening up here in the second quarter, we're adding a total of 30 or so head count to be able to support those service centers, because we already have the labor in those markets and we're just splitting the teams between the new service centers or relocating from one service center to another.

So, we don't see the macro as impacting our cadence of opening these. We expect to open up to 12 by the second quarter, another 11 to 12 in the back half of the year, and the remaining 5 or so sites in early 2025.

**Stephanie Moore**

*Analyst, Jefferies LLC*

Q

Great. I'll leave that with my one question. Thank you.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Thanks, Stephanie.

**Operator:** Thank you. Our next question is coming from Tom Wadewitz with UBS. Please proceed with your question.

**Thomas Wadewitz**

*Analyst, UBS Securities LLC*

Q

Hi. Yeah. Good morning and congratulations on the really strong results. Let's see. I want to ask you a question kind of related to that momentum you have. How much sensitivity do you think that your volume and pricing trend has to just what the overall freight market does? Obviously, your service improvement is a big factor, but it's hard to think there's no impact from the actual freight market trend. So, maybe just a thought on that kind of volume and price, how sensitive are you to freight if it gets weaker or whatever?

And then, I guess the second part would be how sensitive is your OR improvement to the volume side? I know it would be sensitive to price, but volume comes in 2 points weaker than you think. Are you still going to be able to do similar margin improvement to what we're talking about? Thank you.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Yeah Thanks, Tom. I'll start with the first one in terms of market sensitivity. I mean, obviously, we're not immune to the market. If things slow down a lot in the back half of the year, then we're going to be impacted. But this said, we do expect to outperform. And the reason why is that our strategy is working, our service product is improving, and customers are rewarding us with higher pricing. We're launching new premium services, and these are resonating in the market. We're growing our local sales force, and that comes at a higher margin.

So, we're doing a lot of things that are company-driven to counter whatever comes from a macro perspective. I mean, you look at the first quarter. It was a very muted freight market. We are still in a freight recession, yet we are delivering great numbers, given that our strategy is working and the team is executing on that strategy. But again, if the volume environment goes down, odds are we're going to be under pressure from a volume perspective. But we expect to gain market share as we go along. And from a pricing perspective, a lot of the initiatives we have that are driving pricing are based on all the things I just mentioned, which enable us to also deliver a good pricing number as a whole.

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**Thomas Wadewitz**

*Analyst, UBS Securities LLC*

Q

And what about the second part being like, if you get 2 points less, whatever, pick a number, volume growth, is the OR improvement sensitive to that or not particularly so?

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**Ali Faghri**

*Chief Strategy Officer, XPO, Inc.*

A

So, Tom, this is Ali. As Mario mentioned, we're not immune to the macro. But within our baseline outlook, we're assuming very modest assumptions around tonnage growth. You saw here in 1Q and also in 4Q as well, with relatively modest tonnage growth on a year-over-year basis in that low-single-digits range, we were able to deliver 400 basis points – nearly 400 basis points of year-over-year OR improvement. As you roll forward into the second quarter, we're assuming tonnage up in that low- to mid-single-digit range. We expect 400-plus basis points of OR improvement.

So, for us specifically, while there is some sensitivity to the tonnage outlook, where we're focused on is driving yield growth, driving cost efficiency, and we have a lot of control over our own destiny and a lot of company-specific levers we can pull to drive both yield growth and cost efficiency to drive stronger OR improvement, even in a softer macro environment.

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**Operator:** Thank you. Our next question is coming from Brian Ossenbeck with JPMorgan. Please proceed with your question.

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**Brian P. Ossenbeck**

*Analyst, JPMorgan Securities LLC*

Q

Hey. Good morning. Thanks for taking the question. Just wanted to maybe get your thoughts on competition, both with other LTLs, some of which are expanding their footprint as well, but also some of the last question from Tom in terms of the freight market, we have seen probably a bit more weight from a weaker truckload market, but you're also seeing better weight per shipment in your trend. So, doesn't seem like you're as exposed as maybe some others, so maybe you can walk through the details on that.

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**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A



Yeah. I'll – first off, actually, with the back half on weight per shipment, or back half of your question, for us, weight per shipment has sequentially improved. A lot of that goes back to the – we are being very disciplined on the type of freight that we are taking into our network to make sure it fits the profile of an LTL network, and it's OR accretive and from an overall margin perspective.

Now, when you look at the move of freight potentially from LTL to truckload, I had a team run an analysis here recently for us, and it's roughly around 0.5 point of shipment are those heavy LTL shipments that we have seen effectively go down more than their corresponding other parts, and that's driven predominantly by the truckload rates being lower, but it's not a meaningful number, but we're seeing some of that in terms of the LTL to TL shift. The good news there is as soon as the truckload market tightens, that becomes the tailwind for LTL and we see it coming back.

In terms of the overall industry dynamics, when you look at the capacity in our industry, you go back a year ago, all of the Yellow service centers were up and running, and now about half of them have been sold. So, look, about 80%, 90% of these are coming back to LTL carriers. In a year from now, would be at 94%, 95% of the industry capacity that was running just a short year ago. And when you look at the overall, we are in freight recession. So, when you look in the LTL industry and you look at all the publicly traded LTL carriers, you can see that from a baseline of 2021, shipment count in our industry is down in the teens since the post-COVID environment.

And it's not that 2021 was a particularly strong year. It was even less shipments in LTL than 2019 or 2018 or 2017. So, the best way to think about it is that that capacity went out at a time when freight markets were down in the teens. About half of it is coming back, but yet we haven't seen yet any meaningful shipment recovery. So, from an industry capacity perspective, as soon as we see any meaningful form of recovery, you would see that we don't have enough capacity in the LTL space as a whole.

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**Brian P. Ossenbeck**

*Analyst, JPMorgan Securities LLC*

Q

So, just to quickly follow up on that then, looking into later half of this year and probably more like next year, what are some of the incremental margins you would expect on, I guess, the new facilities in particular, especially in some of the bigger areas with more density? Should that be similar to what we saw this quarter, around 40% or so, or maybe a little bit less? And, of course, it would depend on the pace of the macro. But just wanted to get your sense in terms of how those assets would fit when the recovery does come back.

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**Ali Faghri**

*Chief Strategy Officer, XPO, Inc.*

A

Sure, Brian. This is Ali. We do expect very strong incremental margins on these new service centers. As you saw here in 1Q, we delivered very strong incremental margins. In 2Q, if you look at what we're implying for OR, that implies incremental margins north of 50%. And as we cycle into the second half of the year and into 2025, as these new service centers come online, we would expect to maintain that very strong performance in incremental margins comfortably above 40%.

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**Operator:** Thank you. Our next question is coming from Jason Seidl with TD Cowen. Please proceed with your question.

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**Jason H. Seidl**

*Analyst, TD Cowen*

Q



Hey, thank you, operator. Mario, team, congrats on the strong quarter. One question, one little follow-up here. How should we think about this push to the more local accounts as an impact on the overall yields? Now, I understand how the margin impact works. I was just curious if there's any impact on yields. And then, Kyle, I wanted to follow up. You mentioned being at the "higher end" of the OR target range. And I'm assuming you meant the better end, but the lower OR. I just want to clarify that.

**Kyle Wismans**

*Chief Financial Officer, XPO, Inc.*

A

Yeah. Hey, Jason. So, I'll take the first part of the question, too. So when you think about the local account strategy and the move from 20% to 30% of the book, when we talk about our overall opportunity from a yield perspective, we said we have probably the mid-teens gap at times. When you think about growing the local accounts, we think that's 2 to 3 points of what that gap could be just from growing that local business.

**Jason H. Seidl**

*Analyst, TD Cowen*

Q

That's great.

**Kyle Wismans**

*Chief Financial Officer, XPO, Inc.*

A

And then with respect – sorry. And then with respect to the OR target, yeah, so as we're performing now and what we expect, just rolling seasonality would put you at the higher end of that target in the 250 basis point range.

**Jason H. Seidl**

*Analyst, TD Cowen*

Q

Yeah. That's what I thought you meant. All right. Fantastic. Thank you very much for the time, as always.

**Kyle Wismans**

*Chief Financial Officer, XPO, Inc.*

A

You got it.

**Operator:** Thank you. Our next question is coming from Jordan Alliger with Goldman Sachs. Please proceed with your question.

**Jordan Alliger**

*Analyst, Goldman Sachs & Co. LLC*

Q

Yeah. Hi. Good morning. Just a longer-term question. I think you'd mentioned that LTL 2.0 is still in the earlier days or earlier innings. And obviously, now, since you first put that plan out, you have the former Yellow terminals that you're rolling out. Any thoughts on assessing some of the longer-term margin improvement potential that you could get to in less than truckloads vis-à-vis the original expectations or updated expectations? Thanks.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Thanks, Jordan. Well, [ph] initially, we were (00:46:45) at least 600 basis points of our improvement from a baseline of 2021 through 2027. But that's what we always said, at least, because we're not stopping at 600 basis points and we're not stopping in 2027. But with the momentum we have and all the initiatives and the plan working

as expected, we do expect to get there faster. But, obviously, we're not stopping at 600 basis points or 2027. Our goal is to get to the 70s from an OR perspective and eventually into the mid-70s and eventually into the low-70s.

**Jordan Alliger**

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. Thank you.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Thank you.

**Operator:** Thank you. Our next question is coming from the line of Brandon Oglenski with Barclays. Please proceed with your question.

**Brandon R. Oglenski**

*Analyst, Barclays Capital, Inc.*

Q

Hey. Good morning. And thanks for taking the question. Mario, I was wondering if you could talk to service outcomes during the quarter. I know you guys were calling out a really low claims ratio. And then how does that factor in with these new terminals opening? Does XPO actually become more of a growth story as you look out the next two to three years, I mean, obviously, cycle contingent?

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

Yeah. So, the way we think about the new service centers, they will help us deliver better service as well. Because, usually, when you have more space on a dock, you turn less often your doors – your dock doors, which gives you more time to load trailers effectively and also being able to build what we call pure trailers that can go through the network without any re-handling along the way. So, we believe that more space is going to enable us to even have a better service product over time as well.

Similarly, we have initiatives around insourcing third-party line-haul, as we mentioned earlier on. And these also come with an improvement in service. And we have obviously the airbag systems and the new loading methodology. And all the things that we are doing as a company to further improve service.

Now, in terms of being growth, our goal is to keep on improving service and drive yield more than tonnage. But at some point, whenever there is a market inflection, we'd be able to take on more freight. But we're focused on making sure it's OR accretive freight and it's operating at the right yield as well. So, again, we're not chasing tonnage, we're chasing yield and keep on improving that service product as well.

**Brandon R. Oglenski**

*Analyst, Barclays Capital, Inc.*

Q

Appreciate it.

**Operator:** Thank you. Our next question is coming from the line of Scott Schneeberger with Oppenheimer. Pleased to see with your question.

**Scott Schneeberger**

*Analyst, Oppenheimer & Co., Inc.*

Q

Thanks very much. Could we touch on Europe? I think, Mario, you mentioned it's the best quarter since COVID and seeing some strength in the UK and in France. What end market specifically. And I guess, I'll throw in the question too of is now an improved time to be considering that disposition? Thanks.

**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

A

So, first, I'll start with the back half of the question. Our long-term plan remains to be a pure play North American LTL carrier and selling that business is a strategic priority of ours. But we're going to be patient. We want to make sure that we are maximizing the returns on that business. It is a business that has a lot of scarcity value in Western Europe with either number one, number two, or number three in LTL truckload and brokerage. And it's in key Western European geographies, think about UK, France, Spain, Portugal. So, it's not a matter of if, but when.

Meanwhile, the business is performing really well. As you mentioned, our EBITDA for the first quarter was the highest it's been since the pandemic. And some of these key geographies, in France, for example, our EBITDA was up in the mid-teens. In the UK, our EBITDA was up in the high-single digits. And a lot of it is driven by really good strong sales pipeline, driven by good pricing. And the team is just executing in every level in our European business.

And keep in mind, that's in the backdrop of a soft freight economy. And we have seen our volumes inflect positive in the month of March. We are seeing more strength in the less than truckload business in Europe, but also in the brokerage side and the truckload side, we are also seeing an improvement in overall trend.

**Scott Schneeberger**

*Analyst, Oppenheimer & Co., Inc.*

Q

Great. Thanks.

**Operator:** Thank you. Our next question is coming from Kevin Gainey with Thompson-Davis & Company. Please proceed with your question.

**Kevin Wade Gainey**

*Analyst, Thompson Davis & Co., Inc.*

Q

Hey, guys. Good morning. Congrats on the quarter. I actually wanted to go into operating cash flow. It was a pretty strong quarter for that. And was wondering what levers kind of drove that from your standpoint? Was there any kind of efficiency changes that you guys have done there? And then maybe the outlook that you guys have for the remainder of the year on cash flow.

**Kyle Wismans**

*Chief Financial Officer, XPO, Inc.*

A

Yeah. From the cash flow quarter, I think it's another strong quarter from a working capital perspective. Obviously, Q1 tends to be negative from a cash flow standpoint. But I think even given that and the higher CapEx, we had a really good end result. I think what's important when you think about cash flow is for rest of the year, we expect to generate over \$100 million in cash flow in 2024. That's even contemplating the elevated level of spending from a CapEx perspective.

So, we said \$700 million to \$800 million in planning assumptions. We think we'll be in that range. And I think even with that, we should still be comfortably over \$100 million in cash flow. Again, timing, you got to think about. So Q1, we said it's negative. But we had a lot of tractor deliveries here in the first quarter, 1,600 deliveries in Q1 most of the whole year. So, that CapEx number for Q1 at \$299 million of net CapEx will come down over the course of the year. We feel very strong – we feel very good about our cash generation ability this year.

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**Kevin Wade Gainey**

*Analyst, Thompson Davis & Co., Inc.*



Perfect. Thanks.

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**Operator:** Thank you. We have reached the end of our question and answer session. I would like to turn the floor back over to XPO's Chief Executive Officer, Mario Harik, for concluding comments.

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**Mario A. Harik**

*Chief Executive Officer & Director, XPO, Inc.*

Thank you, operator, and thank you all for joining us today. I'm proud of our strong first quarter and the tremendous progress we're making. As you can see from our results, our LTL 2.0 plan is working and is gaining momentum in a soft macro for freight transportation. We look forward to updating you on our continued progress next quarter. Operator, you can now end the call. Thank you.

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**Operator:** Thank you. Ladies and gentlemen, this does conclude today's teleconference. We thank you for your participation, and you may disconnect your lines at this time.

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