Q3 2020 XPO Logistics Inc Earnings Call

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CORPORATE PARTICIPANTS

Bradley S. Jacobs, XPO Logistics, Inc. - Chairman & CEO
David B. Wyshner, XPO Logistics, Inc. - CFO
Matthew Jeremy Fassler, XPO Logistics, Inc. - Chief Strategy Officer

CONFERENCE CALL PARTICIPANTS

Allison Poliniak-Cusic, Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst
Allison M. Landry, Crédit Suisse AG, Research Division - Director
Amit Singh Mehrotra, Deutsche Bank AG, Research Division - Director and Senior Research Analyst
Ariel Luis Rosa, BofA Merrill Lynch, Research Division - Associate
Brandon Robert Oglenski, Barclays Bank PLC, Research Division - VP & Senior Equity Analyst
Brian Patrick Ossenbeck, JPMorgan Chase & Co, Research Division - Senior Equity Analyst
Christian F. Wetherbee, Citigroup Inc., Research Division - MD & Lead Analyst
Jason H. Seidl, Cowen and Company, LLC, Research Division - MD & Senior Research Analyst
Ravi Shanker, Morgan Stanley, Research Division - Executive Director
Scott Andrew Schneeberger, Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst

PRESENTATION

Operator

Welcome to the XPO Logistics Q3 2020 Earnings Conference Call and Webcast. My name is Hector, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

Before the call begins, let me read a brief statement on behalf of the company regarding forward-looking statements and the use of non-GAAP financial measures. During this call, the company will be making certain forward-looking statements within the meaning of applicable securities laws, which by their nature involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those projected in the forward-looking statements. A discussion of factors that could cause actual results to differ materially is contained in the company's SEC filings. 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. You can find a copy of the company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures in the Investors section on the company website.

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

Bradley S. Jacobs, XPO Logistics, Inc. - Chairman & CEO

Thanks, Hector. Good morning, everybody. I'm here today with David Wyshner, our CFO; and Matt Fassler, our Chief Strategy Officer. And also for the Q&A portion of the call, we have Tavio Headley, our Vice President of Investor Relations; Ravi Tulsyan, our Treasurer; and Kyle Wismans, Senior Vice President of FP&A.

We had solid beats versus consensus across the board in the third quarter. We beat revenue by $364 million or 9%. We beat on adjusted EBITDA by $87 million or 25%. We beat on adjusted EPS by 115%. And notably, we beat free cash flow by $173 million or 234%. The [$439 million] (corrected by company after the call) of adjusted EBITDA we generated in the quarter brought us back to par with the same period last year and even a little bit better. That was a big swing. Our third quarter adjusted EBITDA was 2.5x our second quarter adjusted EBITDA.

I'm particularly pleased that our performance was broad-based. We rebounded to pre-COVID levels across our service lines and geographies. In LTL, we improved our adjusted operating ratio by 110 basis points year-over-year to 79.7%. That's the best adjusted operating ratio of any quarter in our history.

Our performance in truck brokerage was off the charts with net revenue up 17% and net revenue per load up 13%. We improved our last mile net revenue dollars by 15% and achieved a third quarter record net revenue margin of

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35%. This was the seventh consecutive quarter that our net revenue margin in last mile was up year-over-year.

Intermodal had a massive recovery in the third quarter. Organic revenue per day recovered from a 34% year-over-year decline in the second quarter to a 2% increase in the third quarter. We grew EBITDA in our logistics business year-over-year by 14% on a 5% increase in revenue. On the technology front, XPO Connect, XPO Smart and our LTL pricing algorithms and other technology innovations have been firing on all cylinders.

On a personal note, it's bittersweet to see my good friend and our Chief Customer Officer, Greg Ritter, retire into the sunset of Colorado. Greg was the fifth person I hired at XPO, way back in 2011. He's been super instrumental in the company's success. He started our brokerage business from scratch. And today, it's the second largest broker in the Western Hemisphere. He also personally signed up dozens of customers who became some of our largest accounts. I am grateful for his many accomplishments and wish him all the best in his retirement.

I also want to mention the recent appointment of Alex Santoro to the newly created position of Chief Commercial Officer. Alex is turbocharging our global sales organization, overseeing everything from sales training, compensation plans, go-to-market strategy and, most importantly, keeping our customers delighted.

So in sum, we had a remarkably good quarter. There are exciting trends in our favor, such as the growth in customer outsourcing and e-commerce. And it's gratifying to know that our years of investment in the business, especially technology, have put us in a strong position to support our customers through the ups and downs of the recovery. We have excellent momentum going into the fourth quarter and for 2021.

With that, I'd like to turn it over to David.

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

Thanks, Brad, and good morning, everyone. Today, I'd like to discuss our third quarter results, our balance sheet and liquidity and our outlook.

In the third quarter, we generated revenue of $4.2 billion and adjusted EBITDA of $439 million. Both figures reflect year-over-year increases despite negative impacts from COVID, and they are higher than we expected at the beginning of the quarter. Our adjusted EBITDA is an all-time third quarter record and reflects cost-saving actions we've taken throughout our operations in what has been a V-shaped recovery for our business.

Amid the pandemic, our financial results have reverted to near-normal levels sooner than we had anticipated. The trend of sequential monthly improvement that began in May continued through the third quarter and across our business. Third quarter revenue increased 21% versus Q2. As revenue increased, we benefited from operating leverage inherent in our business and from actions we've taken over the last 6 months to reduce our costs. Matt will review our segment detail in a few minutes.

Our adjusted earnings were $0.84 per share in the quarter. Our year-over-year EPS comparison was negatively impacted by a higher-than-usual effective tax rate this year as well as increased interest expense.

We generated $298 million of cash flow from operations in Q3, spent $122 million on CapEx and received $71 million of proceeds from asset sales. As a result, we generated positive free cash flow of $247 million in the quarter. This brings our year-to-date free cash flow to $463 million, which represents a year-over-year increase of $56 million.

We've been able to generate positive free cash flow during the pandemic by closely managing our working capital. We became even more disciplined about collections in the COVID environment, working with our customers to limit our receivables and staying disciplined with respect to payment terms we provide. We didn't repurchase any shares in the third quarter, so we continue to have $500 million of authorized share buyback capacity.

In April, as you know, we throttled back our planned capital expenditures dramatically. In the third quarter, we resumed some projects as our outlook for operating cash flow strengthened and new business opportunities rebounded.

We estimate that our gross CapEx will be $530 million to $550 million this year, which is up from our July estimate of $450 million to $475 million, but still represents a reduction of 14% from our pre-pandemic plan. And we estimate that as a result of our regular course asset sales, our net capital expenditures will be $330 million to $350 million this year.

Maintaining strong liquidity continues to be a top priority for us as an organization. We repaid $400 million of borrowings under our ABL facility in the third quarter, and those funds continue to be available to us if we wish to access them.

Our cash balance at September 30 was $2 billion. This cash, combined with available debt capacity under committed borrowing facilities, gives us total liquidity of more than $3 billion. Our net leverage at September 30 was 3.4x adjusted EBITDA. We have no significant debt maturities until mid-2022. Our liquidity position is strong.

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Turning to our outlook. Our guidance reflects the improved operating environment we saw in the third quarter when we had a sharp sequential rebound in revenues and adjusted EBITDA, as well as our current estimates of the continuing effects from COVID.

We expect to generate $400 million to $410 million of adjusted EBITDA in Q4, even with the typical fourth quarter pressure on margin from our business mix and lower year-over-year gains from LTL real estate sales. We're optimistic that demand will continue to be solid as many of our consumer-facing customers anticipate a strong holiday peak, particularly in e-commerce. The year-over-year decline in fourth quarter adjusted EBITDA that we're forecasting is entirely due to lower LTL real estate sale gains and COVID costs, which together represent a headwind of $25 million to $30 million.

On the cash flow front, we've generated more than $460 million of free cash flow so far this year. And we estimate that our full year free cash flow will be roughly $500 million. This implies lower free cash flow in Q4 than in Q3, largely due to our decision to resume some capital projects we had put on hold and to working capital movements. Approximately $60 million of free cash flow came in Q3 rather than Q4 due to the timing of working capital.

This past quarter, we successfully delivered year-over-year growth in revenue and EBITDA, even though COVID and the uneven economic conditions associated with the pandemic continue to impact our business. Our third quarter results are a credit to our colleagues around the globe who proved to our customers that we can rise to challenges and serve them well in any climate.

Our liquidity is strong, and our free cash flow generation is robust. In addition, we continue to invest in our business in order to drive efficiency and differentiate our service offerings. We're delivering on the objectives we laid out 6 months ago, and we're positioning our business for future growth. As a result, we're enthusiastic about our prospects as a leader in the markets we serve.

I'll now turn things over to Matt.

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

Thanks, David. I'll review the third quarter operating details, starting with our transportation segment. In North American LTL, we showed a solid progression in tonnage and revenue through the quarter. Tonnage was down 4% in the third quarter, with July down 6%; August down 4%; and September down 2%.

Our LTL shipments were 4% lower than last year, which was relatively consistent through the quarter, with weight per shipment improving through the quarter and tracking in line with last year's performance. These trends in LTL reflected the ongoing strength in consumer spending, particularly e-commerce. The consumer continues to lead the U.S. economy. We also saw improvement in industrial production, notably in auto, as our customers resumed production after the Q2 shutdowns. The pricing backdrop for LTL remains rational.

Yield, excluding fuel, rose 1.7% year-over-year, consistent with the Q2 increase. As Brad mentioned, we posted a record quarterly operating ratio for LTL. Our adjusted OR improved to 79.7%, which was 110 basis points better than the third quarter a year ago. Excluding real estate, we achieved an OR of 82.5%, 100 basis points better than a year ago. Both operating ratios include a 50 basis point impact from COVID-related costs.

We also saw terrific improvements in productivity in LTL. Our load factor increased by 2.1% year-over-year, and we were 3.7% more efficient in pickup and delivery than we were last year. We're reducing LTL cost per stop by providing P&D planners and dispatchers with the visibility to lower costs during route planning.

Our freight brokerage business delivered outstanding results. The star here was our truck brokerage business, where we generated a 17% increase in net revenue and a 13% increase in net revenue per load, outperforming the market. The truckload market got tighter through the quarter and, by September, was as tight as we'd ever seen. It was a dynamic environment, and our team seized the opportunity with fantastic results.

We honored our contracts, taking losses where we needed to, and our customers rewarded us with high-margin spot business. The leaders of our brokerage effort have had every job in the business, from procurement to customer engagement to tracking loads, and our incentive plans reward our reps for profitable volume and customer satisfaction.

Our performance was aided by XPO Connect and our other proprietary technology across brokerage. Our Drive XPO carrier app had 60,000 downloads in Q3, which was nearly double the number of Q2 downloads. Cumulative downloads of the app now exceed 200,000, which is more than 3x higher than the download count at this time last year. And active customer users on Connect have jumped 94% since the start of the year.

Our intermodal business also rebounded from Q2 levels. The year-over-year decline in intermodal edged towards flat in the third quarter with the rebound led by the resumption of automotive. We also saw increased demand for intermodal from retail customers, in part because of higher truckload rates.

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Our last mile business was a standout in the quarter. We grew last mile revenue 11% year-over-year, powered by strong growth in e-commerce, the shift in consumption to goods from services and a growing consumer focus on the home environment. We saw notable growth in furniture, appliances and other home improvement goods, as well as exercise equipment, with much of it served through our last mile hub network. These market dynamics contributed to our 15% growth in last mile net revenue in the quarter and increased our net revenue margin by 160 basis points to a third quarter record of 35%.

In European transportation, revenue was down 3% year-over-year, which was a 26 percentage point improvement from the second quarter's year-over-year growth rate. European LTL and brokerage had the strongest performance of our major service lines.

On a country basis, our transportation business in Spain recovered to pre-COVID levels and then some, followed by France, while the U.K. continued to lag. Importantly, we're getting significant traction in Europe with XPO Connect. We now have more than 4,000 customers registered on XPO Connect in Europe and plan to onboard thousands more by year-end.

Turning to our logistics segment, we increased revenue 5% in the third quarter year-over-year and realized meaningful operating leverage. This helped grow adjusted EBITDA in the segment by 14%. Key drivers of our revenue growth in logistics include the global acceleration of e-commerce, which increases both fulfillment and returns, as well as an increase in the customer trend toward outsourcing and the rapid growth of supply chain automation. We excel in all of these areas, and we're actively engaged in discussions with customers on many new business opportunities.

Our XPO Smart labor management tools are driving productivity across our operations. We've rolled out the technology to about 80% of our supply chain sites in North America and about 50% in Europe, with ongoing rollouts underway. Initially, we saw productivity gains of 5% or better from deployments of XPO Smart, and now our warehouse managers are realizing additional gains beyond the first year of adoption.

Our European logistics revenue rose 12% in the third quarter year-over-year or 7% excluding the impact of FX. Consumer verticals generated 82% of revenue in European logistics. And within consumer, the largest areas were e-commerce and food retail, positioning us for current trends and the long run. Several large new contracts are contributing to revenue growth in European logistics. Our operations at Nestlé's warehouse of the future are fully launched, as is our service for Waitrose, which was a major win earlier this year.

In North American logistics, where our mix is a bit more diversified beyond the consumer, our revenue was down 6% year-over-year, but that was a significant rebound from the second quarter. We had a tailwind from the reopening of brick-and-mortar retail and from some of our industrial customers, with restocking activity coming back in both of these verticals. We're also serving growing demand in omnichannel retail and the consumer packaged goods. We expect to see our revenue continue to improve in North American logistics as more of our customers return to pre-COVID levels, we onboard new wins and we lap the exit of some lower-margin contracts.

Our XPO Direct distribution network continues to thrive in this environment. The downsizing of U.S. retail activity and the emergence of more direct-to-consumer brands are driving a surge in opportunities for this unique shared-space network. XPO Direct has operated in the black all year, and we saw nice year-over-year profit improvement in the third quarter.

Looking forward, across our business, the shift in consumer spending to goods and services continues to aid in the freight markets. The retail peak has started earlier with more holiday shopping expected to take place via e-commerce. Brick-and-mortar shopping is likely to be spread over a longer period of time as well as consumers look to avoid crowds. Our supply chain and last mile operations will be the biggest beneficiaries.

As we moved into October, we saw a continuation of the solid trends that underpinned our performance in Q3 even as COVID has ebbed and flowed. Consumers, businesses and governments have a much better understanding of how to operate safely. At XPO, we've shown that we operate at a high level under the most trying conditions and fulfill our responsibilities to our customers.

Applying that same forward lens to our service offerings, in North American LTL, growth in tonnage and revenue per day accelerated in October with tonnage turning positive year-over-year. We expect our fourth quarter OR, excluding real estate, to be equal to or better than last year. We believe that the industry's LTL tonnage trends are healthy, especially considering that industrial production is still soft. If the industrial economy moves into expansion mode, our LTL business is capable of significantly more acceleration.

Looking at our other transportation lines. In truck brokerage, the market remains tight. Net revenue per load in October was robust, and load growth accelerated. In intermodal, capacity is also tight. This is expected to persist. In last mile, consumer demand for heavy goods remains strong, propelled by secular shifts to large e-commerce purchases and direct-to-consumer sales of fitness equipment, appliances and mattresses. In European transportation,

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activity tracked in line with Q3. And the same is true in our logistics segment, where our activity levels and sales opportunities are robust.

Finally, we remain very focused on our 10 profit improvement initiatives. Pricing optimization, margin expansion in European logistics, the high efficiency of XPO Connect in brokerage and last mile and our XPO Smart labor analytics were all particularly effective.

I'll close with a few of the accolades we received in the quarter, starting with Whirlpool awarding us with Intermodal Carrier of the Year for 2020. We also received the Maytag Dependability Award for superior results in reverse logistics. In addition, we received a Gold World Excellence Award from Ford for our managed expedite service, and we were just named Supplier of the Year by Owens Corning. XPO was designated a bronze-level Military Friendly Employer by Viqtory, that's Viqtory with a Q, for helping connect veterans with career opportunities.

As we prepare to move on to Q&A, we know there's been speculation in the media about our M&A activity. We're not going to address questions about potential acquisitions or divestitures on this call.

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

QUESTIONS AND ANSWERS

Answer – Operator: (Operator Instructions) Your first question comes from the line of Jason Seidl with Cowen.

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

Question – Jason H. Seidl: Impressive quarter. Wanted to talk a little bit about the overall exposure to e-commerce/retail. In the past, you've talked about it at 25% levels. Clearly, just the market itself is growing exponentially. And you have some very good products out there in the marketplace that are probably allowing you to take market share above market growth rates. Where should we see that number growing over time?

Answer – Matthew Jeremy Fassler: Jason, this is Matt. We continue to expect that number to move higher as a proportion of our mix. You spoke about some of the products that we have that are well positioned to help us take more share in that arena. I'd really focus on a couple of different avenues.

First of all, e-commerce is a critical driver of our business in global contract logistics. We have the leading -- we are the leading e-fulfillment platform in Europe. We're a leader in reverse logistics globally. And a disproportionate amount, in a good way, of our forward revenue opportunities for global contract logistics come from e-commerce.

Secondly, as you know, we are the U.S. leader in last mile for heavy goods. This has been an outstanding place to be this year, obviously, but there's a terrific secular opportunity. It relates to -- certainly relating to the growth of e-commerce and to changing consumer habits. Also, our scale here is a critical advantage in terms of procuring capacity, offering the best combination of loads and business opportunities to our carriers.

Finally, within LTL, kind of an emerging opportunity, we're seeing more and more impact of consumer and, within that, e-commerce driving LTL. That certainly is beginning to help us here as we exit 2020 and enter 2021. So very optimistic about our ability to capitalize on this secular trend.

Question – Jason H. Seidl: That's good color, and that goes well into my next question. Here's a follow-up on the LTL. You guys continued to impress there. I mean that's a great operating ratio. I've covered XPO Freight/Con-way for a long, long time. Wanted to know sort of where are you at with some of the productivity measures that you guys outlined for us a couple of quarters ago. And sort of how much left do you think you can squeeze out of the margin and sort of get to that sort of top level that one of your peers keeps raising the bar on?

Answer – Matthew Jeremy Fassler: Jason, it's Matt. I'm happy to grab that one as well. We have a lot of room to go. We have a number of initiatives within the 10 levers that we've discussed that relate to LTL. Pricing and revenue management is a terrific opportunity for us in LTL. We've talked about the impact of XPO Smart on labor productivity, and we continue to see improvement in dock productivity, driven by Smart. And somewhat earlier stages, but gaining momentum, our route optimization for P&D and line haul. As you know, we have $1 billion adjusted EBITDA target for LTL in 2022, and embedded in our path to that target is realization of some of the opportunities that we just discussed.

Answer – Operator: Your next call comes from the line of Allison Poliniak with Wells Fargo.

Analyst: Allison Poliniak-Cusic, Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst

Question – Allison Poliniak-Cusic: Just following on the last question. Looking at your growth through the lens of your technology investments, is there a way to help quantify what percent of growth or above-market growth or business wins were attributed to some of those technology investments here?

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Answer – David B. Wyshner: Allison, it's David. It's really hard to point to one particular item like technology in terms of a new business win. But it's clearly having an impact and, in our case, a very positive impact. It's differentiating us in conversations with customers and I think, in many cases, helping us get over the finish line and helping us also in terms of other elements of the negotiations we have with our customers because our technology gives us a differentiating factor.

And that's really one of the reasons why we've made the decision to step back up our technology and capital spending compared to how we had cut it back at the start of the pandemic. We see opportunities for strong returns on investment associated with that technology spending across our business.

Question – Allison Poliniak-Cusic: Great. And then just on the lines of the new hires that you announced this summer, certainly still early in their tenure here. But any unique insights that they brought to the company over the past few months that are sort of having you look at the company and the business model a little differently here?

Answer – Bradley S. Jacobs: Yes. Allison, it's Brad. So you're referring to Eduardo and Alex. Eduardo has been focusing on revenue management, on LTL efficiency initiatives and procurement, amongst other things, but those 3 are the big things. And lots of progress on those and a lot of high expectations going forward.

Alex, we gave an additional responsibility recently to be Chief Commercial Officer because he was looking at our organization and saying we could do it a little bit differently, we could structure the sales force differently, we could have the reporting lines a bit different, we can do this with training, we can do this with compensation, maybe we could refine our go-to-market strategy here. And these are all fresh ideas and we said, okay, go run with it. So we also have high expectations for him as well.

Answer – Operator: Your next question comes from the line of Chris Wetherbee with Citi.

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

Question – Christian F. Wetherbee: Maybe a little bit more specific on the LTL outlook for 2021. I know it's early yet still. But when you think about the operating ratio sort of puts and takes, it seems like you have some COVID expenses, which I guess may or may not stick around for an extended period in 2021, but you'll begin to lap those at least in the back half of the year. But then you have tonnage turning positive. And then presumably, pricing getting a little bit stronger, given what's going on with the truckload backdrop.

So can you talk a little bit about sort of how you would view sort of natural incrementals in that business in the circumstances that I just outlined? I guess keeping in mind, too, that there's gain on sales that you have to comp to. So when you think about putting all that together, how should we be thinking about incrementals in that business next year?

Answer – David B. Wyshner: Sure, Chris. It's early for us to be talking about 2021, and we expect to provide our guidance there in February when we announce full year results. But the points you raised I think are the right ones to be thinking about. This past quarter, COVID costs were probably a 0.5 point headwind. And at some point in 2021, we expect that to go away. That's a half point on operating ratio.

Clearly, our tonnage was down 4% in the third quarter. And it was significantly impacted early in the quarter by COVID. So we see opportunity for volumes to be stronger. We've seen yield be fairly consistent, up a couple of points or so year-over-year for a while. And our hope would certainly be that yield continues to be a headwind -- a tailwind, a favorable item for us going forward. We've seen the ability to drive load factor and dock productivity and overall productivity up over time. And we've been doing that even up against the challenges of COVID, which produced some inefficiencies, some loss of network density and so forth.

And as a result, while the direct COVID costs were only about a 0.5 point impact on our operating ratio, we could certainly make the case that the broader COVID impact is greater than that. So again, it's too early for us to predict or project specifically on 2021. I do think that there are a number of tailwinds or things that were headwinds this year that should go away as we move into next year.

Question – Christian F. Wetherbee: Okay. That's helpful. I appreciate the color on that. And then on the logistic -- contract logistics business, margins improved nicely. You got some operating leverage back into that business as the revenue came back. You've had some, I think, key business wins, as you've outlined, benefit the top line here. As those continue to sort of mature, how should we think about the margin profile of that business in general? Will those new contracts and sort of the pipeline that you're building generally be accretive? Or does that have a bit of a dampening effect as you get some of these businesses up and running and realize other start-up costs kind of associated with that? Just kind of a sense of how that plays through the contract logistics margins.

Answer – David B. Wyshner: Yes. We feel good about the new business that we're bringing on. We also feel good about a couple of contracts that we've stepped away from because they were low margin over the last year or so. So I

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think as we look forward, we're enthusiastic about how we're positioned. And the same as LTL, some of the -- COVID has had some negative impacts on efficiency in our business. And I think as those ameliorate over the next year or so, ideally over the next 6 months, as COVID impacts become less, that will be helpful to us as well. But I think the -- I think our ability to differentiate ourselves in terms of automation and technology that we bring to bear is really helpful to us as we negotiate contract renewals and new business, and that can be helpful to us from a margin perspective going forward over time.

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

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

Question – Brandon Robert Oglenski: I guess I don't want to get too nitty-gritty on the EBITDA outlook for the fourth quarter. But Matt or Brad, it does feel kind of sequentially like a normal pattern seasonally for you guys from 3Q to 4Q. Can you just talk about the puts and takes here with, I think, lower expected sale gains and then maybe what you're assuming for kind of like normal underlying acceleration in the economy?

Answer – David B. Wyshner: Sure. It's actually David. I'll take that one. The decline that we have sequentially is a typical -- actually a little bit less than a typical Q3 to Q4 margin decline that we have. And when we look at EBITDA year-over-year, the decline is entirely due to lower LTL real estate gains and COVID costs. So from that perspective, excluding those 2 items, we'd be essentially flat year-over-year in terms of our EBITDA. And when we look at the sequential trends and adjust for items like that, what we see is that our decline is actually less than we would typically see moving sequentially from Q3 to Q4.

Question – Brandon Robert Oglenski: Okay. I appreciate that, David. And I guess, if I were to just annualize that, you guys are around $1.6 billion in annualized EBITDA. When should we start thinking about these 10 initiatives really starting to deliver on that $700 million to $1 billion target? And is it going to be linear? Or do you get it in chunks at a time?

Answer – David B. Wyshner: Sure. We think we are delivering benefits already from the 10 levers, and they're helping us. They helped us this past quarter, and they will continue to help us going forward. It's not perfectly linear, but I do expect these benefits to come in over time. And our goal, our target, our expectation is really to be at the $700 million to $1 billion run rate by the end of 2023. So we are expecting these to come in over time and to produce benefits. And that's -- and that will help us as we move into 2021.

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

Answer – Allison M. Landry: So just if we go back to the beginning of this year and the original EBITDA guidance for 2020, I think, implied around $1.8 billion of EBITDA. And just as we look at the second half run rate, you're sort of tracking pretty close to those levels. I mean I know you don't want to give specific guidance, but maybe as a framework or a starting-off point, is it reasonable to assume that 2021 could look like the original 2020 guide?

Answer – Bradley S. Jacobs: Gee, we just don't want to give guidance yet for 2021. You got the COVID thing out there, you got the election thing, you got positive stuff going on with e-commerce. There's a lot of puts and takes, and let's see how the world looks. But right now, we're feeling very good. I mean, obviously had a very big rebounded quarter. And we got a lot of momentum continuing into the fourth quarter. But let's wait a little bit until we get in a position to say what 2021 is going to look like. At the moment, right this second, it's looking very good. But some of that depends on things that have nothing to do with XPO Logistics.

Answer – Allison M. Landry: Okay. Fair enough. And then just without commenting on the European logistics sales, could you give us an update on how you're thinking about capital allocation more broadly? Where do you stand as far as revisiting a strategic sale or asset spend versus reengaging in M&A? And are you more inclined to consider one versus the other?

Answer – Bradley S. Jacobs: You're right, we're not going to comment on strategic alternatives on this call. In terms of, generally, capital allocation, it's the same choices that we've always had between M&A and CapEx and paying down debt and buying back shares and so forth. And our strategy is always going to be the same. Whatever is the best thing for our shareholders in terms of creating the most amount of shareholder value, that's what we'll do.

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

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

Question – Amit Singh Mehrotra: David, I wanted to ask about free cash conversion relative to EBITDA. I think it was -- if you look at the guidance this year, it implies kind of 37%. It was pretty much the same in 2019, plus a little bit higher, but pretty much the same. Is that the right way to think about it structurally for the business mid, long term?

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And the reason I ask, obviously, because we're expecting -- I think everybody is expecting nice growth, particularly in the logistics business next year. I know there may be some working capital investments that are disproportionately high as a result of that kind of mix shift even though, I guess, maybe you guys have been doing actually a pretty good job on the working capital side. But I just want to understand kind of what's the right expectation for free cash conversion relative to EBITDA.

Answer – David B. Wyshner: Yes. The way I think about it is the interest costs are essentially a fixed outlay that we have. And as a result, measuring that as a percentage of EBITDA will change depending on where our EBITDA is. So as our -- as EBITDA rebounds, we're seeing the interest outlay portion go down a bit. And so I think that will be helpful.

Other than that item, I don't really see anything really impacting cash flow conversion a bit. But we will -- but we should have the tailwind associated with -- that you saw in Q3 where interest becomes a lower percentage of EBITDA as EBITDA rebounds.

The other thing I would just point out is that you're right to look at free cash flow and free cash flow conversion on an annual basis. There's a fair amount of noise and volatility from quarter-to-quarter. So I do think it's very helpful to approach it the way you were suggesting on more of an annual basis.

Question – Amit Singh Mehrotra: So just if I'm reading your comments correctly, the working capital and CapEx evolution relative to EBITDA growth shouldn't be that materially different, correct?

Answer – David B. Wyshner: Yes. We're not giving a projection on 2021 yet, but yes, that's correct.

Question – Amit Singh Mehrotra: Okay. And then just a follow-up for me. David, the company has had this $0.5 billion cost opportunity out there for some time. I think that's 60% of the $700 million to $1 billion. The balance is revenue and pricing-driven, but this idiosyncratic cost opportunity is about $0.5 billion. You've brought in -- the company has brought in kind of proven executors to go after that opportunity and then some. Do we start seeing more of a bending of the cost curve in 2021?

I mean you guys have talked about 23-77 fixed versus variable cost structure. That implies 30 percentage points -- sorry, 30% of kind of incremental/decrementals at your margin level. But when do we start seeing some bending of that cost curve in the context of that idiosyncratic cost opportunity?

Answer – David B. Wyshner: Yes. I mean we're -- it's a great point. And I think it will be easier to see next year. We're actually generating benefits from the actions we've taken, whether it's XPO Smart labor planning in helping us manage costs from that perspective, the optimization initiatives that are going on and even SG&A and back-office savings that we've been able to implement. Obviously, amid the pandemic, the -- seeing that amid all the other moves in our -- in revenues and cost is a bit harder. But we believe we're making progress there already. And I do think it will become even more evident over time.

And one of the ways we'll be able to see that is as we look at 2021 compared to our last normalized year, which is 2019. I expect the benefits that we're generating and the efforts that Eduardo and Alex and I and a ton of other people in our operations are taking will be evident.

Question – Amit Singh Mehrotra: So that's a great point. So what you're saying, if I read you correctly, is when we look at 2021, we should really compare the top line of the revenue evolution for 2019 and kind of the contribution margins associated with, hopefully, that growth or whatever, even that contraction, hopefully not, the contribution margins associated with that change will reflect a better kind of implied drop-through than what the 23-77 fixed variable cost structure. Is that -- am I reading you correctly?

Answer – David B. Wyshner: Yes. Yes, the comparisons to 2019, not only for us but for a lot of companies, are going to be cleaner and easier to understand. And in our case, the benefits of various initiatives will be more evident as well.

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

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

Question – Scott Andrew Schneeberger: Could you please compare and contrast conditions in North America versus Europe thus far in the fourth quarter? And just with regard, they seem to be a little bit ahead of us, hopefully we don't follow, in restrictions right now, so just curious, what are -- you have a pretty tight guidance range for the fourth quarter, only 1.5 months to go. What are your considerations in the guidance for COVID impacts and timing of peak season?

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Answer – Matthew Jeremy Fassler: So Scott, it's Matt. I'll take that with a couple of thoughts here. Obviously, in the third quarter, the economy saw a meaningful recovery, both here and in Europe versus the second quarter. Each month was better than the next. The U.S., probably from a macro perspective, talking about macro activity, not COVID, is a bit ahead of Europe at this point in time. That's probably different from where we were a few months ago, where we had started to see Europe recover earlier. I think in both regions, the consumer is stronger than industrial. The Fed's industrial production number was down 7% in the third quarter, as I'm sure you saw.

For the balance of the fourth quarter, if we see good momentum now, there's 3 things that we need to watch: how the virus evolves, how governments respond and how people behave in reaction to that. We've considered in our guide the potential impact of some of the partial shutdowns that were announced in Europe over the weekend, understanding that the shutdowns are more limited and more protective of business and particularly the kinds of businesses where we have exposure. If there's impact, it's more likely to be travel, entertainment, leisure; less so some of the fallout for industrial, for example, that we saw in the second quarter. So we think if there is an impact, and we do anticipate there could be some, it will be more limited for the areas that matter to us.

Answer – Bradley S. Jacobs: Matt is exactly correct. Each month in the quarter was better than the previous month. So there's a meaningful recovery taking place despite all these adverse things going on in the world. That's partly due to our own positioning because we have so much consumer and we have so much e-commerce. The demand for automation is strong and demand for outsourcing. People are outsourcing more than they were before the pandemic. So a lot of wind to our back here. Let's see how the good things that are about us overtake any bad things in the outside world or let's see if the bad things in the outside world get better.

Question – Scott Andrew Schneeberger: All right. Matt and Brad, I appreciate that. And then just a quick follow-up. XPO Direct, you touched on a little bit in prepared remarks, but looking for a progress report. Curious to see -- obviously, it's probably very dynamic this time of year. Curious to see how you think that's tracking towards your long-term objectives?

Answer – Matthew Jeremy Fassler: Scott, we're really happy with Direct. We saw our third consecutive quarter of solid profit growth. We're seeing a surge in revenue opportunities here as e-commerce continues to gain share versus brick-and-mortar retail. And when you think about Direct and the sweet spot for Direct, think about the growth from medium-sized consumer-facing firms who really want to leverage this network rather than develop their own distribution infrastructure for e-commerce. So growth from those kinds of players is really what's propelling both the growth and the additional opportunities that we see for XPO Direct.

Answer – Operator: Your next question comes from the line of Ravi Shanker with Morgan Stanley.

Answer – Ravi Shanker: Brad, David, Matt, I know you guys don't quantify your pipeline of new business anymore, but can you just give us some color on kind of how that's looking? And also kind of relative to that, I'm not asking you for 2021 guidance. But if the world was relatively normal, do you think that pipeline can support GDP-plus growth or go back to the 2017-'18 playbook of growing at like 2 or 3x GDP?

Answer – Matthew Jeremy Fassler: I mean GDP plus is GDP plus. 2 to 3x GDP is also GDP plus. So clearly...

Answer – Ravi Shanker: I'm greedy with my plusses...

Answer – Matthew Jeremy Fassler: Yes. In a quarter like this one, by the way, our revenue growth nicely outperformed growth in global GDP. Global GDP year-on-year was down. GDP was down year-on-year in every major market in which we participated, and our revenue as a company was up year-on-year. We see terrific revenue opportunity. We'll obviously guide to '21 when we get there, and we'll also probably have a better sense of what global GDP might look like, certainly a better sense than we do now for 2021. But we continue to expect our businesses based both on the spaces that -- in which we operate, the fastest-growing areas of transportation and logistics and our idiosyncratic revenue opportunities to nicely outgrow the economies in which we operate.

Answer – Ravi Shanker: Great. And as a follow-up, Walmart recently announced a plan to drop a trial of using robots to stack its store shelves and going back to humans instead. Are you surprised by this? Is this a one-off thing kind of as a leader in warehouse automation and robotics? I get that warehouses are different than stores. But are you seeing any trend either towards using robotics and automation or away from it, kind of given the state of the current workforce?

Answer – Matthew Jeremy Fassler: Ravi, it's Matt. We saw that news. I've seen those robots in action. Our -- we have excellent momentum for the deployment of robotics in our warehouse. The way we use robotics in our contract logistics operations and the way an inventory tracking robot operates in a store are very, very different. We have excellent momentum up and to the right for the deployment of robotics, both in North America and in Europe in contract logistics. We feel very good about the productivity that we're getting from our goods-to-person and collaborative robots in that regard.

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Don't forget that a warehouse is a very controlled environment. You're not interacting with, bumping into consumers. This is a -- we can really write our own ticket for how we want a traffic pattern from such to operate in the warehouse. The story is very, very different.

Answer – Operator: Your next question comes from the line of Brian Ossenbeck with JPMorgan.

Analyst: Brian Patrick Ossenbeck, JPMorgan Chase & Co, Research Division - Senior Equity Analyst

Question – Brian Patrick Ossenbeck: So this is a question about the investments, so maybe starting maybe for David. Can you just give us a sense as to what you're comfortable putting back in the play here, even from a capital or a technology perspective? And then as you look at these opportunities for the next couple of years, what do you think the capital intensity in the tech spending will be relative to the previous years to meet that potential growth, especially compared to maybe a couple of years ago when you were scaling up some of the larger platforms and investments?

Answer – David B. Wyshner: Sure. When we look at the fourth quarter, our guide for capital spending, gross CapEx for the full year of $530 million to $550 million implies potentially about $170 million of gross CapEx in Q4. And so that's sort of the ramp-up and a little bit of catch-up that we're seeing in the fourth quarter.

When we look ahead at technology spending, we continue to expect that to be a considerable part of our aggregate CapEx. And we're really excited about the returns that are available to that. So I would expect that to be consistent with what we've been doing over the prior years because we've been really happy with the returns we're able to generate on that.

I think the other thing to think about with respect to CapEx is the -- that there is the potential for some lumpiness there over the next couple of years, particularly in contract logistics, based on the contracts we sign. So there are situations there where additional CapEx, if it happens, would be a good thing for us because it means we're bringing on attractive new customers. So that's an opportunity we'll continue to look at from a CapEx perspective going forward.

Question – Brian Patrick Ossenbeck: Okay. Got it. One quick follow-up on LTL. When you think about -- maybe you can just give us the renewals for the quarter, if you gave it, I think I missed it. And then do you expect that can reach sort of the mid-single digits next year, similar to 2018? Or do you think that can -- you can potentially outpunch that with some of the focus you have on pricing? And then maybe it's not just focus on price, but more of a holistic network approach with utilization and not just rate when you look at the longer-term EBITDA target.

Answer – Bradley S. Jacobs: Contract renewals in LTL were positive 4.4% in the quarter, so that's up from 3.7% in the second quarter. The pricing environment in LTL is good. It's very rational. It's very, very constructive. We're migrating more and more towards IT-generated pricing as opposed to human-generated pricing, and we're seeing great benefits in that from the get-go. And as we keep refining it and keep validating it, we're going to increase it. And I think that's the way of the future.

That's a general trend across our whole business and across industries in general, is automation, AI, machine learning, taking the power of the computer and figuring out ways to use it that are much better and more efficient, more productive and more profitable than humans. That's an inevitable wave, in our opinion.

Answer – Operator: Your next question comes from the line of Ari Rosa with Bank of America.

Answer – Ariel Luis Rosa: Congratulations on the strong results. So we saw a strong recovery, obviously, from second quarter. With the benefit of a little bit of distance in terms of time, maybe you could reflect on what went wrong in second quarter? And how can investors get comfort that those kinds of stumbles are unlikely to recur, especially as we see kind of rising COVID cases and lockdowns in Europe, which you addressed a little earlier, Matt?

Answer – Bradley S. Jacobs: I don't think we agree with the characterization that the second quarter was a stumble. In the second quarter, we didn't focus on profit. And we told people that. We told people, right when COVID hit, we are going to put profit off to the side for a little while here, and we're going to concentrate on the health and safety of our employees to the extreme in terms of investing money and also investing time, management time. So management's time across the organization globally was displaced from focusing on raising revenue, taking out costs, growing margins, generating free cash flow and all the things that -- all the blocking and tackling that we normally do and do well.

We put that to the side, and we prioritized getting our arms around this new and potentially very deadly pandemic that was unfolding. And that's what we did. And we didn't cut salaries. We paid $48 million of direct COVID costs. We paid out a lot of employee appreciation bonuses. In LTL, we didn't furlough as much as some of our competitors did. We knew the business was going to come back. We didn't want to have to retrain newbies later.

And in the second quarter, industrial business got much worse than retail. Obviously, the consumer was still buying stuff in the second quarter. But the industrial kind of shut down, and we have a large amount of our business in LTL, in

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particular, that's industrial-related. So that hurt us. So industrial in LTL and then industrial in European transportation, we have outsized exposures to. Sometimes that works for us. Sometimes that works against us. In the second quarter, that worked against us.

So now you see in the third quarter, we've got all the things that we have to learn already behind us in terms of protecting our employees in an efficient way. And we've had the organization not compromising on that one iota, but also focusing on the blocking and tackling that we've done throughout the whole company that's generated the superior returns that we've done. I feel very, very comfortable about where we are going into the fourth quarter and going into next year. And I'm just hoping that the world stays sane as well.

Answer – Ariel Luis Rosa: Got it. Understood. And then just along those lines, we saw a bit of a step-down in terms of SG&A expense on a sequential basis this quarter. I know there were some bonuses and things like that, that occurred in second quarter, speaking of taking care of your employees. But maybe you could talk about the sustainability of the SG&A line as a percent of revenue that we saw this quarter going forward.

Answer – David B. Wyshner: Yes, there was a sequential step-down. And even so, the third quarter had a number of items in it that were working against us. Our self-insurance costs are moving up a little bit. FX, it didn't impact the percentage, but it did impact the amount of SG&A expense we had year-over-year. And there are still obviously COVID-related costs, direct COVID-related costs that are impacting those numbers. So when we look at that, we actually still see some things that, over time, should abate and work in our favor.

Answer – Operator: Ladies and gentlemen, we have reached the end of the question-and-answer session, and I would like to turn the call back to Mr. Brad Jacobs for closing remarks.

Answer – Bradley S. Jacobs: Well, thank you, operator, and thank you, everyone, for participating in our call. Obviously, it was a really great quarter, and we look forward to talking to you again in 3 months. Have a great one. Thank you.

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

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