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Company: **XPO Logistics, Inc.**

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- Ken Hoexter - Analyst
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MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the XPO Logistics First Quarter 2022 Earnings Conference Call and Webcast. My name is Laura and I'll 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. Please note, 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 the applicable SEC rules. Reconciliations of such non-GAAP financial measures to the most comparable GAAP measures are contained in the company's earnings release and the related financial tables 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 Investor section on the company's website.

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

Bradley S. Jacobs

Good morning, everybody. Thanks for joining our call. With me today in Greenwich are Ravi Tulsyan, our CFO; Matt Fassler, our Chief Strategy Officer; and Mario Harik, our CIO and Acting President of LTL; and Drew Wilkerson, President of North American Transportation. As you saw, we delivered a quarter of record results with solid beats across revenue, net income, adjusted EBITDA and adjusted EPS, including our eighth straight quarterly beat on adjusted EBITDA.

We grew revenue by 16% over last year's first quarter, generating the highest revenue of any quarter in our history. We also had first quarter records for net income, adjusted EBITDA and adjusted EPS, which was up year-over-year by 58%.

To reflect our momentum, we raised our full year financial outlook by more than the first quarter beat. We're now guiding at the midpoint to adjusted diluted EPS growth of 26%. Both of our core North American businesses, LTL and truck brokerage, delivered double-digit revenue growth in the quarter. Our LTL network today is a very different business than it was just six months ago. Many of the network improvements we're driving are ahead of plan.

We expect our adjusted operating ratio to improve sequentially by more than 400 basis points for the second quarter. And we continue to expect our adjusted operating ratio, excluding real estate gains, to inflect the year-over-year improvement later in the quarter and for the full year to be at least 100 basis points better than 2021. Our goal is to create a world-class LTL carrier that delights our customers and our shareholders.

Turning to North American truck brokerage. We're continuing to fire on all cylinders there. Our volume growth exceeded 20% for the sixth consecutive quarter. This best-in-class brokerage business is continuing to take share and do it profitably. First quarter margin dollars were up 21% year-over-year and rose 5% sequentially, outperforming typical seasonality, in large part due to the effectiveness of our digital platform, XPO Connect.

I'm pleased that we have a brokerage veteran lined up to lead the spin-off through Wilkerson. Drew will be CEO and he's been the main architect of our brokerage growth since joining us in 2012, most recently as President of North American Transportation. He'll have a long runway to grow the business as a pure-play brokerage company. The spin-off process is on track as is the planned divestiture of our European operations, which had an excellent first quarter.

And finally, we're pleased with the deleveraging we achieved in the first quarter. In three months, we brought our net leverage ratio down from 2.7 times to 2 times, which is at the top edge of our target range. So in sum, we produced an excellent quarter and raised our outlook. We have multiple company-specific avenues for value creation, including the spin-off of our tech-enabled brokerage platform, the ongoing transformation of our LTL business, the divestiture of our European operations and our continuing deleveraging.

Now I'll ask Ravi to cover our results and our balance sheet. Ravi?

Ravi Tulsyan

Thank you, Brad, and good morning, everyone. Today, I will discuss our first quarter results, our balance sheet and liquidity and our outlook for the balance of 2022. For the first quarter, we delivered strong year-over-year growth in revenue, adjusted EBITDA and adjusted diluted EPS. Revenue in the quarter was a record $3.5 billion, up 16% year-over-year. The net impact of fuel prices and FX accounted for 2 points.

Organic revenue growth for the quarter was 14%. We grew adjusted EBITDA by 15% to a Q1 record of $321 million; adjusting for gains from real estate sales, the year-over-year growth in adjusted EBITDA was 25%. This reflects particularly strong growth in our brokerage and other services segment. Looking at a two-year stack, adjusted EBITDA was up 55%. For the quarter, our adjusted EBITDA margin was 9.2%; excluding gains from real estate sales, this was an improvement of 60 basis points year-over-year. Operating conditions in the quarter were favorable, and the pricing environment stayed firm. This was partially offset by inflationary pressures on labor and purchased transportation.

Corporate cost in the quarter was down 19% year-over-year as we continue to optimize our corporate cost structure following the spin-off of GXO. Our interest expense during the quarter was $37 million compared to $65 million in the year-ago period. This reflects the pay-down of approximately $3 billion of debt last year. The effective tax rate for adjusted EPS during the quarter was 23%. Our adjusted earnings per diluted share for the quarter was $1.25, which was up from $0.79 a year ago, an increase of 58%. This increase was primarily driven by higher adjusted EBITDA and lower interest expense.

We generated $200 million of cash flow from continuing operations, spent $137 million on gross CapEx and received $3 million of proceeds from asset sales. Gross CapEx was up $63 million year-over-year with the majority of the additional spend going towards equipment purchases for North American LTL business.

As a result, our free cash flow was $66 million, which was above our expectation. This includes the impact of $15 million of cash outflows related to transaction costs that were not contemplated in our free cash flow guidance.

We are making significant progress on our strategy to create two pure-play transportation powerhouses, and we remain on track to complete the spin-off of our tech-enabled brokerage platform in Q4 of this year. As part of our strategic plan, we took an important step last quarter when we completed the sale of our intermodal business for cash proceeds of $710 million, which represented a multiple of approximately 10 times 2021 EBITDA.

Including the proceeds from the sale of the intermodal business, we ended the quarter with $1 billion of cash on the balance sheet. This cash, combined with available debt capacity under committed borrowing facilities, give us $2 billion of liquidity at quarter end.

We had no borrowings outstanding under our ABL facility. After quarter end, we repaid $630 million of 2025 notes. This was another significant step in our plan to reduce our debt and deleverage our balance sheet. Our net leverage at quarter end was 2 times adjusted EBITDA. We are ahead of schedule on our deleveraging plan, and we now expect to be below 2 times leverage before year-end.

In light of our strong first quarter results and ongoing earnings visibility, we updated our full year guidance after market close yesterday. Our new full year guidance for adjusted EBITDA is $1.35 billion to $1.39 billion. The update reflects our first quarter outperformance, the sale of the intermodal business and our strong outlook for the remainder of the year.

The real estate assumptions we gave you in February remains the same. For the second quarter, we expect our adjusted EBITDA to be $360 million to $370 million. Pro forma for the intermodal sale, the midpoint of our second quarter EBITDA guidance implies a year-over-year growth rate of 15%.

We have raised our outlook for full year adjusted EPS to a range of $5.20 to $5.60. This increase reflects our new EBITDA guidance and the reduction in interest expense resulting from our pay-down of debt. The midpoint of our adjusted EPS guide implies year-over-year growth of 26%.

On the cash flow front, our outlook for full year free cash flow remains $400 million to $450 million. As a reminder, our outlook excludes all transaction-related cash outflows. Our full year guidance for depreciation and amortization expense is approximately $385 million, down from $400 million, reflecting the sale of the intermodal business.

We expect interest expense of $150 million to $160 million, down from $170 million to $180 million previously. There is no change to our previous guidance for CapEx and the tax rate.

In conclusion, we are continuing to execute on our strategic plan and we remain excited about our prospects for the balance of 2022. I will now turn things over to Matt.

Matthew J. Fassler

Thanks, Ravi. I'll review our first quarter operating results, starting with our North American LTL segment. We grew LTL revenue by 15% year-over-year to $1.1 billion, the highest revenue of any quarter in our history. Excluding fuel, we grew revenue by 9% year-over-year. We had a 0.8% decline in tonnage per day, which represented 4.1 percentage points of acceleration from our fourth quarter growth rate as our network flow improved. The 4% increase in the level of weight per day from the fourth quarter nicely outpaced typical seasonality.

Yield, excluding fuel, increased 9% year-over-year. Our weight per shipment growth of 2% increased from flat in the fourth quarter and our length of haul increased 0.2% versus a 1% increase in the fourth quarter. Adjusting for these factors, underlying pricing trends were stronger.

The LTL pricing environment remains firm, and we're driving yield with our own company-specific pricing initiatives. Our yield growth is even stronger this quarter to date. Our LTL adjusted operating ratio was 85.7%. That's 140 basis points higher than the first quarter a year ago and significantly better than the 200 basis point year-over-year increase we guided to in February. Both numbers exclude gains from real estate, and note that, consistent with our guidance, we booked no such gains in the first quarter. And sequentially, our adjusted OR improved by 180 basis points from the fourth quarter, which was notably better than our typical seasonality.

The single biggest driver of the year-over-year increase in our adjusted operating ratio was the higher cost of purchased transportation. Third-party line-haul miles as a proportion of total line-haul miles increased in the quarter to 24.5% from 23.9% a year ago. This aligns with our plan to use more third-party line-haul in the near term as volume recovered prior to our onboarding new capacity.

In addition, most of our purchased transportation is subject to contractual pricing. Headwinds from this pricing are starting to abate as we cycle big truckload price increases from a year ago and as new line-haul contracts cycle in. Those are the highlights for North American LTL.

In our brokerage and other services segment, we grew revenue by 17% to a record $2.4 billion and adjusted EBITDA by 31% to a record $164 million. Adjusted EBITDA margin for the segment expanded by 60 basis points to 6.7% from 6.1% a year ago. The largest revenue and profit driver in the segment is our North American truck brokerage business, which had another outstanding quarter. This will be the core business of our planned spin-off later this year.

We increased our brokerage loads per day by 23% versus a year ago and up 52% from two years ago. First quarter truck brokerage revenue rose 38% year-over-year. Margin dollars rose 21% against another tough comp and nearly tripled from the first quarter of 2020. On a sequential basis, margin dollars in the first quarter were 5% higher than in Q4. Our truck brokerage growth reflects our strong execution in a dynamic market. Drew will speak more about the specific drivers in a minute.

Organic revenue in Europe grew 5%, accelerating by 2 percentage points from the fourth quarter. We saw acceleration in organic revenue growth in both the UK and in France, our two largest European geographies, and we're pleased with our resilience in the context of uncertainty in the European environment. We expect to continue to build on our position as a leading provider of truck brokerage and LTL in the UK, France and Iberia, within our broader pan-European platform.

We're grateful for some external recognition we received during the quarter. General Motors named us Supplier of the Year for the fourth straight year. In addition, we were recently given Vets Indices Employer (sic) [Indexes Recognized Employer] (00:16:51) status for our strong record of hiring members of the military community. Last week, we published our fourth annual sustainability report, which details our progress on ESG initiatives and our materiality index for 2021. You can download this report online.

Finally, I want to mention that we plan to hold separate investor events later this year for both our brokerage SpinCo and our LTL RemainCo prior to completing the spin. We'll use those events to give you a deep dive into our longer-term vision and key financial targets for each standalone company.

Now, I'll turn it over to Mario for his comments on North American LTL.

Mario A. Harik

Thanks, Matt, and good morning, everyone. As Brad said, LTL is a very different business than it was six months ago. Our network is much more fluid and balanced. We're realizing significantly stronger service metrics in key areas such as on-time transit and freight handling. The short rebound has brought our network efficiency back to pre-pandemic levels. Our investment in capacity are on track, and we're rolling out new proprietary technology to improve pricing and drive further productivity.

Most importantly, there is widespread excitement across the LTL team around the many new initiatives we've launched to optimize the network. I'll give you an example. This month, we kicked off a national initiative to further improve the quality of our trailer loading and on-time delivery. We're also engaging with customers on best practices in how they package their freight.

When we announced this initiative, it triggered a tidal wave of enthusiasm in the field. In just a few weeks, we've seen great momentum building in the organization. Our goal is to create a world-class LTL carrier that delights our customers and our investors. It won't happen tomorrow, but the commitment is there, and we're already moving in that direction. I wanted to give you the backdrop first because the transformation we're undertaking in LTL helped us beat our guide for adjusted operating ratio in the first quarter.

In February, we guided to 200 basis points of year-over-year degradation, reflecting our continuous progress in moving the operating ratio back towards year-over-year improvement. In reality, we did better than the guide. Our Q1 degradation was just 140 basis points. This gave us an adjusted operating ratio ex real estate of 85.7% for the quarter. We expect to inflect year-over-year improvement in adjusted operating ratio at some point later this quarter, as we said we would, and we're on target for a year-over-year improvement of more than 100 basis points in adjusted operating ratio ex real estate for the full year.

We plan to drive hundreds of additional basis points of OR improvement in the coming years to get the ratio well into the 70s. And importantly, the underlying trends are favorable. We reported record first quarter revenue of $1.1 billion, which is 15% higher than last year. Our year-over-year yield improvement was a first quarter record at 9%. Tonnage was down slightly year-over-year, within the rates we told you to expect.

When you look one step deeper, the sequential trends are also positive. Growth in revenue per shipment accelerated every month in the quarter. Our yield also accelerated throughout the quarter with the strongest gain coming in March. We're operating in a very robust pricing environment.

Our tonnage in the quarter was up 4% sequentially, which is better than typical seasonality. Usually, our tonnage is flat from Q4 to Q1. And as I mentioned, the momentum in our operating ratio is building ahead of plan. We expect our second quarter adjusted operating ratio to improve by more than 400 basis points from Q1 to Q2. So the business is very much on track.

Now, I want to cover some of the first quarter actions we took to expand our capacity and deploy technology. These are the two main areas where we're investing in growth. We recently opened new terminals in California and Georgia. These sites bring our net new doors to 345 since October against a target of 900 net new doors added by year-end 2023. So we're more than a third of the way there.

The San Bernardino terminal will serve growing demand from manufacturing and retail in Southern California and the Atlanta terminal expands our capacity in one of the largest LTL regions in the South. It also gives us a larger gateway into Florida. These two sites will be growth levers for us in 2023 and going forward.

We're also making great progress in expanding our fleet of trailers. In the first quarter, our manufacturing facility in Arkansas produced more trailers than any other quarter in our history. We also opened new fleet maintenance shops in Florida, Ohio, Nevada and New York, which will help us manage maintenance costs. We continue to budget for gross CapEx at 8% to 9% of revenue this year and again, we're on plan. On the technology front, recent developments include the ongoing application of our proprietary pricing platform, which is driven by advanced automated analytics around customer shipment data.

This means our pricing experts are now able to focus more time on analyzing account performance and we can negotiate with better results. In Q1, our price increases on contract renewals accelerated to 11%.

In April, we brought onboard David Phalen as Senior Vice President of Pricing for LTL. David's career includes decades of success in optimizing pricing for transportation sectors, including the airline industry where he specialized in pricing and yield management. In other developments, we launched automated billing for accessorials, to make sure we capture those revenue dollars, and we rolled out a new digital dashboard with self-service tools to enhance the customer experience.

This quarter, we'll be introducing proprietary cost models to enhance visibility into cost management levers as well as new piece-level tracking functionality for our network.

So to sum it up, our comprehensive growth and optimization strategy for LTL comes down to one goal. We're creating a world-class LTL carrier, and we have every confidence that we'll succeed at this goal. Just as we succeeded in dramatically increasing LTL returns over the first six years we owned the business. We continue to expect to generate at least $1 billion of adjusted EBITDA in LTL in 2022. This has nearly tripled the adjusted EBITDA generated by the LTL network in 2015 when we acquired it from Con-Way.

What you're seeing from us in 2022 is that we're full steam ahead, laser-focused on efficiency and superb customer service. And our momentum will continue to grow because we have the support of our people who are some of the best LTL operators in the industry.

Now, Drew will cover truck brokerage. Drew?

Drew Wilkerson

Thanks, Mario. North American truck brokerage had another very strong quarter. We continued to do what we do best, outpace the industry on volume growth, operate at a strong margin and use our experience and technology to make sure our customers' freight gets where it needs to be.

In the first quarter, our loads were up year-over-year by 23%, driving a 38% increase in revenue. It was our sixth consecutive quarter of load growth over 20%. And margin dollars were up year-over-year by 21%. That's more than double the increase in the fourth quarter. Gross margin per load increased sequentially from the fourth quarter and our margin percentage was a very healthy 16%.

So a strong start of the year, and we continued with the same strong trends in April with both volume and margin percentage. We built our model as a growth engine that's working exactly as we intended. There are five compelling advantages specific to our platform. First, 68% of our business is contract-based, and about 75% of that contract revenue is locked up on a annual basis. This gives us good visibility into the future revenue performance.

Second, we have many long-term customer relationships with blue chip market leaders across diverse verticals. These customers think of us as a strategic partner. Our top 10 brokerage customers have an average tenure with us of 15 years, and our top 20 customers have a tenure of 13 years. Third, we're continuing to expand our pool of independent carriers who provide our customers with truck capacity. This massive capacity is at the heart of our value proposition. As of March, we have relationships with 88,000 carriers in North America and access to more than 1.5 million trucks.

Fourth is our XPO Connect technology, which continues to attract customers and carriers to our business. Our first mover advantage with brokerage technology is one of the main drivers behind our rapid growth. XPO Connect lets us capitalize on two interrelated secular trends that work in our favor. More shippers are outsourcing truckload transportation to brokers, and increasingly, these shippers want digital brokerage capabilities.

At the same time, more carriers are realizing that we can give them access to thousands of loads on a daily basis. Carriers and customers love to do business with us because we have a state-of-the-art digital platform. In the first quarter, the number of registered carriers on XPO Connect year-over-year was up 39%. Registered customers were up 41% and weekly carrier usage was up 59%. We also surpassed 700,000 cumulative downloads of our mobile app.

And 74% of our loads were created or covered digitally in the quarter, which is up 4 points sequentially. That number is already trending higher in the second quarter.

The fifth compelling advantage is our exceptional truck brokerage management team, all of whom will be joining the spin-off. It's a privilege to work with these great operators and technologists since the early days of XPO. Together, we've built a best-in-class brokerage platform that delivers outsized results and puts us in a strong position to spin off as a pure play.

As a new company, we'll manage about $7.5 billion of transportation spend and continue to innovate the business to grow it from there. From day one, it will be easier for investors to appreciate our flexible asset-light business model, our economic resilience and our very high return on invested capital. We're excited to take this business to the next level as a separate public company when the spin-off is complete.

With that, I'll turn it over to the operator, and we'll go to Q&A.

QUESTION AND ANSWER SECTION

Operator

At this time, we'll be conducting a question-and-answer session Our first question comes from the line of Ken Hoexter with Bank of America. You may proceed with your question.

Analyst: Ken Hoexter

Question – Ken Hoexter: Great. Thanks, and good morning, Brad and team, nice job on the quarter and outlook, and Drew, congrats. So if I can start out, Brad, you made some comments during the quarter. You noted some weakness in the trucking market. Matt, you noted that some of the line-haul contracts are cycling in at a lower rate. So I just want to understand, are you seeing contract rates down already? And I guess, how does that contrast with your target for hundreds of basis points going forward in LTL margin? Is that more then on the cost side? Or is that still on the pricing strength in the industry to continue? Thanks for the (00:29:44).

Answer – Mario A. Harik: I'll take this on the line-haul contractual rates. So we just completed our yearly bid for our third-party line haul where we outsource line-haul miles to third parties here last week is when we had the new rates come in. And contractual rates have actually gone up slightly versus where they used to be but nowhere near on the level of increases that we've seen, obviously last year and through Q1 as well on a year-on-year basis. So rates are moderating. But the contractual rates are still up and it was a competitive bid, obviously, across multiple carriers there. But this is what we're seeing on the line haul outsourcing side with LTL.

Question – Ken Hoexter: And your thoughts on the LTL margin then, is that due to pricing gains solely that when you talk about 100s going – basis points going forward?

Answer – Mario A. Harik: Yeah, when we look at the overall improvement in LTL, looking at the second quarter and moving forward, it's really driven by three categories. One is pricing; one is volume and one is operational excellence and costs. On the pricing side, we continue to see very robust pricing. So we ended the first quarter with a full year improvement of 9% year-on-year. And heading into the second quarter here, we crossed into double-digit territory.

On the volume side, we – for the second quarter, we expect to be down low- to mid-single-digit and then accelerate in the back half of the year. And then finally, on the costs side, the third component is around some of the cost headwinds that we had last year, such as purchase transportation would end up being a much lower headwind as we head through the year and starting here with the second quarter in the month of May. And also our network is much more efficient, so now that our network fluidity has improved substantially, also, overall, our cost footprint is down, which leads to the OR improvement of more than 400 basis points in the second quarter.

Question – Ken Hoexter: Thanks, Mario.

Answer – Mario A. Harik: Thank you.

Operator

Our next question comes from the line of Scott Group with Wolfe Research. You may proceed with your question.

Analyst: Scott H. Group

Question – Scott H. Group: Hey. Thanks. Good morning, guys. Can you talk about the contractual pricing environment in LTL? And I think last quarter you talked about the potential for another LTL GRI, if you can give an update there.

And then just separately, Brad, can you give any update on the process in Europe? And does the macro environment in Europe put this at risk or timing of this at risk at all? Thank you.

Answer – Bradley S. Jacobs: I'll start with the last part, Scott. The European process is going well. It's a vibrant process. And to date, the Russia-Ukraine thing has not affected it.

Answer – Mario A. Harik: And Scott, on the pricing environment in LTL, it continues to be very strong. When we look at the first quarter for us, we – our contract renewals accelerated to 11%. And our yield in the second quarter accelerated from 9% in the first quarter and crossed double-digit so far quarter-to-date. So it remains a very strong environment.

Question – Scott H. Group: Brad, can I – do you think that at this point, a sale or a separate listing is more likely?

Answer – Bradley S. Jacobs: I think a sale is.

Question – Scott H. Group: Okay. Thank you, guys.

Answer – Bradley S. Jacobs: Thank you.

Operator

Our next question comes from the line of Chris Wetherbee with Citigroup. You may proceed with your question.

Analyst: Chris Wetherbee

Question – Chris Wetherbee: Hey. Thanks. Good morning. Sticking on LTL, I was wondering, could you give us a little sense of sort of maybe the volume progression and how maybe things are looking in April. I know you're looking for, I think, low-single-digit tonnage decline in the second quarter. I just want to get a sense of how April is trending.

And then Mario, maybe a little bit bigger picture, when you think about where you are in terms of cost takeout. So we've gone through some contracting on the truckload line-haul side. I think you've been trying to improve network efficiency. I think you actually said it's back to where it was before you had issues.

So, want to get a sense of sort of when we can start to expect that to generate positive margin progression from here. Still – and the guidance is good from a sequential standpoint and I know you're guiding for the back half to improve but I just want to get a sense of maybe what the costs that are – still need to be wrung out of the system are and how we should think about that happening over the rest of the year.

Answer – Mario A. Harik: Hey, thanks, Chris. So first for Q2 tonnage, so we expect the tonnage to be down low- to mid-single digits, as I just mentioned. And April was within that range. And however when it comes to revenue when we look so far in April, our revenue growth per day in the month of April has accelerated versus the Q1 revenue growth per day.

Now when we look at the tonnage momentum as a whole, we still expect tonnage momentum to build through the course of the year, because we have great sales momentum and the team is very energized. That team has driven here in the month of April the best win rate we've had in sales over the past four years. We have dozens of multimillion dollar opportunities that have either closed in the month of April or early May, or about to close in the month of May, including a new top 10 customer. So when we think about the momentum building through the course of the year, we expect to build that momentum in the back half.

And on the balance, it's still a very healthy environment, we expect, and that's why we expect more than 400 basis points of OR improvement from Q1 going into Q2 and a full year of at least 100 basis points of OR improvement.

Now when we look at the cost side of it, so obviously, a big component of our cost is purchased transportation. And these costs will be – are starting to normalize, now as we finalized the bid for line haul this past week and the new rates are into effect. So that's going to be an improvement in the back half of the year.

Similarly, when you think about our dock costs or our P&D costs, when we're running a much more efficient network, a lot of these metrics are trending up into the right, in terms of higher efficiency of dock labor and P&D labor as well. So when we head into the back half of the year, these would be some – and also reducing re-handling costs as well. And all of these would lead to the back half of the year, I think a lot of these cost pressures abate on a year-on-year basis. Now obviously, there's still inflationary costs with wages and other portions. But all of these – again, the pressure on costs is going to abate in the back half.

Question – Chris Wetherbee: That's helpful. One point of clarification on the purchased trans when you're thinking about these contract renewals, those contracts are renewing at higher levels, correct? So the costs go higher going forward? Or it will actually be net lower because you're just relying less on the spot market? I just want to make sure I understand how that plays out.

Answer – Bradley S. Jacobs: The costs are a little bit higher, but the increases are abating as you go through the year. We had big increases in Q1. Those increases diminish as we go through the year. Consequently, the headwind from PT diminishes and flips to a favorable factor for OR as you move to the back half.

Question – Chris Wetherbee: Okay. Thanks for the time.

Answer – Bradley S. Jacobs: Thank you.

Answer – Mario A. Harik: Bye, Chris.

Operator

Our next question comes from the line of Brandon Oglenski with Barclays. You may proceed with your question.

Analyst: Brandon R. Oglenski

Question – Brandon R. Oglenski: Hey, good morning, everyone. So I don't mean to belabor this point, but with the volume trends down low-single to mid-single digits this quarter, do you think that's where the market is? And have you guys fully recovered from a service perspective with your customers? And I guess, longer term, I think in the release, and you guys have talked about before, you're going to have like 6% or 7% door growth in the network between now and next year. Do you think that's coming on at the right time?

Answer – Mario A. Harik: Yeah, let me try to cover all of them. So why – the first one is on tonnage. So it's fair to say that there are crosswinds in the freight environment. Now I'll tell you, we frequently engage with the group of salespeople in the company when we get the feedback on what's happening, what feedback they're hearing from customers. And we just had the last review here yesterday. And we're still hearing a lot of optimism about demand from customers.

But we're also hearing that the lockdowns in China limited some of the inflows of goods into the country. And some of the shortages, either the chip shortages or the raw material shortages, are also impacting some of our industrial customers. Now, when see overall as these dynamics abate, and they will, these will become natural tailwinds for us in the back half of the year.

And as I mentioned earlier, what we're excited about is our momentum from a sales perspective, but we have a energized sales team that is driving great results as we head into the back half.

And now in terms of the adding capacity and the door plan, so obviously, we don't look at adding doors as being a short-term lever. LTL is a very attractive industry that has great vitality through the cycles. Today, we're the top three pure-play provider when the spin is completed. And our company-wide ROIC is 38%, and LTL has a higher ROIC than that. So when we think about adding doors, equipment and head count, it's supporting the long-term vision of the network where we are going to gain market share and get back to growing our top line, both from a volume perspective and obviously from a capitalizing on the yield as well as the industry.

Question – Brandon R. Oglenski: Thank you.

Operator

Our next question comes from the line of Tom Wadewitz with UBS. You may proceed with your question.

Analyst: Michael Paul DiMattia

Question – Michael Paul DiMattia: Good morning. This is Michael DiMattia for Tom. You mentioned that new contract renewals were up 11% in the quarter, which was greater than the revenue per hundredweight growth ex fuel. Does that imply that you expect yields to improve or accelerate in the second quarter? And also, how should we think about new contract wins impacting tonnage per day going forward?

Answer – Matthew J. Fassler: I'll take the first part of that. First of all, I think I alluded to this in my prepared remarks, we saw weight per day or rather weight per shipment moved higher and length of haul growth moderate a bit. So (00:39:30) relative to underlying pricing trends. We are currently tracking double-digits in yield quarter-to-date. So you're seeing yield track much closer to price increases on contracting loads (00:39:44). And Mario will take the second part on new contracts.

Answer – Mario A. Harik: Yes. Based on what we're hearing from customers, it continues to be a very robust pricing environment. If you think of our industry, you have top 10 players in the business that today manage roughly 76% of the $51 billion LTL industry. And when you think about those dynamics, the pricing environment is still firm in LTL. And as I said earlier, from a sales perspective, we just landed a top 10 customer, and we continue to have great momentum in terms of opportunities in the pipeline as well, and pricing seems to be robust.

Question – Michael Paul DiMattia: That sounds great. Thank you.

Answer – Matthew J. Fassler: You bet.

Operator

Our next question comes from the line of Jonathan Chappell with Evercore ISI. You may proceed with your question.

Analyst: Jonathan Chappell

Question – Jonathan Chappell: Thank you. Good morning. If we look at the guidance that you gave for the enterprise as a whole and then LTL and try to back into what that means for brokerage and other, there's obviously a deceleration from the first quarter on the adjusted EBITDA. Clearly, most of that is intermodal. But as you're thinking about the margin for the brokerage and other business overall, what was the impact that the pro forma intermodal is going to have? Is that margin going to go down tens of basis points more substantially? And how should we think about that run rate EBITDA going forward?

Answer – Matthew J. Fassler: It's Matt. I'll speak about the impact that the divestiture of intermodal had on our guidance for the second – for the rest of the year. And hopefully, that will help you get an answer to your question. So if you look at the delta from the guidance that we issued at the end of the fourth quarter entering the year and the guidance that we just gave you today, we had about $60 million of adjusted EBITDA modeled for intermodal for quarters two through four. That's obviously out.

The guidance change reflects that coming out, plus the first quarter view, which versus the midpoint of the range was about $38 million and, at the midpoint, about $12 million of additional EBITDA, so an intrinsic raise for the rest of the business for quarters two through four. Obviously, the increase in EPS range reflects all those factors as well as the lower interest expense, reflecting the debt pay-down from the proceeds of the intermodal transaction.

Question – Jonathan Chappell: That's helpful, Matt. And obviously, intermodal is better-margin business. But I mean, is there any just guide you can give at all, 20, 50, 70 basis points, what that may mean to the pro forma adjusted operating ratio on brokerage going forward? Or is it too early to say?

Answer – Matthew J. Fassler: I don't think the difference between intermodal and the rest of the business in terms of adjusted EBITDA margin is sufficiently different to really move the needle for segment level margins.

Question – Jonathan Chappell: Okay. Thanks, Matt.

Operator

Our next question comes from the line of Allison Poliniak with Wells Fargo. You may proceed with your question.

Analyst: Allison PoliniakCusic

Question – Allison PoliniakCusic: Hi. Good morning. Mario, you continue to highlight the technology around pricing, and I think the accessorial charges you mentioned. Is there a way to disaggregate for us the contribution of what those – I would say, these pricing tools have given to you this quarter? And then second, with brokerage, you highlighted market share gains, and it's been a consistent story there. Is there any way to think about how you're viewing market share gains in the context of your growth expectations for this year? Thanks.

Answer – Mario A. Harik: Thanks, Allison. I'll talk on the pricing platform. So we're very excited about the new pricing platform we launched in Q1 with continuous enhancements through the course of the year. Because it's driven by advanced analytics and it allows us – around customer shipment data. So we analyze customer data more efficiently. And it really helps our pricing experts – it reduces manual task and manual data processing by as much as 80% where it enables the pricing experts to spend more time negotiating with the customer and supporting our sales team to do so.

It also enables us to analyze RFP data of RFPs we submitted in the past, which leads into lead generation tools. Similarly, we're also – this coming quarter, we're launching new capabilities with a proprietary costing model that allows us to improve how we look at costing in our network across the board. And we also improved dynamic pricing where we can adjust pricing based on market conditions and customer demand as well.

Now when you look at the overall results, obviously, we accelerated our yield from 9% in the first quarter to double digit – we crossed the double-digit mark in the second quarter with 11% contract renewals in the first quarter. Now it's tough to be able to get to how much of that was the work that the technology is doing versus the people are doing, but technology is definitely having a big contribution as part of that.

Answer – Drew Wilkerson: Good morning, Allison, this is Drew. On the second part of your question, we're in the early innings of continuing to go out and take market share within our truck brokerage team. Obviously, we've grown volume by 20% for six consecutive quarters. So overall, this is – the trucking industry is a $400 billion for-hire trucking market. Of that brokers have about $88 billion, and we're – our brokerage is roughly $3 billion. So when you look at it, we've only got about 3% share of the market. Our technology has given us first mover advantage and is allowing us to continue to go out and take share.

Question – Allison PoliniakCusic: Great. Thank you.

Operator

Our next question comes from the line of Scott Schneeberger with Oppenheimer. You may proceed with your question.

Analyst: Scott Schneeberger

Question – Scott Schneeberger: Thanks very much. First one is kind of a two-parter for you, Drew, and congratulations on the announcement of your new role.

Answer – Drew Wilkerson: Thank you.

Question – Scott Schneeberger: In truck brokerage – where would you say are we in the truck brokerage cycle from what you've seen in the past and where you feel we are right now and then the follow-up there is the – you've seen great penetration on digitally covered orders, up to 74% from 70% last quarter. How high do we anticipate that to go and any thought on what type of financial contribution a 1,000-basis-point move actually contributes? Thanks.

Answer – Drew Wilkerson: Yeah. So thank you for the question. So on the cycle, you look at it right now and rates are up on a year-over-year basis overall. As we start heading into the back half of the year, there are a few indicators that show you that capacity could actually tighten as the year goes on. First, you've got beverage season, which is coming in, and that's going to create about 100, 120 days where your major beverage distributors tick up their volume during that time. You also have DOT checkpoint week that comes in over the summer, which typically causes a little bit of chaos in the market.

And the third thing is you have a lot of built-up demand that's sitting in the ports of China that's going to come over and hit the US ports. So all of that tells you that it could tighten up a little bit as we head into the back half of the year.

On our digital orders, it's something that you're going to continue to see go up and to the right. I don't think that there's a limit to what we can do. Obviously, we've invested in technology from day one. It's been an 11-year investment for us, and it's something that has allowed us to become sticky with both the customers and the carriers that we're working with. So we expect that to continue to go. And it's one of the things that our technology – as you hit on, is one of the things that allows us to come in and have best-in-class EBITDA margins, and we'll continue to see gains off of that.

Question – Scott Schneeberger: Great. Thanks. Appreciate that. And then Brad, as the founder and large shareholder, you had in April another transaction in the shares. Could you just update us and remind us kind of your strategy with regard to your ownership in the company going forward? Thanks

Answer – Bradley S. Jacobs: Well, we discussed my [Rule] 10b5-1 plan at length in the last earnings call. I don't have anything more to add to that. In terms of my future with the company, I do plan to be with XPO for a very long time.

I'm non-Executive Chairman of GXO. I'll be non-Executive Chairman of the new spin. I'd like to remain Executive Chairman of XPO for as long as investors will have me, and I'll remain CEO until someone comes along who I think is better than me.

Question – Scott Schneeberger: Great. Thanks, Brad.

Answer – Bradley S. Jacobs: Thank you.

Operator

Our next question comes from the line of Bascome Majors with Susquehanna. You may proceed with your question.

Analyst: Bascome Majors

Question – Bascome Majors: Yeah. Thanks for taking my questions. Brad, can you update us on the LTL President search as kind of a corollary to the last question there? And where do you stand? What's the time line look like? And what's the balance of internal versus external candidates that you're still looking at? Thank you.

Answer – Bradley S. Jacobs: Well, our search in the management lineup is still ongoing. We don't have anything new to add to that, in terms of timing, as soon as it makes sense. We're not going to rush it. We're not going to delay it. As soon as it makes sense, then we'll do it. In terms of the other question you had about internal versus external, we're considering all possibilities. So long story short, we're staying flexible as we always are.

Question – Bascome Majors: Okay. Thank you.

Answer – Bradley S. Jacobs: Thank you.

Operator

Our next question comes from the line of Christopher Kuhn with [The] Benchmark Company. You may proceed with your question.

Analyst: Christopher Kuhn

Question – Christopher Kuhn: Yeah. Hi. Good morning, guys. Thanks for taking my question here. I just was – you mentioned digital orders are going up and to the right, and I was just wondering what the margin profile of that will be as the price transparency gets better and better.

Answer – Drew Wilkerson: Thanks for the question, Christopher. Our digital orders trend in line with our overall orders as far as margin percentage goes.

Question – Christopher Kuhn: Okay.

Answer – Drew Wilkerson: It does allow us to leverage – SG&A leverage though (00:49:35), Christopher. So the EBITDA margin is going to be higher.

Question – Christopher Kuhn: Right, right. So is it possible that the gross margins could trend down, but EBITDA could be higher as you leverage flows over employees or revenue over fewer employees?

Answer – Drew Wilkerson: Yeah, that's absolutely possible.

Question – Christopher Kuhn: Okay. Thanks. Appreciate it.

Answer – Drew Wilkerson: Thank you.

Operator

Our next question comes from the line of Brian Ossenbeck with JPMorgan. You may proceed with your question.

Analyst: Brian P. Ossenbeck

Question – Brian P. Ossenbeck: Hey. Good morning. Thanks for taking the question. So maybe a two-parter for you, Drew, can you just talk about big picture, what else do you think you'll be investing in or focused on as a separate entity? And maybe the answer is just more of the same, but would still like to hear your thoughts on that and how you're thinking of that going forward.

And then, just secondarily on the head count side, if you can just give us a sense in terms of what's the head count you're being on the system, how much do you have in the pipeline and hit those load growth targets that you've been generating here in the last couple quarters?

Answer – Drew Wilkerson: Yeah, absolutely. Thank you for the question. On big picture, we've got a model that is proven that it's working. So we want to continue to execute the model. It has allowed us to go out and grow volume by over 20% for the last six quarters, and it's allowed us for the last eight years to outperform the industry revenue growth by more than 3 times. So we want to continue to execute on the model.

But there's three things that I'm focused on right now. The first is continuing to build out an exceptional management team that complements the great operators and technologists that we have in the business. The second piece is to go out and continue to delight our customers and service our customers extremely well and go out and continue to outperform and take market share. And the third is to continue to evolve XPO Connect. Our goal for XPO Connect is to have that to be the go-to tool for shippers as they are using that to make their transportation decisions, whether it's what mode of transportation that they're using, whether it's what day of the week they're shipping something or if they should consolidate something, we want that to be their go-to tool.

On the third – on your last point on head count, we are continuing to add head count as we go forward. And as you look at it, over a five-year trend, volume still significantly outpaces head count that we've added.

Question – Brian P. Ossenbeck: And on the point on XPO Connect, just to follow-up there real quick. Is there anything you're thinking of adding that's more step change in terms of capabilities? Or are you just adding more – a little bit more bells and whistles or more functionality rather in terms of what you're rolling out here in the next couple of quarters and years? Thanks.

Answer – Drew Wilkerson: We're constantly adding the bells and whistles. That's something that we continue to do. We do that on a biweekly basis. And we're excited to share more with you as we get closer to the Investor Day and the spinoff.

Question – Brian P. Ossenbeck: All right. Thank you, Drew.

Answer – Drew Wilkerson: Thank you.

Operator

Our next question comes from the line of Bruce Chan with Stifel. You may proceed with your question.

Analyst: Casey S. Deak

Question – Casey S. Deak: Hey, guys, it's Casey Deak in for Bruce. This might go to Brad. There's just been – there's been a lot of talk about consumer to services rotation in the space. Some peers have been saying that probably already happened. When you look across your book of business, across your business lines, and especially we're talking about like final mile here, do you see evidence that that shift is already taking place or is occurring right now?

Answer – Matthew J. Fassler: If you think about the consumer to services, obviously, we're in the goods business. So we're moving both consumer goods and industrial goods. Obviously, the industrial economy is still on its way back, Mario spoke about the opportunity for loosening up supply chains as we see more raw goods and unfinished goods make their way into the customer supply chains. You're going to see better revenue momentum from industrial customers, and there have been signs of that continuously in LTL.

The consumer has obviously had a couple of very good years. Consumer has a very strong balance sheet and is in very strong shape. And if you think about our brokerage business, where load growth was up 23%, consumer customers – or consumer companies comprise the majority of our customer base and revenue in that business. So that's some indication of what we're seeing from the consumer.

Question – Casey S. Deak: Got you. I guess my only follow-up there would be, the way the economy is shaking out right now does any of the current demand, current cycle change, how you think about the spin when you kind of talk, the brokerage on the consumer side, industrial on the LTL side, do you – the spin was announced a little while ago. Does anything in the current environment change how you guys, as a management team, think about how you move forward?

Answer – Bradley S. Jacobs: Not really, no. We're going full speed ahead with the spin because regardless of what happens in the macro or in the economy, the rationale for the spin still stands. The rationale for the spin is when we have separate companies that are pure plays and the management team is focused on one thing and one thing alone, they're going to do better. They're just going to do a better job. They'll be more focused, there'll be more fit-for-purpose.

And from an investor point of view, investors will be able to evaluate those companies on a standalone basis in a more comparable basis to the peers, and there'll be a wider universe of investors who only want an LTL company or only want a truck brokerage company. So no, we're going full speed ahead on the spin.

Question – Casey S. Deak: Thank you. Thank you, guys.

Answer – Bradley S. Jacobs: Thank you.

Operator

Ladies and gentlemen, we have reached the end of today's question-and-answer session. I'd like to turn this call back over to Brad Jacobs for closing remarks.

Well, thank you, operator. And I'd like to leave everyone with the following points. Number one, we're executing on multiple avenues to create outsized shareholder value. In LTL, we're ahead of plan and we have enormous momentum. If you look at April, the growth in revenue per day in April exceeds the first quarter's growth.

Year-over-year OR comparisons should flip favorable in the back half of Q2, and we firmly expect to generate more than 100 basis points of improvement in OR for the full year.

In truck brokerage, we continue to perform at best-in-class levels. In the first quarter, we grew loads on a year-over-year basis at 23%. And April was our best month ever for margin dollars in truck brokerage, and we expect to continue to significantly outperform the market.

On the balance sheet side, I'm very pleased that we brought leverage down from 2.7 times to 2.0 times in the first quarter, and we remain on track to reduce leverage below two times by the end of this year, which is ahead of plan. On the spin, we're progressing nicely, and we expect to turn one great company to two great companies in the fourth quarter.

So with that, I'd like to thank everyone, look forward to seeing you at the upcoming conferences. Have a great day.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation. Enjoy the rest of your day.