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XPO.N - Q1 2021 XPO Logistics Inc Earnings Call

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OVERVIEW:

Co. reported 1Q21 revenue of $4.8b and adjusted diluted EPS of $1.46. Expects FY21 adjusted diluted EPS to be $5.90-6.50.

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PRESENTATION

Operator

Welcome to the XPO Logistics First Quarter 2021 Earnings Conference Call and Webcast. My name is Melissa, and I will be your operator for today's this call. (Operator Instructions)

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 these non-GAAP financial measures. During this call, the company will be making certain forward-looking statements within the meaning of the applicable securities laws, which, by their nature, involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those projected in the forward-looking statements. For instance, there can be no assurance that the company's planned spinoff of its logistics business will occur as currently contemplated or at all.

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 are 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 in the related financial tables on its website.

You can find a copy of the company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures in the Investors section of the company's website. I'll now turn the call over to Brad Jacobs. Mr. Jacobs, sir, you may begin.

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

Thank you, operator. Good morning, everybody. Thanks for joining our conference call. With me today in Greenwich are David Wyshner, our CFO; Matt Fassler, our Chief Strategy Officer; and from London, Malcolm Wilson, our current CEO of XPO Europe, and future CEO of the planned spin, GXO.

As you saw, we had a tremendous first quarter that beat expectations and gave us a very strong start to 2021. On a year-over-year basis, our first quarter revenue was up 24% to $4.8 billion, which is an all-time high, not just for a first quarter, but for any quarter.

Our revenue includes 22% growth from our transportation segment, where the truck brokerage market is white hot, and the LTL environment is coming back strong. In the logistics, our revenue growth was a hefty 27%. Our logistics segment also had a great first quarter for sales with a number of large contract wins.

Company-wide, we set new first quarter records for both net income and adjusted EBITDA. Both of our segments generated robust EBITDA in the first quarter, leading to our third consecutive quarterly record. Our $443 million of adjusted EBITDA was a year-over-year increase of 33%. And our first quarter adjusted EBITDA margin of 9.3% was up from the prior year by 70 basis points.

Technology and operational excellence were the 2 big drivers here. Even with the gains we've been reporting, we're confident that we're in the early innings of margin improvement. On the back of our first quarter beat and considering the optimism we're hearing from our customers, we significantly raised our full year 2021 adjusted EBITDA guidance to a range of $1.825 billion to $1.875 billion.

Our LTL business in North America is on a solid upward trend. Tonnage per day in LTL was up 3.7% in the quarter compared with a year ago, and yield, ex fuel, was up 4.2%. Our LTL adjusted operating ratio, ex real estate, improved to a first quarter record of 84.3%, which was 220 basis points better than a year ago. In truck brokerage, the story is growth, growth and more growth. 3 months ago, we reported a record fourth quarter for our brokerage business, and now we've driven results higher to top it with another record quarter. Our loads per day in brokerage were substantially better than the market, up year-over-year by 25%.

Revenue in brokerage was up 83%, and net revenue was up 132%. Our net revenue margin in brokerage was up 389 basis points to 18.6%. The big driver behind our brokerage performance is our technology and the productivity we're getting from XPO Connect, our digital platform. Over the last 5 years, our technology enabled us to handle 41% more volume with just a 3% increase in sales and procurement head count.

In logistics, our growth is being driven by the big 3 tailwinds of e-commerce, outsourcing and customer demand for warehouse automation. I'm delighted to report that we recently won the largest contract in the history of our North American logistics business. It's also the largest win for our company overall at $1.8 billion of projected revenue through 2032. This includes both an extension and an expansion with a longstanding customer.

Malcolm will talk about some other recent wins in a minute, including 3 major brands that, in total, will be using over $1 billion of our logistics services over the next 5 years.

We're also continuing to make excellent progress on GXO, the planned spin-off of our logistics business. We remain on track to complete the spin in the second half of the year and our goal is to have GXO be investment-grade from day 1, followed by XPO.

Our strategy and our spin address the consistent themes we've heard from shareholders over the last year — to simplify the company and reduce leverage. With that, I'll ask Malcolm to share some recent developments in our logistics business. Malcolm?

Malcolm Wilson - *XPO Logistics, Inc. - CEO of Europe*

Thank you, Brad. Demand for our logistics services is very strong due to a combination of secular tailwinds and our company's positioning within this environment. The 3 big mega trends of outsourcing, e-commerce and warehouse automation are driving the double-digit revenue and EBITDA growth in our logistics.

Outsourcing has been a consistent trend for years, but it accelerated as a result of the pandemic. Large companies have become more aware of both the critical importance of supply chain continuity to their success and the potential vulnerability of handling logistics completely in-house. We collaborate strategically with customers to help them redesign their supply chains, and we give them greater visibility and flexibility through our technology. This sustained rise in e-commerce we're seeing is a secular shift in consumer buying behavior. We can all relate to this. Right now, order fulfillment times are being compressed, most notably in the [direct-to-consumer e-commerce] (corrected by company after the call) space.

What used to be a 5-day logistics process is now down to 1 day or less. Advanced automation and intelligent machines are cost-effective ways to meet these expectations in consumer end markets where supply chains are becoming increasingly complex. Our investments in robotics and advanced automation are delivering fast, smarter logistics processes at lower cost for our customers and our company. We're utilizing more and more robotic technology to deliver crucial improvements in speed, control, accuracy, safety, quality of employment and consistency of outcomes.

This gives us strong positioning as a large-scale operator and industry innovator. More than [ever before, our] (corrected by company after the call) blue-chip customers see the strategically and deeply integrated solutions we provide as mission-critical. This is evident in the growing number of [customers who are awarding us] (corrected by company after the call) business. In the first quarter, we had a number of important wins with some significant value attached to each of them. As Brad mentioned, one of these wins is the largest contract in our company's history.

We also won several other very large customer contracts. An exciting development is the contract we just signed with Apple, who is a major new customer for us. We'll open a massive distribution center for Apple in Indiana with over 1 million square feet of state-of-the-art space for e-commerce fulfillment. It will be direct-to-consumer distribution that uses advanced automation [to accelerate deliveries] (corrected by company after the call) and robots to personalize products before we ship them to consumers.

Two other examples of large customer wins in Europe are ASOS and Waitrose. ASOS is a global online fashion retailer we've been serving since 2014. Our recent agreement with them is a pair of contracts that further cement our position as the U.K.'s e-fulfillment leader. ASOS has renewed our [operation of a large] (corrected by company after the call) distribution center and expanded the relationship with a second hub we'll open next month.

Waitrose is a prominent UK food retailer that values our specialized expertise in temperature control and ambient food distribution. We implemented our first contract with Waitrose in the midst of COVID last year and, this year, they are entrusting us to run an incremental distribution center. These contracts demonstrate how blue-chip customers trust our reliability and value our ability to deliver innovation, the great examples of tremendous potential for profitable growth we're seeing in the logistics landscape in Europe and North America.

Of our new business signings overall, there's a good balance between established customers seeking longer-term contracts and new first-time customers like Apple. All in all, year-to-date, we are executing on customer agreements with a combined value of more than $4 billion on the contract life. These agreements also give us great visibility into future revenue and margin performance in our logistics business, which is planned to be spun off as GXO.

All of the work streams required for the spin are in good shape and running to schedule. Importantly, we've been building the GXO C-suite over the last month with strong internal appointments and external hires. I'd like to mention Baris Oran, who will be GXO's Chief Financial Officer. Baris is a hands-on CFO, who also think strategically about value creation. During his tenure as CFO of the Sabanci Group, he led the multinational finance operation of one of Turkey's largest publicly traded companies.

I'm also pleased to welcome Mark Manduca, who will be our Chief Investment Officer. Mark has been the #1 ranked transport analyst in Europe for 8 years in a row with an impressive track record at Citigroup [and Bank of America] (corrected by company after the call).

GXO will be a high growth company, and I'm pleased that we're making great progress in bringing a world-class team together in preparation to lead that growth. There will be more announcements to come.

Now David will go over the quarter.

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

Thanks, Malcolm, and good morning, everyone. Today, I'd like to discuss our first quarter results, our balance sheet and liquidity and our updated outlook for 2021.

In the first quarter, we generated revenue of $4.8 billion and adjusted EBITDA of $443 million. The revenue number reflects a year-over-year increase of more than 20%. Adjusted EBITDA is up more than 30%, and both figures are higher than we expected at the beginning of the quarter.

Our record Q1 adjusted EBITDA reflects commercial momentum and powerful execution across our business units in a strong ongoing economic recovery. As Brad mentioned, revenue grew 24% year-over-year in the first quarter. Our U.K. logistics acquisition contributed 3 points of revenue growth, and foreign exchange contributed 3 points. As a result, our organic revenue growth in the quarter was 18%.

Our revenue growth translated into even stronger adjusted EBITDA growth of 33%, and our EBITDA margin increased 70 basis points year-over-year. We had limited COVID impact on first quarter EBITDA last year. So our year-over-year growth this year largely reflects our strong operational execution and favorable market dynamics. Both of our segments made a strong contribution to our adjusted EBITDA growth.

Logistics adjusted EBITDA increased by 28% in the first quarter, and transportation adjusted EBITDA was up 36%. We continue to see robust consumer demand and a more modest rebound in industrial activity. And as revenue increased, we benefited from the operating leverage inherent in our business and the cost reduction actions we took last year. Weather also affected us in February, but the negative impact in the quarter was minimal.

Matt will review our segment detail in a few minutes. Our adjusted earnings were $1.46 per diluted share in the quarter, which is more than double what they were last year. We generated $173 million of cash flow from operations in the first quarter, spent $140 million on gross CapEx and received $36 million of proceeds from asset sales.

As a result, we generated free cash flow of $69 million in the quarter. Q1 free cash flow exceeded our expectation despite stronger-than-expected revenue that gave rise to a use of working capital for receivables in the period. Maintaining strong liquidity continues to be a top priority for us as an organization. Our cash balance at March 31 was $629 million. This cash, combined with available debt capacity under committed borrowing facilities, gives us nearly $2 billion of liquidity at quarter end.

We redeemed our 6.5% senior notes due 2022 in January. This reduced both our debt balance and our cash by $1.2 billion. We also refinanced our $2 billion term loan in March, lowering the average interest rate by the 3/8 of a point. We had no borrowings outstanding under our ABL facility at quarter end and we have no significant debt maturities until September 2023.

Our net leverage at March 31 was 3.1x LTM adjusted EBITDA and 2.5x the midpoint of our projected 2021 adjusted EBITDA. Our free cash flow in 2020 and our EBITDA growth in 2021 are helping us delever fairly swiftly. Our steady progress on this metric is important in the context of our commitment to move both XPO and GXO toward investment-grade ratings.

Over the last several weeks, we've spoken with the rating agencies about GXO. In those discussions, we've highlighted how GXO's business model is based on contractual commitments and long-term relationships with a diversified group of blue-chip customers. These are attractive attributes from a credit perspective. Our plan is for GXO to be investment-grade from day 1. We expect to have more details soon about precisely how much debt GXO will carry and how the proceeds paid over to XPO RemainCo will be deployed.

Turning to our outlook. We've updated our full year guidance to reflect our strong first quarter results as well as our expectation that the effects of COVID on our business will continue to moderate in 2021. All of our projections exclude impacts from our planned spin-off of GXO.

As Brad highlighted, we now expect to generate $1.825 billion to $1.875 billion of adjusted EBITDA this year, with growth of 28% to 32% in our logistics segment and 30% to 34% in transportation. Our outlook assumes a modest amount of ongoing COVID-related costs in Q2 and Q3 and intentionally lower year-over-year gains from LTL real estate sales. We expect that consumer demand will continue to be solid, e-commerce will continue to grow, industrial demand will continue to recover, and new business opportunities will continue to emerge.

In fact, that is precisely what we've seen so far this year. In the second quarter, we expect that our adjusted EBITDA will be in the mid-20s as a percentage of our full year adjusted EBITDA, which is typical seasonality for us. We expect continued strong margin performance in our LTL business and about $5 million of gains from LTL real estate sales versus $10 million in last year's second quarter.

Our year-over-year growth metrics in Q2 will be extremely strong due to the significant pandemic impacts we experienced in the second quarter of 2020. On the cash flow front, we've upped our estimate of full year free cash flow to a range of $650 million to $725 million. We've also upped our full year CapEx estimates by $25 million and are now targeting roughly $675 million of gross capital expenditures and $525 million of net CapEx. These estimates could vary based on new business opportunities in our logistics segment.

We currently expect D&A, excluding the amortization of acquisition-related intangibles, to be $625 million to $645 million. Due to our opportunistic term loan refinancing in March, we're now forecasting $270 million to $280 million of interest expense in 2021, which represents a $50 million year-over-year reduction. And we continue to estimate that our effective tax rate will be in the 24% to 26% range. As a result, and with roughly 113 million diluted common shares outstanding this year, we're now projecting adjusted earnings of $5.90 to $6.50 per diluted share. At the midpoint, this is year-over-year EPS growth of 109%.

In sum, our business has been firing on all cylinders. In Q1, we generated stellar top line growth and even stronger bottom-line growth. We grew our margins in the process and we've now delivered 3 straight quarterly records for adjusted EBITDA. Our results not only reflect strong execution throughout our operations, they also underscore how our businesses are strategically well positioned to meet customers' needs and capture profitable growth opportunities in logistics, LTL and brokerage.

We remain enthusiastic about our prospects as a leader in the markets we serve, and we're proceeding decisively towards the planned spin-off of our logistics business with the wind at our back. I'll now turn things over to Matt.

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

Thanks, David. I'll review the first quarter operating results, starting with our transportation segment. We had a very strong quarter in North American LTL, driven by the recovery in the U.S. economy, a healthy pricing backdrop and our ongoing progress improving our pricing and operating disciplines. Our LTL revenue growth accelerated to 7.1% and revenue, ex fuel, grew by 6.7%.

These were our strongest year-on-year growth rates in LTL since we acquired the business in 2015. We also grew tonnage per day by 3.7% year-over-year, which was a pickup from the fourth quarter of 2.1 percentage points. Shipments per day rose 2.4%, accelerating by 3.1 percentage points from the fourth quarter. Tonnage improved in 5 of our 6 largest verticals, which together comprise over 80% of our volume.

Retail and consumer verticals remain stronger than industrial, but trends in industrial continued to improve, most notably late in the quarter. Tonnage and shipment count both outperformed typical seasonality. Our weight per day ticked down by 10 basis points from Q4, outperforming the typical Q1 decline of 90 basis points. Yield, excluding fuel, rose 4.2% year-over-year, which was a sharp acceleration from the 1.5% increase we posted in the fourth quarter.

Revenue per shipment, excluding fuel, grew 5.5%, improving from the 3.8% growth we had in the fourth quarter. Growth in revenue per day, excluding fuel, accelerated to 8.4%, up 4.7 percentage points from Q4. Our LTL adjusted operating ratio of 82.6% compared favorably to 83.4% a year ago. Excluding real estate gains, our adjusted OR improved to 84.3%, which was 220 basis points better than the first quarter a year ago.

Our adjusted OR, ex real estate gains, also improved sequentially by 20 basis points. And adjusted operating income, ex real estate, increased by 23% year-over-year. Importantly, we're seeing ongoing improvements in productivity in LTL. Our load factor increased by 2.3% year-over-year and we reduced empty miles by 6%. And we were 4.8% more efficient in pickup and delivery than we were in Q1 last year, aided by our XPO Smart labor management tools. We're firmly on track to deliver at least $1 billion of adjusted EBITDA in LTL next year, driven by both revenue growth and continued improvement in our operating ratio.

Turning to truck brokerage. Our North American truck brokerage business delivered another spectacular quarter. On a year-over-year basis, we generated an 83% increase in revenue and more than doubled net revenue with an increase of 132%. Loads per day increased by 25%, once again, sharply outpacing the market and net revenue margin rate increased by nearly 400 basis points to 18.6%.

We controlled costs well, and earnings growth in truck brokerage substantially outpaced an increase in net revenue. Truckload capacity was quite tight in Q1 with a high load-to-truck ratio. Our technology, team and carrier network, working together, allowed us to find capacity for our customers.

I want to take a step back for a minute to last year's third quarter in brokerage, when we made the decision to invest in headcount at a time when our competitors were pulling back. This may have seen counterintuitive at the time, given the environment as it was, but we had a plan to be first out of the gate in the recovery, and now it's paying off.

Our new hires are ramping productivity significantly faster than in the past, aided by XPO Connect. And over time, as you heard from Brad earlier, our productivity in brokerage has increased dramatically. Carrier and customer adoption of XPO Connect continues to surge. We approached 400,000 downloads of the platform's mobile app in Q1, representing 30% growth quarter-over-quarter and tripling the cumulative number of downloads year-over-year.

In the first quarter, we topped 81,000 registered carrier accounts on XPO Connect, up nearly 50% year-over-year. And the number of customer accounts on the platform grew sequentially from the fourth quarter to the first quarter of 2021 by 16%. We're also securing volumes through API technology at a profitable clip.

Looking at our transportation segment overall, year-over-year, we increased first quarter revenue by 22% and increased adjusted EBITDA by 36%. Our adjusted EBITDA margin in the segment was 11.5% compared with 10.3% a year ago. We project 30% to 34% growth in full year adjusted EBITDA in the transportation segment, which is above our prior outlook of 24% to 29%.

Turning to our logistics segment. We increased revenue by 27% in the first quarter year-over-year. Organic revenue growth accelerated to 13% from 9% in the fourth quarter. The remainder of our revenue growth reflected our U.K. acquisition and favorable FX conversion.

We saw exceptionally strong growth from our customers in the omnichannel retail, CPG and technology verticals. The holiday peak was not only an early peak, it was an extended peak as well. And our warehouse operations were running at a high velocity for our customers in consumer-facing businesses. These sectors, e-commerce — reverse logistics, consumer tech — continue to represent enormous new revenue opportunities for us.

In Europe, our logistics business generated 15% organic growth, which underpinned the 38% year-over-year increase in our revenue. In North American logistics, we grew revenue by 9% over last year. Labor is still tight, but we're managing it well. We continue to see 5% to 7% productivity improvement with XPO Smart, our proprietary suite of intelligent analytics and labor management tools. This technology is rolled out in most of our North American warehouses and more than half of our European sites.

Globally, in logistics, our adjusted EBITDA in the quarter was 28% higher than in Q1 last year, and our adjusted EBITDA margin increased 10 basis points to 8.5%. As David mentioned, we expect annual adjusted EBITDA growth in this segment. We expect it to grow 28% to 32%, which is above our prior forecast of 24% to 29%. We're pleased that the strong momentum we achieved in the first quarter continued through April.

The industrial rebound is helping our LTL business with a lot more runway to the recovery. The pricing environment remains helpful and it's showing up in our yield, which is outperforming typical seasonality. In brokerage, capacity is still tight, and the volume backdrop remains fantastic. In logistics, new contracts are on the rise. Malcolm gave you a sense of just how exciting our growth prospects are in logistics.

The operations we acquired in the U.K. and Ireland are ramping up volumes as COVID restrictions are lifted. We're also seeing the resumption of more normal activity in Italy. We're continuing to bring operations online from new business wins in the U.S. as well. And the global tailwind from e-commerce is creating demand for XPO Direct, our shared space distribution network in North America.

While we're happy we've delivered a strong quarter, we're also focused on delivering sustainable results for the long term. And increasingly, we're collaborating with customers on ESG strategies. This melds with our own pursuit of environmental sustainability, social responsibility and good governance and our commitment to diversity, equity and inclusion.

We prioritize these parts of our culture because it's good for our employees and communities and because it helps make XPO a great place to work. When we use our expertise to further our ESG goals, it resonates with like-minded customers who share these values. Within our company, we're tracking about 40 ESG initiatives with a new scorecard that documents our progress.

The metrics are largely operational and 25% of the long-term incentive comp for our senior execs is tied to this scorecard. We have a number of initiatives underway to help our customers achieve greener supply chains. For instance, we've had a massive rollout of LED lighting in our warehouses, and we're constantly focused on reducing empty miles in our transportation businesses.

We're a leader in alternative fuel vehicles in key European markets, where we have over 250 natural gas-powered trucks in our fleet across France, the U.K. and Spain. We've also invested in improving the sustainability of our packaging, waste management and recycling.

I'll close with a few of the accolades we received in the quarter. We were recently named a Forbes best company to work for in Spain for the third straight year. Intel recognized us with their supplier achievement award for our COVID-19 response. And 3 XPO executives — Ashfaque Chowdhury, Drew Wilkerson, and Eric Caldwell — were recognized by Supply & Demand Chain Executive Magazine for their accomplishments in the industry.

So altogether, an outstanding quarter for our transportation business, our logistics business and our progress on the spin, with much more to come. With that, we'll take your questions, and operator, over to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Tom Wadewitz, UBS.

Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

Congratulations on the strong results. Wanted to ask you a bit about pricing and kind of how you think about the contour of that this year. I guess 2 components, so one would be on LTL pricing. Obviously, you saw a nice acceleration in first quarter. How do we think about where that can go to? If it's 4% in first quarter, can it be 6%, 7% when you get to the second half of the year? Or is that asking for too much?

And then I guess the second question would -- well, actually, let me just leave that, and then I'll come back on the second one.

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

Tom, the LTL pricing environment is strong. You commented on the acceleration that we noted in our yield in the first quarter versus the fourth quarter. Obviously, the market is tight. There's lots of demand for our capacity. Our price increases on contract renewals continue to move in the right direction, both quarter-over-quarter, month-over-month, and into the second quarter. So that's a very helpful harbinger of the yield outlook for the rest of the year, which is a good one.

Thomas Richard Wadewitz - *UBS Investment Bank, Research Division - MD and Senior Analyst*

So then the second question would be on logistics. I think it's quite evident on transport that there's a very favorable dynamic, supply demand is very tight, and that's benefiting pricing. How does -- is there any impact in logistics pricing? I know it's a very different market. Are you seeing stronger pricing? Would you expect stronger margin performance in logistics contracts you're signing now? Or are those markets kind of just disconnected in terms of some of the tightness in pricing and transport and how that could affect whether there's tightness or more pricing in logistics?

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

Tom, one of the things we love about the logistics business is its consistency. That's evident in pricing, and it's evident in the kind of financial results that we're able to generate in a variety of backdrops. So, we're able to manage price movements very well in that business, and you shouldn't expect to see any impact in logistics results based on the movement that you're seeing in transportation markets today. Obviously, to the extent that there are indicators of a strong demand backdrop, that's good for the logistics business as it is for transportation, but generally a constructive backdrop there as well.

Operator

Our next question comes from the line of Hamzah Mazari with Jefferies.

Hamzah Mazari - *Jefferies LLC, Research Division - Equity Analyst*

My question is on the logistics GXO side. You've talked about getting to double-digit EBITDA margins. Could you just remind us what the big levers there are to get there and your confidence level in the time frame?

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

Sure. First of all, labor productivity. We have our smart workforce management platform. It drives 5% to 7% labor productivity per annum as we roll it out. That rollout is still maturing in the U.S. and it's really in the middle innings at most as you think about Europe. So, there's lots of headway for us to make progress in terms of labor productivity. There's organic growth at existing sites, particularly when you think about our sites with exposure to e-commerce, which is our fastest-growing area right now. That will help us drive operating leverage.

There's, of course, the acceleration of the rollout of automation and robotics, a huge part of our value proposition to our customers. There's tremendous new business opportunities. Obviously, we seek out lucrative business opportunities and the incremental revenue helps us drive operating leverage as well.

Finally, XPO Direct continues to season and continues to contribute to our profit outlook. So really, I think those 5 drivers are going to be the key for our operating leverage in logistics going forward.

Hamzah Mazari - *Jefferies LLC, Research Division - Equity Analyst*

Got it. And just my follow-up question, I'll turn it over. Again, just on logistics, could you remind us how you think about the reoccurring revenue base in the logistics segment? I know customer retention is high. But when you do lose a customer, do they take that in-house? Do they go to a competitor? Just give us a sense of the reoccurring revenue base in that business.

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

The renewal and retention rates in contract logistics are very strong. Many of our largest customers have been with us for many, many years. We've had multiple renewals with them, and we expect that to remain the general cadence of the business. There are some instances where we part ways, and typically -- that typically comes to an arrangement and then we move on.

But generally, the retention and renewal dynamics are very powerful in our logistics franchise.

Operator

Our next question comes from the line of Brandon Oglenski with Barclays.

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

So I know we've talked about this a little bit in the past calls, but it sounds like like the split is coming along much closer now. So, can we just revisit the priorities for each business post-split? I think we're getting some more information from you guys here, it sounds like investment-grade balance sheets might be in the future as well. So, can you talk to maybe the priorities from the capital side as well as maybe a resumption of M&A?

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

Sure, Brandon. So, in terms of capital allocation, we're always looking for the best ROI from the cash that we generate from the business. Our current focus, to your earlier point, is effectuating the spin, which is going to create lots of value, then paying down debt to become investment grade. And then obviously, in parallel to that at all times, is investing in CapEx. Those are our priorities for capital.

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

Okay. And does M&A become a bigger piece of the story then, once separate?

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

Accretive M&A and stock buybacks, each of those is really always an option. We're always aware of what's happening in the market. We'll announce any moves after the fact, and we're very highly disciplined, obviously, as we think about those opportunities.

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

Okay. And then a quick follow-up on the margin question in logistics. I think you guys brought on a pretty large portfolio of U.K. contracts this quarter. We thought it was going to be potentially dilutive to margins, but it looks like you guys have pretty good performance there. So, can you speak to how that business has been integrated?

Malcolm Wilson - *XPO Logistics, Inc. - CEO of Europe*

Yes. Please allow me to just give an update on that. It's Malcolm here. So, in fact, new business coming in has been a combination of brand-new customers. So we've had some really exciting new customers coming in, big whale type of size contracts with established customers and brand new customers. And also, we brought in, in the quarter, the acquisition, the tactical acquisition of the K&N business. And that's come with some real blue-chip customers.

Just to remind, that came with new verticals. So, in tech, in e-comm, food services and beverages. And we've seen very strong synergies coming from that project. We've also seen a lot of synergies coming from customers. There must have been a pent-up demand in those verticals, because we've seen a very large sales flow of new opportunities coming into us. And lastly, really, we've renewed and reviewed through some of the existing agreements. So, those have all been margin accretive. And I think that's really giving the background that you're describing.

Operator

Our next question comes from the line of Amit Mehrotra with Deutsche Bank.

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

I wanted to go back to the comment around the GXO leverage, and just how this will work. I think the way these things have worked in the past is like the SpinCo draws down new debt, the proceeds from that debt are dividended back to RemainCo, which then uses the proceeds to offset dilution.

Is that the right pathway? And do you expect the dilution at RemainCo to largely be offset pro forma for the spin of GXO?

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

It's David. The way you're thinking about it is the right way to think about it. We're confident that GXO will be investment-grade on day 1. We haven't announced a precise capitalization plan yet, and we're still talking to the rating agencies. But as you say, the remainder of the debt will stay with XPO RemainCo, and we want to drive RemainCo to being investment-grade soon.

And from a process standpoint, to the extent that we issue debt for GXO, some or most of that cash would be dividended up to XPO to pay down RemainCo debt. And so that will allow us to reduce the leverage. In addition to that, we generate a lot of cash, and we're prioritizing the allocation of that cash to pay down debt. And to me, what's really exciting is that if you look at the Q1 balance sheet for the combined company, net leverage is at 2.5x our current EBITDA guidance for this year. And that means that the aggregate amount of debt that needs to be allocated between the 2 companies, is manageable and really positions us well for GXO to be investment-grade on day 1, and for XPO RemainCo to move rapidly to being investment grade.

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

Got it. So, it's not really an offsetting a dilution, but really a transfer of the debt load from XPO to GXO because of the recurring revenue stream and the asset-light intensity of GXO? Correct me if I'm wrong on that, but I'll move on to my follow-up, if it's okay.

So Matt, I think the operating leverage in the business will tick up in the second quarter, just given more growth coming from LTL? I think that's kind of a consolidated dynamic. But if I just look at logistics, and I think this is kind of important as it relates to GXO, this is an asset-light business. I assume most of the D&A is amortization of intangibles as opposed to depreciation of the asset base. But if I look at the logistics business, given that asset-light in nature, I guess, ROIC is the best way to look at that business.

And so, is there any way you or Malcolm or somebody can talk to us about what these new contracts that you're bringing on — they're humungous — are underwriting from an ROIC perspective? I guess, you look at it on a project basis because of the contract nature of the business. But any help there in terms of what the ROIC is being underwritten at in terms of what these new contracts are coming on?

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

Sure. You're absolutely right. We look at every project at the project level. We solve for pretax and after-tax ROIC. We look at the IRR. We look for a return on capital at the project level of at least 20% and approaching 30% over the life of the first contract. We get paid back and more on the first contract, assuming no renewals. Obviously, we have a very strong track record of generating renewals, and we're extremely disciplined about the kind of new business we take in and the financial profile of the business that we bring in. That's critical to our success in contract logistics.

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

So on an unallocated basis, you're saying the ROIC of logistics is 20% to 30%, and on a fully allocated basis, it's, what, 10% to 15%?

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

We'll share more of those numbers with you as the Form-10 comes out. But at the project level, that's what you tend to see. Then, obviously, there's some G&A, et cetera, that you layer on. Though, we obviously think about all the associated overhead, anything -- any incremental overhead, as we consider bringing on a customer or a new project.

Operator

Our next question comes from the line of Chris Wetherbee with Citi.

Christian F. Wetherbee - *Citigroup Inc. Exchange Research - Research Analyst*

I wanted to touch on the EBITDA guidance and maybe a little bit about seasonality. I think 2Q is expected to kind of move back into the mid-20s range, which I think is typical from a seasonal perspective. Obviously, a strong outperformance in the first quarter. So, I guess I just wanted to make sure I understood some of the moving parts in terms of cost, maybe revenue growth. Obviously, the comps are fairly challenging. That sort of lead to going from the significant outperformance from an EBITDA seasonality standpoint in 1Q to maybe something that's a little bit more normal. And do you think that kind of last for the rest of the year? So just some helpful color around the seasonality of the profits of the business.

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

Chris, we had a really, really good first quarter in a terrific environment. We're going to have a very strong second quarter. We framed the seasonality for you, David did, he talked about mid-20s as a share of the year. Obviously, we expected a very good year as well. We talked about the EBITDA guidance for the Europe, for the company overall and for each of the businesses. And we see, obviously, a very strong performance in the second quarter, very good trends, both in transportation and logistics.

Christian F. Wetherbee - *Citigroup Inc. Exchange Research - Research Analyst*

So nothing specific that's changing materially from 1Q to 2Q about the business environment or otherwise that maybe sort of changes the dynamic of seasonality?

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

No. No particular changes. Obviously, the year-over-year comps are strange this year because of the pandemic last year. But when we look at the year overall, we've delivered 33% EBITDA growth in the first quarter, and that's right at the midpoint of what we're expecting for the year as a whole. So that -- I think there's a consistency there between our first quarter results and what we're expecting for the full year. On a year-over-year basis, the comps will be easier in the second quarter because of the pandemic effects last year and will be tougher in the second half.

Christian F. Wetherbee - *Citigroup Inc. Exchange Research - Research Analyst*

Okay. That's helpful, I appreciate it. And then if you guys could help maybe share -- you mentioned some of the leverage numbers on the EBITDA guidance as it stands right now. And I think you've talked to the rating agencies recently. So, what does investment-grade look like for GXO in terms of leverage? And maybe how do we think about that for both companies, I guess? Any sort of guidance that you've gotten or helpful color would be interesting.

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

We're really still working through the details of that, and we expect to have more details around that soon. What I would emphasize is that we're confident that GXO can be investment-grade on day 1, and that would allow us to give us the flexibility to issue some debt that GXO can support and still be investment-grade and dividend those funds across to XPO to reduce the amount of net leverage remaining at XPO following the spin.

Operator

Our next question comes from the line of Todd Fowler with KeyBanc Capital Markets.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

The logistics pipeline sounds very healthy. Obviously, very strong right now as we look out to the rest of the year. Also, we understand that there's some benefit on the comps from the acquired Kuehne + Nagel business. But how are you thinking about logistics revenue growth with where the pipeline is at? Basically, when does the pipeline start to translate into revenue maybe for the remainder of '21? And then some thoughts on kind of what you'd expect for a normalized top line growth rate in logistics beyond '21?

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

Sure. So, the business that we spoke about today, some of it comes online later this year, more of it comes online in 2022. That said, there's new business that we underwrote and signed previous to today, which we've discussed and signed prior, which is going to flow in, obviously, to revenue in the second quarter, third quarter, et cetera. So, there's a very nice, consistent flow of revenue from new business meeting its way into the -- into our logistics operations.

In terms of the long-term cadence of logistics revenue, it's certainly at least a high single-digit growth rate is the algorithm that we've spoken about over time. And I think that's a pretty good way to think about the long-term revenue algorithm for contract logistics.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. Great, Matt. And then as a follow-up, obviously, some advantage on the decisions you made on the brokerage side to add head count into the market. The volume growth there is just exceptionally strong right now. How do you think about the stickiness of some of that business? I mean, once you're handling some of that volume, is that more transactional that if we start to see the market become more balanced at some point in the future, that reverts back to a contracted or an asset-based carrier? How should we think about some of the success that you're having in the strong brokerage top line and volume growth that you've seen recently?

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

We have a terrific customer base. We have terrific people, and we have terrific technology. And we've delivered for those customers during this very tight market. We expect the strength of the franchise to continue to resonate through the cycle and really across the vagaries of any truck brokerage cycles. We feel exceptionally good about the durability of the franchise and the sustainability of strong results relative to the market in brokerage.

Operator

Our next question comes from the line of Scott Schneeberger with Oppenheimer & Company.

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

I'm going to ask you about last mile. It's -- I know it's small. It doesn't get in a lot of airtime anymore. But look like a really strong quarter. Would love if you could elaborate on that, both in North America and in Europe?

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

It was. It was a terrific quarter for last mile. Focusing on North America for a moment, demand for heavy goods is still very, very strong. Our revenue growth was 22% year-over-year. And importantly, we're continuing to drive volume to our network of 85 last mile hubs. We're leveraging those facilities and their proximity to population centers around the U.S. Recall that we're the leading outsourced provider of last mile logistics for heavy goods and the largest provider for many of the leading retailers and e-tailers.

In Europe, this business is at an earlier stage of its development, but the results there were outstanding — stronger growth in general, last mile in Europe than we had in the U.S. So, a very strong quarter for last mile in both regions, Scott.

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

Great. And then on XPO Direct in contract logistics, I'm curious -- congratulations on a really strong first quarter with these wins. How is XPO Direct affected? And how are you progressing towards your long-term objectives there?

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

XPO Direct is doing really well and obviously outgrew the North American business nicely. It's a critical service for emerging e-commerce players, direct-to-consumer players who don't have their own distribution capacity and are seeking to build their connectivity with consumers. It's a very differentiated offering in the market, and it's a real nice element of the growth story that we have in contract logistics.

Operator

Our next question comes from the line of Allison Poliniak with Wells Fargo.

Michael Paul DiMattia - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

This is Michael DiMattia on behalf of Allison. Strong quarter in LTL. I just had a question on strategic priorities for the business with RemainCo post the spin. And also, as we look out over the next 3 to 5 years, what a realistic OR for this business can be as it gets more attention? Can this sustainably be a 75 to 80 OR business?

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

The strategic priority for LTL is obviously to drive more EBITDA. And that's our #1 priority, to simplify it for you. We have an initial goal for 2022 of at least $1 billion of adjusted [EBITDA] (corrected by company after the call), as I said in my earlier remarks. That's going to result from a combination of revenue and operating leverage. Remember that in LTL, we have a number of very high-potential technology efforts underway. We're working on our labor optimization through XPO Smart. Obviously, our route optimization, impacting both linehaul and P&D. And you saw some of the impact of that manifest itself in the first quarter. And then obviously, the work we're doing on LTL pricing elasticity. Optimizing our pricing as we get better and better data on the market and use our own data more effectively.

Each of these technology initiatives has lots of runway and is going to help us drive our profitability going forward. If higher OR was good OR, I'd say the sky is the limit, but I think you get my point. We have lots of opportunity to improve our operating ratio further from here in LTL.

Operator

Our next question comes from the line of Jason Seidl with Cowen.

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

Two quick questions. One, on the LTL front, that seems to be a little bit more weighted towards the industrial manufacturing side of the economy. That's coming back, but it's still slower than the consumer. How should we think about tonnage growth as we move into the back half of the year and then early 2022?

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

Obviously, Jason, tonnage growth in the second quarter is going to look amazing, think about our compare. But the good story here, we obviously just finished April, so had a fresh look at the numbers. The March -- the April weight per day compared to March weight per day relative to typical seasonality was slightly better. So it's not just easier comps, there's also intrinsic, underlying acceleration in that LTL business. So, we'll have very, very strong tonnage growth in the second quarter and healthy tonnage growth, we think, in the second half of the year as well. Obviously, the comparisons normalize a bit, but we have a very good outlook for tonnage.

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

Okay. That's good color. I want to also switch on to logistics side in how we should think about XPO sort of returns as they open up more and more of sort of these modern facilities that feature more and more robotics. How is the margin profile on a new facility like that compared to a more legacy facility that doesn't use that type of technology?

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

Every project is different. And as I said in the answer to an earlier question, we underwrite every project considering the capital that we deploy, the duration of the contract and all of those considerations. And whatever the automation is, whatever the robotic component, we still have the same financial framework for evaluating the project. So, we underwrite a project if it's promising for our customer and financially promising for us

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and for our shareholders. And we work with every proposal to ensure that it will deliver on that potential regardless of the amount of automation and technology.

Just so happens, we have lots of very compelling opportunities to introduce advanced automation and robotics. It's one of the things that our customers are looking to us for. It's one of the big drivers of outsourcing in contract logistics. It ties in very well, obviously, to e-commerce and omnichannel retail. So, all those themes are really converging.

And obviously, we're considering that as we underwrite our financial proposition. And keep in mind, automation becomes more and more cost-effective over time. And the lead we have in implementing this automation helps differentiate us from the rest of the marketplace, both in delivering for customers and in delivering the associated financials for shareholders.

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

So I guess the best way to think about it is the contracts are done on a contract-by-contract basis, and you pretty much put in good returns to make sure that you're covering your investments, but the technology that you're employing in the marketplace is going to help you win more and more awards as we go forward?

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

You nailed it.

Operator

Ladies and gentlemen, that concludes our time allowed for questions. I'll turn the floor back to Mr. Jacobs for any final comments.

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

Thank you, operator. So let me conclude by highlighting -- in LTL, we improved the operating ratio by 220 basis points. In truck brokerage, we grew loads by 25% and net revenue by 132%. In logistics, we signed a bunch of whales — massive contracts — with premier customers, both here in the United States and in Europe, each worth hundreds of millions of dollars over the life of the contract, one worth significantly more than that. And in logistics, we're benefiting from 3 powerful growth drivers: outsourcing, warehouse automation and e-commerce. And finally, based on the Q1 beat and the strength we're seeing in April, we raised guidance significantly for the full year. We raised the new low end above the prior high end.

So, I'd like to thank the team. None of these accomplishments were done by any one specific person, it's always the team. So XPO, good job. Thank you. See you in 90 days.

Operator

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