Wolfe Research Global Transportation & Industrials Conference
Interview with Brad Jacobs and Matt Fassler of XPO Logistics
Conducted by Scott Group of Wolfe Research
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1. **Scott Group, Wolfe:** We're really happy to have XPO Logistics here. We've got Brad Jacobs, Chairman and CEO, and Matt Fassler, Chief Strategy Officer. Thank you both for being here. We're going to go right into questions.

   Brad, on revenue trends, are we at the bottom yet? You guys have a great view of the globe. If I look at the first quarter, on the call you said that April revenue was down 20-25%, with logistics better than that, and non-LTL transportation relatively worse. You also talked about seeing some improvement in France and Spain; maybe some signs of a bottom in the UK and the US. Give us a more current update, going around the globe and through each of the businesses.

2. **Brad Jacobs, XPO:** First of all, thanks for the invitation. Love to be here. The trends are pretty much the same, Scott. April was the bottom, assuming there's no second wave of infections. May is better than April was. Asia's almost back to normal. In Europe, France has come back sharply. It's still not where it was, but it's come back sharply off the bottom, with Spain following after, and then the UK after that. In the US, you can see some signs, some green shoots. It's not a robust rebound, but it's certainly stabilized and hasn't been getting any worse.

   If you look at how we see the company positioned after this is over, after COVID is behind us, I think we'll emerge much stronger for several reasons. Number one, we have outsized exposure to e-commerce, and e-comm has been booming, even through the pandemic. I think that's secular. I don't think that's just a specific, event-driven thing. We're going to benefit from all the billions of dollars we've invested in technology. I believe the outsourcing trend is going to accelerate, because shippers are attaching a greater importance to stability and they'll be outsourcing more of their supply chains to people who do this for a living, people who've invested in the technology. We have the #1 e-fulfillment platform in Europe. We have strong processes for reverse logistics management. We're big in omnichannel retail logistics.

   I also think we'll have a better cost structure in all kinds of logistics, because there's going to be more warehouse automation, where we're a leader. In transportation, XPO Connect, our digital freight marketplace, has a lot of good traction to it. And we have those 10 levers that represent a pool of up to $1 billion of opportunity to improve EBITDA. Those are still valid and we're making progress on almost all of them.

3. **Scott Group, Wolfe:** We just had a private LTL panel. We heard that, relative to the bottom that happened on the LTL side in early to mid-April, we've seen a 5-10% bounce.

Directionally, does that seem about right for what you're seeing on the LTL side?

4. **Matt Fassler, XPO:** I think "bouncing off the bottom" is a good description of April. We haven't given an update on May. I think we felt that, across the board in the US, April marked the bottom. There could be some glimmers of light in LTL — nothing I'd want to quantify — but certainly we feel like we hit that baseline when the shutdowns hit their trough. Since then, the world is opening up a bit, and I think you're going to see that ripple through our businesses in the US, as it did in Europe.

5. **Scott Group, Wolfe:** Matt, on the call you said 77% of XPO's costs are variable. Can you help us break that down by business? Is it right to think that non-LTL transportation is the most variable, with the most purchased transportation, and LTL is the least variable? Is that, directionally, the right way to think about it?

6. **Matt Fassler, XPO:** To recap what we said on the call, our cost structure coming out of last year was about 77% variable, 23% fixed. Within that, the contract logistics business is showing the most flexibility in this environment. That's somewhat a function of the customers we have and their resilience through a downturn. It's also a function of the kinds of contracts we have. Many of them give us downside protection. When you look at that formula, I think you can see why our contract logistics margins and cost variability look quite good. The LTL business has a bit more of a fixed cost structure — it's a network business. Then, our non-asset business lines in North America and Europe would be somewhere in the middle, closer to the company average.

   There's one other point I want to make. As we moved through the quarter week-by-week, and now move through the year, we're working to bend that cost curve. Fixed costs are only fixed if you let them be fixed. We're looking to chip away at some of those. And, particularly in our network businesses, I think we're doing very, very well at moving our variable costs down to levels that are commensurate, or better, within the volume decreases we see. So, 77%/23% is the right way to model the business, but we think we can do better than what's implied by those numbers, particularly as we move through the year.

7. **Scott Group, Wolfe:** Normally, you'd never know in March that April's going to be terrible relative to March, but we sort of knew that this time around. So, maybe you could get a little bit more ahead of it than in prior downturns. Is that a fair thought?

8. **Matt Fassler, XPO:** I think there are two items. First of all, again, one thing that we do know is that if revenue slows down in contract logistics, we have hedges. We have protections that help us maintain the kind of P&L and margins that we aspire to in that business. Second, to your point, we've had — it didn't feel like a lot of notice — but a little notice to prepare for the rest of 2020, and we're acting aggressively to address costs across our lines of business.

9. **Scott Group, Wolfe:** Brad, I want to think more strategically for a few minutes. You said on the first-quarter call that the strategic review process is completely off the table — and it's behind you. I'm curious as to why, once we get back to normal, we don't reconsider this. If anything, what we've seen in the last few months is that pure LTL valuations have gotten even higher. Why not re-focus on the strategic review process again, once things get back to normal?

10. **Brad Jacobs, XPO:** While we're in the pandemic, that's not something we're spending any time on whatsoever. From a strategic point of view, we have alternatives, we have options, we have choices. We have a great "problem" — we generate a lot of free cash flow. We can pay down debt. Every dollar of debt we pay down should increase equity by that same dollar. We can call the notes that mature in 2022 at some point. The non-call period is ending. We can always do M&A, if we choose to. And we can always invest capex. We have tons of capex opportunities, particularly in technology, that are earmarked for very high returns. We can consider all kinds of strategic activities.

    XPO was the 7th best-performing stock of the Fortune 500 in the last decade. That's because we take our duty very seriously, to make the best choices in how we allocate capital. Of the different choices we have, in a very disciplined way, we'll choose whatever has the highest return on capital. We'll continually revisit that.

11. **Scott Group, Wolfe:** If you're not thinking about selling or spinning off logistics or non-LTL, do you naturally then go the other way and say, "Hey, do we want to be back in making acquisitions?" And, if that's right, do you think about the US? Europe? Is it LTL? Is it logistics? Is it large? Is it small? Where do you think you start to re-focus on M&A?

12. **Brad Jacobs, XPO:** M&A is one of the alternatives we have. It's certainly not the only one. I gave an interview to a trade magazine a few weeks ago. It was an hour-long interview and we spent maybe three minutes on M&A, but then the entire article was on M&A. I've learned — or, I'm learning — to be a little quieter about M&A. So, we'll just leave it at that: M&A is just one of the alternatives we have and, if and when we do something on M&A, we'll announce it at that time.

13. **Scott Group, Wolfe:** You generate a lot of cash. What else would it be for? When you do M&A and you do the right M&A and you lever up for M&A and, if you execute the deal right, then you naturally de-lever, which lets you do the next one, whereas buying back stock doesn't necessarily have that same impact, right? Is there a preference for M&A, or not necessarily?

14. **Brad Jacobs, XPO:** There's a strong preference for whatever creates the most shareholder value. That's our mission. We take it very seriously. We look at it objectively. We do it by the numbers. If buying back our stock creates more alpha than doing M&A, we're going to buy back our stock. If doing M&A creates more value than something else, we'll do M&A. If paying down debt with our cash makes the most sense,

that's what we'll do. We'll always be rational and disciplined in the way we evaluate the different alternatives for our cash.

15. **Scott Group, Wolfe:** Let's go back to LTL for a few minutes. Margins improved 300 basis points last year — I think over 400 basis points in the first quarter. How should we be thinking about LTL margins, not for the quarter, but for the year? More importantly, longer term, is it a goal to get to an 80% operating ratio in LTL? Do you think that that's possible?

16. **Brad Jacobs, XPO:** I would be extremely disappointed if we didn't do better than an 80% OR over time. It's not going to be in the second quarter. In the second quarter, I think practically the entire industry is going to see unfavorable ORs, given the significant decreases in revenue. But, long-term, absolutely. Every year we should be able to have a better OR than the previous year. And, we will certainly get to $1 billion of EBITDA in LTL. The timeframe for that isn't clear, because we don't know exactly how the pandemic is going to play out. If you look at the first quarter, it showed what we can do in terms of execution and operational excellence. Adjusted operating income was up 32% year-over-year. New business won was up 22%. Load factor was up 520 basis points. Dock productivity was up 8%, largely due to our XPO Smart labor technology. We improved the way we purchased transportation in linehaul by 7%. We brought down empty miles by 23%.

    So, there's a lot of very tangible progress being made on our long-term plan to continually improve the profitability of LTL. A lot of that's due to our technology prowess — the pricing algorithms, the P&D optimization, the dock productivity, the linehaul optimization. There are many different workstreams that we have going on in LTL that are showing demonstrable results. That momentum will continue.

17. **Scott Group, Wolfe:** One of the factors you mentioned driving the LTL margin improvement was the load factor improving by 500 basis points. Where are you relative to where you want to be? How much more is there to go on load factor?

18. **Brad Jacobs, XPO:** We're going to keep pushing on load factor, because every 100 basis points is $10 million of EBITDA, and there's no cost associated with it. It's pure profit improvement. That's a core objective of ours, to keep hammering at load factor. It's an important, long-term lever. If you look at us versus the LTL industry leader, Old Dominion, they're still much better than we are on load factor, so we have a long way to go. Look at this way: we have a great opportunity to get to best-in-class on load factor.

19. **Scott Group, Wolfe:** What about LTL pricing trends? Is that getting tougher in a weaker volume environment? I think you said yield, excluding fuel, was up 2.6% in Q1. What's the underlying pricing environment you're seeing in LTL right now?

20. **Matt Fassler, XPO:** I'm happy to take this one. Pricing is holding. Our GRI is holding. Mix is a factor with yield right now. That was true late in Q1 and to some degree in April. Some of the higher-yielding verticals, like certain parts of auto and retail, saw tonnage down more than some verticals with lower-prevailing yields. But the market remains rational.

    Importantly, we're deploying our pricing tools. Pricing is one of the 10 levers that Brad cited, and it's a particularly big opportunity in LTL, to help us drive yield and profitability. I'm especially excited about the work we're doing with price elasticity, which is helping us make the right proposals to the right customers. Our proposals have a better chance of sticking, and the yield tends to flow through. We're also automating more of our RFP responses to local LTL customers, which is leading to better conversion with those customers.

21. **Scott Group, Wolfe:** Someone submitted a question: "How is the e-commerce final mile volume increase offsetting the decline in B2B revenue? What is the impact of the differential in margins between the two segments?" We hear from UPS and FedEx, "Our B2C is up a lot. Our B2B is down a lot. The net of it is bad for mix and margins." That's a parcel comment. Should we apply the same logic to your business?

22. **Matt Fassler, XPO:** Our last mile business is primarily big and bulky goods. That business did exceptionally well for us in Q1. Our organic revenue was up 9%. We saw ample demand for lawn and garden equipment, for home appliances, consumer electronics and also home fitness equipment. We have a very strong presence in all these areas. In the last couple of days, the two largest home improvement retailers in the country put out their results. Both of them generated very strong same-store sales in their April quarters, and they spoke favorably about the start of May, so that bodes well for B2C.

    Our last mile business is, of course, almost entirely B2C. If you want to talk about B2B, that's more LTL. We've spoken about the tonnage declines that we had in LTL, but within that business, some of those same B2C kinds of customers have done well and continue to do well. Those are some of the verticals within LTL that have stronger trends right now — general merchandise retail, home improvement retail and some other areas like that. As a company, our exposure to the consumer is 50% or more, so we're very well-diversified and very well-balanced. The macro trends we see now are trends that we're able to manage well.

23. **Scott Group, Wolfe:** On the non-LTL side of the transportation business, EBIT results were sort of breakeven in the first quarter. Can you break that down between the US and Europe? Do you think you'll get back to profitability in the second quarter, or is that tougher?

24. **Matt Fassler, XPO:** You know, Scott, for Q2, we'll have to see. Given the headwinds that we saw entering the quarter — and we spoke about those — I think almost every

business is likely to look softer for the quarter overall than they did in Q1, even though we think we hit the bottom very early in Q2, and trends are likely to improve progressively for all areas of our business as we move through the quarter. Longer term — and this is true for European transportation and the non-LTL North American transportation — we intend to drive margins over time that are higher than the margins we generated in 2019.

We have some very good lines of business in non-LTL transportation, including last mile, where we're the leader in North America for heavy goods. Our freight brokerage business, which we're driving forward with XPO Connect, is another one. In European transportation, we're the leading LTL provider in France and Spain and a top-three LTL provider in the UK, as well as a major truck broker in the European arena. These are all excellent businesses for us. So, when you ask, "Hey, can you get back to last year's number?" We can get there and go higher, we think, over time.

25. **Scott Group, Wolfe:** Brad, I want to get your perspective on the news on Uber Freight from earlier this week. Does this change, in any way, the way you think about the long-term direction of margins or gross margins in this business? Has it changed the way you think about deploying technology and capital to brokerage at all?

26. **Brad Jacobs, XPO:** It really doesn't, Scott. We've been on this path of growing our truck brokerage business, largely organically, for almost a decade now, and investing heavily in that technology. We listen carefully to our customers to learn what they want the technology to do. We listen carefully to our people to learn what they want the technology to do. We started pioneering that in 2012 and it's working very well. You saw our first-quarter results for truck brokerage. What our competitors are doing is interesting to hear, but it doesn't really affect what we're doing. We have a path and we're continuing on that path.

27. **Scott Group, Wolfe:** But you don't say, "Hey, a potentially disruptive competitor may be less disruptive and now we want to refocus and accelerate the growth of this business?" Should we not think about it like that?

28. **Brad Jacobs, XPO:** We've already been accelerating the growth, so it doesn't make us accelerate more or less. It would probably help the market, with what's going on there, but it's not a huge deal. It's interesting.

29. **Scott Group, Wolfe:** On your comment about generating hundreds of millions of dollars of free cash flow, have you said, directionally, if you think you'll generate more or less free cash flow than you did last year? You generated $400 million, give or take, of free cash flow last year? Do you have a directional view, more or less?

30. **Brad Jacobs:** We had over $600 million of free cash flow last year.

31. **Matt Fassler, XPO:** We'll see where the year turns out. We said hundreds of millions of dollars. I think it's too early to guide the year more precisely than that. In the first quarter, as you saw, we over-delivered on free cash flow, and that was a function of strong working capital management. For the year, we're reducing our capex from our original plan by at least $200 million. If earnings are lower than they were a year ago — the Street is modeling EBITDA down for the year — then our cash taxes will also be lower. Those two items alone get us at least $300 million of tailwind versus our original plan.

    On working capital, this is a swing factor. It depends on how we close the year. If sales are sluggish, it will be a source. It's a hedge we built into our model. If we build sales momentum, it can be a use, but that would mean that the world is recovering and that we're regaining revenue momentum. We'll take that. In either of those scenarios, we have the ability to deliver hundreds of millions of dollars of free cash flow.

32. **Scott Group, Wolfe:** Someone is asking if you can add some more color, Brad, to your comments about warehouse automation. Are you seeing more customer interest in this due to social distancing from COVID? Or is that just a bigger picture statement on the evolution of supply chains?

33. **Brad Jacobs, XPO:** Well, we have a very good window into that, because, as you know, we have a 15-year joint venture with Nestlé to create the warehouse of the future — and that's opening. It was going to open in May, and now it may get delayed a couple of months because of COVID, but it's to the point of opening. We see pretty much every single vendor of warehouse automation pitching to us, because they want to attach their wagon to our star. It's very high-profile.

    There's is a lot of demand from our contract logistics customers to figure out ways to make warehousing more cost-effective, make it more efficient, make inventory more accurate, and have much greater visibility at every moment in time, to know where the goods are. Warehouse automation is the secret to all of that. Warehouse automation was already a fast-growing trend. It's accelerating, for sure, and we're a leader.

34. **Scott Group, Wolfe:** What other longer-term changes do you see in supply chains as a result of COVID? There are a lot of people talking about re-shoring or near-shoring. Whatever the right word is, is that something you believe is going to be happening at an accelerated pace? Beyond that, what are the other things that you see?

35. **Brad Jacobs, XPO:** I do think you're going to see more nationalism, more government-mandated manufacturing within countries, particularly for essential supplies — things to do with healthcare, for example, like pharmaceuticals. And yes, between the tariffs and COVID, I think you're going to see shorter supplies chains. You're going to see less Asia-to-US and more domestic US. Of course, that works to our advantage, in principle, because we don't do a lot of international freight forwarding, although we do some. We

do a lot of domestic transportation and we do a lot of domestic warehousing, both here and in Europe. It should benefit us.

36. **Matt Fassler, XPO:** In addition to everything that Brad said, if companies are looking to reposition elements of their supply chain, we have the consultative capability to help them figure out exactly how they want to do that. If they need to build new infrastructure, that's something that we can work on with them, in terms of implementation. If the world moves in that direction, there are some ways for us to help companies that will be helpful to our business as well.

37. **Scott Group, Wolfe:** Brad, when you talked about outsourcing accelerating, is that a contract logistics comment? As you think about the logistics business, what's more likely, in your opinion: getting to a sustained double-digit growth rate or getting to a double-digit margin? Or, is it a combination of the two? Where do we want to see your contract logistics business?

38. **Brad Jacobs, XPO:** On the second part, I'll let Matt answer, but I'll just say that we do look for both revenue and margin growth. More importantly, we look at how both of those lead to return on capital. We look at every one of our businesses and all our capital allocations in terms of how much money are we putting out and how much money are we getting back. How quickly are we getting it back? How long is that in-stream going to last? The way we allocate capital and make decisions is focused on returns.

    With respect to the first part, the outsourcing question, that does affect many parts of our business — including, for example, managed transportation — but it mostly affects contract logistics. Contract logistics is largely managed internally by the companies themselves. But it's being increasingly outsourced to good operators of contract logistics. That's different than some other lines of transportation and logistics, where you have dozens or hundreds of thousands of choices. There really aren't a whole lot of choices in contract logistics, so the gating factor has been the capacity of the providers, the vendors who provide the logistics services. We are very, very good at that. The more that's outsourced, the more we should benefit. I think the long-term growth rate projected for contract logistics is higher now than it was pre-COVID. Matt, over to you.

39. **Matt Fassler:** Scott, I think the question was on margins in contract logistics. Can you elaborate a bit please, and I'll try to give you a sharp answer.

40. **Scott Group, Wolfe:** The question was, do you see the potential to either get to a double-digit growth rate in contract logistics or potentially a double-digit margin, or maybe both?

41. **Matt Fassler, XPO:** I think we can get to both: sustained, double-digit, top-line growth and a double-digit EBITDA margin. There's a point where we would consider capping the

margin and re-investing the upside in growth. We're not there quite yet — and we weren't there last year either, for context. And to Brad's earlier point, we're very focused on ROI, so I encourage people to focus less on the margins per se, and more on where it takes the return on capital of the business.

Now, we've got a number of drivers to help us get to those margins. Our XPO Smart workforce productivity platform, which was initially launched in North American contract logistics, drove labor productivity up 5% where we implemented it, in the first quarter. We're reducing our loss-makers in Europe — European contract logistics profitability is another one of our 10 levers. Smart is too, by the way. We exited some low-margin business. And I also want to talk about XPO Direct, our shared distribution network. XPO Direct was solidly profitable for the first time since launch. It took only about a year to achieve profitability. You asked about e-commerce earlier. Well, XPO Direct is a unique offering that we have in North America to help facilitate fulfillment for a number of our e-commerce customers, both brands and retailers.

In European contract logistics, we have a number of great revenue drivers coming on board. We spoke earlier in the year about our new contract with Waitrose. It's a three-year deal at about $85 million per year. It's our second-largest contract ever in European contract logistics. Brad spoke about the Nestlé warehouse of the future. That's a 15-year deal. In addition to serving our customer, it's going to be a test bed for lots of our new automation ideas, in coordination with many vendors. We'll be testing innovations that can be rolled out on a global basis from there. And then, of course, later this year, we expect to close on our acquisition of the bulk of Kuehne + Nagel's UK contract logistics business. We're going to get access to some great verticals there, and do more in technology and e-commerce, and in the food and beverage arena. So, there are a lot ways for us to drive revenue in contract logistics in Europe.

42. **Scott Group, Wolfe:** That's great. We've got to wrap it there. Brad, Matt, thank you so much. Really appreciate you guys being here. Be well and stay safe.

43. **Brad Jacobs, XPO:** Good to see you. Thank you.