CtW Investment Group

April 12, 2021

Michael Jesselson
Lead Independent Director
XPO Logistics, Inc.
Five American Lane
Greenwich, CT 06831

Dear Mr. Jesselson,

XPO's recently announced plan to spin off its logistics operations as GXO raises important questions concerning the structure and governance of the two independent companies going forward. Financial research shows that while spin-offs create value for investors in some cases they destroy value in others. We urge XPO to provide robust disclosures of the board's decision process leading up to the announcement and to commit to governance best practices both during and following the separation, including:

1. Issue timely and comprehensive disclosure of the details of the upcoming transaction
2. Provide clear disclosure of the board's decision process
3. Avoid executive compensation windfalls
4. Commit to corporate governance best practices

Comprehensive Disclosure Needed

First and foremost, because a spin-off is not a transaction that requires shareholder approval, shareholders will have to determine for themselves if they wish to retain shares in both XPO and GXO or in just one of the companies, or sell their shares prior to the split. However, it is not currently possible for shareholders to develop an educated view of the relative merits of the post-spin off companies, because XPO has not disclosed in any detailed way how the existing company will be divided between the two new companies. In particular, while the transportation and logistics divisions have been separate reporting segments for some time, shareholders do not know how corporate expenses will be divided between XPO and GXO, or more importantly, exactly how assets and liabilities will be allocated. Given the significant difference in revenue between the segments (transportation revenue typically exceeds logistics revenue by 40%), and in their operating margins (transportation margin is about twice the logistics margin), this allocation of assets and liabilities could substantially affect the attractiveness of either company. Moreover, the increase in logistics investment over the past five years, reflected in a higher ratio of depreciation charges to revenue in the logistics segment, implies that this allocation is unlikely to be proportional to revenue. Until shareholders have clarity on the details of the spin-off, they cannot assess the viability and attractiveness of continuing on as an XPO shareholder.

Clearly Describe Board Process

Additionally, and as we communicated in our March 19, 2020 letter, we believe it is essential that a review of strategic alternatives is actively and objectively overseen by independent directors. This is preferably through a special committee equipped with a broad mandate to consider all strategic options with the assistance of outside advisors. Decisions to spin off a business, we recognize, are commonly taken as a positive indication of a company's commitment to maximizing shareholder value; however, this does not necessarily absolve the resulting transaction from potential conflicts of interest. Management in general - or in this case,

1900 L Street NW, Suite 900 Washington, DC 20036
202-721-6060
www.ctwinvestmentgroup.com

CEO Bradley Jacobs in particular – can have strong private interests in the specific structuring of the split or, indeed, in pursuing a spin-off over other competing options. Not least here is the risk that CEO Jacobs, with the bulk of his $3.1 billion personal fortune tied up in shares of XPO, may have interests differing from public shareholders. As we noted in our March letter, for instance, particular transactions and monetization strategies could trigger tax liabilities that, while palatable to public shareholders, could be intolerable to CEO Jacobs given his tax exposure.

Accordingly, we request that the board publicly disclose the process by which the independent directors oversaw the strategic review and provide a narrative of the decision process leading up to the spin-off, including if, and when, independent advisors to the board were engaged, and what, if any, competing proposals were considered by the independent directors.

Avoid Executive Pay Windfalls

The use of retention awards, transaction bonuses, jump-start awards, or the generous modification of outstanding incentive awards are some of the ways in which executives can benefit from spin-offs, irrespective of the results for investors. While we appreciate that some adjustments to compensation are par for the course in any spin-off, the board must avoid providing windfalls to executives. This is essential in ensuring that the interests of management remain aligned with those of investors during such a pivotal moment for the company.

To this end, we believe it is crucial that the sizable PSU awards granted to executives in recent years remain outstanding and performance-based even if modifications are necessary to reflect the impact of the spin-off and an individual executive's position vis-à-vis the two separate entities going forward. Adjustments to the performance-based targets, if necessary, must be done in a manner that is clearly justified and which ensures executives are only rewarded for strong, sustainable performance. How the board chooses to treat outstanding awards is all the more important to shareholders given XPO's frequent use of mega-equity grants to compensate CEO Jacobs and the repeated criticism of this practice from investors.[1]

Similarly, we believe the board must refrain from granting excessive one-time awards in connection with the spin-off, be it in the form of retention or transaction bonuses, or overly generous grants of equity to 'jump start' executive ownership at the new logistics spin-off. Given XPO's history of poor say-on-pay votes, the spin-off ought to mark an opportunity to right-size the company's pay practices, rather than further weaken the company's pay-for-performance profile.

Adopt Corporate Governance Best Practices

We are concerned that, in some instances, when companies have undertaken a spin-off, the governance policies and practices at the new company may be further from best practices than had been the case for the original firm. We believe that the new company stands a far better chance of success if management is clearly accountable to its shareholders. To this end, we urge

[1] According to our analysis, CEO Jacobs has more than $56.7 million in target value PSU awards outstanding (as of Dec. 31, 2019), with vesting tied, varyingly, to absolute stock performance, relative stock performance, earnings per share goals, and absolute and relative cash flow per share. The latest award, in July 2020, could pay out as much as $80 million in cash.

the company to refrain from adopting regressive governance practices such as a classified board, supermajority vote provisions, poison pill provision, or other entrenchment structures. Rather, we believe the new company should follow governance best practices, including adopting policies providing for proxy access, requiring the board chair be independent, and pro-rata vesting of equity awards following a change-of-control event.

In keeping with this view, we were alarmed to discover that the company plans to install Mr. Jacobs as chairman of GXO, given that he will continue to serve in his dual role as CEO and chair of XPO. Not only is an independent chair invaluable in ensuring strong independent board oversight in general, but we specifically worry, in this instance, that having Mr. Jacobs serve as chair of GXO raises potential conflicts of interest given the expectation of related services agreements between the two companies and their operation in adjacent or perhaps even overlapping markets. Similar concerns extend to any other executive, of either GXO or XPO, who simultaneously serves on the board of the other company.

Finally, we believe the spin-off offers the valuable opportunity to recruit new, high-quality directors to both GXO and XPO. We are skeptical that overlapping directorships between the two companies will be of value to either company and worry that it could lead to conflict of interest concerns. Board recruitment should be undertaken through an extensive search process that actively seeks diverse candidates in terms of race, gender, and ethnicity. We expect to see directors with an array of suitable professional backgrounds and financial, industry, human capital management, international, legal, and technological expertise.

Conclusion
XPO stands at a critical juncture with the upcoming split into two companies. It is imperative that the board disclose the due diligence process that it undertook to determine that this strategy was the best of its strategic alternatives. Any executive compensation windfalls risk sowing doubt among investors as to the intentions of the split. Conversely, increased and timely disclosure of the details of the split and the adoption of best corporate governance practices will go a long way in getting investor support for the transaction. If you have any questions or want to discuss this further, please contact my colleague Emma Bayes at emma.bayes@ctwinvestmentgroup.com.

Sincerely,

Dieter Waizenegger

Dieter Waizenegger
Executive Director