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# EDITED TRANSCRIPT

XPO - Q1 2018 XPO Logistics Inc Earnings Call

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**OVERVIEW:**

Co. reported 1Q18 YoverY organic revenue growth of 11%.





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**Scott B. Malat** *XPO Logistics, Inc. - Chief Strategy Officer*

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## PRESENTATION

**Operator**

Welcome to the XPO Logistics Q1 2018 Earnings Conference Call and Webcast. My name is Melissa, and I'll be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded.

Before the call begins, let me read a brief statement on behalf of the company regarding forward-looking statements and the use of non-GAAP financial measures. During this call, the company will be making certain forward-looking statements within the meaning of applicable security laws, which, by their nature, involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those projected in the forward-looking statements. A discussion of factors that could cause actual results to differ materially is contained in the company's SEC filings. The forward-looking statements in the company's earnings release or made on this call are made only as of today and the company has no obligation to update any of these forward-looking statements, except to the extent required by law.

During this call, the company may also refer to certain non-GAAP financial measures as defined under applicable SEC rules. Reconciliations of such non-GAAP financial measures to the most comparable GAAP measures are contained in the company's earnings release and the related financial tables or in the Investors section on the company's website at www.xpo.com. You can find a copy of the company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures in the Investors section on the company's website.

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

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

Thank you, operator. Good morning, everybody. Thanks for joining our earnings call. With me in Greenwich are John Hardig, our CFO; Scott Malat, our Chief Strategy Officer; and Tavio Headley, our Head of IR.

First of all, I'm happy to welcome Kenny Wagers to the team as our new chief operating officer and to congratulate Troy Cooper on his promotion to president. These appointments will support the high levels of organic and acquisition-related growth we're anticipating.

As you saw from the press release, we had a strong start to 2018. We posted record first quarter revenue, net income, EPS and adjusted EBITDA. We generated robust organic revenue growth of 11%. And we increased our adjusted EBITDA 14% year-over-year to a first quarter record of $330 million. The growth was broad-based across our operations. We grew contract logistics organic revenue 14% and last mile 15%, driven by demand from our e-commerce customers. And in a tight market, we grew freight brokerage revenues 30%.

Our logistics business keeps picking up steam. We brought 20 new sites online in the first quarter. We're now opening on average 2 facilities a week. Company-wide, our sales pipeline stands at a record $3.66 billion, which is 23% higher than a year ago. In the first quarter, we signed up new business of $972 million, that's up 36%, and a new quarterly record for us.

Since the beginning of the year, we've been launching one innovation after another for our customers. Scott will describe our new shared distribution network, our next-generation warehouse management system, our digital freight marketplace and mobile driver tools and our voice-enabled tracking that integrates with Amazon Alexa and Google Home. These investments and others should propel our earnings growth in 2019, 2020 and beyond.

We remain on track to deliver on our targets of at least $1.6 billion of adjusted EBITDA this year and approximately $1 billion of cumulative free cash flow for 2017 and 2018.

And on that note, I'll ask John to review the first quarter numbers in more detail. John?

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**John J. Hardig** - *XPO Logistics, Inc. - CFO*

Thanks, Brad. Our results of the quarter reflect a healthy diversification of customer verticals and service lines.

I'll start with our transportation segment. We increased revenue 16% to $2.8 billion. Operating income increased 32% to $139 million and adjusted EBITDA grew by 14% to $266 million. We had a good quarter in less-than-truckload. Our adjusted OR improved 120 basis points to 87.8%. This was the best first quarter operating ratio in 18 years. And it's an acceleration from the 60 basis point improvement in the fourth quarter. Our full year 2018 adjusted OR is on track to improve 100 to 200 basis points over 2017.

Yield in the quarter accelerated and was up 3.9%. This compares to 2.6% in the fourth quarter and 1.8% in the third quarter last year. Pricing on contract renewals was up 5.9%, also an acceleration from the fourth quarter when it was 5.3%.

We recently made a substantial investment in our LTL sales organization. We added 190 people since November, including 140 in the first quarter. We launched our new sales effectiveness program. We're capitalizing on the strong LTL market to make changes to our freight mix. We're focusing on profitable freight that matches our network for the long term. As a result, we expect to see meaningful acceleration in operating income growth in the second half of the year.

Weight per shipment increased 4.3%. Tonnage per day was down 1.1%, as we continued to call less profitable freight, mainly in our largest national accounts and replace it with freight from local accounts. As a result, we've grown our local revenue by 22% over the last 2 years.

Despite a tight truck market, we reduced purchase transportation costs 8.5% by increasing utilization and moving more of the freight to our own fleet.

In last mile, we delivered another strong quarter with 15% revenue growth, driven by growth in e-commerce. We've won more last mile business in the first quarter than in any other first quarter in the last 11 years. And we expect revenue growth to accelerate as we move through 2018.

In freight brokerage, we continue to perform exceptionally well. We grew revenue by 30% year-over-year as the favorable market conditions in the back half of 2017 continued into this year. Our net margin in freight brokerage increased 60 basis points. Truck brokerage, which is the largest component of freight brokerage, grew volume 21%, while our gross margin per load also improved significantly.

In intermodal, we grew domestic volume 7%, and we're seeing an increasing trend of shippers converting from truck to rail.

Our European transportation operations generated a solid performance. We grew revenue 21% with an approximate 16% benefit from foreign exchange and fuel. Revenue growth was driven by dedicated truckload throughout Europe, truck brokerage in France and LTL in Spain. We saw capacity tighten significantly in March and that continued through April. There is a trend of customers seeking out dedicated solutions due to the tight capacity.

Our last mile implementations in Europe are also going well. We've deployed members of our North American last mile team to Europe to share best practices. We're up and running in the U.K., Ireland, France, Spain and the Netherlands, and we're seeing strong demand for this service.

The star of the quarter was our logistics segment. We performed exceptionally well in both North America and Europe. Total logistics revenue increased 23% to $1.4 billion. Operating income increased 44% to $48 million and adjusted EBITDA increased 28% to $112 million.

Our global sales pipeline for logistics has grown to $1.9 billion, which is nearly doubled from a year ago.

Looking at the logistics performance by region, Europe continued on a strong growth path. We grew revenue 29%, including a benefit of about 15% from foreign exchange. We had double-digit organic growth across multiple verticals, including retail and e-commerce, consumer packaged goods and fashion. We're also seeing strong demand for our reverse logistics services as e-commerce becomes a larger part of our business.

In North America, logistics revenue increased 15% in the quarter. The largest gains came from e-commerce, industrial, consumer packaged goods and technology. Our pipeline for logistics in North America is up nearly 80% to over $1 billion. We grew EBITDA significantly in the quarter, while executing a large number of new site implementations. We improved productivity at our sites by increasing the level of automation and implementing new labor planning tools.

Interest expense for the quarter decreased 21% to $59 million due to debt paydown and repricings of our term loan at lower rates.

Our free cash flow was a use of $151 million, which was in line with our expectations. Working capital accounted for a significant use of cash, which is typical for the first quarter, primarily due to the seasonal revenue pickup in March and annual incentive payments, which we were very pleased to pay out to approximately 20,000 of our employees.

Similar to the first quarter of last year, our effective tax rate for the quarter was negative, largely due to the deduction of annual equity vesting. We expect the full year effective tax rate to be 22% to 25%, which implies a higher rate for the remaining quarters in the year.

And now I'll turn it over to Scott.

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**Scott B. Malat** - *XPO Logistics, Inc. - Chief Strategy Officer*

Thanks, John. From a macro standpoint, we're continuing to see broad-based strength in both North America and Europe. In North America, the truckload market continues to be favorable, although not quite as tight as earlier this year. Produce season started late. We're expecting volumes to pick up alongside the start of beverage season this month.

In Western Europe, all of our major transportation markets improved in March, and again in April, reflecting steady economic growth. These are all positive signs of the upcycle, but what we're most excited about are the long-term growth opportunities that are being fueled by our investments in the business.

Our most significant investments are in the areas of innovation and sales. XPO Direct is a great example of how we use innovation to serve our customers and gain new business. XPO Direct is a brand-new shared space distribution network that positions goods in close proximity to 95% of the U.S. population. Customers share our technology, warehouses, last mile hubs, cross-docks, trucks and broker capacity at a fraction of the cost of setting up their own distribution centers and with a lot more flexibility. We've already signed up a number of Tier 1 e-commerce and retail customers.

On the technology front, we've launched a number of major innovations since the start of the year. WMx is our next-generation warehouse management system. It's proprietary to XPO. It gives us the ability to implement new logistics sites more rapidly, integrate the latest automation and robotics and create more data analytics for our customers. WMx also pairs well with our new security robot program, called C3-XPO, which has improved security at our logistics sites.

Another recent innovation is Drive XPO. It's a mobile app for brokerage carriers that's launched in North America and is being rolled out in Europe. Drivers use it to bid on and manage loads from the road. The app helps to reduce empty miles, lowers fuel waste and improves customer service.

Drive XPO interacts with our freight optimizer system through one of our most exciting introductions: XPO Connect. It's our cloud-based digital freight marketplace. This new platform is designed with multimodal architecture, which means that our transportation customers will have visibility across modes, such as truck, rail and drayage, along with pricing information and business intelligence tools. If a customer's freight has to get from point A to B by Monday, XPO Connect will lay out all the options in real time.

We're also investing in fast-growing reverse logistics. We manage over 170 million returns annually and generate revenue approaching $0.5 billion. Reverse logistics can be complex, with inspections, repackaging, refurbishment, resale or disposal and refunds. Many require warranty management. Our technology is a major differentiator in this space. We've developed predictive analytics that use machine learning to forecast the future rate of return by SKU number. That's a big deal for our e-commerce customers because consumers are test driving more of the products they buy online.

In last mile, our most recent news is our launch of voice-enabled consumer self-service. Consumers will be able to follow their purchase from the point of sale through fulfillment and transport and schedule delivery using Google Assistant or Amazon's Alexa.

We're the first in the industry to offer this capability, and it got a great reception when our CIO demonstrated it at a national supply chain conference last month.

We're also in the middle of a major expansion of our last mile network, which should bring us to 85 hubs this year. We opened 6 new hubs in April, with 10 more slated for May and June. The remaining 14 hubs should be in place in the third quarter, in time for the holiday peak.

In LTL, we launched the next-generation web integration for customers that gives them access to more shipping tools without custom programming. These include delivery and pickup management, planning tools, pricing and electronic document handling. Technology like this differentiates XPO to LTL customers and supports our recent investment of $15 million in expanding our sales force. This should generate incremental LTL growth with an optimal freight mix. We've rolled out new training programs and equipped our sales people with new data-driven tools to help them ramp up productivity.

So we're off to a strong start in 2018. We are building momentum across our operations and at the same time, we're leaving no stone unturned in pursuing long-term earnings and free cash flow growth.

With that, let's open it up for Q&A. Operator?

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from the line of Chris Wetherbee with Citi.

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**Christian F. Wetherbee** - *Citigroup Inc, Research Division - VP*

Brad, maybe we could start on the M&A front. Just wanted to get a sense, if you could give us sort of your most updated thinking in terms of, I guess, either timing, sort of what the target environment looks like, sort of how that process is all progressing at this point?

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

It's progressing, it's progressing well and it's progressing as expected and as originally outlined last year, when we returned to the M&A market. You recall, when we first announced that last year, we said we want to do that in a very methodical, disciplined way. The same way we did it from 2011 to 2015. And we wanted to cast a wide net, speak to lots of potential acquisition targets and then funnel it down to a smaller and smaller amount and then end up selecting the one that's the most accretive and most valuable for our shareholders and our customers. And we said the base case scenario is, we would have a big acquisition or 2 medium-sized acquisitions announced by the end of this year. And we're very much on track for that. That could be 3 weeks from now, that could be 3 months from now, that could be December, but the base case scenario is this year.

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**Christian F. Wetherbee** - *Citigroup Inc, Research Division - VP*

Okay, that's helpful. Any thoughts in terms of where you're looking? Has that changed in terms of the end markets that you're most interested?

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

It hasn't -- we're still looking; from a geographic point of view at companies because of their size, are in more than one country, usually more than one continent, so global companies. And the headquarters are generally in North America or Western Europe. And the types of companies are ones that are identical or similar or very adjacent to the service lines that we're actually offering right now.

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**Christian F. Wetherbee** - *Citigroup Inc, Research Division - VP*

Okay, that's helpful. And then just to follow-up thinking about the organic revenue growth. So you've announced a lot of initiatives over the course of the relative -- over the last quarter or so and very recently as well. I wanted to get a sense - you posted a nice organic revenue growth number in the first quarter - how do you see that playing out with new sales people onboard, some of these new initiatives heading in towards the peak season? Do you see a nice acceleration in revenue growth? Just want to get a sense of kind of how that looks relative to your pipeline and everything else.

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

I don't know if I'm really good at predicting that, because the last 2 quarters, we were thinking it was going to come in between 5% to 8% and it came in at 10% and 11%. So we've been underestimating the amount of organic growth that's out there to be gotten and our ability to go and get it. Brokerage, obviously, had 30% organic growth, logistics had 14% organic revenue growth, last mile had 15% organic revenue growth. So everything is performing very, very, very well. I would say the likelihood of us only doing 5% to 8% organic revenue growth for the full year is very low. And the chances of us doing the high end of that range or bit higher than that range is highly likely.

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**Operator**

Our next question comes from the line of Brian Ossenbeck with JPMorgan.

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**Brian Patrick Ossenbeck** - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

So just wanted to talk about the last mile for a little bit. Clearly growing pretty fast, 15% this quarter, should accelerate throughout the year -- big and growing market, but we've seen some more headlines of -- and some more transactions for other competitors again in this space, especially in North America. So I'm wondering, if you can talk about what are you seeing on the competitive dynamic, specifically from customers, any retention? And then just provide a little more color on the European rollout a couple of months into it.

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

Okay, great. Thank you for those questions. So last mile is going very well. We grew 15% in the first quarter. We have read the same headlines about competitors coming into the market, and some very professional, experienced, high-quality companies coming in, which is great. Always good to have sophisticated competition rather than unsophisticated competition. We have competition in all of our lines of business. We don't have a monopoly or dominant market share in anything that we do. So every day we have to earn our customers' business. In last mile, customers demand extremely high level of service, more than in most of the lines of business. And there's a lot of ingredients that go into being able to deliver that excellent level of customer service. You need scale, you need density, you need a national network of last mile hubs, you need proprietary technology to do the dynamic route planning, the customer satisfaction scoring at the point of delivery. You saw recently, we did an industry first and integrated with Alexa and Google Home. So there's a lot of pieces to the puzzle in last mile. We have all those pieces to the puzzle. I think some of the people, who are trying to get into the business might get all those pieces and some of them won't. In any case, we don't take our leading position in last mile for granted, and we continue to deliver great customer service for our customers every day. We won more last mile business in the first quarter than in any other first quarter in XPO's history. And with respect to your question about Europe, Europe is a place we entered last mile just within the last year, and we're now up and running in 5 countries: U.K., Ireland, France, Spain and the Netherlands. And there's strong demand for last mile business, particularly well-executed last mile business with really high levels of operational excellence.

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**Brian Patrick Ossenbeck** - *JP Morgan Chase & Co, Research Division - Senior Equity Analyst*

Okay. Thanks for the detail on that. Just a quick follow-up on the contract logistics pipeline and reverse logistics. In particular, you mentioned you're doing about $0.5 billion in revenue there. Clearly, another big growth area. So I wonder if you can give us a sense of how much of those opportunities are in the current pipeline, if that's what fueling some of that growth. And is it big of an opportunity in Europe as it is in North America?

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

It is. Reverse logistics, which is largely related to e-commerce, is very big for us in Europe, because we have the largest e-fulfillment platform in Europe. So this is a large business. It's fast growing. As Scott mentioned, we're now managing over 170 million returns annually. And our revenue in reverse logistics is approaching $0.5 billion. So this is a business that we gravitate to because it's a complex business. It's a business that has a lot of moving parts that many things have to be done. If you noticed the theme, the types of businesses that we are doubling down in and that we're investing more and we are building, are ones that are complex, ones that have high value add, ones that can differentiate ourselves from competition, ones that are non-commoditized and ones that are technology enabled. So reverse logistics has a -- in reverse logistics, technology is a big, big differentiator. You will know that of our substantial tech spend, a big part of that is for predictive analytics. So in reverse logistics, we use machine learning to forecast the likely rate of returns by SKU. And this is highly valuable data and information for our customers because it helps them manage the inventory more and helps them place their goods closer to the customer. Oh you asked one other thing, you said, do we have reverse logistics business in the pipeline? The answer is yes. That's one of the faster-growing parts of our business.

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**Operator**

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

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

The yield accelerated in LTL in the quarter. Could you please discuss the drivers there and elaborate on how you anticipate yield trending over the coming quarters?

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

Scott, are you referring to LTL?

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

Yes.

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

So in LTL, yield was up 3.7%?

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**John J. Hardig** - *XPO Logistics, Inc. - CFO*

Yes.

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

3.7%. No, 3.9%, 3.9%, which you are right accelerated from the fourth quarter, where it was 2.6% up and accelerated from the third quarter, which was up 1.8%. So it was up 1.8% third quarter, 2.6% fourth quarter and now 3.9% in the first quarter. So it is accelerating and that's for 2 reasons: number one, we have to recover our cost. There is cost inflation. So that's covering that. And number two, it's a good market. It's a very, very healthy market. The industrial end markets are strong and competition is rational and that's one of the reasons why our contract renewals in LTL are up 5.9%, also an acceleration from the fourth quarter where it was 5.3%. I expect yield to remain strong for the balance of the year. And we made a substantial investment in our LTL sales organization. We added 190 new sales people in our sales organization and sales support as well since November, including 140 in the first quarter. So lots going on in sales in LTL.

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

Great. Thanks for that. And then shifting gears a little bit. Could you please elaborate on the investments that you made in the first quarter? And what you expect as far as the cadence of investment OpEx spend over the coming quarters? And then kind of rounding this out, based on business trends and demand influence,-- how will that influence your investment spending over the balance of the year? And could you provide a perspective on what type of elevated investment you might expect in '19 and beyond from obviously this very high level of activity starting this year?

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

So I don't -- I can't really speak to 2019 and 2020 because we haven't done the budget for that yet. But I can tell you precisely what our strategy is for making investments in the now that are drags on earnings that are big improvements in earnings going forward in the future years for this year.

In this year, we made a commitment to The Street to deliver $1.6 billion of EBITDA and free cash flow of $625 million. To the extent that we have extra EBITDA that we have a, what is it called something of riches...

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**John J. Hardig** - *XPO Logistics, Inc. - CFO*

Embarrassment.

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

Embarrassment of riches. We have an embarrassment of riches and have more or even significantly more than $1.6 billion of EBITDA. We will continue to invest that into the business. So for example, the 190 LTL sales and support that we've hired in the last few months; growing the sales organization in Europe more than was originally planned; opening 30 last mile hubs by the end of the summer; ramping up -- staffing up our organization so that we can continue to do 2 contract logistics implementations a week, which is the run rate we're on; and investing in technology, and we've been rolling out one innovation after another after another, the most recent one XPO Direct. We did grow EBITDA 14% year-over-year in the first quarter. And we do expect to grow EBITDA 17% for the full year. So I like where we are in terms of delivering the numbers. The more -- the higher the numbers come in, don't expect the $1.6 billion to go up, but do expect us to invest more in the business in things that will reap rewards -- significant rewards in the out-years.

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**Operator**

Our next question comes from the line of Ravi Shanker with Morgan Stanley.

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**Ravi Shanker** - *Morgan Stanley, Research Division - Executive Director*

Brad, if I can just follow up on your last response here. So actually, you're telling us that you're drawing a line on the sand at $1.6 billion of EBITDA and kind of just given that your organic growth rate in the first quarter was well above our expectations and it seemed like above your expectations as well. You're going to plow in kind of -- if that organic growth accelerates through the year and you make more money that gets plowed back into the business, when do we see that upside? So does that mean that your EBITDA in 2019 is going to be kind of exponentially higher than 2018 levels? I mean, what's the payback going to be like on the incremental investments you're making over that $1.6 billion that you made on this year?

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

Good morning, Ravi. Well, first of all, exponential is a pretty strong word. I don't know that I can say it's going to be exponential, but we are building the business for the long term. We are building the business so that we're well positioned to serve customers with high levels of customer satisfaction for many years. And that we build up on the scale that we've got to make each one of our service lines better, that our customers -- we are able to delight our customers more in each one of our lines of business. So we will continue to invest industry-leading levels into things like technology and innovation. So in terms of what the profit growth will be in 2019, 2020, we haven't worked through that. We haven't released that. We haven't even begun the budgeting for that. But our goal is to make it very, very healthy, very strong.

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**Ravi Shanker** - *Morgan Stanley, Research Division - Executive Director*

Okay. And also your pipeline growth this quarter was really impressive. Can you give us a little more detail on where that new business is coming from, which segment, which region? And also, how much incremental cost or investment will you have to make to take on that new business?

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

So you're right. The new business pipeline was a record. There were a lot of records in this quarter. That was one of them. And it was at $3.66 billion, up 23% from a year ago. It's -- where the biggest pipeline -- year-over-year pipeline increases were logistics, European transportation and last mile. The customer wins, we won $972 million new business, up 36% from a year ago. In terms of how it breaks out between the segments, a little more than half, 52% in logistics, 48% in transportation. And in terms of -- and that's where the pipeline is. And in terms of geography, it's about little more than 2/3 here in North America and a little under 1/3 in Europe.

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**Ravi Shanker** - *Morgan Stanley, Research Division - Executive Director*

Great. And then just one last follow up for maybe John or Scott. Can you quantify any unusual cost headwinds you may have had this quarter, whether it was weather or incentive comp or something? I'm sorry if I missed that in your prepared remarks.

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**Scott B. Malat** - *XPO Logistics, Inc. - Chief Strategy Officer*

Sure, Ravi. Hey, it's Scott. There's always headwinds and tailwinds in any quarter. We had a good quarter within those. In terms of things within the quarter, there were the investments in the LTL and the European sales and XPO Direct and added up to about $17 million. From a weather prospective, it was a tough winter, especially in France and other parts of North America. That was a $16 million headwind. But you always have things going for you and against you.

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**Operator**

Our next question comes from the line of Ari Rosa with Bank of America.

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**Ariel Luis Rosa** - *BofA Merrill Lynch, Research Division - Associate*

So first question, wanted to touch on the acceleration in European transportation on the truckload and less-than-truckload side. It looked like there was a real step-up there and it was kind of continued from fourth quarter. So just wanted to talk about what's kind of driving that? Is that kind of the organic growth opportunity? Or is that you guys kind of expanding your service offering and drawing in more business that way?

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

Good morning, Ari. It's the latter, not -- it's the tight capacity mainly. So the capacity is even tighter in Europe than it is over here in North America. And unlike North America, where it's still tight, but it's a little less tight than it was at the beginning of the year, in Europe, capacity actually tightened more in March, then tightened more in April, and we're starting May with even tighter levels. I don't want to sound like a broken record, but record is actually the right word for this quarter. We had the best quarter ever, best first quarter ever in European transport. That was due to dedicated truckload in the U.K. and France. Because as a result of the tightness in the market there, we're seeing more customers who want to ship to dedicated versus one-way truckload. And also growth in last mile is starting to put some numbers up.

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**Ariel Luis Rosa** - *BofA Merrill Lynch, Research Division - Associate*

Okay, that's really helpful. And then on some of these initiatives that you have underway, XPO Direct and the digital freight marketplace, et cetera. Is there a good way to quantify what the opportunity looks like there in terms of, whether it's incremental revenue growth or thinking about EBITDA contribution from those opportunities? Should we view that as incremental growth above and beyond the $1.6 billion? And even if it's not for 2018 that it really materializes, how do we think about what the opportunity set looks like going forward from those initiatives?

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

The answer is yes, Ari. All of those 5 major technology and other innovations that Scott went over earlier in the call. They are all designed for 2 things: to delight our customers and to generate more profits for our shareholders. So XPO Direct, which is that shared space distribution network, that's designed to give flexible capacity to our customers, so they can position their goods closer to the end consumer without putting in additional capital cost. It's a shortened delivery time. So effectively, we're renting out our scale to the customer and allowing them to reach 95% of the U.S. population within 1 or 2 days. So right now, we have about 75 facilities in the network, and we're going to expand that to 100 by the third quarter. XPO Connect is something a little bit different, that's a cloud-based digital freight marketplace. It's fully automated, self-learning, it's dynamic, automatically finds loads and it gives customers full 100% visibility across our modes in real time. So that's more on the transportation side. The voice-enabled tracking in the last mile that was an industry first, integrating with Amazon Alexa and Google Home - that is a really cool function. We've been demonstrating that a lot here internally throughout the company and you go right onto Alexa or to Google Home and you talk with -- back and forth with smart speakers and you can place your order, you can track your order, you can change your order, you can confirm your order. And in last mile, nailing down the exact delivery window to as precise amount of time as possible and if anything changes from our side or from the consumer's side, being able to make that known and visible and transparent to the other side and work around that, that's a big, big, big deal there. The other 2 that Scott mentioned were Drive XPO, which is our mobile app for contract carriers. There you have a lot of voice interaction, too, where a driver could just say I'm available. That's all they have to say is, I'm available. It's not a dating site, but it's a carrier app. Just say I'm available. And automatically, it will show them a list of loads available for bidding. They can select one. They can offer rates. They can confirm the transaction, all with their voice as that's where the world is going. And the other one that Scott mentioned was my favorite one, which is C3-XPO, which looks like a little Star Wars character. It's our autonomous security robot. So this is state-of-the-art security technology. So it moves around the parking lot, around our facilities, monitors them 24/7. It does all kinds of cool stuff where it compares the license plates in the parking lot to a master approved list. It scans vehicles with thermal imaging sensors and it detects a vehicle that's got a warm engine, where other cars may be cold. If it finds something suspicious, the robot can do alarms, both visual and audible. It speaks recorded commands. It can broadcast live audio from the command center. Employees can go up to it and touch its emergency call button. We rolled this out. We test piloted this in Atlanta last year, and we reduced the amount of money that we have to pay to third-party human security firms by a significant amount. And now we're expanding it out throughout the organization. So yes, all these innovations are designed to help customers and help our bottom line. And they will.

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**Ariel Luis Rosa** - *BofA Merrill Lynch, Research Division - Associate*

That's a great run down. And then just last question for me, returning to this question about last mile. Obviously, there were kind of some news headlines around that yesterday and sounds like it's very early stage. But just thinking about XPO strategically within that business, obviously there's the speculation that UPS is looking to partner with a last mile provider. Would it make sense for XPO to partner with someone like UPS, who could funnel large amount of heavy goods freight into your network? Or do you prefer to kind of continue to do the one-off relationships that you have with customers? What makes sense kind of from a strategic standpoint for you guys?

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

Yes, it would make absolute sense for us to cooperate with other logistics providers, who don't want to actually do the last mile, but have inquiries from their customers in other lines of business, who also have last mile business. It will make absolute sense for us to work together with other firms doing that.

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**Ariel Luis Rosa** - *BofA Merrill Lynch, Research Division - Associate*

There's not a concern around like loss of control or anything of that sort?

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

Well, you're really not losing control because in the scenario that I think you're describing, basically a customer -- another logistics provider in parcel or in LTL or in other part of the business other than last mile has a customer who also has last mile needs. So instead of delivering something just to a distribution center, they also wanted to go from the DC right to the last mile and be installed and assembled and maybe they don't have that expertise. Sure, it'd make absolute sense for us -- for them to hand that over to us and to do the last mile. This happens all day long in the world of transportation logistics globally, where a freight order, for example, is managing something coming in from Asia into Long Beach and then they hand it off to an intermodal provider, who puts it on a box and gets it up to Chicago and then they may hand it off to a broker or to a trucking company that go by truck and then eventually goes to a warehouse and then from warehouse to a last mile provider like ourselves and ends up in somebody's apartment in Manhattan.

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**Operator**

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

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

Wanted to focus again on the XPO Direct. You mentioned, Brad, I believe, that some of the customers that you've signed up were Tier 1 e-commerce and retail-type people. Are these people who don't already have established supply chains for their e-commerce business? And if they do, what percent of their business are they moving over to sort of the XPO Direct product?

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**Scott B. Malat** - *XPO Logistics, Inc. - Chief Strategy Officer*

Hey, Jason, it's Scott. These are customers that do have established legacy networks. What we're getting for them with XPO Direct is additional capacity. It's modern distribution centers with automation. It's capacity both in the transportation, the last mile hubs, the LTL capacity that we can provide for them. And we can do not only e-commerce deliveries, but we also do store-based distribution out of that network.

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

And when you look at some of the established players versus maybe some of the people that are smaller and up and coming, this sounds like a network that could be used by both, if I'm not mistaken?

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**Scott B. Malat** - *XPO Logistics, Inc. - Chief Strategy Officer*

It is. We've started with very large customers that have large distribution networks, very complex requirements and the things that we can provide for them. Certainly, over time, some smaller players could use our network to scale up, but we have large Tier 1 players filling that network today.

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

The problem that it solves is, there is generally a trade-off between speed and cost. And with XPO Direct, by renting out our network, we're able to offer airspeed at ground rates.

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

That makes sense, Brad. I wanted to have a follow-up question about some of the e-commerce in Europe. Brad, you said you were in 5 countries and you listed them. I was wondering, what plans do you guys have to expand that? And would that expansion be organic? Or would that be maybe one of the targets for your acquisition hunt?

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

Well, last mile in Europe is up and running in a handful of countries right now. And we're going to keep growing that because there is a lot of demand for it. So that's the big organic push. We haven't bought anybody in last mile in Europe. There aren't a whole lot of last mile companies to buy in Europe. By the way, there are not a whole lot of last mile companies to buy in North America. We bought the biggest one, 3PD and then we bought ACL in U.S. and Optima and we've fully integrated them into one platform. And once we got scale, once we got density, we were able to crack the nut of last mile. It's a tricky, tricky business. And in Europe, that's our main dilemma, is how do we quickly get up to the scale that we need in order to get the density, in order to get the cost structure that allows us to give extremely high levels of customer satisfaction and make a decent profit on it as well. Does that answer your question?

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

No, it does. So it seems like you're going to try to build the densities in these existing 5 countries before you go out and start expanding organically beyond, is that a good way to read that?

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

Yes, we have, but we do have a couple other countries that -- where -- we have on our radar. But these are the main countries. When you look in Europe, where we have our main population centers of XPO people are U.K., France, Spain. Those are the 3 biggest ones. So that we have the technology -- that we have the set up and network and the customer. So that's where we started.

**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*

Just a follow up, quick one on XPO Direct. It doesn't seem, and correct me if I'm wrong, but it doesn't seem like you're just renting out the scale, but also fulfilling the order. I'm just trying to understand if that's the accurate way to think about it and just the economics and how the economics work. Do you just kind of take commission, kind of like what Amazon does with fulfillment by Amazon for the footprint part and then maybe direct the fulfillment maybe through your broker channel or LTL network. Is that how should we think about it in terms of the potential opportunity strategically?

**Scott B. Malat** - *XPO Logistics, Inc. - Chief Strategy Officer*

Hey, Amit, it's Scott. From a distribution standpoint, we do the last mile -- what's unique to the XPO network is that we provide the last mile for heavy goods right into the home. So we have the heavy goods in distribution facilities that have every day transport going back and forth between our last mile hubs and it does the full distribution all the way to the final home. When you do small package, which is also part of the network, we do use third-party providers for that last piece and use those. In terms of the contracts, they vary and they are customized based on what customers need. It is generally a fixed/variable type contract where there are some fixed costs covered and then there is a variable component to it by piece.

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

And I guess, this would be in North American -- the revenues of this business would be in North America logistics. If that's correct, just let me know. And then when should we start to see some inflection as a result of maybe more ramping of the business?

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

It's mostly on logistics, but as Scott was explaining as well, there is a brokerage part of it, there is a last mile part of it, sometimes there is an LTL part of it too. But the bulk of the revenues and profits you will see in the logistics part. You're correct.

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

Okay. And then on the second question, I appreciate, Brad, like the budget is not done for 2019, but we're also kind of in an environment in the last couple of weeks where there are concerns around peak cycle, especially, I guess, within the shorter cycle businesses, that your transportation segment has, which is close to 50%-or-so of the revenue. So in that context, is there any kind of reason to think the revenue and EBITDA growth of the business is actually very strong, not even just the 11% or the 10.4% you did last quarter, but really kind of even within that high single-digit framework that you provided. Is there any reason to think kind of that type of revenue growth and EBITDA growth that you're achieving even this year slows? If you can just help us think about that as you look at the pipeline of new business, because that is kind of top of mind right now, especially in the transportation segment?

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

Sure. There is no reason to think it's going to slow, and I don't know that we're in any better position than everyone else to predict what the economy is going to do over the next few years. I do remember very well in 2015, everybody, when I say everybody, I mean like close to 100%, agreed that we were going into a recession and the big argument was how deep is the recession going to be? How long is it going to be? But everyone had all kinds of very well thought-out analysis of how long the cycle had been since the last recession and so forth and the number of recessions over the decades. Everyone thought that. And it didn't happen, obviously. So I don't know that we can just look into what everybody is thinking. Everybody is thinking, "Oh, maybe it's peaking now." Maybe they're right. Maybe they're wrong. All I know is, where we are right now is very strong. No doubt about that. We're in 32 countries, none of them are in recession. They're mostly in a 1% to 3.5% GDP range, with most of them in the upper end of that. And in every single one of our lines of business, we have significantly more demand than we have capacity, which is why you're seeing pricing going up. So for the time being and for the foreseeable future, absent some geopolitical events, life looks good, at least from our point of view just looking at our customers and seeing what our customers are doing and saying.

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

I think you're maybe disappointed that you didn't get more M&A questions on this call. So I think if it's okay, I can just ask you a quick one. Less about potential targets, but more around how your philosophy around applying -- philosophy that you're applying, I guess, to potential deals and I'm really talking about kind of the parameters that, at least for me, are important in terms of the company not paying a premium to its own multiple, the CapEx, capital intensity of the business not really changing materially and then the potential acquisition as you leverage your technology investments is effectively under earning. And so when you think about those kind of parameters, and clearly, those are my parameters, not yours, but just help us think about how maybe the philosophical aspects of your M&A strategy has evolved in the context of those parameters.

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

I got the first 3, the multiple CapEx, different industry, what was the fourth one?

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

There was just 3. So the multiple, relative to your CapEx intensity and then also, the acquisition will be under earning when kind of you leverage your own technology investments.

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

Okay. So with respect to the multiple, we're -- we have the same philosophy. The philosophy is, there's no reason to do an acquisition unless it's extremely accretive. There's just no reason to. It's a bad use of time, resources and capital. So any acquisition that we do will be both strategically compelling to our customers - so they read it, they get a smile on their face - and something that's highly accretive to our earnings, to our EBITDA per share, that is sacrosanct in our philosophy. So there is no conflict on that. In terms of CapEx intensity, the vast majority of the ones that we're looking at are asset lights and have the similar or less CapEx as a percentage of revenue as we do. There is a small number of ones we're looking at that have higher CapEx as a percentage of revenue than we do. We would keep an open mind for that. It's not our first choice. But we'd keep an open mind for that at the right price. So for anything there is a right price; something that would be more asset-intensive would have to be a very, very compelling price. But I don't want to signal you that we're likely to do something asset heavy because we're not. But if we were, it would have to be something that was extremely, extremely accretive. And then the third topic, as I heard it, was, something has to be under earning. I would say slightly differently, which is, we would always want to buy something that, after we bought it, with a fresh set of eyes and with a new set of enthusiasm and with synergies and putting one to one together and coming up with more than 2, we would be able to grow the earnings quite a bit. And -- but that doesn't mean that it's an under-earning asset on its own, it could be. Con-way was under earning. It could be a company like Norbert Dentressangle, which was not under earning, but once we bought it and applied our management techniques and the synergies of the rest of the company and our enthusiasm, then it's making records in terms of the amount of earnings power it has.

**Operator**

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

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

So Brad, it did sound like you have some confidence on the EBITDA outlook, let's say, even if we come in above organic growth rates, probably not going to be much above $1.6 billion this year. So I just want to reconcile that, because normally, when I see top line upside at most transports, we see earnings upside as well. So what are those incremental investments? And why not just put them in the budget right now?

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

So the incremental -- it's a good question. The incremental investments are in sales and sales support. And that we've already had 190 people that we've added in the last few months. Depending on how business evolves over the rest of the year, we may add more, that's in United States. In Europe, we did not have in the budget an expansion of the sales force. And because business is good over there, we have been investing in the sales force. The last mile hubs, right now, we're budgeting 30 of them by the end of the summer. We will then have a truly national footprint where we're close to the vast majority of the population. There could be a few more that would get us even closer and we will have to just see whether we want to invest in that or not. We have staffed up for the robust level of contract logistics activity that we have. If we see that, that contract logistics activity goes even more, we will want to staff up, because we always staff up in advance of the expansion so that we're not overloaded. And particularly for peak, we always want to be in our customers' different peaks around the world very amply staffed up, so we don't let them down. Technology is a lever that we can always push. We always have many, many more technology requests in our pipeline than we have time to do, but we can always add more people and put more money into technology, which is essentially our most secret, secret sauce. I mean, I can keep do- going down the list, but the key point you have to understand is, we balance this. We want to balance short-term performance and long-term growth in earnings. And we want to have both of those. So we feel that the $1.6 billion is a nice 17% growth from last year. Not a whole lot of our competitors growing EBITDA 17% year-over-year. And we would like to plow back into the company any excess of earnings into the kinds of things I just mentioned.

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

Well, I guess, in that context, can you talk about the CapEx budget this year, and maybe why that's not creeping higher given this environment?

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

Well, the CapEx budget is 2 things: it's technology and it's assets. Those are the main things. Technology, we can control that, and we have expanded it a little bit. And on assets, there's 2 ways you can grow the business, you can either add more assets or you can so-called sweat the assets. You can utilize the assets at a higher level, and that's what we've been doing. We've not been growing the container fleet in the intermodal, yet we had 7% volume increases in the intermodal. We've not been growing the LTL fleet, but we've been growing to our best quarter -- OR quarter in 18 years there. We've been not growing the truckload fleet in Europe, but we've been improving our performance there. So the emphasis is more on utilization and operational excellence than on just -- in an undisciplined way, just add a lot of CapEx.

**Operator**

Our next question comes from the line of Matt Reustle with Goldman Sachs.

**Matthew Edward Reustle** - *Goldman Sachs Group Inc., Research Division - Senior Equity Analyst*

Not to beat a dead horse here on the reinvestment in the business, but is it fair to say it's essentially accelerating future investments that you would have planned to have made just given the opportunity to do so, if given the opportunity to do so?

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

For the most part, Matt, yes, but in our technology, we come up with new ideas seemingly every month and some ideas of things that we're rolling out we did not have in the past. But for the most part, yes. It's accelerating things we would have done anyways in the future.

**Matthew Edward Reustle** - *Goldman Sachs Group Inc., Research Division - Senior Equity Analyst*

Okay. And then one other point, and you reference this in the release and the comments about growing your share of wallet with your existing customers, where do you think you are on average with your biggest customers in terms of share of wallet? And do you have any context for where that's trended over time and where you think that can get to over time as you roll out this broader product suite?

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

Yes. So if you look at just the lines of businesses that we are in and where we're in them, that adds up to about $500 billion here in North America and a similar amount in Europe. So about a $1 trillion of total addressable market. And even though we have a substantial amount of business, we're less than 2% of the total addressable market. So we have a very small percentage of the total market. Now if you look at our specific customers, we had different levels of penetration with those customers. Some of them we have as much as all of their business in a specific line of business versus in logistics, we have a few customers like that. In others, we have a fraction of a percent. But on average, we have less than 2%. Our goal in our sales organization has been over the last 2 years to identify who are the customers who we have the best match with, what are they spending in each one of our lines of business? How much business do we have with them in each line of business, not in totality, but in each line of business? And what's our goal? What's our account plan? How can we get closer to that customer to serve that customer better and more? And that's how our salespeople are compensated, by meeting that account plan. Now with respect to cross-selling, cross-selling has gone well. We had about 26% of our sales coming from secondary service lines, which is up from about 23% a year ago. It's up from about 15% 2 years ago. So it's very, very strong growth in that. And if you look at our top 100 customers, 93 of them are using multiple service lines now. You go back 2 years, that was 75. So big increase in that.

See I've been very long-winded of this call and it's 9:30 already. So we'll take 1 or 2 more questions and then let people get back to the market.

**Operator**

Our next question will come from the line of Allison Landry with Crédit Suisse.

**Allison M. Landry** - *Crédit Suisse AG, Research Division - Director*

I'll just ask one. In terms of free cash flow, how should we think about the cadence for the balance of the year and specifically within that, working capital needs? And I think in the past, maybe you've given us a proxy for how much working capital requirements increase for maybe every points of revenue growth, if I'm remembering correctly. So any comment there with respect to how we should think about modeling the changes in working capital and free cash flow going forward?

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

So free cash flow is very important for us. In 2016, it was $211 million; in 2017, it was up 77% to $374 million; and this year, we're projecting another 67% increase in free cash flow to $624 million, which will deliver $1 billion of free cash flow between last year and this year. With respect to the quarterly breakout of the free cash flow, the first quarter is always our big cash usage. It's our lowest EBITDA quarter. We pay out our bonuses, and this year, we paid out $138 million in bonuses to 20,000 employees. And we front-loaded -- we front-end loaded some of the CapEx this year because there was demand for it. So working capital, by the nature of the business, the business model shows that when business is growing and sales is growing, obviously your working capital needs will grow. But for the course of the year, we're confident that we will deliver $625 million of free cash flow.

Thank you, everyone, for participating in the call. And we look forward to talking to you in 3 months. Have a good day.

**Operator**

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