Q4 2019 XPO Logistics Inc Earnings Call

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PRESENTATION

Operator

Welcome to the XPO Logistics Q4 2019 Earnings Conference Call and Webcast. My name is Kevin, 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 review the 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 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 may refer to certain non-GAAP financial measures as defined by 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 related financial tables. You can find a copy of the company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures in the Investors section of the company's website.

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

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

Thank you, operator. Good morning, everybody. Welcome to our earnings call, and thank you for your interest in XPO. I'm joined here this morning by Matt Fassler, our Chief Strategy Officer; and Tavio Headley, our Senior Director of Investor Relations.

I'm pleased to report that we delivered a solid full year performance, capped by a strong fourth quarter. I'm particularly pleased that on a year-over-year basis, our fourth quarter adjusted EPS was up 56%, coming in at $1.12 versus $0.72 last year. And our adjusted EBITDA was $432 million for the quarter, up 14% from the prior year, with margin up 170 basis points. Full year adjusted EBITDA was up 7% to $1.67 billion.

We beat on free cash flow for the quarter at $221 million. Full year free cash flow was $628 million, just above the midpoint of the higher guidance we issued in August. In LTL, we had the best fourth quarter adjusted operating ratio in our history, coming in at 82.3%. Year-over-year, this was an improvement of 500 basis points, and excluding real estate, it was an improvement of 150 basis points. LTL yield, excluding fuel, remained strong, up 3.1% year-over-year. Pricing on contract renewals was also strong at 3.4%.

Our team in truck brokerage executed remarkably well in the quarter. We're continuing to automate brokerage and improve productivity. In the fourth quarter, we grew volume 1%, with nearly 20% fewer people. Excluding the downsizing of our largest customer, volume was up 19%.

We've been experiencing exponential growth in XPO Connect, our digital freight marketplace. We exceeded our goal of 100,000 driver downloads of our Drive XPO app in December.

In European transportation, we generated low double-digit organic revenue growth in the U.K. and high single-digit organic revenue growth in Spain. This offset a mid-single-digit decline in France.

In logistics in the fourth quarter, we achieved a double-digit adjusted EBITDA margin for the first time since 2015. We've been laser-focused on cost control and also exited some low-margin business.

Last week, we announced we signed up a new customer, Waitrose, one of the biggest supermarket chains in the U.K. This is one of the largest logistics contracts in our history. We'll be operating 2 critical logistics hubs for Waitrose starting midyear and distributing an estimated 143 million cases of product annually. We're proud that they chose us for our expertise in omnichannel distribution. Based on signed contracts and a strong pipeline, we have excellent visibility into significant revenue growth into 2021 in our logistics segment.

To sum up the company-wide results, we delivered a good quarter and a good year despite a choppy macro. We remain disciplined on cost and pricing, and we continue to reap the benefits of our tech initiatives. For 2020, we expect organic revenue growth of 3% to 5%, adjusted EBITDA growth of 7% to 10% and robust free cash flow in the range of $600 million to $700 million.

As you know, on January 15, we announced we're exploring the sale or spin-off of some of our business units. As we said, we're not considering the sale or spin of North American LTL. This process is consistent with our long-held priority of maximizing shareholder value. We're proud of the outsized returns we've already delivered for our shareholders, but we continue to trade at a significant discount to the sum of our parts and to the valuation of our pure-play peers. The process is off to an excellent start, but we have no updates to share with you on this call.

Finally, I want to welcome David Wyshner, who will become our new CFO on March 2. David is a fantastic hire. His 28-year career includes 13 years of CFO experience with multibillion-dollar public companies that completed major asset sales, spin-offs and acquisitions during his tenure. You'll get to meet him on our next call.

With that, I'll turn the presentation over to Matt. Matt?

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

Thanks, Brad. As I review the numbers, you'll see that we're harnessing our tech-driven initiatives in each business unit to drive solid results against a mixed macro backdrop. I'll start by going through the fourth quarter numbers and our strategic focus by business unit.

We'll begin with our transportation segment. In North American LTL, we improved profitability despite softer demand. Growth in yield and pricing on new contracts reflected the rational market pricing we've seen all year.

Tonnage declined by 6.3% year-over-year due to softer results from many of our industrial customers. This is consistent with the U.S. industrial sector's performance in general. By contrast, most of the metrics related to volume for our customers in the consumer sector were steady.

Our adjusted operating ratio improved by 500 basis points to 82.3%. Excluding gains on sale of real estate this year and last, our adjusted OR improved by 150 basis points to 85.8%. As Brad said, it's our best fourth quarter adjusted OR ever. This strong performance was the result of steady yield improvement and tight cost control. Our optimization of pricing and labor using our proprietary technology also continues to contribute to these results.

Within freight brokerage, we increased volume while remaining disciplined on price. Our freight brokerage gross revenue declined by 12% year-over-year, a slight improvement over Q3. Excluding the previously announced decrease in the brokerage business from our largest customer, our underlying freight brokerage gross revenue fell by 6%. Our net revenue margin eased across freight brokerage by 70 basis points to 17.9% as contractual rates declined and the spot market stabilized.

In truck brokerage specifically, loads increased by 1% after declining 4% in Q3. Importantly, excluding brokerage business with our largest customer, our load count grew by 19%. Our XPO Connect digital freight marketplace is giving our customers more visibility, enhancing price discovery and contributing to our market share gains.

Turning to our last mile operation. Revenue declined 24% year-over-year in the wake of the wind down of our postal injection business in Q1. Excluding postal injection, growth in our core last mile heavy goods business accelerated to 7%. We brought on new customers, particularly through our hub network, where our investment paid off through strong growth in volumes in its first full year.

Net revenue margin in last mile increased sharply year-over-year. This was primarily due to mix as we discontinued our postal injection business earlier in the year and as we increased margin for our core heavy goods business by almost 200 basis points. We expect ongoing organic revenue growth for this line of business in 2020.

In Europe, revenue declined by 1.7% in our transportation business during the quarter. FX weighed on revenue by about 2 percentage points.

Transportation revenue trends in Europe, measured in local currency, were excellent in the U.K. and Spain. They were softer in France as social unrest emerged again late in the quarter.

We're the biggest LTL provider in France, top 3 for dedicated truckload and LTL in the U.K. and a leader in European brokerage. Our competitive position in European transportation is strong, and we're excited for our prospects across the region.

Looking across our transportation segment overall, revenue was down 8.3%, but adjusted EBITDA was up 12.5%, and adjusted EBITDA margin rose by 220 basis points to 11.8%, driven by improved margins in North American LTL, intermodal, managed transportation and last mile.

Turning to the logistics segment. In North America, our revenue declined 0.8%, reflecting the downsizing of business with our largest customer, which impacted revenue by about 3%, and exiting of some lower-margin sites. Growth in the consumer packaged goods, aerospace and food and beverage sectors offset this decline.

In Europe, logistics revenue declined 2.5%. FX had a negative impact of about 2 percentage points. E-commerce and chemicals were our strongest verticals in European logistics. We continue to build on our market-leading position as the largest outsourced provider of e-fulfillment logistics in Europe.

We're confident about contract logistics revenue trends during the second half of this year for a lot of reasons, including the lapping of the downsizing of our largest customer, recently signed new business, a robust pipeline and the ramp-up of previously signed contracts that have longer implementation lead times, like our Nestlé warehouse of the future in the U.K. We see excellent visibility into 2021 and 2022 as well.

Adjusted EBITDA for logistics as a whole rose 28% year-over-year, and adjusted EBITDA margin rose to 10.4%. Our improved profitability reflects strong cost management, including savings from recent restructurings, and positive results from our technology initiatives.

XPO Smart continues to deliver strong productivity gains in the U.S., and we started to roll out more of these capabilities in Europe. We exercised pricing discipline as we seek to deliver profitable growth. Recall that increasing our European supply chain margins is one of our 10 profit levers. We executed well in Europe during peak and reduced the number of loss-making sites.

Also, our XPO Direct shared distribution platform is delivering better profitability, given more scale and the optimization of our linehaul model. We're enthusiastic about the growth we're seeing from XPO Direct. It continues to offer enormous opportunities for new business, and we're in active discussions with a compelling list of customers.

We ended 2019 with a company-wide sales pipeline that surpassed $4 billion. In fact, our pipeline exceeded $4 billion in every quarter of 2019. It rose 22% year-over-year and was up double digits in both transportation and logistics.

New business wins declined 7% year-over-year. Cyclically lower truckload market pricing put pressure on the dollar value of our brokerage new business won. Supply chain new business won increased year-over-year, and we're starting to see the logjam associated with Brexit in the U.K. clear up, as customers get more clarity about the path forward. Our LTL new business won increased year-on-year for the eighth quarter in a row.

Moving down the income statement. Interest expense rose to $74 million from $52 million a year ago. This reflects our debt issuance earlier in the year to fund our share buyback program.

Our GAAP effective tax rate fell to 22% from 23% a year ago. Our weighted average diluted share count was 103 million at year-end compared with 137 million shares a year ago. The year-over-year decrease reflects our share buyback activity. There was no meaningful change quarter-to-quarter as we didn't repurchase any shares in Q4.

Our diluted earnings per share was $0.93, up 50% from $0.62 a year ago. Our adjusted diluted EPS rose to $1.12, up 56% from $0.72 a year ago. Our buyback activity was $0.13 accretive to adjusted EPS for Q4 and $0.37 accretive for full year 2019.

Q4 gross capital expenditures increased to $188 million from $138 million a year ago, with the increase reflecting timing between quarters. Net capital expenditures were $128 million compared with $87 million a year ago.

All in, for the quarter, free cash flow was $221 million versus $479 million a year ago. For the year, free cash flow was $628 million compared to $694 million a year ago.

In Q4, we had asset sales of $60 million, including $52 million from real estate and the remainder from equipment. We booked a gain on sale of assets of $37 million in the quarter, of which $36 million related to real estate.

We had a sequential benefit to free cash flow from trade receivables programs of $60 million in the quarter. For the full year, these programs provided an incremental benefit to free cash flow of $110 million.

Detailing our 2020 guidance. We expect organic revenue growth of 3% to 5%. This is based on gradual improvement in transportation markets in the second half of the year.

As Brad said earlier, we expect growth in adjusted EBITDA of 7% to 10%. We expect free cash flow of $600 million to $700 million. This includes gross CapEx of $600 million to $650 million and asset sales of $150 million to $175 million, implying net CapEx in the range of $475 million to $525 million.

We expect cash interest in the range of $285 million to $305 million and cash taxes in the range of $155 million to $180 million. We expect an effective tax rate for full year of 2020 in the range of 24% to 27%. All of our forecasts exclude the potential impact of transaction-related expenses.

We continue to make significant progress on the 10 operating initiatives that are driving $700 million to $1 billion of potential EBITDA improvement by year-end 2022. Speaking to some of the specific initiatives, our tech workstreams across the company continued to gain momentum. In LTL, we rolled out our Smart workforce planning platform to our full network during Q4. We are seeing great results. For instance, dock operations productivity improved 9%. We launched a new P&D platform for route planning and rolled it out to all of our terminals. We will start seeing results through the course of 2020.

We introduced an automated RFP platform for local account pricing. 50% of all new opportunities in the local channel in the quarter were fully automated, leading to quicker turnaround times and aiding our ability to close new business. We launched many advances in linehaul, including a visual monitoring tool that helps supervisors determine how full a trailer is so they can manage the dock more efficiently.

In freight brokerage, our counteroffer capability within XPO Connect enables us to work with carriers to negotiate a fair and competitive price, contributing to our share gains as it has since we launched it in 2018. While our technology is a fantastic gateway to our service, our carrier relationships are critical to delivering that service to our customers. We have strategic relationships with thousands of contracted carriers in North America, for which we're a significant source of freight and revenue. Overall, we are experiencing dramatic growth in users, bids and book loads. And we're using the Dynamic Max Pay capability we developed in North America to drive share in our European brokerage line of business.

In contract logistics, our ability to assess a customer's supply chain, recommend optimal cost-efficient solutions and implement them with speed is winning us high-quality, long-term contracts with blue chip customers. It starts with tech leadership. Our sales platform is backed by investments we've made in big data analytics. When a customer comes to us with large amounts of data, our ability to deploy that data to create a customized solution exceeds that of anyone else in the marketplace.

We have our own warehouse management and order management platforms. These integrate well with robotics, and we are accelerating the pace of automation in our warehouses. This is resonating across verticals ranging from omnichannel retail to consumer technology to aerospace and defense to broader industrial and to many more.

I'm proud to say that we were named to the Fortune Most Admired Companies list for the third straight year and ranked #1 in the category of trucking, transportation and logistics. We were named to the top 100 of America's Most Responsible Companies by Newsweek and ranked in the top 5 in our category on the Corporate Equality Index by the Human Rights Campaign Foundation, underscoring our commitment to the LBGTQ community.

With that, I'll turn it back to the operator, and we'll take your questions.

QUESTIONS AND ANSWERS

Answer – Operator: (Operator Instructions) Our first question is coming from Chris Wetherbee from Citi.

Answer – Christian F. Wetherbee: I guess maybe starting on the specifics, can you talk a little bit about the LTL side and maybe the tonnage declines that you saw in the quarter. I wanted to get a sense of sort of what's happening there. Where you think it's customer attrition as you go through repricing? I just want to get a sense of that. It looked like it was a step down from what we had seen earlier in the year.

Answer – Bradley S. Jacobs: It's Brad. I don't think it's specific to us, for the better or for the worse. I think it's just the market. I think the industrial economy has been soft for quite a long time now, and it was soft in the fourth quarter. We do see some potentially encouraging signs in January and year-to-date numbers where in LTL, tonnage is definitely still down, but it's down less than it was in the fourth quarter. And by the same token, yield is up and up more than it was in the fourth quarter. So I think it's too early to call a definitive bottom and have high conviction with that, but there are some encouraging signs about what's going on in the industrial economy.

Answer – Christian F. Wetherbee: Okay, that's helpful. I appreciate that. And then I know you probably don't want to talk too much about the M&A process or the divestiture process. But when you think about -- if you could maybe give us a little bit of sort of the road map of what to expect from here in terms of either a timing or a process standpoint? I think it'd be helpful just to kind of frame up what you think is going to happen as you play out over 2020.

Answer – Bradley S. Jacobs: The process is off to an excellent start. There's a lot of good momentum, more than we had expected. We don't have any further updates to share with you at this time. And when we do, we'll do it publicly.

Answer – Christian F. Wetherbee: Okay. I appreciate it. If I can squeeze one more in. Just when you think about the $700 million to $1 billion potential cost savings that you've outlined over the course of the next couple of years, how much do you think is included in guidance? Or how do you think about that? Is that still the opportunity set as you think about it, maybe putting that aside relative to the divestiture process? And how much should we think about in 2020?

Answer – Bradley S. Jacobs: So the 10-lever process is still front and center of what we're working on. It's our main focus throughout the company, the major projects like automated pricing; like many forms of automation, including robotics; productivity enhancements, especially workforce planning through the Smart labor tools, attacking that $1.3 billion a year we spend on linehaul and LTL and so forth. These are big-ticket items. These are ones that can have very demonstrable results- improvement in results. And we're not taking our foot off the pedal at all on that independent of the process to evaluate strategic alternatives for 4 of our business units. 6 of those 10 levers are driven by technology, and we're still investing in technology and still developing that competitive advantage.

When you look at the business split and you look at that $700 million to $1 billion of potential profit improvement over the next couple of years, about half of it is in supply chain, with a little bit more in North America versus Europe. About 30% is in LTL, and about 20% is in transportation, again a little bit more in North America than in Europe. So we're still moving full speed ahead on those 10 levers, and we're on track with all of them. And that's because of the intense focus we have as a management team on them.

Answer – Christian F. Wetherbee: Okay. That's -- but no sort of -- any sense of what's going to actually be in 2020? How do -- is that sort of back-end loaded? Do you think it's sort of linear throughout the period? I guess that's what I was sort of looking for.

Answer – Bradley S. Jacobs: Some of those, we've already started to see some benefit from. Some of those are more longer term in nature and require more investment and more time. There is some benefit from them embedded in the 2020 budget and the guidance. And those were all created on a bottoms-up basis from the field with people tying their compensation to those results. So while we don't want to quantify in specific dollars each one of the levers and how much hits each quarter, I hope I'm giving you a feel of there's a beginning of results already coming in, and that increases quarter-after-quarter, year after year.

Answer – Operator: Our next question is coming from Amit Mehrotra from Deutsche Bank.

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

Question – Amit Singh Mehrotra: Brad, I just wanted to circle back on the strategic alternatives. I fully appreciate you not wanting to talk about it. But I guess the question comes from a little bit of a different perspective because you and the Board have characterized it as a sale or a spin. Sale is obviously not in the company or Board's control, given it depends on the pricing you get out in the marketplace. But the spin of the businesses are completely in your control or the Board's control. So really in that context, I just want to understand how committed are you to actually separating the LTL businesses from the non-LTL businesses? And what are the circumstances whereby you don't pursue a spin-off, given the avenue is completely in the management and Board's control?

Answer – Bradley S. Jacobs: Well, what I can tell you is we're 100% committed to creating shareholder value. And that's always been our plan and still is our plan. And in our estimation today, the best way to create substantial shareholder value is to run a process for 4 of those business units, but not LTL, and see what our options are in terms of valuation that comes back from those. We're not putting a huge amount of effort right now into the spin because the sales process is in full gear. So let's see how that goes, and then we'll take it step by step.

Question – Amit Singh Mehrotra: Okay. And then can you just also talk about the disruption that this process has had on the business? And one, I mean, you have, obviously, I don't know, 10,000-plus employees related to the businesses, maybe even more, that you're looking to spin off or sell. What are you doing there to retain them? And then what has the customer reaction been given some of these contracts in logistics, in particular, are multiyear, and I would just imagine that it has an impact on the customer mindset with respect to potential changes of control or management.

Answer – Bradley S. Jacobs: Yes. Well, in terms of employees, we have a large amount of goodwill that we've built up over the years with our employee base, our 100,000 members of the XPO Logistics family. And one of the reasons that we have that immense goodwill is that we've been very transparent and very communicative, very straightforward with everything that we're always doing. And people appreciate that. And we've kept them in the loop of what our plans are, just as we've kept The Street, and they appreciate that.

Now nobody likes -- well, I shouldn't say nobody. Most people don't like change. Most people don't like ambiguity. But our organization is agile, it's flexible, it's dynamic, and it's used to dealing with rapid change. All the transformation projects that we've had in order to grow revenue $2 billion organically over the last few years and grow EBITDA $0.5 billion over the last few years, that's because we had tens and tens of thousands of employees who were highly motivated and -- to succeed and to contribute to a major, major process. So some people are actually excited that they could be part of a smaller, more focused business unit. But frankly, many people are mixed about it because we've created a great global family atmosphere. And if we end up selling or spinning these 4 units, that will go.

With respect -- in terms of your question about what we've done for retention, we've obviously spent a lot of time on retention and on incentivization programs. And I feel we've -- the team in the HR and the comp/ben groups have done an excellent job at taking care of that.

In terms of customers, customers also appreciate open communication. They just want to get the job done. So if they're in the transportation part of the business, they want goods moved from here to there. If they're in the supply chain part of the business, they want everything that goes on in the 4 walls of that warehouse to be done with maximum efficiency and productivity, and nothing's changed in that respect. We're still having very high levels of execution in our supply chain business.

We've been winning new contracts. We recently won Waitrose, the large supermarket chain in the U.K., and recently won Mercedes-Benz, which is another big contract we got over in Europe. So we're winning contracts even after we've announced the strategic alternatives process.

Answer – Operator: Our next question is coming from Scott Schneeberger from Oppenheimer.

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

Question – Scott Andrew Schneeberger: I guess on the guidance for 2020 organic revenue and EBITDA, could you speak, I guess, to how you look at it by segment and cadence and kind of macro versus internal?

Answer – Matthew Jeremy Fassler: Sure. So as you think about cadence, we're expecting part -- one of the premises of the guide is that the industrial economy and the transportation markets show some recovery in the second half of the year. So the revenue momentum embedded in that 3% to 5% would build over the course of the year.

If you think about LTL, we expect OR improvement, adjusted OR improvement of approximately 100 basis points or more, so at least 100 basis points. And then you can think about relatively even EBITDA growth among our transportation and logistics segments.

Question – Scott Andrew Schneeberger: Great. And then I want to swing over to CapEx, a big pickup year-over-year on what you're planning to spend. Could you speak a little bit to where that's going? I presume a lot into the IT budget. And just how much of that may or may not be spent given the strategic alternatives and how that could potentially influence what the plans are there?

Answer – Matthew Jeremy Fassler: So the CapEx budget is based on the company in its current structure. And from a CapEx perspective and investment perspective, it's business as usual. We're investing in all of our businesses.

Now the gross CapEx number of $600 million to $650 million is kind of at the 2019 number at the low end and slightly above at the high end. The net number is a bit bigger because the asset sales embedded in the guide of $150 million to $175 million are lower than the level that we had in 2019. Recall that in 2019, we sold an office property with proceeds in excess of $70 million. That's really the delta in the asset sales, and that's a big piece of the delta in the net CapEx number.

Answer – Operator: Our next question is coming from Allison Landry from Crédit Suisse.

Answer – Allison M. Landry: So just a question on LTL, in terms of bridging to the $1 billion of profits by 2021. How should we think about the pace of improvement this year versus next year? And would you expect EBIT to grow faster in 2020 or more back-end loaded? And then if you think about just sort of the different buckets, whether it's linehaul, P&D, utilization, price, where do you think you have the most opportunity left there?

Answer – Matthew Jeremy Fassler: Sure. So as you think about growth in EBITDA, I mean, I'll let you do the specifics of your model. Let me just give you a couple of the premises that back our guidance. We do expect a better tonnage environment as the year progresses, based both on comps and our expectation that the industrial economy stabilizes and begins to grow. We sized our expected OR improvement, adjusted OR improvement at 100 basis points or more. You can use that certainly to get to an EBITDA number. You'd probably look at something close to even pacing between the years. But again, you should work out the details on your own.

In terms of the 4 specific levers within our strategic initiatives that are driving LTL, we're seeing the earliest benefits from pricing, and that's manifested both in yield and also to some degree in market share. Our automated pricing effort, for example, helps us get to local accounts quicker. We expect it to increase our conversion.

Also, as we said earlier on the call, we finished the rollout of Smart to all of our LTL terminals. So that has starting to have an impact on dock productivity today. We cited that number in the fourth quarter, but that's pound for pound. It's only really been in place through the network for a very short period of time.

We spoke also during the call about the rollout of our P&D and linehaul initiatives among the 4. Those are the 2 more back-end loaded initiatives. So you'll see implementations and some benefits this year, but those are more stories for 2021 and beyond.

Answer – Allison M. Landry: Okay. So the other question I wanted to ask. So in the past, you've highlighted that a number of your customers use more than one XPO service, and that's been a key selling point. I know you just signed a couple of big contracts. But for shippers that you're trying to get new business with and that are also looking to use more than one service, have you noticed that in the conversations with them that there's been sort of any less willingness to sign contracts because of the strategic exploration?

Answer – Bradley S. Jacobs: A little bit, Allison, but not a lot. People have confidence in whatever decision we make we will maintain high levels of customer service and execution, a little bit of delays in some customers, but not a big trend.

On the cross-selling, we still see a significant and growing amount of cross-selling within North American transportation and within European transportation. Actually, I would say the momentum of cross-selling within North American transportation is increasing. We had about a little over $300 million of cross-selling within North American transportation in 2019. That was up about 37% from the previous year, which was up about 26% from 2018.

And in Europe, we had about EUR 170 million of cross-selling within European transportation in 2019. That was up not quite as much as it was in North America, but it started after it, it started after North America. That was up about EUR 10 million year-over-year. So when you look at the $2 billion of increase in revenue that we organically drove from 2015 to 2019, about $500 million of that was from cross-selling, and nearly all of it was within those 2 business units that I just mentioned.

Answer – Operator: Our next question is coming from Brian Ossenbeck from JPMorgan.

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

Question – Brian Patrick Ossenbeck: I just wanted to ask about competition more broadly in a softer freight market. Are you seeing any indications across the business lines of discipline slipping on price more than you would expect at this point in time?

And then maybe specifically in brokerage, it looks like truckload held up pretty well in terms of margin. But have you seen anything in Europe where you've -- where a few additional competitors, especially Uber Freight, has started to launch and roll out more scale in that region specifically?

Answer – Bradley S. Jacobs: Brokerage always, in every part of the cycle, has a wide range of competitors, some of which are being more disciplined and some of which are being less disciplined on price, depending on their strength, depending on their -- where they stand in the marketplace.

What I'm very excited about is in truck brokerage, we grew year-over-year volumes, when you exclude the largest customer downsizing, by 19% in the fourth quarter. Our volumes were up 19% year-over-year if you take that largest customer's downsizing out of both periods. Even if you include that downsizing, volumes are still up. They're up about 1% on nearly 20% fewer heads. So the automation that we've been focusing on, the technology that we've been focusing on here in the company has dramatically improved productivity, where we can be growing volumes with about 1/5 less headcount. And we have an enormous opportunity in brokerage to target Tier 2 and Tier 3, so midsized and smaller-sized customers, because our main focus has been on those Tier 1 customers.

So I'm encouraged by what we're doing in freight brokerage. I can't say the freight brokerage market is vibrant or even very healthy. It's loose. Pricing is weak with soft volumes and soft pricing, but we've been able to continue to stay focused on what we do well and the applications that we're using our technology for to grow despite the external environment.

Now you asked about Uber and Europe. We have a tremendous amount of respect for Uber. We think that they have a tremendous -- a really enviable cultural ability to think big and to move fast, and these are things that we value ourselves as well. They understand the importance of tech. They really just bring a lot of dynamism in the industry. And it's just exciting to have a competitor that's got a lot of energy going on there.

In Europe, they've just begun. So we really haven't seen any effect on our business there. But frankly, we haven't seen a whole lot of effect on our business here from Uber. So we have another competitor coming into the market, like we have for years. And they have big plans, and we wish them the very best.

Question – Brian Patrick Ossenbeck: Okay. And just a follow-up on the technology. Can you give some more context around the XPO Connect platform? What's the size either on a run rate basis or growth or anything you can give us just in terms of the context of how big that is? Is it reaching critical mass with shippers? And then you highlighted you got about 100,000 drivers to download the app to connect into it. What's your sense of the retention for people who are downloading and using it? Are they increasing in the stickiness with this platform as it continues to grow?

Answer – Bradley S. Jacobs: We have not reached critical mass by a long shot with shippers. We've made huge -- and by the way, I don't think anybody has. The vast majority of brokerage is still done over the telephone with human beings for the most part throughout the industry.

That's changing. There is a trend for sure for it to be more digitally enabled, and we are right at the forefront of that. Our strategy has been a little bit different than some of our competitors. Our strategy has been to go in 2 phases, where the first phase is intensely focused on carriers and particularly what we call our core carriers, who handle most of our business. There, we have reached critical mass. There, we have 40,000 different trucking companies having downloaded XPO -- Drive XPO, and that represents about 100,000 drivers. So we have a very strong digital platform with the carrier base. We did not want to go to the shipper community until we had that critical mass with the carrier community. We have that now. And so phase 2 will begin, where we very aggressively market to the shipper universe, with the system fully worked out and with access to very large amounts of capacity.

We also -- and you saw that we exceeded our -- we exceeded our 100,000 download target by the end of December of Drive XPO. We also launched a special app for last mile carriers that plugs right into Connect.

And now in Europe, Connect also went live, and 100% of our loads there are now published digitally. And we're rolling out Connect to LTL customers in the U.K., France and Spain. But our strategy will be very similar and consistent: We perfect the technology. We market it to carriers. We gain tremendous access to capacity, so when we go to a customer on the system, they get very competitive bids.

The last thing in the world we want is to roll out to customers, they put freight on the system, and it's slower than just calling somebody on the telephone. So I like the progress we've made in XPO Connect. It's very methodical. I'm very optimistic on its future.

Answer – Operator: Our next question today is coming from Brandon Oglenski from Barclays.

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

Question – Brandon Robert Oglenski: Brad, I guess I want to ask about the dual narratives I'm hearing on the call here because you guys are talking about potentially 50% improvement in earnings the next couple of years. A lot of it's through like overhead, procurement, common tech platform, cross-selling. But at the same time, the strategic review kind of wants to break up some of those opportunities. So can you talk about why the best path forward isn't just pursuing the $700 million to $1 billion of EBITDA improvement as opposed to potentially breaking that up and taking away some of those opportunities?

Answer – Bradley S. Jacobs: We've always been focused on creating tremendous shareholder value in both transportation and logistics. The strategy has always been consistent. And that's why, one of the reasons why, we were the seventh best-performing stock of the decade of the Fortune 500. We've been agile, and we've adapted to evolving circumstances as they change.

The possibility to continue in an intact company with the profit improvement opportunities of up to $1 billion is very attractive, frankly. And that's not a bad plan B. It's actually an excellent plan B. But plan A is to get more shareholder value creation in the here and now because the reality is that the market has given us what we call a conglomerate discount, and we trade at a very significant discount to the sum of our parts as well as to the valuation of our peers.

And therefore, if we take these 4 business units and market them in sales, there's a very good chance that we're going to get multiples that exceed by a substantial amount what we trade for as a conglomerate, so to speak. And while we're in love with the multimodal solution and the global reach, the market does not reward us for that. And as the saying goes, don't fight with reality because reality always wins. The reality is, what we've put together here is a great company that customers appreciate, that employees love, gets about 8x EBITDA, and now even with this announcement, only about 9-and-a-bit x EBITDA. So we think the opportunity to create shareholder value in the here and now in a significant way is best served by exploring these options. It's strictly math.

Question – Brandon Robert Oglenski: Well, I follow you on that at a moment in time, Brad. But I guess if you have tremendous amount of confidence in this earnings outlook, I would like to think that not only would shareholders benefit from the earnings upside that you guys are projecting, but also most likely an improved valuation range at that level of profitability. So I guess, again, it just comes back to this dual narrative: If you have a lot of confidence in that earnings expansion, why even risk the cultural shock, the potential breakup, potentially losing employees over what could be a very uncertain future for the organization?

Answer – Bradley S. Jacobs: So it really comes down to whether I agree or disagree with one of your one of your sentences that the market is likely to give us a much higher multiple as they recognize our consistent profit improvement. I haven't seen it, Brandon. I haven't seen it despite many analysts, including yourselves, on rooftops saying how great the company is. The reality is the market has given us a high single-digits EBITDA multiple, and you have to accept that reality.

I don't feel there's a big risk to the things you mentioned about cultural shock and employees and customers. These are temporary situations that will get resolved very easily, any issues that come up on that.

The basic business is very, very strong. We've got the second-largest contract logistics company in North America. We're a leader in fast-growing reverse logistics and omnichannel. We've got an unmatched blue chip customer list. We're the leader in automation and in robotics. And if you look in Europe in our supply chain business, there, too, we've got leading positions in the fastest-growing parts of logistics. We're the second-largest contract logistics provider in Europe. We're the #1 e-fulfillment platform in most European markets. We're the leader in click and collect. We're a top 3 logistics company in France. We're managing logistics for the biggest fresh foods network in Spain. We are a top 5 industrial tenant in Europe, and if you look in Europe in transportation, an extremely strong position, where we're the #1 transportation company in France and Spain. We're the biggest LTL provider in France. We're a top 3 truck broker in France, top 2 full truckload in France, top 3 LTL in U.K., top 3 dedicated transport in the U.K., #1 truck broker in Spain, long list of great blue chip customers.

And if you come over to North America and looked at our North American transportation unit, we're -- I don't know if we're the third or fourth, depending on how you count it, largest truck broker in North America. We have technology that's proven. We have management that's been together for years and is very stable, and 3/4 of our truck brokerage leadership has held every single job function in truck brokerage. So we're very long in the tooth in expertise in how to make money in truck brokerage.

We're #1 in last mile for heavy goods. We're a top 5 managed transportation company. We're the third largest intermodal company. We have one of the largest drayage networks in the United States. We're #1 in expedite. So I can go on and on for hours, but we've built up a very strong company, and I don't think the public markets have given us value for that. If I agreed with you that we would get value for that to the same extent we'll get in a sale, we wouldn't we consider a sale.

Answer – Operator: Our next question is coming from Stephanie Benjamin from SunTrust.

Answer – Stephanie Benjamin: I wanted to switch to the logistics segment and the contract logistics and just the very strong margin expansion you saw in the fourth quarter. Can you maybe give us a little bit of color on how we should think about the opportunity in 2020? I understand that there's a lot of labor tools and productivity initiatives that went into place towards the end of 2019. So maybe how we should think about the run rate going forward in terms of margin improvement. That would be helpful.

Answer – Matthew Jeremy Fassler: Sure. Stephanie. So looking at adjusted EBITDA margin across the businesses, this was a year in contract logistics, a quarter and a year where we exercised excellent cost control really across the franchise. We rolled out our Smart workforce productivity tools, generated strong pricing. We spoke about the progress that we made addressing loss-maker sites in Europe, exited some low-margin business. We spoke to you a bit about XPO Direct and improved profitability there. We executed very well at peak. We benefited from some restructuring in Q3, which helped us rethink our SG&A org chart and drove benefits there. There's really no single magic bullet that helped us optimize profitability in contract logistics in 2019.

As I said earlier, as we look at the breakout between the 2 major segments, contract logistics and transportation, I think about EBITDA growth at roughly similar levels, in the same neighborhood within our 7% to 10% overall adjusted EBITDA growth in 2020. We have a number of initiatives that have excellent long-term payout.

In fact, as Brad highlighted a moment ago, contract logistics represents 50% of the ultimate benefit from among our business units from our 7 to 10 levers. Speaking specifically about some of the larger ones, they include automation and XPO Direct. They're 2 of the biggest contributors to the profit levers overall. And that's obviously a 3-year effort from here.

Answer – Stephanie Benjamin: Great. And lastly, if you could provide a little bit of an update on just your XPO Direct platform? I think you've said that you ultimately believe this could be $1 billion business. Where we are today or after 2019? Kind of how you saw the business performing in the fourth quarter, particularly around the holiday season? So any additional color there would be great.

Answer – Bradley S. Jacobs: So XPO Direct is our shared space distribution network, and we serve omnichannel, e-com and retail and manufacturing customers in North America. We don't have XPO Direct in Europe. This was a start-up where we started roughly about a year ago. As all start-ups do, they lose money at first. And true to form, XPO Direct lost its fair share of money. I'm pleased that we've improved the profitability of it in a significant way recently and expect it to break even here in the first quarter, which is great because revenue is growing, and we want profitability to grow. We are confident that we will be on a $1 billion revenue run rate by the end of 2022. That is the glide path that we're on.

You asked about how it performed over peak, over holiday. It performed very well. And that's why XPO Direct is working and working well is because customers are getting good results from it.

Answer – Operator: Our next question is coming from Ari Rosa from Bank of America.

Answer – Ariel Luis Rosa: Nice quarter in the face of tough macro. Just wanted to touch on the outlook first. So I hear you saying getting contract renewals on LTL in the 3% range. I wanted to contextualize that against the outlook for 3% to 5% revenue growth. Obviously, lapping the loss of a large customer in 2020, what are you kind of assuming in terms of the volume growth picture? Because I guess I would have expected that to be a little bit stronger against the context of about 3% pricing gains. So is there something that I'm kind of missing? Or is there one segment that you expect to maybe contract a little bit more in terms of facing continuing headwinds on the volume side?

Answer – Bradley S. Jacobs: I'll let Matt answer the majority of that, but I want to say just one thing. You'll recall that when we had our largest customer in source $600 million of business roughly about a year ago, we said 2019 is going to be a year where we rebuild. That we replace the business that we lost and then regrow, rebuild from there, afterwards resume growth from there. I'm happy we did that. I'm happy we started the year with $600 million in the hole and still were able to produce fantastic numbers in a lousy market. So I'm very happy about that.

In terms of the guidance for this year, we assume a slight recovery in the second half in the industrial economy, but not a huge one. We assume that the consumer still continues to stay reasonably strong, which it is and has been. It's been incredibly resilient, which is one of the reasons we had 7% organic revenue growth in our big and bulky last mile business. We're assuming that truck brokerage recovers somewhat, but not humongously. It does recover a bit in the second half because that cycle's getting a little old now, and you start -- starting to see rebalancing mechanisms take place.

We're not assuming any impact from the strategic alternatives process. We're not assuming any major geopolitical shocks. So that's our overview of the guidance that we gave. Matt, do you want to add to that?

Answer – Matthew Jeremy Fassler: Yes, just at a very high level, consider that LTL is really an extremely stable business. You don't have -- there's not a ton of volatility in the revenue line. So we do expect to see some recovery in LTL revenue. We expect to see tonnage improve gradually. We expect yield growth to hold at or improve a bit from current strong levels. But there's probably a little more swing in some of the other areas of the business that get us to the 3% to 5% guidance level.

Answer – Ariel Luis Rosa: Okay, great. That's terrific color. Just for my second question, I wanted to ask it seems like a lot of the IT initiatives and the tech initiatives around efficiency savings have been driven by tech teams looking across the platform, and I just wanted to understand better. As you think about divestitures, how does that -- kind of how do you think about spreading the efforts of the tech team across those divisions? Does that change the nature of how XPO thinks about allocating resources for its tech team? Who stays in the case that you have spin-offs? Obviously, XPO's done a lot of great work around implementing technology. But how does the -- how does that division look subsequent to some of these spin-offs?

Answer – Bradley S. Jacobs: So our tech organization is structured in 2 ways: We have robust tech professionals embedded within each business unit. And over that, we have Mario's group that's leading the strategic vision and transplanting -- cross-planting things that work in one area to another area, so for example, Smart. Smart, the genesis of Smart was in our logistics business in North America, and it was showing mid- to high single-digit labor productivity out of the gate. So wow, this is a really good invention, and so we transplanted that into LTL. We transplanted that into Europe, and those processes are going underway.

So the cross-fertilization of best practices is really done top side. So you won't have that going forward if we split into 5 different companies. You will still have each business unit with a very mature substantial tech organization, each of which has a leader, each of which has a great leadership team and is extraordinarily effective.

The kinds of initiatives that we've got going in LTL will just continue. It will continue as is, all the P&D, the linehaul, the pricing, the cross dock.

And the last part of your question about where does technology go. The technology goes where it belongs. So for example, we were talking about Smart a minute ago. Smart will be licensed in one form or another to the contract logistics businesses here and in Europe, if we end up divesting or spinning them off. And it will also be in the LTL business because we need it there as well. We don't need Smart in the more non-asset parts of the business, so that doesn't really apply to there. The pricing algorithms are specifically designed, for the most part, specific to each business unit because the business is different and so have different algorithms. So the part that is appropriate to them, which they've already been using, they'll continue using that.

So Mario and the team have worked through a very careful plan that if we end up divesting these 4 companies, the technology will be where it needs to be.

Answer – Operator: We have reached the end of our question-and-answer session. I'd like to turn the floor back over to Brad for any further or closing comments.

Answer – Bradley S. Jacobs: Okay. Well, thank you, everybody. We had a good quarter. Anytime EPS is up 50% and adjusted EPS is up 56%, we're going to say we have a good quarter and be justified in saying that. We do feel that we're well positioned going into 2020. You saw our guidance of adjusted EBITDA, up 7% to 10% and free cash flow of $600 million to $700 million.

In LTL, we're proud of the record OR. We're completely on track for the $1 billion of EBITDA that we've committed to for next year. On the CFO, the culmination of the CFO search, I think we found the perfect match for what we need. And the strategic alternatives process is going very, very, very well.

And final point is, you can count on us, no matter what the situation is, to do what's best for the shareholders. Thank you very much for your attention and speak to you in a few months.

Answer – Operator: Thank you. That does conclude today's teleconference. You may disconnect your lines at this time, and have a wonderful day. We thank you for your participation today.
