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XPO - Q4 2016 XPO Logistics Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 22, 2017 / 1:30PM GMT

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PRESENTATION

Operator

Welcome to the XPO Logistics fourth-quarter 2016 earnings conference call and webcast. My name is Rob and I will 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 securities laws which, by their nature, involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those projected in the forward-looking statements.

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 also may refer to certain non-GAAP financial measures as defined under applicable SEC rules. Reconciliations of such non-GAAP financial measures to the most comparable GAAP measures are contained in the Company's earnings release and 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.

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

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

As you saw last night, we had a very strong finish to 2016 with record fourth-quarter results for net income, cash flow from operations, EBITDA and free cash flow. We reported $291 million of adjusted EBITDA for the quarter; this brought us to $1.25 billion of adjusted EBITDA for the year, which was just above target.

You may recall that our original full-year target for 2016 free cash flow was a range of $100 million to $150 million. In August we raised our target to at least $175 million. In the end for the full year we generated free cash flow of $211 million.

The quarter was highlighted by strong organic growth in Last Mile and European contract logistics driven by our leading position in e-commerce. This more than offset a soft intermodal environment and mixed market conditions in other lines of transportation.

In North American LTL we continued to improve our margins and delivered an increase in fourth-quarter adjusted operating income of 40%. Companywide 2017 is off to a great start. We are continuing to raise our already high levels of customer service and execute on the numerous profit improvement opportunities embedded in our business.

We are on track to deliver at least $1.35 billion of adjusted EBITDA this year; this equates to a year-over-year increase of at least $200 million excluding the North American truckload unit that we sold last year. The $200 million includes the full-year benefit of the substantial improvements we put in place throughout 2016 plus additional savings in further procurement, real estate and back office operations in 2017.

We are also executing on plans to enhance labor productivity, warehouse efficiencies and the adoption of best practices. And we've transformed our sales organization; we have more than doubled the number of strategic account managers and our sales people now global visibility across our business to better serve our customers and drive returns.

We have a concrete bridge to an adjusted EBITDA margin of over 10% in 2018 and we expect to generate a cumulative $900 million of free cash flow over 2017 and 2018 with almost 40% of that $900 million this year.

I am pleased to say that we have met or exceeded every single financial target we have issued in 2012, 2013, 2014, 2015 and 2016. Now in 2017 we are on track to accelerate our EBITDA growth and increase our free cash flow at an even faster pace. And with that I will turn the presentation over to John to review the numbers in more detail.

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

Thank you, Brad. We delivered an excellent fourth quarter; revenue increased 10% to $3.7 billion. Net income attributable to common shareholders for the quarter was $27 million and adjusted EBITDA was $291 million. These results include approximately one month of the North American truckload business that we divested on October 27.

Our organic revenue growth excluding Con-way was 7% in the quarter, which is an adjusted non-GAAP number. Including Con-way, our pro forma organic revenue growth was 3%. Our strongest growth was in our Last Mile and supply-chain operations. These were partially offset by market softness in North American Intermodal and Expedite.

Revenue in our transportation segment was $2.3 billion, up 11% over last year, and adjusted EBITDA, a non-GAAP measure, was up 40% to $212 million due to the acquisition of Con-way inorganic growth partially offset by the sale of truckload. Operating income in transportation was $84 million, adjusted EBITDA margin was 9.1%, an increase of 190 basis points versus last year.

Within our transportation segment in freight brokerage, we increased revenue by 1% year-over-year. Net revenue margin declined to 16.1% from 20.3% last year due to margin declines in intermodal, truck brokerage and Expedite. In intermodal, the market remained weak from continued access truckload capacity and a more competitive environment. Our year-over-year intermodal performance was also impacted by a tough comparison to 2015 when port disruptions benefited our drayage operations.

In truck brokerage we grew volumes by 23% year over year while margins were 270 basis points lower from a year ago due to lower revenue per load. Margins in truck brokerage have trended marginally higher over the course of the second half of 2016.

In less-than-truckload we had another exceptional quarter. On an adjusted basis, excluding amortization of intangibles and integration costs, operating income increased 40% in the quarter. This was driven by an adjusted operating ratio improvement of 280 basis points.

For the full year we improved our adjusted operating ratio to 89% from 93.4% the prior year. This was an improvement of 440 basis points. On a pro forma basis, as if we had owned Con-way on October 1, 2015, revenue per 100 weight in the fourth quarter, excluding fuel surcharge, increased 3%; and daily LTL tonnage declined 1.7% over the same quarter last year.

In December tonnage increased 0.4% over last year, which was an inflection point in what has been a declining trend all year. SG&A expenses declined year over year due largely to lower costs per headcount, purchased transportation and outsourced technology.

Although we reduced the number of units in our North American LTL fleet through better utilization in 2016, we continue to invest with new purchases and, as of yearend, our LTL tractor age was 5.4 years, which is slightly lower than last year.

In Last Mile we continue to generate strong growth. We grew revenue by 16% in Q4 driven by new contract startups, especially in e-commerce, and strong holiday season volumes. We had a very successful holiday season and managed our costs well during an especially sharp peak.

In our European transportation operation, revenue was 3% lower than last year primarily due to foreign exchange and lower fuel revenue. Average daily shipment volumes across Europe increased approximately 2% and pricing in constant currency was up slightly. Revenue growth was strong in our UK and France operations partially offset by a more competitive pricing environment in Spain and Eastern Europe. We continued to reduce cost through operating efficiencies and procurement initiatives in the quarter.

Our logistics segment had a very strong performance in the quarter. Revenue increased 9% to $1.4 billion and operating income increased 47% to $51 million. Revenue and operating income increased due to the acquisition of Con-way along with strong organic revenue growth. Adjusted EBITDA increased by 10% to $109 million.

In European logistics revenue was down 1% compared to a year ago due to foreign exchange translation. Excluding FX, European logistics revenue growth was 9% from new contract starts notably with e-commerce and food and beverage customers. Revenue growth was led by our operations in the UK, Italy and the Netherlands.

In North American logistics revenue increased 21% to $674 million due to the Con-way acquisition as well as organic growth. Areas of strength included the e-commerce, food and beverage and aerospace verticals while automotive was weaker versus a year ago. Contract wins have picked up and should deliver strong growth in the second half of 2017 as projects ramp up.

Net CapEx for the quarter was $154 million resulting in full-year CapEx of $415 million. CapEx in the quarter was lower than our expectations due primarily to the delay of new contract startups and final negotiations with certain major vendors. Given the delay in CapEx at the end of 2016, we expect CapEx to be weighted toward the first half of the year in 2017.

Interest expense was $80 million for the quarter, down $13 million sequentially from the third quarter due to the refinancing we completed in August and debt reduction from the truckload sale. Free cash flow for the full year was $211 million. We ended the year with $373 million of cash and over $1 billion of liquidity including availability under our ABL.

To help you with your models, in 2017 we expect the following: net CapEx will be $430 million to $455 million; D&A will be $630 to $650 million, of which depreciation will be $460 million to $480 million; and interest expense will be $310 million to $320 million, of which approximately $18 million will be non-cash.

Our book tax rate is expected to be in a range of 34% to 37%. Integration and rebranding expenses are expected to be $40 million to $50 million in 2017. And we expect free cash flow to be at least $350 million this year and $900 million in aggregate over 2017 and 2018.

Now I will turn the call over to Scott.

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

Thanks, John. Starting with the macro, in North American transportation we are seeing some early signs of improvement. For example, our LTL operations increased weight per shipment in January and February partly because of demand from industrial customers. However, the truckload market remains relatively loose. Although we will get a better view of this over the next few weeks as volumes pick up seasonally.

In Europe transportation trends are largely tied to national economies. We are seeing some economic tailwinds in the UK and Spain while business in France has been slower ahead of the May elections. Our logistics operations have come off a strong fourth quarter, driven in good part by strong holiday sales from e-commerce customers. So overall it is a mixed environment, which is something we deal with very effectively given our service range.

Now turning to our operations. North American LTL is full steam ahead. Our investments in salespeople, training and incentives are delivering results. Volumes are up since December. Our IT team developed new pricing tools that we're using to make more analytical decisions by lean and customer.

These tools are successfully helping us to maximize operating income, in some cases leading to changes in our weights per shipment and length of haul. The resulting impact could be lower revenue per hundred weight in some lanes but higher operating income.

We also recently rolled out proprietary workforce planning tools to improve dock efficiency and pickup and delivery. And we are using engineered standards in line haul to better utilize the space in the trucks. At the same time we are continuing to enhance our industry leading performance for on-time pickup and delivery and damage.

We're also continuing to execute on our LTL cost out initiatives. We are now up to more than $150 million in annual incremental profit improvement on a run rate basis. That puts us well on the way to our target of $170 million to $210 million this year.

There are a lot of positive developments in our European transportation networks as well. We've been running successful pilots for enhanced LTL pickup and delivery and dock operations in France and Spain in advanced of a broader rollout. We are defining engineered standards across the network and we are using our Freight Optimizer technology in our European brokerage operations as well as new lane-based pricing algorithms in our LTL networks.

Last Mile continues to be a fast-growing area due to e-commerce. We currently have a pipeline of over $250 million in North America. And in Europe we have signed new Last Mile business in the UK, Ireland and the Netherlands with some marquee customers.

Those are the highlights in transportation. In our logistics segment we built a global sales pipeline of over $1.3 billion. These are active bids. In North America we are currently ramping up on the $390 million of new business we signed in 2016, and we have already signed up over $90 million in new business in the first six weeks of 2017.

Most recently we won a reverse logistics contract for a major consumer goods company. That one will start up in the second half of 2017.

In Europe we won over EUR325 million of new logistics business in 2016. A significant portion is coming from outsourced e-fulfillment where we are the leader in Europe, as well as from cold chain distribution.

One of our most exciting recent initiative has been combining our Last Mile supply chain and LTL networks. We can serve a heavy goods e-tailer by handling the supply chain from the manufacturer, or e-tail facility, to our warehouse, to our LTL cross dock, to the last mile delivery, to installation inside the home. It is becoming a seamless solution and it is unique in the industry.

Our service lines are working more and more as an integrated unit and that is how our strategic account managers are selling our services. 86 of our top 100 customers already use multiple XPO service lines. Approximately 24% of the sales we generate from these large customers come from secondary service lines. That is up from 17% a year ago.

We are also operating more cost efficiently. In procurement we've completed bids for large categories such as tractors, tires, waste, office supplies, temporary labor, facilities and travel-related items. We are now in the final stages of deals for material handling equipment, security and utilities. The next wave will include trailers, fuel, packaging, maintenance and repair and dozens of other categories.

So the strategy is working. We are using our network of people, technology and assets to move goods through customer supply chains in the most efficient ways. Our integrated service offering has a healthy diversity across geographies, verticals and lines of business. And we will continue to execute on numerous Company specific margin opportunities to grow our bottom line faster than our top line.

63% of companies in the Fortune 100 use XPO. But we still have an enormous opportunity to provide more services to our customers and more growth and returns for our investors. We operate within a $1 trillion addressable market. And even with about $15 billion of revenue, we still have only a 1.5% share, so we are just getting started.

With that we will turn it over for Q&A. Operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Todd Fowler, KeyBanc Capital Markets.

Todd Fowler - *KeyBanc Capital Markets - Analyst*

Congratulations on a good year. Maybe just to start, John, you made a couple of comments about the timing of the CapEx and how it is going to impact the free cash. Can you just go over what your expectation was again for the first half and how you see free cash moving throughout the year?

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

Yes. So, Todd, as you know, our business is seasonal and we did defer some CapEx from 2016 into 2017. And so, there is going to be a bit of a wait in the first half from a CapEx perspective. And then on top of that you overlay the seasonality of the business and the first quarter being our weakest quarter of the season.

So that would tell you that we are going to have very weak cash flow in the first half, especially in the first quarter, and that we really make up our cash for the year in the second, third and fourth quarters. And more so in the third and fourth than in the second. So that is how it should trend through the year.

Todd Fowler - *KeyBanc Capital Markets - Analyst*

Okay, I think that that is going to be helpful for us from a modeling perspective. And then just, Brad, on a big picture standpoint, when I think about the $900 million of cumulative free cash over the next two years, I've got the leverage at some point in 2018 dropping below your targeted range of 3 to 4 times.

Can you talk about how you are thinking about your capital once you get below the range and kind of the timing of when you would expect to either revisit the targets and how you think about the free cash you are going to be generating and the leverage targets going forward?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Sure. So, we will have choices. So far we have applied extra cash, whether it is from the sale of truckload last year, whether it is from free cash flow to reducing debt and we've done a very good job at that. Debt is down to now 3.8 times -- interest -- debt is down to 3.8 times EBITDA, which is a very healthy level. It will continue to trend down as we continue to throw off more cash.

Our first use of cash will be to continue to pay down debt. We've had a lot of discussion about that internally, that is where we came out where the modeling shows is the best use of cash. Sooner or later, whether it is sooner like in 6 to 9 months, or later like 2 years or 2.5 years, we will go back and start doing some M&A. And then we will use the cash for M&A purposes.

But the targets are the same. We don't long-term want to be for any long period of time below 3 times because we are very, very comfortable with that amount of leverage and it improves the returns on the common.

Todd Fowler - *KeyBanc Capital Markets - Analyst*

Understood. And then just the last one to follow up on that point. What would be the difference between -- what would make you go to the market sooner in that 6- to 9-month window versus the 2-year window, what would be the factors that you would be thinking about that would bring you to the market to do M&A sooner versus later? It is kind of a wide range, and so what are some of the things that you are evaluating?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Well, the main thing is bandwidth, is management time. How do we want to spend our time? Is it return on capital, is it return on time? Both are very, very important. Right now we've got so many work streams under way that create lots and lots of value. And we don't have to pay 10 times EBITDA for those; we just have to put time into it and effort.

So, as long as we still have all these projects going on that is the best use of our time. There will come a point in time, Todd, where we are 80%, 90% through with most of those projects and then we will have the bandwidth to go back to the M&A world. However, building up an M&A pipeline doesn't happen overnight and that is something we are not doing right now.

We have looked at one or two acquisitions that were just extremely strategically compelling. But we ended up not doing them for this main reason that from a return on time point of view it is better to keep us focused on internal operating initiatives. So acquisitions are not in our life at the moment. They will be sometime in the future. Hard to button-down exactly when that will be.

Todd Fowler - *KeyBanc Capital Markets - Analyst*

Okay, understood. All that is helpful. I will turn it over. Thanks for the time this morning.

Operator

Ravi Shanker, Morgan Stanley.

Ravi Shanker - *Morgan Stanley - Analyst*

Brad, if I could just follow up on that last response. When you said that you had a couple of strategically compelling options recently, does that mean transformative or does that mean kind of lines of businesses that you currently aren't in?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Well, both. Transformative in terms of size, but in lines of business that we are already in. Ravi, we are not trying to get into any other lines of business. The lines of business that we are in are the ones we want to be in.

We like the leading positions that we have got in Europe and in North America in some of the fastest-growing parts of transportation and logistics. So we want to keep doubling down on those lines of business. We are not interested in getting into new lines of business.

Ravi Shanker - *Morgan Stanley - Analyst*

Okay, understood. And I think you gave us the logistics pipeline of bids. Can you remind us what your conversion rate typically is on that? And if I remember right that was like $1.3 billion. And does that include any transformative deals there as well?

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

Yes, Ravi, it is Scott. Generally the win rate has been anywhere from 25% to 33%. And the last year is more like -- it reached more like 33%, toward the high end. We tend to turn over that pipeline twice a year, so you can get an idea for how much we are growing.

Ravi Shanker - *Morgan Stanley - Analyst*

Got it. And just last question, how do we think about your truck brokerage margins, maybe not in 2017, but 2018 and beyond, just given some new entrants in the space, both small and large? Do you think that puts pressure on margins for existing players?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

This is Brad. I do. I think long-term truck brokerage margins are going to come down. There will be new entrants coming into the market; there will be new technology, more competitive influences there. There will be more transparency on price discovery. I think margins are going to come down.

I think volume is going to go up. I think volume ultimately will go way up, because like in other industries there will be derivatives and hedging products that will be traded, just like right now it is all just physical commodity.

I also think cost is going to come out, Ravi. Because I think as technology becomes a bigger and bigger factor, as it has been, but that is even accelerating in truck brokerage, the cost of -- the human cost will go down quite a bit. You don't have to pay bonuses to computers and computers are becoming more and more the brokers and the carrier reps.

Ravi Shanker - *Morgan Stanley - Analyst*

Got it, very helpful. Thank you.

Operator

Scott Schneeberger, Oppenheimer.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

John, could you follow up just on the CapEx questions earlier? You gave guidance for 2017. Should we think a similar level in 2018 and also a similar cadence?

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

Yes, Scott, the CapEx is really not going to grow with revenue proportionately. So we do expect that CapEx in 2018 would be very similar to what we have given guidance for in 2017. I think it is difficult to predict cadence within any given year around that because it does tend to be lumpy based on -- in the logistics business in particular, new contract starts have CapEx in the front end of the contract initiation and that does tend to be very difficult to predict.

On the equipment side we should be buying generally pretty consistent through the year absent any back and forth with vendors on pricing that could delay the start of a new contract in any given year. So, I think it is tough to give a real clear cadence within any given year.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

Thanks, that is helpful. And then on IT spend, if you could remind us kind of like a CapEx/OpEx breakout and some of the major initiatives that are going on there. Thanks.

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

Yes, Scott -- hey, it is Scott. We have about $425 million in annualized IT, about $125 million of that is capitalized. Some of the more exciting things that we are working on are in contract logistics. You have automation projects with increasing use of robots. We are also implementing employee productivity tools, especially in Europe where we use to track work streams and identify inefficiencies in the systems.

In LTL, we just watched both the workforce planning and pricing tools; there is several upcoming releases with improved algorithms. We are developing route optimizers to improve the efficiency of pickup and delivery. And then we have some planning tools to improve the line haul efficiency, which is our largest cost and we have already started to see some improvement in the line haul efficiency.

The rail optimizer in intermodal has been working great. It has increased visibility in the system; it has improved on time pickup and delivery. It has made our teams more efficient. The things that we are working on now in that area are generally around optimizing the drayage to improve the efficiency of the network.

In Last Mile there is a lot of work streams, all different things going on. We have been implementing new functionality to handle increasingly complex installs. So installs that typically require different experts. We're also building out tools for our national sales network to better fill in rural areas so that we can be more cost effective for full country service.

And then in truck brokerage we are always putting in new releases for the Freight Optimizer, it is more than one time a month. In Europe we are continuing to improve the pricing functionality, the algorithms that need to be refined and then we are launching additional functionality in Europe. And in general our initiatives in brokerage have to do with freight marketplace or allowing customers and carriers to do more to our portals as well as automating more tasks internally, some of the things that Brad was talking about.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

Great, thanks for that, Scott. One final quick one for me. What type of macro environment is implied in the guidance that you have going forward? How much is based on an improving environment? Thanks.

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

We based it on 2% GDP growth and we have factored in mid-single-digit organic revenue growth for this year.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

All right, great, thanks. Nice work this year.

Operator

Kevin Sterling, Seaport Global.

Kevin Sterling - *Seaport Global Securities - Analyst*

Brad, let me touch on the disruptive technology a little bit you talked about. Not all of brokerage will move to an app. So what percentage in your mind of the business can be automated with technology?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

I think it all will eventually, ultimately, in the fullness of time. That is going to happen over a number of years. But like all industries not just truck brokerage, the role of technology is becoming more and more prominent and eventually more dominant, because it takes out cost, it takes out inefficiencies, it takes out waste, it takes out defects, it is where the world is going. And truck brokerage is right for that.

I don't think that is all a bad thing, it is just going to be a different thing. You are going to have much more transparency of where trucks are and what the right prices are and what is going to -- what the fluctuations are in the market. So margins will come down as a result of that. But you will have less cost, because you won't have rooms full of 500 -- millennials using telephones to call shippers and to call carriers, it will be done machine to machine.

So, I think the volume will go up, the cost will go down and the margins will come down. And depending on how much those three things move, that will end up describing how attractive the business is eventually. But I think it will all go, Kevin. I think it will all go electronic in due course.

Kevin Sterling - *Seaport Global Securities - Analyst*

Okay. And so, I imagine along those lines we are going to see, at least in your mind, a lot of smaller players just go poof or exit the business or get consolidated. Is that how you are thinking about it too from a consolidation perspective?

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Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

I think there will be a dramatic transformation of brokers of all sizes, including the large ones like us and including small ones too. Technology is going to have a very transformative effect on the industry. And I think it is going to be good for shippers, by the way. And it is going to be for the economy because it is going to be more efficient.

Kevin Sterling - *Seaport Global Securities - Analyst*

Yes, okay. And also with just the phenomenal growth you are seeing in Last Mile, and obviously that is not slowing down anytime soon. Do you worry about finding enough capacity to satisfy the demand or service levels possibly deteriorating?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Well, as we approach $1 billion in Last Mile, we are now about 3 times the size of the next three competitors combined. So we obviously have a lot of capacity. And a lot of business comes to us because of the very high quality of our national network. So one of the things we are good at in Last Mile is getting capacity.

And that is one of the reasons why we had an exceptionally strong quarter in both revenue and EBITDA in Last Mile. In fact, Last Mile was again the fastest-growing unit that we have got. We had double-digit revenue growth and even much higher EBITDA growth.

It is not all because of us; the tone of the Last Mile environment has been exceptionally good too. We had a lot of new wins especially in appliances. So, I feel good about our positioning in Last Mile. I think it is one of the strongest parts of the Company.

Kevin Sterling - *Seaport Global Securities - Analyst*

Okay, thanks. And lastly, could you update us on how much you plan to spend on technology this year? And is that kind of a good run rate for the next couple years how we should think about it?

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

Yes, the run rate of $425 million is a good run rate. We have been taking out infrastructure costs and getting savings on in sourcing some projects and technology. But we are also investing and increasingly investing in development.

Kevin Sterling - *Seaport Global Securities - Analyst*

Okay, great. Thanks, Scott and Brad, John. Thank you so much for your time this morning. Congratulations on a very good year. Best of luck to you.

Operator

Chris Wetherbee, Citi.

Chris Wetherbee - *Citigroup - Analyst*

Just wanted to touch on the LTL side. So it sounded like things turned positive in the month of December, even if just modestly. I wanted to get a sense of maybe how things were looking in the first part of the first quarter from a tonnage standpoint.

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

So, LTL in the fourth quarter was another fantastic chapter in a continuing major success story. Operating income was up year over year 40%, and OR in the fourth quarter was up -- it was improved to 90.5% from 93.3%. And for the year it was improved from 93.4% to 89%. So very, very good trends and the numbers explain it. The yield -- to answer your question, the yield in the fourth quarter was up 3%, the tonnage per day was negative 1.7%.

As you know, we've been on a project since we bought Con-way to shed the money losing freight, the ones that had ORs over and sometimes very significantly over 100. And that has been a process, it has taken a while because we want to be very respectful to our good customers and maintain those relationships. But we had to phase out of money losing freight. So that caused tonnage to go down.

Now for the first time, starting in December, tonnage is inflicting positively on a year-over-year basis. And that is in part because we have an easy comp because we started the process of shedding money losing freight. It is partly because the industrial economy is getting better. And the industrial recession is over and has been over now for a few months.

And when you meet with our LTL customers, they are not whining about how business is getting worse and worse. There is actually a little skip in their -- there's a little step in their skip. So they are more positive.

So one very interesting development to pay attention to is weight per shipment. Weight per shipment, if you look in the release buried on page 6 or 7 or somewhere, weight per shipment was up 1% in the quarter. And you might think, well, what is the big deal, up 1%? It is a big deal. It was the strongest year-over-year reading in 2.5 years. The last quarter that weight per shipment was up was in the fourth quarter of 2015 but that was one aberration in a long period of time.

The last year weight per shipment was for us was 2014. And it has generally been down between 1% and 1.5% every quarter. Weight per shipment has increased even more than that, by several percentage points in the first six weeks of this year. So we attribute that to improved industrial economy and partly due to internal initiatives to target higher weight, denser shipments. So things like metal stampings or batteries or seed or pellets or machine parts or chemicals or paper, dense -- stuff that is going to weigh out [or cubes] out.

So, a whole slew of operational improvement initiatives in LTL from safety to trailer utilization, to workforce planning, lots and lots of good things going on. And that is translating into the great numbers that we are seeing. We are only second-best now in terms of our OR. OD is still ahead of us. So we have a goal. I am very happy that OD is ahead of us. We have something to strive for.

Our goal is to have the best number one OR in the industry. And our focus is on OR, it is on operating income. So as you see the weight per shipment move around a little bit, that will affect some of the other metrics as well.

Chris Wetherbee - *Citigroup - Analyst*

Okay, so it sounds like tonnage is also up if weight per shipment is sort of flexing up here in the first six weeks.

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Correct.

Chris Wetherbee - *Citigroup - Analyst*

When you think about your customer base, so just kind of catching on that comment that you made there. Is it fair to say that you are kind of done with sort of the housekeeping and the culling of what you have there? Is there more work to be done there? Obviously you are seeing some growth, but are you sort of happy with sort of the customer group that you have in terms of the freight that you are moving for them?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

I am happy with the direction, I am happy with the significant progress we've made. But frankly we are only about 80% done on that. This is a process and we have reached compromises with many customers to lose a little bit less than we have been losing but we are still losing.

So we still have some work to do, we still have some wood to chop at culling that freight. I am happy that we have had a big push with increasing the size of our local account executives who are targeting small- and medium-sized accounts. And there we have seen a lot of growth, more growth than in the 3PL business and in the large accounts.

Chris Wetherbee - *Citigroup - Analyst*

Okay, that is helpful. And then one final question, just taking a step back and thinking about some of your procurement initiatives that you've talked about in the past in terms of the buckets of your spending and your ability to go after those buckets and try to reduce the cost on it. Can you give us an update on where that stands or how much of a contribution can that be in 2017 and 2018?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Okay -- well, let's start with 2016 to see the base. So in procurement in 2016 we completed bids for tractors, tires, waste disposal, office supplies, temp labor, we outsourced facilities management, we did some travel-related items, I'm probably leaving out two or three other categories. That is the main categories that we did last year.

So we had about $20 million in savings that actually hit the numbers last year from these bids. And with the full-year benefit in 2017, because we did those RFPs throughout the whole year, that will translate into savings of about $80 million. So what comes next?

We are now rolling out RFPs for security, for material handling equipment, utilities, and then the next group is going to include trailers, fuel, packaging, maintenance and repair, dozens of other categories. And these next categories should save us an additional, same kind of numbers, about $70 million to $80 million. And we will get -- again, we will get partial benefit in the year that we do the RFPs, so in 2017, and we will get the full-year benefit in 2018. So that is the pace that we are going at.

Chris Wetherbee - *Citigroup - Analyst*

Okay, that is very helpful. I appreciate your time this morning, guys. Thank you.

Operator

Amit Mehrotra, Deutsche Bank.

Amit Mehrotra - *Deutsche Bank - Analyst*

First one is simply just what the organic growth was for the overall Company in the quarter, please?

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

Yes, the organic growth revenue wise was 7% in the quarter.

Amit Mehrotra - *Deutsche Bank - Analyst*

Okay, great, thanks. Just had a couple quick follow-ups on the free cash flow outlook. As a follow-up to a previous question, but maybe just asking it a different way in terms of how much of that $900 million is revenue driven growth or how much of it is revenue agnostic?

I am just trying to get a sense of there is a lot of shifts going on maybe in the way you are optimizing working capital, and there is obviously a lot of cost initiatives. So just want to get a sense of what is not revenue-related on an absolute dollar basis.

And then a couple follow-ups to the free cash flow is what is embedded in that guidance in terms of a headwind from cash taxes? And how much is attributable to minority interest or is the entire $900 million available I guess to you guys, the debt holders and equity holders of the Company? Just trying to get a sense of that. Thank you.

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

Sure, I will take the first part and maybe John can take the second part. In terms of what is embedded in the numbers, we have included mid-single-digits revenue growth into our EBITDA targets which then turns into the free cash flow. And then we have 200 basis points of margin expansion. On a normalized EBITDA margin we are a little over 8% excluding the North American truckload business that we divested and we are moving towards 10%.

If you look at the bridge to 2017 it is pretty simple. I mean EBITDA is up $100 million, although $200 million on a normalized basis, but include truckload, it is $100 million. M&A related costs are going down. Interest expense is going down due to the refinancing and the lower debt. And then one offset is higher cash taxes. Cash taxes should be in the range of let's say $90 million next year.

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

And on the minority interest in terms of the amount of EBITDA that we get to hang onto or control, we do have a minority shareholder in our French business in Europe, but that doesn't really dictate how we use our cash. So we use our cash to invest in the business to make capital investments to service our debt and all those things. We are not paying any dividends out to any shareholders right now. So essentially all that EBITDA is retained in the business.

Amit Mehrotra - *Deutsche Bank - Analyst*

Okay, that is helpful. And then just one clarification. The EBITDA bridge from 2016 to 2017, I mean pro forma for the TL business -- and I could be wrong on this, so please correct me. But I thought it was like 70% of that growth was cost initiatives and not revenue driven. Am I wrong on that or is that the right number?

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

Of the EBITDA excluding truck brokerage? Well, we have 100 basis points of margin improvement or so in the model for 2017. And then we have mid-single-digits revenue growth. So, yes, it is probably about 70% is in the cost savings.

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

Excluding truckload that we divested.

Amit Mehrotra - *Deutsche Bank - Analyst*

Truckload, yes.

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

That's right.

Amit Mehrotra - *Deutsche Bank - Analyst*

Okay that is helpful, thank you very much. One last one for me on just following up on Chris' question on Con-way. Obviously the OR improvement was pretty impressive and a pretty -- I mean the revenue side of the equation wasn't really helping you, which was even more impressive then. But now you have got a little bit of the profit drivers of that business kind of rowing in the right direction at least for the first couple months here.

So just in terms of margin expansion, I know you want to get to where OD is as a benchmark. But if we look at the margin expansion opportunity in 2017, could we see margin expansion on a year-over-year basis exceeding what you did in 2016? Or was that just more disproportionately because there was some low hanging fruit on the cost side?

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

I think the targets are right. I think 100 basis points of margin expansion this year would be very good, it would be a very good result. Things are going well. Are you talking about in LTL specifically or the whole (multiple speakers)?

Amit Mehrotra - *Deutsche Bank - Analyst*

Yes, I am talking about LTL specifically.

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

Oh, LTL specifically. I think 100 to 200 basis points is a good target for LTL. I think we continue to have initiatives to take out cost. We are using the new pricing algorithms to price lane by lane and by customer. So it helps us target better business in the first place. We have increased the sales and service separate, so we will get some more sales than we did last year.

As Brad said, we doubled the size of the [SAMs], but we also added to more of the local account executives. The LTL playbook with the best practices, improving labor productivity through workforce planning, dock engineered standards. The P&D optimization, it is a big area. We are working on now mostly the process and then adding to the technology. We are implementing plans to improve the line haul optimization -- the line haul utilization.

So it is -- there is a lot of different initiatives going on. I think 100 to 200 basis points is a good target.

Amit Mehrotra - *Deutsche Bank - Analyst*

Okay, that is very helpful. One last quick one for me if I could is on the leverage target. Brad, I think you said earlier you don't want to go below 3 times, so that is clear. But could you provide a number where you don't want to go above? I know you have a three to 4 times target, but I think you have said if the right deal comes across you may want to go above that.

Can you just give us a sense of how much above that so we get a sense of maybe the bookends in terms of the size of the deals and what you potentially look to digest if you get to either end of that bookend? Thank you.

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

In the past we have gone up to 5 times knowing that it was temporary. And that is something that, depending on where we are in a cycle, we could be comfortable with that again on a temporary basis. But we are getting way ahead of ourselves because we are not even thinking in that direction.

We are thinking all about head down, focus on the business, keep executing on these many, many streams of operational improvement that create significant value for our shareholders without having to do M&A. I don't want to let you think that we are just about to do some M&A, it is not the plan.

Amit Mehrotra - *Deutsche Bank - Analyst*

Right. Shocking an equity analyst getting ahead of himself. All right, guys, thank you very much. Great quarter, appreciate it.

Operator

Allison Landry, Credit Suisse.

Allison Landry - *Credit Suisse - Analyst*

So in terms of CapEx, I was wondering if you could help us think about gross capital spending in 2017, particularly as the proceeds from the sale of truckload roll off. So sort of curious if the gap between growth and net narrows.

And then in terms of working capital, it looked like accounts payable and the prepaid expenses were fairly significant sources of cash in Q4. So wondering if you are delaying payments to vendors and how do we think about modeling working capital in Q1 and for the full year 2017? Thanks.

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

Hi, Allison. On the CapEx, if you -- over guidance for the year is $430 million to $455 million in total. Of that maintenance CapEx is around $275 million. So the rest of that would be considered growth. So just think about that as the split between maintenance and growth. So hopefully that is helpful there.

On the working capital you really have to look at working capital on a full-year basis. If you look at the full year, we used $190 million in working capital. We had about $133 million of one-time integration and rebranding costs. Of that about $100 million flowed through the working capital accounts.

So that leaves about $90 million of working capital use for the year for trade accounts, trade AR, trade AP. And that is pretty much right in line with what we guided to before the start of 2016. So from a working capital perspective trade accounts only, we used about $90 million in 2016 and it will be about a similar number in 2017.

Allison Landry - *Credit Suisse - Analyst*

Okay. And then, John, another question. I think it was you or Scott that mentioned cash taxes of about $90 million in 2018. But curious when you are expecting to become a cash tax payer. And if that happens in 2018 what you would expect the run rate for the cash taxes to be in 2019 and beyond?

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

Sure. The $80 million to $90 million of cash taxes is for this year, 2017. And we will use up most of, if not all of, the federal US NOL this year. And so, we will become a taxpayer next year. And then think about cash taxes as a mid-30% tax rate on pretax income.

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

Once you start going out to 2019, I mean there is so many things being discussed in the United States and in Europe on taxes, it gets a little speculative.

Allison Landry - *Credit Suisse - Analyst*

Sure. Okay, thank you.

Operator

Brian Ossenbeck, JPMorgan.

James Allen - *JPMorgan - Analyst*

Hey, guys, it is James Allen on for Brian. I just wanted to talk about the new initiative you mentioned whereby you are combining the elements of contract logistics, LTM, Last Mile. Because I think it is something we talked about conceptually when you were newer to LTL.

So I was wondering whether it is contributing to the organic growth over and above the industry levels. If it is, how much? And also whether you are marketing it as a discrete service or if it is just a natural combination for existing customers?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

It is not significantly impacting our business right now, but it will in the future. I believe this is catching traction. I believe this has legs to it. So what this is is we had three separate businesses, LTL, contract logistics, so we had the warehouse network and we had Last Mile.

What we have done is, in response to customers, collaborating with customers to [vie] solutions that make a seamless integrated solution for the movement of their goods that is more efficient, that is cheaper, that is one throat to choke, that is one vendor response that has responsibility, one invoice. And this is just starting.

So we have customers who now want to give their inbound logistics to us at the warehouse and then that is it, that is ours from there on in. We do the repurposing, the repackaging, for sorting and we -- in the warehouse and we do the Last Mile from the warehouse either to a distribution center and then to someone's home or apartment or sometimes directly to someone's home or apartment.

That is a new thing. That is not, to my knowledge, being offered by our competitors at least yet. I think that is an example of the future of the industry where you have more integrated solutions on behalf of shippers.

In addition to that, as you know from our Last Mile network, we have the largest national -- we probably have the only national, truly national Last Mile distribution network. But we are increasing the density of that and increasing the amount of the population that we are closer to that we can reach with that network by selectively taking some of our LTL cross docks and repurposing small parts of them for Last Mile.

And this is in the early stages, so it is really not impacting our P&L very much at all right now, a little bit but not very much. But the combination of those two mergers, so to speak, from a service point of view, merging the warehouse with the Last Mile and merging part of the LTL network with the last mile network is very powerful. Very powerful added value to the customer.

James Allen - *JPMorgan - Analyst*

Perfect. And a quick follow-up if I could. There's been a couple of moving parts on the supplemental LTL disclosure. I am thinking of the average age of the tractor fleet and the maintenance expense which got up to sort of a $32 million rate in 4Q 2016. I am just wondering if there is a target age that you specified that you are looking to hit for the fleet and if the $32 million is a good run rate going forward for maintenance expense.

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

Hi, this is John Hardig. In terms of what would happen with the fleet in LTL, we did have -- on the maintenance expense line item we did have a big rebranding charge in the fourth quarter. So most of that increase that you are seeing in maintenance is related to rebranding the fleet.

In terms of fleet age, we don't have a specific target that we are trying to hit. Although the fleet age that we have today is where we are comfortable. So we are not expecting to reduce the age of the fleet or increase the age of the fleet. It did come down slightly over last year, so if you look at what was in the press release that gives you the average for the quarter.

The actual ending point at the end of the month of December, because we had a pretty sizable investment in December into the LTL fleet, was actually lower than what is in the press release. So it is like 5, 5.2 average age or so at the end of that year. So it did come down slightly, but that is just based on the timing of capital investment.

James Allen - *JPMorgan - Analyst*

Perfect, thank you very much, guys.

Operator

Jason Seidl, Cowen.

Jason Seidl - *Cowen and Company - Analyst*

Quick question -- you talked a little bit about the organic growth rate for the entire organization. Can you guys break it out by your divisions?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

No. We don't want to be doing [MORs on the operating reviews] for the entire Street. But generally speaking you are going to see European transport, while growing faster than the market, that is not going to grow gangbusters because it is truckload business. You will see brokerage in North America growing very healthy amounts.

European supply chain near the top of the ladder in terms of organic growth. I mean double-digit organic growth in the fourth quarter and year to date it has gone up from where it was in the fourth quarter. So a real high grower in European supply chain.

If you look at North American supply chain you are going to see high growth, not quite as high-growth as in European supply chain only because of the churn of the customer base in some cases because we integrated three different supply chain organizations as opposed to Europe where it was just one. But still good grower.

North American truck brokerage -- don't know. It is going to depend on will margins continue to more than offset volume. And depending on that rubric you will see middling or under middling organic revenue growth.

North American Expedite, can't predict. That is a volatile business, it really all depends on disruptions in supply chain in general in the country.

Last Mile, we'll probably stay at the top of the heap and we will continue to have healthy double-digit organic revenue growth because of our scale, because Last Mile is a good business, because it is more e-commerce.

Intermodal has been weak and I have a feeling it is going to stay weak for a while. It is highly competitive, light volumes, trucking capacity, which is the alternative to Intermodal, is ample. So until truck capacity gets tight we are not really predicting -- or we are not even predicting positive organic growth in Intermodal.

So that gives you kind of flavor for the different parts of the business. Does that get you where you need to go?

Jason Seidl - *Cowen and Company - Analyst*

That was very helpful, Brad, thank you. And I guess my last one here, you mentioned e-commerce really growing in some different parts of your business. What percentage does e-commerce now account for across all your networks?

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

26% is e-commerce and retail.

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

So, some of that is retail and we don't know actually whether it is e-commerce or not. Some of our customers are pure e-commerce customers or the e-fulfillment centers that we run for them are 100% e-commerce.

Other facilities we run, we get the order, we get it in EDI, we don't see whether it came in from the Internet or it came in through a bricks and mortar. We just don't see that because we don't have visibility to it. But over a quarter of our business is either retail or e-tail and a big, big chunk of that is e-commerce.

Jason Seidl - *Cowen and Company - Analyst*

Okay.

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

And the two parts of our business that are most levered to e-commerce are supply chain and Last Mile. That is where we are seeing the most amount of e-commerce business.

Jason Seidl - *Cowen and Company - Analyst*

No, that make sense. Gentlemen, thank you very much for the time.

Operator

Bascome Majors, Susquehanna.

Bascome Majors - *Susquehanna Financial - Analyst*

Yes, I had a question on cross-selling. I think you mentioned that your penetration of the multiple business lines had risen to 24% in your top customer base, I think that was up a few points from the last quarter.

Can you just confirm how much that has risen sequentially? And do you think that is leveling kind of steady expansion in cross-selling efforts or if there is an opportunity to maybe even accelerate as integration becomes tighter across the portfolio?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Yes, Bascome, so it's actually up more than a few points; it was up 1.5, almost 1.5 times. So it was 17% a year ago and it was 24% now. So real nice rise. And do we think that is going to accelerate? Absolutely. Because all the meetings we are having with our big shippers, or big customers, it is not about a single mode.

Virtually no meetings we are having with our customers is about one mode, it is about how do we help them take cost of their total supply chain. All of the SPP supply chain, the chief logistics officers, heads of transportation, all the customers that we deal with are getting intense pressure from the C-suite to take call it a couple percent of cost out of the system.

The C-suite is seeing, they are spending $0.5 billion or $4 billion or $2 billion on transportation and logistics globally and they are saying, find me 2%. And you figure out how to do that.

So partnering with a company like ours who has many different modes and can understand the entire supply chain, we almost always can find ways to take 0.5%, 1% and even 2% out of their system. And that is a message that resonates very strongly with our customers. And it is probably the main reason why we have such great cross-selling and organic growth.

Bascome Majors - *Susquehanna Financial - Analyst*

Thank you for that. Just one final question on incentives. You have been very transparent on your long-term incentive plan and in the free cash flow per share targets that you rolled out last year for that. I was wondering if you could talk about in the short-term plan or annual bonus, is there any different focus this year than last year? Just what metrics are being emphasized and why as we head into 2017 and 2018?

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

It's real simple, it is EBITDA minus CapEx minus interest expense. So we are aligning the executive suite with shareholder interest. So when we meet with our top shareholders we usually -- we do it and they give us a QBR, quarterly business review, just like our customers give us a QBR, the main three metrics that they look at are: first, how is your EBITDA growth going?

Second -- box checks very well there, very significant above average EBITDA growth. Second one they look at is cash flow and nice big ramp up of cash flow this year from the previous year, nice expected free cash flow increase 2017 over 2016 and even continuing that in 2018 over 2017.

And the third metric they look at is organic revenue growth. They are looking for mid-single-digits organic revenue growth. So those are the three things that our owners, our shareholders are looking at, so that is what we want to incentivize our organization to focus on as well.

Bascome Majors - *Susquehanna Financial - Analyst*

Thank you for the time today.

Brad Jacobs - *XPO Logistics, Inc. - CEO & Chairman*

Thank you. So, to summarize how we look at the quarter, we obviously had a very strong finish to the year. We had record fourth-quarter results across the board. We had strong organic growth in Last Mile, European contract logistics and that is driven by our leadership positions in e-commerce.

And we unfolded another amazing chapter in North American LTL and had year-over-year adjusted operating income up 40%. And we continued our proud tradition of meeting or exceeding our financial targets. A tradition that goes back to 2012 and every year between 2012 and now.

And we issued a cumulative free cash flow target of $900 million between this year and 2018, including more than $350 million of free cash flow this year. And we have a clear path to our $1.35 billion EBITDA target for this year and $1.57 billion for next year. So thank you for your support, we look forward to talking to you next quarter. Have a great day.

Operator

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