Q1 2020 XPO Logistics Inc Earnings Call

ST. JOSEPH May 5, 2020 (Thomson StreetEvents) -- Edited Transcript of XPO Logistics Inc earnings conference call or presentation Tuesday, May 5, 2020 at 12:30:00pm GMT

CORPORATE PARTICIPANTS
- Bradley S. Jacobs, XPO Logistics, Inc. - Chairman & CEO
- David B. Wyshner, XPO Logistics, Inc. - CFO
- Matthew Jeremy Fassler, XPO Logistics, Inc. - Chief Strategy Officer
- Meghan A. Henson, XPO Logistics, Inc. - Chief HR Officer

CONFERENCE CALL PARTICIPANTS
- Allison M. Landry, Crédit Suisse AG, Research Division - Director
- Amit Singh Mehrotra, Deutsche Bank AG, Research Division - Director and Senior Research Analyst
- Ariel Luis Rosa, BofA Merrill Lynch, Research Division - Associate
- Bascome Majors, Susquehanna Financial Group, LLLP, Research Division - Research Analyst
- Christian F. Wetherbee, Citigroup Inc, Research Division - VP
- Scott Andrew Schneeberger, Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst

PRESENTATION

Operator

Welcome to the XPO Logistics First Quarter 2020 Earnings Conference Call and Webcast. My name is Michelle, 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 forward-looking statements with the meaning of applicable security laws, which, by their nature, involve a number of risks and 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.

These 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.

You can find a copy of the company's earnings release, which contains additional 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.

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

Thank you, operator. Good morning, everybody. I'm joined virtually this morning by David Wyshner, our Chief Financial Officer; Meghan Henson, our Chief Human Resources Officer; and Matt Fassler, our Chief Strategy Officer. Also, for the Q&A portion of the call, we have Tavio Headley, our Senior Director of Investor Relations; Ravi Tulsyan, our Treasurer; Kyle Wismans, SVP of Financial Planning and Analysis; and our newest addition, Kevin Sterling, who's joined as VP of Strategy. Welcome to the team, Kevin.

I want to start by expressing my profound appreciation to all the frontline workers at our company in our industry and across other professions who have kept society functioning during the pandemic. I'm particularly grateful to our warehouse workers, dockworkers and drivers who provide an essential service to our customers. You'll hear directly from Meghan about the actions we've taken to keep our people safe. Then Matt will cover the quarter and some improvements we drove in the business and provide color around April. And David will wrap up the prepared remarks and then on to Q&A.

Turning to the quarter. We had a strong January and a strong February, then the pandemic sharply disrupted our end markets. It started with our European operations in early March and began to affect parts of our North American business later in the month. We quickly terminated our strategic review process and turned 100% of our focus to keeping our employees safe, our customers operational and our balance sheet rock solid.

We had $1.3 billion of liquidity as of quarter end and we added another $1.2 billion in April for total liquidity of $2.5 billion.

We delivered $333 million of adjusted EBITDA in the quarter and expanded our EBITDA margin by 30 basis points.

And I'm proud that even in an economy on pause, we delivered $95 million of positive free cash flow in a quarter that's typically negative. We expect to generate hundreds of millions of dollars of free cash flow this year.

Like all crises, this pandemic has a beginning, a middle and an end. We're in the middle of it now, and it will end. XPO Logistics will emerge far stronger than we were pre-COVID. Many of our core strengths position us for growth on the other side of the pandemic, including our proficiencies in e-commerce, advanced automation and data science and our focused, compassionate culture. Our billions of dollars of investment in these areas give us a head start on growth in the recovery.

That's why while I'm a bear in the short term, I'm a bull in the medium term and I'm a mega-bull for XPO in 2021 and beyond.

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

Meghan A. Henson, XPO Logistics, Inc. - Chief HR Officer

Thanks, Brad. I'll start by emphasizing 2 key aspects of XPO's response to COVID-19: prevention and appreciation. The safety protocols we've implemented are comprehensive and designed to prevent exposure to the virus in addition to dealing with it after the fact. We've procured enough PPE to safeguard our employees at work around the globe, including gloves, hand sanitizer, wipes, thermometers and masks. Inside our facilities, social distancing is our strongest defense. This includes holding shift meetings outdoors where employees can remain 6 feet apart, redesigning traffic flows and changing shift schedules, installing barriers between workstations and having only one chair per table in break rooms. Our sites have regular proactive cleaning schedules.

To encourage our employees to stay home when they're sick, we've added an additional 2 weeks of pandemic paid sick leave to our current paid time off in the U.S. and Canada. We've added free COVID-19 testing to our U.S. insurance policy and free access to telemedicine. And we've expanded mental health programs for all employees globally and their dependents.

As soon as we know of a confirmed or presumptive case, we follow a tracing protocol and notify those who may have been exposed. Employees who are exposed are required to self-quarantine for 14 days. And when one of our people tests positive, we close the facility for deep cleaning using a team of certified specialists overseen by an industrial hygienist. When we shut down a site for deep cleaning, we send all of the employees home with full pay.

We follow the guidelines of the World Health Organization, the CDC, government policies and our own health and safety protocols to determine when we can safely resume work.

In recognition of the contribution of our colleagues who are providing critical supply chain services, we've announced front line appreciation pay for nearly 40,000 employees in the U.S. and Canada. Hourly employees in our warehouses receive an extra $2 per hour on top of their regular pay rate. Later this month, full-time employees working on our LTL service centers will receive a one-time bonus of $500 and part-time employees will receive a $250 bonus.

I'm proud of the work our people are doing around the world. We'll continue to put their safety and well-being first. With that, I'll turn the call over to Matt.

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

Thanks, Meghan. I'll review Q1 and how we're using our internal initiatives to optimize performance in this challenging backdrop and then discuss current trends.

Starting with our transportation segment. Our North American LTL business had another improvement in profitability despite softer demand. Tonnage per day declined by 6.4% year-over-year, primarily due to subdued activity from our industrial customers. This has been the case for quite a while. Yield, excluding the impact of fuel, improved 2.6% year-over-year. Price increases on contract renewals remained healthy at 3.7%. Our proprietary pricing tools within LTL are helping us gauge elasticity for prospective bids aiding our yield profile.

In addition, 66% of all local account RFPs in the quarter were automated, up from about 50% in Q4.

Our technology is driving faster turnaround times and helping us win more new business. In fact, our new business won in LTL posted a double-digit increase as it has in each and every quarter over the past 2 years.

Our adjusted operating ratio improved by 420 basis points to a Q1 record of 83.4%. Excluding gains on sale of real estate, our adjusted OR improved by 320 basis points to 86.5%. This strong performance was the result of steady yield improvement and solid cost control, driven by our profit improvement initiatives.

Our XPO Smart workforce planning tools drove dock productivity up 7% year-over-year to the best level we've seen since 2012.

Also in Q1, we launched new capabilities for our line haul optimization model. This helped us improve load factor by 5% and reduce our empty miles by 23%, so a win for both asset utilization and the environment.

Moving on to freight brokerage. Gross revenue declined by 5% year-over-year, which was a sharp improvement from Q4. Our net revenue margin increased across -- eased, that is, across freight brokerage by just 40 basis points sequentially to 17.5%, but it fell 300 basis points year-over-year against a tough comparison as contractual rates declined and the spot market stabilized.

Within freight brokerage, our truck brokerage loads per day increased by 9%, accelerating significantly from 1% growth in Q4.

Like others in the industry, we experienced a surge in volume late in the quarter from customers in the consumer staples sector, both producers and retailers. This was related to meeting increased demand for food and dry goods as people stayed at home.

Our XPO Connect digital freight marketplace continues to gain traction. We saw our carrier rep productivity improve by 16% in Q1, driven by an increase in automated transactions. Weekly active users hit a new weekly high in March. And we launched new capabilities in our pricing algorithms that allowed us to improve our forecasting accuracy for truck brokerage by 16%.

In our last mile operation, revenue declined 10% year-over-year in the quarter. Excluding postal injection, which we exited in the middle of the first quarter last year, growth in our core last mile heavy goods business accelerated to 9% year-over-year.

All told, we had a standout quarter in last mile, meeting increased customer demand for electronics and fitness equipment. We also benefited from the trend towards buying big and bulky goods online. We implemented new safety protocols for last-mile deliveries in March, including curbside drop-off and PPE and social distancing during in-home installations.

Turning to Europe. In our transportation business, Q1 revenue declined by 8.8% versus 2019. FX weighed on revenue by about 2 percentage points. We were tracking to plan into March when COVID began to impact France and Spain.

We continue to hold numerous leadership positions across our transportation verticals, geographies and service lines in Europe. For example, we reinforced our status as the #1 LTL provider in France and Spain and a top 3 LTL provider in the U.K.

Across our transportation segment, adjusted EBITDA fell by 4%, while adjusted EBITDA margin rose by 40 basis points to 10.3%.

Moving on to our Logistics segment. Our revenue declined 4.3% in North America, reflecting the downsizing of business with our largest customer and our decision to exit some lower-margin business. Consumer packaged goods was our strongest vertical. Our proprietary XPO Smart tools are driving productivity and cost efficiency in staffing in our warehouses.

And I'm pleased to report that XPO Direct operated solidly in the black as it passed its first anniversary. Our shared distribution model is resonating with brands who want to optimize their direct-to-consumer efforts and shippers looking to augment their e-commerce and omnichannel capabilities. Customers value supply chain flexibility, now more than ever. We built XPO Direct to address that need.

In Europe, logistics revenue declined by 3.5% year-over-year. FX had a negative impact of about 2.5 percentage points. E-commerce and food retail were our strongest verticals in European logistics.

Our effort to drive margin improvement in European logistics, which was one of our 10 core profit improvement initiatives, continues to resonate. We reduced loss-makers and drove efficiencies throughout the business.

Across our Logistics segment as a whole, we doubled our new business wins to the highest level we've seen since the third quarter of 2018. Since the pandemic, we're seeing intense customer interest in surge management. We're meeting that need, and in some cases, converting these opportunities into longer-term deals.

Adjusted EBITDA for our logistics segment rose 7% year-over-year, and adjusted EBITDA margin rose to 8.4% from 7.6% a year ago.

Moving down the income statement. Interest expense was $72 million versus $71 million a year ago.

Our GAAP effective tax rate rose to 30% from 27% a year ago.

Our weighted average diluted share count was 103 million, about the same as Q4, and compared with 117 million shares a year ago and down 25% from our peak in the fourth quarter of 2018.

Our diluted earnings per share was $0.20 versus $0.37 last year, and our adjusted diluted EPS was $0.47 versus $0.51 in the prior year quarter.

We remain up and operating across our lines of business in all of our major markets. The pressure on demand is influenced by regional stay-at-home mandates and varies by customer verticals. For example, we have seen pockets of strength in e-commerce, food and beverage and personal care.

Our overall revenue in April declined in the low to mid-20s on a percentage basis, which we believe is in line with industry levels for our lines of business. We saw smaller declines in logistics, LTL tracked in line with our full company revenue performance and softer performance from the rest of our transportation segment. North American LTL yield was flat in April, similar to March. Truck brokerage volumes eased sequentially from the surge the market experienced in late March, but notably, margin dollars per load and net revenue margin have improved from Q1.

This has not been a conventional slowdown in any sense. For many customers, it's been a shutdown. While we have been up and operating across our lines of business, some customers have temporarily closed their stores and factories. I mentioned France and Spain earlier. Our activity in those countries hit its lowest levels in early April, and our transportation volumes are recovering modestly as these markets prepare to emerge from lockdown. Volumes have been bouncing along the bottom in the U.K. and the U.S. since mid-April. As industries and geographies reopen, we expect to see improvement.

Against this backdrop, consider 3 important factors: first, 77% of our costs are variable and 23% are fixed. We've been aggressively addressing our costs. Some of our expense reductions are likely to endure post-pandemic, aiding our earnings power when the environment eventually normalizes. Our XPO Smart planning tools are helping us manage through the volatility on a real-time basis. And our investments in LTL route optimization and supply chain automation are driving structural cost improvements.

Second, as Meghan discussed, we're prioritizing the well-being of our people. We expect expenses related directly to these efforts of up to $50 million or more in the second quarter, and it's hard to imagine a better investment. Our people are the bedrock of XPO.

Third, we dialed CapEx way back. We remain committed to a number of important growth investments. For instance, we're in the final stages of prepping our warehouse of the future with Nestlé, which will launch later this month. And we're continuing to optimize our routing and LTL pickup and delivery and linehaul, 2 of the highest ROI opportunities across the company.

XPO is built to withstand disruption. And when we emerge from the pandemic, we'll be even better positioned for success. For example, we're a leader in e-commerce logistics. E-commerce growth has accelerated globally and we expect that to continue after the pandemic. We expect to benefit as the #1 outsourced e-fulfillment platform in Europe, the leading reverse logistics platform and the #1 last mile platform in the U.S. for big and bulky goods.

We envision more demand for logistics automation where we're a leader in providing advanced solutions at scale, and we've been applying this expertise straight through the depths of this downturn.

We'll see more value placed on data visibility by customers of all types who want more transparency in their supply chains. Our value here lies in our digital freight marketplace, our intelligent analytics, machine learning and our ongoing routing and pricing enhancements.

Our cost structure will be leaner. We will remain focused on disciplined capital allocation as we have been since day 1, seeking out the strongest risk-adjusted returns.

We're a resilient organization. We've been there for our customers, and our relationships with them will be stronger on the other side of the COVID curve.

Now I'd like to turn the call over to David Wyshner, our CFO.

David B. Wyshner, XPO Logistics, Inc. - CFO

Thanks, Matt, and good morning, everyone. Today, I'd like to discuss our first quarter cash flow, our balance sheet and our liquidity and then share some closing remarks.

We generated $180 million of cash flow from operations in Q1, spent $139 million on CapEx and received $54 million of proceeds from asset sales, including our ongoing program of selling appreciated real estate. As a result, we generated positive free cash flow of $95 million in the quarter versus a free cash flow use of $96 million in Q1 last year.

As the scale of the COVID pandemic became clearer in March, we aggressively managed working capital and focused on turning our receivables into cash. We became even more disciplined about collections and derived an incremental $72 million year-over-year benefit from our trade receivables programs in the quarter. As our revenues slowed in March, it naturally brought down our receivables balance below the March 2019 level.

We repurchased 1.7 million shares of our stock at a cost of $114 million in late February and early March under a trading plan that was put in place earlier in the quarter and was triggered when our share price declined fairly dramatically. We stopped buying back stock in mid-March. We also throttled back our capital expenditures significantly and currently estimate that gross CapEx will be roughly $400 million this year, which is down more than 1/3 from our 2020 plan before the pandemic.

As markets became increasingly volatile in March, maintaining strong liquidity became a top priority for us as an organization. In addition to the actions I just mentioned, we drew $600 million on our ABL facility in March and ended the first quarter with a cash balance of $1.1 billion. That cash, plus another $200 million of available ABL borrowing capacity, brought our total liquidity at quarter end to $1.3 billion.

In early April, we added a $350 million credit facility to further strengthen our liquidity. And in late April, we issued $850 million of 6 1/4% 5-year senior notes. These financings give us pro forma liquidity of $2.5 billion, including $2 billion of cash as of March 31. We have no significant debt maturities until mid-2022, so we feel great about how we've fortified our already strong liquidity position.

Our net leverage at quarter end was 2.95x, which is just below the lower end of our targeted range of 3 to 4x adjusted EBITDA.

So while XPO, like all companies and industries, is facing a highly unusual operating environment, we have the benefit of continuing to operate as an essential business and that gives us feet on the ground and momentum when the uncertainty subsides. We have an exceptionally strong balance sheet and our industry is a leading indicator, meaning that we'll be at the forefront of the recovery when it comes.

As you may know, I joined XPO in early March. I'm happy to be part of a management team that is focused without flinching on keeping our employees safe and providing essential services to our customers in an unprecedented environment. I'm happy to be part of a business that is resilient, both operationally and in its ability to generate cash. And I'm happy to be part of a global team that provides transportation and logistic solutions that are reliable, in demand and important.

With that, we look forward to taking your questions.

QUESTIONS AND ANSWERS

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

Answer – Christian F. Wetherbee: Maybe starting on the transportation side ex LTL. If you think about sort of that segment, it appears on an EBIT basis, but I know I'm not sure that's necessarily how you guys look at it. But on an EBIT basis, it looks like it was either breakeven or maybe slightly loss-making. Can you talk a little bit about sort of what was going on in the business there? Was that sort of the earlier impacts of COVID related to the European piece of the transportation business? Was that related to sort of freight brokerage having a tougher March because of the spike in TL rates? Can you just give us some color on sort of that piece of the business and maybe how that kind of could be trending as an earlier indicator of recovery in 2Q?

Answer – Matthew Jeremy Fassler: Sure, Chris. It's Matt. Three points to talk about there. First of all, the only place we really felt the impact of COVID early in Q1 in the U.S. was in intermodal, and that business was impacted by the flow of freight from China, which, as you know, slowed down with the moderation in the pace of Chinese manufacturing as that country felt the early impact of COVID. So we had slower quarter in intermodal throughout. Again, that was the only place in the U.S. we really saw prior to early March. So that had an impact on that line.

The second item to think about is within freight brokerage. Obviously, the entire industry has been -- was experiencing lower net revenue margins year-over-year. That was a function primarily of the -- of contractual rates continuing to come down and the spot market stabilized. As we indicated, that margin dynamic did improve in April, but that's the reality that we saw in Q1.

And third, as we discussed, we did see a slowing in Europe early to mid-March kind of country by country, Spain and France being most significant for our transportation business among the countries that showed slowing earlier in the month, and that also weighed on results for that line item.

We look at this on an EBITDA basis and the numbers on an EBITDA basis were solidly positive in each of those business units and for that segment of transportation as a whole. But those are the 3 items that would have moved transportation ex LTL in Q1.

Answer – Christian F. Wetherbee: Okay. Okay. That's helpful. I appreciate that. And then maybe sort of a bigger picture question about free cash flow and leverage. So Brad, I know you've talked about several hundreds of millions of dollars of free cash flow generation this year. When you think about sort of the impacts of the business in terms of an EBITDA perspective, relative to the free cash generation, can you give us some parameters, maybe a little bit more specificity around free cash flow? And do you think you can delever through 2020? Would that be an initiative for you guys?

Answer – Bradley S. Jacobs: Well, free cash flow -- we'll generate hundreds of millions of dollars of free cash flow. We can't be more specific than that because we don't know. We don't know how the pandemic is going to play out. We don't know if Europe, even though it's coming back really fast and really sharply, whether that will continue on that trajectory. We don't know if the United States, which has bottomed -- from our perspective, we see volumes bottomed, we see a lot of things stabilized, but we don't see it getting better yet. So we don't know how fast it's going to get better and how much it's going to get better. So there are still a lot of imponderables here that we really don't know. In our models, in all scenarios, we should be generating hundreds of million dollars of free cash flow, though.

In terms of leverage, we have the same parameters. We've always felt that 3 to 4x leverage is the right amount of leverage to not put the company at risk, but to improve the returns for the common shareholders. In this environment, there are some of our shareholders who would like us to shoot for a lower leverage target. Maybe we will, we'll revisit that at the Board.

In terms of the ability to deleverage, I think we will generate substantial free cash flow, but we don't have a firm handle on exactly what the EBITDA will be. So we don't know what the multiple will be on that.

Answer – Christian F. Wetherbee: Okay. Okay. That's helpful. And maybe just one quick one here, Brad, while I have you. You obviously stopped the strategic alternative exploration mid-quarter, which was understandable given the circumstances that we're in here. Can you talk just a little bit sort of how you think about the relative value of the business? Is that still something that is stable once we get passed this? Just trying to get a sense of sort of conceptually how you think about the business as it stands right now from a valuation standpoint.

Answer – Bradley S. Jacobs: Well, the strategic review process is completely off the table. It's yesterday's news. We're not spending a minute on it today.

In terms of the question about what do we think of the value of the company, we look at the value of the company from a long-term perspective not from what it's -- its multiple of this particular quarter or even this particular year. And we look at the cash flow generation ability over the next 5, 10 years and we discount that.

And we think by all parameters, the stock is trading at significant discount to its intrinsic value. But all we can do is focus on everything we can to improve the quality of the company, keep our people safe, maximize the revenue and the EBITDA and free cash flow, and we think the multiple will take care of itself in due course.

Answer – Operator: Our next question comes from the line of Amit Mehrotra with Deutsche Bank.

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

Question – Amit Singh Mehrotra: Brad, there's really no history in terms of how XPO's earnings profile trends in a recession. You had a recession, kind of industrial recession, in '15 and '16, but of course, you were still building the company at that point. So in that context, I mean, I know you said 23% of the costs are fixed, which obviously implies that type of operating leverage in the business. Of course, it doesn't really work that way in the real world. It's not linear.

So I was just hoping maybe you or David or Matt or anybody could just help us really think about a hypothetical scenario. Maybe that's kind of the better way to think about it. If we saw a 10% decline in the revenues of the company, how should that translate to EBITDA declines given the variability in the cost structure as well as kind of the nonvolume cost opportunity? Any color there, I think, would be really helpful.

Answer – Matthew Jeremy Fassler: So 2 points to make on that. Number one, as we have built our detailed models based on our current experience, revenue trends and what we're seeing in the business, that 77% variable, 23% fixed cost mix is the right way to think about the business and will likely take you to the proper outcomes for what earnings will look like under different revenue scenarios. Of course, we're working on our cost structure. We're attacking our cost structure. We're looking to take out, obviously, variable costs and that is happening. We're also looking to take fixed cost out of the business. But that formula that we've used historically is withstanding the test of reality, and is the appropriate prism to think about as you build your model out for the current quarter.

On top of that, obviously, consider the pains that we're taking to care for our people and the costs associated with that. Obviously, we hope and expect that that is a transient cost and that, that does not repeat. That will be a function of the progress of the pandemic and we're hoping that, that passes quickly.

Consider 2 other things. One, this is a shutdown. This is not a slowdown. We've spoken in the past about what recessions would look like. There are customers and segments of industries that have shuttered their facilities for periods of time. That's unusual. And as the economy gets up and running again, we expect our business to slightly lead that and certainly move and slightly -- and certainly move in concert with that, and this is just a moment in time. And as we move past Q2, we'd expect that 77%/23% formula really to work in our favor.

Question – Amit Singh Mehrotra: Yes. And I just -- I appreciate that. That's a very clear answer, but I just wanted to follow up on the first quarter. Revenues were down over $250 million and profits were only down -- or EBITDA was only down $10 million. So that's obviously 4%. Are you saying like that number is really the good -- or a good way to think about the annual type performance this year and in all years, and maybe there's going to be some volatility around the quarters? Is that the right way to think about it?

Answer – Matthew Jeremy Fassler: Right now, the comments I made are specific to Q2. We obviously have different scenarios that we're modeling for the year, but we have the greatest visibility to Q2. Obviously, we have good visibility to April and we shared our revenues to date with you from that perspective. In thinking about how Q2 is going to play out, we're thinking about that fixed-variable cost mix as the appropriate basis for modeling. We did a good job managing the business through the volatility that we saw at the end of Q1. And yes, we generated operating leverage despite a modest revenue decline. But with the revenue declines that we're seeing in April, and it's a different order of magnitude because the world is in a very different place, you're going to see the math work out the way I discussed rather than reflective of the performance that we had in Q1, which, again, to your point, we're very proud of.

Question – Amit Singh Mehrotra: Okay. The last question very quickly for me. Can you talk about the automotive and aerospace exposure in North American logistics? I think you've got specific exposure on the 787 program for Boeing, which obviously production is getting cut in half over time. But just talk about the exposure to those 2 end markets and the impact on the North American logistics market.

Answer – Bradley S. Jacobs: Auto, we have mid-single digits of our revenue tied to auto. Auto has been way down. I mean many of our auto customers have been at 0. The good news is if you talk to Ford or Toyota or Honda, they're all opening up in the next few weeks. So they're going to go from nothing to something and we'll see how fast they ramp up and where they get up to on the peak. But it's going to be a lot better than nothing.

In terms of Boeing, Boeing is a valued customer of ours. And we do 2 things for them: we do military and we do commercial. The military part of the business is strong and stable, and the outlook is really positive. On the commercial side, there could be some lightness there. There could be some decrease. It certainly won't go down to nothing. It will go down somewhat but not way, way, way down. It will go down a little bit.

Answer – Operator: Our next question comes from the line of Scott Schneeberger with Oppenheimer & Co.

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

Question – Scott Andrew Schneeberger: In recent years, XPO has really built up a big focus on e-commerce, which seems to be accelerating in the current environment. Obviously, there's a lot of end market pressure just addressed. But could you please speak to the end markets of strength, how they're performing in April. And kind of at a total company level, what percent of the company is seeing some good relative to the bad in this environment?

Answer – Bradley S. Jacobs: Well, Scott, e-commerce saved us in April, frankly. It was our strongest performing vertical across the board. It was actually going up and most of everything else was going down. Food and beverage was also strong. But you take out e-comm, you take out food and beverage, except for a few little specifics, all other parts of transportation logistics did not perform well from the middle of March till the end of April.

It's a great business to be in right now because it's not a cyclical phenomenon, in our opinion, as much as a secular phenomenon. We expect some of these behavioral changes that have taken place during the pandemic to continue post-pandemic. We had 9% organic revenue growth in our last mile business in the first quarter, and that's a standout. And the reason is people were inside and people were ordering exercise equipment online. People were ordering DIY and lawn and garden and home improvement from their homes. People are ordering appliances and home electronics online. So that growth of online is a big -- we're a big beneficiary of that.

Of course, in Europe, we're the largest provider of e-fulfillment services for e-commerce and that's also been really positive recently.

And then if you look at reverse logistics, and we do so many different diversified things in reverse and returns management around the globe, that's also a winner that's going against the trend here, omni-channel and so forth and so on. So I think e-comm is a good place to be right now. And fortunately, we have a good exposure to it. It's not the majority of our business, though.

Question – Scott Andrew Schneeberger: Okay. And then with regard to the $700 million to $1 billion long-term profit growth plan initiative, could you just provide an update? Obviously, there's a lot of focus on cost efficiencies in this environment. So just curious what the look of that is right now and how meaningful that could be in 2020.

Answer – Bradley S. Jacobs: The 10 levers are still very much on. Obviously, we're prioritizing the health and the safety of our employees over the 10 levers, but the 10 levers are still important for the financial health of our employees. And some of the initiatives are on kind of pause, but others are full speed ahead. So the major projects and the biggest ones that are still full speed ahead are pricing algorithms because every time we get pricing right, it optimizes our bottom line because we don't lose business that we shouldn't lose and we get business that we should get and we don't leave money on the table unnecessarily. And pricing -- the pricing initiatives affect all of our business. All of our businesses involve pricing.

The other lever that is growing and it's growing in importance is automation, particularly warehouse automation. One of the things that we had to focus on and deal with in a way that no one focused on before is how do you run a warehouse with keeping 6-feet distancing, between everybody. How do you run a cross-dock facility with 6-feet distancing around everybody? In the warehouse, we're farther along on automation than we are in LTL. But even in LTL, some of the equipment over time can be automated for safety's sake, for efficiency's sake. In the warehouse, we're either the leader or one of the top 2 leaders in warehouse automation. And all of our robotics and our AI and our machine learning, it's all -- we're doubling down on that. That's something that we're still spending money on, and we feel good about spending money on that because, forget about the long term, even in the medium term, there's going to be a big return on that. Customers like it, our workers like it, frankly.

Of the other levers, the Smart workforce planning tools, labor management tools, to enhance productivity, those are also full speed ahead. I am so happy that we had Smart rolled out to the majority of our locations where we have workers prior to this pandemic because we would have never been able to manage the head count so accurately as we did. It would have been much more random. So getting the right size of the staffing, getting the right blend between full-time and part time, getting the right shift times and shift endings, Smart saved the day on that one. So that's still full speed ahead.

In LTL, we're still working on the P&D optimization. That's something that's very important. We haven't stopped on that. We're still working on the linehaul optimization. And of course, the pricing opportunity is there.

When you look at the 10 levers, most of them are driven by technology. So, our tech team is all working from home. And of course, a lot of them always work from home, that's a tech kind of thing, and they've been highly productive and highly focused at keeping progress made on these very, very important levers.

Answer – Operator: Our next question comes from the line of Ari Rosa with Bank of America.

Answer – Ariel Luis Rosa: So Brad, maybe you could talk about where you see opportunities to cut costs in this environment. Obviously, if revenues are contracting and you guys are looking to preserve some margin there, are there opportunities to cut meaningfully into whether it be SG&A cost or cost at the individual segment level?

Answer – Bradley S. Jacobs: Yes. 77% and rising of our costs are variable. The 2 biggest categories within that 77%, Ari, are labor and purchased transportation. Those are the 2 big things that we spend lots of money on, billions and billions of dollars on. On the labor, that -- we have a system that has labor go up when we have more volume and has labor go down when we don't have volume for them to do. So that is a self-regulating cost control process that's been in place for a while and we just keep improving the technology that powers that every month.

On the purchased transportation, similarly, it's fairly self-regulating because if we don't, in our transportation business, have load count, well, we don't have shipments coming in, we don't go out and purchase third-party capacity, we don't add drivers, we don't add trucks. So the model self-corrects quite a bit because of the way -- what we spend the money on.

Answer – Ariel Luis Rosa: Great. That makes a lot of sense. And then just for my second question, maybe a little bit of a silly question, but I'm curious to hear your take. If you guys still are targeting hundreds of millions of dollars of free cash flow generation even in a downside scenario, why do you guys have so much cash on hand? And what are your intentions for that cash?

Answer – Bradley S. Jacobs: Well, when the pandemic hit, it was quite a shock to everyone, including us. And the first thought that went through our mind was, well, how do we protect our people? We have 100,000 people. How do we protect our people from this terrible virus? And that took up a large percentage of our efforts. We had to learn a lot of stuff. We had to learn all about hygiene. We had to learn about social distancing. We had learn about training. We had to learn about PPE. There's lots to learn immediately, quickly. So our HR organization led that multi-disciplined effort and that became the top priority after that.

In terms of where we can allocate capital going forward, we would think about creating shareholder value by one of 4 things: paying down debt and prefunding the 2022 maturities, for example, or CapEx where we see growth. We're still investing in CapEx. We have a wonderful joint venture with Nestlé, a 15-year joint venture. It's the warehouse of the future that's going to open up in the next few months. We're still investing in that. We still have contract logistics businesses that are coming our way, either because goods came in from China and there's no demand for them, so people need storage. So we're helping many, many customers with that. Or customers who are reopening and coming back into a business and they need contract logistics help, so we're investing CapEx into that because we see a very defined and measurable and high return on those projects.

The third category we look at in terms of capital allocation would be M&A. While it's not top of mind right now, it's kind of difficult to buy a company over Zoom. It is something we think about and something we're talking about, something we're watching.

And then the fourth category of capital allocation would be share repurchases. So we want to always be looking at our stock and seeing if it makes more sense to buy back our stock or to do one of the other 3 things I just mentioned.

All of these big things require capital. And the survival of the company was the thing that we thought about in the same breath as the survival of our employees. And from a financial perspective, we wanted to load up on cash. It's hard to be -- it's hard to go broke when you have $2.5 billion of liquidity, let's put it like that. So we had over $1 billion of liquidity at the end of the quarter, and we went out and we raised a high-yield bond offering and we did a couple of transactions with some banks. And now we've got $2 billion of cash in the bank and we have $500 million of availability on various lines.

So we have $2.5 billion of liquidity and we're cash flow positive. So I feel that we've, from a financial perspective, done our duty to protect the company from another surprise, which could happen. We don't know if the virus is going to come back. We don't know if there's going to be a W. We don't know that. So I feel we're protected by having $2.5 billion of liquidity and it gives us flexibility and options and also gives us protection.

Answer – Ariel Luis Rosa: Sure. So that makes a lot of sense. And just a quick follow-on. In this environment, would you consider share repurchases or -- and if not, what would you have to see that would get you comfortable with going back to resuming share repurchases?

Answer – Bradley S. Jacobs: Well, we've got about $500 million left on the repurchase program authorization, but it's not the only application of capital and we'll have to be more disciplined -- even more disciplined than we always have been on stock buybacks because there's more risk and uncertainty in the future. So it's not the highest priority for us to go buy back shares, but I don't rule it out. And we would announce that retroactively, not prospectively. So we would announce any share repurchases we did at the end of the quarter, not ahead of time.

Answer – Operator: Our next question comes from the line of Bascome Majors with Susquehanna.

Analyst: Bascome Majors, Susquehanna Financial Group, LLLP, Research Division - Research Analyst

Question – Bascome Majors: Yes. Brad, you said you're a mega-bull on XPO in 2021 and beyond. I was hoping we could flip some of the earlier questions about downside operating leverage to think about what the recovery might look like for you guys. Now how do you expect the model to perform as global freight and global economies recover?

And if organic revenue growth returns to a reasonable longer-term trend of GDP -- GDP plus modestly, what kind of operating leverage should we expect to see on EBITDA to that?

And should we see further leverage dropping from EBITDA to free cash flow? Or if some of the working capital come back and CapEx come back and to maybe mute that growth versus EBITDA?

Answer – Bradley S. Jacobs: Bascome, I think the answer to all those questions are we think the same thing we thought prior to the pandemic. And we look at 2020 as kind of a lost year for earnings growth. This is a year to stay strong, stay solid, stay safe, be well, protect our employees, protect the balance sheet, protect our relationships with customers and live to fight another day. And our base case scenario is this all works itself out over the course of this year.

In 2021, we look back at 2020 and go, whew, what a crazy year that was, but we're glad it's over with. And 2021, in that scenario that we think is the base case scenario, should look pretty much like we thought 2020 was going to look like before the pandemic happened.

So we will see operating leverage from revenue growth transferring to EBITDA, transferring to free cash flow. We will see all the cross-selling opportunities. We will see all the opportunities to get more market share because of our outsized exposure to fast-growing places in the industry like e-commerce. We will see the fruit, as we have been seeing, of the billions and billions of dollars of investment we made in technology into the warehouse automation, into our digital freight marketplace and XPO Connect, all the projects I mentioned a few minutes ago in LTL on pickup and delivery, in linehaul and so forth.

I think we'll come out of the crisis with a lower cost structure. I think that's partly because we've been rolling out our Smart labor tools and they've just been working very, very, very well. And I think it's because we just learned, as many companies have, not just in our industry, many companies, how to work differently, how to work more leanly, how to reduce travel and entertainment costs, how to reduce the time cost of all this traveling, the big cost in time, all the fatigue and getting sick and being out of the office. And so I think we're going to have a greater work-from-home population. And I think we'll figure out ways to crack the nut on making sure that everyone working from home is just as focused, just as productive as they would be if they were in the office. Now you won't be able to work from home if you work in a warehouse or if you're driving a truck. So that part of the business will look fairly the same except there'll be a little bit more automation.

Question – Bascome Majors: Brad, thank you for that comprehensive answer. If I could add one more related to that. Is anything expected to shift on the cash taxes front as we think about cash flow going forward? Or maybe any other cash flow items beyond the more obvious ones that we tend to look at?

Answer – Matthew Jeremy Fassler: Bascome, if our EBITDA and income are lower, our cash taxes will be lower as well. So as you think about cash flow more broadly, we've spoken about our CapEx coming down from the original plan. Our cash taxes are likely to be lower than our original plan. Working capital was very favorable in Q1. Working capital can be a source for the year, how it turns out for the year has a lot to do with where revenue is in the fourth quarter. If revenue is strong, it could be a use of cash; or if revenue is softer, it would more likely be a source of cash. Those are the biggest moving pieces to think about for free cash flow.

Answer – Operator: Our next question comes from the line of Allison Landry with Credit Suisse.

Answer – Allison M. Landry: So I wanted to touch on LTL, obviously a good performance on the load factor and solid deals. So if we assume Q2 is hopefully the bottom, maybe there's some at least -- some modest recovery in the back half and into next year, is the $1 billion of EBITDA in the LTL segment still attainable by 2021? Or should we sort of go back to your comment, Brad, that you just made a couple of minutes ago that 2020 is kind of a lost year for growth. And does this also kind of get pushed out a year?

Answer – Bradley S. Jacobs: The answer is, Allison, I don't know. We have to see the timing of how all this plays out. We have a very clear path of action points in LTL, which will steadily improve its margin, will -- and steadily improve EBITDA generation, will steadily improve its free cash flow generation and its returns. Timing of it, like with all our businesses, we -- it's really hard to nail it down.

I mean, LTL had a great quarter, by the way, in the first quarter. We had a record OR. It improved 420 basis points with real estate -- without real estate and 320 basis points excluding real estate, the operating income was up 32% on a year-over-year basis. I'd call that a good quarter. There were many bright spots. We had lots of new business won. The load factor was up 5.2%. Dock productivity was up 8%. So we're firing on all 8 cylinders in LTL.

The problem is the industrial economy is not open for business yet. So we've seen tonnage dramatically decrease as the whole industry has. And tonnage had gone down as much as 20%, even a little bit more than 20%, that's the bad news. The good news is it's stabilized. It hit bottom. It found a bottom. There were weeks over the last couple of months where we were seeing -- we have about 60 metrics that we watch every morning and they're color-coded and almost all of them were red week after week. It was not very pleasant to watch those metrics. They started turning yellow and they started turning green. So they're stabilizing towards forecast. We used to do bi-weekly forecast. We moved to weekly forecast. We're doing daily forecasting now, and LTL is tracking to the forecast.

So I'm very confident in the management we have in LTL. I like our position in LTL. I love the projects that we're working on. They're really cutting edge. I have great confidence in them. I do believe we'll get to $1 billion of EBITDA in LTL. Whether it's next year or the following year, it's too early to confidently predict that.

Answer – Allison M. Landry: Okay. That's totally fair. Contract logistics, I would imagine that there weren't any specific protections related to a global pandemic. But could you help us think through the contract structures and the built-in protections? Are these enough to mitigate such severe revenue and demand declines?

And then if you could remind us how the contract structures differ between Europe and North America.

Answer – Matthew Jeremy Fassler: Allison, it's Matt. We have lots of different contract structures ranging from cost-plus to fixed variable, which means there's a piece that's fixed and another portion that's volume-dependent, to purely transactional. Broadly speaking, the incrementals or decrementals that we expect to see in contract logistics in Q2 are on the better end of what we expect to see for the broader company, which is consistent with the kinds of protections that we've built into our contracts, which were not, to your point, designed explicitly for global pandemic but were designed with the intent of protecting us from the slowdown. The slowdown in some verticals and for some customers in some regions is more significant than what we would previously have contemplated because we did not contemplate the cessation of business activities in regions or sectors. So that will have an impact. But the way the model is built, very big picture, is working.

One other point. Our expectation, having spoken with the Head of our European business yesterday, is that our European contract logistics volumes are going to get back pretty close to par, not quite there, but getting closer to that by the end of Q2 and we have good visibility on recovery, almost the benchmark levels, well before the end of the year. So that is a very resilient business so long as economies and customers are up and running in some form or fashion. So that's an inkling of good news from European contract logistics.

Answer – Operator: We have reached the end of our question-and-answer session. I'd like to turn the call back over to Mr. Jacobs for any closing remarks.

Answer – Bradley S. Jacobs: Thank you, operator, and thanks, everyone, for turning into our call and we'll be seeing many of you in the upcoming conference season over video conference. We're looking forward to the time when we -- when it's safe for us to all see each other in person and to, where appropriate, shake hands or even give a hug and be back to normal.

So thank you for your support and talk to you in due course. Have a great day. Be safe.

Answer – Operator: Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.
