

XPO Logistics Inc

Highlights from a Fireside Chat with the CEO

Optimistic view on the freight cycle & XPO initiatives in 2021

On Wednesday afternoon we hosted a fireside chat with XPO's CEO Brad Jacobs and the UBS equity sales team. The discussion was upbeat in terms of both cyclical tailwinds and also traction on XPO's initiatives. We expect XPO to deliver strong performance in its LTL and brokerage divisions in 2021 and we also anticipate acceleration in the pace of operating income growth within XPO's Logistics segment. In our view, the anticipated 2H21 spin out of Logistics is also a positive catalyst for XPO stock.

Pricing + productivity support strong OR improvement in LTL

XPO provided an upbeat view on trends in their LTL business pointing to stronger pricing in December and January and the expectation of a meaningful tailwind from a cyclical upturn in the industrial economy. We are modeling 257 bp of LTL OR improvement in 2021 but setting aside a large step change in 2Q21 versus a very easy comparison, our model only assumes about 100 bp of y/y improvement in 1Q, 3Q and 4Q21 which leaves room for potential upside.

Strong brokerage momentum supported by tech investments

We believe the impressive 4Q20 growth XPO delivered in its brokerage business (net revenue +113% y/y) was driven by both investment in more people and also a clear expansion in the use of XPO's technology by shippers and carriers. While the number of trucking companies on XPO's digital platform (XPO Connect) rose in 2020, the more dramatic step up was with shippers with an increase from 1,400 on XPO's platform at year end 2019 moving up to >15,000 shippers on the platform at year end 2020. Shippers also clearly utilized API connections with XPO which supported significant growth in spot volumes in 4Q20. We expect XPO's strong brokerage momentum to continue in 1H21.

Valuation: clear strategy + leverage to the right markets => upside for XPO

XPO is trading at an EV / EBITDA multiple of 9.7x on our 2021 EBITDA forecast. We believe the combination of XPO's clear strategies within its three major business segments and leverage to what we expect to be strong LTL and brokerage markets in 2021 supports strong financial performance and upside for XPO stock in 2021. Our price target of \$142 is based on applying a sum of the parts approach using 11x and 8x EV/ EBITDA multiples for XPO's Transportation and Logistics businesses on our 2022 forecasts. We continue to rate XPO Buy.

Equities		
Americas		
Transportation Services		
12-month rating	Buy	
12m price target	US\$142.00	
Price (17 Feb 2021)	US\$119.00	
RIC: XPO.N BBG: XPO US		
Trading data and key metrics		
52-wk range	US\$126.89-40.69	
Market cap.	US\$12.1b	
Shares o/s	102m (COM)	
Free float	98%	
Avg. daily volume ('000)	275	
Avg. daily value (m)	US\$32.2	
Common s/h equity(12/21E)	US\$3.21b	
P/BV(12/21E)	4.2x	
Net debt to EBITDA(12/21E)	3.6x	
EPS (UBS, diluted) (US\$)		
	12/21E	
	UBS	
	Cons.	
Q1E	1.03	0.97
Q2E	1.30	1.37
Q3E	1.63	1.52
Q4E	1.43	1.48
12/21E	5.43	5.35
12/22E	6.39	6.22
12/23E	7.15	6.90

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Highlights(US\$m)	12/18	12/19	12/20	12/21E	12/22E	12/23E	12/24E	12/25E
Revenues	17,279	16,648	16,252	18,282	19,314	20,194	21,027	21,464
EBIT (UBS)	704	821	391	907	1,040	1,121	1,168	1,123
Net earnings (UBS)	431	427	205	611	719	804	852	830
EPS (UBS, diluted) (US\$)	-	4.03	2.01	5.43	6.39	7.15	7.57	7.38
DPS (net) (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	(3,808)	(7,174)	(6,929)	(6,211)	(5,431)	(4,516)	(3,545)	(2,561)
Profitability/valuation	12/18	12/19	12/20	12/21E	12/22E	12/23E	12/24E	12/25E
EBIT (UBS) margin %	4.1	4.9	2.4	5.0	5.4	5.5	5.6	5.2
ROIC (EBIT) %	-	8.2	3.9	9.4	10.9	12.0	12.8	12.7
EV/EBITDA (UBS core) x	-	7.7	13.1	11.1	9.6	8.6	7.8	7.5
P/E (UBS, diluted) x	-	16.2	41.7	22.6	19.2	17.2	16.2	16.6
Equity FCF (UBS) yield %	-	6.1	5.2	5.9	6.4	7.5	8.0	8.1
Dividend yield (net) %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US\$ 119.00 on 17-Feb-2021

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FIRESIDE CHAT PROVIDES AN UPBEAT 2021 FRAMEWORK FOR XPO

On Wednesday afternoon we hosted a fireside chat with XPO's Chairman and CEO Brad Jacobs for the UBS equity salesforce. The conversation was upbeat as Mr. Jacobs provided the framework of a cyclical upturn in freight plus company specific drivers of improvement which support a strong outlook for 2021. We expect pricing gains and margin expansion in XPO's LTL business and strong top line growth in its brokerage business to support attractive EBITDA growth in 2021. In addition, with roughly two thirds of their Logistics business as closed book type of contracts, we expect XPO to deliver modest margin improvement in its Logistics business against a backdrop of growing revenue. XPO remains on track to spin out its Logistics business in 2H21 which we also view as a catalyst for XPO stock.

Technology Investments Are Supporting Strong Growth in XPO's Brokerage Business

XPO has delivered industry leading revenue growth in its truck brokerage business in both 3Q and 4Q20 which was supported by both headcount addition and also increased customer use of XPO's technology. In the following table we show gross and net revenue growth for XPO and four other public transport companies with large truck brokerage businesses. XPO's 3Q20 gross revenue growth of 27% and its net revenue growth of 15.4% y/y were strong and better than the competitive set. In 4Q, XPO's growth accelerated sharply to 75.5% gross revenue growth and its net revenue growth was even more impressive at 113% compared to 59% at JBHT, 28% at ECHO and only 1.6% at CHRW. XPO grew its brokerage headcount 20% in 4Q and expanded use of XPO's technology also supported growth. From 3Q to 4Q the number of API transactions doubled which supported XPO's spot market growth while the number of shippers using XPO Connect rose from 1,400 at year end 2019 to over 15,000 shippers on the platform at year end 2020. We expect XPO to continue delivering strong revenue growth in 1H21 against a supportive backdrop of strong freight demand and tight truckload capacity. We also believe that recent disruption to the freight transport market from severe winter storms may further boost the need for shippers to use brokers in the near term.

On a longer term perspective XPO offered the perspective that a group of the largest brokers (perhaps the top 10) could continue to grow as they have the combination of scale and resources to continue investing aggressively in technology. XPO also did not believe that the small brokers would go away in the medium term.

Figure 1: XPO Truck Brokerage performance vs. Industry

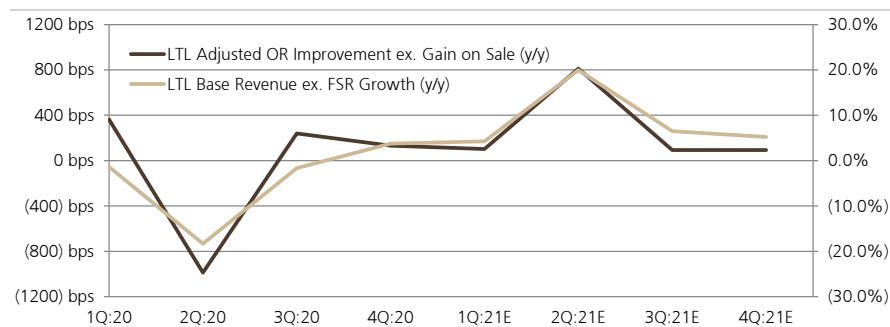
	3Q20	3Q20	4Q20	4Q20
	Gross Rev. (y/y)	Net Rev. (y/y)	Gross Rev. (y/y)	Net Rev. (y/y)
XPO	26.8%	15.4%	75.5%	113.0%
CHRW NAST	3.5%	(15.2%)	10.8%	1.6%
JBHT Brokerage	28.0%	(23.4%)	56.0%	58.9%
SNDR Brokerage	20.5%	n.a.	64.4%	n.a.
ECHO	23.2%	3.5%	41.9%	28.0%

Source : Company information, UBS analysis

Stronger Revenue Growth Supports OR Improvement in 2021

We expect a backdrop of improving revenue growth to support OR improvement for XPO in 2021. In the following chart we show XPO's y/y base revenue growth (ex fuel surcharge) and the y/y change in its adjusted Operating Ratio ex gain on sale. The chart clearly shows the large decline in revenue and OR deterioration that took place in 2Q20. This provides a very easy comparison for XPO in 2Q21 and we expect 20% type of revenue growth and ~800 bp of OR improvement in 2Q21. The ~100 bp of OR improvement we are modeling in 1Q, 3Q and 4Q21 allows plenty of room for upside performance from XPO in our view. Clearly improvement in pricing is a key lever for OR improvement while labor productivity is also a contributing factor. The combination of a cyclical lift in the industrial economy and an already tight LTL market should support rising pricing in 2021 and XPO indicated it has realized stronger pricing in December and January compared to the full 4Q20 increase of 1.5% in revenue / hundredweight ex fuel.

Figure 2: XPO LTL Base Revenue ex. FSR vs. OR Improvement



Source : Company information, UBS analysis

Key Model Assumptions

The following table shows our key model assumptions for 1Q21, 2021 and 2022 in LTL, Freight Brokerage and Logistics. We are forecasting 6.5% tonnage growth and 257 bp of OR improvement in 2021 in XPO's LTL business. In freight brokerage we are modeling 18% revenue growth and in Logistics we forecast strong 24% growth in Europe gross revenue and more modest 4.4% growth in North American Logistics. The acquisition of Kuehne + Nagel's UK Logistics business contributes about 16 pp to the Europe Logistics revenue growth in 2021.

Figure 3: UBS Key Model Assumptions

	1Q21E	2021E	2022E
North America LTL			
Shipments, y/y	1.0%	4.2%	1.0%
Tonnage, y/y	3.0%	6.5%	2.0%
Revenue per Hundredweight (Excl. Fuel), y/y	2.5%	3.1%	4.0%
Oper. Ratio	84.5%	83.7%	82.1%
Oper. Ratio, y/y	125 bps	257 bps	157 bps
Adj. Oper. Ratio (Excl. Gain on Sale)	83.4%	82.9%	81.4%
Adj. Oper. Ratio (Excl. Gain on Sale), y/y	103 bps	256 bps	158 bps
North America Freight Brokerage			
Revenue, y/y	25.0%	17.9%	8.0%
Transportation Segment			
Adjusted EBITDA	313.3	1,364.4	1,499.5
Adjusted EBITDA w/ Corporate Allocation	280.3	1,237.1	1,357.2
Logistics Segment			
N.A. Gross Revenue, y/y	3.0%	4.4%	4.0%
Europe Gross Revenue, y/y	12.0%	23.8%	5.0%
Oper. Mgn.	2.7%	3.8%	4.4%
Adjusted EBITDA	126.1	629.8	706.8
Adjusted EBITDA w/ Corporate Allocation	105.0	548.3	617.1

Source : UBS estimates

Forecast returns

Forecast price appreciation	+19.3%
Forecast dividend yield	0.0%
Forecast stock return	+19.3%
Market return assumption	5.1%
Forecast excess return	+14.2%

Company Description

XPO Logistics, Inc. is a top 10 global provider of supply chain solutions. XPO's Transportation segment (~64% of consolidated revenue) includes its services for truck brokerage and truckload; less-than-truckload (~44% of segment revenue); last mile; intermodal and drayage; expedite; managed transportation; and global forwarding. XPO offers these services in North America and Europe, except for intermodal/drayage, which is strictly North America., and truckload, which is in Europe. With its Logistics segment XPO is the second-largest global provider of contract logistics based on facility space.

Valuation Method and Risk Statement

Our price target is based on a multiple of EBITDA.

A softer freight market in 2021 and weaker than expected pricing could cause downside risk to our EPS estimates and price target for XPO. More than expected capacity addition in less-than-truckload industry in 2021 could also be a risk to XPO's pricing and performance in 2021. Inability to grow its fleet due to the tight driver market is a source of risk to our revenue growth assumptions. Less growth in its brokerage business due to competitive pressures is a risk to our revenue growth forecast. There is also execution risk associated with XPO's planned spinoff of its Logistics business. Given the lack of clear comps for XPO's logistics business, it is less clear where this business will trade after the spin-off expected in 2H21 and stand-alone valuation could be lower than anticipated.

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Buy	FSR is > 6% above the MRA.	51%	31%
Neutral	FSR is between -6% and 6% of the MRA.	37%	29%
Sell	FSR is > 6% below the MRA.	12%	18%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 2020.

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Company Disclosures

Company Name	Reuters	12-month rating	Price	Price date
XPO Logistics Inc ¹⁶	XPO.N	Buy	US\$119.00	17 Feb 2021

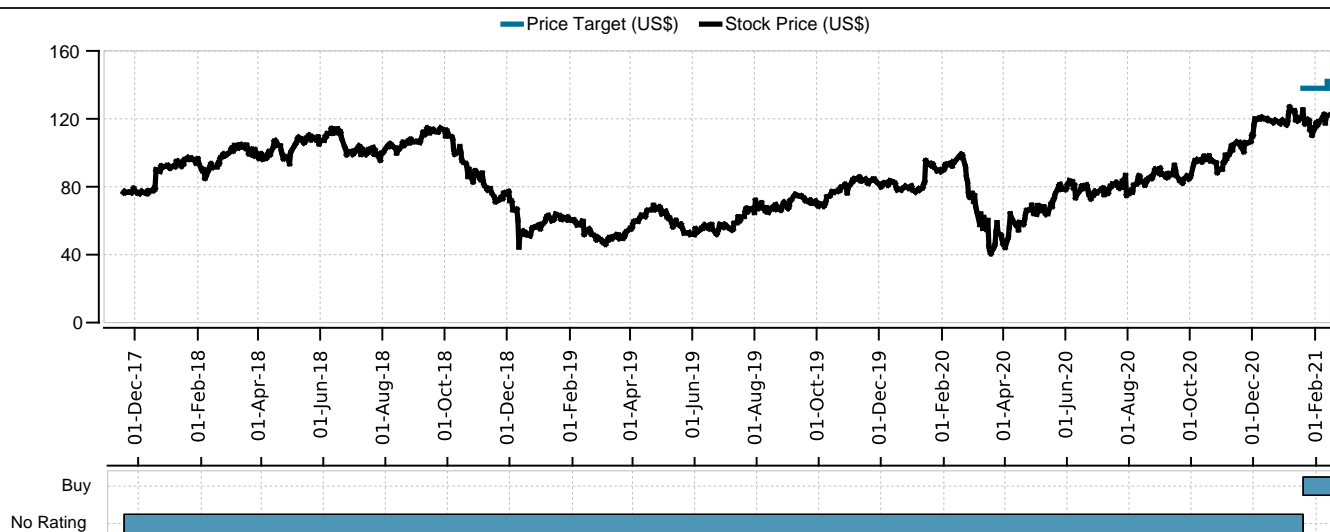
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XPO Logistics Inc (US\$)



Date	Stock Price (US\$)	Price Target (US\$)	Rating
2017-11-17	74.67	-	No Rating
2021-01-19	121.07	138.00	Buy
2021-02-12	121.31	142.00	Buy

Source: UBS; as of 17-Feb-2021

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