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EDITED TRANSCRIPT

XPO - Q4 2018 XPO Logistics Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 15, 2019 / 1:30PM GMT

OVERVIEW:

Co. reported 4Q18 results.

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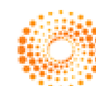

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PRESENTATION

Operator

Welcome to the XPO Logistics Fourth Quarter 2018 Earnings Conference Call and Webcast. My name is Melissa, 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 make certain forward-looking statements within the meaning of applicable securities 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.

The forward-looking statements in the company's earnings release or made on this call are made only as of today, and the company has no obligation to update any of these forward-looking statements, except to the extent required by law.

During this call, the company may also refer to certain non-GAAP financial measures as defined under applicable SEC rules. Reconciliations of such non-GAAP financial measures to the most comparable GAAP measures are contained in the company's earnings release and in the related financial tables. You can find a copy of the company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures in the Investors section 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, and good morning, everyone. Thanks for joining our call. With me in Greenwich are Matt Fassler, our Chief Strategy Officer; and Tavio Headley, Senior Director of Investor Relations.

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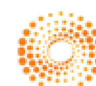

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Well, look, there's no other way to say it, we missed the quarter. We miscalculated the weakness in France and the U.K. And in December, our largest customer pulled back their postal injection business, which is part of last mile. That affected our EBITDA in December. This had a significant impact in December and in the quarter.

That said, we delivered record full growth profitability. We generated organic revenue growth of 9.3%, and we grew our adjusted EBITDA faster than revenue at 14.3%.

In the fourth quarter, in our logistics segment, we realized organic revenue growth of 12.4%, driven by our technology. A few years ago, before we developed our own warehouse management system, it wouldn't have been possible to implement 100 logistics start-ups to 1 year. In 2018, we completed a record 118 start-ups, up from 91 in 2017.

In our North American less-than-truckload business, we improved our adjusted operating ratio by another 260 basis points to 87.3%. That's our best fourth quarter ratio in over 30 years.

In December, our XPO Direct network reached critical mass for very large customers with national distribution needs. We've grown XPO Direct to more than 90 facilities now. We have a backlog of blue-chip customers hungry to get access to the variable cost solutions we offer: contract logistics, last mile, labor, technology, transportation and the storage capabilities of XPO Direct.

Also in December, our board authorized $1 billion stock buyback, which we completed earlier this month. As we announced yesterday, the board has authorized an additional buyback of up to $1.5 billion. While we love M&A, the acquisition that will create the most shareholder value right now is acquiring our stock.

As you saw in the release, we brought down the numbers for 2019. We can't ignore the fact that our largest customer is curtailing about 2/3rds of its business with us. We had substantial capacity dedicated to this customer in brokerage, last mile and logistics. But we believe the great bulk of these resources should be redeployed over the next couple of quarters.

And then there's the macro in Europe, not great. On the bright side, we have a new strategic account organization in Europe. That's very good at getting our message across to large customers with complex supply chains. And to some degree, this may help with volatility.

We have a number of other tailwinds working for us in 2019 and many of them are substantial. There's a high demand for our e-commerce services, and we expect full-year benefits from the record number of logistics projects we started out through 2018. Also, there's the expansion of our last mile hubs and our LTL pricing technology, which we can get into more in our Q&A.

Finally, I'd like to tip my hat to our 100,000 employees. They've created a culture that has led to Fortune magazine naming us as one of the World's Most Admired Companies for the second year in a row and the Most Admired Company in our category.

We are also honored that we were voted the third-best place to work in the U.K. in a survey taken by Glassdoor. We have 22,000 employees in the U.K., and I appreciate their enthusiasm and we share that enthusiasm.

We have a firm handle on 2019, plenty to be excited about and are -- and I'm confident in our ability to create significant shareholder value.

With that, I'll ask Matt to review the numbers in more detail. Matt's been done a fantastic add to the team. I hope you enjoy working with him as much as I do. Matt?

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

Thanks, Brad. I'm delighted to be on the team. XPO is an amazing organization. And to those on the call, I look forward to meeting many of you in the weeks and months ahead.

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Now I'll walk you through the numbers, the backdrop and our strategic focus by business unit. Starting with our transportation segment. We grew revenue in the quarter by 1.8% to $2.8 billion. GAAP operating income declined by 19%, inclusive of a number of charges. Adjusted EBITDA from transportation grew by 3% to $272 million. While our revenue growth moderated, we were disciplined with costs and expanded our adjusted EBITDA margin for the quarter as we did for the year.

In North American LTL, our tonnage declined 1.1%, moderating from a 1.5% decline in Q3 as we continued to target more profitable freight. Revenue per hundredweight excluding fuel rose 1.1%, reflecting pricing initiatives, higher rate per shipment and shorter length of haul. We also achieved a 4.9% rate increase with contract renewals. We're leveraging our labor more efficiently and improving our claims performance, both of which are contributing to better profitability in LTL.

Turning to freight brokerage. Our technology helped us navigate mixed market conditions in the quarter. Our net revenue increased 6.2%, despite a 3.3% decline in gross revenue. Within freight brokerage, truck brokerage revenue was down a bit more. We're continuing to deploy technology across our brokerage business.

In XPO Connect, our digital freight marketplace, we now have more than 14,000 carriers registered. And we've more than doubled the number of digital bids submitted by drivers seeking loads. We've also grown the number of transactions booked through XPO Connect by more than 4x compared to Q3, and we've increased the conversion of digital bids by a factor of 3. We attribute much of the success to our counteroffer feature, which negotiates automatically based on real-life market conditions. This has led to better gross margins.

In Intermodal, our fourth-quarter revenue increased in the low double digits year-over-year. The peak season was strong. Pricing in Intermodal has recently become more subdued as the truck market loosens. But keep in mind that with our multimodal footprint, we're poised to move with the market and capitalize on transportation volume of any kind.

With last mile, our revenue tracked flat year-over-year and net revenue declined by $10 million or 13%. For context, the largest part of our last mile business is heavy goods delivered directly to consumers on behalf of major retailers and consumer brands. This is our core last mile business, and we are the undisputed leader in North America. This core business is performing well, and we're continuing to win new contracts for dedicated service, which is supported by our national network. We have 85 last mile hubs in North America, and we're excited to have that capacity for growth. A smaller part of last mile for us is direct injection of freight into the postal system. While we welcome this business, it has lower barriers to entry and it's less differentiated than heavy goods. We had a major impact to the fourth quarter when our largest customer decided to curtail its postal injection. We'll be cycling through this in 2019.

Our European transportation business generated revenue growth of 6.1% in the quarter, which, on an organic basis, equates to 4.5% growth. This was slower than our third-quarter trend and it weighed in EBITDA.

In France, where we have our largest European presence, the yellow vest disruption, so to speak, put a damper on LTL, brokerage and dedicated truckload.

Turning to our other segment, the growth story in logistics remains terrific. Segment revenue was up 10% globally in the quarter and 12% on an organic basis. Operating income was $42 million and adjusted EBITDA was $127 million, up 11% from Q4 of the prior year.

In North America, our revenue growth in logistics reflects ongoing strength in consumer packaged goods, food and beverage and e-commerce. In Europe, revenue grew 6%, higher organically, with the main tailwind coming from e-commerce.

Through 2018, we averaged more than 1 customer start-up per week in each of the U.S. and Europe. Now in 2019, we have a robust logistics pipeline of active bids and good long-term visibility. We expect some moderation in the pace of new logistics start-ups coming off an exceptionally strong year. The uncertainty in Europe could be a factor, but the segment overall is definitively in secular growth mode.

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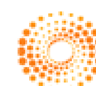

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Company-wide, cash flow from operations in the quarter was $566 million and free cash flow was $479 million. For the full year, we generated cash flow from operations of $1.1 billion and free cash flow of $694 million, which was substantially above target. Our net CapEx was $408 million. This included growth CapEx of $551 million and asset sales of $143 million.

I want to mention the fourth-quarter restructuring charge we reported. It was $19 million or $14 million after taxes. This was largely for severance costs. We expect to realize annualized savings of about $55 million.

Before I wrap up, I'll spend a minute on working capital management. This was brought up on the third quarter call as a focus for the company going forward. In the fourth quarter, we did a good job of controlling our working capital through 2 initiatives. The first is factoring. Our use of factoring become more significant in Q4, and I want to provide you with some insights. The majority of our factoring relates to large customers in our contract logistics business. Most of these customers require extended payment terms. At the same time, our logistics business is growing fast, which uses more working capital. So factoring is a good strategy here. It's also a low-cost source of funding for us. In most cases, our cost ranges from LIBOR plus 70 to LIBOR plus 110 basis points. The incremental year-over-year benefit for our free cash flow from factoring was about $200 million.

The second initiative is collections. This has been a big focus of our working capital management. With progress on speeding up collections in Q4, we outperformed our own expectations for operating cash flow and free cash flow.

For 2019, we're guiding to adjusted EBITDA of $1.65 billion to $1.725 billion, which represents 6% to 10% growth. This range reflects the fact that we'll be managing through the significant reduction in business from our largest customer beyond postal injection. And we're also taking a more cautious view of Europe. We do think we'll see increasing benefits from our internal growth initiatives in the back half of the year.

For the full year, we're expecting free cash flow in the range of $525 million to $625 million. This compares to the $650 million target we shared with you in December. It reflects the lower growth rate we expect for adjusted EBITDA and the higher interest expense we expect from funding our new share repurchase program.

We anticipate net CapEx of $400 million to $450 million and D&A of $765 million to $785 million. We're planning cash interest expense of $275 million to $315 million. And we're using a tax rate of 26% to 29%, with cash taxes in the range of $165 million to $190 million. We expect to be users of free cash in the first quarter, with free cash flow building over the course of the year, consistent with our typical seasonality.

So in summary, 2018 was a strong year of growth and profitability, ending on a down note that will impact part of 2019, but we are focused on growth. There are many opportunities for us across the marketplace. We have a broad range of integrated solutions for customers, leading positions in fast-growing areas of the industry and a strong track record as an innovator.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jack Atkins with Stephens, Inc.

Jack Lawrence Atkins - *Stephens Inc., Research Division - MD and Airline, Airfreight & Logistics Analyst*

So Brad, I guess, the first one is on the receivable factoring. And I appreciate the additional commentary there. But I can't think of another transportation logistics company that does that. And does that -- I guess, can you kind of help us think through why you're choosing to do that now versus in prior years? And I guess, when we see other companies do that it's really to manage around liquidity challenges and is that the case here with XPO?

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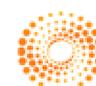

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Matthew Jeremy Fassler - *XPO Logistics, Inc. - Chief Strategy Officer*

Sure. Jack, it's Matt. I'm happy to take that question. Most of our factoring, the majority of our factoring is associated with our contract logistics business. And we believe that factoring is fairly common around -- among our contract logistics peers. And our customers, oftentimes, have facilities in place with money center banks that are accustomed to working on factoring transactions with them. We have ample liquidity, as evidenced by our buyback and our ability to fund capital allocation at our discretion.

Jack Lawrence Atkins - *Stephens Inc., Research Division - MD and Airline, Airfreight & Logistics Analyst*

Okay. Thank you for that color, Matt, and then, I guess, the second question, Brad, for you, bigger picture question. But the message from yourself and XPO senior leaders during 2018 was that this company was investing for the future, taking excess profits and reinvesting them so that you could drive sustainable double-digit or midteens EBITDA growth, really, regardless of what the cycle is doing. That's why you guys told folks to expect -- not to expect a big surge in profits in 2018 despite an extremely strong freight cycle. We have seen a significant reduction in your EBITDA outlook over the last 3 months. How do you explain the step function change in your growth outlook when you guys were supposed to be a secular growth story?

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

Fair question, Jack. So several quarters ago, I was asked if the macro stays the same as it is, what would we grew at? And I said 15% to 18%, which is the level we were growing at. That's on the EBITDA level. If we have the same macro now as we had a year ago, we would still be growing at that level. We don't. The macro softened. When we saw that softening, particularly in France and the U.K., where we have a quarter of our business, we brought down guidance. We brought down guidance when we saw that 15% to 18% was not there because the macro was deteriorating for the geographies that we have business in. And we brought it down to 12% to 15%. We had another significant development when our largest customer pulled back at least 2/3 of their business and that's just a big development. And there's no way that you can't bring guidance down when you lose $600 million of revenue on very short notice. I'm optimistic that we will get that business back from other customers. We've got strong, strong people in place, technology in place, access to capacity, we give excellent service, we gave excellent service to that customer. We will -- we turned done business from other customers because we had limited resources. We are going to redeploy those resources over the next couple of quarters, and I believe that they'll be utilized in the second half of the year.

Operator

Our next question comes from the line of Ariel Rosa with Bank of America Merrill Lynch.

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

So I wanted to start talking about customer concentration. One of the things that I think XPO has touted as one of its strengths is that it's not overly focused on any particular customer. But here, we've seen kind of 2 quarters in a row where some disappointing news from a particular customer has really put a real dent in results. And I want to talk about -- I kind of want to get your thoughts on the extent to which maybe that perception is changing or how you manage your customer base maybe has shifted? Or should investors be thinking about customer concentration differently from how they would have maybe 6 months ago?

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

Well, in 2018, our top 5 customers represented about 11% of revenue, and you saw that in the K. The largest customer, however, represented roughly about 4%, 5% of that. 2/3 of that business has gone away, so that's a body blow, no question about it. Going forward, with that customer having downsized, we anticipate that our top 5 customers in 2019 will represent about 8% of revenue. So customer concentration will be less. But

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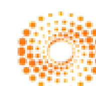

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when you lose your -- when you lose the majority of your top customer's business, that hurts. Nothing you can do -- there's nothing positive. It's only negative. You mentioned also the House of Fraser write-off in the third quarter. I don't view that as anywhere near as significant as losing $600 million of business from our top customer. That was a bankruptcy. Cost us $16 million. We did not take it as an add back. We deducted it from earnings. And that's -- that was a miss. But $16 million of a miss when the full year is over $1.5 billion. I don't view that as a big significant thing. I view the loss of $600 million of revenue as a significant thing that we will rebound from in the second half of this year.

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

Okay. Great. That's helpful color. And then just on my second question. I wanted to see if you can talk, Brad, maybe about how you see XPO's technology differentiation as a point that maybe puts it apart from peers? Obviously, you guys talk a lot about your IT capabilities. With this customer stepping away, obviously, they feel that they can replicate that. I'm wondering if that's a risk that is present with other customers or do you feel that your moat is still sufficient to make the business fairly defensible against this kind of thing recurring going forward? And then maybe just really quickly if I could tag on a side note to that question. Maybe you can talk about the margin impact that we'll see from the departure of this customer.

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

On tech, I view what we do in tech extremely positively. We spent about $500 million in tech in '18. We'll spend $550 million in tech this year. And we go over the ROIs of every tech investment that we have very carefully. And if we wanted to, we would have a lot more opportunities to deploy in tech. But what I like about our technology innovations are things like our labor productivity tools. When a company has as many billions and billions of dollars of labor costs as we do, managing labor productivity in terms of rightsizing the headcount in terms of managing overtime, not too much, not too little, has a big impact. And the labor productivity tools that we rolled out last year in contract logistics improved our productivity between 2% and 5%, and we are transferring those over to LTL and have a big employee base there too. So in addition to labor productivity tools, we rolled out new inventory management tools in contract logistics last year. Again, helps us further differentiate ourselves from our competitors. Continued traction with XPO Connect continues. We've got 14,000 carriers sign ups to date. So the trajectory there has been very, very fast. And we have a whole bunch of LTL technology that rolled out over the course of 2018, from dynamic route optimization to advanced pricing algorithms, to AI-based load building to linehaul bypass models and many other features. And if you look at the company in every country in every line of business, automation, automation, automation is a key, key focus. We have thousands and thousands of robots that just we keep rolling out, particularly in contract logistics. In the back office, robotic process automation is having a real positive effect in many places of our organization. So I think our technology is very strong and gives us an extremely competitive moat. It's one of the main reasons that customers choose us. Yes, we've lost 2/3rds of our largest customer, but we have 50,000 other customers. And we feel very strong about the technology we bring to bear. More importantly, our customers feel very strongly and they value the technology.

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

Okay. Great. And then just really quickly, the margin impact?

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

Yes. So -- it's Matt, I'll take that. So you should think about that margin flowing through it because you have to think about contribution margin. When we lose that business, that business erodes, we don't necessarily lose the corporate expenses associated with that, not right away. So think about that flowing through. It's slightly higher than company average EBITDA margin. Now obviously, we have steps in place to defray that impact. That would be more evident in the second half of the year, so it's not a lot to the business based on everything we've told you. We're doing what we can do to keep the EBITDA margin flattish -- the adjusted EBITDA margin flattish in the first part of the year. And then you would expect to see, certainly embedded in our plan, some adjusted EBITDA margin expansion in the second half of the year. Some of that's associated with cycling House of Fraser in Q3, cycling the particularly painful impact of the direct postal injection business in Q4. But it's also the general recovery we expect as we redeploy some of that capacity in the second half of the year.

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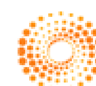

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Operator

Our next question comes from the line of Chris Wetherbee with Citi.

Unidentified Analyst

It's James on for Chris. I wanted to ask about organic growth. Where do you expect the lion's share of that to come from? And what might the cadence of it be?

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

What was the second part of your question, the cadence of organic growth?

Unidentified Analyst

Correct.

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

Sure. The organic growth this year should be more weighted to supply chain. It's where we have the highest visibility due to the contractual nature of the business and the new start-ups that we spoke about over the course of 2018. The majority of the business that we're losing with our largest customer is going to come in the transport segment. So that's where you're going to see more pressure on organic growth. As you think about rules of thumb, based on what we know this year, looking at FX, looking at fuel, there is a point to a point plus of difference between organic growth and reported revenue growth on a full-year basis. That difference is bigger in the first part of the year, which is a function of the strength in the dollar. And that gap should narrow as you make your way through the year.

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

I'll add on to that. If you look at 2018, supply chain, contract logistics was a juggernaut. It definitely remains in secular growth mode, and we remain in taking market share mode. The -- in Q4, globally, our logistics organic revenue growth was up 12.4%. And we've been averaging more than 2 start-ups a week. And we did a record number of 118 start-ups in contract logistics in 2018, including 28 in the fourth quarter. So all those 118 contract logistics start-ups that we layered in throughout 2018, we'll get the full-year contribution of those here in 2019.

Unidentified Analyst

And then focusing a little bit more on Europe, should we expect that to grow? Or do you -- should we see net revenues in decline across 2019?

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

Well, in order to answer that question, you got to figure out what your assumption is for Brexit and for France. So in U.K., if there's a hard exit, that's going to be a negative. If there's a soft Brexit, that's going to be a positive. If there's an extension of Brexit and they just both agree to keep negotiating for a longer period of time, that -- I would give that a neutral. Obviously, if they change their whole position and it becomes remain and they say forget about Brexit, that'd be extremely positive. But from our perspective, in our numbers, we've baked in status quo. And that would change the positive to negative, depending on where Brexit ends up. In France, we're also assuming the status quo in the guidance we've given. France, Troy was in France, representing us with President Macron's annual event with business leaders. And the tone was a lot different than it was a year ago.

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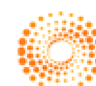

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A year ago, everyone was bragging about their new commitments, their new expansions and openings and CapEx. And this year, it was quite subdued. We are assuming that the yellow jacket events keep continuing. That it doesn't go into a recession, but doesn't go 2%, 3% GDP positive. That the level of malaise, to use a French word, in France continues just the way it is right now. Obviously, if you went into positive GDP in a significant way, that would be a positive. If it went into recession, that would be a negative. Now, we are taking actions in all these situations. There's things we can control, there's things we can't control. But even the things we don't control, we can react to those, and we can position ourselves for the best outcome in regards to eventuality. So in France, we've added 2 fantastic executives, Jean-Emmanuel Mongnot and Bernard Wehbe, who were with us here in Greenwich for a week -- a few weeks ago. I'm just very, very impressed with them. And they have replaced and upgraded about 2/3 of their middle management teams. So it's a strong morale. It's a strong group. Obviously, we're focused on cost control when there's not a lot of top line growth. And in Brexit, we are -- in U.K., we've had a fantastic team there and on the senior and middle level for a long, long time. And they're very agile, very capable, very competent to deal with and experienced in dealing with all types of economies.

Operator

Our next question comes from the line of Amit Mehrotra with Deutsche Bank.

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

Brad, the company has missed expectations 2 quarters in a row. It's brought down guidance 3 times in the last 4 months. Just given that near-term track record, why -- I think there's a real question about why we should believe the company guidance today. And I think it's an important question to understand, how robust the 2019 guidance is and what are the assumptions that underpin it? And how confident are you in achieving that? And what's the likelihood that 2 months from now, we're looking at flat EBITDA and another down free cash flow number? And then related to that, what are you assuming for the $300 million that remains with the existing customer for 2019?

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

Okay. Let me -- plenty of questions in there. All good ones. Let me unpack them. First of all, I agree with the implication in the first question that is, gee, you've missed 2 quarters in a row and you brought guidance down. So you don't believe in exactly what our guidance is and having some skepticism in it is understandable. And this has not been our track record. This is not who we are. We accurately forecasted our performance for 7 years. And then 2 quarters in a row, we slipped on a banana peel twice. Not good. Having said that, there was a reason why we missed in the third quarter. One of our customers, House of Fraser, went bankrupt. And we had -- they had been a good customer until they went bankrupt, and we had a $16 million write-off. So we missed. And that's what it was and it's unfortunate. And we've tightened up our controls, so we don't have another exposure like that. In the fourth quarter, the reason -- it has nothing to do with the bankruptcy. Really, the main factor was, in the middle of December, we were notified by our largest customer, who also happened to be our largest customer in postal injection that they were pulling the business. And that turned into a business that was expected to have a significant profit in December and turned into a significant loss in December. We had a lot of capacity all ready to go and it wasn't utilized and it was getting close to Christmas and we kept the people. And we just lost money, simple as that. So that blew the quarter. And France and the U.K. were a little softer. But the real big killer was postal injection. Look, that's unfortunate. All of the things that are unfortunate happen. But those things happened and the results are what they are. You asked about going forward. The guidance that we've given has been brought down significantly. We believe that we can hit that guidance. It's reasonable. It's well considered. It's a bottoms up guidance. It's been pressure tested. It changed a lot and was brought down this week because on Tuesday, we were notified of the bulk of that $600 million going away. So we had to revise our guidance internally within a few days, and we believe we've put out guidance that we can hit. Are we going to beat a little bit or miss a little bit on certain lines? We could. We're human. But overall, the guidance that we've given is the guidance that we believe in. And you've noticed that in our materials, we've especially brought down guidance for the first half of the year, while we're regaining our traction from the business that we've lost. But I feel good about the second half of the year because we'll have had the time to reposition, to redeploy those people and those resources, it's not going to happen overnight. It's going to take a couple of quarters. As I mentioned before, we'll get the full year contribution of the 118 logistics start-ups we did the whole year. Similarly, we'll get the full year benefit of the 85 last mile hubs that we layered in through the year. The North American strategic account manager organization is on fire. The closed wons increased 45% in [2018] versus 2018. It's been so successful that we've copied that winning strategy and formed a single point of contract sales organization in Europe. In November, we hired a great person from DHL -- excuse me, from DB Schenker. And he's now hired 11 SAMs, strategic

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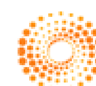

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account managers, under him. We have 4 more to go. We've assigned the top 200 customers to that team, and I have a lot of positive expectations from them. So the second half has easier comps than the first half does. The second half, we won't -- we'll have lapped that House of Fraser write-off. We'll have lapped that Department of Defense contract. We'll have lapped the fourth quarter last mile loss. So life gets a little easier as we build back the business that we lost and that we lap these money-losing events that happened in the second half of this year.

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

I wrote down...

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

But last -- I'm sorry to interrupt you. You asked also what are we assuming on the other $300 million that remains with that customer. Most of that business, but not all of that business, is under long-term contracts that expire over the next 3 years. So contractually, that business shouldn't go away. There's other parts of that business that could be at risk, and we've assumed some of it might go away, not all of it. And we haven't assumed all of it will stay.

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

Okay. Just for my follow-up. There's obviously a lot of highly valuable assets in the business on their own merits, whether it's the LTL business that isn't being impacted by the largest customer moving out, the faster-growing logistics business. But the implied valuation of these businesses suffering from like the conglomerate discount of the complexity of the model. So just given that fact, would you then maybe be more willing in light of what's occurred over the last 6 months just to spin-off certain parts of the business, bring in new management at those businesses and allow those business to float on their own to get the valuation that they deserve? Is that something that's more possible now?

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

I don't think that would be a wise course of action. And the reason I think that -- there's several reasons. Number one, from a customer perspective, and don't forget, it's the customers who wire money from their accounts to ours. So we have to always make our decisions based on what's going to please the customer, what's going to get the customer give us more business, what's going to do ingratiate ourselves with the customers, what's going to delight the customer. And having that total package of supply chain solutions and having, for the big customers, a single point of contact that can be a solutions provider is big. It's really big. It gets us talking to the most senior levels of supply chain officers in our customers and makes us more consultative rather than just a bidder on RFPs. On LTL, the business is going strong. We grew adjusted operating income by 33% in the fourth quarter on a year-over-year basis. We improved our operating ratio by 260 basis points. We had our best operating ratio in 30 years. In each quarter in 2018, our operating ratio improved on a year-over-year basis. So I feel good about where we're going on LTL. We have more opportunity to improve it ahead of us. I think if that business was separate, it would be less valuable to our customers and therefore our shareholders than it is as part of an organization. So if you look at our top customers in LTL, almost all of them are using many other modes of our business as well. I can't think of one of them that just uses LTL. If you look at our top 25 LTL accounts, on average, they use 5 or 6 -- I mean, they're very big users of all of our different services. And when our SAMs, our strategic account managers, are meeting with those customers, those are several-hour meetings, where there's many people from the customer in those meetings and we're going over how can we save them money, how can we change modes for them, how can we help redeploy their inventory, how can they use our predictive analytics, how can we update their technology, how can they outsource more things to us that we can do better than they can. If you have the company in separate pockets, you would never have those conversations and your value proposition would be weaker. Now the other part I'd like to address is, so what do we want to use our capital for? What we want to use our capital for is the best acquisition that is out there, our own stock, because we have confidence in the long-term value of our stock and that's what I want to use the cash for.

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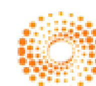

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Operator

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

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

Brad, in addition to this -- the loss of your largest customer, I think you guys closed a couple of warehouses in the last couple of months, one with Verizon and one with an unnamed customer. Can you give us some more color there? I mean, was that loss of business as well? Or was -- were you just kind of moving business between facilities?

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

We are always opening and closing contract logistics facilities. So last year, we opened up 118, including 28 in the fourth quarter. We did -- when we open a facility, we don't put out a press release. The press usually doesn't pick it up. Sometimes they do, usually they don't. When we close a facility, so it has a certain number of employees, we put out what's called a WARN notice, W-A-R-N notice. And that becomes widely distributed and gets a lot of attention. But the amount of locations we closed last year, you could count on a couple of hands. So we're clearly in growth mode in contract logistics. Growth remains very strong there. You saw that in -- North America organic revenue growth in the fourth quarter is 17%. And our strength in consumer packaged goods and in food and beverage and e-com, growth is accelerating in these places. Now I feel very, very bullish about our -- I think on the supply chain part of our business very, very strong. So the challenge we have is more on the tech. Now you mentioned a couple of facilities that get a lot of press closing, 2 of them, which were -- one on the East Coast, one in the Midwest. That was with our largest customer. So those were contracts that had been many year contracts and the contract were coming up for renewal or for ending. And they chose to end them. And I don't know for sure whether they brought them in-house or not, but whatever they decided to do with them, we respect that decision. The customer is the king, and the customer can decide whatever they want to do with those. You mentioned the Verizon facility. We have a great relationship with Verizon. It goes back decades. They're an important partner of ours. It's strong. We serve them in many parts of the country, and we love them. We think they're an amazing company, and we wish we had more of Verizon. We did close 1 facility in Tennessee because Verizon is always evaluating its supply chain. They have a complex supply chain, a big supply chain. It's a global supply chain. And they made the decision to transition the distribution of their wireless products out of Memphis to several other distribution centers around the country. So that is just one part of their ongoing process.

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

Got it. That's really helpful. And just a follow-up on your largest customer. I mean, it looks like they've made some moves pretty aggressively, I'd say, to in-source logistics. And maybe even build-out their own logistics network. I mean, do you see them becoming a competitor over time as they build that network out?

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

Look, most of our large customers are our "competitor". Most of them have their own trucks, their own fleet. And their dedicated business, for the most part, they do themselves. And the irregular and difficult and challenging and spot business, they largely outsource. And we get a lot of their backhaul business. So they're running repetitive loads and they have a headhaul, they don't have a backhaul. So they use 3PL like ourselves for the backhaul. So there's -- it's not like customers are -- most customers are not all in-house or all outsourcing, most of them are a blend. And some outsource more than others. And some -- the trend is to outsource more over time and some customers, the strategy is to in-source more over time. So we have $1 trillion ocean that we're swimming in here. The addressable market, even just between North America and Europe, for the exact services we provide is $1 trillion. And we've got -- even at $17 billion, $18 billion, we have less than 2% of that total addressable market. So we can be agile, we can be flexible and we can move to and fro with our changing needs of our customers.

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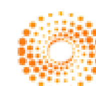

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Operator

Our next question comes from the line of Scott Schneeberger with Oppenheimer and Company.

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

I guess, if we could focus on LTL for a moment. Brad, you touched on how it performed in 2018. I was curious what you're thinking about for operating ratio, volume, price yield, things of that ilk as we look into 2019? And how much of that is a driver for the guidance?

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

I think on LTL, the strategy that we've had will continue. So we have been emphasizing more yield improvements than tonnage. We like tonnage. We'll take all the tonnage we can get as long as it matches our system and at a reasonable price. We're not interested in practice runs with tonnage that we don't make a profit on. And we've had a multiyear process of calling out that freight. And I mentioned earlier in the call that, for good and bad, our -- almost all of our top LTL customers use many other modes of business. So we can't just fire a customer without having influences on other parts of the business. So in getting reasonable yield improvements with both customers and other customers and sometimes that's been at the sacrifice of tonnage. And that strategy is going to continue. We're -- we see industrial economy is still good. It's not great like it was a year ago, but still good. It's positive and growing, and we're going to participate in that growth.

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

All right. And then shifting gears. It was asked about the remaining $300 million, but the $600 million that's going away is sizable. Could you give us a sense of how much of that was the postal injection? And then how much maybe was other parts of the business? And Matt touched upon the contribution margin, but just wanted to get a feel for how large that postal injection business was and what the other parts are?

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

So you're going to be able to see this play out in the financial statements through gross revenue in the last mile segment, which is likely to come down for most of the year because that is where the postal injection business was. You should think about very high-level ballpark, 1/3 or so of the $600 million associated with that business, and we'll do our best as the year goes on to quantify its impact in any given period. The rest of it would be in the transportation. Elsewhere in the transportation arena, some of it in brokerage, a little bit of it in intermodal. And maybe a smattering of it in the contract logistics business. But as we said earlier, most of it in the transportation arena.

Operator

Our next question comes from the line of Kevin Sterling with Seaport Global Securities.

Kevin Wallace Sterling - *Seaport Global Securities LLC, Research Division - MD & Senior Analyst*

Brad, switching gears here real quick. Can you update us how the CFO search is going?

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

The CFO search is going well. We did pivot in December what the specs should be when we had the short seller report come out, the stock went down quite a bit. We said, hey, we should really be buying our stock rather than buying companies, given the valuation discrepancy. So we had invested a fair amount of time in looking for CFO who was a CFO of a public company of at least our size and hopefully much more, given the amount of acquisition activity that we're planning. So we're looking for someone who had a lot of M&A experience, a lot of integration and multiyear

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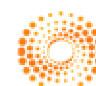

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transformation experience. When we pivoted to -- okay, that's -- we have to deal with reality that is, our stock price has come down, our valuation's come down and therefore, we should be doing our stock -- buyback our stock rather than buying another company. So -- and we need a different type of CFO. So we, more or less, restarted the search in December. That's -- the good news is that's a much wider pool of candidates than ones who have been Fortune 50 CFOs who have M&A experience. So we've seen a big upflow, a big uptick in CFO candidates. I can't put a time frame on it, but I can tell you that we've got good candidate flow.

Kevin Wallace Sterling - *Seaport Global Securities LLC, Research Division - MD & Senior Analyst*

Got you. Okay. And just -- I don't want to dwell on it too much, but just understanding the business with your large customer that's pulling out. When you guys got in the last mile business with the acquisition of 3PD, was this customer a customer of 3PD? Or had you grown with this customer just recently? I guess, my question is, had they always -- had this large customer always been a customer of 3PD or just recently have you -- had you grown with them?

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

I'm not 100% certain of that, but I think that they were not a customer of 3PD. Or if they were, they were a small one. So the more important part of your question is, have we grown with them? Yes, we grew a lot up with them over the last few years. And we knew that, that business wasn't going to stay forever and forever and ever and ever because of that particular customer's stated business plans and because that customer is transactional in some respect in terms of the nature that they have with their vendors. And that's fair. Customers can have any kind of approach they want with their vendors. We didn't think it was going to come to end so quickly. We didn't think it was going to come to an end so abruptly. And it really hasn't come to an end. It's been downsized. We still have a chance to prove to them that maybe we should get a second chance and come back and do something that can help them. And I don't rule out that we could possibly get some business back, but we're not counting on it. We're counting on that they're going in a different direction for the most of their business. And that we should be redeploying those resources for new customers.

Kevin Wallace Sterling - *Seaport Global Securities LLC, Research Division - MD & Senior Analyst*

Okay. And last question here, Brad. We're seeing some shake-up in the LTL industry, with some companies that are struggling, some bankruptcies. Are you seeing an opportunity there as we see possible further consolidation in capacity reduction within LTL?

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

I was surprised to see the LTL carrier bankruptcy announced recently in the Northeast, given that the market environment is pretty good for LTL. To answer your question, yes, we have seen an uptick in inquiries from their customers. Some of that freight matches our network and we're happy to take it and other part of freight doesn't. We were in a meeting earlier this week actually, and our -- in LTL and everyone's phones were lighting up, and it was basically from customers looking for replacement capacity there.

Operator

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

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

In terms of the excess capacity related to the customer loss, could you give us a sense of where -- rather what segments you plan to redeploy those resources? And then, I wanted to get your thoughts on whether this loss of business is also hurting your ability to attract contract carriers in last mile since, presumably, the utilization is now a lot lower?

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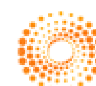

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Bradley S. Jacobs - *XPO Logistics, Inc. - Chairman & CEO*

Allison, the answer to the first part of your question is transportation far more than logistics. In the logistics segment, it really was a few warehouses. So that's not the end of the world. In the other parts of transportation, very significant. And with respect to geography, North America, almost entirely. The business we have in Europe with that customer is of a long-term contractual nature and on the logistics side. You asked another question about our ability to attract contract carriers in last mile. We are doing great in last mile for heavy goods, for big and bulky. That is a different part of the business than what this customer was removed from us. The business that we did for that customer that left was postal injection, meaning going into fulfillment centers in the middle of the night and getting lots of parcels and putting shrink wrap around them and putting them on pallets and putting them in the truck and zipping them over to the post office. So that business has been very substantially decreased. In our big and bulky business, we still are the largest one. Our customers love us. The feedback we get from our customers is extremely positive. Carriers like working with us since we have a steady, repeatable business. When we gain customers and lose customers, that's -- you can do that in any business, including that one. But overall, that business is healthy.

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

Okay. And then in -- FedEx has also talked about entry into last mile heavy goods maybe in the next 12 months or so. So just curious to know how you're thinking about that and how you're handicapping the competitive risk.

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

I have a huge amount of respect for FedEx. I think FedEx is just an amazingly run company. And they're a great competitor and customer and vendor of ours. So we have a good relationship with FedEx. In this particular case, we're going to be a competitor. And we're going to be honorable competitors competing in the market. They have an amazing brand. They have an amazing sales force. They know how to run a transportation business. So I'm sure they're going to do very well. They're going to test pilot it, and we'll see them in the competitive arena. We like the positioning we've got, like the critical mass. We have the technology. We like the long term. It's a business in last mile that's a business that takes a long time to figure out and get right. And customers demand extremely high levels of customer satisfaction. If anyone can copy us and get it right, it would be FedEx. They are not the only competitor we have in last mile that's also a fantastic company that we're seeing in the marketplace. J.B. Hunt has made a big move in last mile, another well-run company. Ryder is coming to the business, another well-run company. On balance, we like having competent competitors because they know how to run a business for P&L. They know how to run a business to make money. They don't do sloppy pricing. They're rational and are honorable. So we welcome the competition and we like our position here in last mile.

Operator

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

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

So just 2 quick ones here on -- going back to the restructuring of the cost structure a bit. You mentioned, Matt, some severance costs there in the prepared remarks. Just wanted to get some clarity as to that $55 million is a full run rate for '19 that's baked into guidance? It seems like it's separate from kind of ongoing labor productivity and inventory management. So if you could just speak and run through that in more detail. And then just from a bigger picture perspective, are there any barriers of the cost structure you think will take a little bit more time to flex down if the macro doesn't cooperate here?

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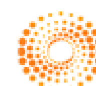

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Matthew Jeremy Fassler - *XPO Logistics, Inc. - Chief Strategy Officer*

Sure. I'll start with that. So the charge that we took was largely for headcount and the severance associated with that. That number of approximately $55 million is an annualized run rate. We're not quite there at the outset of the year, but we're likely to make our way to that run rate reasonably soon. Keep in mind that we're experiencing labor inflation like everyone else. And we did not execute on this restructuring tactically to counter labor inflation. But as you think about the modeling of the business, there is a reality that we're facing labor inflation in this economy as our competitors and our peers. And from a modeling process, the proceeds, if you will, or the run rate benefits of the restructuring will aid the earnings of the business, but they're somewhat of an offset to that from the other underlying wage inflation in the marketplace. Your second question, again, if you would, please?

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

Yes. Sure. On the -- any structural impediments, whether it's labor agreements, unions that would take a little bit more time to adjust if volume doesn't hit that guidance or hit the mark where you think it could be.

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

That's not applicable to us. We don't have labor agreements and any significant measure here in North America. That's only in Europe.

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

Okay. And then just a quick follow-up on the buyback. Obviously, you announced and completed the last one fairly quickly. And I understand you're buying back the best company you think there is right now, which is the XPO portfolio. When do you think you'd be in the market. Are you watching to see what the -- do you see kind of what the market's tell you, which is maybe keep some dry powder for another deal down the road? Just how do you envision that program rolling out here coming on the heels of the other one you just completed?

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

Well, we ended the year in about 2.4 net debt to EBITDA. If we buy back another $1 billion or so out of the $1.5 billion in the coming, let's say, months for the sake of discussion, that would bring our leverage up to 3.3, 3.4. And then if we use our cash flow to pay down net debt, it will bring our leverage back down to 2.6, 2.7. So we're comfortable in that range. And we'll take into consideration leverage levels. And we'll take into consideration economic conditions. If the economic conditions get better, we'd be more aggressive, but we -- and if the economic conditions worsen, we'd be a little bit more cautious. But we'd also take into consideration the stock price. And at various levels, we would be more opportunistic than others. I think you also mentioned something about M&A, Brian. As I said earlier and you intimated, yes, M&A is in our corporate DNA. There's no question about that. We love M&A. We have a very good track record of creating significant shareholder value through M&A. But today, even though we spent a lot of time, we're getting very close to concluding a long search for a good M&A candidate, the best M&A target is acquiring our own stock. And for that, that's where we're going to deploy our resources for the foreseeable future, not on external M&A.

Operator

Ladies and gentlemen, our final question this morning comes from the line of Todd Fowler with KeyBanc Capital Markets.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Brad, I guess just to help contextualize. We see freight move around a lot. But with the downsizing of your large customer, can you put some context around what happened, specifically in the fourth quarter? And the fact that this is across a couple of different service lines and maybe outside of the bid season, do you have a sense of why they made this decision at the time that they did?

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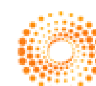

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Bradley S. Jacobs - *XPO Logistics, Inc. - Chairman & CEO*

I can't speak to their reasoning, I can't speak to their timing, I can't speak to their long-term planning in part because I don't fully know. What I do know is the customer is king. And if the customer wants to move in a different direction, whether that's in-sourcing or whether that wants to go to a -- they want to try out another competitor of ours, we -- or they want to give us more business, while we prefer the third curtain, the first 2 curtains are their choice. And we always respect the customer when they exit us. And when they do, we act in a very respectful way and take a high road on it and make sure we leave them with a good taste in their mouth as they're going out the door and that's what we did here and we'll continue to do with them. In terms of timing, it was an unfortunate timing. We had guidance that we put out on December -- I forget whether it was 11 or December 12 without knowing this. Within a few days, our postal injection business was significantly impacted by this customer's actions. And then here in the last -- just -- literally just last week, we had significant news about the rest of it going, but the customer has the choice. And the customer can control the timing that's suitable for them and we respect that.

Todd Clark Fowler - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Yes. No, I understand. And I was just trying to get some context if there was service issues or change in supply chain or something like that because, again, when we see freight move around, it's just something, I guess, unique that I haven't experienced where it's across a couple of different service lines at this time. So that's helpful. Look, I know we're up against the hour. The question I did want to ask though is, with the EBITDA guidance, it still looks likes that you're looking for, let's call it, roughly $90 million to maybe $160 million of incremental EBITDA into 2019. Maybe just to close, if you could give us some idea of the buckets where you'd expect to see that EBITDA improvement. I think, previously, you talked about LTL showing $100 million of improvement over a couple of years. Can you give us some of the buckets where you're expecting to grow EBITDA into '19, given some of the headwinds that you're facing?

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

The biggest growth driver in EBITDA and revenues is going to be on the logistics segment. We've got headwinds on the transportation because that's the bulk of where this business is going away. And the biggest headwind is going to be in North America where most -- almost all of it went away as well. So that's where you're going to see the biggest growth for the full year, but we're going to see a lot of growth in the second half of the year as we rebound from redeploying those resources. Look, we're resilient, we're strong, we're very well positioned in the business. We have excellent employees. Morale is very, very high. We have extremely high levels of customer satisfaction, fantastic technology. We are very well positioned for the future. We have a headwind, a significant headwind that we'll work ourselves through over the next couple of quarters. And that's our (inaudible).

Okay. Thanks everyone for your questions. We're fully available over the next few days and at the upcoming conferences to meet with any and all of you and to answer any and all of your questions. Have a great day. Thank you.

Operator

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

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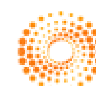

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