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XPO Logistics (Ticker: XPO.N, Closing Price: **101.68 USD**, Target Price: **133.00 USD**, Recommendation: **Buy**)

We met 1on1 with XPO's senior mgmt. team yesterday at the company's HQ in Connecticut. In attendance was CEO Brad Jacobs, Chief Strategy Officer Scott Malat, and Director of IR Tavio Headley. The discussion centered on the long-term and strategic direction of the company- focused on three areas: **(1)** XPO's ability to react to a cyclical downturn; **(2)** M&A, and **(3)** sustainability of recent strong growth revenue, earnings and cash flow trends. We came away more comfortable in all three areas, with our specific takeaways as follows:

- **Recession stress test:** We believe XPO's ability to preserve revenue, earnings and cash flow in a recessionary environment is underappreciated- a critical point in an environment of peak cycle fears. Mgmt. believes it can grow free cash flow in a recession- reflective of half of total capex earmarked for growth, which can be reduced in a falling demand scenario. We also see potential for Contract Logistics (40% of total sales) to grow both top line and earnings in a downturn- as customers accelerate outsourcing of logistics during recessions to achieve capital and expense savings. Also the majority of contracts in this business have minimum volume commitments, making revenue resilient while allowing costs (particularly labor) to be scaled back in a downturn- giving XPO the ability to capture the savings and allowing for earnings and cash flow growth during periods of macro weakness (mgmt. noted that ebitda at New Breed- a high-value contract logistics company XPO acquired in 2014, increased by more than 30% each year in 2008 and 2009 due to above-mentioned factors). There is clearly downside potential in a recession within the company's more cyclical businesses (i.e. brokerage and LTL, which together account for half of total revenues), though we estimate blended decremental margins are in the 15% range, which limits the earnings hit from revenue declines. All told, and based on our discussions, we estimate XPO is likely to see a consolidated ebitda decline of \$150M (10%) in a deep recession scenario, reflecting 20% rev declines in LTL and Brokerage partially offset by continued growth in Logistics and Last Mile (albeit at more moderate levels).
- **M&A:** Mgmt. remained consistent in its characterization of M&A opportunities, i.e., potential for a deal to be announced before the end of the year, majority asset-light, synergy opportunities through leveraging of XPO's technology prowess, and we continue to sense that mgmt. remains highly disciplined on price. Not surprisingly, not much was offered beyond these mostly philosophical points, though CEO Jacobs did stress that M&A was not needed to drive significant further value creation given organic growth opportunities. This is consistent with previous comments, but it does seem growth opportunities on the base business are accelerating via new initiatives like XPO Direct and expansion of Last Mile network into Europe.
- **Sustainable growth trends:** Mgmt. appears very confident in the current environment and pipeline of new business to sustain recent acceleration in top line growth and at least mid-teens EBITDA growth (which we estimate translates to 30% free cash flow growth given limited incremental capex needs). This alone should result in 20% annual appreciation in shares assuming current 10x multiple. XPO Direct (which we view as effectively an alternative to Fulfillment by Amazon for other large retailers), is expected to be a \$1B revenue business in a "few years"- from \$0 last year. And the company appears to be winning significant market share of new contract logistics opportunities, reflecting its heavy investment in supply chain technology which allows XPO to more quickly adapt to changing customer requirements vs. competitors. We believe mgmt. will be in a better position to discuss these organic growth opportunities over the next 3-6 months, including expansion of Last Mile network in Europe (now in 5 countries vs. just 1 relatively recently).

NET/NET following our meeting we remain confident in XPO's ability to create significant value over the mid and long term. XPO sits at the center of significant secular growth drivers in transportation, retail and supply chain, which when overlaid with mgmt's focus on shareholders and long-term equity value creation, is a potent recipe for significant further upside in shares. Maintain Buy and top overall pick.