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XPO - Q2 2018 XPO Logistics Inc Earnings Call

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OVERVIEW:

Co. reported 2Q18 YoverY organic revenue growth of 11%.

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PRESENTATION

Operator

Welcome to the XPO Logistics Q2 2018 Earnings Conference Call and webcast. My name is Robin 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 brief statement on behalf of company regarding forward-looking statements and the use of non-GAAP financial measures. During this call, the company will be making certain forward-looking statements within the meaning of applicable securities laws, which by their nature, involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those projected in the forward-looking statements. A discussion of factors that could cause actual results to differ materially is contained in the company's SEC filings.

The forward-looking statements in the company's earnings release or made on this call are made only as of today, 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 the 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 important information regarding forward-looking statements and non-GAAP financial measures in the investors section on the company's website. I'll now turn the call over to Brad Jacobs. Mr. Jacobs, you may begin.

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

Thank you, operator. Good morning, everybody. Thanks for joining our earnings call. With me in Greenwich today are John Hardig, our CFO; Scott Malat, our Chief Strategy Officer; and Tavio Headley, our Head of Investor Relations. I'm pleased to report that we had an outstanding quarter. Revenue, operating income and earnings were all strong. And in fact, all were company records for second quarter.

We generated higher-than-expected organic revenue growth of 11% and we continue to grow adjusted EBITDA at a faster rate than revenue. On a year-over-year basis, our EBITDA in the quarter was up 18%, underscoring the broad-based growth that we delivered across our operations. In our transportation segment, we increased freight brokerage revenue by 27% and increased brokerage net revenue by 46%.

In North American LTL, we achieved an adjusted operating ratio of 84.3%, which was our best operating ratio in 30 years.

In last-mile, we grew revenue in the quarter by 17%. And once again, the big driver of last-mile performance was e-commerce. We opened another 16 last-mile hubs in the second quarter, bringing our last-mile network to 71 hubs across North America, on track for a total of 85, ahead of the holiday peak.

The growth in e-commerce is a global phenomenon. In our logistics segment, e-commerce fueled an acceleration of our organic revenue growth to 14%. We implemented a record 37 contract logistics start ups in the quarter, bringing our year-to-date startups through June to 64.

We expect this strong growth to continue due to our $1.8 billion logistics sales pipeline, which is up 48% from $1.2 billion a year ago. Companywide, we're benefiting from positive macro conditions across all our markets, and we're also generating our own company-specific momentum. Through June, we signed $2.1 billion of new business. And our global sales pipeline for transportation and logistics combined stands at a healthy $3.4 billion, up 17% from a year ago.

Now before I pass it over to John, I want to mention the other press release from last night. We announced that John will be stepping down as CFO on August 15 to spend more time with his family. And I would like to take this opportunity to thank John publicly for his many contributions to our success since joining us in 2012. He will always have a place in our history, as XPO's first CFO. And he has been a good friend to me personally over the last 6.5 years.

John, you've built a great finance organization that stands ready to continue our growth. We wish you and your family the very, very best.

I'm pleased that Sarah Glickman, our Senior Vice President of Corporate Finance will be stepping up as acting CFO. I've known Sarah for a number of years during her days at Honeywell and Novartis. She came on board in June, and she brings tremendous experience in running optimizing large financial organizations. We're lucky to have here at the helm of our finance organization while we complete the CFO search process.

And with that, I'll ask John to review the second quarter numbers in more detail. John?

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

Thank you for the kind words, Brad. Being XPO's CFO has been the highlight of my career. I'm sad to be leaving my friends and colleagues, but I'm very proud of the work we did together to build XPO into such a strong company. I'm certain that XPO's best years are still ahead.

Now let me walk you through the numbers. We had a very strong results in the second quarter. Starting with our transportation segment, we increased revenue 15% to $2.9 billion. We grew operating income by 25% to $205 million and grew adjusted EBITDA by 14% to $355 million. Freight brokerage was the star of the quarter. The tight freight market that started in the second half of last year continued to drive a significant amount of spot business at higher margins. On a year-over-year basis, we improved net revenue margin by 220 basis points.

Within freight brokerage, our truck brokerage business continued to achieve extraordinary year-over-year revenue growth and margin expansion with a steady upward trend, increasing revenue, net revenue and net revenue margin sequentially through the quarter. Our intermodal business achieved double-digit revenue growth and net revenue increased over 30%, as capacity remained tight and we renewed annual contracts at higher rates. Similarly, our expedite operation continued exceptional year-over-year revenue and profit growth, as the truckload market tightness drove more demand for expedited shipments.

In last mile, we continue to fire on all cylinders and delivered another quarter of strong mid-teens revenue growth, while improving net margins. This growth was led by the strength of e-commerce demand and the expansion of our last-mile footprint, making it a more attractive alternative for customers in terms of geographic coverage and cost per delivery.

In North American less-than-truckload, we made significant investments in sales, training and technology and still achieved a record operating ratio. Contract renewal pricing improved to 6.4% versus 5.9% in the first quarter and 5.3% in the fourth quarter last year. Revenue for hundredweight excluding fuel increased 2%. This metric was affected by mix, specifically a 6.1% improvement in weight per shipment and a shorter length of haul.

Despite the tight truckload market, we decreased purchase transportation cost by 10%, by shifting more freight to our own fleet. We are confident the investments we've made in LTL over the last few quarters will accelerate operating income growth in the second half, and we are raising the midpoint of our estimate for full year OR improvement to 150 to 200 basis points. We had a solid performance in our European transport operations. We grew revenue 20% with solid organic growth of 5% and a 15% benefit from foreign exchange and fuel.

Our organic growth was the highest in 2 years and we expect this to carry through the third quarter. Revenue growth in European transport was led by dedicated truckload throughout the region, brokerage in France and LTL in Spain. Last mile revenue continues to grow in Europe as we expand the service.

Our logistics segment performed exceptionally well. We increased our global logistics revenue to $1.5 billion, up 19%. Operating income of $67 million was up 36%, and we increased adjusted EBITDA up to $134 million or an increase of 21%. We grew our global logistics sales pipeline to $1.8 billion, a year-over-year increase of 48%.

In Europe, our 21% revenue increase was driven by 13% organic growth and an approximate 8% benefit from foreign exchange. We had double-digit organic growth across multiple verticals, including fashion, consumer packaged goods and food and beverage.

Our fastest year-over-year growth by country was in the Netherlands, Spain and the U.K. Reverse logistics or returns management has become a high-growth revenue stream for us, as consumers return unwanted items back into our e-fulfillment network at record levels.

In North American logistics, our sales initiatives kicked into the high gear and we accelerated our second quarter revenue growth to an exceptional 16%. The largest gains came from e-commerce, consumer packaged goods and technology.

We're seeing accelerating demand for our services across all customer verticals, but especially in e-commerce.

Other income was $30 million in the quarter versus $20 million in the first quarter. The largest piece of this was due to our well-funded pension plans where strong asset returns have outpaced expense. It also included a mark-to-market gain of derivative used to hedge our exposure to foreign debt. We expect other income to be a total of $20 million a quarter in the second half of the year.

Interest expense for the quarter decreased 26% versus last year, due primarily to debt paydown and repricings of our term loan at lower rates. Net CapEx was $206 million for the first 6 months of the year. We expect net CapEx to ramp up in the second half of the year, due to the timing of replacement tractor purchases as well as implementation cost for new logistics facilities.

We're maintaining our full year net CapEx guidance of $450 million to $475 million.

Cash flow from operations was $268 million and free cash flow was $193 million. We expect free cash flow to improve sequentially in the third quarter and improve again in the fourth quarter, in-line with our historical seasonal pattern. We are on track to generate free cash flow this year of approximately $625 million.

And with that I'll turn it over to Scott.

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

Thanks, John. Starting with the macro, global transportation markets remain tight through the quarter and into July.

In North America, on a year-over-year basis, our average cost of truckload capacity in the quarter was up 20%. While July is typically a seasonally slower month, it turned out to be our best month for brokerage so far this year. The best revenue, net revenue and EBITDA.

European transportation market is experiencing similar tightness, especially in the U.K. and Spain. That's leading more companies to ask about dedicated truckload services to guarantee access to capacity. We grew dedicated truckload revenue in the quarter by over 20%.

We're also seeing more demand for brokered capacity in Europe, as shippers increasingly tap into this channel.

The current tight global labor market plays to our core strengths. We use our scale to share resources across customers to better support spikes in volumes. In technology, we're in the middle of accelerating several new automation projects ahead of the holidays. For instance, we're currently rolling out a significant number of [cobox] to some of our biggest e-tail and retail sites, which working in tandem with our people, deliver 35% to 50% greater efficiency and reduce error rates by approximately 40%.

And our recruiting expertise is one of our key competitive advantages. We have a strong brand in the labor marketplace. We attracted 600,000 job applicants last year, and we're on pace to process about 900,000 job applications this year. While no one can predict the macro with certainty, our conversations with customers has been positive. In general, they expect growth to continue and they plan to invest more in their supply chains. Our strategy is to invest in areas that will keep us growing faster than the market through all points in the cycle.

A good example of this kind of investment is XPO Direct, our shared space distribution network that we launched earlier this year. The first adopters are integrating and ramping up volume and the queue of customers in the pipeline is growing rapidly.

We'll grow the XPO Direct footprint from 75 facilities to about 100 by the end of this year. From a technology standpoint, we added new cross-dock tools and an updated mobile app. We rolled out APIs that our customers use to integrate with our systems. We also expanded our order management and tracking capabilities on XPO.com. With logistics overall, this is an area, where our investments are propelling our growth.

As you may recall, we were averaging around 2 implementations a week at the start of the year and we've now accelerated to 3 a week. We have the infrastructure in place to grow quickly and to manage that growth with discipline through investments in warehouse management software, site automation, operational tools and additional recruiters and real estate professionals.

In June, we announced an exciting partnership with Nestle to create a next generation logistics facility for their brands in the U.K. This "warehouse of the future" will also house an XPO innovation laboratory to beta test new innovations. We're investing about $77 million into this cutting-edge site.

Another big focus for us is data-driven efficiency. We're in the middle of a national rollout of dynamic forecasting and labor planning tools for our logistics facilities. These tools continually analyze real-time order flow and employee productivity at large sites. The software identifies opportunities to improve efficiency by adjusting that day's shifts and immediately alerts our managers.

In the first wave of deployments, we are generating approximately 3% labor efficiency savings and increased consistency in shipping metrics. We are accelerating the rollout to our largest sites across the network in the second half.

In transportation, our digital freight marketplace, XPO Connect is gaining traction. We went from 0 to 6,000 carrier sign-ups for XPO Connect in just the first 3 months. That speaks to the quality of our technology and also our scale -- scale with both shippers and carriers.

In LTL, our investments in hiring and training local salespeople are improving our business mix. Local freight growth has been accelerating since the beginning of the second quarter.

In addition, the rollout of the new route efficiency tools in the second quarter has started to translate into savings. We saw more acceleration in LTL operating income in July. We've come a long way in LTL. We still have the opportunity to improve our operating ratio by several hundred more basis points. Our goal is to reach a full year ratio in the low-80s over the next few years.

And lastly, we were proud to be the official transport partner of the Tour de France again, the 38th consecutive year. We moved 360 tons of equipment and supplies over 270,000 kilometers. Throughout the race, our brand was on display in one of the biggest sporting events in the world.

So big picture, we're operating in a strong macro environment across all our markets. Importantly, we're growing the business faster than the economy and we expect to continue to do this throughout all parts of the cycle. The growth investments we're making in technology and automation, data-driven productivity tools, sales, training and customer service are increasing our advantages in e-commerce and other fast growing parts of the supply chain. And the XPO brand has global traction with customers. 2018 is on track, and we'll have lot of wind at our back heading into 2019.

With that, let's open it up for Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

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

Christian F. Wetherbee - *Citigroup Inc, Research Division - VP*

John, best of luck in the next phase of your life and career. Wanted to start on the LTL side, if I could. Wanted to get sense, I guess, of sort of the costs that were in the first half of the year that you see sort of dropping away. If you can kind of run through some of them to give us a better sense of sort of the operating leverage in the business. There's obviously a good tailwind for the freight market. Kind of curious what's been holding back the leverage and sort of what that catalyst for getting a better operating ratio improvement in the back half?

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

Hi, Chris. This is Brad. So the investments we put in the LTL business were as follows: We added about 200 sales and sales support people since October. And obviously, that's an expense right away, which takes a while to ramp up, but they are ramping up. And we hired 2,500 new dockworkers. Again, they take time ramp up, but they are ramping up. And we rolled out training programs across-the-board, which we think is really good long-term investment and even a short-term pay off as well. And we ramped up the driver schools as well. And the drivers -- we've graduated more drivers in the first half of the year than we did in all of last year. And finally, we had technology investments in many different places throughout LTL. So lots of investments into the business. And despite that, we were still able to generate our best operating ratio in 30 years. It might be more than 30 years, but we can't get records from old Con-way files past 30 years.

Christian F. Wetherbee - *Citigroup Inc, Research Division - VP*

Okay, fair enough. That's helpful. And when you think about sort of that acceleration, how much does volume play a part in that. So volume from a tonnage perspective has been a little bit on the light side. Is that a pivot towards a little more growth as we move into the back half. Scott, I know you said, July was looking better. Just kind of get a sense of how that looks?

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

Well, our focus is not on tonnage growth. Our focus is on selecting the right tonnage that matches our network and deselecting freight that doesn't match our network and to get the right price, the right yield for the premium service that we provide. So I would not guide you to expecting some big tonnage increase, because it's not what we're trying to do. We're trying to get the right mix of tonnage.

Christian F. Wetherbee - *Citigroup Inc, Research Division - VP*

Okay, right. That's helpful. And just a follow up, thinking about the revenue outlook. Organic revenue growth, you're kind of at 11% in the last couple of quarters. How do we think about the back half in the context of the environment we're in right now? And then assuming we continue to have pretty decent backdrop here, is it fair to say that sort of excess profit gets invested, so the EBITDA remains roughly the same, despite the fact that we're in a pretty strong freight environment?

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

That's absolutely correct. Nothing's changed in our strategy in that respect. All of our excess profit, over and above $1.6 billion EBITDA, we're going to plow back into the business for planting seeds for next year and the year after that. We've got some amazing sales growth in the company -- in every part of the company, everywhere, whether it's here, whether it's in Europe, whether it's in transportation, whether it's in supply chain. And we're going to keep capitalizing on that and to the extent that we've got excess profits, we're going to invest in the future.

Christian F. Wetherbee - *Citigroup Inc, Research Division - VP*

In terms of revenue, does it feel like a decent run rate to think about for the back half. Just trying to get a sense of how that looks?

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

Yes, in this range. We've always been saying for the last few months, high single digits, low-double digits and nothing's slowed down at all in terms of that guidance.

Operator

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

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

So just want to follow up quickly on that -- on the organic growth in terms of drop-through in EBITDA and free cash flow. You're obviously investing a significant amount of business, accelerating projects, things like that. Just want to understand is kind of the 17% or mid-teens type EBITDA growth that you're posting this year sustainable in your view, as you look through '19 and '20, given the book of business and then, does the CapEx intensity change at all. I think you're running about 2.8% of sales this year. Does that actually go down as the sales growth, or should we expect that to kind of move up, given some of the initiatives that you're accelerating?

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

Sure. So let's do all 3 lines. Let's do organic revenue growth, let's do EBITDA growth, let's go free cash flow/CapEx since they're related to each other. On the sales side, on the revenue growth side, very buoyant, that's partly because it's a good economy, it's a good market. It's partly because we're doing a lot of company-specific things in terms of operational excellence, in terms of hitting on all 8 cylinders that customers are rewarding us with our greater-than-fair share of their wallet. So I expect that organic revenue growth is going to stay in this high level, high single digits, low-double digits for the foreseeable future. I don't see any slowing down on that. EBITDA, we haven't done a bottoms-up budget yet at all, that process is just starting. On a preliminary basis, yes, I think something in the 15% to 18% range is very reasonable to assume for continued EBITDA growth for the foreseeable future.

In terms of free cash flow, we will generate more free cash flow next year than we did this year, even though we've generated very substantial amount of free cash flow this year. And this year we'll have about 70-something percent more free cash flow than last year. I don't think it's going to be 70% more, because I think there's going to be more opportunities for deploying CapEx, but it's way too early in this year to be giving specific guidance for CapEx for next year. But I can tell you this: last week, we had about 45 of our top executives in for 3 days for quarterly operating review. People are confident in their business. Peoples' customers are confident in their business. There's a lot of opportunities to invest in the same things that we've been investing so far in, like in contract logistics startups, where we were so proud and happy that we were then doing 2 contract logistics installations a week last quarter. We're now up to 3 a week. So that's really, really big growth here. The last-mile hubs we'll probably tap out this year. I don't know that we'll go past the 85 hubs that we'll have done by September of this year. I think that'll get us closer -- close enough to all our last mile customers that we won't have to put more CapEx into that. Technology, we have so many projects on the drawing board to delight our customers with and to run our business more efficiently. I don't know what we'll spend on technology. I hope we'll spend more on technology next year. We want to be the -- we want to remain being the industry leader in terms of our commitment to innovation and technology is a big part of that. Sales growth, if this top line growth continues, we will invest more in sales people, so that we don't miss sales opportunities.

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

Right, that's helpful. And then just one follow up for me. Specifically on XPO Direct. Scott, you mentioned 75 sites going to 100 sites. It's my understanding that the vast majority of those sites are actually existing sites that were already there. So when we think about the revenue opportunity for XPO Direct, I was wondering, if you guys could provide a little bit more meat around that. I think, it could be a $1 billion plus business at some point in the relative near future? And then, just given the fact that you're leveraging the existing structural cost base of the company, what is the right contribution margin relative kind of that 10% to 15% that you highlighted for the overall company on a blanket basis what do you think about that?

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

It's Scott, thanks. On XPO Direct, you're exactly right. It is ramping up. This is roughly $1 billion business opportunity annually to report $1 billion in revenue from this over the next 3 to 4 years. What we're seeing is a lot of demand not only from the retailers and the e-tailers, we talked about that, where they're signing for time definite, fast order fulfillment for store replenishment. But we're also seeing a lot of demand from manufacturers, from suppliers. They're looking at this as a one-stop shop, where they can pool their inventory, they can fulfill for all their selling channels. Things like their own websites, when they're selling goods, things like partner retailers that they work with. This is an opportunity that will likely have higher margins than our average margin in contract logistics. Right now, it's in investment stage.

Operator

Next question comes from the line of Scott Schneeberger with Oppenheimer.

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

I guess I'll jump in with a lead-off prior and ask the M&A question. Could you guys just speak to the size of the ripe pipeline. What you're seeing as far as valuation trends of what your targets are looking for? And just any other thoughts, timing-related or otherwise?

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

Good morning, Scott. So as you know, we started off about a year ago with a universe of about 250 targets. And we've contacted almost all of them, not every single one of them, almost all of them. We pared it down to a few dozen as of earlier this year. And we are now concentrating mainly on about a dozen ones and we're in different level of discussions with them. We are patient, we are disciplined, we are only going to do a deal when we have a deal that will likely create immense shareholder value. And the reason that we feel that patience is that, if we continue to grow EBITDA in the 15%, 16%, 17%, 18% range with the leverage we have on the balance sheet and taking free cash flow and paying down debt - each dollar we pay down creates a dollar of equity value -- we'll have share appreciation in mid-20s, even without multiple product expansion. So we don't feel any pressure to do M&A. We like the business prospects we got right now. We do want to do M&A. Want to do the right M&A and if that's next month, great. If that's later in the year, that's great. If it slips past the end of the year, it's not end of the world.

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

Okay, great. I guess, following up, the truck brokerage really impressive growth. It sounds like automation is a big driver. Could you guys please speak to how much of it was productivity of your reps? How much of it was the automation of the process? And kind of what you see as the progression in future years there?

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

So in freight brokerage, I mean, it was an amazing quarter. Revenue grew 27%. Net revenue grew 46%. Net revenue margins were up to 16.2%, which was a 220 basis point improvement from a year ago. The brokerage market is obviously hot. It's very favorable, but we're also clearly outperforming. Why are we outperforming? We are performing in large part because of our portable proprietary technology. We're also outperforming because for the last 7 years we've been developing relationships with about 38,000 core carriers that we give freight to every day. And the shippers that we have really appreciate that we performed on contracts last year, even when we were under water. So that's why we were able to generate about 1.5x more revenue than we did a year ago, with 3% fewer people. So the 3% fewer people is partly because our people are more seasoned and longer tenured, but also because we have more technology. If you look at XPO Connect, we rolled out XPO Connect in April. 90 days later, we had gone from 0 carriers on the platform to 6,000. I mean, the momentum we have with the technology products that we're rolling out, and this is just one example. They're designed well, they are resonating with customers and they're being adopted with great excitement.

Operator

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

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

Brad or Scott, if I can ask you to just elaborate a little bit more on XPO Direct. What's the initial rollout been like? You gave us some numbers on the facilities, but what's the customer reaction been like and who are the ideal customers you have gotten so far? And how does that compare to the kind of people you thought would sign up for that?

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

Hey, Ravi, it's Scott. It has been very strong. It's been, what I'll call, hitting above its weight. So if you go into any of our customer conversations, it's one of the main topics of conversation. We definitely expected that from the retailers and e-tailers. This is right down the fairway for retailers and e-tailers. The manufacturers and suppliers interest has been significant though. The fact that they can use it to get fast delivery of their goods into things like marketplaces, so they can be preferred in the marketplace. The fact that they can use it to do store-based distribution to their partners has really been something that they are interested in. We allow them to reach 95% of the country within 1 and 2 days and that's been very appealing.

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

Understood. Shifting gears to brokerage. It's pretty impressive to see you guys do a 46% revenue growth with lower headcount. Can you just talk about what you guys are doing there in terms of automation, or how you're able to achieve this? Do you have a number of what percentage of their transactions, at this point, are automated and kind of where do you see that revenue growth versus headcount, those 2 trajectories going over time?

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

Hey, Ravi, It's Scott. So there's different parts of transaction, some are more and less automated. we have gone to automated track and trace, which is great for our customers. It adds visibility. They can see where a shipment is at any time. We used to have rooms full of people and our carrier reps calling the trucking companies, checking where that freight is. That track and trace has become automated. With the XPO Connect platform adding 6,000 carriers to the network, they are going on and doing things like looking at loads, bidding on those loads. We have a buy-it-now feature, where they can actually bid on that load and procure it right in that moment. So more and more of that is becoming automated, but that's been the rapid growth even over the last 3 months. We still work with the customer quite a bit. While we have increased the amount of volume on the sales side, we still have a lot of customer service reps that are working with our customers. Now that we have capacity on the network, we are differentiated in the marketplace and we expect more and more shippers to ramp up and start to directly contact those carriers that are in our network -- those 6,000 carriers and growing in our network. And more and more of it will become automated, but our reps will be able to help on the 15% of freight that needs the most help, that has something that we can do differentiated for the customer, there were some issues, some problem and we're doing problem resolution.

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

Got it. And just lastly, Brad, I don't think any investor can complain about a management team being disciplined on pursuing M&A. But to the extent that the timing of the likelihood of a deal kind of does get pushed out, that leaves you with another high-quality problem of having a balance sheet with a decent amount of cash on it. So what is the level of leverage you are comfortable with? I think in the past, you may have indicated that 3 turns is probably too low even. So kind of what's the long-term level of leverage here?

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

Well, we're about 2.6x 2018 projected EBITDA. That's too low. Our base range should be between 3 and 4x by our estimate in order to create the most amount of return for our common shareholders without putting any risk to the business, if we went into a downturn or even a deep downturn. So we are underleveraged right now. But I don't want to stay here for a long period of time. We would like to use our leveragability to do a real good deal, but it's got to be real good deal.

Operator

The next question is from the line of Bruce Chan with Stifel.

Jizong Chan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate VP & Equity Research Analyst*

I just want to echo the congratulations to John for a very successful career and wish you the best of luck. Couple of questions here around peak season. Wondering, if you can share any expectations you have for us in terms of the peak this year given some of the conversations that you have with customers, especially on the contract logistics side. Do you have any indication of early ordering our inventory stocking in light of some of the recent tariff discussions, any commentary there?

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

Our customers are telling us to be prepared for a big peak. Do they know there is going to be a big peak? They don't. They're speculating, they're inferring, they're hoping, they believe that will happen, but that is what our big customers are telling us that they expect to have a big peak and they want us to be prepared to support them. And that's what we're doing. We've geared up with all our technology and our recruiting and got a big recruiting machine. And I think Scott mentioned before, we're getting 80,000 applicants a month now, job applicants around the world. So we really invested in our talent acquisition organization, and we're ready. We're ready to support our customers for a substantial peak.

Jizong Chan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate VP & Equity Research Analyst*

Great. And then as far as the tariff discussions, any indication of early ordering or stocking there?

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

We have not seen that, but it's early days in the trade wars. If the trade wars go on for a long period of time, it's going to be bad for everybody. If they resolve themselves in a short period of time, I don't think we'll have noticed any difference from it.

Jizong Chan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate VP & Equity Research Analyst*

Great. And just one last one for me, Scott. You mentioned some of the [cobox] and the benefits you're seeing there, definitely some pretty cool stuff. How many facilities have you implemented those in so far? And is that a customer-driven decision or is that an XPO-driven decision? Do you have a time line for rollout in maybe some of the other facilities out there?

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

Sure, it is depending on the contract whether or not it's an XPO decision or a customer decision. Especially depending on the contract type of fixed-variable versus cost-plus. In fixed-variable contracts we're generally making the decision ourselves. We'll work with the customer, making decisions ourselves to drive as much productivity as possible. On a cost-plus contract, we'll work a lot more with the customer. We have some type of automation in almost all of our facilities. In terms of the cobots, these specific round of cobots several of our largest e-commerce, e-tailer, retailer type of company that we are going out as we speak over several of those large facilities over the next few months.

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

Cobots are 1 type of automation that we're rolling out, we're rolling out smart glasses, rolling out swarm bots, we're rolling out semiautonomous guided picking robots, we're rolling out robotic arms, rolling out drones for inventory counts, rolling out all kinds of artificial intelligence and machine learning models, doing all kinds of predictive analytics and the goal is for every single 1 of our 800-plus contract logistics facilities to be state-of-the-art automated; that's the goal, that's the program and that's a major investment and endeavor that we are doing.

Operator

The next question is from the line of Bascome Majors with Susquehanna.

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

The 8-K you filed this morning gave some color on serious restricted stock award around the interim CFO. And the disclosure was basically that stock needs to double again to $200 over the next 5 years, which would be a compound equity or return of about 15% over that period. Brad, can you share your and the board's thought process behind that incentive? And what it says about your longer-term expectations for XPO and shareholders?

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

Yes, we are fervent believers that management should not get paid a lot of money if we don't deliver a lot of shareholder value for our owners. And we are equally fervent believers that if our management team delivers superior value to our shareowners, then they should get paid really well. That is what allows us to attract great talent and that's our philosophy in compensation. In terms of how we calculated the number, it goes back to the earlier question on the call, which is, if we continue to grow EBITDA in the mid- to high-teens percent and then you look at the leverage that we have, and you take the free cash flow we generate and then pay down debt, it's just math. If we keep the same multiple, the stock should go up in the mid-20s per year. And if we get multiple expansion then every turn of multiple expansion is about $13, $14 a share. So with Sarah, we made it so that she gets a grant of about $2.5 million that, at today's price, obviously, we work twice that at $200. And it dependent on that and there's other conditions as well. But we're all in it for the shareholders. So we want our compensation plan to be geared towards shareholder appreciation. It's as simple as that.

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

I appreciate that thoughtful response there. And kind of maybe extending that discussion, I think, we're about 2.5 years into the current long-term incentive plan for senior management, which I believe is tied pretty squarely to improving free cash flow per share of the company. Now -- it sounds like we're about to add some business at the portfolio, before the not too distant future here. Just how do you expect that long-term incentive to maybe change, as we get through the next round of acquisitions here?

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

Well, all of our -- we have many different compensation plans throughout the company. And as you go down in an organization and closer into the field and close to the customer, we like to tie the compensation to what that person or that group of people can do to contribute towards that $1.6 billion EBITDA this year and the higher amount of EBITDA next year and the following in the following year. But we don't just usually tie it to EBITDA. We tie it to EBITDA minus CapEx minus other charges that get us to free cash flow. And at the end of the day, cash is king. And tying compensation to free cash flow makes a lot of sense. But the people in the field don't have a whole lot of control over that. So we try to have their compensation tied to their KPI. At the senior level, we do feel that compensation should be primarily tied towards things that create shareholder value. And from a financial perspective, it's cash.

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

Great. So it sounds like the focus on free cash flow at the senior management level is unlikely to change?

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

It's unlikely to change. You could see variations of it as we adopt best practices and we fine tune it with shareholder input, which we always take. But the basic concept of tying senior management equity incentives to long-term shareholder value is a core part of our culture. We pay our people well, but if and only if, they deliver superior value to our shareholders. Otherwise they get a reasonable, but not great base salary.

Operator

The next question is from the line of Allison Landry with Crédit Suisse.

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

I also wanted to ask a couple of follow-up questions around XPO Direct. First, when you talk about B2C fulfillments, are we talking about parcel or freight or maybe both? And then is XPO exclusively handling the transportation, whether it's LTL, brokerage or the last mile contract carriers? And will you need to meaningfully expand capacity in any of these modes longer-term in order to support that $1 billion of growth longer-term?

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

Okay. Great questions. The network is primarily for heavy goods, but it's also competitive for small parcel solutions, but that's through arrangements with the parcel carriers. We had an RFP and we selected 1 partner for that and that's who we're using. Customers want predictable, fast, integrated, end-to-end solutions for all their transportation needs, that is where the world is going towards. People don't want to have 5 different vendors to get their goods from where they are to the end customer. So that's what we're giving them. We're giving them an opportunity to have an integrated one-stop shop. Will we have to add more capacity as the business grows? Yes, because we expect this to be a $1 billion revenue business within a few years. And each part of the business that we have, whether it's the warehouse component, whether it's LTL component, whether it's last-mile component, we'll grow the business with that. But there will be great returns from it.

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

Okay. Okay, that was helpful. And then it was either Brad or Scott. I'm not sure which one, but earlier you mentioned being selective about picking the right freight and LTL, which I think, has been heavy freight, given the growth in weight per shipment that we have seen. And I know at least prior to the second quarter, Old Dominion was following a similar strategy, but it sounds like more recently, it's been pricing itself out of that market to some extent. So curious, have you guys also seen a shift in the profit profile of some portion of the heavier weight shipments? Or should we continue to expect negative mix from increasing weight per shipment?

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

Hey, Allison, we don't necessarily target heavier weight shipments. We target the shipments that make the most sense in our network. We do not have the heaviest weight per shipment in the industry. If you know that, ours is around 1,450. In certain parts of the industry it's over 1,600 pounds per shipment. We have found that some of the heavier shipments than what is in our existing portfolio are more attractively priced and fit within the network right now. So it's not necessarily a plan to go after heavier weight shipments. It's a plan to offer things that make the most sense in our network that could change over time and has changed in certain instances, where there are some heavier weight shipments on the southeast that we found last year that we found were not as profitable as some other things that are less heavy. But we are seeing increased weights and we expect that for some time.

Operator

The next question is from the line of Ariel Rosa with Bank of America.

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

So first question I want to ask was, obviously we're seeing a really tight brokerage market, there have been a lot of calls throughout the second quarter earnings about -- concerns about peak. And I won't to ask you specifically about peak, but with regard to kind of the sustainability of margins where they are in brokerage, maybe you could talk about what you expect going forward? Do you expect, you can continue to make this kind of progress on the margin front?

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

Brokerage is the hardest one to predict, because it's so volatile and it's so specific to what the market's doing in that particular month, that particular quarter. But I can tell you that the market's real hot and that we are getting really good receptivity from our customers. And that customers are definitely more focused on having guaranteed, reputable suppliers, who're going to perform as opposed to getting the very, very best possible price. So I think margins are going to continue to be pretty good. With respect to the part of your question about the peak, we don't know that we are at a peak, we don't know whether we are or we are not. We hear a lot of people talking about that we might be at a peak and the main reason seems to be that we've had it so good for so many years, so we have to take it seriously that chorus of voices who are predicting we are at a peak. But if we took out all the external voices and just paid attention to what's going on inside our business and what the trends are and what customers are telling us, we would not be thinking this is a peak - or if it were a peak, it's going to be long plateaued peak. In other words, we don't see any indication inside the company from how business is going or from what customers are telling us saying it's going to decelerate and get worse. That we don't see. But we do have to take into strong consideration what the wise folks on Wall Street and elsewhere are saying.

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

Got it. And then just to touch on XPO Direct again, I know a lot of people have asked questions about this. But maybe if you could talk about why you saw -- this was a useful solution for customers, or if it was kind of filling in a gap that customers are asking for? And then it seems like it creates an opportunity to expand your addressable market maybe towards mid-sized clients. Maybe you could talk about whether or not that's true? And what kind of receptivity you have gotten from customers?

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

Absolutely, that's all our major endeavors. We don't invent them here. We invent them by getting input from customers. Trying to understand what the customers want, what they value, how we can help them, how we can be of service to them, it's what they pay money for. And one of the things that customers want is for us to rent out our scale to them. We have scale, we have 800-plus warehouse facilities, we have 400-plus cross-dock facilities, we've got a last-mile hub network that's going to be 85 by September. We have lots and lots of assets that represent capacity to move goods through the supply chain and customers don't just want a little of it, they want to crowd-source the whole part, the whole network. So we are renting out our scale to our customers. And that allows them to reach about 95% of U.S. consumers in 1 to 2 days. And XPO Direct reduces their inventory costs, instead of having their inventory in a large volume in 1 or just a few places in the country, we can use our predictive analytics and work with them to suggest, where it makes sense to place their inventory all across the country in smaller volumes that's closer to the customers we think based on previous history, customers are going to make orders. So that has a couple of advantages to our customers. One is, it allows for quicker delivery, which is big these days, and it allows them to reduce the amount of inventory they have in aggregate around the country.

Operator

The next question is coming from the line of Matt Reustle with Goldman Sachs.

Matthew Edward Reustle - *Goldman Sachs Group Inc., Research Division - Senior Equity Analyst*

Just wanted to touch a bit more on the logistics business and the acceleration you have in implementations there. Is that 3 per week pace that you see continuing into the back half of the year? Any guidance in terms of how that trends into '19? And in a related question, Brad. As you referenced that solid top line outlook that you have into 2019 right now. Is there any inherent shift in mix of where that revenue growth is coming from that you would guide to?

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

Well, the revenue growth is very much across-the-board. You have 11% organic revenue growth company-wide, and you break it out by our 2 business segments, logistics is growing at 14% and transportation is growing at 8.5%. Now are the markets growing 14% and 8.5%? No, they're not. We're obviously taking share and we're growing our business faster than the market, no question about that. But we still expect both of those conditions to persist. Good markets, it helps to outperform the market. Now specifically to your question about our logistics business, the supply chain business. In Europe, we had 13% organic revenue growth. In July, we see continuing strong sales in new business growth in fashion, in general retail, and of course, in e-com and in food and beverage as well. So July was actually up 20% versus last year. Booming organic revenue growth in fashion, low unemployment in almost every country. In the Netherlands, there's almost 0% unemployment. You see the GDP in France is about 1.2%, in U.K. about 1.6% and Spain about 2.7%. So lower than here in the states, but still positive growth. And then if you look at the supply chain business here in North America, 16% growth in North America. So globally, supply chain business is growing 14%, much faster than the market. Now we added 21 million square feet of warehouse space year-over-year that's up 13%. So the amount we grew in our logistics business year-over-year is about the size of many of our smaller competitors, so that's really a fast-pace and we are getting high marks from customers for operational excellence. We added 4,000 new jobs in our logistics business, and lots of momentum there. If you look at this, the logistics pipeline, our logistics pipeline globally is $1.8 billion, which is about 1.5x what it was a year ago. Just absorb that for a second, we had $1.2 billion of logistics pipeline a year ago. We have a $1.8 billion supply chain logistics backlog today. So the short answer to your question is, I see a lot of growth here. So that's going to be one of our stronger growing businesses. Last-mile is also going to grow very fast that's another place we just have a good positioning in the market, that grew about 16.5% in the quarter. I don't know whether it will be 16% or 14% to 15% or 17%, but that mid-teens percent feels like it's going to continue to grow.

Matthew Edward Reustle - *Goldman Sachs Group Inc., Research Division - Senior Equity Analyst*

Okay, that's very helpful. And then one follow up on your CapEx point. You mentioned there's going to be vast opportunities out there again in 2019. When you think about differentiating what those opportunities are, giving more context around technology versus assets? How would you reference that outlook for '19 and where you see the biggest opportunities?

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

Hey, this is Scott. It's growth. It's growth CapEx. The 2 biggest areas of growth CapEx are setting up new contract logistics facilities to support that very rapid growth and also technology investments. Technology investments in customer service, visibility, enabling our customers to get more information about where their freight is at any given time, more automation, more robotics, more on the digital freight marketplace, so matching-up supply versus demand more automatically.

Operator

The next question is from the line of Brian Ossenbeck with JPMorgan.

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

So just, your comment, Brad, on real estate, you're adding -- it sounds like a small competitor in size on a regular basis. So you talked earlier about labor, automation, how you're building a pipeline for inside the warehouses, but how do you approach the market to get the space, right space in the right place when it seems like it's getting increasingly harder to do that. Do you have a commercial real estate team in-house or is it something that you outsource?

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

We do do that in-house, obviously, we use brokers as well. They have listings. We have direct relationships with all the major landlords and owners of warehouse space. I think we're Prologis' fourth biggest customer. And we're very close to our landlords because we're good credit and long-term tenant. So we will continue to capitalize on those relationships and the savvy that we have within our organization, the professional expertise in procuring real estate leases. And I don't think that's the big gating factor. Our bigger gating factor is high-quality labor and the price of that labor, and making sure we are protecting ourselves in our contracts with our customers to -- in the case of increased labor inflation globally.

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

Okay. So on the real estate side, it sounds like, if the market were to get tight in some area, that's something you could probably pass along to the customers through the contract negotiations?

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

Yes, and actually it's in the present tense, not the future tense. Real estate market for kind of real estate that we use is tight and has been tight for a while. And I don't expect it to get untight anytime soon because there's a lot of demand.

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

Okay. And one quick follow up on leverage on the balance sheet. So you used equity revolver to help pay down $400 million of debt a few days ago. So if you can just update us where the leverage stands now, John? And what sort of cash interest savings you expect to get from that and is that something you continue to use free cash for as you evaluate the M&A pipeline? Or are you going to be geared more towards organic growth and investments across the business?

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

When we did the equity arrangement last year that cash is and still is earmarked for M&A. So that's the ultimate purpose of that cash that we raised. On a short-term basis, we did pay down some debt because it's just a smart thing to do from a cash management perspective, from a treasury perspective. If that debt were paid down for whole year, which is not the intent, obviously we plan to do acquisitions with that capital, you'd save about north of $20 million a year in interest savings.

Operator

Our next question comes from the line of Kevin Sterling.

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

John, let me just echo my congratulations to you. I really enjoyed working with you for all these years and best of luck to you in your future endeavors. If I can just give you just a little bit of advice, find a hobby, you don't want to drive your wife too crazy being home more. I have learned from experience. So Brad, you answered most of my questions. I really just have one. As you continue to build out your last-mile offering, dive deeper into the world of e-commerce and I think you said you will be at 85 last mile-hubs by the end of this year. Longer term, say the next 3 to 5 years, how many more last-mile hubs do you need? Is it 150, 200, is that kind of endgame there to really kind of give you penetration across the country?

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

I don't know yet. We want to get to 85 and then take a pause, and see if that does the trick. And see if our customers and more importantly, their end customers are happy with that delivery time. If they are then that's good enough. If it's not then we will do what is necessary to please the customer. But after 85, we're going to pause and see how that looks.

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

Got you, okay. And Scott, I think, last quarter, you had mentioned, Europe, the road-freight market actually has been stronger than North America. Do you think still that's the case? Or has maybe kind of North America caught up a little bit with Europe as the quarter has progressed?

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

It's the case in some places and not in others. So in U.K., it's been very tight, very strong. Spain has been very strong as well. France, not as much as other 2. Those are our 3 big transportation markets.

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

Kevin, if you look at our European transport business, 80% of EBITDA is from 3 things: it's from dedicated, brokerage and LTL. And in Europe, you are seeing -- being a more conservative continent than North America, in my opinion, at least --you have seen bigger migration towards dedicated as opposed to spot. So our dedicated business is growing gang-busters over there. We had the best growth ever in the history of XPO and the former Norbert Dentressangle in the second quarter. It was 5% organic growth. That may not sound like a lot, but for European transport that's pretty good. We had record quarterly EBITDA. So capacity is tight over there and you have a strong pricing environment.

Operator

I'll now turn the floor back to management for closing remarks.

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

Thank you all for giving us the hour. We appreciate the opportunity, and look forward to seeing you soon. Have a good day.

Operator

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