Robert Dunn

Michael Wolleben

HIDDEN OPPORTUNITIES

Valuing possible breakups by providing sum-of-the-parts analysis.

- ✓ XPO Logistics, Inc. (NYSE: XPO) currently operates two segments: (1) Transportation (62% of consolidated sales in 2020 and 67% of adj. EBITDA), which provides asset-based less-than-truckload (LTL) and non-asset-based truck brokerage services in North America and Europe; and (2) Logistics (38% of revenue and 33% of adj. EBITDA in 2020), which operates 212 million sq. ft. of warehouse space in 27 countries and offers supply chain services, such as e-commerce fulfilment, warehousing & distribution, reverse & cold-chain logistics, packaging & labeling, inventory management, and factory & aftermarket support.

- ✓ In January 2020, XPO disclosed a strategic review to explore the potential spin-off or sale of one or more of its business lines (excluding its North American LTL business). The review was terminated in March 2020 (due to market conditions) but a tax-free separation of its freight transportation and contract logistics/warehousing operations was ultimately announced in December 2020. The impending transaction, which is expected to be completed in 2H 2021, is rooted in management's frustration that, despite industry-leading scale and operating performance, in terms of growth, profitability and free cash flow (FCF), its businesses trade at discounts to their most relevant peers. In pursuit of narrowing that discount, XPO is seeking to both simplify its business (hence the spin-off) and achieve investment grade credit ratings at both post-spin entities (which portends that the main use of FCF, which is expected to be $600-$700 million in 2021, will be toward deleveraging).

- ✓ XPO currently trades at ~9.1x 2022E EV/EBITDA, whereas its most applicable LTL and truck brokerage peers trade, on average, at ~15.5x and 12.5x, respectively. Public valuations in the contract logistics space are less consistent but average ~12.0x 2022E EV/EBITDA. In that context, amid solid underlying fundamentals, which we think could support incremental upside to our current forecasts, we see the opportunity for a re-rating across the XPO's portfolio. In that regard, even assuming XPO's discount to peers simply narrows (but does not close) an initial pre-spin fair value estimate of $159 per share, implying more than 25% upside, can be derived (with bull and bear cases of $176 and $141, respectively). While our initial bias is toward the post-spin Transportation business, we think the Logistics business will enjoy favorable secular tailwinds from growth in e-commerce fulfilment and could ultimately see more material upside, in terms of improvements in its operating performance and the magnitude of its multiple expansion, over the longer-term.

XPO Logistics, Inc.

(NYSE: XPO)

Date (4/7/2021)

Price $125.50/share

Market capitalization ~$12.85B

Transportation/XPO Logistics: $111 per share

Logistics/GXO Logistics: $48 per share

SOTP: $159 per share*

***SOTP may not add due to rounding**

NOTE: This publication could be considered as advocating for corporate restructurings. Authors select companies for this report based on the potential for a future value-unlocking transaction. In many cases, these companies have or could come under activist investor pressure, media scrutiny, or general market speculation that a spin-off or asset sale is possible.

IRG Institutional Research Group

PCS Research Group
100 Wall Street, 20th Floor
New York, NY 10005
(212) 233-0100
www.pcsresearchgroup.com

The Background

XPO Logistics, Inc. (NYSE: XPO), based in Greenwich, CT, was, for all intents and purposes, formed in September 2011 when Brad Jacobs made a controlling investment in Express-1 Expedited Solutions, which, at the time, traded under the ticker XPO and generated ~$175 million of annual sales, with the goal of using it as a platform to build a "multibillion-dollar transportation brokerage business over the next several years". Previously, Mr. Jacobs had founded United Waste, which was sold to Waste Management (NYSE: WM), and United Rentals (NYSE: URI), which, although in divergent industries both successfully employed roll-up acquisition strategies in highly fragmented industries. In that context, between 2011-2015, XPO was an active consolidator, making 17 acquisitions, including: 3PD, the largest provider of last-mile service for heavy goods in North America (NA), in August 2013; Pacer International, NA's third largest intermodal transportation provider, in April 2014; New Breed, a contract logistics company, in September 2014; Norbert Dentressangle, a French-based leader in contract logistics, freight brokerage, and global forwarding, which it purchased for ~$3.5 billion in June 2015; and Con-Way Freight, the third largest U.S. LTL company, purchased for ~$3 billion in October 2015. In 2016, XPO sold its NA truckload (TL) unit, primarily the legacy assets of Contract Freighters that were purchased as part of the Con-Way transaction, to TFII International (TFII CN) for ~$558 million and went through a period of integration/digestion, during which it made substantial investments in technology (as well as share repurchases), before completing its most recent acquisition, Kuehne + Nagel's (KNIN SW) U.K. contract logistics operations, in January 2021.

Background #1 XPO Logistics, Inc.: Consolidated Selected Financial Items, 2017–2022E
($ in millions)

	2017	2018	2019	2020	2021E	2022E
Revenue:						
Transportation	$10,276	$11,343	$10,687	$10,199	$11,039	$11,456
Logistics	$5,229	$6,065	$6,093	$6,182	$7,187	$7,713
Eliminations	($124)	($129)	($132)	($129)	($130)	($130)
Total	**$15,381**	**$17,279**	**$16,648**	**$16,252**	**$18,096**	**$19,039**
Adj. operating income:						
Transportation	$618	$738	$818	$606	$874	$976
Logistics	$238	$257	$277	$217	$323	$386
Corporate	($147)	($149)	($166)	($196)	($207)	($233)
Total	**$709**	**$846**	**$929**	**$627**	**$991**	**$1,129**
Depreciation & amortization:						
Transportation	$447	$461	$447	$453	$468	$484
Logistics	$203	$244	$277	$301	$321	$349
Corporate	$8	$11	$15	$12	$12	$13
Total	**$658**	**$716**	**$739**	**$766**	**$800**	**$847**
Adjusted EBITDA:						
Transportation	$1,065	$1,199	$1,265	$1,059	$1,342	$1,460
Logistics	$441	$501	$554	$518	$645	$735
Corporate	($139)	($138)	($151)	($184)	($196)	($220)
Total	**$1,367**	**$1,562**	**$1,668**	**$1,393**	**$1,791**	**$1,975**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Today, XPO operates two segments (see Background #1): (1) Transportation (62% of 2020 sales and ~67% of adjusted EBITDA), which provides asset-based less-than-truckload (LTL) and non-asset-based truck brokerage services in North America and Europe; and (2) Logistics (~38% of sales and 33% of adjusted EBITDA in 2020), which operates ~212 million sq. ft. of warehouse space in 27 countries and offers supply chain services such as e-commerce fulfilment, warehousing & distribution, reverse & cold-chain logistics, packaging & labeling, inventory management, and factory & aftermarket support.

That said, as mentioned earlier, on December 2, 2020, XPO announced plans to separate its contract logistics business from its freight transportation operations via a tax-free spin-off that is expected to be completed in 2H 2021. (In terms of its progress, the company recently filed its Form 10 with the SEC, albeit confidentially, but remains in the process of finalizing its post-spin management/board structure as well as the ultimate inter-segment allocation of debt.) The new standalone company, which is expected to be the second largest contract logistics provider globally, will adopt the corporate moniker GXO Logistics, Inc. (As an aside, the corporate moniker GXO is meant to represent the "game-changing" opportunities it brings to its customers, along with a "nod" to its XPO heritage.) The stock is expected to initially trade on the New York Stock Exchange (NYSE), although management has stated that the spin company is likely to pursue a dual listing on the London Stock Exchange, at some point. Post-spin, Brad Jacobs, XPO's current chairman and chief executive, will retain those positions at RemainCo, which will maintain the current corporate moniker, XPO Logistics, while also serving as chairman of GXO Logistics, where Malcolm Wilson, the current head of XPO Logistics Europe, will take the helm as chief executive.

For background, this separation announcement followed a strategic review that was announced in January 2020 but terminated in March 2020, given market conditions amid the burgeoning COVID-19 pandemic. At the review's inception, XPO indicated that the potential spin-off or sale of one or more of its business lines would be explored, with the exception of its North American less-than-truckload (LTL) operation, which essentially represents the legacy operations of Con-Way Freight, which XPO purchased in 2015. At the time, the decision to both break up the business and increase the focus on its more asset-based operation (although the truck brokerage business is non-asset based) could have been viewed by some investors as a somewhat surprising tack for Mr. Jacobs given that he is known for active acquisition strategies in fragmented industries and that his initial focus after assuming control of XPO in 2011 was squarely on non-asset-based and asset-light transportation services. That said, the impending transaction seems rooted in management's frustration that, despite industry-leading scale and operating performance in terms of growth, profitability, and free cash flow generation, its myriad businesses trade at persistent discounts to their most relevant peers. In pursuit of narrowing this perceived discount, XPO is seeking to both simplify the company (hence the proposed spin-off, which essentially separates its freight-moving and warehousing businesses) and to achieve investment-grade credit ratings for both RemainCo and GXO. (As such, although the company is still in discussions with rating agencies on how to optimally allocate debt, it could be expected that the most likely use of near-term free cash flow, which is projected to be $600-$700 million in 2021, will be toward leverage reduction.) As well, the company sees potential commercial benefits from more focused management and capital allocation, particularly with regard to each business's specialized technology requirements, as well as from having pure-play equity currencies that could facilitate longer-term M&A. (With respect to potential dis-synergies, management anecdotally suggests that $10-$20 million of potential incremental costs will likely be offset by operating efficiencies, of which management sees, on a combined basis, $700 million-$1 billion looking toward 2023-2024.)

Additionally, for some near-term context, the company has provided selected consolidated 2021 financial guidance, including adjusted EBITDA of $1.725-$1.800 billion, adjusted diluted EPS (excluding acquisition-related amortization of intangibles) of $5.10-$5.85 (versus an apples-to-apples comparison of $2.97 per share in 2020), and free cash flow of $600-$700 million (see Background #2). Regarding share count, management indicates that "with nearly all of our outstanding convertible preferred stock having been converted into common stock in December (2020), we'll have 113 million diluted shares outstanding this year (2021)".

Background #2 XPO Logistics, Inc.: 2021E Consolidated Financial Guidance s
($ in millions)

	2020A	2021E
Adjusted EBITDA	**$1.393 billion**	**$1.725 - $1.80 billion**
Depreciation & amortization	$766 million	$780 - $800 million
Interest expense	$325 million	$275 - $285 million
Effective tax rate	21%	24% - 26%
Adjusted EPS	**$2.97**	**$5.10 - $5.85**
Gross capital expenditures	$526 million	$625 - $675 million
Net capital expenditures	$331 million	$475 - $525 million
Free cash flow	**$554 million**	**$600 - $700 million**

Source: Company reports.

Transportation – XPO Logistics (RemainCo)

The Transportation segment primarily provides asset-based, over-the-road, less-than-truckload (LTL) transportation services (~43% of segment sales in 2020), as well as non-asset-based truck brokerage (TB) services (~42% of segment sales in 2020), along with so-called last-mile logistics (~9%), managed transportation (3%), and global freight forwarding services (3% of segment sales in 2020), in North America and Europe (see Background #3). In terms of the geographic split, ~72.5% of Transportation segment sales, including the bulk of its LTL and TB offerings along with all its last-mile and managed transportation services, are generated in North America, while 24.5% of segment sales, primarily LTL and TB, are generated in Europe (with the remainder being comprised of its global forwarding services).

Background #3 XPO Logistics, Inc.: Transportation Segment, Selected Financial Items (2017-2022E)
($ in millions)

	2017	2018	2019	2020	2021E	2022E
Total revenue	**$10,276**	**$11,343**	**$10,687**	**$10,199**	**$11,039**	**$11,456**
LTL	$4,519	$4,839	$4,815	$4,450	$4,824	$4,983
Freight brokerage	$4,148	$4,784	$4,383	$4,373	$4,751	$4,942
Last mile	$966	$1,065	$873	$908	$976	$1,030
Managed transportation	$494	$462	$496	$344	$361	$370
Global forwarding	$301	$338	$299	$300	$308	$311
Eliminations	($152)	($145)	($179)	($176)	($180)	($180)
Operating income	**$547**	**$646**	**$752**	**$507**	**$874**	**$976**
Other	*$20*	*$41*	*$31*	*$54*	-	-
Litigation	-	*$26*	-	-	-	-
Transaction & integration	-	*$13*	*$3*	*$21*	-	-
Restructuring	*$51*	*$12*	*$32*	*$24*	-	-
Adj. operating income	**$618**	**$738**	**$818**	**$606**	**$874**	**$976**
North American LTL	$442	$523	$656	$573	$695	$739
Depreciation & amortization	$447	$461	$447	$453	$468	$484
Adjusted EBITDA	**$1,065**	**$1,199**	**$1,265**	**$1,059**	**$1,342**	**$1,460**
North American LTL	$641	$733	$849	$763	$891	$943
Adj. operating margin	6.0%	6.5%	7.7%	5.9%	7.9%	8.5%
Adj. EBITDA margin	10.4%	10.6%	11.8%	10.4%	12.2%	12.7%

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Less-than-truckload (LTL) transportation, as the name suggests, primarily serves shippers with less than a full truckload of freight (typically less than 10,000 lbs.) and involves the movement of goods for multiple customers on a single truck. By its nature, the LTL transportation model takes a "hub and spoke" approach that could be conceptually thought of as akin to a postal or parcel service but for heavier freight. Roughly 80% (or ~$3.6 billion) of XPO's LTL revenue is generated in North America (NA), where its network of 290 terminals/service centers, 7,800 tractors, and 25,000 trailers facilitate service of more than 75,000 next-day and second-day delivery lanes. [Note: XPO's U.S. LTL footprint largely reflects the legacy operations of Con-Way Freight (formerly NYSE: CNW), which XPO purchased for ~$3 billion in October 2015.] By revenue, XPO is the third largest LTL player in North America behind FedEx Freight (NYSE: FDX) and Old Dominion Freight Line (NASDAQ: ODFL). Other competitors in the relatively consolidated NA LTL market, where the top 10 players control ~70% of the $40-$50 billion market (and the top 25 well above 80% of the market), include Yellow Corp. (NASDAQ: YELL), Estes Express (private), UPS Freight (NYSE: UPS), ArcBest Corp. (NASDAQ: ARCB), Saia, Inc. (NASDAQ: SAIA), R + L Carriers (private), and Southeastern Freight Lines (private). As well, we would note that from a profitability perspective, XPO's LTL business compares favorably against peers, with only Old Dominion posting a lower operating ratio (see Background #4). [Note: operating ratio or OR is an industry-specific metric for profitability that is simply the inverse of a traditional operating margin calculation; as such, lower is better.]

Background #4 XPO Logistics, Inc.: North American LTL – Peer Profitability Comparison (OR)

	2017	2018	2019	2020
Old Dominion (ODFL)	82.9%	79.8%	80.1%	77.4%
XPO Logistics (XPO)	**87.7%**	**86.2%**	**82.7%**	**83.8%**
Saia, Inc. (SAIA)	93.3%	91.5%	91.5%	90.1%
FDX Freight (FDX)	89.8%	92.4%	93.5%	91.8%
ArcBest (ARCB)	97.1%	95.2%	95.2%	95.3%
Yellow Corp. (YELL)	97.6%	97.2%	99.7%	98.7%

Source: Company reports and Bloomberg.

Truck brokerage (TB) takes a non-asset-based approach to matching shippers' loads with third-party capacity; to that end, XPO is the "middleman" between those with freight to ship, in this case typically a full truckload, and those with the capacity/equipment to move it. (On the capacity side, it can be noted that in stark comparison to the LTL market, the ~$350 billion U.S. truckload or TL transportation market remains highly fragmented, with the top 10 players controlling less than 10% of the market and the top 50 less than 30%. The U.S. brokerage market is also relatively fragmented, with over 10,000 players, of which only about ten generate more than $200 million of annual net revenue.) In its brokerage operation, XPO does not own the physical transportation assets but rather leverages its proprietary technology platform and relationships with some 60,000 carriers in North America (and 75,000 globally) to help meet the shipping needs of a diverse customer base across myriad sectors, such as retail/e-commerce (23% of 2020 revenue), food & beverage (21%), industrial & manufacturing (19%), transportation & logistics (12%), agriculture & chemicals (4%), automotive (5%), and consumer (5%), among others (11% of 2020 revenue). XPO is the third largest brokerage player in North America, where TB generated ~62% of its sales in 2020, behind C.H Robinson (NASDAQ: CHRW) and Total Quality Logistics (private), and the second largest globally (with strong positions in the U.K., France, Spain, Portugal, and Morocco). Other competitors include Coyote Logistics, which was purchased by UPS (NYSE: UPS) in 2015, Echo Global Logistics (NASDAQ: ECHO), Landstar (NASDAQ: LSTR), Worldwide Express (private), and GlobalTranz (private), as well as brokerage divisions of trucking companies such as J.B. Hunt (NASDAQ: JBHT). Among the company's other non-asset-based services, which include managed transportation and global forwarding, we would highlight the so-called last-mile logistics business, which facilitates the delivery of heavy goods, such as appliances, electronics, and furniture, directly to the consumer's home (often with installation or so-called "white glove" service) as an attractive growth opportunity, given the increasing penetration of e-commerce.

In 2017-2019, following the acquisition of CNW (~$5.2 billion of annual sales, ex truckload) in late 2015, XPO's Transportation segment posted primarily organic compound annual top-line growth of 2.5%, with an ~11% CAGR for adjusted EBITDA. In 2020, segment sales fell ~4.5% to

$10.2 billion, primarily due to the impact of COVID-19 (along with lower fuel revenue), with a ~26% decline in adjusted operating income to $606 million and a 16% decline in adjusted EBITDA to $1.06 billion (see Background #3). As illustrated in Background #3, Transportation's North American LTL operation represents the bulk of segment profitability, which, along with the company's North American truck brokerage (~3% operating margin) and last-mile business lines, suggests that the company's European operations, primarily LTL and TB, make a minimal contribution from an operating profit perspective (but where the opportunity for improvement will clearly be a management focus in the next several years).

Within a broadly constructive outlook for freight transportation, for which the American Trucking Association (ATA) has pegged average annual growth in general freight tonnage at 2.8% in 2021-2031 and growth in trucking volumes at 4.9% in 2021, followed by average annual growth of 3.2% per year through 2026, we would note that, in our estimation, U.S. industrial production is also a solid barometer for the less-than-truckload sector specifically. In that regard, Trading Economics estimates U.S. industrial production growth of 3.6% in 2022 and 3.2% in 2023, while the Congressional Budget Office forecasts broader growth in gross domestic product (GDP) to be 3.7% in 2021, 2.4% in 2022, and 2.3% in 2023. (As well, we would note that the ISM Manufacturing Index hit its highest mark since December 1983 at 64.7% in March 2021, following readings of 58.7% and 60.8% in January and February 2021; for context, any reading above 43.1%, over a period of time, generally indicates an expansion of the overall economy.) Longer term, while acknowledging that the sector is clearly still cyclical, we would note that pricing discipline within the highly consolidated LTL sector, which has high barriers to entry, has tended to serve as a mitigating factor for the industry during periods of economic contraction. With respect to truck brokerage, with the tailwinds for growth from outsourcing and just-in-time inventory management, which has helped drive the industry's penetration rate to ~20% in 2020 (from 10% in 2008; potentially reaching 30%-plus in 2030), as well as e-commerce and last-mile delivery, most industry estimates suggest the brokerage industry will outpace growth in the broader transport industry (and GDP) over the next decade. (As well, while we would note that the asset-light model reduces overall cyclicality, gross margin can be sensitive to shifts in underlying industry capacity.) As it relates to XPO specifically, management recently indicated, anecdotally, that, given current trends, its North American LTL segment should experience "operating ratio improvement of at least a couple of hundred basis points excluding real estate" in 2021. Longer term, the company has set a target for the North American LTL operation to achieve adjusted EBITDA of "at least $1 billion" in 2022, as it continues to optimize its pricing, routing (for both line-haul and pickup & delivery), and asset utilization technology. On the North American truck brokerage side, Armstrong & Associates predicts the U.S. brokerage market will grow in excess of 5% over the next five years, and XPO management expects to narrow the gap in profitability (~200-300 bps) with best-in-class peers such as CHRW, which sported an operating margin of ~5.0%-5.5% in 2019-2020.

Assuming compound annual top-line growth of ~6% in 2021-2022, with incremental margins in the mid-30%s at the North American LTL segment, which is conservative relative to the aforementioned anecdotal guidance, and only modest improvements in profitability in the remaining business lines, it is possible to derive 2022E segment sales and adjusted EBITDA of $11.45 billion and $1.46 billion, respectively (see Background #3).

Logistics – GXO Logistics (SpinCo)

The Logistics segment designs, implements, and manages supply chains for customers; to that end, the company operates ~212 million sq. ft. of global warehouse space across 890 locations in 27 countries and provides services, such as e-commerce fulfilment, warehousing & distribution, inventory management, reverse logistics (i.e., returns), cold-chain logistics (i.e., for temperature-sensitive goods), packaging & labeling, and factory & aftermarket support (i.e., procurement, sub-assembly, and tracking) to the retail/e-commerce (39% of 2020 segment sales), food & beverage (13%), consumer & packaged goods (13%), and consumer electronic/technology (11%) sectors, among others (24% of segment sales in 2020). In terms of geographic dispersion, XPO has 103 million sq. ft. of warehouse capacity in Europe, 101 million sq. ft. in the U.S., and ~8 million sq. ft. in Asia. By revenue, the company generates ~62% of sales in Europe and ~38% in North America, with a large majority of revenue from the U.S., U.K., France, and Spain (see Background #5).

Background #5 XPO Logistics, Inc.: Logistics Segment, Selected Financial Items (2017-2022E)
($ in millions)

	2017	2018	2019	2020	2021E	2022E
Revenue	**$5,229**	**$6,065**	**$6,093**	**$6,182**	**$7,187**	**$7,713**
North America	$2,024.0	$2,358.0	$2,468	$2,359	$2,477	$2,650
Europe	$3,205.0	$3,707.0	$3,625	$3,823	$4,710	$5,063
Operating income	**$202**	**$216**	**$241**	**$140**	**$323**	**$386**
Other	*$20*	*$31*	*$22*	*$27*	-	-
Transaction & integration	*$16*	*$4*	-	*$28*	-	-
Restructuring	-	*$6*	*$14*	*$22*	-	-
Adj. operating income	**$238**	**$257**	**$277**	**$217**	**$323**	**$386**
Depreciation & amortization	$203	$244	$277	$301	$321	$349
Adjusted EBITDA	**$441**	**$501**	**$554**	**$518**	**$645**	**$735**
Adj. operating margin	4.6%	4.2%	4.5%	3.5%	4.5%	5.0%
Adj. EBITDA margin	8.4%	8.3%	9.1%	8.4%	9.0%	9.5%

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Logistics is an asset-light business (e.g., more than 40% of its facilities are owned or leased by customers), with relatively low cyclicality, long-term contractual relationships (i.e., five years or more), and high renewal rates (i.e., better than 95%), and one where XPO has established itself as a leader, not only in terms of scale, as it is the second largest player (behind Deutsche Post AG [DPW GR]) in a ~$130 billion market, but also in technological sophistication, most notably in the use of automation & robotics. Other competitors include Ceva Logistics (part of privately held

CMA CGM Group), Clipper Logistics (CLG LN), DB Schenker (private), DSV Panalpina (DSV DC), Kuehne + Nagel (KNIN SW), and UPS Supply Chain (NYSE: UPS).

In 2017-2019, following several acquisitions in 2014-2015, including New Breed (~$597 million in annual sales) in late-2014 and Norbert Dentressangle (~$5.5 billion in annual sales) in mid-2015, XPO's Logistics segment posted primarily organic compound annual top-line growth of almost 9%, despite the loss of ~$600 million worth of business with Amazon (NASDAQ: AMZN), which took about two thirds of its outsourcing spend in-house during 2019, and posted a ~15% CAGR in adjusted EBITDA. In 2020, segment sales increased 1.5% to ~$6.2 billion, primarily driven by growth in its European business, which more than offset the impact of COVID-19 as well as the elimination of some low-margin businesses and the ongoing impact of Amazon's in-sourcing initiative, while adjusted operating income declined ~21.5% to $217 million and adjusted EBITDA fell less than 5% to $518 million (see Background #5).

In our estimation, the contract logistics industry stands to continue benefiting from a trend toward outsourcing as well as, more importantly, secular growth in e-commerce fulfilment (and omnichannel retailing), which, per Transport Intelligence, is growing in excess of 10% annually. Moreover, as a leader in automation/robotics (and the use of technology more broadly), we view XPO as critical to its customers' need to increase the speed, efficiency, and accuracy of their supply chains, which are likely to become increasingly fragmented, while reducing costs (as e-commerce can be significantly more labor intensive than brick & mortar retailing). In that context, we do not think it is unreasonable to expect high-single-digit/low-double-digit organic growth over the next several years. For 2021, it should be noted that in January 2021 XPO closed on the acquisition of Kuehne + Nagel's U.K. contract logistics operations (~$585 million of annual sales in 2020 and projected sales of ~$600 million in 2021), and it has indicated it has several "high-profile" engagements/contracts commencing, including the operation of a fully automated facility in the Netherlands for Danone's (BN FP) healthcare products business, Nutricia. As well, on March 30th, the company announced that its 638,000 sq. ft. facility in Leicestershire, England, which serves Nestle (NESN SW) and is billed as the Digital Distribution Warehouse of the Future, had ramped up to full operation (following its initial opening in 2H 2020). More specifically, the company has anecdotally indicated the expectation that segment adjusted EBITDA could advance 24%-29% for full year 2021. Additionally, the company has anecdotally discussed the expectation that incremental margins on organic growth could be "into the 20%s", which, by our calculation, suggests the segment's adjusted EBITDA margin could expand into the double-digit range over the next several years.

Assuming compound annual top-line growth of ~11.5% in 2021-2022, with incremental margins in the low double-digits, which, again, seems conservative relative to the aforementioned anecdotal guidance, 2022E segment sales and adjusted EBITDA of $7.7 billion and $735 million, respectively, could be projected (see Background #5).

Balance Sheet and Cash Flow

XPO ended 2020 with net debt of $4.65 billion, including $2.05 billion in cash and $6.7 billion in debt, and a net leverage ratio of 3.3x (see Background #6). In early March 2021, XPO closed a refinancing of its existing $2 billion term loan, which previously had a $1.5 billion term B facility that bore interest of LIBOR plus 2.0%, as well as a $500 million term B-1 facility that bore interest of LIBOR plus 2.5%. The refinanced facility, which still matures in February 2025, bears interest of LIBOR plus 1.75%. This transaction, along with ~$1.2 billion of debt the company indicated was repaid in January 2021, is expected, per management, to reduce annual interest expense by ~$86 million. (For context, XPO's previous guidance for 2021 interest expense was $275-$285 million.) Currently, XPO's credit rating, per Moody's and S&P, is Ba2 and BB-, respectively; the company indicates it remains in discussion with the rating agencies to finalize the optimal distribution of debt post-spin but that its stated goal is for both standalone companies to ultimately achieve investment-grade status. While we will make more granular forecasts of allocation of debt upon further management disclosure, it is our initial expectation that the post-spin Logistics business, GXO Logistics, would likely be levered around 1.0x (or less), implying that the post-spin Transportation company, XPO Logistics, would have a leverage ratio of ~2.5x-3.0x. In its pursuit of an investment-grade credit rating, which management strives to achieve "as soon as practically possible", the company is cognizant that it is "going to have to bring the leverage levels down".

Background #6 XPO Logistics, Inc.: Balance Sheet Snapshot
($ in millions)

	2017	2018	2019	2020
Cash	**$397**	**$502**	**$377**	**$2,054**
Short-term debt	$104	$367	$84	$1,338
Long-term debt	$4,418	$3,902	$5,182	$5,369
Total debt	**$4,522**	**$4,269**	**$5,266**	**$6,707**
ABL facility	$100	-	-	$200
Term loan	$1,456	$1,474	$1,969	$1,974
6.5% senior notes due 2022	$528	$529	$1,192	$1,195
6.125% senior notes due 2023	$1,583	$1,190	$530	$531
6.75% senior notes due 2024	$203	$205	$987	$989
6.25% senior notes due 2025	$299	-	-	$1,138
6.70% senior notes due 2034	-	$281	$208	$210
Securitizations	$105	$246	-	$50
Finance leases	$248	$344	$380	$420
Net debt	**$4,125**	**$3,767**	**$4,889**	**$4,653**
Leverage ratio	3.3x	2.7x	3.2x	4.8x
Leverage ratio, net	**3.0x**	**2.4x**	**2.9x**	**3.3x**

Source: Company reports.

For 2021, on a pre-spin consolidated basis, management has forecasted free cash flow of $600-$700 million, based on a capital spending budget, net of asset disposals, of $475-$525 million (see Background #7). Given the company's aforementioned balance sheet improvement goals, it could be reasonably assumed that the bulk of free cash flow will be deployed toward leverage reduction, at least in the near term, which, could add incremental upside to our current valuation scenarios. That said, we discern that additional M&A remains likely over the longer-term.

Background #7 XPO Logistics, Inc.: Sources and Uses of Cash Flow

($ in millions, except per share amounts)

	2017	2018	2019	2020	2021E	2022E
Net income	$360	$444	$440	$117	$593	$763
Depreciation & amortization	$658	$716	$739	$766	$800	$847
Other	($233)	($58)	($388)	$2	($200)	($225)
Net cash from operations	**$785**	**$1,102**	**$791**	**$885**	**$1,194**	**$1,384**
Cash from deferred purchase receivable	-	-	$186	-	-	-
Purchase of property, plant & equipment	($504)	($551)	($601)	($526)	($675)	($675)
Proceeds from the sale of assets	$118	$143	$252	$195	$150	$100
Net capital expenditures	**($386)**	**($408)**	**($349)**	**($331)**	**($525)**	**($575)**
Free cash flow	**$399**	**$694**	**$628**	**$554**	**$669**	**$809**
Acquisitions	-	-	-	-	($300)	-
Divestitures	$548	-	-	-	-	-
Share offerings	$288	-	-	-	-	-
Share repurchases	-	($536)	($1,347)	($114)	-	-

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

The Breakdown

Based on the assumptions discussed throughout this report, we think it can be reasonably projected that XPO could generate 2022E sales and adjusted EBITDA of ~$19.0 billion and ~$1.975 billion, respectively (see Breakdown #1).

Breakdown #1 XPO Logistics, Inc.: Adjusted 2017-2020 Results and 2021E-2022E Forecasts
($ in millions)

	2017	2018	2019	2020	2021E	2022E
Revenue:						
Transportation	$10,276	$11,343	$10,687	$10,199	$11,039	$11,456
Logistics	$5,229	$6,065	$6,093	$6,182	$7,187	$7,713
Eliminations	($124)	($129)	($132)	($129)	($130)	($130)
Total	**$15,381**	**$17,279**	**$16,648**	**$16,252**	**$18,096**	**$19,039**
Adj. operating income:						
Transportation	$618	$738	$818	$606	$874	$976
Logistics	$238	$257	$277	$217	$323	$386
Corporate	($147)	($149)	($166)	($196)	($207)	($233)
Total	**$709**	**$846**	**$929**	**$627**	**$991**	**$1,129**
Depreciation & amortization:						
Transportation	$447	$461	$447	$453	$468	$484
Logistics	$203	$244	$277	$301	$321	$349
Corporate	$8	$11	$15	$12	$12	$13
Total	**$658**	**$716**	**$739**	**$766**	**$800**	**$847**
Adjusted EBITDA:						
Transportation	$1,065	$1,199	$1,265	$1,059	$1,342	$1,460
Logistics	$441	$501	$554	$518	$645	$735
Corporate	($139)	($138)	($151)	($184)	($196)	($220)
Total	**$1,367**	**$1,562**	**$1,668**	**$1,393**	**$1,791**	**$1,975**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Breakdown #2 XPO Logistics, Inc.: Public Comparables

($ in millions, except per share amounts)

4/6/2021	XPO Logistics Inc	Old Dominion Freight Line Inc	Saia Inc	ArcBest Corp	FedEx Corp	Yellow Corp	CH Robinson Worldwide Inc	Echo Global Logistics Inc	Landstar System Inc
Ticker	XPO	ODFL	SAIA	ARCB	FDX	YELL	CHRW	ECHO	LSTR
Price	$125.50	$244.59	$228.67	$72.15	$282.17	$9.14	$97.56	$32.38	$168.64
Shares Out	102.2	116.9	26.3	25.4	265.3	51.2	131.1	26.6	38.4
M Cap	12,826.6	28,601.6	6,020.8	1,832.3	74,871.6	467.8	12,794.2	861.6	6,477.2
Cash & Equiv	2,054.0	731.7	25.3	369.4	8,856.0	439.3	243.8	41.3	290.7
Minority Interest	140.0	-	-	-	-	-	-	-	-
Total Debt	6,707.0	99.9	71.0	284.2	23,443.0	1,225.4	1,093.3	133.9	175.5
Net Debt	4,793.0	(631.8)	45.7	(85.1)	14,587.0	786.1	849.5	92.6	(115.2)
EV	17,620.6	27,969.9	6,066.5	1,747.1	89,458.6	1,253.9	13,643.7	954.2	6,362.0
Revenue									
2019	16,648.0	4,109.1	1,786.7	2,988.3	69,693.0	4,871.2	15,309.5	2,185.0	4,089.6
2020E	15,835.1	3,988.5	1,820.8	2,927.1	68,285.6	4,508.0	15,875.7	2,460.2	4,035.8
2021E	18,148.8	4,651.6	2,043.8	3,355.9	81,871.1	4,866.0	17,477.0	2,876.2	4,691.5
2022E	18,952.7	5,084.0	2,208.3	3,464.6	85,728.0	5,062.3	17,886.1	2,917.3	4,749.4
EV / Sales									
2019	1.1x	6.8x	3.4x	0.6x	1.3x	0.3x	0.9x	0.4x	1.6x
2020E	1.1x	7.0x	3.3x	0.6x	1.3x	0.3x	0.9x	0.4x	1.6x
2021E	1.0x	6.0x	3.0x	0.5x	1.1x	0.3x	0.8x	0.3x	1.4x
2022E	0.9x	5.5x	2.7x	0.5x	1.0x	0.2x	0.8x	0.3x	1.3x
EBITDA		26.6%	16.5%				6.3%		
2019	2,200.0	1,093.2	294.6	242.2	8,573.0	335.2	958.9	79.9	341.9
2020E	1,329.9	1,162.6	312.4	226.3	6,426.2	194.0	750.0	74.8	300.2
2021E	1,769.9	1,422.4	388.1	275.3	9,830.3	297.3	891.2	96.8	384.5
2022E	1,931.5	1,586.5	440.2	294.6	10,774.3	334.8	948.6	101.4	392.9
EV / EBITDA									
2018	11.9x	26.7x	24.9x	7.5x	11.3x	3.9x	13.5x	10.5x	17.0x
2019	8.0x	25.6x	20.6x	7.2x	10.4x	3.7x	14.2x	11.9x	18.6x
2020E	13.2x	24.1x	19.4x	7.7x	13.9x	6.5x	18.2x	12.8x	21.2x
2021E	10.0x	19.7x	15.6x	6.3x	9.1x	4.2x	15.3x	9.9x	16.5x
2022E	**9.1x**	**17.6x**	**13.8x**	**5.9x**	**8.3x**	**3.7x**	**14.4x**	**9.4x**	**16.2x**
EPS									
2019	$3.28	$5.15	$4.29	$2.71	$15.56	($2.90)	$4.19	$0.58	$5.70
2020E	$1.43	$5.64	$5.01	$3.18	$8.67	($1.58)	$3.61	$1.22	$5.04
2021E	$5.37	$7.22	$6.75	$4.13	$17.66	($0.37)	$4.34	$1.83	$6.62
2022E	$6.24	$8.25	$7.89	$4.48	$19.47	$0.17	$4.70	$1.90	$6.95
P/E									
2019	38.3x	47.5x	53.3x	26.7x	18.1x	-	23.3x	55.6x	29.6x
2020E	87.6x	43.4x	45.7x	22.7x	32.5x	-	27.1x	26.7x	33.5x
2021E	23.4x	33.9x	33.9x	17.5x	16.0x	-	22.5x	17.7x	25.5x
2022E	20.1x	29.6x	29.0x			52.8x	20.8x	17.1x	24.3x
P/B	4.7x	8.6x	6.2x	2.2x	3.4x	-	7.0x	2.1x	9.4x
Dividend Yield	0.0%	0.2%	0.0%	0.4%	1.2%	0.0%	2.1%	0.0%	1.7%
FCF Yield	3.1%	2.5%	1.3%	8.9%	5.2%	14.8%	3.6%	5.0%	2.8%
ROE	12.2%	21.4%	15.1%	5.4%	2.9%	-	35.3%	3.8%	32.3%
ROIC	6.1%	19.0%	11.4%	4.8%	17.6%	-0.4%	19.4%	3.9%	24.8%
Operating ROIC	9.8%	25.5%	15.1%	5.8%	11.9%	7.9%	25.3%	6.2%	32.1%
Leverage Ratio (2021)	2.7x	-	0.1x	-	1.5x	2.6x	1.0x	1.0x	-
Leverage ratio (2022)	2.5x	-	0.1x	-	1.4x	2.3x	0.9x	0.9x	-

4/6/2021	JB Hunt Transport Services Inc	Expeditors International of Washington Inc	Hub Group Inc	Clipper Logistics PLC	Deutsche Post AG	DSV PANALPINA A/S	Kuehne + Nagel International AG	United Parcel Service Inc
Ticker	JBHT	EXPD	HUBG	CLG LN	DPW GR	DSV DC	KNIN SW	UPS
Price	$169.30	$109.94	$66.64	$617.00	$47.19	$1,251.50	$274.30	$172.97
Shares Out	105.7	168.7	33.8	101.8	1,239.1	230.0	120.0	721.4
M Cap	17,895.9	18,546.2	2,294.7	627.8	58,465.0	287,845.0	32,916.0	150,382.4
Cash & Equiv	313.3	1,527.8	124.5	-	4,563.0	4,060.0	1,697.0	6,316.0
Minority Interest	-	3.6	-	-	301.0	(88.0)	6.0	12.0
Total Debt	1,305.4	-	272.2	-	8,585.0	8,881.0	402.0	24,654.0
Net Debt	992.1	(1,524.2)	147.7	-	4,323.0	4,733.0	(1,289.0)	18,350.0
EV	18,888.0	17,022.0	2,442.3	631.5	62,788.0	292,578.0	31,627.0	168,732.4
Revenue								
2019	9,165.3	8,175.4	3,668.1	460.2	63,341.0	94,701.0	21,094.0	74,094.0
2020E	9,489.1	9,413.9	3,473.6	506.3	66,714.4	114,771.0	23,590.8	82,587.7
2021E	10,853.6	10,512.3	3,989.6	659.7	70,270.5	121,701.5	23,592.3	87,600.9
2022E	11,723.4	10,348.0	4,230.4	743.3	72,468.0	126,863.9	24,717.2	90,905.2
EV / Sales								
2019	2.1x	2.1x	0.7x	1.4x	1.0x	3.1x	1.5x	2.3x
2020E	2.0x	1.8x	0.7x	1.2x	0.9x	2.5x	1.3x	2.0x
2021E	1.7x	1.6x	0.6x	1.0x	0.9x	2.4x	1.3x	1.9x
2022E	1.6x	1.6x	0.6x	0.8x	0.9x	2.3x	1.3x	1.9x
EBITDA				6.4%	12.1%	10.6%	8.2%	
2019	1,353.7	899.6	287.4	29.4	7,638.0	10,034.0	1,732.0	11,153.0
2020E	1,231.1	959.6	231.5	34.3	8,552.3	13,646.9	1,854.4	10,747.7
2021E	1,464.5	1,024.3	278.7	79.2	9,586.8	15,510.2	1,903.8	12,493.1
2022E	1,622.4	1,044.9	314.8	86.4	10,024.2	16,115.4	2,014.9	13,383.4
EV / EBITDA								
2018	16.7x	20.0x	11.8x	23.7x	9.4x	47.1x	26.9x	17.6x
2019	14.0x	18.9x	8.5x	21.5x	8.2x	29.2x	18.3x	15.1x
2020E	15.3x	17.7x	10.6x	18.4x	7.3x	21.4x	17.1x	15.7x
2021E	12.9x	16.6x	8.8x	8.0x	6.5x	18.9x	16.6x	13.5x
2022E	**11.6x**	**16.3x**	**7.8x**	**7.3x**	**6.3x**	**18.2x**	**15.7x**	**12.6x**
EPS								
2019	$5.33	$3.39	$3.38	$0.13	$1.98	$20.32	$6.04	$7.53
2020E	$4.66	$3.99	$2.29	$0.15	$2.76	$27.47	$6.43	$7.70
2021E	$6.15	$4.21	$3.14	$0.23	$2.89	$36.85	$7.58	$8.92
2022E	$7.18	$4.34	$3.79	$0.28	$3.08	$40.71	$8.25	$9.64
P/E								
2019	31.7x	32.4x	19.7x	-	23.8x	61.6x	45.4x	23.0x
2020E	36.4x	27.5x	29.0x	-	17.1x	45.6x	42.6x	22.5x
2021E	27.5x	26.1x	21.3x	-	16.3x	34.0x	36.2x	19.4x
2022E	23.6x	25.3x	17.6x	-	15.3x	30.7x	33.3x	17.9x
P/B	6.9x	7.0x	2.0x	17.7x	4.2x	6.0x	13.6x	201.9x
Dividend Yield	0.6%	0.9%	0.0%	2.7%	-	-	-	2.3%
FCF Yield	2.1%	3.3%	2.7%	14.4%	7.3%	3.2%	4.6%	7.4%
ROE	23.6%	28.2%	10.4%	32.5%	18.9%	11.6%	34.4%	141.2%
ROIC	13.4%	24.8%	7.5%	18.2%	9.8%	10.8%	18.1%	25.3%
Operating ROIC	17.8%	34.2%	10.1%	19.6%	13.6%	14.7%	23.7%	26.2%
Leverage Ratio (2021)	0.7x	-	0.5x	-	0.5x	0.3x	-	1.5x
Leverage ratio (2022)	0.6x	-	0.5x	-	0.4x	0.3x	-	1.4x

Source: Company reports, Bloomberg, and Institutional Research Group estimates

Transportation Segment – XPO Logistics (RemainCo)

In our estimation, the best pure-play, non-union peers to XPO Transportation's less-than-truckload (LTL) operation are Old Dominion Freight Line (NASDAQ: ODFL) and Saia, Inc. (NASDAQ: SAIA), which trade at ~15.5x 2022E EV/EBITDA (in a range of ~14.0x-18.0x; see Breakdown #2). In contrast, we would note that FedEx Freight is ultimately a small part of FedEx (NYSE: FDX), which is primarily a parcel concern, and that Yellow Corp. (NASDAQ: YELL) and ArcBest (NASDAQ: ARCB) are unionized and far less profitable (see Background #4 on page 6). Peers to XPO Transportation's truck brokerage (TB) operation include C.H. Robinson (NASDAQ: CHRW), Echo Global Logistics (NASDAQ: ECHO), and Landstar System (NASDAQ: LSTR) as well as, to a lesser degree, other trucking companies with brokerage divisions, such as J.B. Hunt (NASDAQ: JBHT) and other brokers, such as Expeditors International (NASDAQ: EXPD) and Hub Group (NASDAQ: HUBG), that focus on different areas of the market, such as air, ocean, and rail transport. On average, this group trades at about ~12.5x (in a range of 8x-16.5x; see Breakdown #2). As well, M&A in the brokerage sector has averaged ~10.5x (in a range of ~8.5x-12.5x) in recent years (see Breakdown #3).

Breakdown #3 XPO Logistics, Inc.: M&A in the Brokerage Sector, Selected Items
($ in millions)

Closed	Target	Buyer	Purchase Price	Total Revenue	EBITDA	EV/EBITDA	EV/Sales
Dec-18	CaseStack	Hub Group	$255	$242	$22	11.6x	-
Sep-18	Mode Transportation	York Capital	$238.5	-	-	~10.0x	-
Jun-15	Command Transportation	Echo Global Logistics	$420	$561	$37	11.4x	0.7x
Jun-14	Pacer Logistics	XPO Logistics	$296	$1,000	$26	11.4x	0.3x
Dec-13	National Logistics Mgmt. (NLM)	XPO Logistics	$87	$500	$10	8.9x	0.2x
Aug-13	3PD	XPO Logistics	$365	$319	$36	10.1x	1.1x
Sep-12	Turbo Logistics	XPO Logistics	$50	$124	$6	8.3x	0.4x
Sep-12	Phoenix	C.H. Robinson	$635	$807	$51	12.5x	0.8x
Avg.						**10.6x**	**0.6x**

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Applying a blended multiple of 12.5x, which reflects a ~14x multiple on the NA LTL business and a 9.5x multiple on the remaining business to 2022E EBITDA, less pro rata corporate costs, implies an enterprise value of ~$16.4 billion. Accounting for projected net debt of ~$3.9 billion implies standalone segment value of $12.5 billion, or ~$111 per share (see Breakdown #4).

Breakdown #4 XPO Logistics, Inc.: Estimated Value of Transportation Based on 2022E EBITDA
($ in millions, except per share amounts; shares in millions)

		Transportation/ XPO Logistics	
2021E Revenue		$11,039	
Revenue growth est.		3.8%	
2022E Revenue		**$11,456**	
EBITDA margin		12.7%	
2022E segment EBITDA		**$1,460**	
Corporate costs		($146)	
2022E Adj. EBITDA		**$1,314**	
Applied multiple	11.5x	**12.5x**	13.5x
Enterprise value	$15,109	**$16,423**	$17,737
Net debt	($3,917.9)	($3,918)	($3,917.9)
Market capitalization	$11,191.6	**$12,505.4**	$13,819.3
Diluted shares	113.0	113.0	113.0
Per share basis	$99.04	**$110.67**	$122.29

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Logistics Segment – GXO Logistics

Public peers for Logistics are somewhat less plentiful (and consistent) than for Transportation, but could include Clipper Logistics (CLG LN), Deutsche Post (DPW GR), whose contract logistics arm is a relatively small piece of the overall busines, DSV Panalpina (DSV DC), Kuehne + Nagel (KNIN SW), and UPS Supply Chain (NYSE: UPS), which as a group trade, on average, at 12.0x 2022E EV/EBITDA (albeit in a wide range of 6.5x-18.0x; see Breakdown #2.) On the M&A front, we would note that XPO's purchases of New Breed and Norbert Dentressangle in 2014 and 2015 were at 8.0x and 9.1x EV/EBITDA, respectively. For additional context, it could be mentioned that when asked at a recent investor forum about what kind of valuation multiple the standalone contract logistics business should be awarded, Mr. Jacobs, XPO's CEO, responded that as the largest outsourced e-fulfilment platform in Europe and a global leader in omnichannel logistics, reverse logistics, and cold-chain logistics, he thought a multiple in the "mid-to-high teens", in-line with higher-valued peers such as DSV and KNIN, was "attainable" as investors became more educated about the business's capabilities.

Applying a multiple of 9.5x, which, for the sake of conservatism, is a discount to the peer average but roughly in line with XPO's current trading multiple (and the purchase multiple of its largest acquisition in the space), to 2022E EBITDA, less pro rata corporate costs, implies an enterprise value of almost $6.3 billion. Accounting for projected net debt of $735 million as well as minority interest implies standalone segment value of ~$5.4 billion, or ~$48 per share (see Breakdown #5). [Note: If Mr. Jacobs were ultimately correct in his prediction that the Logistics business should be awarded a mid-teens valuation multiple it could add incremental upside to ~$80 per share (see Breakdown #5).]

Breakdown #5 XPO Logistics, Inc.: Estimated Value of Logistics Based on 2022E EBITDA
($ in millions, except per share amounts; shares in millions)

		Logistics/ GXO Logistics		
2021E Revenue		$7,187		
Revenue growth est.		7.3%		
2022E Revenue		**$7,713**		
EBITDA margin		9.5%		
2022E segment EBITDA		**$735**		
Corporate costs		($74)		
2022E Adj. EBITDA		**$661**		
Applied multiple	8.5x	**9.5x**	10.5x	15.0x
Enterprise value	$5,622	**$6,284**	$6,945	$9,922
Net debt	($735)	($735)	($735)	($735)
Minority interest	($140)	($140)	($140)	($140)
Market capitalization	$4,747.2	**$5,408.6**	$6,070.1	$9,046.5
Diluted shares	113.0	113.0	113.0	113.0
Per share basis	$42.01	**$47.86**	$53.72	$80.06

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Sum of the Parts Valuation

All told, including pro-rata corporate costs and net debt, our sum of the parts valuation for pre-spin XPO is ~$159 per share, comprised of $111 per share for XPO Logistics, the post-spin Transportation company, and $48 per share for GXO Logistics, the post-spin Logistics company (see Breakdown #6).

Breakdown #6 XPO Logistics, Inc.: Sum-of-the-Parts Fair Value Estimate

($ in millions, except per share amounts; shares in millions)

	Transportation/ XPO Logistics	Logistics/ GXO Logistics	Total
2022E Revenue	**$11,456**	**$7,713**	
EBITDA margin	12.7%	9.5%	
2022E segment EBITDA	**$1,460**	**$735**	
Corporate costs	($146)	($74)	
2022E Adj. EBITDA	**$1,314**	**$661**	**$1,975**
Applied multiple	12.5x	9.5x	
Enterprise value	**$16,423.4**	**$6,283.7**	**$22,707**
Net debt & minority interest	($3,917.9)	($875.1)	($4,793.0)
Market capitalization	**$12,505.4**	**$5,408.6**	**$17,914.1**
Diluted shares	113.0	113.0	113.0
Per share basis	**$110.67**	**$47.86**	**$158.53**
Bull	$122.29	$53.72	$176.01
Base	$110.67	$47.86	$158.53
Bear	$99.04	$42.01	$141.05

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

The Wrap-Up

In January 2020, XPO disclosed a strategic review to explore the potential spin-off or sale of one or more of its business lines (excluding its North American LTL business). The review was terminated in March 2020 (due to market conditions) but a tax-free separation of its freight transportation and contract logistics/warehousing operations was ultimately announced in December 2020. The impending transaction, which is expected to be completed in 2H 2021, is rooted in management's frustration that, despite industry-leading scale and operating performance, in terms of growth, profitability and free cash flow (FCF), its businesses trade at discounts to their most relevant peers. In pursuit of narrowing that discount, XPO is seeking to both simplify its business (hence the spin-off) and achieve investment grade credit ratings at both post-spin entities (which portends that the main use of FCF, which is expected to be $600-$700 million in 2021, will be toward deleveraging).

XPO currently trades at ~9.1x 2022E EV/EBITDA, whereas its most applicable LTL and truck brokerage peers trade at ~15.5x and 12.5x, respectively. Public valuations in the contract logistics space are less consistent but average ~12.0x 2022E EV/EBITDA. In that context, amid solid underlying fundamentals, which we think could support incremental upside to our current forecasts, we see the opportunity for a re-rating across the XPO's portfolio. In that regard, even assuming XPO's discount to peers simply narrows (but does not close) an initial pre-spin fair value estimate of $159 per share can be derived (with bull and bear cases of $176 and $141, respectively). While our initial bias is toward the post-spin Transportation business, we think the Logistics business will enjoy favorable secular tailwinds from growth in e-commerce fulfilment and could ultimately see more material upside, in terms of improvements in its operating performance and the magnitude of its multiple expansion, over the longer-term.

Potential risks include a lack of management execution, competition/technological changes, leverage, insurance liability/government regulation, labor issues/dependence on third-party contractors, currency fluctuations, integration issues on future acquisitions and pricing pressure due to deteriorating industry fundamentals.