Air Freight & Logistics
XPO Logistics
Deutsche Bank
Markets Research
Rating
Buy
North America
United States
Industrials
Air Freight & Logistics
Reuters
XPO.N
Bloomberg
XPO US
Exchange Ticker
XPO
NYS
Company
XPO Logistics

Potential for 30%+ FCF growth in 2019

Valuation & Risks

We are reiterating our Buy rating on XPO Logistics (XPO) as we see good potential for FCF growth to surpass 30% in 2019. This alert should be read in conjunction with our comprehensive industry report, released concurrently with this alert, and which includes our 2019 FCF walk for XPO.

Making the case for 30%+ FCF growth in 2019

Our 2019 free cash forecast of $750M implies 20% yoy growth, with upside to 35% growth (to $835M) if current organic growth rates are sustainable- which we think is a realistic outcome given macro backdrop, e-commerce exposure, the company's growth investments, and mgmt's recent comments. From this standpoint we see a relatively quick trajectory to our $133 price target, which represents 40% add'l upside. See our FCF walk in our industry report.

Ignore the chart; XPO shares are still cheap

Our long-held positive stance on XPO has been predicted on accelerating revenue and free cash flow growth. Indeed, organic growth accelerated to +10.4% in 4Q, and free cash flow has tripled in two years- from $211M in 2016 to expected $625M this year. In the context of this free cash trajectory, an exact tripling of equity value in a little over a year is highly explainable, if not conservative, as it implies little in the way of multiple expansion (i.e. equity value has increased almost exactly in-line with free cash flow). This is also in the context of strong transportation industry fundamentals, with demand drivers (CASS, truck

tonnage,
U.S. IP) seemingly firing on all cylinders.
Valuation and risks
Today's forward FCF yield of 4.8% on 2019e FCF equates to equity value of $111 per share. Ultimately, we expect FCF yield to continue to contract (which would increase equity value), as investors increasingly prescribe a more reasonable multiple for XPO's secular growth prospects. Our sum of the parts analysis suggests a fair Ev/EBITDA multiple of 11.5-12x (vs. 9.5x today), which would imply a forward FCF yield of about 4%. Applying a 4% forward yield to our 2019 FCF estimate equates to $133 per share, which we think should be highly achievable over the next 12-18 months (and even higher under our above-mentioned upside FCF forecast). Risks to the downside include recession, weak integration of any potential new acquisition, and over-leveraging of the balance sheet.
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Seldon Clarke, CFA
Research Analyst
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Kenya Watson
Research Associate
[redacted]
Chris Snyder, CFA
Research Associate
[redacted]
Date
22 February 2018
Company Update
Price at 21 Feb 2018 (USD)
Price Target
52-week range
93.99
133.00
97.12 - 44.99
Deutsche Bank Securities Inc.
Distributed on: 22/02/2018 21:04:22 GMT

22 February 2018
Air Freight & Logistics
XPO Logistics
Appendix 1
Important Disclosures
*Other information available upon request
Disclosure checklist
Company
XPO Logistics
Ticker
XPO.N
Recent price*
93.99 (USD) 21 Feb 2018
Disclosure
1, 7, 8, 14, 15
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Amit Mehrotra

22 February 2018
Air Freight & Logistics
XPO Logistics
Historical recommendations and target price. XPO Logistics (XPO.N)
(as of 02/21/2018)
125.00
100.00
75.00
4
50.00
2
1
25.00
0.00
May '16
Sep '16
Jan '17
Date
1. 02/26/2016 Buy, Target Price Change USD 37,00 Robert Salmon, CFA**
2. 08/05/2016 Buy, Target Price Change USD 42,00 Robert Salmon, CFA**
3. 11/01/2016
Buy, Target Price Change USD 60,00 Amit Mehrotra
4. 03/02/2017 Buy, Target Price Change USD 75,00 Amit Mehrotra
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Newly issued research recommendations and target prices supersede previously published research.
5. 11/02/2017
Buy, Target Price Change USD 110,00 Amit Mehrotra
6. 01/17/2018 Buy, Target Price Change USD 125,00 Amit Mehrotra
7. 02/08/2018 Buy, Target Price Change USD 133,00 Amit Mehrotra
May '17
Sep '17
Jan '18
3
5
Current Recommendations
Buy
Hold
Sell
6 7

Not Rated
Suspended Rating
** Analyst is no longer at
Deutsche Bank

Security price

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Air Freight & Logistics
XPO Logistics
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flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus
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most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client
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instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to
FX depreciation, or to specified interest rates – these are common in emerging markets. The index fixings may – by
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the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed
to a typically short-dated interest rate reference index) are exchanged for fixed coupons. Funding in a currency that differs
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