



## XPO Logistics turns profitable on M&A spree

by [Crystopaz ANGA](#)

XPO Logistics Inc. (XPO) proved critics wrong after reporting its first positive profit in four years. Since its inception in 2011, XPO has grown exponentially with revenues multiplying from USD 177mn in 2011 to USD 7.6bn in 2015. It is currently the second largest contract logistics and freight brokerage company in the world and one of the biggest companies in North America's less-than-truckload (LTL), last mile, intermodal and drayage business segments. XPO's astronomical growth had been mainly fueled by a series of acquisitions and corporate actions. In June 2015, the company [raised](#) USD 1.26bn of equity and issued USD 2bn of bonds. Given the sheer pace of XPO's growth and debt-fueled acquisitions, many analysts had raised concerns over the company's ability to integrate its wide-ranging businesses.

Prior to its big acquisitions in 2015, XPO was an asset-light company, which mainly brokered arrangements with shippers and carriers. The asset-light model gained popularity in the past few years as it lowered the company's operating cost while provided greater flexibility and scalability. However, XPO's large acquisitions in 2015 indicated a [strategic shift](#) from its asset-light model towards a more asset-heavy profile. Not long after acquiring a French trucking company Norbert Dentressangle (Norbert) for USD 3.53bn, XPO acquired Con-way, the second largest LTL company in the US, for USD 3bn. CEO Bradley Jacobs [justified](#) the move based on the current driver shortage. An ageing driver population, more stringent regulation, and low compensation have resulted in a [driver shortage](#) in the US that is likely to persist, if not worsen, in the near future. The acquisitions of Norbert and Conway would provide XPO a greater control over the trucking capacity, more cross-selling opportunities and greater operating efficiency in light of its wide-ranging services

Despite the rosy grand scheme, investors remained [wary](#) of XPO's acquisition spree. Following the announcement of the Con-way acquisition, XPO shares plunged by more than half in September last year from their historic high in May 2015. More importantly, XPO's credit metrics deteriorated in the face of ballooning debt and persistent losses (see Table 1). In 2015, XPO's total debt ballooned from USD 981mn in Q1 to USD 5.4bn in Q4. XPO's debt to equity ratio also tripled from 58 times in early 2015 to 177 times at the end of 2015 (see Table 1). In line with worsening credit metrics, the RMI-CRI 1 year PD for XPO surged to an all-time 482bps in October, coinciding with the successful acquisition of Con-way (see Figure 1). In response to the Con-way acquisition, Moody's placed XPO ratings under review for a [possible downgrade](#) as the sheer pace and magnitude of the acquisition amplified the company's execution risk and leverage.

The tide turned in August 2016 when XPO reported a [positive profit](#) in the second quarter. Despite a slower economy in the first semester, the company reported a record USD 42.6mn profit and USD 170mn free cash flow (see Table 1). XPO's acquisition of Con-way proved beneficial as its North American LTL's operating income grew by 66% YoY in Q2 while the operating ratio improved to 86.7% in 2016 from 92.4% in 2015. E-commerce was also touted as a major tailwind, driving growth in the last mile and logistics segments. Last-mile revenue grew 18% YoY in Q2 and is expected to continue to experience a strong growth whereas new logistics contracts from e-commerce businesses helped to boost revenues in the European logistics operation. In line with the better-than-expected earnings, XPO raised its EBITDA target of at least USD 1.265bn from a previous target of USD 1.25bn and free cash flow target of at least USD 159mn from an initial range of USD100mn to USD 150mn.

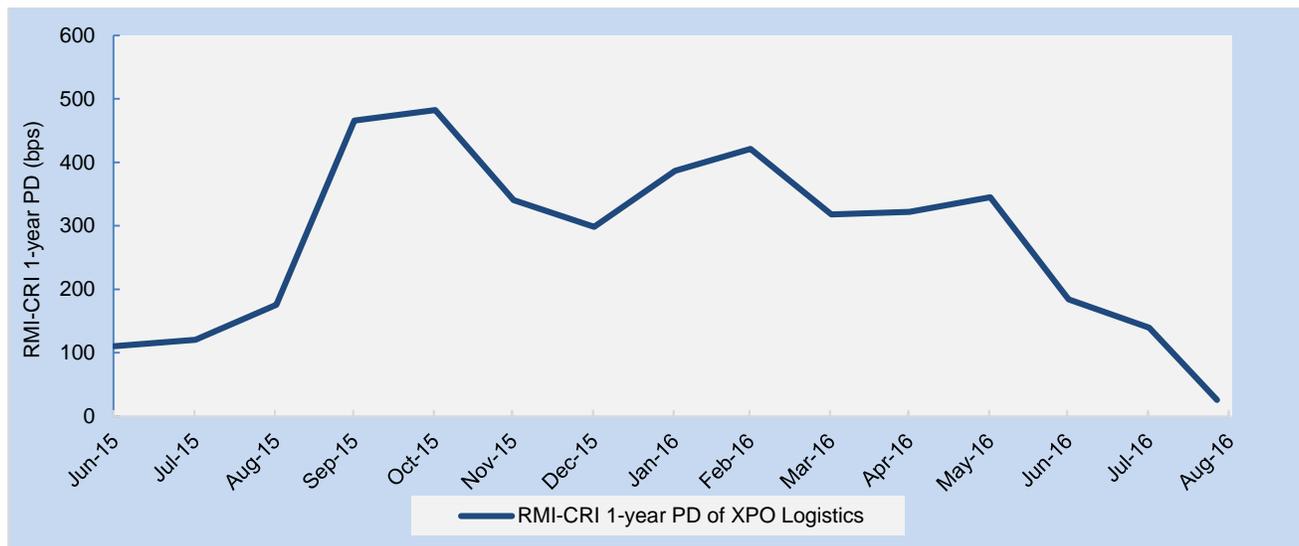


Figure 1: RMI-CRI 1-year PDs for XPO Logistics Inc. Source: RMI-CRI

The RMI-CRI 1 year PD for XPO has fallen to 25.8bps in August 2016 from its all-time high of 482.3bps in October last year (see Figure 1), indicating a marked improvement in XPO's credit health. In line with higher earnings in Q2, the net debt to EBITDA ratio fell to 6.07 times in Q2 2016 from 23.8 times last year (see Table 1). Following the record-breaking results, the company [refinanced](#) its USD 1.6bn term loans with a more favorable rate of LIBOR plus 3.25 percent compared to the previous rate of LIBOR plus 4.5 percent. CEO Jacobs announced that the company reduced interest expense by USD 40mn a year, extended the maturity of the debt, and increased the flexibility to pay the debt sooner. In August, S&P also [upgraded](#) XPO's credit rating to B+ from B with a positive outlook, citing improving earnings and cash-flow generation as the reason.

Quarter	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016
Revenue (USD bn)	0.70	1.22	2.36	3.34	3.55	3.68
Net Income (USD mn)	-14.7	-74.4	-40.4	-62.1	-22.5	46.6
Free Cash Flow (USD mn)	35.9	-101.0	-9.9	-83.2	-107.8	151.4
Short and Long Term Debt (USD bn)	0.98	3.77	3.47	5.41	5.51	5.46
Net Debt/EBITDA (X)	-0.6	23.8	9.1	15.2	9.8	6.1
Total Debt to Total Equity(X)	58.5	133.5	110.8	176.7	178.9	177.6

Table 1: Financial data for XPO Logistics Inc. Source: Bloomberg

Moving forward, CEO Jacobs says that XPO will not go for another acquisition. Instead, the company aims to optimize the wide-ranging businesses that it had acquired. The company is currently focusing on company-specific opportunities, that are independent of macro conditions, in improving its profitability. With 77 percent of customers using more than one of its services, XPO plans to further boost its top line by cross-selling its TL (truck-load), LTL, intermodal and logistics services. It also exited low-margin businesses in North America's logistics segment while purging unprofitable freight, improving its profit margin. In addition, the company will invest USD 425mn in IT development, maintaining its competitive edge in logistics and transportation technology. The company's proprietary technology in rail and freight systems has been frequently touted as a key differentiator in its services, allowing it to remain nimble and scalable.

XPO's profitability amid weak economic condition gave testament to the management's ability to integrate its wide-ranging logistics and transportation businesses. With a declining cost of capital and a subsiding credit risk, CEO Bradley Jacobs might be right in saying that XPO is at 'an inflection point for EBITDA and cash flow acceleration'. After a series of acquisitions and fund-raising in the past five years, XPO's future growth now hinges on its ability to roll-up its logistics and transportation businesses.

**Credit News****Hanjin Shipping faces de facto bankruptcy**

**Aug 26.** Since the Korea Development Bank and other creditors remain unwilling to extend more funds to Hanjin Shipping, South Korea's largest container carrier, the distressed shipping company will possibly enter court receivership. The company has been under creditor-led rehabilitation since May due to its mounting debt level. This includes cutting charter fees, joining the shipping alliance and securing additional cash flow. The request for self-rescue has become more aggressive recently as the deadline for extending loan payment is approaching. While the company declared that it could only offer up to KRW 400bn, the creditors insisted Hanjin inject at least KRW 700bn to save its shipping arm. If the agreement cannot be reached by Sep 4, it would be difficult for the shipper to avoid court receivership. ([Korea Times](#))

**Key Energy plans bankruptcy filing after reaching debt pact**

**Aug 25.** After creditors of Key Energy Services Inc. agree to its restructuring plan, bondholders would attain control of the company before the company seeks bankruptcy protection. From the company's regulatory filing, the debt restructure would see holders of senior notes, which includes Platinum Equity LLC, possess 95% of the reorganized oilfield services company's shares. The filing also stated that Platinum Equity and certain lenders have supported the restructuring plans. Since the start of 2015, data from Haynes and Boone LLP indicated that more than 80 North American oilfield services have declared bankruptcy. ([Bloomberg](#))

**Seadrill profit beats estimates as debt restructuring looms**

**Aug 25.** Offshore drilling company Seadrill Ltd.'s earnings before interest, taxes, depreciation and amortization declined from USD 651mn a year ago to USD 557mn in Q2 2016. Still, the earnings before interest, taxes, depreciation and amortization fared better than the USD 510mn average estimate as forecasted by analysts. With the slump in crude prices, offshore-rig companies have been reducing their expenditure on equipment with rig owners such as Seadrill and Transocean lowering their expenses, delaying vessel deliveries and suspending dividends as sagging profits curbs their ability to repay debt. In a report by Exane BNP Paribas, Seadrill's net debt, which had been forecasted "to be five times projected annual EBITDA" was mentioned as "unsustainable". ([Bloomberg](#))

**Brazil defaults show signs of stability despite July rise**

**Aug 25.** Goldman Sachs Group chief Latin America economist predicted that the worst of the credit crunch in Brazil may be over and the economy may recover from a recession soon. The amount of defaults may not increase any further as macroeconomic conditions have improved. Last month, the percentage of loans in arrears between 15 days and 90 days declined even though the percentage of 90-day delinquent loans climbed to 5.7% from 5.6% in June. Brazil's largest banks by assets, Banco do Brasil SA, indicated that the household and corporate sectors were in a healthier state after a two-year crisis. The country's top mortgage lender Caixa Economica Federal also projected defaults to begin declining by the end of 2016. ([Reuters](#))

**Liquidity losses disrupt USD 450bn mortgage market in Denmark**

**Aug 24.** Danish mortgage market is showing signs of eroding liquidity. According to a survey, trades in Danish mortgage bonds that once took two minutes can now take a full day. Furthermore, Scandinavia's two biggest banks, Danske and Nordea, are only doing two-thirds of the repo agreements they used to do in mortgage bonds. The signs of eroding liquidity are putting strains on the record-low borrowing cost, making it more difficult to refinance home loans. In response, Denmark's mortgage bankers have tried to improve liquidity, consolidating more than 80% of bonds into series of more than EUR 500mn each. ([Bloomberg](#))

**Twin Butte says Reignwood deal failure would mean credit default** ([Bloomberg](#))

**Glencore steps up debt reduction as earnings drop** ([FT](#))

**US mortgage insurers step into the M&A light** ([FT](#))

**Regulatory Updates****Chinese banking regulator lays out new P2P loan restrictions**

**Aug 24.** According to state media, China's banking regulators have recently issued a new set of provisional rules, forbidding peer-to-peer (P2P) lending platforms from pooling funds or selling wealth management products. The authorities warned P2P firms that their industry must rely mainly on small-scale loans as the basis of their future business, a guideline that resulted in the setting of a ceiling of RMB 200,000 for lending by individuals and RMB 1mn for organizations. However, organizations can lend up to RMB 5mn across multiple platforms. In addition, the rules forbid P2P companies from engaging in asset securitization and require banks to act as third parties that hold and manage funds on behalf of peer lending platforms. ([FT](#))

**China close to launching credit default swap market**

**Aug 23.** With corporate defaults and downgrades increasing in China, the need for a credit default swap (CDS) market in the country has been rising. It is likely that People Bank of China will open the hedging market in the upcoming months. As a matter of fact, back in 2010, the National Association of Financial Market Institutional Investors attempted to introduce the product. However, it turned out to be a failure due to the low occurrence of defaults back then. Furthermore, the credit rating and bond trading were both in their infancy stage. Since then, the market backdrop had changed rapidly and the launch of the CDS market is expected to succeed this time. The CDS trading was even considered a possible measure to improve corporate financing for some provincial government. ([FT](#))

**Central bankers spurn call for radical approach at Jackson Hole** ([Bloomberg](#))

**Hong Kong regulator wants a tighter grip on IPOs in blow to HKEx** ([Bloomberg](#))

**Hong Kong securities regulator fines Morgan Stanley USD 2.4mn** ([WSJ](#))

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