

RXO, Inc.

Lower to Neutral; 1H pressure in elongated downcycle pushes targets out; PO to \$22

Rating Change: NEUTRAL | PO: 22.00 USD | Price: 21.54 USD

Lower to Neutral on continued squeeze ahead of inflection

We lower our rating on RXO to Neutral from Buy given the sustained freight downcycle and resultant pressure on margins. We lower our PO to \$22 (from \$25), on 15.5x our '25e EBITDA, which equates to 37.0x P/E (from 19x '24e EBITDA) as we push out our view of a cycle recovery. We remain positive on RXO's ability to gain share yet see margin headwinds persisting into the cycle upturn (it targets 2H24 inflection). We lower our '24e/'25e EPS 82%/ 41% to \$0.10/\$0.60 from \$0.55/\$1.00. We lower our 2024e EBITDA to \$111 million from \$172 million.

4Q upside on share gain; 1Q EBITDA view below tgt

RXO posted 4Q23 adj EPS of \$0.06, down 79% year-year, above our/Street's \$0.04 target. Truck brokerage load volumes increased 15% year-year, better than our +8% target, outpacing peers' average 3.5% decline (C.H. Robinson NAST Truckload -1.5%, Schneider Logistics -11.0%, J.B. ICS -11.6%, Knight-Swift Logistics +2.6%), highlighting strong share gains in the elongated freight downcycle. Nevertheless, Truck Brokerage gross margin was 14.8%, a 310 bps deterioration year-year, and 50 bps worse than our target. RXO noted that while 4Q started strong, the market weakened throughout the quarter, leading to sequential declines in gross profit per load per month. CEO Drew Wilkerson noted gross margin compression continued into January, though gross profit/load declines have eased over the past several weeks. It targets 1Q24 Brokerage Gross Margin of 12-14% (below our prior 15.2%, now 12.5% target), and mid- to high-single digit volume growth year-year, after 8% growth in January (we target 9% for 1Q24). It targets 1Q24 adj EBITDA of \$12-\$18 million (we're at \$15 million), significantly below our prior \$30 mil tgt. After capex, it expects negative FCF in 1Q.

Revenues beat, but margin miss on cycle squeeze

Revenues were \$978 million, down 7% year-year, yet \$14 million above our target. Gross Profit was \$176 million, down 22% year-year, in line with our target. It posted an 18.0% Gross Margin, below our 18.2% target, and 160 bps lower year-year. Adj operating income was \$21 million, down 56% year-year, and \$3 million above our target (+\$0.02/sh). RXO aims to remove \$25 million in 2024 operating expenses, led by its productivity and cost optimization initiatives. While its ending cash balance was \$5 million in 4Q23, it noted it has ample liquidity, with \$595 million revolving credit capacity and \$700 million in unencumbered accounts receivables. RXO's leverage (debt/TTM) is 2.5x, and projects 2.9x based on its 1Q24 target Adj EBITDA range, as it remains below its 3.5x its revolver leverage covenant limit.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.59	0.30	0.10	0.60	0.85
EPS Change (YoY)	11.2%	-81.1%	-66.7%	500.0%	41.7%
Consensus EPS (Bloomberg)			0.44	0.87	1.15
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	13.5x	71.8x	215.4x	35.9x	25.3x
EV / EBITDA*	10.0x	22.7x	27.4x	15.8x	13.1x
Free Cash Flow Yield*	9.8%	1.0%	1.1%	11.9%	20.9%

* For full definitions of *IQmethod*SM measures, see page 6.

08 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Inv. Opinion	C-1-9	C-2-9
Inv. Rating	BUY	NEUTRAL
Price Obj.	25.00	22.00

Ken Hoexter

Research Analyst
BofAS
+1 646 855 1498
ken.hoexter@bofa.com

Adam Roszkowski, CFA

Research Analyst
BofAS
+1 646 855 5498
adam.roszkowski@bofa.com

Nathan Ho, CFA

Research Analyst
BofAS
+1 646 855 3599
nathan.m.ho@bofa.com

Stock Data

Price	21.54 USD
Price Objective	22.00 USD
Date Established	8-Feb-2024
Investment Opinion	C-2-9
52-Week Range	16.94 USD - 24.33 USD
Mrkt Val (mn) / Shares Out (mn)	2,576 USD / 119.6
Free Float	119.6%
Average Daily Value (mn)	11.40 USD
BofA Ticker / Exchange	RXO / NYS
Bloomberg / Reuters	RXO US / RXO.N
ROE (2024E)	2.0%
Net Dbt to Eqty (Dec-2023A)	59.6%
ESGMeter TM	Low

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

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Timestamp: 08 February 2024 02:03PM EST

iQprofileSM RXO, Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	15.2%	5.5%	3.3%	7.2%	16.7%
Return on Equity	22.2%	6.1%	2.0%	11.0%	29.0%
Operating Margin	2.9%	1.3%	0.8%	3.0%	3.4%
Free Cash Flow	253	25	29	307	539

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.7x	2.5x	6.3x	5.1x	6.0x
Asset Replacement Ratio	0.8x	1.2x	0.8x	0.8x	0.8x
Tax Rate	20.7%	16.3%	30.0%	30.0%	30.0%
Net Debt-to-Equity Ratio	60.6%	59.6%	53.6%	11.5%	NA
Interest Cover	NM	2.4x	1.6x	4.8x	7.9x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	4,796	3,927	3,977	4,444	4,972
% Change	2.3%	-18.1%	1.3%	11.7%	11.9%
Gross Profit	1,172	960	887	1,032	1,171
% Change	16.2%	-18.1%	-7.6%	16.3%	13.5%
EBITDA	307	135	112	194	234
% Change	17.9%	-56.0%	-17.1%	73.3%	20.7%
Net Interest & Other Income	(3)	(34)	(38)	(31)	(28)
Net Income (Adjusted)	184	36	12	71	98
% Change	11.6%	-80.4%	-67.2%	498.3%	39.0%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	184	36	12	71	98
Depreciation & Amortization	71	54	57	62	66
Change in Working Capital	28	(51)	67	97	109
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	27	50	(62)	129	318
Capital Expenditure	(57)	(64)	(45)	(52)	(52)
Free Cash Flow	253	25	29	307	539
% Change	143.5%	-90.0%	13.9%	959.7%	75.6%
Share / Issue Repurchase	(3)	(16)	0	(60)	(100)
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	(19)	152	230	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	98	5	59	226	0
Trade Receivables	907	743	810	907	0
Other Current Assets	32	48	48	48	0
Property, Plant & Equipment	119	124	169	221	0
Other Non-Current Assets	882	905	905	905	0
Total Assets	2,038	1,825	1,991	2,307	0
Short-Term Debt	4	3	3	3	0
Other Current Liabilities	835	679	832	900	0
Long-Term Debt	451	356	381	301	0
Other Non-Current Liabilities	159	193	169	426	0
Total Liabilities	1,449	1,231	1,385	1,631	0
Total Equity	589	594	606	676	0
Total Equity & Liabilities	2,038	1,825	1,991	2,307	0

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Freight Forwarding

Company Description

RXO is an asset-light tech focused brokerage-led carrier. It was spun off from XPO Logistics on Nov 1, 2022. It provides Truck Brokerage (60% of revenues, 80% of op income), and is the 4th largest Broker in the US, as well as Last Mile services for heavy goods (largest US provider through contractors, 22% of revenues), Managed Transportation (13% of revenues), and Freight Forwarding (9% of revenues).

Investment Rationale

RXO is an asset-light tech focused brokerage-led carrier. We believe it should trade at a premium to its closest peer broker/forwarder on an EV/EBITDA basis given RXO has grown market share nearly 1,300 bps faster than its peer, generates 40%+ cash conversion ratio, yielding nearly \$130 million in 2022, yet could see near-term margin headwinds given rising cost of capacity.

Stock Data

Average Daily Volume 529,369

Quarterly Earnings Estimates

	2023	2024
Q1	0.11A	-0.04E
Q2	0.08A	0.02E
Q3	0.05A	0.01E
Q4	0.06A	0.10E

Winning share in consolidating market

RXO posted 15% volume growth, led by 11% growth in Truckload volumes and 45% growth in less-than-truckload volumes, up from 13% and 55% a year ago. This was better than our +8% target, outpacing peers' average 3.5% decline (C.H. Robinson NAST Truckload -1.5%, Schneider Logistics -11.0%, J.B. ICS -11.6%, Knight-Swift Logistics +2.6%), highlighting strong share gains in the elongated freight downcycle.

Its Gross Margin of 14.8% is the third highest among Logistics peers, although Knight-Swift at 17.8% includes its Power-only (drop trailer) offering, a higher margin segment. It remains well above peer C.H. Robinson's 12.7% gross margin, highlighting its relative focus on rate per load. RXO remained at 80% of its business under contract (20% spot), which is similar in mix to CHRW at 75%:25%.

In 2024, it targets \$40-\$50 million CapEx (we target \$45 million), net interest expense of \$31-\$33 million (we target \$32 million), and 30% tax rate (we target 30%).

Exhibit 1: Truck Brokerage Peer Comparison

RXO Gross Margins were 14.8% in 4Q23, outpacing CHRW and JBHT yet trailing KNX.

Truck Brokerage	Gross Rev	Gross Profits	Gross Margins	Operating Ratio	Load Growth	Gross Rev/Load
RXO	\$ 610	\$ 90	14.8%	97.9%	15.0%	-23.0%
Schneider Logistics	\$ 342	n/a	n/a	98.2%	-11.0%	-8.5%
C.H. Robinson NAST	\$ 3,001	\$ 380	12.7%	n/a	-1.5%	-13.5%
Werner Logistics	\$ 234	\$ 41	17.5%	98.5%	n/a	n/a
J.B. Hunt ICS	\$ 364	\$ 51	14.0%	104.1%	-11.6%	-14.9%
Knight-Swift Logistics	\$ 165	\$ 29	17.8%	93.1%	2.6%	-7.4%

*Note: WERN is BofA 4Q23 estimate and includes ReedTMS acquisition

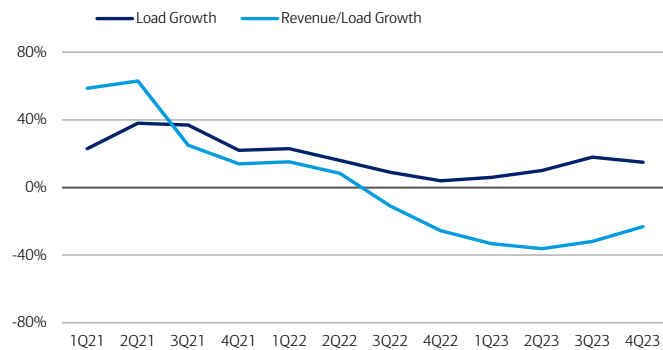
**Note: CHRW Rev/load are ex-fuel costs, and Loads are Truckload

Source: BofA Global Research estimates and Company Reports.

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Exhibit 2: Truck Brokerage Load Growth and Rev/Load Growth

Loads were up 15% year-year, (vs our +8% target) and Revenue/Load declined 23% year-year (in-line with our -25% target).

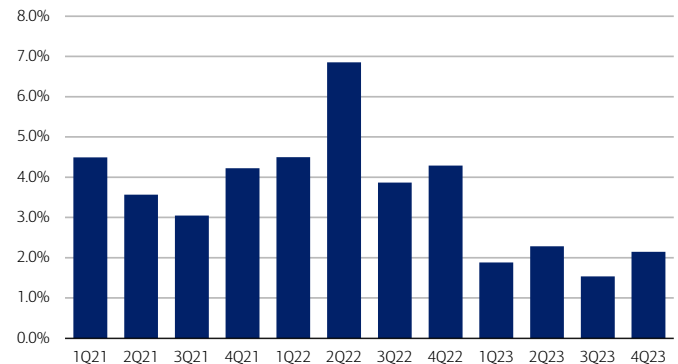


Source: BofA Global Research estimates and company reports.

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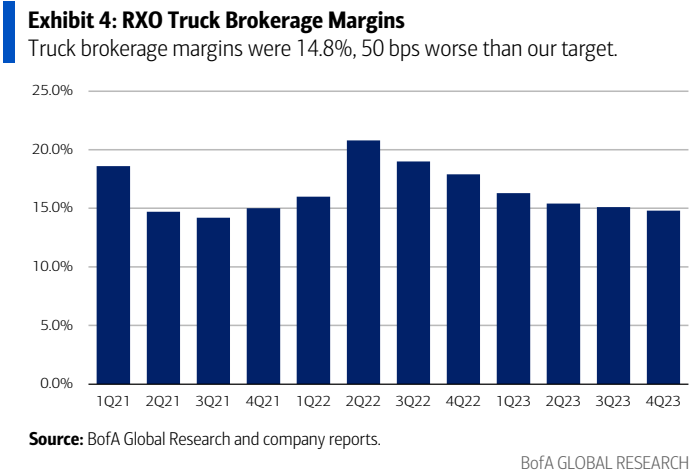
Exhibit 3: RXO Adj Operating Margin

Adj Operating Margin was 2.1%, 210 bps worse year-year yet 30 bps better than our target.



Source: BofA Global Research and company reports.

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Price objective basis & risk

RXO, Inc. (RXO)

Our \$22 price objective is based on a 15.5x 2025E EV/EBITDA multiple. We hold a balanced view on shares as we remain positive on its ability to win share over its truck brokerage peers yet see risks to margins into a cycle upturn as cost of capacity moves higher.

Upside risks to our target includes a faster than expected inflection in the truck freight cycle, which may drive a rapid influx of spot-related project volumes for RXO. Increased shipper freight demand, which may lead upside to rates, as well as better-than-expected execution on cost reduction may result in higher than expected margins.

Downside risks to our price objective are weaker than expected economic conditions resulting in more spot and less contract revenues, which could compress gross profit margins, it relies on third-party carriers to deliver customers freight (exposing it to service parameters it does not control, higher carrier prices which could decrease op income), fuel price volatility could impact results, unusual weather could impact operations (freight volumes), carriers status as independent contractors or labor disputes among its carrier base, risk to IT systems being compromised by cyberattacks, court decisions on insurance accident exposure from a 3rd party performance, ability to retain qualified employees, and cost initiatives may not prove fruitful (its target to eliminate some overhead costs).

Analyst Certification

I, Ken Hoexter, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Canadian Pacific Kansas City Ltd	CP	CP US	Ken Hoexter
	CSX Corporation	CSX	CSX US	Ken Hoexter
	FedEx Corp.	FDX	FDX US	Ken Hoexter
	J.B. Hunt Transport Services	JBHT	JBHT US	Ken Hoexter
	Kirby Corp	KEX	KEX US	Ken Hoexter
	Knight-Swift Transportation Holdings Inc	KNX	KNX US	Ken Hoexter
	Norfolk Southern	NSC	NSC US	Ken Hoexter
	Old Dominion Freight Line	ODFL	ODFL US	Ken Hoexter
	Saia Inc.	SAIA	SAIA US	Ken Hoexter
	Teekay Tankers Limited	TNK	TNK US	Ken Hoexter
	Union Pacific	UNP	UNP US	Ken Hoexter
	Wabtec Corp.	WAB	WAB US	Ken Hoexter
	XPO, Inc.	XPO	XPO US	Ken Hoexter
NEUTRAL				
	Canadian National	CNI	CNI US	Ken Hoexter
	RXO, Inc.	RXO	RXO US	Ken Hoexter
	Schneider National	SNDR	SNDR US	Ken Hoexter
	Scorpio Tankers Inc.	STNG	STNG US	Ken Hoexter
	TFI International	TFII	TFII US	Ken Hoexter
	TFI International	YTFII	TFII CN	Ken Hoexter
	UPS	UPS	UPS US	Ken Hoexter
UNDERPERFORM				
	ArcBest Corporation	ARCB	ARCB US	Ken Hoexter
	C.H. Robinson	CHRW	CHRW US	Ken Hoexter
	The Greenbrier Companies	GBX	GBX US	Ken Hoexter



US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Werner Enterprises	WERN	WERN US	Ken Hoexter
	World Kinect	WKC	WKC US	Ken Hoexter

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	67	50.38%	Buy	44	65.67%
Hold	31	23.31%	Hold	13	41.94%
Sell	35	26.32%	Sell	17	48.57%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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