

RXO, Inc.

Margins impacted by low rates, hits EPS; AI provides share opportunity; PO \$25

Reiterate Rating: BUY | PO: 25.00 USD | Price: 22.19 USD

Sees margin headwind; but load-to-truck begins to climb

RXO and truck brokers are impacted by sustained low rates (truck contracts renewing at low rates, spot rates remaining soft) while capacity costs rise from 2Q's floor level. As such, gross margins were pressured in 2Q23, likely beyond our original estimates. Thus, we lower our 2Q Truck Brokerage Gross Profit Margin forecast to 14.8% from 16.0%, and from 16.3% in 1Q23. It has 77% of its brokerage mix tied to contracts (Brokerage is 55% of RXO's Gross Revenues), an approximate 700 bps higher mix than peers. We also expect 2Q23 gross revenue/load to decline 31% year-year (from -15% prior) as the company sees a similar decline to 1Q23. Alternatively, RXO noted that since 1Q23, its load-to-truck ratio, a relative measure of truck demand to available capacity, has climbed to 2.5x from 1.9x. The increase was led by produce-related verticals in the Southeast to Texas, where carriers operating below cash costs continue to exit the market. It also expects volume growth to continue, as it gains share (we estimate volumes up 2% year-year in 2Q23, above the American Trucking Association's -2% decline 2QTD). Thus, as it reaches an inflection in rates (we estimate end-2023), RXO has historically been able to shift its spot-contract mix by 1,000 bps in a quarter as spot demand returns.

Lower '23/'24 EPS estimates 47%/19%; Hold PO at \$25

We reiterate our Buy and \$25 PO on RXO's shares, based on 15.5x our 2024e EBITDA (from 16.5x 2023e), equating to 27x our 2024e EPS (from 30x 2023e) as we roll our target to '24. We use a slightly lower multiple on discounted future growth. We remain positive on RXO's ability to gain share, as well as its tech leadership, yet lower estimates given near-term margin headwinds. We decrease our 2023, 2024, 2025 EPS estimates 47%, 19%, 11%, to \$0.45, \$0.90, \$1.20, from \$0.85, \$1.10, \$1.35, respectively.

Generative AI opens door to cost efficiencies and growth

Last week, RXO hosted its AI/Machine Learning Day with CIO Yoav Amiel, Data Science Director Tudor Bodea, and VP Brokerage Technology Alyssa Myers. Led by its in-house developed tech stack and 10 years of lane data, RXO believes it has an edge over peers who rely on 3rd party services. Thus, it can price/source loads faster than the industry average, with 96% of its loads covered or created digitally. As a result, it increased productivity (loads per hour) 50% from 2018-2021. It expects Generative AI to aid its expansion to small- and medium-sized shippers and further reduce its cost intensity.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	1.43	1.56	0.45	0.90	1.20
GAAP EPS	1.43	1.56	0.45	0.90	1.20
EPS Change (YoY)	308.6%	9.1%	-71.2%	100.0%	33.3%
Consensus EPS (Bloomberg)			0.58	0.92	1.16
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	15.5x	14.2x	49.3x	24.7x	18.5x
GAAP P/E	15.5x	14.2x	49.3x	24.7x	18.5x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	12.2x	10.6x	8.7x	7.1x	6.3x
Free Cash Flow Yield*	3.9%	9.6%	-0.1%	2.9%	8.2%

* For full definitions of *IQmethod*SM measures, see page 4.

05 July 2023

Equity

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	22.19 USD
Price Objective	25.00 USD
Date Established	6-Mar-2023
Investment Opinion	C-1-9
52-Week Range	14.75 USD - 25.50 USD
Mrkt Val (mn) / Shares Out (mn)	2,649 USD / 119.4
Average Daily Value (mn)	30.86 USD
BofA Ticker / Exchange	RXO / NYS
Bloomberg / Reuters	RXO US / RXO.N
ROE (2023E)	8.7%
Net Dbt to Eqty (Dec-2022A)	60.6%
ESGMeter™	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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iQprofileSM RXO, Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	11.4%	15.0%	6.8%	11.0%	12.1%
Return on Equity	15.4%	21.8%	8.7%	15.3%	17.1%
Operating Margin	3.9%	2.5%	1.6%	3.8%	4.7%
Free Cash Flow	104	253	(2)	77	216

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	0.9x	1.7x	0.9x	1.2x	2.0x
Asset Replacement Ratio	0.5x	0.7x	0.9x	1.0x	1.0x
Tax Rate	20.5%	15.4%	20.9%	24.0%	24.0%
Net Debt-to-Equity Ratio	-2.7%	60.6%	65.8%	54.3%	27.7%
Interest Cover	NA	9.9x	2.9x	4.8x	6.0x

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	4,689	4,796	3,928	4,327	4,658
% Change	39.7%	2.3%	-18.1%	10.2%	7.7%
Gross Profit	1,008	1,172	913	1,033	1,122
% Change	28.3%	16.2%	-22.1%	13.2%	8.6%
EBITDA	261	299	364	449	502
% Change	103.5%	14.8%	21.7%	23.4%	11.7%
Net Interest & Other Income	28	(4)	(36)	(40)	(41)
Net Income (Adjusted)	165	181	53	104	136
% Change	371.1%	9.8%	-70.8%	96.2%	31.5%

Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	165	181	53	104	136
Depreciation & Amortization	75	81	54	52	52
Change in Working Capital	30	28	9	100	75
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	(127)	20	(70)	(127)	5
Capital Expenditure	(39)	(57)	(48)	(52)	(52)
Free Cash Flow	104	253	-2	77	216
% Change	-28.8%	143.5%	NM	NM	180.3%

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	29	98	44	60	216
Trade Receivables	1,010	907	870	970	1,045
Other Current Assets	44	32	46	46	46
Property, Plant & Equipment	111	119	153	205	257
Other Non-Current Assets	874	882	872	872	872
Total Assets	2,068	2,038	1,985	2,153	2,435
Short-Term Debt	0	4	4	4	4
Other Current Liabilities	816	835	796	893	937
Long-Term Debt	0	451	451	451	451
Other Non-Current Liabilities	182	159	109	76	179
Total Liabilities	998	1,449	1,360	1,424	1,571
Total Equity	1,070	589	625	729	865
Total Equity & Liabilities	2,068	2,038	1,985	2,153	2,435

* For full definitions of iQmethodSM measures, see page 4.

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 1300 bps faster than its peer, generates 40%+ cash conversion ratio, yielding nearly \$130 million in 2022, and has a low 1.1x leverage ratio.

Stock Data

Average Daily Volume 1,390,583

Quarterly Earnings Estimates

	2022	2023
Q1	0.50A	0.11A
Q2	0.41A	0.06E
Q3	0.37A	0.09E
Q4	0.28A	0.19E

Price objective basis & risk

RXO, Inc. (RXO)

Our \$25 price objective is based on a 15.5x 2024E EV/EBITDA multiple. Its target EV/EBITDA multiple remains above peer C.H. Robinson due to its accelerating share gains and ability to grow volumes above that of its peers given its advanced technology.

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

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US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Canadian National	CNI	CNI US	Ken Hoexter
	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
	RXO, Inc.	RXO	RXO US	Ken Hoexter
	Saia Inc.	SAIA	SAIA US	Ken Hoexter
	Schneider National	SNDR	SNDR US	Ken Hoexter
	Scorpio Tankers Inc.	STNG	STNG US	Ken Hoexter
	Union Pacific	UNP	UNP US	Ken Hoexter
	Werner Enterprises	WERN	WERN US	Ken Hoexter
	XPO, Inc.	XPO	XPO US	Ken Hoexter
NEUTRAL				
	Teekay Tankers Limited	TNK	TNK US	Ken Hoexter
	TFI International	TFII	TFII US	Ken Hoexter
	TFI International	YTFII	TFII CN	Ken Hoexter
	UPS	UPS	UPS US	Ken Hoexter
	Wabtec Corp.	WAB	WAB 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
	TuSimple	TSP	TSP US	Ken Hoexter
	World Kinect	WKC	WKC US	Ken Hoexter
RSTR				
	Triton International, Ltd	TRTN	TRTN US	Ken Hoexter

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

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

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

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

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

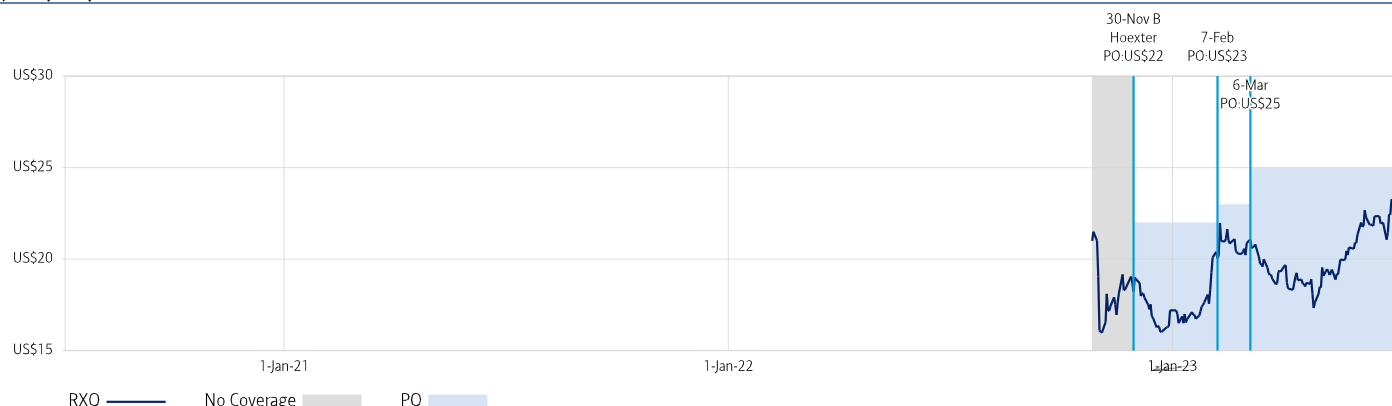
EV / EBITDA

Basic EBIT + Depreciation + Amortization

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B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	72	52.94%	Buy	42	58.33%
Hold	29	21.32%	Hold	13	44.83%
Sell	35	25.74%	Sell	17	48.57%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{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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