

## XPO, Inc.

## Sees 70's Op ratio long-term, 150-250 bps gain in '24 with YELL onboard; PO to \$132

Reiterate Rating: BUY | PO: 132.00 USD | Price: 98.05 USD

## Yields accelerate on price/service/mix focus

XPO posted strong 4Q23 results, with margins ahead of our (and its own) forecasts on robust (and accelerating) pricing gains, improved mix, and cost controls. It posted 10.3% year-year growth in less-than-truckload (LTL) revenue per hundredweight ex-fuel gains in 4Q23, above BofAe +8.8%, up from +6.4% in 3Q23. It posted an LTL adj operating ratio of 86.5%, a 380 bps improvement year-year, and 160 bps above our estimate. CEO Mario Harik sees a path to an operating ratio in the 70's long term, closer to best-in-class peer Old Dominion (ODFL, 71.8% in 4Q23), improving on its view of 600 bps improvement from 2021-2027 (or a then end-goal of 82%). XPO made progress on closing the mid-teens pricing gap to best-in class peers, which it sees led by 700-800 bps from better service, 200-300 bps from increased local account mix (rising from 20% of its base to 30%), and 500 bps from accessorial fees (to 15% of revs from 10%). XPO's damage claims ratio improved to 0.3% in 4Q23, its lowest ever, and just behind ODFL's 0.1%, with claims frequencies down 64% since the start of its LTL 2.0 plan in 2021. XPO's local account business, which it views as both higher-yielding and margin accretive, grew 12% year-year. XPO noted contract renewals averaged 9% in 4Q, higher than those of SAIA (+8.7%) and ARCB (ArcBest 5.6%). It targets rev/cwt ex-fuel growth of mid- to high-single digits in 2024 (BofAe +7.6%). XPO expects 150-250 bps of yr-yr operating ratio improvement in 2024 (we are 180 bps better, or 85.5%), noting productivity momentum as it starts onboarding 28 acquired Yellow facilities in April.

## Aims to outpace normal 4Q-1Q margin seasonality

XPO posted 4Q23 adj EPS of \$0.77, down 22% year-year, above our/the Street's \$0.62 estimate. Revenues were \$1.94 billion, up 6% year-year, \$22 million above our target. Adj operating income was \$160 million, up 1% year-year, and \$26 million above our projection, for an adj operating ratio of 91.8% and 120 bps better than our estimate. It sees upside to seasonality in 1Q, targeting a LTL operating ratio to outperform normal sequential deterioration of +40 bps (we target 86.8%, or +30 bps).

## PO to \$132; path to multi-year growth and leverage gains

We reiterate our Buy rating and increase our PO to \$132 (from \$102) on 36x (from 31x) our '24e EPS (from 31x). We increase our multiple assumption to 1.4x PEG, similar to our SAIA target, which falls sub 1x into '25, as it executes on its LTL 2.0 plan, sees accretive share gains, and improves service. We increase our '24e/'25e EPS 11% each, to \$3.65/\$5.05 from \$3.30/\$4.55, respectively.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	3.53	2.93	3.65	5.05	6.30
GAAP EPS	1.58	1.63	2.90	4.30	5.53
EPS Change (YoY)	82.0%	-17.0%	24.6%	38.4%	24.8%
Consensus EPS (Bloomberg)			3.37	4.60	5.93
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	27.8x	33.5x	26.9x	19.4x	15.6x
GAAP P/E	62.1x	60.2x	33.8x	22.8x	17.7x
EV / EBITDA*	24.1x	24.1x	18.3x	14.9x	12.8x
Free Cash Flow Yield*	6.7%	-7.1%	0.9%	2.7%	4.3%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 6.

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Timestamp: 07 February 2024 02:07PM EST

07 February 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	102.00	132.00
2024E Rev (m)	8,291.4	8,423.6
2025E Rev (m)	8,693.9	8,889.6
2026E Rev (m)	NA	9,407.5
2024E EPS	3.30	3.65
2025E EPS	4.55	5.05
2026E EPS	NA	6.30

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## Stock Data

Price	98.05 USD
Price Objective	132.00 USD
Date Established	7-Feb-2024
Investment Opinion	C-1-9
52-Week Range	29.02 USD - 98.89 USD
Mrkt Val (mn) / Shares Out (mn)	11,776 USD / 120.1
Free Float	96.5%
Average Daily Value (mn)	127.15 USD
BofA Ticker / Exchange	XPO / NYS
Bloomberg / Reuters	XPO US / XPO.N
ROE (2024E)	29.6%
Net Dbt to Eqty (Dec-2023A)	236.3%
ESGMeter™	Medium

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".

# iQprofile<sup>SM</sup> XPO, Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	8.5%	8.6%	9.8%	11.5%	26.5%
Return on Equity	38.0%	30.4%	29.6%	31.0%	68.0%
Operating Margin	7.8%	7.8%	9.5%	11.3%	12.5%
Free Cash Flow	785	(839)	102	320	504

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	3.2x	2.0x	1.9x	1.7x	1.6x
Asset Replacement Ratio	1.3x	3.5x	1.7x	1.6x	1.5x
Tax Rate	22.0%	23.1%	23.5%	24.0%	24.0%
Net Debt-to-Equity Ratio	204.7%	236.3%	138.4%	96.2%	NA
Interest Cover	4.5x	3.6x	3.2x	4.4x	5.8x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	7,718	7,744	8,424	8,890	9,408
% Change	7.2%	0.3%	8.8%	5.5%	5.8%
Gross Profit	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
EBITDA	661	663	869	1,071	1,243
% Change	-26.4%	0.3%	31.1%	23.1%	16.1%
Net Interest & Other Income	(80)	(153)	(225)	(207)	(183)
<b>Net Income (Adjusted)</b>	<b>409</b>	<b>346</b>	<b>440</b>	<b>607</b>	<b>753</b>
<b>% Change</b>	<b>84.1%</b>	<b>-15.3%</b>	<b>27.2%</b>	<b>37.9%</b>	<b>24.0%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	408	346	440	607	753
Depreciation & Amortization	392	432	434	460	492
Change in Working Capital	1	(99)	(31)	(13)	(13)
Deferred Taxation Charge	80	31	0	0	0
Other Adjustments, Net	425	(16)	(3)	(3)	(3)
Capital Expenditure	(521)	(1,533)	(738)	(731)	(725)
<b>Free Cash Flow</b>	<b>785</b>	<b>-839</b>	<b>102</b>	<b>320</b>	<b>504</b>
<b>% Change</b>	<b>128.9%</b>	<b>NM</b>	<b>NM</b>	<b>214.6%</b>	<b>57.5%</b>
Share / Issue Repurchase	0	0	0	(100)	(100)
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	0	2,891	0	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	460	412	687	589	0
Trade Receivables	954	973	1,048	1,077	0
Other Current Assets	216	208	208	208	0
Property, Plant & Equipment	1,832	3,075	3,359	3,619	0
Other Non-Current Assets	2,807	2,824	2,824	2,824	0
<b>Total Assets</b>	<b>6,269</b>	<b>7,492</b>	<b>8,127</b>	<b>8,317</b>	<b>0</b>
Short-Term Debt	59	69	69	69	0
Other Current Liabilities	1,448	1,521	1,565	1,581	0
Long-Term Debt	2,473	3,335	2,980	2,650	0
Other Non-Current Liabilities	1,277	1,301	1,806	1,803	0
<b>Total Liabilities</b>	<b>5,257</b>	<b>6,226</b>	<b>6,421</b>	<b>6,103</b>	<b>0</b>
<b>Total Equity</b>	<b>1,012</b>	<b>1,266</b>	<b>1,706</b>	<b>2,214</b>	<b>0</b>
<b>Total Equity &amp; Liabilities</b>	<b>6,269</b>	<b>7,492</b>	<b>8,127</b>	<b>8,317</b>	<b>0</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Sector

Road Transport/Trucking

## Company Description

XPO is a pure play LTL carrier along with a European Transport segment (it previously spun off RXO, which included its Truck Brokerage, Last Mile, and Other brokerage operations, GXO, its warehousing and logistics segment, and sold its Intermodal operations, it has noted it continues to plan to sell its Europe operations). It has over 50,000 customers and is headquartered in Greenwich, CT.

## Investment Rationale

XPO is a pure play LTL carrier (the former Con-way), along with a European Transport segment (non-core, which it is expected to sell in the future). Given the benefits to LTL from ecommerce growth, and XPO's focus to improve ops, it should unleash earnings gain potential and trapped value. We rate XPO Buy given its progress in its Network 2.0 growth strategy, which should allow it to close a margin gap to leading industry operators.

## Stock Data

Average Daily Volume 1,296,819

## Quarterly Earnings Estimates

	2023	2024
Q1	0.56A	0.71E
Q2	0.71A	1.04E
Q3	0.88A	1.03E
Q4	0.77A	0.87E

## Targets \$700-800 mil in 2024 CapEx, accretive growth

XPO targets \$700-\$800 million in 2024 Gross CapEx (BofAe \$718 million) as it aims to improve its tractor fleet age further in 2024 (from 5.0 average age in 4Q23, we anticipate 4.9 years in 2024). Given the increased equipment, it sees \$74-\$75 million in LTL Depreciation & Amortization costs per quarter in 2024 (we estimate \$79 million on average). It also expects \$240-\$260 million in 2024 interest expense, as it added debt to finance its acquisition of Yellow's terminals (BofAe \$250 million).

XPO sees mid- to high-teens percentage excess capacity from its real estate network. With the 28 terminals acquired in the Yellow auction, it anticipates net adds of ~2,000 doors (with half of the acquired facilities replacing current sorts). This implies approximately 10-15% increase in its real estate capacity, which should lead to 25-30% total excess capacity after full launch. It expects to launch the first dozen sorts in three to six months, the next dozen in 6-12 months, with the remainder in 12-18 months. Newly added sorts are expected to be margin accretive after a 30-60 day ramp given its proximity to existing business and efficiency gains (which will lead service gains, thus pricing upside). It sees the added sorts as EBITDA accretive by 2024, Operating Ratio/EPS accretive in 2025.

## LTL 2.0 plan driving clear service gains

XPO continues to drive significant improvements in its service offerings as it makes operating adjustments in 4Q23. Claims ratio was 0.3% (vs SAIA's 0.6% and ODFL's (Old Dominion) 0.1%), 10 bps better from 3Q23 and 60 bps better than 4Q22 as it made progress on its service initiatives such as the rollout of freight airbags for use in its trailers at 50% of its doors. At those facilities, damage frequency was lowered by 20% on average. It expects full implementation at its remaining service centers of the freight airbag systems by mid-2024. The company noted that 64% of the improvement to its claims ratio since 2021 was led by lower damage frequency as a result of its service initiatives. On-time performance was also up 3% year-year in 4Q23.

### Exhibit 1: LTL 4Q23 Operating Metrics Peer Comparison

XPO Tons/Day and Rev/Hundredweight ex-fuel (cwt) outpaced peers average of -0.3% and +9.5% in 4Q23.

LTL	Tons/Day	Rev/cwt (ex-fuel)	Rev/cwt (all-in)
XPO, Inc	2.0%	10.3%	5.8%
ArcBest	-7.2%	n.a.	6.8%
FedEx Freight	-10.1%	n.a.	7.0%
Knight-Swift LTL	9.7%	9.5%	4.2%
Old Dominion Freight Line	-2.0%	7.5%	3.0%
Saia, Inc	8.2%	11.7%	7.0%

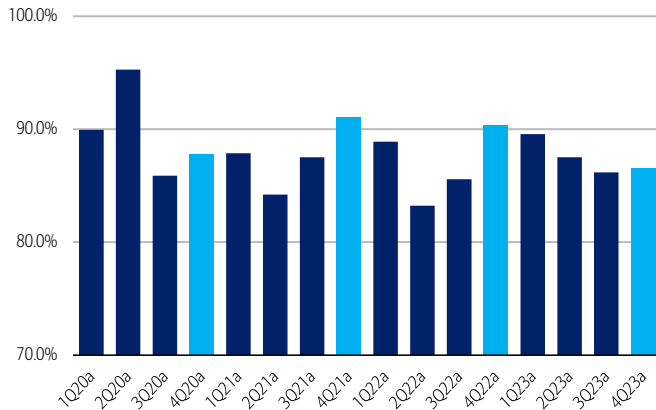
Source: BofA Global Research and company reports.

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**Exhibit 2: XPO LTL Adj Operating Ratio (4Qs in Light Blue)**

Adj. LTL Operating Ratio was 86.5%, 380 bps improvement year-year, and 160 bps above our target.

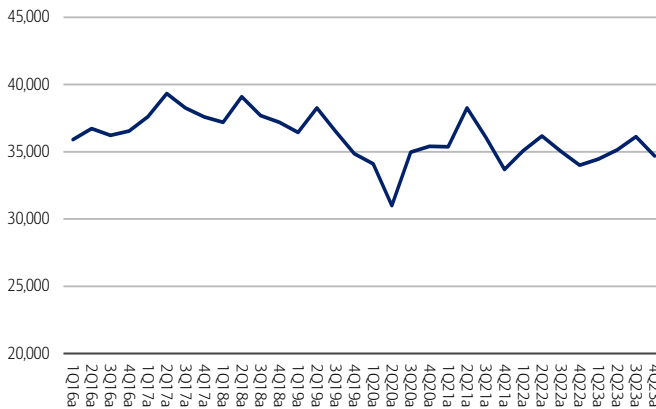


Source: Company reports.

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**Exhibit 4: XPO LTL Tons/Day**

Tons/Day were up 2% year-year in 4Q23, above our +1% target.

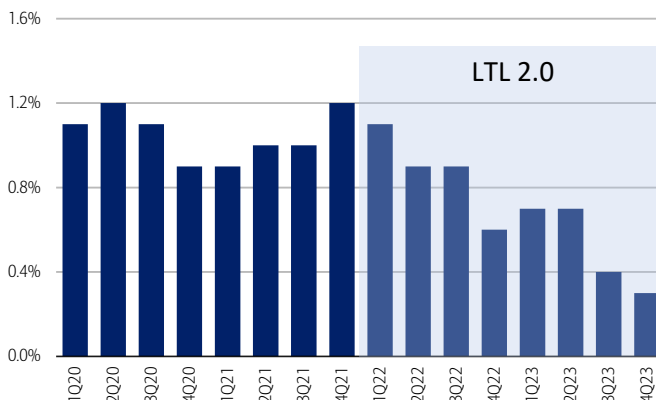


Source: Company reports.

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**Exhibit 6: XPO LTL Damage Claims Ratio**

Damage claims ratio was 0.3% in 4Q23, down from 1.2% in 4Q21.

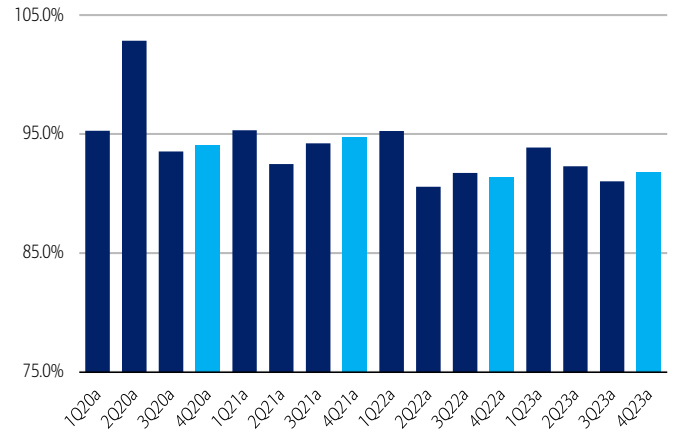


Source: Company Reports.

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**Exhibit 3: XPO Group Adj Operating Ratio (4Qs in Light Blue)**

Adj Operating Ratio was 91.8% in 4Q23, 120 bps better than our target.

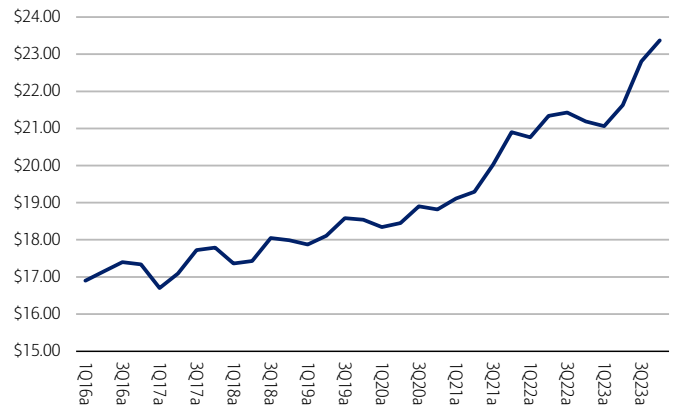


Source: Company reports.

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**Exhibit 5: XPO LTL Revenue/Hundredweight ex-fuel**

LTL yields ex-fuel were up 10% year-year in 4Q23, above our +9% target.

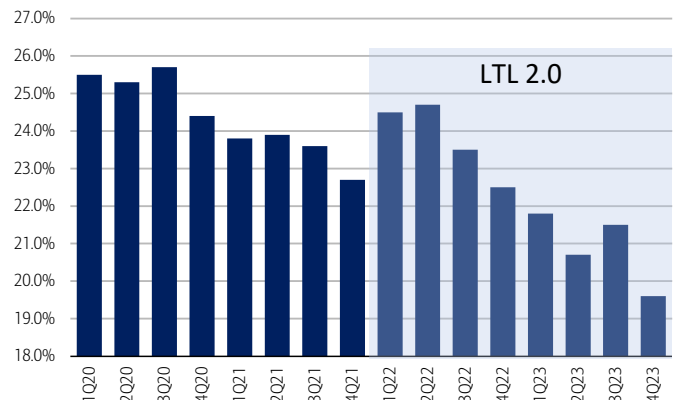


Source: Company reports.

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**Exhibit 7: XPO LTL Percent of Third-Party Line-Haul Miles**

Percent of line-haul miles outsourced was 19.6% in 4Q23, down from ~25% in 2022.



Source: Company Reports.

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## Price objective basis & risk

### XPO, Inc. (XPO)

Our \$132 price objective is based on a 36x P/E multiple on its 2024e EPS, above the upper end of peer range at 8x-24x, as we look for it to close the premium gap to best-in-class peers as it executes on its Network 2.0 growth plan and its purchase of Yellow real estate.

Downside risks to our price objective are a downturn in the global economy, which could reduce volume and pressure margins, while also potentially having a disproportionate impact on XPO's earnings given its leveraged capital structure. Long term inability to secure a sale of its Europe operation may also be a downside risk to our price objective. Its inability to improve cargo claims, insource linehaul, obtain tractors/trailers at pace it desires, and failure to improve pricing on its improved service levels would be a downside risk to targets/valuation. A potential turnaround at Yellow could lead to increased freight capacity and negative pricing pressures.

## 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
<b>BUY</b>				
	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
	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
<b>NEUTRAL</b>				
	Canadian National	CNI	CNI 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
<b>UNDERPERFORM</b>				
	ArcBest Corporation	ARCB	ARCB US	Ken Hoexter
	C.H. Robinson	CHRW	CHRW US	Ken Hoexter
	The Greenbrier Companies	GBX	GBX US	Ken Hoexter
	Werner Enterprises	WERN	WERN US	Ken Hoexter
	World Kinect	WKC	WKC US	Ken Hoexter



## iQmethod<sup>SM</sup> 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 &amp; 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

Basic EBIT + Depreciation + Amortization

iQmethod<sup>SM</sup> is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

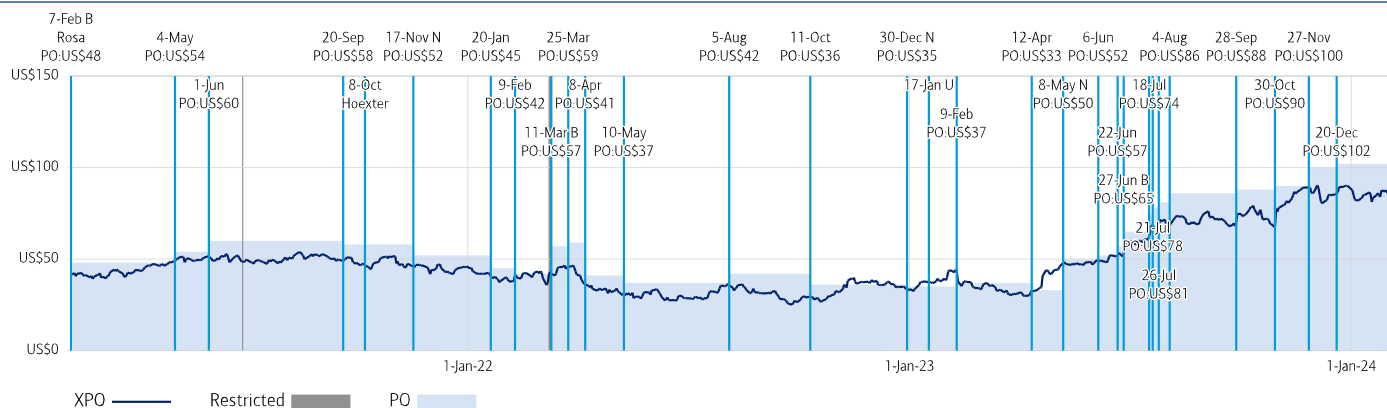
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## Disclosures

### Important Disclosures

#### XPO, Inc. (XPO) Price Chart



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 31 Dec 2023)**

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	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 <sup>R1</sup>	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%

<sup>R1</sup> 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.

**FUNDAMENTAL EQUITY OPINION KEY:** Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. VOLATILITY RISK RATINGS, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. INVESTMENT RATINGS reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

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

<sup>R2</sup> 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.

**INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. *Coverage Cluster* is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

Price Charts for the securities referenced in this research report are available on the [Price Charts website](#), or call 1-800-MERRILL to have them mailed.

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The issuer is or was, within the last 12 months, an investment banking client of BofAS and/or one or more of its affiliates: XPO, Inc.

BofAS or an affiliate has received compensation from the issuer for non-investment banking services or products within the past 12 months: XPO, Inc.

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BofAS or an affiliate has received compensation for investment banking services from this issuer within the past 12 months: XPO, Inc.

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