GXO

GXO First Quarter 2022 Results

May 5, 2022

GXO First Quarter 2022 Results
May 5, 2022

Presenters
Malcolm Wilson – CEO, GXO Logistics
Baris Oran – CFO, GXO Logistics
Mark Manduca – CIO, GXO Logistics

Q&A Participants
Scott Schneeberger – Oppenheimer
Christian Wetherbee – Citi
Amit Mehrotra – Deutsche Bank
Bascome Majors – Susquehanna Financial
Brian Ossenbeck – J.P. Morgan
Mario Cortellacci – Jefferies
Ravi Shanker – Morgan Stanley

Operator
Welcome to the GXO Q1 2022 earnings conference call and webcast. My name is Darryl and I'll be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. If anyone should require operator assistance during the conference, please press star-zero on your telephone keypad. Please note that this conference is being recorded.

Before the call begins, let me read a brief statement on behalf of the company regarding forward-looking statements, the use of non-GAAP financial measures, and company guidance. During this call, the company will be making certain forward-looking statements within the meaning of applicable securities law, which, by their nature, involve a number of risks, uncertainties, and other factors that could cause actual results to differ materially from those projected in the forward-looking statements.

A discussion of factors that can cause actual results to differ materially is contained in the company's SEC filings. The forward-looking statements in the company's earnings release or made on this call are made only as of today, and the company has no obligation to update any of these forward-looking statements, except to the extent required by law.

The company may also refer to certain non-GAAP financial measures as defined under the applicable SEC rules during this call. Reconciliations of such non-GAAP financial measures to the most comparable GAAP measures are contained in the company's earnings release, and the related financial tables are on its website. Unless otherwise stated, all results reported on this call are reported in United States Dollars.

The company will also remind you that its guidance incorporates business trends to date and what it believes today to be appropriate assumptions. The company's results are inherently unpredictable and may be materially affected by many factors, including fluctuations in foreign exchange rates, changes in global economic conditions and consumer demand spending, labor market and global supply chain constraints, inflationary pressures, and the various factors detailed in its filings with the SEC. It is not possible for the company to actually predict demand for services, and, therefore, its actual results could differ materially from the guidance. You can find a copy of the company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures, in the Investors section of the company website.

I will now turn the call over to GXO's Chief Executive Officer, Malcolm Wilson.

Mr. Wilson, you may begin.

Malcolm Wilson – GXO Chief Executive Officer
Thank you, operator.

Good morning, everyone, and welcome to GXO's first quarter 2022 earnings call. Joining me today are Baris Oran, our Chief Financial Officer, and Mark Manduca, our Chief Investment Officer.

We have started 2022 with outstanding top- and bottom-line performance.

Our revenue grew 14% year over year in the first quarter of 2022, and our organic revenue, which excludes the impact of M&A and foreign exchange, grew by 19%. This is our highest first-quarter performance ever. Our adjusted diluted earnings per share increased by 59% year-over-year. Finally, our new business wins of $344 million is also a record for the first quarter, underscoring the growing demand for our best-in-class solutions. As a result of this continued strong performance, we are raising our full-year organic revenue growth guidance.

We are clearly in an environment where supply chains have become far more complex and will require much greater scale and innovation. Our role as a trusted, long-term partner to global businesses is more critical than ever, which is why we continue to see record new business wins, a huge sales pipeline, and increasing demand for customer first-time outsourcing.

All of our verticals are growing, both organically and through new customer wins, and it's worth taking a moment to discuss where we are winning new business. While we continued to expand the scope of operations with existing customers and gain market share during the first quarter, first-time outsourcing – especially in the ecommerce and omnichannel sector – was again the largest source of our new business wins.

Our first-time outsourcing contract wins included BT, Carrefour, Decathlon, Raytheon, and Zalando. We saw expansion of operations with several existing customers including Abercrombie & Fitch, Diversey, Ingersoll Rand, and iRobot.

In the short term, as physical retail reopens, we have seen some shifts from ecommerce back to brick-and-mortar retail. However, our customers continue to invest heavily with us in developing their direct-to-consumer channel. When you combine this with our high revenue retention levels, we have great confidence in the robust nature of our growth trajectory in 2022 and the coming years.

In early April, we were very pleased that Clipper Logistics' shareholders voted in favour of our offer to acquire the company. We anticipate that this acquisition will be highly accretive to GXO's financial results, our vertical expertise, and our geographic coverage.

At GXO, we are proud of the way we do business, and we have made excellent progress establishing ourselves as the logistics partner of choice for forward-looking companies that share our commitment to ESG. As a new company, we have the unique opportunity to tailor our environmental, social and governance strategy to what matters most – our people, our partners and our planet.

With the recent release of our inaugural ESG report, we're off to a strong start. In the report, we provide updates on our progress toward our global targets, share details of how we have delivered against our stakeholders' priorities in our first months as an independent company, and we will preview our plans for the years to come.

I will now hand the call over to Baris, who will take you through our quarterly performance in greater detail. Over to you, Baris.

Baris Oran – GXO Chief Financial Officer
Thank you, Malcolm, and good morning, everyone.

To start, I'm going to review our record first quarter results, and then I'll discuss the durability and visibility of our contractual business model.

In the first three months of the year, we delivered 19% organic revenue growth, our fifth consecutive quarter of double-digit growth, and secured a record number of new business wins.

Net income attributable to shareholders in Q1 2022 was $37 million, which compared to $14 million a year ago. Adjusted EBIT-D-A grew to $155 million, up from $143 million on a pro forma basis a year ago. And adjusted diluted earnings per share increased by 59% year-over-year. Our return on invested capital was stellar at over 30%.

We are implementing larger and more complex solutions on an unprecedented scale. You see this in the investment we have made in the first quarter starting up these operations. This will drive full-year margin expansion, more visible in the second half of the year and into 2023. The average contract duration of our wins was approximately six years, which continues to extend our overall contract life.

The strong secular trends within this business are demonstrated by the fact that we have raised our revenue growth guidance for the year. We have also introduced an adjusted EPS guidance of between $2.70 cents and $2.90 cents per share, implying a growth range of between 29% and 39% year over year.

Turning to cash flow – our business in the first quarter typically sees modest cash outflows due to seasonality. This first quarter was no different: $16 million in cash outflows in Q1 2022 vs $20 million in cash outflows in Q1 2021. As you may recall, we have said that our growth capex to sales is approximately 2%, and, as we grow and implement new business, we have a modest working capital drag. We remain very confident in delivering our guidance of 30% free cash flow conversion from EBIT-D-A in 2022.

Our investment grade rated balance sheet continues to be rock solid, with leverage at under 1x the Last Twelve Months' Adjusted EBIT-D-A.

To conclude, GXO's high earnings predictability continues to be underwritten by:

- A stellar new business pipeline;
- Longer and longer contract durations;
- A highly variable cost base;
- Inflation pass-throughs;
- Minimum volume guarantees; and
- Best-in-class revenue retention rates.

Our first quarter results clearly demonstrate that this business is not just an exciting structural growth story, but one in which we expect to deliver outstanding profits and strong cash flows, with great returns for our investors.

I'll now hand the call to Mark, who will elaborate on our record wins, technology investments, ESG achievements, as well as our raised growth guidance.

Over to you, Mark.

Mark Manduca – Chief Investment Officer
Thanks, Baris.

GXO delivered a record first quarter for new customer wins. We've won over $344 million in the first quarter, and about two thirds of that will fall this year, meaning we now expect over $1 billion in incremental 2022 revenue. Importantly, we've also sustained our strong mid-to-high-90s revenue retention rate.

Our wins, and our $2.5 billion pipeline, can be attributed to our reputation for quality and reliability – but also, our leadership in technology-enabled solutions. We are the innovation leader in our industry, and we never stop working to retain our technological edge. The rise you can see in our average contract duration in the first quarter reflects the fact that we are partnering on more complex solutions with our customers.

Over the past few years, we've invested to increase the level of automation across our global footprint. Notably, in the US, we've seen a year-over-year increase of more than 40% in automated solutions in the first quarter. And, at the end of the first quarter, one third of our revenue is driven from highly automated sites globally.

This is driving real benefits for our business and for all our stakeholders. For example, in a number of cases, cobots in GXO warehouses have materially improved productivity and accuracy rates, while enhancing our already great employee retention rates. I would also note that we've recently launched a 3D automated packaging solution in our ecommerce sites that custom fits boxes to their contents, saving significantly on materials and contributing to sustainability.

These technological advancements not only drive our business forward, but they are well aligned with our firm belief that how we do business is every bit as important as what we do. As Malcolm mentioned, we published our inaugural ESG report last week, highlighting that we are on track to achieve our long-term targets, while also supporting our customers as they work to achieve their own ESG goals.

In particular, I'd like to call out a few key highlights from the report on the environmental side:

Our greenhouse gas emissions fell by 3%, but what's more impressive here, given the growth of GXO, is that the per-dollar of revenue actually fell by some 24% year-over-year. Additionally, nearly half of our global floorspace is now using more efficient LED lighting.

It's clear, through both our wins and pipeline, that we have considerable growth opportunities ahead, as more and more customers are looking to GXO to optimize the warehouse, a mission-critical component of the supply chain.

All of this is contributing to our raised guidance. Let me take you through those highlights:

- Firstly, in terms of organic revenue growth, we're now guiding to 11-15% for 2022 – that's up from 8%-12%. This reflects the phenomenal new business wins we have seen in the first three months, the size of our sales pipeline, and the strength of our existing business.

- Secondly, we've provided adjusted diluted earnings per share guidance for the first time; and we're looking for EPS between $2.70 and $2.90 dollars. This implies a growth rate of between 29% and 39% this year, and puts us in the top 20% of the S&P 400 Midcap companies.

In closing, we're clearly off to a phenomenal start in 2022. GXO has extremely high, multi-year revenue visibility, some exceptional growth with global blue-chip customers, resilient returns, and excellent cash generation.

We'll now open the call up to Q&A.

Question-and-Answer Session

Operator
[Operator Instructions]

Our first question comes from the line of Scott Schneeberger with Oppenheimer. Please proceed with your questions.

Scott Schneeberger – Oppenheimer
Thank you very much. Good morning gentlemen. For my first question, I'll ask if you could please discuss what you're seeing in supply chains right now from a macro perspective; how that's developed in recent months; and how it's impacting your business? Thanks.

Malcolm Wilson – GXO Chief Executive Officer
Thanks, Scott. It's Malcolm Wilson, and let me come in and give you some background. So first and foremost, if I think about what GXO is seeing, well, you've just heard our call. I mean, it was a great quarter and we're operating in a huge addressable market: $430 billion. We had great organic growth: 19%. As Mark just mentioned, EPS guidance puts us in the top 20% of the S&P 400. We launched our inaugural ESG report. So really, it was a super quarter. What was very, very pleasing, though, was the level of new business that was being signed: $340 million. There was a huge amount of implementations taking place, as well that will flow through from 2021. So, overall, very, very good.

We've got to put that against the kind of bigger picture, and what we saw really progressively through, from January onwards, was, in some of our customers where we operate in an omni-channel capacity – so we operate e-fulfillment, but we also deliver into brick-and-mortar facilities for them – we've seen that consumers, as a consequence of the pandemic receding, have drifted back into the shopping mall. That's a great thing. We're happy about that. So we've seen some volume change as a consequence of that.

We've also seen, of course, in Europe – we can't imagine the situation, the shock aspect of the Russian invasion of Ukraine. But that shock, that initial shock has really dissipated now. Sad to say that people have become familiar with the situation.

And the last thing I want to comment, about the big picture, is there are still evident supply chain disruptions. Right now, a lot of customers across our North American business and European business are affected by shortages of products as a consequence of the rise again of COVID in Asia, particularly in China., and of course, various type of shipping disruptions. Last year, it was Long Beach inbound port; this year, probably more outbound ports, like Shanghai.

So that's the kind of big picture. But overall, we are constantly monitoring our sales order pipeline. It's retained at a very high, very positive level, over $2.5 billion. Our conversion has remained very constant, retention of customers very constant. Contracting terms, if anything, are going upwards. So an average for the quarter was around six years. So overall, we're kind of not seeing the impact of these larger-picture events.

But I do want to say, in the end, we're not 100% immune to any kind of macro world. You know, interest rates are going up. We're not 100% immune to that. But I would say that the very nature of how we do business, the nature of how we strike our contractual deals with our customers, our ability to pass through – and, you know a lot of inflation to pass through at the moment, but we're successfully doing that – really gives us a very strong base. It shields us to a certain extent from these momentary volume modifications that we're seeing. We see a bit of softness on one customer, the scale of our business really tends to allow us to not see any major impact across our results.

Scott Schneeberger – Oppenheimer
Excellent. Thanks, Malcolm, I appreciate that color.

For my follow-up, I'd like to ask about margins in the quarter. If you could please elaborate, looking at slide 16 – thank you for the bridge – you had going in the right direction “Performance improvements and other.” If you could elaborate on that?

And then obviously, you had this great new activity and new business start-ups, which is a bit of a headwind. So if you could just speak to how we should expect to see the margin develop over the balance of the year, kind of a thought of how you would bridge 2021 to 2022 in a similar fashion, and elaborate on some of those drivers? Thank you.

Baris Oran – GXO Chief Financial Officer
Sure. This is Baris here. I'm going to take that margin question.

We have written 19% organic growth in Q1, and when you look into the components of that growth, literally close to half is coming from net new business wins. Bearing in mind that our earlier guidance was about 5-8% of our organic growth would come from new business wins, we are clearly trending at the peak of this range.

And when we start that new business, due to the complexity of the solution we provide to our customers, it takes time for each operation to reach margin maturity. This ranges by contract type: open book, or cost-plus contracts, take roughly three to six months to mature, while closed book and hybrid contracts takes six to 12 months to mature.

Accordingly, we'll see profitability of these contracts more prevalent in the second half of the year, which will drive our margin expansion on a year-over-year basis. So the impact of new business wins in Q2 will be less than Q1, but we will see a positive margin contribution starting in the second half of the year.

Scott Schneeberger – Oppenheimer
Great. Thanks for the color, guys. I will turn it over.

Operator
Thank you. Our next question is coming from the line of Chris Wetherbee with Citi. Please proceed with your questions.

Christian Wetherbee – Citigroup
Hey, thanks and good morning, guys.

Maybe if I could just piggyback on that margin question, maybe understand it a little bit better as we think about – really, more bigger picture, so beyond just sort of the second half of this year, as you think about the opportunity set in front of you, the pipeline that you're expecting, is there a way we can think about how much start-up costs should be sort of generally in the business in any given year, I don't know if that is a percent of revenue, or if you want to think about that as a percent of adjusted EBITDA margin – just want to get a sense of what should be sort of assumed in our expectations as we move forward beyond 2022?

Baris Oran – GXO Chief Financial Officer
Sure, Chris.

As we have mentioned, this has been an extraordinary quarter of new start-ups. And when you look into the Q1 detail, the delta in EBITDA was about 40 basis points. And 68 basis points' delta is coming from net new business wins, the remainder reflecting our operating activities, including operating excellence. So this has been – as we mentioned earlier, in our Q4 earnings call – this has been a very robust start-up time. We have been extremely busy, and it is reflecting that in our margins. And over time, in the second half, you will see more prevalent improvement in our margins. We're writing a lot of contracts, very solid contracts, for return on invested capital.

I'll give you an example, I was reviewing a contract with huge revenues, and only 6% EBITDA margins, but return on invested capital of 86%, and EBITA margin above our group average. This is the kind of contract that I will sign every day, and all day.

Christian Wetherbee – Citigroup
Okay. Okay. So I guess there's not necessarily, like, a good rule of thumb that we could think about in terms of, "X revenue equals – on an annualized basis – equals an initial upfront start-up costs of something" – some percentage of that. Is there any way to think about it in that context?

Mark Manduca – GXO Chief Investment Officer
Yes, Chris. There's a couple of ways of thinking about this.

So just to Baris's point about the pipeline – it's Mark here, obviously – we've got a very long-duration pipeline. That's what your question tilts towards. But really, what's happening in this $2.5 billion pipeline – which, by the way, is up 20% year over year – we're winning some great contracts, and those contracts have tilted to our strengths, which obviously are margin- and return-enhancing.

So you'll notice that, in our presentation pack that we put out last night, 70% of our mix is coming from ecommerce, omni-channel retail and consumer technology. And all of the contracts that we signed through Q3, Q4, and Q1 have some element of automation attached to them. You'll know we've talked about automation contract wins as having 300 to 400 better basis point margin improvements in our business.

So there's lots to like here in the pipeline. There's lots to like in terms of the new wins that we're signing. We're winning a lot of outsourcing contracts, wallet expansion, and competitor wins in the business. And that, over time, will naturally be margin-expansion-enhancing, and also return-enhancing, as Baris and Malcolm have both alluded to.

Christian Wetherbee – Citigroup
Okay. That's really helpful. I appreciate the color, Mark. Thank you so much.

Quick follow-up here, so just thinking about the current environment that we're in: ecommerce growth was fairly robust in the quarter from a revenue perspective; is there any way that we can look within the contract to get a sense of where volume is trending, from a sort of quarter-to-quarter dynamic? Just getting a sense of where you are relative to your, sort of, the floors and ceilings within the contracts, specifically on the ecomm side, would be helpful.

Mark Manduca – GXO Chief Investment Officer
Yes, let me help on that, Chris. It's Mark here.

So, if you think about our business right now, let's go back to basics in terms of the 8-12% guidance range that we had, so that was essentially coming from two elements. That was coming from existing growth, which was 3-4% at the time; and then 5-8%. We've obviously raised that range, as you know, to 11-15% for this year.

That now goes, in essence, you can think about it as being existing customer wins of 4-5%, so that gives you a sense of what's going on in the underlying business, which, as you say, is highly skewed, in our business, towards ecomm. And then, of course, new business wins in the 7-10% range. So if you think about that, that gets you, if you take 4% and 5% and 7% to 10%, that gets you to 11% to 15%, which is that new guidance range.

And I don't think, in terms of your underlying point, the run rate, as you talk about in your question, I don't think it would be unfair to surmise that the existing customer range that we've talked about is tracking ahead of trend in the first quarter, as we saw in the third and the fourth quarter as well. So underlying volumes, as Malcolm spoke about to Scott's question, looking good.

The reason I'm also confident in this 7-10% range – just kind of looking into the looking glass, as you say – is the fact that the new customer wins are now accumulating at this $1.02 billion range. We've got a lot in the hopper in terms of new wins, as the guidance talks about. It's essentially the $830 million that we talked about at the last quarter, plus the $192 million from the last quarter. That basically is 10.5%, plus 2.5%, which means we've got a gross win rate already banked for this year of 12.9% in the bag, *plus* anything that we could potentially win in the April that's just passed, and the May that we're currently sitting in.

So that's what really drives our confidence in terms of existing customers, gross wins, and when you combine that with the fact that, as Malcolm said, this mid to high-90s revenue retention rate, that's very strong for a business services company such as us, as I'm sure you're aware.
So you've got really everything heading in the right direction for this business: you've got existing customer growth, a stunning pipeline, you've got stellar retention rates, and you've got plenty of new wins coming through. So there's lots to be excited about here, Chris, in terms of the underlying growth and the new growth coming through in the business. I hope that helps.

Christian Wetherbee – Citigroup
Yeah, it does. Thanks so much for the time. Appreciate it.

Operator
Thank you. Our next question is coming from the line of Amit Mehrotra with Deutsche Bank. Please proceed with your questions.

Amit Mehrotra – Deutsche Bank
Thanks, Operator. Hi, everybody. Congrats on the results.

Malcolm, I want to go back to your commentary on the first question, I think Scott Schneeberger's question. So Europe, there's a lot going on in Europe right now. Almost all of it, if not all of it, presents macro challenges. And you guys are – your customers – you're engaging with your customers for $10, $15, $20 million outsourcing projects, which are huge investments for your customers. And so I understand that the markets you serve and the solutions you provide have incredible secular tailwinds attached to it.

But if you can just – I mean, you're doing business right now for 2023, 2024, 2025; have the challenges in Europe at all presented any hesitation from your customers, around, maybe, deferring some of these capital projects in light of what's happening in Europe? Because I'm not worried so much about 2022 growth, probably not worried about 2023 growth, but I'm a little bit worried about if there's an air pocket in growth in late 2023, 2024, 2025, as a result from the long lead times of your business?

Malcolm Wilson – GXO Chief Executive Officer
Yes. Amit, thanks for that. And it's a really good point that you're asking, because I think, as GXO, we are a good bellwether. We can see ahead that long runway that we have of visibility of what our customers are doing. And what I can say is right now, e-fulfillment – I mean, we talked earlier about, we've seen a drift back to brick-and-mortar. I think that's a good thing. But overwhelmingly, all of our customers are continuing to want to put more and more of their business online. And they're doing that, quite simply, because it improves their ability to see directly the consumer experience. They touch it firsthand, they see it directly, and also, not to lose sight of the fact, it's a lower cost model for them to service the consumer directly, rather than through a brick-and-mortar.

So when we look at our e-fulfillment business, which is, for GXO, broadly around 50% of our activity, that's really going like a rocket. And those projects that we talk to customers about, they're never-ending. I mean, a big proportion of the sales pipeline at the moment is those kind of projects, and the typical projects that incorporate quite a lot of automation because it's a volume business. It's all about future-proofing the solution. And generally, those projects are very buoyant, lots of discussions with new customers, pipeline at the moment heavily populated with new projects, and going very, very well.

When we look across the rest of our business – I mean, our food, beverages activities, I mean, it is what it is. People have to eat, and customers are becoming more attuned to automation and that drives longer-term contracts. So on that side of the business, equally, what we're seeing is a shift to longer-term deals, simply because they can carry more capital; they're being put up really with the intent of servicing the consumer for 5, 10 years plus.

And then the rest of our business, I can only kind of comment that really, pipeline-wise it's strong, lots of long-term projects in amongst it. So we're not really seeing – I've heard a lot of customers talk about – not customers, but I've heard a lot of companies in the last week mention about, maybe, slower, things like that; we're not seeing it. We're just seeing, really, a continuation of what we saw through 2021, 2020. The start of this year is very, very good for us.

That's why we're lifting our topline guidance, and as Baris mentioned, I mean, we are awash. In quarter one, we have – probably our teams have never worked harder in the context of just standing up, implementing new facilities. Everybody is running very, very busy at the moment, but all for the long-term benefit.

Amit Mehrotra – Deutsche Bank
That's pretty amazing. I think it speaks to the opportunity and the execution.

So a couple of other quick ones, if I could.

Baris, one thing that I noticed is, when I look at the adjusted cost of the business – so taking out transaction and restructuring costs and deal amortization cost – the adjusted cost of the business was up year over year, but at a lower rate than revenue growth. And I'm including FX in both numbers.

I just want to think about – we talk a lot about margins for this business, but at the end of the day, it's a very growth-centric business and even if you don't expand margins, as long as you're not declining margins, your EBITDA is still growing. So, as we think about the next three to four years, including the start-up costs, do you feel comfortable that the adjusted OPEX base of the company inflates at a lower rate than revenue, which allows you to drive some margin expansion, is that the right algorithm for the company?

Baris Oran – GXO Chief Financial Officer
Yes, I feel fully confident on that. As we look forward, we will have higher margin expansion in our, especially on EBITA. And you should continue to see that our EBITA margin expansion is faster than our EBITDA margin expansion.

Currently, we are about 40% open book. After Clipper, we're going to be pretty much close to 50% open book, and that's going to be accelerating our EBITA margin expansion much higher than EBITDA.

Amit Mehrotra – Deutsche Bank
Yes. I'm just more focused on EBIT, because obviously, the useful life of your assets is tailored to how you price the business and your ROIC. But it seems like that should translate to EBIT as well.

The last question for me, if I could. I'm sorry, I'm over my allotment, but I think it's an important question, is that you guys paid a very big price for Clipper Logistics on a pre-synergy basis. Post synergies, it looks very compelling, but one could argue that you're capitalizing a lot of the benefits based on the pre-synergy price.

Malcolm, I mean, you've been in Europe for decades and been in this business for decades; what does Clipper give you that makes the price worth paying for? And can you just talk about the strategic rationale and why you're willing to pay such a high price on a pre-synergy basis for the company?

Malcolm Wilson – GXO Chief Executive Officer
Yes, Amit, thanks. Let me give you the feedback on that.

So, and you're right, I've been in Europe for a while. And when we made our spin as a business, we created a kind of list of companies that we admire, that we thought would make really super M&A opportunities, and Clipper was right at the top. So we were super pleased to have found an agreement, very happy with Clipper shareholders, who voted for the deal.

And by the way, just on timing on that, it's got to go through a traditional kind of regulatory approval. We don't anticipate any difficulties on that; likely to be closing probably in the summer, maybe as early as – I would say, very earliest August, but we're heading into the kind of holiday periods for a lot of the people who work on those matters. So it's more likely to be September, but it's in the coming months for sure. And we're really looking forward to welcoming all those new team members across into the business.

It's very accretive for our business. Even in the first year, it's going to be accretive. And you're right, we're paying a good price for it, but it's coming with just an absolute ton of cost synergies: about $48 million, very visible to us. It's kind of, we're an experienced management organization; we're experienced at M&A; we're experienced at integrating businesses and eking out all of the benefits that come out of an integration.

What that business is bringing us, I mean, it's – I could consume the rest of this call, Amit, just to tell you about it. But it's bringing a reinforcement of e-fulfillment in core markets that we operate. Virtually no crossover of customer – I think when I looked at it, I think there's maybe one, maximum two, customers where we actually have business together at the moment. Very, very small. So it's no crossover of customers, so there's a massive opportunity for cross-sales across the customer base. So a lot of the Clipper customers are multinational, so they're not just UK activity.

And then, outside of the customers, Clipper is very advanced, more so – pains me to say it, but more so, even, than GXO when it comes to reverse logistics and returns management. It's a real skill; it's an art for them. They've got a lot of very sophisticated software that drives it. So that is going to help us tremendously leverage those skill sets and those technologies across the rest of GXO's customer base – not just in UK, Continental Europe, but even bringing out to North America.

Then, when we look at the geography, Clipper's core business is a UK business, but they've done a great job of expanding. And, particularly in Germany, they've done really well. Now, for GXO, we admire Germany. It's on our list of M&A target countries. But with Clipper, in fact, when we put our existing business together with their business for Germany – which is, by the way, Europe's largest single economy – it gives us critical mass. And if we just see accelerating growth in Germany in the same scale as the rest of our business – wow, that's going to be incredible for us. It's a big market, dominated by a handful of players at the moment, plenty of room for a new technology-driven organization like GXO.

And the last thing, on new verticals, Clipper has done a great job of developing some verticals. They're very heavy in repairs and refurbishment. We will leverage that across all of our customer base. They've been growing out a small network organically and through small M&A., and we'll look to carry that good work on. But huge leverage across our existing customer base, and it fits well with ESG as well. And lastly, health care and life sciences, and it's a business where you need scale. When we marry that to GXO's scale, that's going to be a winner. We're not in it today. It's going to grow like a weed. We've really got good hopes for it.

So I think, all in all, this is what gives us such a compelling reason to make that agreement. I think big cost synergies, huge top-line synergies are going to come from that agreement.

Amit Mehrotra – Deutsche Bank
Okay, that's very clear. Thank you, Malcolm; thank you everybody. Appreciate it.

Operator
Our next questions come from the line of Bascome Majors with Susquehanna. Please proceed with your questions.

Bascome Majors – Susquehanna Financial
Malcolm, you joined the GXO predecessor, Norbert, in the fall of 2007, and walked, effectively, right into a deep global recession and had to manage through that. Can you talk a little bit about the signs of the business changing that you saw 15 years ago, and how those inform, how you manage this business for downside risk into the current environment? Thank you.

Malcolm Wilson – GXO Chief Executive Officer
Yes, for sure. I mean years ago, logistics, I have to say – sadly, many years ago, it was viewed as a commodity. It's no longer viewed as a commodity today. It's viewed as an essential part of doing business. It's viewed as, it can make a difference to the success of any company, when it comes to the consumer experience. And that's what's changed. That's the fundamental thing that's changed, over all of those years.

Today, we're an integral part of the customer activities that we work with. Those blue-chip customers, no wonder they sign 5-, 10-, 15-year agreements, because we become absolutely integral, very sticky with them. We're part of how they deliver their service. When we look at how we work together, it's very much a contractual type of environment. We have set boilerplate-type of agreements. That's why you've heard Baris mention about the pass-through of inflations. It's actually never a big discussion.

Customers, particularly when you think about wage inflation and energy inflation, these are the kind of essentials to delivering a great service. And that's the most important thing, delivering a great service. So we never tend to have a big drama in the discussions with them, even though they're actually cost increases. But nevertheless, those tend to easily go through to our customers under the terms of the agreements that we have with them.

And more and more, as Baris mentioned, we're seeing a lot of open-book deals coming along. I think in these high levels of inflationary environment that we see, that's not a bad thing. That's actually a good thing for us. We're quite happy with those.

So that's the overview that I can kind of share with you. We've become, I think we've matured as an industry – all of a sudden full of technology, full of automation. I can remember in the days when you could have a graduate trainee induction day, and you'd have a few people who turned up. Now, it's thousands of people. People want to work for GXO, because they just see us as a super high-technology company with a very loyal, very strong, very structured customer base.

Bascome Majors – Susquehanna Financial
Thank you for that.

And on the quantitative side, I know you guys talked about this in the Investor Day last summer, but the business is changing. You're doing a fairly sizable acquisition. I don't know, Malcolm or Baris, who wants to take this, but can you talk a little bit quantitatively about your modeling for how the business would fare in a deeper recession? Just want to understand how instructive the Norbert's 2009 scenario is, or is not. Thank you.

Baris Oran – GXO Chief Financial Officer
Sure, I'll take that. This is Baris here.

When you look at our customer base, it's very strong, and our volumes are really strong, as Mark mentioned. We have seen a stellar 19% organic growth result and we are forecasting really continued growth in our business.

However, if you go to see a downturn, 25% of revenue is fixed. And based – that's one side. And because of the resilience of our open-book, cost-plus contracts and inflation pass-throughs, our margins are very stable in different cycles.

We have long-term visibility: we're booking revenue all the way to 2024 right now. We have fantastic visibility in 2022, 2023, booking into 2024. And we have minimum volume guarantees that reinforces our strength in both up and down cycles. So our mix of our business is very resilient, and it's a business for all seasons. Remember, the fixed revenue, 25%; 40% open book. We have minimum volume guarantees, inflation pass-throughs, and booking revenue all the way up to 2024 right now.

Bascome Majors – Susquehanna Financial
Okay, thank you for that.

Operator
Thank you. Our next questions come from the line of Brian Ossenbeck with J.P. Morgan. Please proceed with your questions.

Brian Ossenbeck – J.P. Morgan
Hey, good morning. Thanks for taking the questions.

So I want to come back to the margins and the start-up costs, kind of a two-part question on that. Can you give us a sense, would these start to fade as GXO gets to a certain size or scale, or would this be kind of just normal seasonality when you look at margins for first half, back half, it'd be helpful to kind of understand?

And then also, more near-term, given the environment and how tight everything is, would you say that these start-up costs are maybe a little bit more than you would have expected, in terms of getting execution on time, the inflation, getting enough people in place to stand up these projects – which sound like they're kind of large? So comments on both those would be helpful.

Baris Oran – GXO Chief Financial Officer
Hi Brian, this is Baris here. Let me take that question.

As I mentioned, 19% organic growth, and a very sizable portion of that is coming from new business wins. We are really trending at the higher, clearly trending at the peak of our range as far as new growth guidance, and this has been extraordinary growth. As Malcolm mentioned, we are extremely busy implementing contracts, left, right everywhere, as our services are in high demand.

And we are delivering quite a lot to our customers. I recently went through some of our performance. For example, in a well-known ecommerce customer site we launched recently, we reduced their variable cost by 40% per unit; reduced their inventory stock units by around 40%; and, most importantly, we delivered a Net Promoter Score – as you know, this is used as a customer intimacy, consumer intimacy, and consumer satisfaction score – a 45% uplift in the Net Promoter Score. So that's what's driving our new business wins.

And as I mentioned, we have 40 basis points' delta in Q1; 68 basis points is coming from new business wins, and it has been an extraordinary growth. In the second half of the year, you should see margin expansion coming from these new business wins as their margin starts to mature.

Brian Ossenbeck – J.P. Morgan
Okay. But I guess in terms of looking forward, is there, is this, like, the way the seasonality of the business should work, where you just have start-up costs that just are higher in the first half versus the second half, or does that depend on other factors, like how much of it's organic or not? Just trying to think about how we should be modeling this, and, really, what's driving most of this impact here in the first half, would this be something which should be considered more so in the future, or just part of the normal business?

Baris Oran – GXO Chief Financial Officer
During the peak, our customers don't like implementations. Everybody is very focused on making sure the volumes are delivered to the consumer base. So that starts with, before the Black Friday, and ends up with the returns process after Christmas. So that's a period that we don't do a lot of implementations. We tend to focus on delivery.

So after that, there is, of course, an accumulation of new start-ups, and we're getting ready for the next week— next *peak*, as we get ready for 2022 peak.

So you should see that on a year-over-year basis, on a quarter-over-quarter basis, because of the nature of our fulfillment business model and the peak season.

Brian Ossenbeck – J.P. Morgan
Okay. Understood. Just one quick follow-up: you mentioned returns in GXO Direct. I think in the past, you've given some relative sizing in growth rates. Can you give us an update on both of those? Thank you.

Mark Manduca – GXO Chief Investment Officer
Hey Brian, I'm happy to take that.

So, with GXO Direct, there's been huge demand, obviously, for the GXO Direct service. We have been, as I mentioned to Chris, inundated with customer inquiries. Margins, you'll be pleased to know, for this year, should be better versus the base business – and they're growing substantially, which is a good sign.

Very broadly, I think this year, we're budgeting for around $400 million of revenue in that business, and, clearly, there's a lot of validation in the market by what you're seeing with some of the M&A in the space. You've obviously seen Shopify and Deliver. That, to me, is a very strong sense of validation that we're seeing interest and growth within that space.

And, like our broader business, it facilitates the customers to get closer and closer – as Baris was talking about earlier, in this D2C element – get closer and closer to their end consumers. So the business will be really one of the mainstays of what we continue to grow.

And to Malcolm's point earlier, it clearly is also a very clear link with what we're doing in the multi-tenanted warehouses of Clipper, which dominate obviously their footprint.

So, we're very excited with what's going on within our base business in the US, and then, as we acquire, obviously, Clipper will provide a growth avenue within the European portion, which will act, to a certain degree, as a GXO Direct Europe, so to speak. So very exciting times ahead, and tons and tons of growth in that business. Customers are falling over themselves to do business with us, and it's a very good margin and returns.

Brian Ossenbeck – J.P. Morgan
Okay, thanks for your time.

Operator
Thank you. Our next questions come from the line of Hamzah Mazari with Jefferies. Please proceed with your questions.

Mario Cortellacci – Jefferies
Hi, this is Mario Cortellacci, filling in for Hamza. Maybe, could you just comment on what you're seeing on labor availability and labor inflation in your model, and kind of how you're managing through that? I know that in your open-source contracts, you can, I guess, pass through some of – or all of that, inflation, or pressure, but maybe, just kind of going back to the implementation of these projects as well, and kind of the cost from, maybe even a CAPEX perspective or implementation perspective – kind of what you're seeing on an availability, and then how you're managing through the labor inflation there?

Malcolm Wilson – GXO Chief Executive Officer
Yes, hi it's Malcolm. Let me come back on this question.

So, I mean, the very tight labor market that we were seeing in 2021, that's eased. We are finding right now it's easier to recruit. There's more labor is available. I mean, having said that, remember, this is the quietest time of the year in some respects, for a lot of our customers. It's not the busiest season as we normally see in the second half of the year, as Baris mentioned. So labor availability is easier. To say, I mean, in 2021 we were able to successfully recruit all of the labor that we needed to – and we do that by paying a lot of attention to how we recruit; recruitment teams are now embedded right in the business, right down in the ZIP code, as it were. So we're abreast of everything that we need to do in terms of making sure we get the right volume and the right skills of labor.

And that, fundamentally, is about making sure that we're competitive. And also, it's about ensuring that for GXO, we're just a great place for people to work. We want people to want to join GXO. So whether you're working in a warehouse, whether you're one of the implementation teams, whether you're an automation engineer, there's a lot to be said out of creating an environment where people actually do want to actually be employed by you. And we take a lot of store in that: we look on pulse surveys – all of the team that's on this call from GXO, every quarter, we read thousands of survey results. And in those survey results, sometimes you can identify things that are not what they should be, and you correct them. And by doing that, I think it gives us this environment of being able to recruit.

When it comes to what we're seeing on the ground right now in terms of labor wage inflation, I mean, it's a real mixed story. We've got some parts geographically where we've got labor inflation at sort of 10% levels. We've got other parts where it's moderated, it's back down into sort of 2-3%. So it's a real mixed bag. But by decentralizing our recruiting model, we are able to fill all of the roles that we need.

And right now – although the busiest time of the year, Christmas, seems a long way away – useful to remember that our teams are now already working. It is May, so it's not that far away. We're already working with our customers in planning out the resources that are going to be needed for all of the different sales events, all of the different new product launches, that are going to come along during the second half of the year. And we apply that same mindset to when we're implementing new business. The new business that we implement is methodically planned. You have to imagine, we're bringing together all manner of different machinery, automation machinery, tens of different manufacturers, and people all into one place to commence a warehouse operation.

And going back to Baris' comment earlier, quarter one was a particularly busy period for us of actually doing implementation – been a very challenging time for all of our operational teams, but they've done an incredibly good job. And we're all very proud of the work that they've done.

Mario Cortellacci – Jefferies
Got it. And just for my follow-up, maybe you can just talk a little more about Germany, just who are the main competitors there; what is the pro forma market share that you guys will have with Clipper; and how big can that market be for you guys? And then I guess, just with that, what gives you confidence in your ability to win that business, versus other players in the market that are much more established currently?

Malcolm Wilson – GXO Chief Executive Officer
Yes. So I mean, Germany – as I think I mentioned – Germany is Europe's largest single economy. It's a market that's good for outsourcing. It's a market that's very open to outsourcing.

When we think of our business today, it's very small for GXO. For Clipper, it's bigger. When you put both together, you get a real critical mass. And with customer business, customers ultimately always want to see what you do. If they're going to give you a $50-million-a-year contract, they want to see that you can do it. And the easiest way they can see that is you take them to see an existing facility. So when you don't have those existing facilities, it's a real blocker for business growth.

So when we combine our business together, Clipper and GXO, for the first time, we'll have real critical mass, lots of locations to show customers, lots of different vertical experience to share with them. And we're very confident that the GXO brand, the reputation that we have in the market for delivering reliable on-time solutions – lots of automation, highly productive, highly efficient, saving our customers lots of money, improving their services, improving the consumer experience – we're very confident that we will see a rapid growth in the market for GXO.

The kind of people we will spar with is probably no different than all the other territories that we were. There's a range of incumbent European players in the market. But the difference is, we'll be a new entry, and we're a new entry with a lot of very high-grade credentials. And I'm very confident that we'll see a very good, accelerated growth in that market. And it will be on top of the growth that we've seen across the rest of our business.

Mario Cortellacci – Jefferies
Understood, thank you.

Operator
Our next questions come from the line of Ravi Shanker with Morgan Stanley. Please proceed with your questions.

Ravi Shanker – Morgan Stanley
Thanks, good morning gents. A couple of questions on resilience of earnings in a downturn, which I think is kind of one of the key tenets of your story.

Maybe I will start with a follow-up: Malcolm, you said a couple of times that you're seeing a shift of demand over to stores, which you said was not a bad thing. I'm trying to get to understand that a little bit better, because obviously, a majority of your volumes are ecommerce. So kind of how is that kind of, how are you agnostic to a shift away from ecommerce towards store?

Malcolm Wilson – GXO Chief Executive Officer
Well, I mean, on one hand, a lot of our customers actually are ecommerce omni-channel. So in fact, we work with them and we actually deliver into stores for them. So from a GXO point of view, we're not really worried whether we're delivering into a store or whether we're delivering online.

But I think it's useful just taking a step back: I mean, we see a drift back to brick-and-mortar, to the shopping mall – but fundamentally, it's not changed at all, large manufacturer retailer sentiment. They want to drive more of the business online, and it's a lower cost for them. It gives them a better input to the consumer experience. They can better judge what's selling, what's not selling. It's a direct contact with the end user. So, whilst we've seen that momentary move back – it's not big volumes, by the way, but we can see it in our data because we analyze very carefully what's happening across our business – we've more than compensated for that with just the sheer number of brand-new, first-time outsourcing customers that are asking us to support them. In our sales pipeline, it makes up the largest proportion: around 44% of our sort of $2.5 billion sales pipeline right now is first-time outsourcing, and that's really important. So more than made up for it in that.

And then from our existing customers, even customers who have seen brick-and-mortar sales picking up, are still trying to expand their online sales because for all of the reasons we've talked about. So we don't really see any big dramatic impact coming from that.

And it was always to be expected that, as the pandemic, as COVID, finally started to disappear, that we would all be welcome, and we'd all relish the opportunity of going to get in a pizza on the Saturday night at the shopping mall, having had a walk around the stores during the day. I think everybody is happy about that, in a roundabout way. So, but for us, very robust growth, and we don't see any sign of that letting go.

Ravi Shanker – Morgan Stanley
Understood. Yes, not complaining about being able to go out either.

And maybe the second question is, on the same topic, can you just help us understand kind of what the construct of your contracts are like? Because obviously, in a downturn, your customers are going to see volumes decline. But how are you protected on that, I mean, do you guys have take-or-pays in your contracts, do you have, for minimum volumes, how does that kick in, is there a cap on that? I'm just trying to figure out kind of what the floor is on earnings if there is a fairly severe recession. Not that that's the base case, but checking.

Malcolm Wilson – GXO Chief Executive Officer
Baris, maybe you can comment.

Baris Oran – GXO Chief Financial Officer
Sure. Our contracts are very well structured for volume fluctuations. Remember, nearly 40% are open-book, cost-plus contracts, which are very resilient. Within them, there's 25% of fixed revenues and high return on invested capital, and they don't require a lot of upfront CAPEX. Inflation pass through, not a concern. And the volumes on these contracts don't really affect our business.

So, the remainder 60%: closed-book hybrid. When you think about them, they also have about 25% fixed revenues associated with them. So they don't, it doesn't matter what the volumes are. And when you look into that cost structure, its workforce is mostly flexible and very scalable. More than 50% of our cost is coming from our workforce. It's very flexible and very scalable. And volumes will impact margins on closed-book and hybrid contracts, but there's a lot of scalability and variability on the cost for these operations. So we scale up or scale down operations in line with our volumes. So when you look into the picture, our contracts on our business is very well structured with this mix. After Clipper, we should be close to 50% open book.

Ravi Shanker
Okay. Understood. I will follow up offline as well. Thanks so much for the time.

Operator
Ladies and gentlemen, that is all the time we have for questions today. I'd like to hand the call back to management for any closing remarks.

Malcolm Wilson – GXO Chief Executive Officer
Thank you. Thank you, Operator, and thanks for managing the call so well.

So, it's Malcolm here. I'm just going to, really, just bring the call to an end. A few comments from my side, on behalf of myself and my colleagues.

So, first and foremost, this is the third time we've made a call. And I hope everybody on the call is starting to get familiar with our process. We're a company that likes to achieve. We're a company that like to make good results. This is a company that's managed by hands-on, sleeves-rolled-up management. We're close to our business. We're close to the markets that we operate in. The acquisition that's coming along is going to be integrated very smoothly. We'll do a great job at that.

The company itself, we're in a strong position. We're continuing to benefit – as we have done from our launch and what we saw even in last year – from a huge amount of outsourcing, more and more companies seeking to outsource their logistics. E-fulfillment is roughly 50% of our business. It's like having a tiger by the tail, even in an environment where people go back to the mall. It's growing at a tremendous pace.

And lastly, we're capitalizing, and we really have been making huge benefits from our first-mover advantage in automation and tech enablement of the warehouse. And nothing – no reason to imagine that we will not continue to do that.

In the quarter itself, it was a great quarter for us. I'm not going to recap everything that we've talked about. But it was really a super quarter for us, and we're very, very pleased about that. And all this, remembering that as a business, we've only really existed since last August. So there is a huge amount of future with this company still to come and still to be shown.

So, listen, I'd like to bring the call to an end. I am very pleased, everybody on the call, you were able to join us today. Really, thank you for giving up your time, and I really thank you, also, for the support that you're giving to GXO. Thank you very much.

Operator
Ladies and gentlemen, this concludes today's teleconference. Thank you for your participation. You may disconnect your lines at this time. Have a wonderful day.