GXO

GXO Q3 2022 Earnings Call

November 9, 2022

GXO Logistics Q2 2022 Earnings Call

Presenters

Malcolm Wilson – GXO Chief Executive Officer

Baris Oran – GXO Chief Financial Officer

Bill Fraine – GXO Chief Commercial Officer

Mark Manduca – GXO Chief Investment Officer

Q&A Participants

Scott Schneeberger – Oppenheimer

Chris Wetherbee – Citi

Stephanie Moore – Jefferies

Allison Poliniak – Wells Fargo

Brian Ossenbeck – JPMorgan

Ari Rosa – Credit Suisse

Casey Deak – Stifel

Operator

Welcome to the GXO Q3 2022 Earnings Conference Call and Webcast. My name is Doug, 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 could 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 extent required by law.

The Company also may refer to certain non-GAAP financial measures as defined under 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 and 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 its services, and, therefore, actual results could differ materially from 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 on the Company's 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, Doug, and good morning, everyone. Thank you for joining us today.
With me in Greenwich today are Baris Oran, our Chief Financial Officer; Bill Fraine, our Chief Commercial Officer; and Mark Manduca, our Chief Investment Officer.

Jumping right in: the third quarter of 2022 was another outstanding quarter for GXO. We posted strong operating and financial results, grew our relationships with several of our large global customers, and added many others. And, in October, we received final regulatory approval from the UK Competition and Markets Authority for our acquisition of Clipper Logistics.

In the third quarter, I'm proud to report that we've delivered our highest-ever quarter of revenue – $2.3 billion – despite foreign exchange impacts from the softening Euro and Pound against the US dollar. This result was driven by strong organic revenue growth of 16%, combined with our high level of customer retention.

We also delivered record Adjusted EBITDA in the quarter, which was up 19% year over year, driving sequential margin expansion, as we've completed the outsized volume of operational startups that we were implementing in the early months of the year. As Baris will discuss in a moment, we've also delivered strong results on free cash flow and adjusted earnings per share.

This quarter, we continued to gain market share, as customers look to outsource more business in order to improve service and reduce costs. It's very clear that many new and existing customers are reassessing supply chains post-COVID.

We signed new contracts with both existing and first-time outsourcing customers, as we continued to grow our market share with international brands. We signed new contracts with Boeing, LVMH, Nike, Samsung, Sky TV, and Syngenta, to name just a few. Half of our wins in the quarter came from new sites with largely existing customers, and half were from market share gains from our peers and first-time outsourcing customers.

I also want to take a moment to touch upon the Clipper acquisition. This is a fantastic company that we've acquired – Clipper is a true diamond. They've got an impressive customer base, expertise in a diverse range of high-value-added service offerings, and, most importantly, stellar people.

Additionally, Clipper helps bolster our already industry-leading ESG credentials. With their focus on reverse logistics and repairs, Clipper is helping to do great business for customers in a manner that is good for the environment. For example, Clipper repaired around 1.5 million pieces of consumer electronics last year, reducing CO2 emissions and enabling the circular economy. The majority of RFPs across the markets now reference ESG credentials and core values, and our leadership position here is a real competitive advantage.

As you may recall, we closed the Clipper deal back in May. This enabled us to ensure continuity and stability for Clipper's customers and top talent. At that time, we were also able to put in place favorable borrowing arrangements, which Baris will touch upon shortly.

With regulatory approval now secured, we're moving forward with the integration, and I am pleased to note that we anticipate delivering the lion's share of the planned £36 million of cost synergies in '23 and '24.

We'll be able to discuss our progress in more detail at our Investor Day, scheduled for the 12th of January.

Looking at the fourth quarter for the group, we expect continued topline and margin growth. Based on the early indications of peak and our updated forecasts, we're reiterating our full-year guidance.

We are anticipating a smoother peak holiday season in 2022. Last year, the whole market experienced sporadic supply chain disruptions, as well as scarcity of inventory and labor. This year, most of our customers have good levels of inventory, and labor is more readily available.

Looking beyond peak, we're confident on 2023. Based on our wins to date, we've already secured nearly half a billion dollars of incremental revenue for next year, strengthening our visibility for 2023 and beyond. Our global sales pipeline has remained strong, conversion is healthy, and tech demand, as you can expect, is continuing to accelerate. Warehouse outsourcing continues to grow, as exemplified by our $2 billion sales pipeline, even after announcing significant wins.

We've seen in the past that this demand for our services and solutions will accelerate during a period of economic uncertainty, as customers look to reduce costs, while improving the consumer experience.

We are an enabler of productivity through technology, and customers are increasingly seeking us out to drive efficiencies in their businesses. We're differentiated in the industry as the tech leader. This quarter, we deployed the most technology in our history – deployments in North America and Europe are over 50% higher in 2022 than in 2021.

So, in closing, while we recognize the more dynamic macro environment, when we look at our customer base, our strategic relationships, the projects we're implementing in the coming quarters, and the high degree of visibility our contractual business model affords us, we're continuing to be confident about our growth and performance in 2023.

Bill will speak more on our commercial outlook and what we're hearing from customers – but first, I'll hand you over to Baris to walk through the financials.

Baris, over to you.

Baris Oran – GXO Chief Financial Officer

Many thanks, Malcolm, and good morning, everyone.

We're pleased with our excellent third quarter results, as we've delivered a record quarter for revenue and adjusted EBITDA, along with strong free cash flow.

This is our seventh consecutive quarter of double-digit organic revenue growth – an all-time record. This result was driven by 16% organic growth, which was underpinned by implementations and our mid-to-high 90s revenue retention rate. Our organic growth was strong across all verticals and geographies, and we're maintaining our revenue retention rate by delivering consistent, high-quality service.

It's important to note that we're seeing organic growth across our diverse vertical base, with particular strength recently coming from consumer packaged goods, technology, and industrials, which in aggregate are similar in size to our largest vertical, omnichannel retail. This is a balanced business.

Net income attributable to shareholders this quarter was $63 million, and diluted earnings per share was 53 cents. Adjusted diluted earnings per share was 75 cents, up 34% year over year, driven by adjusted EBITDA growth and the continued lower cost of financing.

The second record we set this quarter was our adjusted EBITDA, which, at $192 million, was up 19% year over year. And our return on invested capital is well above our 30% target, as we maintain our quality governance on new contracts.

Turning to cash flow, we had strong working capital management in the third quarter, delivering operating cash flow of $116 million, compared with $105 million dollars in the same period last year. And our free cash flow for the quarter was $47 million, putting us on track to deliver 30% adjusted EBITDA conversion for the year. We anticipate strong free cash flows in the fourth quarter.

We took the opportunity to begin deleveraging from the Clipper acquisition. At the end of the third quarter, our leverage levels stand at 2.1x trailing twelve months' adjusted EBITDA, down from 2.3x at the end of the second quarter. We plan to maintain our deleveraging trajectory, and we expect that our leverage will be around 1.5x by the end of next year, opening the door for further shareholder-accretive capital allocation. Our balance sheet is rock solid and investment grade, and we continue to generate solid cash flow.

Looking ahead at the full year 2022, our current internal forecast is showing mid-to-high-single-digit organic revenue growth for the fourth quarter. As Malcolm mentioned, there were a few transient factors related to last year's peak season, including the timing of startups, extraordinary volumes, and a tight labor market, which we don't expect will recur this year. On this last point, it's worth noting that across our business, we are no longer finding it necessary to pay holiday season incentives to attract and retain our team members.

Beyond Q4, and looking into 2023, we're currently projecting at least high-single-digit organic revenue growth, driven by our long-term contractual relationships, our continued high revenue retention rate, and the nearly half a billion dollars of incremental revenue already secured. We will provide full financial targets for next year on our fourth quarter call.

We’re laser focused on continuously improving our business. 2023 will be a year of balancing productivity and growth. With the benefit of operating as a standalone company for one year, we have kicked off a number of internal studies assisted by Accenture. We’ll be sharing further details on the productivity initiatives we’re implementing during our Investor Day.

Like most global companies, we are experiencing headwinds due to FX and rising interest rates, and we have taken measures to manage our downside risks. We’re continuing to monitor the markets closely.

Moving from the macro markets to GXO: there are significant tailwinds to being a pure-play contract logistics provider, especially in this environment. The vast majority of our business operations occur inside the four walls of the warehouse, and we have contractual relationships that include inflation pass-throughs and minimum volume guarantees. This is a low-risk business model with long-term contracts that are not exposed to short-term rate fluctuations in the shipping or transportation markets.

The current market backdrop gives us an opportunity to showcase the resiliency of our contractual business model, and we have a strong outlook driven by balanced growth in our geographies and verticals.

With that, I’ll turn it over to Bill, who will give more detail on just what we’re doing for, and hearing from, our customers.

Over to you, Bill.

Bill Fraine – GXO Chief Commercial Officer

Thanks, Baris.

Our growth opportunity is best exemplified by our sales pipeline, which remains strong at $2 billion. The exciting thing is that our pipeline is diversifying: the mix of our current pipeline is skewing more heavily to industrial, technology, and food & beverage, reflecting balanced growth in our verticals. At the same time, our retail and e-commerce partners are looking to GXO to help them expand footprint and geography. We're also seeing our pre-pipeline fill with more transformational customer projects, as companies strive for higher levels of both customer service and productivity. These types of projects are right in GXO's wheelhouse.

While we did see some customer decisions delayed in the third quarter, this was primarily related to expansion, as customers took a pause to reassess their strategy in this changing environment. Most of these projects are now moving forward.

This is the sort of environment where a supply chain partner can really deliver exceptional value to its customers – and GXO is doing just that. Over the past three weeks, I've met in person with 15 of our top customers around the world. They're all looking for ways to deliver structural cost savings in their supply chain, and the number one topic of conversation is technology. They're asking us:

- How can we use technology to reduce the impact of inventory build in my supply chain?
- How can we use technology to deliver a better consumer experience?
- And finally, how can we use technology to reduce costs by driving warehouse productivity improvements?

This is where GXO steps in with innovative solutions for our customers. As Malcolm mentioned, we've deployed a record amount of technology across our business. Recently, we went live with two highly automated sites.

First, a new flagship site in the US, where we will drive a 250% improvement in productivity for this technology customer, while reducing space by 40%. Second, a high-profile ecommerce site in Europe with the capacity to deliver a massive 25 million units a year, or over 150,000 per day during peak.

This is a huge increase in capacity and efficiency for this customer in this important market. Technology like this is a key lever for our margin growth going forward.

In today's macro, customers choose GXO because they need a confident, battle-tested partner to help design and implement future strategy.

With that, I'll turn it over to Mark. All yours, Mark.

Mark Manduca – GXO Chief Investment Officer

GXO has delivered strong growth throughout 2022, taking share through tech leadership and through the tremendous value that we deliver to our customers.

We expect to deliver robust growth next year. Let's break that down:

On revenue:

- Firstly: To date, we've won contracts worth 6% of gross revenue growth for 2023. For context, from this point last year through today, we've won an additional 5% of revenue growth for 2022. And as Bill explained, we are particularly excited with our current pipeline.
  - Unlike a transactional business model, where pricing is driven by short-term supply and demand conditions, our pricing is driven by long-term contracts with inflation protection embedded within them. So, on revenue, you can see why we are confident about our at least high-single-digit growth targets for next year.

- Secondly, moving to margins: In the last two quarters, we said that our margins would improve throughout the year, as we worked through the flood of startups that we were implementing. That margin expansion is now well underway – and in Q4, our margins will be up at least 50 bps year over year. For 2023, we expect our core margins to improve due to maturing contracts, more automation, and, as

Baris highlighted, an increased focus on productivity.

So, in summary, we believe we have just scratched the surface of the huge opportunity ahead of us, and we look forward to giving you more granularity about our long-term targets at our Investor Days in January.

With that, we'll open the call to Q&A.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions]
Our first question is from Scott Schneeberger with Oppenheimer. Please proceed with your question.

Scott Schneeberger – Oppenheimer

Thank you very much. Good morning, everyone.

A few questions: Malcolm, peak season presumably shaping up to be a bit lighter year over year for many of the multi-channel retailers, and, presumably, a bunch of your customers – is it an environment so extreme we might be triggering minimum volume requirements, broadly?

And more importantly, how is GXO approaching this potentially lower volume environment operationally, and maintaining its economic profile? Thanks.

Malcolm Wilson – GXO Chief Executive Officer

Thanks, Scott.

Well, we're in peak. We're already in peak season now. We've already gone our way through October, and that's going in alignment with our planning and what we expected.

So what we're seeing directly on the ground from our customers, across all our business, so all of our regions – our Europe business, UK business, North America – is really, we're expecting, actually, a buoyant end to the year. And what I mean by that is, the business is actually really doing very well in that context, but it's going to be different than a year ago.

So let me just give some picture on that. If I go back to Q4 in 2021, we were all coming out of the pandemic. Product availability was actually quite scarce. I remember visiting several of our warehouses, and we weren't full with products, and everything was coming in from the ports – remember all those delays at Long Beach – everything was coming in right on the last moment. So it meant that peak season was, really, a very, very heavy workload for our company. There was all the remnants of all the different supply chain disruptions. Labor availability at that time, also, was really a challenge and that was a consequence of, there was still a lot of people out of the labor market following the pandemic.

This year, it's very different. So, our warehouses generally have good levels of inventory in them, and, importantly, labor is readily available. And a good way to look at that, as Baris mentioned, is the fact that, last year, we were having to pay quite extensive labor incentivization programs to get the peak resources that we need.

This year, that's not the case, and in fact, right now we're amidst recruiting around 20,000 new team members. Not all of those are for peak – as Bill's mentioned, we've had robust growth and we'll be setting up new sites in January, and those people are being brought in for training, but a good deal of them *are* actually in activation for our peak season.

So in summary, I think we're going to have a very buoyant peak, but it is going to be a smoother holiday season than what we experienced in 2021. And, probably, if I was to speak to all of our operational teams, they'd probably say, we're very pleased about that.

It was exceptional, tough year last year, to deliver the holiday season. This year I think our business is going to be much more smoother.

Scott Schneeberger – Oppenheimer

Okay, great. Thanks appreciate that.

The margin in the third quarter expanded 20 bps year over year, and, with the addition of Clipper, predominantly open book contracts, I imagine that may have presented an initial integration headwind. So I was hoping, could you please elaborate upon primary drivers of margin expansion in the third quarter?

Bill Fraine – GXO Chief Commercial Officer

Sure. As you have highlighted, Clipper was a headwind, as it has high EBITA margins and has been trading well. But, because of the lower capital intensity, it has lower EBITDA margins than the entire group.

When you look into year-over-years, the vast majority of the improvement came from operational efficiency, driven by our investment into technology, retrofitting our existing operations with advanced automation, and some productivity initiatives we already rolled out.

Scott Schneeberger – Oppenheimer

Thanks. And just following up on that and on automation: Clipper comes in, I believe it's a little bit less automation mix than GXO is. And then you noted there's still, 30% of revenue is automation, but a lot in these prepared remarks and commentary about increasing automation. So just wanted to get a sense, are you – will you be existing operations of Clipper, will that get increasingly converted, or is that going to be left alone and more of the automation push it’s just going to be on the go-forward wins? And when might we see that automation mix start to lift going forward? Thank you.

Malcolm Wilson – GXO Chief Executive Officer

Yes. Scott, it's Malcolm. Let me come in, back on that.

So I mean, generally, automation, it's rolling out more and more across our business, and the last quarter was just an incredible quarter for that. We were up significantly in the amount of tech enablement that we pushed out into the warehouses. One of the things we were really attracted to about Clipper was that it's a great company, great amount of customers, but actually, when it comes to tech enablement, automation – so, when you visit a typical GXO site, you're going to see lots of collaborative robots, goods-to-person robots, robotic arms. In fact, when you visit a Clipper site, you don't actually see that, it's broadly a more manual-based business. So one of the things we saw when we were making the deal was a big opportunity to automate a lot of the operations. And, obviously, following the regulatory approval, our teams have been able to be in depth together, working together, and we're already planning on that. So the answer to your question is definitely yes, we will be rolling out more and more tech into the Clipper sites.

And then, broadly, I think what we're going to see on the go-forward – you know, we are in a more challenging macro environment in 2023. Whether we refer to technical recessions – I don't think we're in a recession: our business isn't behaving as if it's in a recession; the consumer’s not behaving as if they're in a recession – but what we are seeing is, lots and lots of early signs of opportunities coming along into our pipeline, pre-pipeline, of customers that need to transform their business.

And invariably, when you say transform your business, you have to do things differently, more efficiently, you have to pull costs out, and the only way you can do that is leveraging automation. And Bill mentioned about two big flagships that we've just set up in the last months. We are going to see more and more of that. The tide of tech rollout for us is going to accelerate as we are going forward.

So I think it's going to be a super exciting period for us, and we're going to go into an even more higher-tech deployment environment as we move forward. But that's partly driven by the more challenge of the macro environment. It's going to make automation all the more appealing to customers, and on the retrofit side as well.

Scott Schneeberger – Oppenheimer

All right, sounds good. Thanks, Malcolm. Thanks, Baris.

Operator

Thank you. Our next question is from Chris Wetherbee with Citi. Please proceed with your question.

Chris Wetherbee – Citi

Okay, thanks. Good morning, guys.

Maybe we could start on the revenue pipeline that you're building for 2023. So I think you have $500 million, roughly speaking, built out already for 2023. And I think, Baris, you said high-single-digit, at least, growth on the top line for next year. I guess, how do you think about some of the other variables within that number? We saw new business wins in the third quarter, maybe, decelerate a little bit vs. the run rate we had seen in the first half of the year. And then there is the potential for, for churn or customer retention as we go into next year.

So as you start to kind of think about high-single-digits or better, how do you sort of deconstruct that? Is there more business that you're likely to win in the fourth quarter that can add to that pipeline, and just sort of how certain are you around that high-single-digit run rate?

Bill Fraine – GXO Chief Commercial Officer

Hi Chris, this is Bill. So to answer the questions you're asking is: One, our pipeline is very strong. We mentioned $2 billion at the end of Q3. It's now actually $2.2 billion, so it's growing.

The pre pipeline, which is what we really focus on when we're hunting for new business, is very strong and growing rapidly. We're adding accounts that are coming in, as we mentioned, from industrial, from food & beverage, and from technology.

The benefit of these new contracts coming in is, they're looking at the economy today and they're looking for ways to get cost out. So while they still want to expand and grow, they want to make sure they're viable, and I'll give you a quick example of one. So we work with a customer in the US, and do a lot of work for them in the Northeast. We run a site that, they would tell you, is the top site in their network. So they have seven or eight other sites that they run, and they have another couple with some other providers.

They've asked us to come in now and look at their sites, and they want us to – “takeover in place,” we call it – takeover in place the sites that they have, and move them to GXO to help them get the same efficiency and cost savings they have in the current one with us today. This might have been something they wouldn't have done before the economic change, but today it's critical for them to do this, so that's one growth opportunity, and that's happening around the globe.

The second one is, I mentioned that we had – we're always working deals, and a lot of our deals are very large and long term with our customers. Going into the third quarter, we had customers who are looking to expand their business from Europe into the US, and some from the US into Europe, and they wanted to pause and just take a look and make sure that strategy was the right strategy in today's environment. We work with them on this, and I'll give you an example of one where they were planning on three sites. They had a three-site plan for the next year and a half, that they would start developing. What we worked on is, we're going to have – we're going to work on one in the Northeast, we're going to put that site up for them and that will be their flagship starting location. And we will use GXO Direct them to cover them in LA, cover them in Chicago, cover them in Dallas, and that gives them the flexibility to move at a better pace. And if they decide – they may not – that they want to put up a bespoke site on the

West Coast, then we'll do that for them. They may stay with just Direct, and do it that way.

So those are the changes we're seeing, is cost out, focused on technology and looking at ways where they can be flexible in the market 'til they really understand what's going on in 2023.

Chris Wetherbee – Citi

Okay. Okay. That's very helpful color.

And I guess maybe, as we think about 2023, Mark, I think you mentioned margins – core margins – up next year. I was wondering if you could help us kind of deconstruct that in terms of, you have Clipper in there, which is probably a headwind to margins. You have FX, which I think you're less hedged next year than you are this year. So can you sort of walk through some of the dynamics that will allow those margins to expand? Is it the fact that you'd expect, sort of, new business, broadly speaking, to decelerate to something less than what it was, this very rapid pace this year? Is that part of it? Can you just walk us through that, please?

Baris Oran – GXO Chief Financial Officer

Sure, Chris, this is Baris here.

We anticipate core margin expansion into next year, and the main drivers of core 2023 is going to be, first, our continued investment in technology – including the retrofitting of our existing facilities, as we talked about, with advanced automation. Remember, about 50% of our capex in the last twelve months was spent on tech.

And, secondly, our productivity initiatives, which we have highlighted in the call, we will highlight more during our Investor Day in January, what those imply and what the impact will be.

And last one is margin saturation from the huge start-ups we have implemented in 2022. Generally, it takes about two to three quarters for an operation to reach full margin maturity. And our margins are expanding, which will progressively – you will see that more visibly in Q4, and into next year. All of those combined will drive our core margin expansion into 2023.

Chris Wetherbee – Citi

Okay, got it. And just one point of clarification, Malcolm: earlier, to a question, you said that business activity was "buoyant." We're hearing from everywhere else in the supply chain that peak season is sort of less than what was expected. I just want to get a sense: do we know what the volume number is for existing facilities, or existing customers within facilities, for the third quarter?

Malcolm Wilson – GXO Chief Executive Officer

Yes. We've seen some normalization post pandemic – obviously, through the course of the year, we saw brick and mortar returning. That's a good thing.

But on top of the core activity, we've obviously, as Baris just mentioned, early in the year, quarter one, quarter two, we really had an outsized amount of new business going in. So we're really benefiting from that in the quarter also. So that's why I'm kind of giving you the view that I think we're very buoyant.

Clearly, in the current environment, we've seen certain customers exhibiting elements of a bit of softer environment. But overall, all the customers, I think we're seeing very good volumes, but in a more smoother, easier-to-deploy way – and to be frank, that suits us. To be frank, I think all of our operational teams went through a huge challenge last year. It was an exceptional last quarter, really, with a lot of volume channeling, through that really ought to have been handled more smoothly, but it was impossible to do that because of all of those disruptions and just disruptions getting hold of product.

So this year, it's a smoother last part to the year. That's why we've called out it's going to be a slightly lower level of growth than what we've been exhibiting through the first three quarters. It's really more about how extreme Q4 2021 was, rather than any change of emphasis in Q4 this year, if that kind of, if you understand my comment.

Chris Wetherbee – Citi

I do. Yes, that's very helpful. Thanks for the clarification. I appreciate it.

Malcolm Wilson – GXO Chief Executive Officer

Thank you.

Operator

Thank you. Our next question is from Stephanie Moore with Jefferies. Please proceed with your question.

Stephanie Moore – Jefferies

Hi, good morning.

Malcolm Wilson – GXO Chief Executive Officer

Good morning.

Baris Oran – GXO Chief Financial Officer

Good morning.

Stephanie Moore – Jefferies

Good morning. I appreciate the initial color on 2023, and certainly from an organic growth standpoint, clearly, there's numerous tailwinds as we look into 2023 – with the new contract wins, pricing; I think, taking it even a step further, Clipper is going to be contributing to total growth, obviously not organic – but I was hoping maybe you could talk about potential headwinds to the business as you think to 2023? Maybe talk through the FX headwinds; expectations around, maybe, volume performance, just given it is a weaker macro.

Just trying to get a sense, I know it's hard for all of us to know, but what are those offsets that we should be prepared for, or we should be monitoring?

Baris Oran – GXO Chief Financial Officer

Thanks, Stephanie. Let me take the first one and I'll ask Mark to come in on the volume side.

Like all global companies, we are experiencing FX headwinds, and our FX exposure is purely translational. Both our revenues and our costs are in local currencies where we operate. As you may recall, we've been – we provided a view on what the FX impact would be at different exchange rates in our prior earnings call. And if we take the current spot rates, at par for EURO and 1.14 for GBP, the year-over-year EBITDA headwind, hypothetically, could increase to $60 million for 2023.

As you would recall, we hedged in 2022, 80% of our EBITDA exposure has been hedged, and that’s valid for Q4. So what I have explained is valid for 2023 EBITDA. And going into 2023, we decided to de-risk some of our exposure by taking certain hedges for the entire year

Mark Manduca – GXO Chief Investment Officer

And Baris, I'll take the question on revenue growth for next year. Hey, Steph, its Mark here.

So for next year, as Malcolm and Bill were alluding to, we're very confident about our ability to deliver high-single-digits organic revenue growth. There's a few things driving that: clearly, we've got this inflationary backdrop, which is remaining persistent.

You've got maturing contracts from the prior year. You've got more tech. as Malcolm was alluding to. We're also upscaling services from contracts in the last twelve months, and you've got those new wins coming through, which is already some 6%. And obviously, as I mentioned in the earlier comments, there's more to come there as well. And then, think about it, as well, in the fact that we've got high levels of retention rates, as you know.

So all of those forces bring an element of countercyclicality to our growth. If you break down the new wins, we've got, roughly, we won in the quarter, around $158 million in Q3 – that's going to fall, broadly, $20 million in 2022 and another $120 million into 2023. So that takes you, in total, to 2023, of some $497 million that you can see on slide 8 of the slide deck.

So that's that 6% growth rate that's coming through already. And then on top of that, you've got another roughly $130 million for 2024.

So all of this is – as Malcolm was saying, all of this points towards multiyear visibility, it points towards resiliency through the cycle, and it's that strong growth that we've been talking about.

Stephanie Moore – Jefferies

Great. No, I appreciate it. And then just talking through what your – in terms of your strong organic growth performance you saw during the quarter, as well as your pipeline, could you maybe kind of break out the exposure and drivers between North America and Europe for those growth?

Baris Oran – GXO Chief Financial Officer

Stephanie, hi, it's Baris here.

When you look into our growth in the quarter, it was quite balanced in geographies and verticals, so it was pretty broad and quite dispersed. We've seen growth all across our verticals and geographies, and we expect that growth to continue.

When you try to break down our growth into our net new business wins, and also our existing operations, that was almost evenly balanced in Q3, and we expect that balance to grow into Q4 as well. We expect contributions almost as much as our increase in our existing operations in Q4 as well.

So balanced across the board – it's a quite a balanced business, from a verticals perspective, as well as geographies perspective.

Stephanie Moore – Jefferies
Thank you so much.

Baris Oran – GXO Chief Financial Officer
Thank you.

Operator
Thank you. Our next question is from Allison Poliniak with Wells Fargo. Please proceed with your question.

Allison Poliniak – Wells Fargo
Hi, good morning. Could you talk a little bit about, potentially, the opportunity set with existing customers? We're all certainly worried about decline in volumes next year. Is there an opportunity for you to capture increased volume with your existing customers, as they, maybe, kind of reset their infrastructure and shut down, maybe, the non-GXO kind of facilities and consolidate into GXO? Just any thoughts there? Is it impactful? Is it an opportunity, if we go into a more significant downturn next year? Thanks.

Malcolm Wilson – GXO Chief Executive Officer

Allison, hi, it's Malcolm. There's no doubt – I think the change of the environment, whether we say a downturn, or a slightly softer market – that change of environment actually is going to play to the benefit of GXO.

What it's driving, as we've mentioned, we can see already certain customers coming to us because they need to. They need to improve their own efficiency. Maybe they're doing by themselves today; maybe they're doing by one of our competitors today, who are not able to deliver the kind of enhancements and initiatives that GXO can do. But we can see already that kind of business activity starting to grow in our pre-pipelines. That's the kind of measure that we use for inbound inquiries, before we actually finally qualify and start making bids. Then it drops into the pipeline. And that's one of the reasons we're very confident about the sales growth for next year.

We are, for sure, cautious about next year, and that's the very reason why we are calling out a more moderated level of growth through 2023. And as Baris mentioned, that's giving us a window, as well, to focus inwardly on some initiatives to improve our own efficiency. I mean, we're twelve months old as a company – we're only twelve months old following our spin. So there is a lot of things internally that we can do, also, ourselves, which will be very positive in terms of our own margins, et cetera.

But overall, for next year, we're not seeing any signs of customers walking their own numbers back significantly. We are cautious, and we're calling out the fact that maybe we'll have a little bit more softness on our core activity, but more than compensated by the sheer growth of business that is already signed – it's already in process of being planned for implementation, leases are signed with buildings, contracts in place with automation providers – and, on top of that, the environment that we're going into, I think, will be very good for our new business growth. But new business growth from companies who maybe in the past would have not sought to outsource. But whenever there is a challenging macro, it pushes people to have to do things differently than how they have done in the past. And that's right in our wheelhouse. It'll be a good environment for us in 2023.

Allison Poliniak – Wells Fargo

Great. That's helpful. And then in terms of the pipeline, I know you talked a little bit about some of the conversion of that pipeline, kind of lagging a little bit. Is that something we should expect in terms of, maybe, a softer period, or people kind of revisiting things?

Does that conversion part of the pipeline start to slow a little bit? Not that it goes away, it's just maybe kind of a longer tail to sort of execute here. Just any thoughts there?

Bill Fraine – GXO Chief Commercial Officer

Yes, hi, this is Bill. What I would tell you is that the pipeline evolves in different markets. And what's happening now is, we talked earlier about customers needing to have us take over sites they currently run. We call this “takeover in place.” So we come into a site, we take over the team that's there and the operation that's there, and then we improve it through the benefits of GXO.

So those are growing dramatically. And we've already closed some, we're gaining more and we're gaining more of that. So that volume is added into our pipeline, and the pipeline is growing extremely well right now.

At the same time, we deal with a lot of blue-chip customers. They’re still moving forward in growth, and so they want us to continue to build out their supply chains for the future. We talked about the technology gains of 250% improvement and a 40% less footprint. So those are the things customers are looking for: how do they get cost out?

And finally, the last thing is, we're all hearing about stock in the industry, supply coming in. We are in the middle of all that, and we're helping our customers get that into what I would say is a “pickable, shippable” standpoint. So it comes into us, we put it into a site, and we have it ready to go now to be sold in the marketplace. We also have a lot of value-added services we perform on that, which, again, raises our revenue.

But the pipeline is strong – it's grown a couple hundred million, which is a normal thing between the end of the quarter to today – and it's diversified across industries.
So whether it's aerospace or automotive or food & beverage, we're growing in those areas too, and they're not slowing down and they're not short-term thinkers.

Allison Poliniak – Wells Fargo
Perfect. Thank you.

Operator
Thank you. Our next question is from Brian Ossenbeck with JPMorgan. Please proceed with your question.

Brian Ossenbeck – JPMorgan
Hey, good morning. Thanks for taking the question. So maybe another one for Bill, if you can just elaborate on this diversification trend that you're seeing?

In the pipeline, historically, we've seen the big e-commerce, the omnichannel, of ecommerce sales. So was that an intentional pivot? Is it just the way the market is shaking out, with some of these customers, as you mentioned, now perhaps needing to think a little bit differently?

Maybe you can just kind of talk through some of the nuances within that shift, and if this is typical or something intentional that you've been pursuing?

Bill Fraine – GXO Chief Commercial Officer
I would say it's a bit of both. So we're very intentional in how we try to grow our pipeline and our customer base, balanced across verticals.

Right now, obviously, you think of the aerospace market – the aerospace market in the last year is coming back into business, they're producing airframes. They are really ginning up and continuing to grow. And we're in the middle of that. We're one of the top providers of that, especially in North America. So we're in the middle of that. So those accounts, we're bringing on board, and as you're hearing, we’re closing as we go forward.

At the same time, with ecommerce, we went through the boom of COVID where everybody was looking to build a site and be online. People still want to do that, but now it's in a more measured approach – as Malcolm mentioned, from peak last year, more measured approach. And we're working with those customers: because we had such a great presence in ecommerce during COVID, we have a great recognition and name right now for that. So other customers are coming to us.

And when we talk about ecommerce, it's not just retail and the “normal ecomm” – aerospace does ecomm, automotive does ecomm, food and beverage does ecomm. So we're expanding into that.

And finally, we talk about reverse a lot. Reverse has been, still, a third of our sales in the third quarter were reverse. So we're adding a lot of reverse, because, again, we have a great reputation in that area, and that's growing and people are coming for that, that's really become a norm.

And I'll just say one last thing: the addition of Clipper we've talked about is just fantastic. I mean, we've already sold three accounts together, and we're working very closely and learning their services. They have some very, very slick return services that are things that are almost like a plug-and-play for a customer. So we are very excited about these, and the teams are meeting right now in the UK to work through some of these, and see how we expand this across Europe – and then, after that, how we go through the US.

Brian Ossenbeck – JPMorgan

All right. Great. Maybe one quick follow-up on that would just be the competitive dynamic – you mentioned taking share. It looks like it actually stepped up quite a bit, if we look at where the new business is coming from. So maybe you can expand on that. I think you gave some examples, but is there any change in the competition landscape, anything, margin pressure?

And then also, just from the health of the customer – we saw, I guess a little while ago, a big-sized write-off from one of your peers. Anything that you are watching or worried about, from a controls perspective, as it comes to credit risk, especially in some of these areas that have seen pretty decent-sized shifts in terms of their fundamentals?

Bill Fraine – GXO Chief Commercial Officer

Yes, thank you. I'll start, and I'll hand it over to Baris. But what I would tell you is we always have competitors that are always in the market. What we try to do is we focus on what our customers' needs are, and we make sure we bring the right services and products. So we are growing, we are taking share, no question. And I see that continuing.

Again, the "takeover in place," when I talk about those, it's not just internal business that customers are taking from their own business – it's also competitors that aren't able to generate the returns we're generating. So they bring that to us also. But I'll let Baris talk more into it.

Baris Oran – GXO Chief Financial Officer

Sure. Our largest customers, whom we have the vast majority of our total receivables with, are really high-quality, blue-chip names, with limited to zero credit risk. And as you would recall, our largest customer makes up roughly around 4% of our revenue.

We manage credit risk very robustly. We have very rigorous credit controls, such as solvency metrics, and we monitor these on a constant basis – not only when we take on new contracts, but through the life of the contract. We ask for parent guarantees, bank guarantees, and if they don't fulfill those expectations, we are not shying away from walking away from these customers. And we have done that in the past and we'll continue to do that in the future.

So we have a very robust process, and we have a strict approach on credit application for our customer base.

Brian Ossenbeck – JPMorgan

Okay. Thanks for the time. Appreciate it.

Baris Oran – GXO Chief Financial Officer

Thank you.

Operator

Thank you. Our next question is from Ari Rosa with Credit Suisse. Please proceed with your question.

Ari Rosa – Credit Suisse

Hey, good morning. Congratulations on the strong quarter here.

So I'm curious to hear, you're talking about the strong pipeline, customers coming to you and asking for more services – obviously we're seeing some challenges in the marketplace from a macro standpoint, where maybe your service gets valued maybe a little bit more at a premium. So I'm wondering, do you see an opportunity to rethink how you're going about pricing your business or pricing your service? Is there an opportunity to maybe be a little bit more aggressive in terms of how you approach customers, how you differentiate yourselves from competitors on a pricing front, given the levels of demand that you are seeing, and kind of the strength of the pipeline and the value-add of the service that you're bringing – kind of, can we see a step-up from a pricing standpoint vs. where you've been historically?

Bill Fraine – GXO Chief Commercial Officer

Yes thank you Ari. I appreciate that.

So when we write pricing for our customers, we're thinking of the long-term nature of our contracts: not just in the first five years, but what continues after that, as our renewal rates continue to rise. So we always want to first develop a price that covers our cost, gets us the return we promise the market, and we make sure we deliver each time. We look at the extent of all the capital that goes into the site.

So pricing, I think, is very sound, what we do. I would say it is a deep focus for us, but it is less of a focus between the customer and us on the deal. What they are really looking for is the throughput: the throughput that we gain them, and the opportunity we gain them, outweighs – by leaps and bounds – any amount of money they are giving us.

So we don't let that become the reason why we're not getting that. And the level of technology we implement in these sites also drives how we look at price and how we develop price for our customers.

And then finally, what I would say is the thing we have done really in the last couple years is, we've made sure we've solidified our pricing for all environments. So we make sure that we are contractually set – whether it's limits or whether it's energy cost or whatever – we make sure all pass through that we have to get, goes into our contracts.

And I'll turn it over to Baris.

Baris Oran – GXO Chief Financial Officer

Yes, thanks Bill.

We are writing contracts for returning investment capital. And what we are seeing is, as we invest into technology, our customers are willing to share the burden as well. And that keeps our returns at a higher level.

And also, we have a quite balanced base of closed-book, hybrid contracts, which makes about 55% of the business; and 45% is coming from cost-plus, open-book business – which is a capital mechanism, which means quite limited capital outplay from our perspective, which helps our returns in the long-term.

Ari Rosa – Credit Suisse

Got it, understood. And then you mentioned – oh, sorry, I didn't know if you were finished there. Is that…

Baris Oran – GXO Chief Financial Officer

Yes, go ahead please.

Ari Rosa – Credit Suisse

Yes. Okay, great. So just, I wanted to ask, you mentioned labor availability has gotten a little bit better. How do you think about what the limiting factors are on your ability to grow for 2023 or 2024, given kind of the level of demand that you are seeing, which seems like it continues to be pretty robust? Are there any limiting factors on your ability to grow or the rate at which you can expand?

Baris Oran – GXO Chief Financial Officer

We can grow faster if we write further contracts, but we have a certain governance mechanism. As we've highlighted, the risk in this business is not writing high quality contracts. We are very careful about it: we are writing high-quality contracts and we are seeking a high-return expectation, as well as differentiating with our customers. That's the limiting factor, but we will continue to focus on writing high-quality contracts and delivering to our shareholders.

Ari Rosa – Credit Suisse

Got it. Okay. That's great color. Thanks for the time, guys.

Bill Fraine – GXO Chief Commercial Officer

Thank you.

Operator

Thank you. Our next question is from Casey Deak with Stifel. Please proceed with your question.

Casey Deak – Stifel

Hey, thanks gentlemen.

Baris Oran – GXO Chief Financial Officer

Hello.

Casey Deak – Stifel

Hey – really, my questions would be on the automation. I know you've talked about the 30%, through the automated sites, for revenue. Is there something that we are driving to? Is there a number you guys would want to share, on the percentage of revenue that we would like to have coming through those sites, or any near-term view of that?

Malcolm Wilson – GXO Chief Executive Officer

Yes, Casey, it's Malcolm, let me take that question.

So I think, first and foremost, we measure automation across our business. So you hear us talk extensively around 30%, 32%. The way we measure what we're putting into the sites is, when it's – basically, that measure is driven from where we have sites that broadly very highly automated: automation is really driving the site, it's the fundamental, it's the core of the site.

But on top of that, we've got a huge rollout where we are deploying technology, we're retrofitting technology across all of the other locations that we operate. And that could be just as simple as our continuous improvement teams going into a site, witnessing, maybe, a pallet-loading operation – so we load goods onto a pallet before it's dispatched to, it could be a brick-and-mortar, or it could be parcels that are going to a parcel network.

And it could be our continuous improvement theme just simply saying, “well, look, we can replace 20 people by putting a robotic arm in.” And so that's taking place all of the time. And I mean, there was question earlier about the Clipper Logistics business. That's a great example. So we talk extensively about cost synergies, and that is doing things smarter, it's leveraging all of our buying power, it's leveraging all of our support teams.

We talk a lot about top-line synergies – but in fact, we've been a little bit quiet about all of the in-operation synergies that are going to flow on that deal. But it's no different than what we're doing across all of our business.

Now, we've got our Investor Day coming up in January, and we're really looking forward to that, because that's a window for us to share a lot about the business, about where we think our verticals will drive in the future, the different geographies, our strategies in terms of the best use of our capital. And one of the aspects you'll probably hear on that – and you'll have access to some of our superb technology experts, and in fact you will be seeing some demonstrations as well; and I know we've got a super site visit planned as well – but you'll get a much better appreciation for the evolution of that tech. It would be easy for us to give a big headline number, but the reality of it is, it's something that's growing year after year. There is no doubt, 32% eventually will be 40%; eventually will be 50%. But it's a gradual process that we are doing. And brand-new sites nowadays, just as Bill mentioned, they are invariably highly automated.

So the new site here in North America, big flagship site for technology – I mean, that is going to have a “wow” factor in the market when we are fully implemented and we're able to start showing people. That's going to have a big wow factor. And similar in Europe.

So these kind of things, that's what's driving our business, and it's what's helping us win market share, because I think we're pretty unique organization in our ability – and the testimonials that you will hear from customers about our ability to deliver these things on time and when they are needed.

Casey Deak – Stifel

That's great. Thank you, Malcolm. I really appreciate it. The follow-up I have to that, so yes, there are, the new sites are very automated, fully automated.

Like are there constraints right now to roll that full automation throughout the network? Is there anything slowing it down, from sourcing the capacity from technological manufacturers? Is it customer adoption where you have to – I would assume that the customer adoption is relatively easier than actually getting it in there, because you can get it and improve, or you have a lot of case studies where you can prove the economics of putting the automation in... Any comments you could have around that?

Malcolm Wilson – GXO Chief Executive Officer

Sure. Yes. So, I mean, the most fundamental point is, labor inflation means it's much simpler to justify, from a cost point of view, putting a big automated site in. And that, in itself, will drive a stronger demand for automation as we go forward. It *is* driving a stronger demand for automation. But if we look back over 2021 and this year, to date, we've had high levels of inflation. So it's driving companies to need to be more efficient.

But it's also, a byproduct is, actually, it means it's simpler to justify putting a lot of automation. The paybacks are much easier for our customers, so they're much more open-minded to do that. It's the kind of double whammy of benefit that customers are getting.

In terms of our ability to deploy, clearly a lot of this equipment is lead-time driven, and that's really where I do see that GXO has had a huge benefit. We're the number one, we're the largest pure player contract logistics company in the world. We outstrip our peer groups by a big, big amount, in terms of volume of automation that we actually deploy. So, frankly, manufacturers want to work with us. We're the kind of go-to organization that they want to work to. They want to have the pieces of equipment showcased in our facilities. It's big kudos for them. So, so far we have not seen any difficulty in actually acquiring the right amounts of equipment. Those very strong relationships – our tech teams have developed very strong relationships with the manufacturers of that automation. So we've not seen any big impact so far.

And I think, actually, we've been through the worst period of chip shortages. My feeling is that that's going to get a little bit easier as we go forward.

So, far we've not seen any impact, and we're not anticipating to see any impact on the go-forward either.

Casey Deak – Stifel

Right. Well, I will pass it back. I know we're past the hour. So thank you, Malcolm. Thanks for the color there.

Malcolm Wilson – GXO Chief Executive Officer

Thank you. Thanks for that.

Operator

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

Malcolm Wilson – GXO Chief Executive Officer

Okay, thanks Doug. And listen, thanks for managing the call so well, I appreciate that. And we've had some great questions this morning.

I just want to say a few words before we close. This is our fifth earnings call, and in every call that we've delivered, we've talked about and we've delivered strong performance. And probably very poignant right now because we're in a very changing macro environment. We're going into a new environment. And, as you're seeing, no difference for GXO. We're delivering very strong numbers. This is a super resilient business. And let's hope we don't go into any big downturn next year.

But if we do, our company is ready for it. We're rock solid, investment grade, and the demand for our service, I think, will skyrocket if we really end up in that situation. But let's hope we all don't end up in that scenario.

You will have seen today that everybody who you speak to on this call, we are a sleeves-rolled-up management team. I've said that before, but it's in part that management focus, us being a pure-play contract logistics player – we're only focused on what happens in the four walls of the warehouse, and that's helping us navigate the company to success.

We're strong across all of our regions. Baris just mentioned there is no real difference, to see, between what's happening in our continental European business, our UK business and our North American business. We we're really doing well across each region, and each vertical, in its own right, is strong and doing well and has very good prospects for the year ahead.

And we'll talk more about that in January, when we're able to share with you in our Investor Day. We're really looking forward to seeing many of you on that day. I hope you'll be able to join.

So with that, I just want to say finally, thanks everybody for your support for GXO. And we're looking forward to having further contact in the future. And with that, we'll close the call. Thank you.

Operator

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