GXO

GXO Fourth Quarter and Fiscal Year 2021 Results

February 16, 2022

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Presenters

Malcolm Wilson, CEO

Baris Oran, CFO

Mark Manduca, CIO

Q&A Participants

Chris Wetherbee - Citi

Scott Schneeberger - Oppenheimer

Amit Mehrotra - Deutsche Bank

Stephanie Moore - Truist Securities

Brian Ossenbeck - J.P. Morgan

Mario Cortellacci – Jefferies

Brandon Oglenski - Barclay's

Bascome Majors - Susquehanna

Jeff Kauffman - Vertical Research Partners

Operator

Welcome to GXO's fourth quarter and Fiscal Year 2021 earnings conference call and webcast. My name is Paul 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 these 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 are reported on this call are reported in the United States Dollar.

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 global 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.

This guidance also reflects the company's estimates to date regarding the impact of the COVID-19 pandemic on its operations. 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
Thank you, operator. Good morning and welcome to GXO's fourth quarter and full-year 2021 earnings call. With me here today are Baris Oran, our Chief Financial Officer, and Mark Manduca, our Chief Investment Officer.

In the fourth quarter, our operations again delivered the highest quarterly revenue and adjusted EBITDA in our history. We delivered double-digit organic revenue growth in every quarter of 2022—2021. We finished the year with an accelerating trajectory, growing at 19%. Moreover, we see great momentum as we have progressed into 2022. As a result, we are raising our 2022 guidance.

We delivered a successful peak for our customers during the fourth quarter, and we played our role in delivering holiday cheer for millions of consumers. We managed the labor market exceptionally well, including recruiting over 20,000 new team members, and we navigated an elongated peak period that ran from mid-November to late December. We helped our customers manage the ongoing ecommerce channel shift, with online spend up double-digits.

It is worth highlighting that, through the Thanksgiving weekend, our overall ecommerce activity levels were up 100% from the start of the quarter and some of our sites handled over half a million outbound ecommerce units per day.

GXO continues to capitalize on the strong secular tailwinds of ecommerce, automation and outsourcing. In 2021, we won contracts with an aggregate lifetime value of approximately $5 billion dollars. This gives us a strong foundation to achieve our 2022 organic revenue growth target of 8% to 12%, and this growth is on top of an already record 2021 year.

Recent and notable customer wins and expansions include Abercrombie & Fitch, ASOS, BT, Carrefour, Currys, Kingfisher, Raytheon, Saks, and Zalando.

It's worth noting that two of our recent large UK technology wins, BT and Currys, are first-time outsourcing partnerships. These wins are a direct benefit of the new technology verticals that we gained through our 2021 acquisition in the UK.

Our sales pipeline at the end of the fourth quarter reached a new record level, at $2.5 billion dollars, and half of these opportunities are in the e-commerce sector. Approximately 60% of our revenue comes from customer relationships that span multiple countries and, over the course of the year, we were able to expand our operations with 80% of our top 20 customers.

At GXO, we believe that being a leader in logistics means making sure we take care of our partners, people and the planet. GXO is bringing significant environmental benefits to customers through our pioneering work on ESG solutions that increase order precision, optimize stock levels, reduce packaging and streamline the consumer returns process. For example, our reverse logistics revenues were up 28% year-over-year in the fourth quarter, and this is indicative of our vital role in the circular economy as we help to reduce the carbon footprint from the global supply chain.

We're looking forward to updating you on our progress towards achieving our industry-leading ESG targets that underpin our 'Double A' MSCI ESG rating, when we will publish our inaugural sustainability report in the second quarter.

I am extremely proud of our team's stellar performance in 2021. Our combination of world-class people, global scale and industry-leading technology is delivering increasing value for our customers and shareholders. Given our strong results and continued confidence in our growth, we will be providing long-term expectations at our capital markets day later this year.

I will now hand the call over to Baris who will take you through GXO's fourth quarter and full-year financial performance. Baris, over to you.

Baris Oran
Thank you, Malcolm, and good morning everyone.

2021 has been a year of records: Record revenue, record EBITDA, and record EPS.

In the fourth quarter, we generated revenue of $2.3 billion, net income of $56 million and adjusted EBITDA of $167 million. Our organic revenue growth was an impressive 19% in the quarter, the highest for any quarter last year, against our toughest quarterly comparison.

For the full year, we generated revenue of $7.9 billion, net income of $153 million and pro forma adjusted EBITDA of $633 million. Our return on invested capital has surpassed 30%, a level we expect to exceed looking forward.

This full-year revenue represents a year-over-year increase of 28% and is up 15% on an organic basis, with M&A contributing 10% and FX contributing 3%. Don't underestimate what we are achieving in terms of absolute growth. In dollar terms, that 28% increase is equivalent to the prior year's sales of our largest European pure-play competitor.

In 2021, revenue from our top 20 customers grew organically by approximately 22%, demonstrating the success of our land-and-expand strategy. When the largest brands in the world want to directly reach consumers via ecommerce, GXO is their partner of choice.

Moving to earnings, our 39% growth in full-year adjusted pro forma EBITDA reflects our strong revenue growth and our high-quality contracts that enable us to pass through labor costs in an inflationary environment. Our business is naturally a high inflation hedge. Our full-year adjusted pro forma EBITA growth was 73%.

Our cash flow from operations for the full year 2021 was $455 million. We spent $250 million in capex. Specifically, we dedicated half of our total capex to automation, technology and software, as we continue to lead the industry in tech implementation, digitization and robotics. We generated free cash flow of $216 million for the full year, which converted above 30% of our adjusted EBITDA. Our fourth quarter free cash flow was $137 million, which reflects our rigorous cash collection processes.

Turning to the balance sheet, we are committed to maintaining our investment grade credit rating. We finished 2021 with net debt of $628 million. Our leverage ratio is 1.0x, which is in line with our previously discussed net long-term leverage range of 1-1.5x. And for additional flexibility, we also have an available $800 million of revolving credit facility. Our balance sheet strength is very important to our customers and gives us great optionality for future growth initiatives.

I'll now turn the call over to Mark.

Mark Manduca
Thank you, Baris.

We've talked before about the three megatrends of automation, ecommerce and outsourcing, and it's very clear from our fourth quarter results that these continue to propel us forward.

Never before has the case for automation been so compelling. Automation provides reliability and massive operational benefits for our customers, and also, an improved working environment for our team members. GXO leads the marketplace in automated solutions, and in 2021, we deployed more than 2,000 new pieces of technology across our sites, up nearly 100% year over year. Our use of goods-to-person systems was up over 100% year over year, and our use of cobots grew over 200%.

Now, to give a real-world example, in one of our recent expansions in the grocery vertical – traditionally viewed by many as a lower-tech, more manual environment – we're deploying cobots here that will drive a game-changing 70% uplift in cases picked per hour. And this is just one of many, many examples of how we're using tech to drive efficiency and higher and higher return on invested capital.

Now, the industry as a whole has yet to embrace technology to the same degree as GXO. We really do have a first-mover advantage, but we're not stopping there: we're currently testing 200 new technologies from around 100 new suppliers. We also have 1,000 tech experts that specialize in bringing together best-in-class technologies. The deployment of technology underpinned our record quarter and, going forward, it's helping us drive more value-added solutions across an increasing number of verticals. And this, in turn, we believe will fuel many, many years of future growth here at GXO.

Now, moving to ecom: in ecommerce, we benefitted in 2021 from persistent strong secular growth vs. tough year-over-year comparisons. Our ecommerce revenue increased some 45% year-over-year in the quarter, markedly accelerating from the third quarter. And we're also now seeing returns volumes continue to rise into 2022. Our ecommerce expertise is clearly well recognized, as evidenced by our wins that Malcolm mentioned, including Abercrombie and Fitch, where we're deploying a cutting-edge goods-to-person robot solution, and Saks, which is a valued and growing customer of our GXO Direct flexible fulfilment solution.

And then, thirdly, on outsourcing, the runway here remains significant, with a massive potential addressable market of $430 billion, of which $300 billion is yet to be outsourced. In 2021, roughly 36% of our wins came from new outsourced contracts, which was a year-over-year increase of over 25%.

Now, as Malcolm mentioned, we are confident about our 8% to 12% organic revenue growth rate for 2022. This range is the amalgamation of growth from existing customers and net new customer wins. And on that latter point, on net new customer wins, what really gives us confidence here is the fact that we've secured contracts with approximately $830 million of brand-new gross revenue uplift for 2022. This is basically the equivalent to a gross revenue growth rate of approximately 10%, even before we consider the opportunity from further wins from our ecommerce-heavy $2.5 billion pipeline, or any growth from existing customers. And of course, on top of those gross win announcements, you should know that our revenue retention rate since the spin has risen to the mid-to-high 90s.

And on a final note, it is worth highlighting that the industry around us is clearly consolidating, as technology and scale drive natural selection. In the last couple of years, warehousing has been recognized as a critical piece of the value chain and the consumer experience, and, as a result, we are seeing more and more M&A in our space. Let's be clear: we are very well-positioned to play a role in the consolidation of our industry. And if you look back at our recent UK acquisition, we've already realized over $30 million of synergies, which is equivalent to 5% of the target revenue, and really speaks volumes to our ability to smoothly integrate acquisitions, much to the benefit of our all-important shareholders.

As we've said before, GXO is a rare breed of company, which combines high revenue growth, high returns, and high visibility. We delivered compelling double-digit revenue and adjusted EBITDA growth in 2021, and this will be, importantly, the basis for our North Star, that we're going to share with you at our capital markets day later this year.

I'll now hand the call back to Baris to discuss our outlook for 2022.

Baris Oran
Thank you, Mark.

Our strong 2021 performance and record pipeline give us increased confidence for fiscal 2022.
In light of all these results and our visibility into the year, we have upgraded our full-year 2022 guidance. We anticipate another year of strong revenue growth in this high return on invested capital business. We are exceptionally busy in the first quarter, as we implement new wins.

We are now forecasting 8% to 12% organic revenue growth, alongside an adjusted EBITDA of $707 million to $742 million and an adjusted EBITDAR of $1.5 billion to 1.6 billion.

There are two positives that I would like to highlight with regard to our value creation:

First, in 2021, the growth within the business skewed toward high return on invested capital open-book contracts. This helped us achieve our higher return on invested capital of over 30% in 2021. One benefit of having more open-book contracts is that we see lower asset intensity across the business. This results in a margin dynamic where adjusted pro forma EBITDA margins increased by 60bps in 2021 vs. 2020, while adjusted pro forma EBITA margins increased by 120bps. In 2022, we expect a similar dynamic between EBITDA and EBITA.

Second, we had a strong working capital performance in Q4 of 2021. This drove our robust free cash flow result, with us converting more than 30% of our adjusted pro forma EBITDA. This underscores the strength of our business model, which delivers high returns, cash flow and growth at the same time.

Given these dynamics, I am pleased to announce that we will be targeting a return on invested capital in excess of 30% on an ongoing basis for the business.

All in all, the record fourth quarter that we delivered to you today is a precursor of more records to come.

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

Operator
Thank you.

We will now be conducting a question and answer session. If you would like to ask a question, please press star-one on your telephone keypad. A confirmation tone will indicate that your line is in the question queue. You may press star-two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

One moment, please, while we poll for questions.

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

Chris Wetherbee
Hey, thanks. Good morning, guys. Maybe I could start on the revenue guidance. So, Mark, as you noted, I think there's a pretty robust backlog that you guys have, that accounts for some pretty significant growth already for 2022, booked through February. So you have a, a fairly robust line of sight, and I would imagine that the backlog isn't necessarily going to stop, you know, here in the first quarter. It probably will continue to grow.

So, can you talk about sort of the confidence interval around that 8-12% revenue growth target? You know, why can't you be at the upper end of that, or maybe, potentially, better, particularly considering it sounds like the attrition of customers is really, uh, trending lower.

Mark Manduca
Yeah, good shout, Chris. It's Mark here.

So, couple of things. Let me talk about the 8-12% organic revenue growth rate, as you mentioned, and why we kept it from a percentage perspective the way it is.

The first point is really that the base is higher. So implicitly, we're actually upgrading, in absolute terms, the revenue guidance range, by nature of the fact that we've obviously got a percentage number on a higher base than 2021.

The second point is, we've got great visibility in this business, as you know. And we're sitting here, in February, obviously, with ecommerce comps in the second half of the year getting markedly tougher. Now, for a business like ours, as you know, we've done better as the comps have got harder over the course of Q3 and Q4. But I don't think, at this stage, sitting here in February, getting ahead of our skis so early on in the year is necessary.

On the third point, talk about this confidence in regards to the 8-12%. Let me give you a breakdown of it, so we fully understand it.

The range here is the amalgamation of growth from two forces. Once as you say is existing customers, which is the 3-4%. And two is the new customer wins, the net new customer wins of 5-8%. So within each of these buckets, the 3-4[%] and the 5-8[%], there are knowns and unknowns. On the 3-4[%], we've been tracking mildly ahead of that in Q3, and slightly ahead of that as well in Q4, largely as a function of inflation. So the unknown is, what's your view on inflation going through the course of 2022? But volume and inflation both have been tracking well so far against that 3-4%. And like I said, tracking slightly ahead of that range.

When it comes to the 5-8% from new customer wins, there's two things to keep in mind. One is the gross revenue uplift that we've had, which is the $830 million of gross revenue uplift. That, as you know, translates to a gross revenue growth rate of some 10%. But the bit that is the unknown is obviously this retention rate. And, as you know, we've been improving that; the revenue retention rate has improved since the spin to the mid to high 90s. That's the bit that's unknown within that calculation. I think you made a really, really good point in your question as well, which is, there is potential to have further wins above and beyond the gross revenue growth rate that's already banked at 10% through the course of this year. I would view it as in the window between January and April, where we'll still be able to get some revenue that hits in this year. And if not, it falls into ‘23 and ’24, which talks to the durability and visibility of this business.

But you can see, if you add all those numbers up, you get very comfortably within the 8-12% range. That underpins our confidence in that range, and that's why we've reiterated the guidance today.

Chris Wetherbee
Okay. That's super helpful. I appreciate the color there.

And then, maybe Baris, a little, maybe a little bit of help on the margin outlook for 2022. So, you know, same revenue growth, but obviously off of a higher base of revenues, they're going up relative to what our expectation was a couple of months ago. Adjusted EBITDA is also going up, but arguably at a little bit of a slower pace there. And I know you've mentioned some dynamics between, you know, EBITA margins and EBITDA margins. Can you talk a little bit about, you know, what you're seeing, whether it be from an open-book perspective, around the cost profile of the new business wins, and if there's anything changing there that we should be thinking about in terms of that ultimate adjusted EBITDA margin for '22?

Baris Oran
Sure. Regardless of whether you're looking at EBITDA or EBITA margins, you should expect a margin improvement, year over year, in 2022. We will have the annualization of our acquisition, and so that's cost of being associated with being a standalone enterprise. And beyond these factors, we will see underlying margin expansion, driven by our improved mix, relating to higher-margin automated contracts.

As far as the seasonality of the margins are concerned, we are very busy. We have a lot of startups right now, and you will see the startup activity, particularly in the first half of the year, and the impact of that on revenue and EBITDA will be spread out throughout the year.

So you should see this expansion throughout the year, with all these drivers getting into accounts.

Chris Wetherbee
And just so I'm clear, that should be in the neighborhood of, you know, maybe 30 to 50 basis points, of type of, sort of, full-year EBITDA margin improvement, or any sort of, you know, parameters you could put around that?

Baris Oran
If you take the midpoint of our guidance that we have guided for, but you should have a higher EBITA margin expansion compared to an EBITDA margin expansion.

Chris Wetherbee
Okay. That's helpful. Thanks for the time this morning. I appreciate it.

Baris Oran
Thank you.

Operator
Thank you. Our next question is from Scott Schneeberger with Oppenheimer. Please proceed with your question.

Scott Schneeberger
Thanks very, very much. Good morning all. I just want to delve in a little bit about the new contracts, one, and talk about automation.

You have this 30% company average you speak to. Or, in Europe; I think it's similar in North America. Just curious how, how, the new contract wins, what type of mix is automated? I assume much higher, but if you could elaborate on that a little bit. And where could that 30% go, in time, just to get perspective on how quickly that could move? Thank you.

Malcolm Wilson
Hi, Scott. It's Malcolm. Overall, pretty much in everything that we are implementing nowadays, there's a degree of automation. And also, you've got the dynamic where we're going back into, historically, less automated business, and we're adding newer automation. So, collaborative robots, goods-to-person robotics, robotic arms, these are very easy to add back. And they deliver, very speedily, improvements in efficiency, improvements in productivity. And going back to Baris's comment, that's one of the reasons why we have our confidence levels on margins. So overall, that's the environment that we're seeing. We'll see a steady, increasing path for automation. But not, not to lose sight of the fact that our business still has a large incumbent workforce: 100,000 very valuable team members. They're very valuable in our business. And so this really goes hand in hand. But overall, you'll see a steady, increasing level of automation across the business.

Mark Manduca
And Scott, was there a second part to your question, about recent contracts we've stood up and the benefits that we're applying to customers?

Scott Schneeberger
Yeah, sorry. Yeah, Mark. Yeah. Go ahead on that, please. I had a follow-up, too.

Mark Manduca
So, we've done a number of different things on the customer side, Scott.

Just to give you an example, we obviously talked on the call about a grocery vertical where we were improving things with the technology that Malcolm talked about. But there are multiple examples throughout 2021, and I'll give you one as a, as a standout. In a solution that we recently stood out for a well-known ecommerce customer, we have reduced the variable cost by 40% per unit via our technology. We've reduced the inventory stock units by some 40%. And perhaps most importantly, we've helped them to deliver a 45% uplift in their net promoter scores. That's one of multiple examples of how we help our customers and why they come to the scaled, technologically proficient player in this space.

Scott Schneeberger
All right. So, thanks, Mark. That sounds like a great value proposition for the customer.

I want to touch on reverse logistics as well, since we're coming off peak season. The growth there was 28% year over year, very strong. I just wanted to talk about how that's gonna carry into first quarter, what you're seeing, and, and the potential for that, that growth remaining elevated. Thanks.

Malcolm Wilson
Hey, Scott. Reverse logistics is growing at a very fast pace. You're right, 28% in the fourth quarter. And that's accelerating, you know, we're expecting similar high levels – even higher levels of growth, through 2022.

What's happening is, customers – typically we're expanding the services that we have with customers. And reverse logistic is a real typical service where, when we're operating for the first time with a new customer – and, remember, of our business wins in 2021, we shouldn't be so different in 2022 – you've got broadly around 36% coming from brand-new outsourcing projects.

And typically for an e-fulfillment customer, for example, we start with the e-fulfillment, the outbound process, the stock holding, and then we gravitate. They generally ask us to then take over returns or activity or repair activity that they might be doing in-house at the present or, alternatively with another competitor.

So returns, definitely, is increasing exponentially across the rest of the business. We're really good at it. We've got great tech that we deploy in it. It's super efficient. It's touching the customer, so it's really very vital for our customers, and we've very pleased that that part of our business is growing very well.

Scott Schneeberger
That's great. Thanks. I'll turn it over.

Operator
Thank you. Our next question comes from Amit Mehrotra with Deutsche Bank. Please proceed with your question.

Amit Mehrotra
Thanks, Operator. Hi everyone. Congrats on the results. I guess I just wanted to come back to Chris's question on the profitability really quickly.
So I know you guys manage the business on an ROIC basis, not margins necessarily. But, you know, at least from our perspective, it's just helpful to understand how the EBITDA growth compares to revenue growth over a sustainable period of time. And I

think that would be helpful, to just get your philosophy around that because, obviously you're putting together this five-year plan, and I just want to understand, is it the right assumption under this business model to assume kind of EBITDA growth that's consistent or maybe even a little bit better than revenue growth? ‘Cause that's what the case is in 2022 with respect to the guidance. I just wanna understand philosophically if that's the right way to think about it.

Baris Oran
Yes, in 2022 we are guiding for an EBITDA margin expansion, and on top of that, we are providing an EBITA margin expansion, above the EBITDA margin expansion.

And as you rightly said, our, we are writing contracts for return on invested capital, and we have surpassed 30% return on invested capital this quarter. And that will be our minimum target moving forward.

Amit Mehrotra
Okay. I wanna talk, I'm gonna return on, I'll get into ROIC in a second. But Baris, the Kuehne + Nagel acquisition, I think they closed very early in ‘21, was obviously pretty dilutive to margins in 2021. What would have the EBITDA margin been, ex the Kuehne + Nagel acquisition, for the entire 2021? So we just get a little bit better of, better, you know, compare and contrast versus 2020.

Baris Oran
Sure. For Q4, there has been a margin degradation coming from the impact of Kuehne + Nagel acquisition, around 100 basis points. Again for Q4, we saw exceptional growth in our open-book contracts, your second point, which brings us a higher EBITA margin, but lower EBITDA margins as they are less capital-intense. And then you look at –

Amit Mehrotra
Okay.

Baris Oran
The acquisition itself overall, we have been integrating quite well. Despite the COVID environment, we have been able to realize over $30 million of synergies through the acquisition. And you will see the full-year impact of that in 2022.

Amit Mehrotra
Right. And so, just so I understand…

Malcolm Wilson
Amit?

Amit Mehrotra
So what you're saying is that – yeah, I'm sorry. Go ahead.

Malcolm Wilson
Well, I was just going to add to Baris's comment, Amit. This is Malcolm.

If you imagine that deal, roughly half of that business is operating already at quite similar margins to the rest of our UK activity. And in fact, it's growing like a rocket. And, you know, two of those recent big open-book contracts – one with Currys, a very significant sized, tech retailer in the UK; and, more lastly, just announced, this week, British Telecom, 10-year deal. Those are coming out of the technology vertical that came – we really wanted that vertical in our UK business.

The flip side of that is 50% of it deals with the hospitality industry. And for sure, through 2021 and even into quarter four, that was a little bit down – really, primarily, coming out of the pandemic. Thankfully, now, certainly in the UK market, we can see all the signs of Omicron really reducing, with, you know, the government recently announcing the removal of most of the remaining limitations. So we're really expecting that business to come good and fly, you know, during the rest of 2022.

Mark Manduca
And Amit, to Malcolm's point about the, as we move out of the Kuehne + Nagel annualization into 2022, this business is deserving of margin expansion. It's not how we write contracts naturally; we've had that conversation before, obviously. But returns is how we think about this business. But margins are the natural output of that, and it's gonna be margin expansion, obviously, as we continue to write great contracts.

This business will see margin expansion largely because of automation. Automated contracts versus non-automated contracts have roughly 300 basis points better margins. That therefore is the flywheel that we're talking about here. Continue to write great contracts at great returns and amazing free cash flow and amazing margins come out the other side.

Amit Mehrotra
Right. And this is, that's very helpful. Just as a follow-up, the return on invested capital, I appreciate the calculation you presented in the presentation. I guess I think about things more on, like, an incremental return on incremental capital. And what was interesting to me, and I want to get your thoughts on this, Baris, is that the invested capital base actually shrunk sequentially, because of the cash that you're generating. And obviously, that's super interesting to me because I want to understand the trajectory of the invested capital base, because it seems like it's shrinking while the earnings are growing, which obviously allows you to grow the absolute. Like, the incremental returns on capital are much higher than the absolute, and if you could just talk about that.

Baris Oran
We are basically looking for three-year cash-on-cash payback when we write contracts. So I give hundred dollars to my operator; I expect about $30 back every year. So that's what we are writing these contracts for, for, average, about five-year contracts.

Now, coming back to your question around cash generation, it has been an extraordinary quarter of cash generation, and we have performed very well in the cash collection process in Q4. And that has resulted in accumulation of cash. And, numerically, you are right. That will reduce our net debt base moving forward as we generate further and further cash throughout the year.

Amit Mehrotra
All right. Okay. Thank you very much everybody. Appreciate your time.

Baris Oran
Thank you.

Operator
Thank you. Our next question comes from Stephanie Moore with Truist Securities. Please proceed with your question.

Stephanie Moore
Hi. Good morning.

Malcolm Wilson
Morning.

Stephanie Moore
I wanted to touch on, uh, cash regeneration. Just sitting here, you know, nice cash balance. A lot of recent contract wins are not requiring as much capital deployment as others. Maybe just talk a little bit, you know, first about investments internally, whether it's a new technology or, or software, and is there an opportunity to accelerate some of those investments here, just given the cash balance, as well as from an acquisition standpoint. You know, you obviously talked – earlier, Mark, you mentioned the consolidation opportunity. But if you could dig a little bit deeper, if there's particular assets or geographies that you would be targeting, just as you consider to expand inorganically. Thank you.

Baris Oran
Thank you. We have about $2.5 billion pipeline and we are generating over 30% of return on invested capital. Therefore, our organic growth is naturally our number one option. And our number two option is to continuously invest in our technology, not only in our new business, but to improve the productivity of our existing businesses, where we have returns frameworks ranging from six months to a couple of years.

And after that, after these options are extinguished, we are also looking into inorganic growth opportunities, where we buy companies, expand them faster than they would have done themselves, cross-sell additional value-added services, get expertise in new verticals just like we have seen in our acquisition in 2021. Through this combination, we can scale them up and we can generate faster value addition. On top of this, on our tech, we will continue to make a differentiator, and we will have a larger base.

And the last option will be, over time, returning on focusing capital – returning capital back to shareholders. That will be our last option.

Stephanie Moore
Great, thank you. And then I, I think a next important point of this business is just the visibility you have into out year revenue. So I think the visibility, obviously, in 2022 is quite high. But could you talk a little bit about as you think to 2023 and 2024, and the visibility you have, just given that the new contracts in place as well as the pipeline?

Baris Oran
We will hold our capital markets day later this year. And during the capital markets day, we will give you more midterm targets. We have been a public listed company for seven months. but we have been generating return on invested capital well above 30% now. And in this high-return business, we have been growing our revenue over 17% CAGR since 2002. We will formalize these targets and you will see targets around revenue, operating profitability, and cash flow in our capital markets day. We will be able to provide you further long-term targets at that day.

Stephanie Moore
Got it. All right. Well, that's it for me. Thank you.

Baris Oran
Thank you.

Operator
Thank you. Our next question comes from Brian Ossenbeck with J.P. Morgan. Please proceed with your question.

Brian Ossenbeck
Hey, good morning. Thanks for taking the question. So Baris, maybe to follow up on the free cash flow, you mentioned the strong cash collection in the fourth quarter, outperforming the guidance for the full year. Is that, that 30% which you still kept for 2022, given all the dynamics you talked about with the shifting contact structure, is there any, is there any visibility to, maybe, outperforming that on longer-term basis, when you look at that 30% conversion number that you just posted above in the fourth quarter? Is that sustainable, just given how some of the contracts are changing going forward here?

Baris Oran
Yes, we had a phenomenal free cash flow conversion in the quarter. And our guidance is, for the entire year, around 30%. And we think that's achievable. We have achieved really good cash collection in Q4 and we will continue to do that throughout the, throughout the year.

Brian Ossenbeck
Okay. Should we expect a drop-off in the first quarter? I know there's normal seasonality and bonuses, so I guess, is that more timing, or is that more structural, the improvement in the fourth quarter?

Baris Oran
You should expect 30% for the entire year. Just like many listed companies in the US, we pay our bonuses in the first quarter; therefore, the first quarter cash flow generation will be impacted from that. But the 30% growth is valid for the entire year.

Brian Ossenbeck
Okay. And then just a quick follow up, if you can just give us an update on GXO Direct, both in the US and plans for potentially expanding into Europe? I would think that's a pretty, well, it always has been a pretty interesting, offering. But I imagine, just given the strong demand you're seeing, that there's probably even, uh, a bigger pool from the market. So maybe an update on the size and growth potential in the US and Europe?

Malcolm Wilson
Hi, Brian. It's Malcolm. And you're absolutely right: it's stellar growth opportunity for us on GXO Direct. So in our 2021 numbers, the win rate for customers was over 40%, revenues were up 32%. I mean, it's really a business that's super appealing to customers. The opportunity for them to place inventory very close to the consumer is really exceptionally interesting and attractive for them.

So we're growing at a great pace here in North America. So much so that also we've got big demands now showing in Europe, and we definitely have a plan. And it'll be one of the things we'll talk about on the capital markets day. But we're planning to roll that system, the IT softwares, the process of how we manage where best to place the inventories for our consumers, our customers – we're rolling that out in Europe and we've got really, we expect it to grow just as quickly across our European landscape. It's a real winner for GXO. We're very, very excited about it. And all the customers that we're supporting are equally very excited.

Brian Ossenbeck
Okay, great. Thank you, Malcolm.

Operator
Thank you. Our next question comes from Hamzah Mazari with Jefferies. Please proceed with your question.

Mario Cortellacci
Hi, this is Mario Cortellacci filling in for Hamzah. Really appreciate you guys laying out, like, the drivers of that 8-12% and kinda how you get there with, I guess, retention being the biggest piece of, of the unknown. I guess, what drives better retention going

forward? What has changed in your business over the past year, and what other tweaks can you make over the following year to help drive that retention even higher, which obviously drives your organic growth even higher?

Malcolm Wilson

Hi, it's Malcolm here. Let me comment on that. I mean, that really goes back to, partly, the whole ethos of the spin. It allows us to focus all of our attention on what happens in the warehouse and the customers that are in the warehouse. So what you're seeing, that elevating level of retention, is really just that we're so focused, laser-focused on our customers.

The other aspect about the retention is customers are seeing that GXO is super reliable. You know, when we say we're gonna implement, we implement. We implement on time. We're bringing lots of tech innovation enablement into the warehouse, and that's driving efficiency, it's driving productivity improvements, quality improvements, accuracy, and not least, also, safety in the warehouse.

So all of those things, when you put it together, it’s improving our customers' consumer experience. So that is why customers are more locked to us, they're sticking to us, they're wanting us to do more and more business. You know, 30% of our new activity in ’21 – and I don't believe it'll be any real difference in ‘22 or the go-forward – is coming from expansion of services with our existing customers. They're asking us to do more and more. So that's, I think, a really strong indicator that our customers value GXO. We can all say again, you know, the pandemic served to demonstrate to every one of us just how critical what happens in the warehouse is. As soon as it's coming into the warehouse – you know, the, last year we had all those supply chain disruptions, all those delays at the ports – as soon as it comes into the warehouse, customers are just so needing, in terms of our ability to turn that process around reliably and get those products to consumers. That's what's driving the high levels of retention. And I don't think it's going to change going forward.

Mark Manduca

And Mario, to Malcolm's point, what really strikes me, having been at this business for, for seven months and, and far more of a newbie than Malcolm, is the rigor of contract writing that takes place with our customers. We just have the right customers on our books, these global blue-chip customers that we've talked about who understand our offering. And within our diversified mix, I would highlight that rigor of contracting translates into landing and expanding.

So our top 20 customers, if you look in Q4, we grew them some 33% year over year and we've expanded operations with 16 of them. It's repeat business, it's an understanding of value added services rather than commoditized services, and it's that technological proficiency that drives repeat businesses and recycling and high retention rates. That's why it's getting better.

Mario Cortellacci
Got it. Thank you. I just, for my follow up, obviously 19% organic growth is fantastic. And I don't want you to think that my, my question is, is to downplay that. But I, I guess, is there any governor on your, your new customer growth. Not, not even focusing on retention, just new customer growth. Think you mentioned 10% earlier; is there any governor on that? Is there, is there any structural reason why you can't grow that even more? Is it sales team size, integration timeline, access to robots, whatever it might be? Or is it just simply a decision by you guys' management team to enter the right contracts at the right time? Just trying to gauge how much is self-inflicted and how much is just a structural, um, again, governor on growth.

Malcolm Wilson
Yeah. Our scale – you know, largest pure-play contract logistics company in the world – that's ensuring that we don't have restrictions, in terms of availability of equipment, robots, deep-seated automation, robotic arms. We're, we're at the top of the queue with the manufacturers, because winners like to win with winners. You know, people want their equipment working with GXO. It's, it's a great combination.

Then, also, the people. You know, 20,000 people we recruited in a very tight labor market in the last part of 2021. We did that because we work hard at ensuring that GXO is just a great place to work. You know, whether you're a manager, whether you're a team leader, whether you're a order picker, we work harder ensuring that we make the company a great place to work.

So in those contexts, no restrictions. What I would say, though, and Mark touched on it: we are super disciplined about the kind of contracts that we write, the kind of customers that we work with. We could grow much higher levels of percentage, but it might not be the same quality level of business that we really want. And so, I think, when you put all of those things together, plus those mega tailwinds, you know, more and more people are outsourcing, e-fulfillment growing topsy turvy, more and more automation going to the warehouse, that's how you get to the kind of numbers that we're guiding to.

I think we're in a very enviable position as a company, high-class quality of customers, you know, nothing -- nothing to suggest that that will change going forward. But, really, that's the basis of where our guidance is coming from.

Mario Cortellacci
Thank you very much.

Operator
Thank you. Our next question comes from Brandon Oglenski with Barclay's. Please proceed with your question.

Brandon Oglenski
Hey guys. Uh, thanks for taking the question. Maybe more of a, a macro question about your customers, you know, we're having a lot of debates with investors about where aggregate levels of inventory sit, especially on the retail side, you know, in North America and in Europe. So anything you can speak to there and, you know, some of the momentum that you saw in your business in the fourth quarter – how do you think about that carrying forward, you know, seasonally into 1Q and 2Q here?

Malcolm Wilson
Brandon, I think we, quarter four is always a peak environment. You know, that's, that's a matter of fact. With our ecommerce business, it's the peak season. You've got Black Friday, you've got the Christmas holiday seasons, et cetera. So quarter four definitely is a peak. But we've taken a lot of that strong momentum, a lot of new contracts being implemented as we speak in our quarter one. So we've taken all that momentum into the new year.

Mark, maybe you can comment further.

Mark Manduca
Yeah, it, I mean, in many ways, Brandon, there, there's an element here of being a company for all seasons. If you think about how our contracts are structured, as Malcolm mentioned, there's really a paper ceiling and a concrete floor in so many ways.

We benefit on the upside from some of the ecommerce trends that Malcolm mentioned just now in the fourth quarter. But equally, with our minimum volume requirements, on the downside, we're protected in a downturn, as I'm sure you saw with our, with our prior entity of Norbert back in the 2008 and 2019 cycle. So the resiliency of our contracts, the rigor of which we're writing these contracts really protects us in terms of belts and braces, in terms of what you're saying on the inventory side. I like what you're saying on the inventory side. It means more goods flowing through warehouses and that's a good thing for us.

Brandon Oglenski
Well, I, I guess, could you speak to the inventory situation, Mark, in North America and Europe?

Mark Manduca
In terms of the inventories going, going up at the moment is what you're saying, in terms of building, or?

Brandon Oglenski
Right. Are your customers at low or high relative inventory levels right now? And has that been an issue that you have been dealing with, you know, recently?

Malcolm Wilson
Yeah, Brandon. I think, I think what we can say is, I mean, really the supply chain disruptions that we saw in 2021, you know, the huge volumes of vessels sitting offshore in Long Beach, that's coming down. And I mean, I think there's lots of statistics to demonstrate that is coming down.

Our customers – the kind of customers that we work, large blue-chips, typically source from multiple destinations on a global basis. So we're not seeing anything untoward in terms of inventory levels that we work with or plans. Obviously, we work with all of our customers in terms of long-term planning. You know, we're, you have to imagine we're working on projects now for ‘23 and ‘24. We're building new warehouses, as we mentioned. So a large percentage of our growth is coming from existing customers' incremental services. So we're working with customers now on projects into the long term. So we're not really seeing any downscaling of inventory levels. But equally we're not seeing any upscaling of inventory levels. We're, we're about where we would anticipate to be just after a very busy quarter four and, you know, starting the planning for the various seasonal peaks that will happen through the course of 2022.

Brandon Oglenski
Okay, appreciate that. And if I can just sneak in one more on, on margins, ‘cause I feel there's a lot of margins that we gotta look at, uh, in your business. And I think Baris was talking about, you know, the difference between EBITA margins and EBITDA margins, as well as, potentially, some startup impacts early in the year. So can you speak to, I guess, one, you know, maybe a little bit longer discussion on the difference between the depreciation on non-open contracts and then your open contracts, and the seasonality of those startups. Thank you.

Baris Oran
Sure. In Q4 generally, a lot of our operations are focused in delivering peak, as we have both Christmas and Black Friday. And throughout the rest of the year, we are very busy with implementing new wins – especially Q1 is, is very busy in implementing new wins. And as we mentioned in our call earlier, we have seen a higher growth in our open-book contracts in 2021 versus the other contracts we have.

The open-book contracts we have, um, they are not as capitally intensive. They are asset-light compared to the closed-book contracts. In a way, very sizable upfront capex is taken over by the customers; therefore, the depreciation charge from, related to those contracts is lower compared to the closed book contracts.

Therefore, we have seen a margin expansion, year over year, of 120 basis points in EBITA margins, vs. 60 basis points in EBITDA margin. And we are guiding for EBITDA margin expansion for 2022, and a higher EBITA margin expansion for 2022.

Brandon Oglenski
Thank you.

Operator
Thank you. Our next question comes from Bascome Majors with Susquehanna. Please proceed with your question.

Bascome Majors
Yeah, can you talk a little bit about the specific timing of the capital markets day and if you have some thoughts on that?

Baris Oran
We will hold a capital markets day later in this year. The timing will be set soon. And we will be providing a number of targets including revenue, updating profits and cash flow. We have been growing this business over 17% CAGR since 2022. And also, the guidance we provided for 2022 on organic growth 8-12%, we would, we would note that this is a normal year for us. 8-12% is a normal year for this business. We'll get back to you with more dates rather soon.

Bascome Majors
All right. Thank you.

Operator
Thank you. Our next question comes from Jeff Kauffman with Vertical Research Partners. Please proceed with your question.

Jeff Kauffman
Good morning, gentlemen. I, thoughts, uh, on capital deployment? You had mentioned you will play in the consolidation game, but I think that's more of a long-term comment. But the balance sheet's kinda where you want it to be; you're still gonna be throwing off $200 million plus in free cash next year. Can you just kinda walk us through? I, I know the priority is grow the business. But, um, where do you need to be before you start considering return of capital to shareholders?

Baris Oran
Our options, as you recall, number one is organic growth. Our option number one. Number two is continue to invest in our technology to improve productivity – not only in the new business, but in the existing business. And after that, number three is looking into inorganic growth opportunities as we have shown in, uh, in the K+N acquisition, we were able to exact $30 million of synergies; roughly 5% of it is tied to sales, in a very difficult year. And we have more benefits that will accrue in 2022.

And lastly, returning capital back to shareholders is our option number four.

These, we are looking into multiple options as far as allocating our capital and we will continue to provide organic growth as a, as a priority number one, followed by tech and inorganic growth. Returning capital back to shareholders over time will be part of the options. But, it will take some time before we do that, as we are very excited about over 30% growth in our, over 30% return in our organic growth options here.

Jeff Kauffman
It makes sense. Thank you for your answer and that's all I have.

Baris Oran
Thank you.

Mark Manduca
Paul, I think that's where we close the call. I think we're at the full hour. I know people have very busy days. Operator?

Operator
This concludes today's conference. You may disconnect your lines at this time, and thank you for your participation.