GXO

# GXO Q2 2022 Earnings Call

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# GXO Logistics Q2 2022 Earnings Call

## Presenters

**Mark Manduca – GXO Chief Investment Officer**

**Malcolm Wilson – GXO Chief Executive Officer**

**Baris Oran – GXO Chief Financial Officer**

**Bill Fraine – GXO Chief Commercial Officer**

## Q&A Participants

**Chris Wetherbee – Citi**

**Scott Schneeberger – Oppenheimer**

**Jason Seidl – Cowen**

**Amit Mehrotra – Deutsche Bank**

**Allison Poliniak – Wells Fargo**

**Brian Ossenbeck – JPMorgan**

**Ari Rosa – Credit Suisse**

**Bruce Chan – Stifel**

### Operator

Welcome to the GXO Q2 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 Investment Officer, Mark Manduca. Mr. Manduca, you may begin.

**Mark Manduca – GXO Chief Investment Officer**
Thank you, Operator.

Good morning, everyone, and welcome to GXO's second quarter 2022 earnings call.

Joining me today in Greenwich are Malcolm Wilson, our Chief Executive Officer; Baris Oran, our Chief Financial Officer; and Bill Fraine, our Chief Commercial Officer. Bill is a newcomer to our earnings call, and he can speak in depth about our exciting growth opportunities and our deep customer relationships.

I'll first turn the call over to Malcolm. Over to you, Malcolm.

**Malcolm Wilson – GXO Chief Executive Officer**

Thank you, Mark, and good morning, everyone.

I want to start by acknowledging that GXO became a publicly traded company only one year ago, after completing our successful spin. We celebrated this one-year anniversary yesterday by ringing the opening bell at the New York Stock Exchange, together with operators from across our business.

We've had a truly remarkable first year as a public company. We've posted consistently excellent operating results, achieving or beating expectations for each quarter. We've completed our first acquisition – Clipper Logistics; we've published our first ESG report and progressed meaningfully towards our best-in-class ESG targets; and we've seen team member satisfaction levels rise quarter over quarter. The benefits of being a standalone pure-play contract logistics company are self-evident.

GXO has quickly established itself as a globally recognized brand. We've been named to the Fortune 500. And recently, we were particularly gratified to be named Supplier of the Year by Boeing, in their Support and Services category. GXO was one of only nine business partners out of their nearly 11,000 total suppliers to receive this award.

Since our spin, we have opened over 90 new sites and 15 million square feet of new warehouse space. We've also signed more than 400 new customer contracts and added more than 15,000 team members. With Clipper, we've gained an additional 57 sites, 10 million square feet, and 10,000 team members in high-growth markets and exciting new verticals.

I'd like to thank our employees, customers, and the broader investment community for making this a tremendous first twelve months as a standalone company.

Now, turning to the second quarter. I'm pleased to report that we've set two quarterly records: first, our highest-ever level of new business wins – $475 million dollars. These wins have a lifetime value of over $2 billion dollars. Second, we've delivered revenue of $2.2 billion dollars driven by our highest-ever organic revenue growth of 20%. This is split in roughly equal measure between 'net new' business wins and like-for-like existing operations growth.

As Baris will discuss in a moment, we've also delivered exceptional adjusted EBIT-D-A, Adjusted Earnings Per Share and Free Cash Flow.

We continue to win new business with major international brands and omnichannel retailers that are looking to give their consumers a best-in-class experience. These customers include Dolce & Gabbana, JD Sports, Lacoste, L'Oreal, PepsiCo, Restoration Hardware and Spanx. We also had significant wins across the industrial sector, particularly in North America.

Our record sales performance, combined with the increasing demand for outsourcing we're seeing in the market, underpin our confidence in the long-term strength and attractiveness of our business.

Across global markets and industries, continuing supply chain complexities, elevated inventory levels, and high inflation, are making seamless logistics management mission critical for more and more companies. This all plays to the strengths of GXO – and it's no doubt helping to drive our significant organic growth and market share gains.

On the one hand, we've seen some return to brick-and-mortar by the consumer. On the other hand, large companies are still continuing to expand their online product offerings. GXO is well positioned to capture outsized gains from both these trends. We see evidence of this in our omni-channel growth, which grew 4% faster than the GXO group as a whole.

Our blue-chip customers continue to invest for the future. This is reflected in the amount of new activity we've won with both existing and new customers, which contributed 54% of our new wins year to date. Our diversified vertical mix, our agility, and our longstanding, deep partnerships with our customers all add to the stability and predictability of our business.

As a result, and taking into account the Clipper acquisition, we're pleased to be raising our guidance for both organic revenue and adjusted EBIT-D-A for the full year 2022. Baris will now take you through the details.

Baris – over to you.

**Baris Oran – GXO Chief Financial Officer**

Many thanks, Malcolm, and good morning, everyone.

We are thrilled with our results for the second quarter, as we've again delivered strong revenue and earnings growth.

The numbers in our presentation include four weeks of consolidated results from Clipper, as we closed the acquisition at the end of May. Our guidance reflects Clipper, ex synergies; current FX rates; and the deconsolidation of our Russian JV.

As Malcolm mentioned, this quarter, we delivered an all-time record of 20% organic revenue growth, reflecting expansion in our existing business, as well as new wins. This is the sixth consecutive quarter in which we've grown organic revenue by double digits. From a profitability perspective, Adjusted EBIT-D-A grew to $176 million dollars, up from $161 million dollars on a pro forma basis a year ago, reflecting the execution of our new startups, as well as continued inflation pass-through in our business. Net income attributable to shareholders was $51 million dollars, up from $11 million dollars last year. Adjusted diluted EPS was 68 cents up from 44 cents, a 55% increase year over year, driven by our growth and capital efficiency. Our Return on Invested Capital was, once again, stellar at over 30%, as we continue to write high-quality contracts. We see great opportunities to continue to reinvest in our business at these returns or higher, creating a snowball effect.

Turning to cash flow, we saw excellent collections performance this quarter, driving operating cash flow of $154 million dollars compared to $99 million dollars in the same quarter last year. Our free cash flow for the quarter was $68 million dollars, well above our guidance of 30% Adjusted EBIT-D-A to Free Cash Flow conversion. We remain confident of our cash conversion guidance for 2022.

We've raised our full-year organic revenue growth guidance. We now expect a range of 12-16%, up from our previous range of 11-15%, reflecting outperformance in the first half and our record sales wins.

We've also upgraded our adjusted EBIT-D-A guidance: previously $707 million dollars to $742 million dollars, is now $715 million dollars to $750 million dollars.

GXO has performed phenomenally through the second quarter, and, given the predictability and resilience of our contractual business model, we are very confident in our upgraded full-year forecast and its phasing.

Our investment-grade balance sheet remains robust after financing for Clipper, with leverage levels at just over 2 times expected Adjusted EBIT-D-A for full-year 2022. The majority of our debt is fixed and has been swapped into European currencies so as to match our geographic exposure. GXO also has an unused $800-million-dollar revolving credit facility available on top of the bonds issued to date. Given our strong Adjusted EBIT-D-A growth and Free Cash Flow generation, our focus over the next 12 months will be integrating Clipper as soon as possible, extracting revenue and cost synergies, and de-levering to within our targeted range.

Beyond our cash resilience, following the Clipper acquisition, our contract mix is even more balanced. With now approximately 45% open book, cost-plus, higher return contracts, we believe our company is even more resilient moving forward.

Now I'll pass the mic over to Bill Fraine, our Chief Commercial Officer. Bill has decades of industry experience, starting with 23 years at FedEx, where he grew from a front-line material handler to Head of Sales. He joined the business in 2011 and has driven strategic sales in contract logistics ever since.

Over to you, Bill.

**Bill Fraine – GXO Chief Commercial Officer**

Thanks, Baris.

This quarter, as Malcolm noted, we've won an all-time record of $475 million in new business, and we continue to gain share in all our markets.

GXO's business is about problem solving for our customers – now more so than ever in the current environment of high inflation and disrupted supply chains.

GXO is great for customers who have high growth needs as we've seen in ecommerce, and it is equally powerful during an economic downturn, when customers are dealing with issues like increasing inflation and the need to reduce operating costs.

Today's reality is that customers still need to move products closer to consumers, while at the same time, they need to increase efficiency. This plays right into GXO's wheelhouse.

Let me give you some current examples of what we're seeing on the ground.

- Ecommerce is growing rapidly for GXO, as more big, global brands continue to put more of their products online to catch up with consumer behavior. eCommerce generates higher product returns, and managing these returns is a problem for most customers. That's why they come to GXO. With GXO involved, our customers get product back into the market faster, with up to 96% of product re-sold to consumers. This is significantly better than the industry as a whole, where 25% of returned products are not re-sold. And remember – approximately 40% of our customer wins in the second quarter included reverse logistics, and we see significant growth opportunity here for GXO.

- Retail inventory levels in the U.S. are 26% above pre-pandemic levels, and we're helping our customers alleviate this problem also. For example, we've helped some customers to optimize sites by installing GXO's suite of software and inventory management systems, which reduces inventory per SKU – in some cases by upwards of 50%.

- Our customers are also facing rising costs in this inflationary environment. They need GXO's cost-out expertise, along with the increased efficiency and precision we can drive with automation, continuous improvement, and inventory reconciliation. As I mentioned earlier, 60% of our wins in the second quarter were for highly automated sites, which can deliver enormous efficiency increases and reduced costs for our customers. Customers come to GXO because they know that we are better at delivering highly automated solutions that also bring further benefits through the life of the contract.

And as we're solving these problems for our customers, we're also building our pipeline, which, at the end of the quarter, stood at over $2 billion dollars. This pipeline is solid in all geographies and is comprised of strategic projects across the industrial, technology and consumer verticals where GXO aims to win. Importantly, the pipeline turnover is high and has accelerated, reflecting the faster speed with which we are winning new business while simultaneously adding new opportunities with existing customers.

In my career, I've never seen such demand from first-time outsourcers and existing customers for reverse logistics and automation. This is a great environment for GXO, and we are gaining share.

I'm now going to hand the call over to Mark.

All yours, Mark.

**Mark Manduca – GXO Chief Investment Officer**
Thanks, Bill.

This has clearly been another quarter of records.

We've heard today about our durable business model, which, at its core, has predictable revenue and earnings, compounding high returns, and robust cash generation.

Coupled with this enviable durability, GXO is about growth.

We've won over $475 million of revenue in the second quarter. And this means three things:

Firstly, for 2022, we expect over $1.1 billion dollars in incremental revenue from our wins to date, implying a 14% gross revenue growth rate;

Secondly, for 2023, we've already secured around $500 million dollars of new business wins through the second quarter, and that gives us a clear line of sight for solid revenue growth into next year.

And thirdly, we've signed approximately $200 million dollars for 2024. Given our high customer retention rate, which rose again in the second quarter to remain firmly in the mid-to-high 90s, this gives us great confidence in our long-term growth.

Irrespective of the macroeconomic backdrop, we expect our growth to continue into 2023 and 2024.

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

## Question-and-Answer Session

**Operator**
Thank you. [Operator Instructions]

Our first question comes from the line of Chris Wetherbee with Citi. Please proceed with your question.

**Chris Wetherbee – Citi**
Yes, hey. Thanks. Good morning, guys.

Maybe I'd like to start with a couple of quick questions on the guidance. So from a revenue standpoint, the increased organic revenue growth does assume a bit of a deceleration in the back half, given how strong the first half has been. So first off, I want to understand how you guys are thinking about the pace of current activity? It sounds like business wins and new business generation during the quarter was quite good. So, I want to make sure I understand the difference between that and maybe a bit of a deceleration in the revenue growth rate that's implied by the guidance in the back half of the year?

And then, kind of similarly, on the EBITDA side, we are seeing organic revenue go up again – I think this is the second time you've raised it this year –but we are not seeing organic EBITDA growth kind of follow that. So I want to understand the dynamics of startup costs within that as well. Thank you.

**Mark Manduca – GXO Chief Investment Officer**

Hey, Chris. It's Mark here. I'll take that. Thank you for the question.

So, I'll take the first portion on the revenue side, and then Baris will pick up on the EBITDA side. And then what we'll do, just to color the revenue question, we'll get Bill to come in and talk about what he is seeing on the ground in terms of his pipeline.

So firstly, Chris, I think to your question, we are optimistic as a business. We just had a quarter where we've done 20% organic growth. So, that's a good sign and that's something to think about.

I think if we look to the second half, particularly through Q3 and Q4, there are two elements to consider: firstly, existing customers; secondly, new customers.

For existing customers, this is going to be the first full year where we're coming out of the pandemic, and therefore, Q4 will be the first more normalized comp for this business. And given the unknowns, obviously, in the macro economy, I would highlight that we're a young company with an experienced management team. So we want to be sensible with this guide. And what we're trying to say to you is it's a conservative message for the second half of this year.

Secondly, on the new customers, this is a very important point. If you look at our new customer wins, what we have is we've roughly got another $69 million that we won in the second quarter of the year. That takes you to roughly $1.1 billion of extra revenue in the hopper for this year – that's 14% gross revenue growth signed in new wins for 2022. And if you couple that, Chris, with the mid-to-high 90s retention rate, that is an overall positive and confident statement for our business about its durability, and also, the desire from our customers for our services.

To your longer-term point, rolling the clock forward about this idea of visibility in this business – and Bill will talk to this as well – this is a business that obviously has $475 million of announced wins in the second quarter of the year. We have got roughly $240 million of that, additionally falling in 2023. That takes your number next year to $457 [million]. So, that gives you a very clear line of sight already – even though there are probably going to be more wins in Q3 and Q4 and Q1 – gives you a very clear line of sight for growth of next year. And on top of that, you have got those new wins that I mentioned in the opening statements for 2024. All of this talks to visibility and strength of our business.

Baris, do you want to talk about the EBITDA side?

**Baris Oran – GXO Chief Financial Officer**
Sure. The margin delta has started to ease from the startup in this quarter is clearly visible from our numbers. And in the third and fourth quarters, we expect to see further margin maturity. Of course, the nature of the peak season will have an impact on the size of that maturity. Net-net, we forecast year-over-year accretion for the second half of the year on the margin side, which will be a lot more prevalent in the fourth quarter.

**Bill Fraine – GXO Chief Commercial Officer**
Yes – and to add to that, this is Bill.

Our pipeline, as I mentioned, was $2 billion at the end of the second quarter. It's now $2.3 billion. So it is growing and continuing to grow. It's growing across all verticals, all geographies, and it's growing with some really strong customers. And the last thing I would say on this is, we mentioned in the second quarter, 40% had reverse in it. With the growth in e-com, and we say e-com, it's across all verticals. It's not just e-comm, as we say, clothing or omni-channels, it is aerospace, it is tech, it is other industrials. But we obviously take them through our large return centers and show them what we're able to do and how we're able to capitalize on getting 96% of products back into the market, which is critical to their throughput.

So these things are making a big difference, and it's why I'm very confident that our growth and our selling will continue to be at the same levels.

**Bill Fraine – GXO Chief Commercial Officer**
Okay. That's very helpful.

Bill, maybe sticking with you, as you think about what you're seeing from customers? I don't know if you want to break it down geographically or otherwise. How does activity look now, versus, maybe, what you guys have seen through previous cycles? I want to get a sense, particularly in Europe, if there is any sort of stress on the consumer there, being reflected in activity or new business wins, or maybe interest coming into you guys for new facilities. I just want to get a sense of sort of the macro dynamics, particularly in Europe, how they're impacting your customers?

**Bill Fraine – GXO Chief Commercial Officer**

I'll give you one example. I was in Europe 3 weeks ago, and I met with one of our larger customers – very strong growth across Europe with us over the past year, and they're growing continual sites there. But they also – their big focus right now is North America. So what they want to do is, they want to work with us at the beginning of the year coming up on, really, two things.

One, putting in what I would say is a 'central facility' for them. But what we focus with on them now is GXO Direct. So our point is, you can put in one core facility and then use GXO Direct to distribute up to other markets, which is very exciting for them because it allows them flexibility and allows them, really, a much quicker response time to their needs. But that's just one example, but that's – so we're seeing – and I can say the same thing from the U.S. to Europe: we're having the exact same questions. We just had a customer who joined us this year with two sites they were going to open. They have now opened three. They are opening a fourth. They just signed for this month in Dallas, and they are moving to Europe. Baris, do you want to add more?

**Baris Oran – GXO Chief Financial Officer**

Sure. Let me give some color from the numbers side. We have delivered 20% organic growth, our record percentage of organic growth.

And when you look into the components of this phenomenal organic revenue growth, the first half is coming from net new business wins and driven by start-ups we discussed last quarter, and the second half comes from our increase in our organic operations, our existing operations, similar to like-for-like growth in our core business.

Now, stepping back to the organic new business wins, when you look into the details of those, the level of activity is almost evenly divided between North America and Europe. So we are growing in both continents. We're growing in multiple geographies right now. The numbers are showing us that.

**Chris Wetherbee – Citi**

Okay, thanks for the time. Appreciate it.

**Bill Fraine – GXO Chief Commercial Officer**

Thank you.

**Operator**

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

**Scott Schneeberger – Oppenheimer**
Thank you very much. Good morning and congratulations on your first year as a stand-alone public company.

I think that was a good overview with regard to the strength of the organic growth of the business. I'm curious, though, I saw in the slide deck, on Slide 14, it bridges the guidance – the changes in guidance. Could we go into that a little bit more in depth, with regard to Clipper contribution, maybe in second quarter; how that contributed; what you're thinking about its contribution for the rest of the year; and maybe a run-rate for going forward from '23 or '25?

**Baris Oran – GXO Chief Financial Officer**
Sure, Scott. Thank you. We completed the acquisition, as you recall, on May 24 and Clipper made a mid-to-low single-digit EBITDA contribution for the 4 weeks that we have been operating the company, that's included our consolidated results. It had $80 million of revenue and $1 million of net income.

And for the future expectation, the historic EBITDA margin for the company has been – in U.S. GAAP basis – has been roughly 5% to 6%. So you can take that as the basis for your modeling.

We cannot provide specific guidance on the remainder of the Clipper. And what we have included in our guidance is basically reflecting what we have included in our acquisition models.

Now, you would see in the EBITDA bridge, there is a 'net M&A.' The 'net M&A' means Clipper, minus the deconsolidation of Russia impact, and the remainder is the FX component. We have hedged, last year, for 2022, roughly 80% of our EBITDA, to shield our shareholders from volatility on the exchange rates. 20% has not been hedged. And the $10 million delta is directly coming from that 20% not hedged. And those are the components on the EBITDA bridge.

**Scott Schneeberger – Oppenheimer**
Great, thanks. I appreciate that, Baris.

And could you speak to the deconsolidation of the 50% owned joint venture and how that works into your consideration for guidance for the rest of the year, what that is, and what type of timing impact that may have? Thanks.

**Baris Oran – GXO Chief Financial Officer**
Yes. It has happened in the first half, as you recall from our last discussion. And whilst we are updating the guidance for the entire year, there are larger components, including

Clipper, that has been included in the EBITDA guidance upgrade as well as FX. FX has moved a lot. So we have included all components to update our guidance for the full year.

**Scott Schneeberger – Oppenheimer**
Okay, thank you.

**Operator**
Our next question comes from the line of Jason Seidl with Cowen. Please proceed with your question.

**Jason Seidl – Cowen**
Hey, thank you, operator. Gentlemen, good morning and congrats on the quarter. Wanted to go back to some of the last comments you made during your prepared remarks. I believe you guys said that you're going to grow in '23 and '24, irrespective of the economic backdrop. I was just want to clarify, is that revenue or is that revenue and EBITDA?

**Malcolm Wilson – GXO Chief Executive Officer**
Yes, Jason, let me comment on that. It's Malcolm here.

We're fully expecting growth through '23 and '24. We're confident on that, and we're confident on it because, many of the contracts that we're writing right now, in fact, are only coming into implementation through the next year, '23 – and even, in some instances, '24. It's good memory jog, in fact – if you remember back, right to the middle of last year, we were announcing huge customer wins, and much of that you are seeing in our organic growth right now.

And just as Bill mentioned, a good deal of that, just under $0.5 billion of new contract wins going to be implemented – not really in this year, because there is a lead time of preparing the warehouse and getting all the automation in place. But actually, a lot of it will go into next year and, in fact, the year after.

On the margins, I think it's an important point, more and more of the business we are signing now – I mean, it's really increasing at a pace – is really containing a lot of tech enablement, whether it's robotic arms or goods-to-person robots or collaborative robots. So honestly, I mean, it's like a huge shopping menu now, that our solutions teams put forward into our size.

And the reality is, these big, automated centers, whilst they take a little bit of time to reach efficiency – you can imagine, it's like starting a huge warehouse, we have a lot of machinery and software in it. And even allowing for that, it's creating a lot of employment. These big centers still, actually, employ 300, 500, 600, 700 people. So it's understandable that these big centers, they do take between, sort of, 6 and 12 months to reach margin maturity.

So all of that put together, we're very confident on '23 and '24. And I mean, that's what we can see. We don't see any fundamentals as to why that can't continue for years in the future.

**Jason Seidl – Cowen**
Okay. I appreciate the color on that.

And then you mentioned, I believe, you said 60% of the new contracts that you win have some tech-enabled in it; what percentage of the contracts that you are bidding on have some sort of tech-enabled component to them?

**Malcolm Wilson – GXO Chief Executive Officer**
Yes. Bill, maybe you can talk to that?

**Bill Fraine – GXO Chief Commercial Officer**
This is Bill.

Yes, it's in the same range. And what we're finding is that labor, obviously, has been a main concern of customers in the last 1.5 years. And so what's happening is, it's driving the need and the willingness to automate.

The other side of that is, we want to create a great employment environment for our employees, and automation helps that. Any site we have automation in, I can tell you, our employees like working with it. They find it's a more, a happier workplace for them, and a better place to work.

So those two things are driving it: one, the benefit, the savings, the throughput for the customer; and then the labor advantage, both in terms of how much labor we need, but also the lifestyle of the labor, where they're enjoying it more. It means we get more sticky labor. And that's what Malcolm's relating to on the productivity. It grows faster with labor.

**Jason Seidl – Cowen**
Thank you for the time as always, gentlemen.

**Bill Fraine – GXO Chief Commercial Officer**
Thank you.

**Operator**
Our next question comes from the line of Amit Mehrotra with Deutsche Bank. Please proceed with your question.

**Amit Mehrotra – Deutsche Bank**
Thanks.

Hey, Bill, just a follow-up to that last question. The 60% of the new wins. You didn't – you said it was 'highly automated,' not 'some automation.' That's a little bit of a nuanced point, because, I don't know if that percentage has changed a little bit, because I know obviously, there is a more fixed charge associated with higher automation, whether it's software depreciation or amortization or automation charges. So obviously, those businesses have higher – those contracts have a little bit embedded higher margins to it.

Is that 60% a change in terms of highly automated, versus what you were doing last year? If you could just quantify that change for us, because I picked up on that wording, and I just want to make sure I'm not making too big a deal out of it?

**Bill Fraine – GXO Chief Commercial Officer**
Yes. Thanks, Amit.

I would say this, that as – in the years, as we've gained the success with automation – and again, as I mentioned, we tour our potential customers through our site. So when they see the automation we have, and they see the results we gain for our customers, and they get very excited about going down an automation path.

When we talk about 60%, it's the processes and the site that are becoming automated. So as you'd imagine, a big portion of the processes in a site involved picking. So when you have either cobots or you have goods-to-person, you're taking the bulk of the processes in the sites and you're automating those. When we say 'highly automated,' that's what we mean, is that you're finding more and more of the labor in the building; the processes are becoming automated, because that allows for what I said before. It's more efficient, and it's also better for the employees. It's a better work life, because employees are able to choose more what they – where they want to work, and they like to work in automated sites that offer them less stress on their body and more enjoyment working with the automation.

**Amit Mehrotra – Deutsche Bank**
Yes. But I just want to make sure. So on a like-for-like basis, is there more EBIT dollars attached to that type of contract, and maybe a less automated contract because you're charging a margin off of a higher fixed-cost base, is that the right way to think about it?

**Baris Oran – GXO Chief Financial Officer**
That's the right way to think about it. Clearly, that we have sizable automated contracts, it does come with sizable fixed revenue and fixed EBITDA through the life of the contract.

And remember, we are writing these contracts for a return on invested capital over 30% -- and we have fantastic returns, as you clearly see from our financial statements, and that trend and track record is continuing: writing high-quality contracts, whether they are automated or less automated.

**Amit Mehrotra – Deutsche Bank**
Okay. That's helpful. And then I just have a couple more here.

So the revenue disclosures around new business wins for next year, I mean, obviously, there is at least $500 million of incremental revenue, probably $700 million to $800 million of new business, if you incorporate the back half of this year. There is $400 million of additional Clipper revenue next year as that cycles through. There is maybe some FX headwinds, some churn, but then there is existing new business. So I mean, it looks like we're talking about $800 million to $1 billion of incremental revenue next year, on a reported basis. If you could just talk about that.

And then I want to know what the contribution margins associated with that incremental revenue are, because Clipper's starting off of a low margin, but then maybe you have opportunity for synergies next year. I wonder if the new business that you're winning is coming more from open book, which is lower margin, but higher ROIC.

So Baris, would you expect whatever reported revenue growth is in terms of dollar basis next year – is that coming on at group margins, group contribution margins, is it a little bit dilutive because you got some FX headwind? Talk to us about, like, the margin profile and the incremental margin profile on the new business next year?

**Baris Oran – GXO Chief Financial Officer**
Sure.

Remember, Clipper has historically about a 5% to 6% EBITDA margin in U.S. GAAP basis, and very limited depreciation; therefore, slightly higher than GXO margins and

EBITA. So better the bottom-line contribution from a top-line perspective, so that we will have the full year effect of that.

The business is trending quite healthy in Clipper and continues to grow, but because of the hold-separate arrangements, we cannot provide further details on that. Once the hold-separate arrangement is completed, we will provide further details.

When you're thinking about next year, of course, you need to have a component of FX impact on EBITDA, but there will be Clipper synergies impact, as well as the maturity of our contracts we have started this year. We have started quite a lot of contracts this year compared to the years before, and you will see the full-year maturity impact of those.

Furthermore, as management, we have decided to put extra effort on continuous improvement efforts in our existing facilities, to improve productivity for our customers and improve the EBITDA margins for the entire organization. So we do expect to see impact of that, through the rest of the quarters, as well as 2023. So, multiple things will be in effect for next year.

**Amit Mehrotra – Deutsche Bank**
So just to tie a bow on that, so whatever revenue growth you have next year, it will be what it will be. I guess the bogey would be EBITDA growth on a percentage basis that's equal to or greater than revenue growth. Is that a fair way to think about the relationship, the EBITDA versus revenue, in 2023?

**Baris Oran – GXO Chief Financial Officer**
There will be a couple of pieces that needs to be balanced: there is an FX component; there is the productivity components; there is the synergies component, if you're looking at the nominal EBITDA; and there is going to be the Clipper impact that's going to be balancing those out. So the balance of those four will determine how our margins will evolve in 2023.

**Amit Mehrotra – Deutsche Bank**
Okay. I tried to ask that question. But I appreciate it. Thank you, guys. Take care.

**Operator**
Our next question comes from the line of Allison Poliniak from Wells Fargo. Please proceed with your questions.

**Allison Poliniak – Wells Fargo**
Hi, good morning.

Just in line with the automation side of it, any concern of your robotics partners and, just given the level of growth that you've had in new contracts, their ability to keep up with some of those implementations? Any risk to that?

And then, you have a contract with 6 Rivers – could you maybe explain sort of what they are providing you that's a bit unique, that would justify that? Just any thoughts there?

**Malcolm Wilson – GXO Chief Executive Officer**
Yes. Allison, hi. It's Malcolm here. Let me give you some background on that.

So really, we don't have any concerns with regard to the availability, if you like, of automation. Reason for that is, when we do a design for a customer, our solutions teams, they're really designing in the optimum. So we don't have, for example, one facility that just has one manufacturer's automation running in it. It's normally comprising of multiple different manufacturing components. So typically, a goods-to-person robot coming from one manufacturer; robotic arms coming from another manufacturer; a collaborative robot could be coming from a different manufacturer.

And what we do, we are working with all of the manufacturers. We have a forward plan. So we talk a lot about our sales pipeline. But what we just mentioned, we're implementing, now, business that was won, broadly, up to a year ago. So we've got long lead times for these implementations. They are not processes where you just win a piece of business and then typically implement within three months for a highly automated center.

So, working with the partners and remembering that, from a GXO perspective, we are the largest pure-player contract logistics company in the world. That scale gives us huge buying power when it comes to equipment like automation, not to mention real estate. I mean, lots of things that are in, kind of, quite tight demand after sales business, we're finding a good process with those manufacturers and providers simply because, I mean, they value us as a company. We're a big player for them. And in automation, we're kind of the benchmark. People want to have their automation in a GXO operation. It sets them apart from their own peers.

So we're really not experiencing difficulties that are creating an environment where our lead times for implementation are any different than what they have historically been for these big kind of centers. So, I hope that gives you a bit of flavor on it.

**Allison Poliniak – Wells Fargo**
Yes, that's great. And just any color on 6 Rivers, like what is it providing you that's a bit unique in the automation space today. Any color there?

**Malcolm Wilson – GXO Chief Executive Officer**
Well, I know Bill. I mean, Bill last week was in a center where we were running a huge amount of collaborative robots. So Bill, maybe you can just comment on that?

**Bill Fraine – GXO Chief Commercial Officer**
Yes. So we've been involved with 6 Rivers for a few years now. And the benefit it brings is – really, a few, but what it brings is, it brings much faster efficiencies in the sites when you have 6 Rivers in place. Here's a quick example: the first thing you do with an employee when you bring them in a site is, you teach them the layout of the site. And that can take, for them to get good at, that can take weeks, and they are usually working alongside a seasoned employee, so they slow down the seasoned employee a little bit.

With a cobot, when you bring an employee in, they can pretty much, at half a day, get very close to top efficiency. And the reason is, the robot already knows the site, knows exactly where it's going, it knows where all the product is. And so, when you put an order into a cobot, it will take them around the site and it will point out the product. It will then show a picture of the product; the employee scans it, and then it shows the bin it goes in. So defects go away, efficiency goes up – and our relationship with 6 Rivers is such that we have favorable position with them. As Malcolm mentioned, we get the product when we need it. And they also like it because they get to say that they are dealing with the largest pure-play logistics company in the world for their product, which helps them sell their products. So it's just a great relationship all around.

**Allison Poliniak – Wells Fargo**
Great. And then just lastly on that pipeline, I know you touched on, it's still a mix of expansion versus new customers. Anything shifting that you're seeing in the diversity of that pipeline, or just even the balance between new customers and existing expansion?

**Bill Fraine – GXO Chief Commercial Officer**
I spend a lot of my time, as you can imagine, on the road. And so I'll give you an existing customer and a new customer – existing customers, what they're looking for, always – and what we deliver, always – is continuous improvement: how do we lower cost, how do we improve efficiencies? How do they get to do more with what they've purchased from us, so, the site that they have? And so we are constantly working those with them and that is a plan that we start at the beginning of the year, and then we put targets together when we work through. It's why we're sticky with our customers.

And on the new customers, we have one of the tech customers that just came on with us, and they were working with a competitor. And their story with us is that, "we're amazed at how easy it is to collaborate and work with your teams." One, we're very seasoned in our leadership teams, from the site level on up. And then number two is the ease of implementation we go through, because these are very planned out. We do, as you can imagine, with a lot of selling, a lot of implementations. So, these are very planned out. We have a very specific implementation process we follow. We have a team that monitors that. We have project managers that monitor it. I sit on that, so do the senior executives of both Europe and Americas. So, we're in this all the time together, and they are just – they are very impressed with that.

So, that would be what I would tell you, is, the view of a customer – whether you are with us long-term or you are with us brand-new, what they see from GXO.

**Allison Poliniak – Wells Fargo**
Great. Thank you.

**Malcolm Wilson – GXO Chief Executive Officer**
Thank you.

**Operator**
Our next question comes from the line of Brian Ossenbeck with JPMorgan. Please proceed with your question.

**Brian Ossenbeck – JPMorgan**
Hey. Good morning. Thanks for taking the question.

Maybe another one for Bill. You mentioned I think about 40% of the new wins have some sort of reverse logistics returns in there. Is that helping you gain market share as well? And do you think that can actually accelerate when you get the full integration of Clipper underway, because I believe they have a pretty good product you might even be able to bring, in some shape or form, back to the U.S.?

And then maybe you can just wrap it up with the size of the returns business, because I think we haven't really heard an update on that overall size in a little while?

**Bill Fraine – GXO Chief Commercial Officer**
Yes. Let me start with the returns because it's a great question.

So, back about four years ago, we started with a large sports company on returns. And really, my opinion is, we changed the way returns are now operated in the marketplace. So, returns had always been, get a ticket back, get me to get my money back and buy another product, and then deal with the product that was coming back. What we started with was – how do we get most of these in-season product back into use almost immediately? That was really our focus. So, they were graded as A, B and C. So, our focus was more A in the market.

And that's what we have been able to do. So, we have been able to get more product back into the market quicker. When we get a truck to the door, it's usually five days until it's in a ready spot to go back out. And we do that by looking at demand planning. We look at the return authorizations, the Ras, as they call them. And we know, coming in, out of 300 trucks, what trucks have what we need right away. We then process that in that manner.

The second thing we did is, we built an e-comm center out of the back of the site. So, instead of having that in, to put it on a truck and ship it to a store, we are selling that product right out of the back of the site for the customer. And during COVID, we were their number one distribution center.

So, I am using that as an example because we take that example, we show it to new customers. And what's happening is, it used to be they would talk to us about their business and then they would look at returns later. We are now talking about them both at the same time, and that's why you see 40%.

And the last thing I will say on that is that is a very margin-rich environment to be in when you are dealing with returns. There is a lot of value for our customer there. So, there is a lot of ability for us to make money and to grow that. And I will let Malcolm talk to the percentage.

**Malcolm Wilson – GXO Chief Executive Officer**
Yes. Well, and thanks, Bill, I was just going to comment on Clipper, because I think Brian mentioned about Clipper.

Clipper in Europe, in fact, it's seen as a leader on the reverse logistics returns management. In fact, it's quite a reasonable percentage of their business. And it was one of the things that really attracted us, because it's not just the processes that we can master, but they have a number of suites of software that really assist on that. And we are looking forward to potentially making some synergy on that and bringing that across all of our business, not just UK, but across all of Europe. And in fact, across, where it's appropriate, actually bringing it back into our North American business. Returns is a really important and growing part of our business.

On the margin side, maybe, Mark, you can just cover off on that.

**Mark Manduca – GXO Chief Investment Officer**
Yes. Thanks, Malcolm.

Brian, on your question about percentage split on returns, it's slightly less than 10% of our business.

**Brian Ossenbeck – JPMorgan**
Alright. Great. Thanks for all that.

And then maybe a follow-up for Baris, with the FX not completely hedged, getting larger in Europe with the acquisition, can you give some sensitivities, I am assuming – I think you disclosed the current guidance that assumes flat FX rates from here. Do you have some sensitivities you could share, in terms of what that might mean to EBITDA if we see some continued FX volatility in the market?

**Baris Oran – GXO Chief Financial Officer**
Yes. For next year, roughly, if you are taking this average rate – FX rates for this year, roughly 1.04-1.05 EUR/USD, and 1.24 GBP/USD – which, we do have as much GBP business as EUR business – the impact year-over-year will be roughly $30 million,. And that's going to be balanced with the net new business wins, continuous improvement opportunities, as well as Clipper EBITDA and Clipper cost synergies.

And when you look into the sensitivity around that for next year, roughly every 1% makes about $2-3 million of impact for each currency, for EUR and GBP separately. But we are not too far away from those levels as we look into it right now.

And as we look into this year, our forecasts are built for roughly the current rates for the rest of the year. And the impact is much less, as about 80% of our exposure is hedged for the entire year.

**Brian Ossenbeck – JPMorgan**
Okay. Just to clarify, if things stay as they are now, there would be a $30 million headwind from currency next year? Is that on EBITDA? And then you would have some offsets from, as you mentioned, from Clipper and other cost synergies. Is that the takeaway?

**Baris Oran – GXO Chief Financial Officer**
That is correct. And $30 million if currencies are staying around 1.04-1.05 for the average of the year for EUR/USD, and 1.24 for GBP/USD, and that's going to be offset by Clipper, Clipper synergies, maturity of our contracts, and the continuous improvement opportunities.

**Brian Ossenbeck – JPMorgan**
Okay. Thanks for those details. Appreciate it.

**Operator**
Our next question comes from the line of Ari Rosa with Credit Suisse. Please proceed with your question.

**Ari Rosa – Credit Suisse**
Hi. Good morning.

So, as you mentioned, Malcolm, at the start, GXO is obviously a relatively new business as a standalone entity, but you guys have been in this industry for a long time. Maybe, as people think about a slowdown in the macro environment, maybe you could give some context on both how this business has performed in past downturns and how the broader industry has performed in past downturns. And specifically, I am thinking, I saw first-time outsourcings seemed to decline to 26% of new business, from 44% last quarter. And with the understanding that that number is likely to be lumpy, I am wondering if that trend on first-time outsourcing is maybe indicative of some hesitancy on the part of customers to, kind of, change their business model around as we are entering potential slowdown?

**Malcolm Wilson – GXO Chief Executive Officer**
Yes. Thanks for that.

Let me answer that in two ways. Let me address the latter part of your question first, in fact. I wouldn't read anything into that sort of quarterly statistic. I mean, the reality is, our sales pipeline moves around. We closed the quarter just over $2 billion. I think this week it's back up at, the number's like $2.3 billion. It's really a moving environment.

And it's the same situation in terms of the mix of business coming from existing customers or brand-new customers. What I'm seeing – and I mean, Bill's all over the point, because that's his line of focus – what I am seeing is, in fact, the sales pipeline really is populated by a good, healthy contingent of first-time outsourcing projects. They are still growing. We are seeing continuation of big companies deciding to outsource. And it's no wonder, when you consider just how much technology and know-how and experience is needed nowadays, to create a highly efficient environment. And the pandemic, I guess, has proven lots of people to want to rely less so, I guess, on people, and more on automation. So, I wouldn't read anything into just the quarterly statistics. So, there is nothing to see on that. It's more just that's how we landed in the quarter. Next quarter will be a different number again.

Then coming to your question about, well, how does our business behave in a more subdued market. The point is, the nature of our contracts mean that all the pass-through costs, etc., are very resilient. Our contracts are all struck with a strong governance. So, everything goes through to the customer from a cost-base point of view. But the reality is, if we were in a more subdued market, if the economy really slowed, what you would find, I'm sure, is that maybe our top line would slow a little bit. But our bottom line, in fact, would be very resilient, and that's just the function of the splits of fixed costs that go to customers, the way we recover management fees.

And in fact, I'm of an age and an experience where I do remember being through this in one of the European businesses that, in fact, came from the former XPO acquisition of Norbert. I remember that very vividly in 2008 and 2009. And exactly what I am describing is what we saw. We saw the top line stabilize, become a bit stagnant, even a little bit lower. Bottom line actually was very, very resilient. And the corresponding effects of that mean that, in fact, you stand less brand-new projects up, your free cash goes through the roof, the management that you have is focused intensely on the existing business, so, you tend to find a surge in margins. So it's kind of really a mixed bag.

Nobody wants a slowed market. But we are working in an organization which is well equipped to deal with if that was to happen. I think we are in a very resilient environment. That's why we talk so much about resilience, predictability.

Listen, we all hope that we don't have a slowdown. But if we were to, I think you would see a dynamic in this company that really is quite unique. And maybe not so much even it's an industry thing, because I think we do a particularly good job of the governance of our contracts and our contracting process.

Hope that gives you a bit of background, Ari. Sorry for the length of the answer.

**Ari Rosa – Credit Suisse**
No. That was terrific and really helpful historical context.

So, second question, I just wanted to ask, so the Clipper acquisition closed in May. Just wanted to get your early read – obviously, it's a little bit different kind of when you are looking at a business from arm's length versus after buying – after closing the acquisition. Just wanted to get initial impressions, since acquiring the business has it kind of met expectations? Has there been anything that surprised you? Has there been anything maybe that's been a little bit divergent from what you expected?

**Malcolm Wilson – GXO Chief Executive Officer**
Yes. Ari, let me come back in on that because, obviously, I know this company very well

having sort of formed the deal, together with the rest of the team here – Baris and myself, we are at the heart of it.

So, we closed the deal in May. We are in what we technically call, now, a hold-separate zone. That's where the CMA regulatory authorities do a review. That's going very well. No big issues on that at all at the moment. And we are expecting to have full clearance on that, hopefully, end of September. We would have hoped for a little bit sooner, but listen, it's a government regulatory body – and in Europe, August is a month where nobody is about, so. So, unfortunately, I suspect it's going to be end of September.

What we are able to do, though is, as Baris mentioned, we can see the numbers. We are also able to have certain amounts of discussion with Clipper management. So, what we have done is we have got to know all of the senior management team. They are all staying in – you know, we're in the process of organizing long-term deals for everybody – but they are all very committed. They are all absolutely looking forward to the integration process that will start.

One thing to call out – and Baris mentioned, I think, when he was doing the bridge – he called out 'Clipper net of synergies.' That's a this-year issue. And that's a management issue; that's a management decision, if you like – kind of, ultimately, it's my bag, inasmuch as, we're cognizant that if that CMA clearance is happening end of September, just like GXO, we're in mad peak season. You know, it's peak, peak, peak season. It's when all of our customers make the best of the year, and Clipper is no different. So, we will purposely not see big synergies in that last part of the year. We don't want to disrupt anything of that busy period for Clipper teams or Clipper customers.

So, but overall, no, our impression is very, very, very good. We are really looking forward to getting the process going. And synergies, you will start to see those commencing from the beginning of January going forward. Hope that gives you some color, Ari.

**Ari Rosa – Credit Suisse**
Yes, absolutely. That's terrific. Thanks so much for the time.

**Operator**
Our next question comes from the line of Bruce Chan with Stifel. Please proceed with your question. [pause] Bruce Chan, your line is live.

**Bruce Chan – Stifel**
Yes. Sorry about that, just on mute here. But good morning, everyone, and thanks for the time.

Just wanted to follow up on Clipper. You gave us some good color on the integration timeline, as far as commencement. But maybe you could offer a little bit of detail on what, kind of, the first steps might be in that process next year? And then maybe just a follow-up on the synergies. I am not looking for a number here, but can you highlight what you are seeing, as far as the big opportunity buckets for those synergies, in terms of margin improvement?

**Malcolm Wilson – GXO Chief Executive Officer**

Yes. Sure, Bruce. I will ask Baris to talk to the synergies. It's a financial point, and he can give you a lot of detail.

But what I would say is, I mean, when I say that we will commence the synergies from January. One thing, very important – I mean, synergies will start to integrate the business right from the get-go. I mean, cybersecurity, all the very, very important things that give business continuity, they will be up and running immediately.

Synergy aspects is where we are really starting to put both management teams together, and we are identifying best-in-class service, best-in-class process, and also, of course, buying power and buying scale, and that covers all aspects, from kind of database management, right, straight the way through procurement synergies. I mean, we are putting two very successful businesses together that are already doing a great job – but when you put sum of the two together, you will get a very, very good result.

Management is already engaged. But as I say, it's really from January where we will start the process and you will start to see those numbers kicking into our results. You will start to see them in quarter one.

Maybe, Baris, if you can just talk a little bit to the color of the values of the synergies. I know we kind of called them out as part of the deal, but maybe you can give a bit more flavor on that.

**Baris Oran – GXO Chief Financial Officer**

Sure, Malcolm.

We anticipate roughly $48 million of cost synergies by the end of the first 3 years of integrating Clipper. As you highlighted, these are including data center consolidation, procurement and further vertical synergies. This does not include revenue synergies that we will be looking into. The company has life sciences, repair and refurbishment, and sizable presence in Germany, which will help us grow much faster.

And Clipper is trading well and winning new business. But due to hold-separate requirements, we are unable to get into the greater level of detail.

As far as the timing of the synergies, on the cost synergies side, historically, the majority of the acquisition synergies related to costs are realized in the first 18 months of the year. Hopefully, that will help your modeling.

**Bruce Chan – Stifel**

Okay. That's terrific. Very helpful.

And then just a quick follow-up here, as you think about M&A through this process, are you still fully in the market? Are you putting that on hold a bit? And if not, are there any verticals or service lines that you are particularly focused on? Thank you.

**Malcolm Wilson – GXO Chief Executive Officer**

Bruce, it's Malcolm here. Clearly, Clipper represents – it's a big acquisition for GXO. It's our second – first one was Kuehne + Nagel. The management teams are already, I mean, they will integrate this business very smoothly and very successfully. But nevertheless, in the end, we need to digest that.

In terms of M&A marketplace as a whole, we're in a consolidating industry. We're a growth company. We have always said, great use of our capital is to put it back into our own business, where we are enjoying immense return on capital invested. Well, as you have seen in this last quarter, this is a company that throws off a ton of free cash. So, no doubt, we will look again in the M&A market. North America, I have to say, is probably our favorite market, lots of opportunities.

We will be very diligent: businesses that really bring a benefit into what we do today. We don't need scale – as you can see, we are not a business that needs to buy in extra turnover. We are growing at a great pace organically, and signing great customer contracts. But where businesses can bring new verticals, new services, these will be super attractive to us on the go-forward.

**Bruce Chan – Stifel**

That's very helpful. Thanks everyone.

**Malcolm Wilson – GXO Chief Executive Officer**

Thank you.

**Operator**

That is all the time we have for questions. I would like to hand the call back over to Malcolm Wilson for closing remarks.

**Malcolm Wilson – GXO Chief Executive Officer**
Okay. Thanks Doug, and thanks for managing the call so well, I appreciate that.

And thanks for all the very great questions from all the people asking questions this morning. We have really enjoyed the call – we're a bit over time, that's how much we have enjoyed it! – but it's been a great call. I just want to say a few words from my side. Really, on behalf of myself and all my colleagues – and in a way, I am kind of speaking for the whole 120,000 people that work in this business.

First and foremost, you might have detected on this call, this is a company that's managed, really, with hands-on approach. Everybody who is on the call today is sleeves-rolled-up management. We are present in the business. We were all present, recently, in North American High Point headquarters. I think really a celebratory day, really congratulating our teams. It's our business approach. We are very 'in the business.'

The company, in all its regions, across all of its verticals, is doing really well. We are very, very proud of that. This quarter is marking our fourth earnings release of strong performance. That's including record organic growth, a record amount of new business wins, as well as consecutively increasing our EBITDA and cash flow, every quarter, year over year. After our first year, we are just getting into our stride.

So, thanks everybody for joining the call. Thank you for the support that you are giving to GXO. And with that, we will close the call. Thank you again.

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