GXO Q3 2023 Earnings Call

November 8, 2023

GXO Logistics Q3 2023 Earnings Call

Presenters

Malcolm Wilson – Chief Executive Officer

Baris Oran – Chief Financial Officer

Adrian Stoch – Chief Automation Officer

Q&A Participants

Stephanie Moore – Jefferies

Chris Wetherbee – Citigroup

Scott Schneeberger – Oppenheimer

Christyne McGarvey – Morgan Stanley

Brian Ossenbeck – JP Morgan

Amit Mehrotra – Deutsche Bank

Jason Seidl – TD Cowen

Operator

Welcome to the GXO Third Quarter 2023 Earnings Conference Call and Webcast. My name is Daryl, 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 the Company's guidance:

- During this call, the Company will be making certain forward-looking statements within the meaning of applicable securities laws, 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 the extent required by law.

- The Company also may refer to certain non-GAAP financial measures as defined under applicable SEC rules during this call. Reconciliations of such non-GAAP financial measures to the most comparable GAAP measures are contained in the Company's earnings release, and the related financial tables are on its website.

- Unless otherwise stated, all results reported on this call are reported in United States dollars.

- The Company will also remind you that its guidance incorporates business trends to date and what it believes today to be appropriate assumptions. The Company's results are inherently unpredictable and may be materially affected by many factors, including fluctuations in foreign exchange rates, changes in global economic conditions and consumer demand and spending, labor market and global supply chain constraints, inflationary pressures, and the various factors detailed in its filings with the SEC.

- It is not possible for the Company to actually predict demand for its services, and, therefore, actual results could differ materially from guidance. You can find a copy of the Company's earnings release, which contains additional important information regarding forward-looking statements and non-GAAP financial measures, in the Investors section on the Company's website.

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

Malcolm Wilson – GXO Chief Executive Officer

Thank you, Daryl, and good morning, everyone.

With me in Greenwich today are Baris Oran, our Chief Financial Officer; and Adrian Stoch, our newly appointed Chief Automation Officer – a first for GXO. We're excited to have him update you on our Automation strategy and how it will lead to further growth and higher returns for GXO.

Turning directly to the third quarter. We are pleased to report that we've delivered record revenue of $2.5 billion, growing 8% year over year, of which 3% was organic growth. We've talked to you many times about the resiliency of our business model, and we're demonstrating just how beneficial that is proving to be this quarter. While the macro environment is uncertain, we're performing strongly in those areas where we do have control: new business wins, profits and free cash flow. Baris will give you more detail on our updated full-year guidance in just a moment.

Our adjusted EBITDA grew to $200 million, and our adjusted diluted earnings per share was $0.69, both coming in above expectations. On top of that, a few weeks ago, we closed the acquisition of PFSweb, and the incremental benefit during the last part of the year allows us to raise both our adjusted EBITDA and adjusted diluted earnings per share guidance for the third time this year.

Our results this quarter demonstrate two key strengths of our business. First, it illustrates that our model is working exactly as it's designed to. We're effectively managing all aspects of our long-term contractual business to deliver consistent margins and drive adjusted EBITDA growth. Second, it shows an acceleration of the structural trends that are driving our growth. Customers are coming to us more than ever, and our value proposition for them is only growing stronger, as they look to us to drive improved productivity, optimize their working capital, and improve their service to their ever-more-demanding end consumers.

This is clear from our new sales wins and our pipeline. We closed over $180 million of new sales wins in the third quarter, nearly half of which came from companies outsourcing their operations for the first time. These fantastic customers included Carlsberg, Daikin, Farfetch, Soda Stream and Versace – and, in October, we began an exciting new partnership with The Quality Group, a great win for us in Germany. These customers join the exceptional blue-chip brands that continue to rely on GXO for their logistics needs.

Also, in the last couple of weeks, we've entered into a significant new long-term contract for a fully automated warehouse project with a leading global sporting brand. We're thrilled to partner with this brand to enable their long-term growth ambitions across both e-commerce and retail. We're positioning the brand to optimize their inventory and costs by leveraging GXO's industry-leading expertise and technologies. Adrian will provide more detail on exactly how we do this for our customers in just a moment: it is exactly why we created this new role of Chief Automation Officer.

We're not only proud of our results this quarter, but also excited by what's ahead. We've secured more than a half-billion dollars of new business for 2024, tracking ahead of where we were at this point last year. Our average contract length remains strong at around five years. GXO is winning market share from our competitors. Our total new contract wins in the quarter are up 15% year over year, even after our record-setting second quarter. Our pipeline remains solid at around $2 billion. It's distributed evenly across our operating geographies, and it's well diversified across both consumer and industrial verticals. We're excited by the opportunity to continue to grow our market share.

I mentioned earlier that one of the key milestones this quarter is the acquisition of PFSweb, a premier e-commerce fulfillment provider based here in the U.S.

PFS serves over 100 of the world's most iconic brands, including L'Oréal, Pandora, Procter & Gamble, Yves Saint Laurent and the U.S. Mint. It has a great track record of profitable growth from its premium service offerings.

We believe the combination of GXO and PFS strengthens our book of business by bringing exposure to key growth verticals, including health & beauty, jewelry, and luxury goods. PFS continues to deliver robust growth and is winning great new contracts with brands like Glossier. We'll build on this momentum, and we'll leverage PFS's vertical expertise to complement our existing business and grow into the massive addressable market on a global basis even faster.

We celebrated closing the transaction with the PFS team in Dallas the week before last, and the level of excitement was palpable. On a personal note, I'm delighted to be working with this team. Like GXO, it's clear that the high caliber of their people is why PFS has been able to build such an incredible business.

And, lastly, on that note of people – we're proud to have won numerous awards for employee satisfaction and inclusion this quarter. I'm very pleased that our constant efforts to create the best possible workplace for our people, and to make GXO the employer of choice in our industry, are being recognized.

In summary, we're confident that we're positioned to capitalize on the immense growth potential within our industry and the continuing tailwinds of automation, outsourcing and e-commerce.

Now, I'll hand it over to Baris to walk you through the numbers and our updated guidance.

Baris, over to you.

Baris Oran – GXO Chief Financial Officer

Many thanks, Malcolm, and good morning, everyone.

This quarter, we've delivered a strong set of results, including great new sales wins, resilient adjusted EBITDA, and, finally, outstanding free cash flow conversion.

As Malcolm mentioned, we delivered a record $2.5 billion of revenue in the quarter. This represents 8% year over year growth, about 3% of which was organic. Our topline performance clearly reflects the impact of near-term macro headwinds on customer volumes, and, as we've highlighted in prior quarters, all other areas of the income statement reflect the incredible stability of our business and our continued strong management execution.

Our operating income was up 25% year over year in the third quarter. We delivered adjusted EBITDA of $200 million. We are delivering consistent adjusted EBITDA margins as a result of our resilient business model, despite a headwind of 90 basis points from pensions and FX hedges. And they have improved 20 basis points sequentially since the second quarter, while these headwinds have increased. This margin strength is driven by our continued focus on cost discipline, specifically productivities we are driving in our site-level operations and in our central efficiencies initiatives.

We've also delivered net income attributable to shareholders of $66 million and adjusted diluted earnings per share of $0.69.

Our return on invested capital was, once again, robust at well above 30%. Our accelerating new business wins year over year highlight the ample opportunity for our business to continue to reinvest and generate these levels of returns in the future.

I would like to particularly highlight our free cash flow, which was a record $191 million for the third quarter, helped by strong cash collections and methodical deployment of capital. We are on track to deliver our free cash flow conversion target of approximately 30% of adjusted EBITDA for the full year.

We've reduced our net leverage to 1.6x as of September 30th. We have no debt repayments due in 2024. Our balance sheet remains rock solid and investment grade after our acquisition of PFSweb, and we expect to end the year with net leverage of around 1.7x.

On PFS, I'd like to take a moment to welcome our new colleagues. The strength of talent of this team is just phenomenal. We are thrilled to have completed this deal. Plans to accelerate our growth together are already underway, and, as Malcolm mentioned, we believe this is positioning GXO for continued and accelerated growth.

Our acquisition of PFS exemplifies our approach to M&A. We're highly selective in our choice of targets, and we've established a track record of pursuing companies that bring opportunities to expand our presence in key markets and further enhance our offerings for new and existing customers.

In PFS, we've bought a double-digit growth trajectory at a very attractive valuation. Going forward, we will continue to deploy our excess cash in the best interests of our shareholders – which includes either share buybacks or accretive M&A.

Turning to the full year: you'll see that we're revising our full-year 2023 organic revenue guidance from 6-8% to 2-4%.

For this holiday season, we are seeing lower customer volume growth than anticipated, particularly in consumer-focused sectors. In many cases, and in contrast with last year, the global brands we're serving are prioritizing pricing over volume. This is resulting in a more uncertain peak. In addition, some seasonal Christmas pop-up projects will not recur this year, because of lower customer volumes. This is a one-off impact in the fourth quarter, causing our organic growth to be softer.

Our adjusted EBITDA and free cash flow remain robust due to the structure and predictability of our customer contracts, which help to insulate our financial performance from volume swings. The incremental benefit from our acquisition of PFS gives us the confidence to upgrade our full-year adjusted EBITDA guidance to $730 million to $755 million. We're also pleased to upgrade our guidance for adjusted diluted earnings per share, to $2.55 to $2.65.

And finally, following our record free cash flow results this quarter, we're reiterating our full-year free cash flow conversion target of approximately 30%, as well as our return on invested capital target of above 30%.

Looking ahead, our long-term growth is underpinned by our continued new business wins. This reflects the value of the services that we're providing to our customers, helping them to manage their businesses more efficiently in the current environment.

We've won $841 million of new business year to date. We've got $520 million of incremental revenue booked for 2024, and nearly $200 million of incremental revenue booked for 2025. In the third quarter, almost half of our new business wins were outsourcing. We're making more headway into our half-trillion-dollar total addressable market.

At the same time, we continue to produce profits and cash flows throughout the cycle. Our margins are resilient, and our free cash flow conversion is rock solid. We will continue to manage GXO with a rigorous focus on contract governance, cost discipline and capital allocation to serve the interests of both our customers as well as our shareholders.

And now I'll pass the mic over to Adrian, who was named as our first Chief Automation Officer in July. He'll brief you on one of our most important levers for growth and value creation: our automation strategy.

Over to you, Adrian.

Adrian Stoch – GXO Chief Automation Officer

Thanks, Baris. Good morning, everyone.

I’ve been at GXO for over two years, and I’ve been working in supply chain and operations for more than three decades. I moved into my role as Chief Automation Officer last quarter. I’ve had the pleasure of meeting some of you during site visits while I was in my previous role as head of our North American Consumer division.

Today, I would like to put some texture around our automation and AI differentiation, as well as how we’re going to accelerate our existing strategy. By unifying our global technology agenda, we will shape the future of the industry, drive better outcomes for our customers, and improve our employees’ experience.

GXO is already the market leader in supply chain automation. Today, about 30% of our revenue comes from automated operations, vs. the industry average of less than 10%. Additionally, we’ve accelerated our deployment of post-go-live adaptive tech, and this has increased the proportion of our revenue from these sites from 5% a year ago to 11% today. The overall amount of tech actively deployed across our footprint has increased by almost 70% year over year. At every site where we deploy this technology, we provide outsized benefits to our customers. As a result, we grow faster, increase our market share, and deliver margins of 200 basis points higher than the group average.

We are at a critical inflection point in the automation of warehouse operations. Up until now, the focus has been on automating tasks that are repetitive, laborious and require heavy lifting. Because significant advancements have been made, today we have multiple finely tuned solutions that can address this problem. The vision of what’s ahead is what is truly exciting. The next phase of automation includes seamless integration of existing discrete solutions, combined with AI to solve significantly more complex problems than merely replacing manual tasks. This will enable operations to be performed faster and more reliably, and free up workers to focus on the value-added services that are critical to our customers’ dynamic and complex supply chain needs.

Let’s bring this to life.

In my previous role, we conducted a major site retro-fit for a household-name apparel retailer, where we implemented several additional technologies that transformed the warehouse into a completely integrated end-to-end flow. This increased productivity, reduced cycle time, improved our safety performance – which is already well above industry average – and drove an overall reduction in costs per unit of 18%. It was a game-changer for the customer and, without question, deepened our partnership.

While the Consumer team led this specific example, there are myriad other successes just like this across our organization. Part of my mission is to unify our efforts and deploy technology that optimizes each of the core warehouse process paths. We will create global standards and best practices which will accelerate deployment and ultimately lead to better margin performance. This is the embodiment of continuous improvement that has been the cornerstone of my operations experience, and now I’ll bring this philosophy of CI to automation.

In tandem, we’re partnering with innovators across the globe to guide and validate their solutions. In multiple sites within the Consumer division, we’ve successfully deployed AI, combined with a goods-to-person robotics solution, to increase the number of barcodes travelled by around 5x per bot stop. This increased productivity tremendously, resulting in significant value creation for the customer and a huge step-up in ROI. The opportunities that AI unlocks for warehouse automation are staggering, and we are partnering with hardware and software vendors alike to identify the most suitable platforms to meet our customers' needs.

In addition, we have been the first to adapt mature solutions from other sectors into the logistics industry. For example, we implemented a high-volume, high-precision storage and retrieval solution that was originally developed for the pharmaceutical industry and adapted it for a specific customer's needs in consumer electronics.

The financial benefit of everything I've just described is extremely compelling, but there's a multiplier effect from the results we drive that also includes [improved] cycle times, quality, reliability, agility and workforce safety.

This intersection of tech and operations is the secret sauce that makes us the partner that our customers turn to. And they are doing so on an increasingly global basis. My role in all of this is to identify, prove and accelerate the right technologies to address our customers' needs. In turn, we will grow our 2% market share in this half-trillion-dollar industry.

I look forward to updating you all on our progress.

And with that, I'll hand you back to Malcolm.

Malcolm Wilson – GXO Chief Executive Officer

Thanks, Adrian.

We're very pleased with our performance this quarter. Against a softer macro, our teams have delivered substantial contract wins as well as strong and predictable adjusted EBITDA and free cash flow, and we've closed another great acquisition. As a result, we've raised our profit guidance for the third time this year.

Our mission remains to enable our customers to run their businesses more efficiently and cost effectively. We are succeeding, and we're also growing our market share.

Our heightened focus on automation will help fuel our growth and bolster our resiliency. And we'll continue to optimize our operating model, drive high returns, and allocate our capital in the best interests of our shareholders.

With that, we'll hand the mic back to Daryl and transition to Q&A.

Question-and-Answer Session

Operator

Thank you. We'll 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 your line is in the question queue. You may press star-two if you would like to remove your question from the queue. And for participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for your questions.

Our first questions come from the line of Stephanie Moore with Jefferies. Please proceed with your questions.

Stephanie Moore – Jefferies

Hi, good morning. Thank you.

I was hoping you could just help us understand what about the macro changed since we last spoke to drive kind of such a material cut in organic growth guidance for the year.

Or have you been seeing some of these kind of moderating or temporary trends really since the first quarter? I'd love to get your thoughts there. Thanks.

Malcolm Wilson – GXO Chief Executive Officer

Hi, good morning, Stephanie. It's Malcolm here. Let me give you first the big picture and then more detail.

So, when we look at the regions that GXO is working in, our Continental European business, so the big countries – France, Netherlands, Spain and Italy – are actually doing okay. We've seen a slight recovery and going well. Our U.K. business, we think that's probably at about the bottom and actually some early signs of green shoots. And here in North America, we think we're quite close to the bottom. So that's the kind of macro picture that we're seeing.

For this last quarter, it's interesting. We've delivered organic growth across every single region, and that's despite a clearly softening in the consumer macro environment. We can see in some of the verticals that we work in – technology, aerospace, food services – actually, they're in a good trajectory. They're doing quite well, but that's countered by definitely a slower, a softer consumer-related business.

If we think about our Q4, what we expect to see looking ahead, we're not expecting to see many of the seasonal pop-up type of short-term warehousing activities that we've seen in previous years. We think that's a consequence of inventory levels generally normalizing and actually how many of our customers are approaching the holiday season.

We've seen that several of our customers are choosing to focus on holding price vis-à-vis a kind of volume type of environment. And we're also hearing that evidence that the consumer themselves, they're putting off holiday shopping. They're looking later into the season for maybe bargains and so on.

We should contrast that, though against very, very strong sales, quarter three very strong sales, $181 million, that's up 15% year over year. And as we mentioned in the call, quarter four, it's off to a great start with a new, very long-term, fully automated contract in its life of contracts worth around $1 billion.
So, we're very, very pleased about that.

In all the areas where we do see softer trading, it's also worth to remember that the contract model that we have – we've often talked about the resiliency of our contract, the pass-through of inflationary pressures – that's protecting us and it's allowing our profitability to remain very good. And you see that, in fact, in the guidance that we've just been talking about.

This uncertain macro, it's kind of an environment where GXO thrives. It really helps us to better demonstrate to our existing customers, but importantly, new customers – remember of $180 million, roughly half of that was coming from new first-time outsourcing customers and they're benefiting from working with GXO. They're benefiting from how we help them improve productivity, improve their services. We're transforming operations for them, and technology is playing such a big part of that. I'm so pleased now that we have Adrian in his new mission, and I hope you'll hear from him later in the call.

And then the last thing I would say, just a couple of interesting points, but nevertheless, it's a summary of the environment. Wage inflation is really moderated. We're seeing that wages pretty much have caught up to the broader inflation. That's helping the consumer. And the last point I'd say is we're seeing equally in the real estate environment, it's really kind of moderated. We're not in the difficulty as we would have been six months ago of having to look long and hard to find real estate. It's a much easier market.

So, all of that, as we see the picture right now, as we will be exiting Q4, a lot of these kind of one-off type of impacts that we're seeing right now, we think will recede, and we should go back to a growth environment in the first half of next year.

Stephanie Moore – Jefferies

Got it. I really appreciate all the incremental color.

Just as a quick follow-up, and you kind of touched on this a little bit, I'm trying to understand the raise in the EBITDA guidance for the year and kind of the puts and takes, despite the cut in organic growth. It sounds like FX was a little bit worse. So that's likely, but that's slightly being offset by the PFS acquisition.

So maybe just talk about what were kind of the underlying drivers to still be able to raise the low end of that EBITDA guidance on this core business.

Malcolm Wilson – GXO Chief Executive Officer

Stephanie, let me ask Baris to come in on that.

Baris Oran – GXO Chief Financial Officer

Sure, Malcolm.

In Q4, our margin will continue to expand, excluding FX and pension headwinds. As you would recall, these were roughly about $15 million per quarter. We expect to continue moderate margin expansion, excluding FX and pension in Q4, and this company is delivering on our promises as we highlighted many times in the past, even when the volume comes down, we continue to generate profits and cash flows due to our strong contract governance.

Furthermore, we will have low single-digit contribution million dollars from PFS in Q4. We have been getting a lot of headway into our integration and restructuring benefits, and they will contribute even more into Q4, getting into a $40 million at the end of the year as we start into next year, that's going to be helping our next year operating profitability. The impact of those in Q4 will be roughly about $10 million incremental versus the prior year.

So, all in all, contracts are working well. Productivity benefits are delivering its promises, and even in this volume environment, we will continue to deliver strong results.

Stephanie Moore – Jefferies

Great. Thank you.

Baris Oran – GXO Chief Financial Officer

Thank you.

Operator

Thank you. Our next questions come from the line of Chris Wetherbee with Citigroup. Please proceed with your questions.

Chris Wetherbee – Citigroup

Thanks, good morning, guys.

Maybe picking up on that last question, particularly around the fourth quarter and the EBITDA guidance, I think normal seasonality the last couple of years has seen EBITDA accelerate from 3Q to 4Q. I know there's a range here, and I think there's a lot of factors kind of at play, but the range bookends the third quarter, both up and on the downside.

So, could you talk a little bit about how you think this might play out? And what sort of would be the factors potentially offsetting that normal seasonal uplift that you have? I think you've talked a little bit about some of the seasonal activity maybe not being quite as good, but a little bit of a finer point on it that would be great.

Baris Oran – GXO Chief Financial Officer

Hi Chris, this is Baris here.

I mean, first is the organic revenue growth. As you've seen, we are now seeing organic revenue growth guidance of 2% to 4%. We delivered 3% in Q3, but heading into Q4 we do see headwinds coming from these reduced pop-up activities, slower ramp-up of new facilities, and more importantly, reduced volume from existing facilities. All of this is balanced by with our business wins and inflation and pricing pass-through. That's on the top line.

On the margin side, we continue to deliver steady EBITDA margins. And as I highlighted, we're going to be providing a slight uptick in our margin, excluding FX and pensions, and that's expected to be a headwind of $15 million into Q4. And we see roughly $10 million benefit coming from the productivity projects we had, integration benefits and restructuring that we have done.

As you recall, we took a number of initiatives this year, including on procurement side, outsourcing of noncore activities. We eliminated roughly 10% of our nonoperational, noncustomer serving staff, reduced the layers in our organization, increase the span of control – basically, meaning more people report to a person. That's the definition of span of control. So, all of these are delivering results in Q4 and helping us go through this lower volume environment.

But at the core of this is our contract structure. Just like we told you about a year ago, how our contracts would operate, would perform in a down cycle, you'll see that in our operation.

Chris Wetherbee – Citigroup

Okay, that’s helpful. I appreciate that incremental color.

And then maybe stepping back a little bit and beginning to think about 2024. Obviously, organic revenue growth is decelerating, but it does appear that the pipeline of new business opportunities remains relatively stable. So, as we think out to 2024, are you seeing any deceleration in terms of incoming interest from the customers about signing up new business? Do you expect the pace of new contract awards to be roughly the same as we start to turn the corner into 2024, can that accelerate? Or is there going to be some economic pressure on that?

Malcolm Wilson – GXO Chief Executive Officer

Chris, it's Malcolm here. Let me give you some color on that question.

So, in fact, as we mentioned earlier in the call, pipelines remained around $2 billion. What we are seeing is our pre-pipeline is actually increasing. So, pre-pipeline for us is where we're receiving projects in – can be from existing customers, it can be from brand-new customers, new brands. That's actually increasing. So, that's a good sign. That bodes well, I think, for the year ahead.

And also, what we're seeing is our ability to convert from the pipeline into closed-won new business is actually also improving. And that's a function of the different works that we have underway within our sales organization to actually improve our actual process with customers.

A couple of quarters ago, we did actually see a momentary kind of hesitation from customers about making decisions. But you have to remember that, in fact, quarter two, it was actually a record of new business signings. So, it was kind of a little bit disguised, but we definitely, our sales teams, were reporting to us just a little bit of hesitation. That's gone. We're not seeing that now at all and our pipeline, I think it's a very healthy pipeline; good proportion of very long-term big projects, big automation projects, as we mentioned, this $1 billion deal that we've just signed. I'm sorry, we can't share the customer name, but I hope we will do on our next call.

So, there's a healthy proportion of those kind of deals and need of deals for sort of '24. So, it's a good pipeline as we see it right now. And nothing that we're seeing from our customer base or the market is giving us any feel that that's going to change as we progress forward.

Chris Wetherbee – Citigroup

Okay, great. Thanks for the time, I appreciate it.

Malcolm Wilson – GXO Chief Executive Officer

Thanks, Chris.

Operator

Thank you. Our next questions come from the line of Scott Schneeberger with Oppenheimer & Company. Please proceed with your questions.

Scott Schneeberger – Oppenheimer

Thank you very much. Good morning, everyone.

I'm going to focus a bit on acquisitions.

Malcolm, could you please discuss, for PFSweb, the attributes that really drew you to the business? Are there any synergy opportunities that you see? What type of integration duration are you anticipating for this? And what's the combination of them in the portfolio going to look like for you? Thanks.

Malcolm Wilson – GXO Chief Executive Officer

Sure, Scott.

Well, listen, it's a great customer-based organization, and we've acquired a super company and at a very attractive valuation. So, it's going to allow us to accelerate the PFS business itself. We will be able to leverage our own scale into the Company. And it's also going to allow us to leverage all of the very specialized blue-chip customer relationships that they have on a more global business. PFSweb is a double-digit growth business. I think it shows very well the strategy that we've had where we've been very selective from an M&A perspective.

We've always talked about what is a good M&A for GXO. Well, it's a company with really strong, good management, good market position either allowing us to enter into a new geographic area or allowing us to enter into new verticals.

So, this business, roughly around $220 million service equivalent of revenues, $20 million of adjusted EBITDA a year, in our fourth quarter we have this business since late October. So, it's a limited impact in 2023, but really coming with a number of specialized, high-touch, fulfillment-type services in really very attractive verticals. So, health and beauty, jewelry and collectibles, prestige kind of luxury goods. And some of the customers, I mean, wow, they are just incredible: Chanel, L’Oréal, Shiseido, Tiffany and Pandora. I mean, I get excited every time I read the customers.

And the last thing I'd say is it's a really super company – great management. Myself, Baris and several of the management team, we were down in North Carolina having one of our own business meetings with our own teams. Several of the PFS team joined the other week. We then also joined down in Dallas and met the entire team. I'm really stoked. I'm ever so excited about what's lying ahead and the top line synergy and just the absolute opportunity of us growing this business on the North American footprint, which is really the core of the business, even though they do have small activities outside of North America. We're very excited. It's a great deal.

Scott Schneeberger – Oppenheimer

Great, thanks.

And Malcolm, what is – or maybe, Baris – how are you thinking about – or how should we think about the M&A pipeline right now? Is there a lot that's ripe? Should we see more of this similar size maybe over the coming 12 months? Or is there going to be a digestion period on this? And just as a side question on that, any update on Clipper integration progress that's quantifiable that you'd like to share? Thanks.

Malcolm Wilson – GXO Chief Executive Officer

Yes. Scott, let me hand you over to Baris to cover on those topics.

Baris Oran – GXO Chief Financial Officer

Sure. We have acquired a great business growing at double-digit rates with fantastic customers and great proposition to the end consumer. I mean – and all of this at an attractive valuation. So Scott, this is more of the type of M&A we would like to do.

We have a strong pipeline of M&A right now in a different range of verticals and geographies. We're interested in Germany, North America are quite interesting. We'll be looking into growing in these locations.

But at the core of this is creating value for our shareholders. We'll always weigh it against investing in our own company through a buyback.

So, valuation is important for us. Opportunities for growing these enterprises faster under GXO is very important for us. In fact, with PFS after the acquisition, we already started working on a number of ways we can even accelerate the growth of PFS into new geographies. We are very excited.

Malcolm Wilson – GXO Chief Executive Officer

And Scott, just to finish off. On the Clipper aspect, I mean, for us, to be frank, it's broadly completed. The integration has been a big success, and now, we're very pleased in the context of how that business is moving forward.

If you remember, we used Clipper as a foothold in the German market where GXO, we're incredibly really, we're small. And when we put our business together with Clipper's, that really gave us for the first time a footprint and we're now capitalizing on that. We've recently opened a state-of-the-art facility at Dormagen. We talked earlier on the call – The Quality Group in Germany. It's one of the first big wins that's going into that site. We've got other facilities in the plan. And we've just launched our GXO Service business in Germany.

So, really, that also – it's been a very successful M&A for us. And with all M&As, we should never lose sight of the fact that the secret of success is a good deal, but also great management execution on the integration. And I'm sure that combined with the PFS team, equally, that will be a very successful integration as we move over the next few months.

Scott Schneeberger – Oppenheimer

Sounds good. Thank you, both.

Operator

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

Christyne McGarvey – Morgan Stanley

Good morning, this is Christyne McGarvey on for Ravi. Thanks for taking my question.

I want to switch gears a little bit here maybe and ask on the strategy – really the evolution of the strategy – as we look forward. I think the first one on this front may be for Adrian.

I appreciated your comments at the start of the call, but just digging in a little bit more. I was hoping you could parse out how you see the role of automation in GXO's strategy as you look forward over the next couple of years, and how that's differed maybe from history here? And if you could talk a little bit about how much of the focus you think is really on revenue or customer acquisition versus cost for automation and robotics, et cetera?

Malcolm Wilson – GXO Chief Executive Officer

Christyne, it's Malcolm here. Let me just say a short point before handing over to Adrian.

So, Adrian mentioned earlier, he's been in our business a couple of years. He's been really at the forefront; he's been one of our key leaders in our North American business over that period of time. And in that window, he delivered consistent improvement for our customers in terms of efficiency, productivity, and importantly, GXO results. That's very important because he brings a practical way of figuring out what is the right automation to use in the right solution.
So, we're very pleased that he stepped into this new mission. It's really his role, we have to remember back to January when we undertook our Investor Day, his role is absolutely a reinforcement of our strategy about accelerating the tech deployment across our business: good for margins, good for customer retention, it continues to allow us to be a leader of the environment when it comes to automating the warehousing space.

So, very pleased to have Adrian in the role. Adrian, over to you.

Adrian Stoch – GXO Chief Automation Officer

Thank you for the kind words, Malcolm. And thank you Christyne for the question.

Before I address the strategy part of it, I just want to share about my philosophy when it comes to how I approach the question of automation. I don't look at the automation opportunity through the lens of the robots per se. My operational perspective is focused on how to solve complex problems and design the best solutions that bring value to our customers and deliver ROI.

And so that gets me to specifically answer your question, Christyne, is the automation agenda, is it about revenue? Is it about margin? Is it about customer acquisition? The answer is all of the above.

What we've seen in Q3, even with the macro and the headwinds is that the GXO thesis on our automation differentiation is proving to be positive. And I saw it in my previous role multiple times with the positive impact of not only launching sites that are highly automated, but then using our adaptive tech where we go in after a site is already live and implement additional technologies to further integrate and bring efficiencies. So, it is our differentiation, and it is in the interest of all three of the items you mentioned.

Christyne McGarvey – Morgan Stanley

Great, thank you. That's really helpful. Thank you both.

Maybe I'd like to just ask one to round out some of the M&A conversation, as being kind of a strategic focus. As you look forward, do you think the pace of acquisitions that we've seen from you in the last couple of years post spin is kind of what we should expect from GXO going forward? Or do you feel like it's just been a function of the opportunities that you've seen? Do you think it could pick up the pace? Just curious, more broadly, how you think of M&A as fitting into the strategy going forward and the pace at which you think you might operate on a go-forward basis?

Baris Oran – GXO Chief Financial Officer

Sure, this is Baris. Let me take that.

It basically depends on the cash generation we have. How much room we have – staying within the investment grade balance sheet – that's first. Secondly, the opportunity set. And third, how does it compare to investing in our own stock. Those will determine the pace and the size of M&A execution in the company.

But today, the environment we're looking into is more like bite-size, capability-enhancing, geography-enhancing M&A transactions instead of transformational M&A transactions, and we are always mindful that our stock – investing in our stock – is an option for us.

Christyne McGarvey – Morgan Stanley

Great, thanks guys.

Baris Oran – GXO Chief Financial Officer

Thank you.

Operator

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

Brian Ossenbeck – JP Morgan

Hey thanks, good morning.

So, wanted to ask, Baris, if you can just come back and follow up on the reasons for the EBITDA update and upgrade here. It sounded like PFS maybe had a bigger impact, but I think in some of the commentary it sounds like it was fairly small. So, I just wanted to see if that was a driving factor for the EBITDA increase here.

And then maybe for Adrian, when you think about the 200 basis point margin upside for automation, I know you touched on it briefly just now, but do you see that going higher over time as you get better at value-added services? Or do you think that actually accelerates the growth and helps tap the addressable market maybe a little bit faster?

Baris Oran – GXO Chief Financial Officer

Hi Brian, this is Baris here.

On the EBITDA upgrade, PFS contribution was low single-digit millions of dollars. It basically shows the resiliency of our business model. And despite volume headwinds and FX and pension headwinds, this business is delivering a steady, slightly improving margin expectation in Q4, excluding FX and pension.

So, we are looking into proving yet again how strong this business model is. But those are the components. Our operating profits increased in Q3 and operating productivity projects – number one. PFS small contribution – number two; against volume headwinds and FX and pension headwinds. But all put together with the resiliency of our contract structure. Adrian?

Adrian Stoch – GXO Chief Automation Officer

Hey Brian, this is Adrian. Thanks for the question.

So, in terms of the 200 basis points and do I see further opportunity? I do both from a growth acceleration perspective, but also in terms of margin improvement.

I'll give a specific example. So, we recently piloted and we're still in the pilot phase, but seeing significant benefits from an AI program on being more predictive with respect to labor planning in a site where we've been able to be more precise by a factor of close to 5%.

And so, the reason why I'm very optimistic on the ability for automation and AI to help improve our margins and our efficiencies is because when we have a successful pilot, and there's many of these, this is just this is one example I am mentioning. We have the opportunity to then standardize and take it to our global sites – close to 1,000 sites. So absolutely, I do see it both as a growth lever and a margin improvement lever.

Brian Ossenbeck – JP Morgan

Thanks, Adrian. Maybe one more for you in terms of the site level operations. I think there has been an area of improved performance here in a softer backdrop.

So, you mentioned some of the post go-live implementations. Maybe give a little bit more color in terms of how that's progressing. Is this more of an opportunity to fill in some of the growth that was pretty fast over the last couple of years, and so, this is kind of an outsized opportunity that you're collecting on now? Or is this sort of what we should think about more so going in the future when a site ramps up, you can actually go back in and potentially add more margin uplift after the fact?

Adrian Stoch – GXO Chief Automation Officer

Yes, it is a significant opportunity, Brian. And we've been very active on this program that we call adaptive tech.

In the deck, actually on Slide 11, it describes how we've increased the number of technology units by 67% year over year, and this has predominantly been through our adaptive tech program. And so, some examples in the space are wearable tech, collaborative robots, vision technology. It doesn't really matter whether the site is manual, partially automated, or highly automated. There is always opportunity for continuous improvement through the adaptive tech program. And part of my remit is to formalize and standardize our best practices and where we've seen ROI in existing implementations is to take those to other sites. So, I see this opportunity as very compelling and extremely significant.

Brian Ossenbeck – JP Morgan

Okay. Thanks very much, Adrian.

Operator

Thank you. Our next questions come from the line of Amit Mehrotra with Deutsche Bank. Please proceed with your questions.

Amit Mehrotra – Deutsche Bank

Thanks. Hey guys. I guess for my first question, I want to double-click on that organic growth discussion at the beginning of the call.

So, Malcolm, I want to understand a little bit better – the organic growth is basically going to be zero in the fourth quarter, but you won a bunch of contracts, including the Sainsbury’s contract, which I think was your highest win ever, that is being realized right now. So, the cross currents are that, obviously, the base business is declining significantly, either because of volume or churn.

And so I'm just trying to understand, is churn going up? It would intuitively make sense to me that churn would go up in the environment that we're in, but I don't know if that's true or not. If you can help us think about what's – I'm trying to get in the mind of the customer a little bit from the context of churn.

Malcolm Wilson – GXO Chief Executive Officer

Amit, it's Malcolm.

So, it's mainly a volume issue. So if you think about churn, churn is pretty consistent with previous quarters. But definitely what we're seeing is on our consumer-related businesses, and it's not universal on every single customer, but as a broad brush, we can say our consumer-related business is those two facets of a lot of our customers are choosing to not discount.

So maybe we can say inventory levels over the past few quarters have normalized out, and inventories being elevated probably over the past couple of years through starting with the pandemic, starting with supply chain disruption, starting with different aspects of manufacturing problems. But now we can see inventory levels generally normalized out.

And as a part of a result of that is basically the customers are not necessarily choosing to discount product, they're choosing to sell at a better price. Now for them, that's good. You see in the numbers of many of the organizations we work in, they're actually faring well. But obviously, in our business, it's more a volume aspect that travels through our warehouses.

So that's probably the most significant point that you're seeing in our quarter four numbers. And it's compounded a little bit by, traditionally quarter four is always a very important quarter for our customers. It is this quarter. Quarter four, it's going to be very important. We're all focused on it. But again, because of the volume, typically, historically, we might be implementing several smaller overflow warehouses, just to cope with those extra volumes that happen in the last quarter. This time around, we're not seeing any evidence of that.

And I guess the last thing, I mentioned earlier, I think there's definitely signs that the consumer themselves, they're putting off starting the holiday season shopping. They're putting it off to later in the – closer to the end of the year, basically, in the hope that maybe some of that discounting will occur.

So, that's the kind of backdrop that we're seeing. Maybe I can ask Baris just to come in on the fine detail on the numbers for you, Amit, because it's really important.

Amit Mehrotra – Deutsche Bank

If I could just ask a question.

So, I'm going to loop Baris in, because I wanted to ask about growth for next year because it seems like there's – it's a cyclical issue, which worries me less than a churn issue. So that's fine. But as we think about – you guys have won a lot of business for next year, I think it all tallies up to like 7% to 8% growth, assuming underlying volume and churn is kind of flat. So, can we get back to organic growth in like the mid-to-high single digits next year, just given the new business that you won and the dynamic that we're kind of at the bottom right now? Is that a fair assumption?

Malcolm Wilson – GXO Chief Executive Officer

Amit, new business, as I mentioned earlier, that’s been incredibly strong. If you just look at this year, $840 million of new business signed this year. $525 million of that is landing in 2024, another $200 million of that $800 million is going to be landing in 2025 and just in the last quarter, $180 million. The very nice stat on that is broadly 50% of that is coming from first-time outsourcing. So, all of that's rolling forward. You're absolutely right in your observation.

I guess when we think about next year, we're right now, literally, this last week, we've had lots of the management teams present in meetings. We're starting our budgeting cycle. And that budgeting cycle will take us through to the end of the year. In that, we're collecting all of the information from customers: all of their forecasts for next year, their plans for expansion, their plans for changing products, everything goes into that. It's a true bottom-up process that then allows us to bring into place our guide for the year ahead. It's a bit soon right now for us to be thinking about that, really, the business, we're just all focused on these last couple of months, so critical for our customers.

Amit Mehrotra – Deutsche Bank

Yes. That's fair. And then one sneaky one, if I could. I know I'm over my allotment. But I wanted to talk to Adrian around the automation.

So, Adrian, everything you said was really compelling and there are a lot of buzzwords in there in terms of automation and AI. I think the problem that we've had on the analytical side is kind of converting that into what it actually means for the model.

And so, as you take on this new position of Chief Automation Officer, what are the KPIs for you that kind of allow you to move? Because there's a lot of anecdotal evidence of automation, but the problem I've had is that the company still has a huge amount of direct labor costs, and I'm trying to balance those two.

So, as you think about this new role, like every quarter, every month, whatever it is, how are you judging the success from a KPI perspective that we can maybe follow to?

Adrian Stoch – GXO Chief Automation Officer

Hi Amit, thanks for the question.

So, I'm going to answer it in two different categories. The first is around operational or tactical metrics, and the second is more strategic and financial.

So, from an operational perspective, we're going to look at the amount of adaptive tech that we're redeploying as a success measure because, of course, the more we're able to establish those best practices and best-case scenarios and then roll them out to other sites, the more we get the leverage of that from a global perspective. So, the extent of adaptive tech expansion.

Secondly, of course, we'll measure very tactically the execution of plans in terms of what each of the regions will be targeting with respect to implementations. And so, from a tactical perspective.

But I think what's more relevant for this audience is around the more strategic and financial indicators, which will be focused on the revenue derived from automation and the margin that we get from the automated operations. Those will be the two primary financial metrics that we'll be talking about.

Amit Mehrotra – Deutsche Bank

Thank you very much, guys. I appreciate it.

Malcolm Wilson – GXO Chief Executive Officer

Thanks, Amit.

Operator

Thank you. Our next questions come from the line of Jason Seidl with TD Cowen. Please proceed with your questions.

Jason Seidl – TD Cowen

Good morning. I wanted to touch a little bit about your outlook for '24. I think before you mentioned that you saw maybe a turnaround coming in late one half.

How should we assume that runs throughout your geographies since you mentioned green shoots in Europe? Should that be hitting Europe first and then maybe North America in the second half of the year? How are you looking at it?

Baris Oran – GXO Chief Financial Officer

Thank you for the question. Let me walk you through some of the elements of Q4 because it impacts 2024 as well.

We're seeing right now 2% to 4% growth for 2023, which is the middle range implies a flat growth for Q4. We delivered 3% organic growth in Q3, but heading into Q4, we're seeing more volume headwinds.
And when you put them into three components, the first is you see seasonal one-off impact from reduced pop-up activities – these are Christmas-related warehouses we have been operating. It's about 1% to 2% impact, slower ramp-up of new facilities. They are not immune from the current volume environment, about 1% to 2% impact. And lastly, number three, is reduced volume from our existing facilities, which is about 5% impact. All of this, roughly making 8% to 9% headwind, is balanced with our business wins and pricing pass-throughs, inflation pass-throughs, that we have in our business that comes to our flattish growth in Q4.

Now looking into 2024, our business has already banked $525 million of incremental revenues from contract wins. We won a large contract win with a U.S. sporting goods, a 15-year contract due to start in 2025, but when you look into the environment, you will probably see gradual increase over time.
Customers' volumes will remain likely subdued at the start of the year and improving throughout the year, and we expect to get back into revenue growth in first half and even acceleration on that in Q4.

And during this time, we expect our margins to hold steady and we will continue to get support from productivity initiatives we highlighted, which is going to give us about a $40 million run rate into 2024.

Remember, we are ending this year about $25 million, $26 million of benefit. So, a lot of new wins supporting next year improvement into first half, more into the second half, and some of these activity headwinds you're talking about in Q4 are seasonal in nature.

Jason Seidl – TD Cowen

That's good color. Let me turn it over a little bit here to Adrian.

I wanted to talk a little bit about AI. A lot was discussed in some previous questions. But when I look at the pre-pipeline conversion rates, they mentioned sales as a part of it. How much has AI had an impact on those conversion rates on the pipeline? And how much do you think it could have in the future? Do you think your pre-pipeline conversion rates could actually improve with the increased use of AI and the increased sort of marketing to the customers on it?

Adrian Stoch – GXO Chief Automation Officer

Yes, I definitely think that there's compelling reason for us to believe in what AI can do to differentiate our pursuit with customers in the pre-pipe and the pipeline.

I mentioned and I gave one example of where AI has been able to make us more precise in our labor planning, but there's other myriad examples across our enterprise where we've used AI to improve robotic travel times and wait times is another fantastic example. We've used AI to optimize transportation routing, which not only has financial benefit. But what's very important to our customers around the ESG metrics that they're also looking for. So yes, I do believe that in our use cases and in our discussions with customers in the pursuits, sharing these success stories and what it can mean to customers is going to be a very big part of it.

Jason Seidl – TD Cowen

So, moving forward, you would expect the conversion rates of the pre-pipeline to increase?

Adrian Stoch – GXO Chief Automation Officer

That is the hope and intention, yes.

Jason Seidl – TD Cowen

Fantastic. Gentlemen, I appreciate the time.

Operator

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

Malcolm Wilson – GXO Chief Executive Officer

Thank you, Daryl, and thanks for hosting our call today. We really appreciate that.

We've delivered a robust third quarter. We've upgraded our 2023 adjusted diluted earnings per share and adjusted EBITDA guidance every quarter, and now, taking into account our strong operating results and the incremental benefit from our recent acquisition of PFSweb, we're very pleased to be raising this guidance again.

Set against a softer macro, we continue to deliver strong new business wins, profitability and free cash flows, underlying the resilience of our business model, the deep expertise of the team and our secular growth story.

With that, I'd like to wish everybody a great rest of the day, and thank you for your attendance. We'll bring the call to an end. Thank you.

Operator

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