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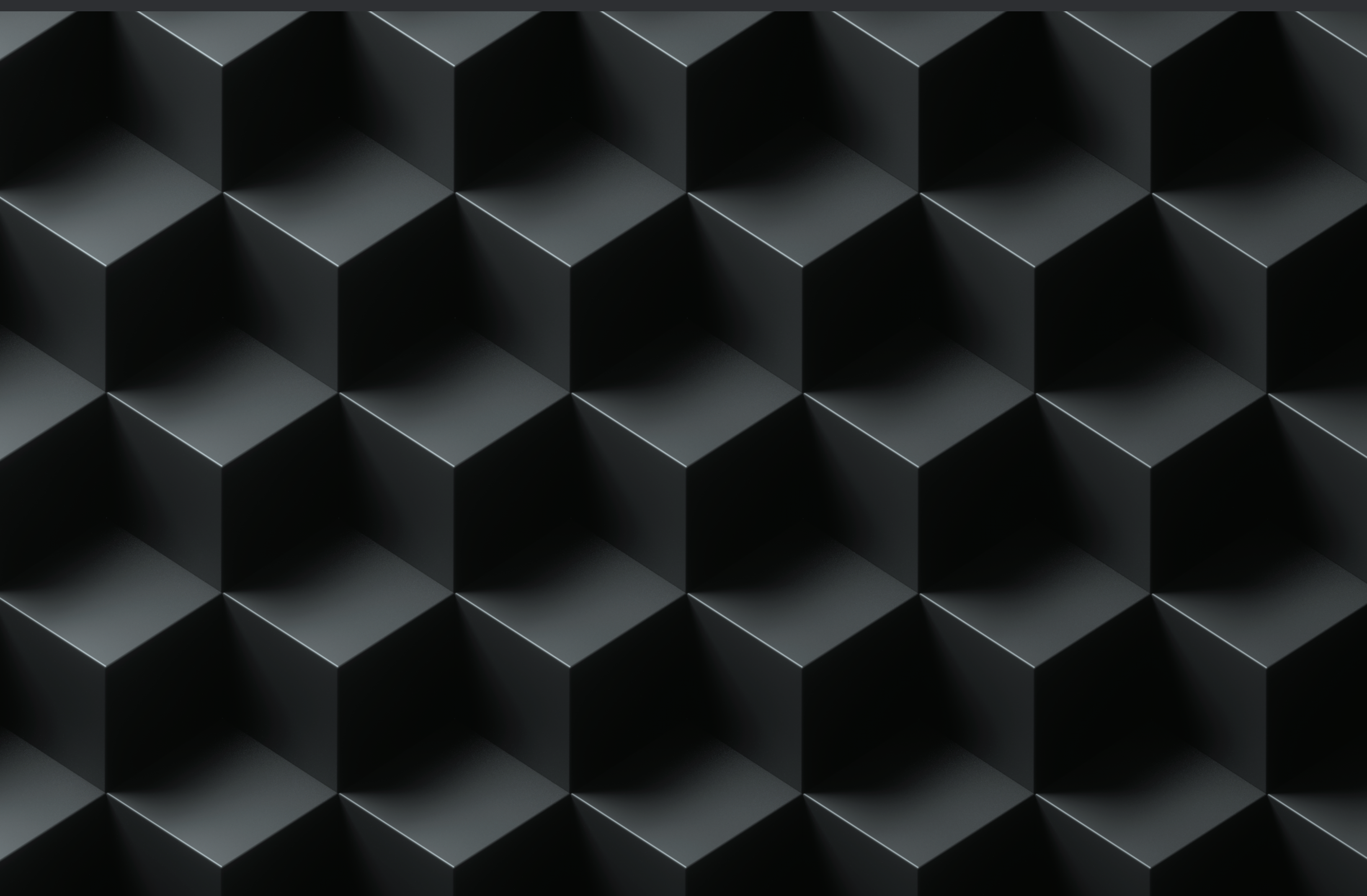
Second quarter 2024 results



GXO Logistics Q2 2024 Earnings Call

Presenters

Malcolm Wilson – Chief Executive Officer
Baris Oran – Chief Financial Officer
Kristine Kubacki– Chief Strategy Officer

Q&A Participants

Stephanie Moore – Jefferies
Scott Schneeberger – Oppenheimer
Chris Wetherbee – Wells Fargo
Brian Ossenbeck – JP Morgan
Ravi Shanker – Morgan Stanley
Jason Seidl – TD Cowen
David Zazula – Barclays
Kevin Gainey – Thompson Davis & Company

Operator

Welcome to the GXO second quarter 2024 Earnings Conference Call and Webcast. My name is Donna 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 law, which, by their nature, involve a number of risks, uncertainties, and other factors that could cause actual results to differ materially from those projected in the forward-looking statements.

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

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

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

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

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

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

Malcolm Wilson – GXO Chief Executive Officer

Thanks, Donna, and good morning everyone. I appreciate you joining us today for our second quarter 2024 earnings call. With me in Greenwich are Baris Oran, our Chief Financial Officer; and Kristine Kubacki, our Chief Strategy Officer.

GXO has delivered a strong second quarter, rounding out a great first half, and we're pleased to be reaffirming our full-year 2024 guidance today.

During the quarter, we signed about $270 million dollars of new business wins. Our pipeline grew for the third consecutive quarter, standing at a new 12-month high of $2.3 billion dollars of high-quality opportunities.

We're also seeing contract duration increase, as customers look to outsource to a trusted partner with global scale who can manage the complexity of their supply chain.

We're particularly proud of our progress in Germany, the largest European economy, which has been part of our growth strategy since the spin. During the quarter, we've signed a new deal with Tchibo, a leading German retailer and coffee distributor, and we've gone live on the 20-year, nearly-billion-dollar contract with Levi's that we announced in May.

We're also pleased to have expanded our relationships with several longstanding customers this quarter, including Boeing, Guess, Marks & Spencer and Raytheon. Our land-and-expand strategy remains a core tenet of our long-term organic growth plan, and today, about half of our revenue comes from customers we've grown to serve in more than one country.

The new contracts we win are the key to our growth. Through the first half, we've won more than $520 million dollars of new business, and, given our increasing pipeline, we're on track to sign a record amount of new business this year, underpinning our growth in 2025 and beyond.

As we've mentioned, we believe we saw the bottom of the inventory cycle in the fourth quarter of last year. We're beyond that inflection point, and we're seeing volume trends beginning to improve.

At an industry level, e-commerce has returned to sustainable structural growth. Customer demand for outsourcing has remained strong throughout the cycle, as customers look to improve productivity, reduce complexity and recognize their supply chain as part of their strategy. About half of the contracts we signed this quarter were for newly outsourced activities.

We're also pleased to have completed our acquisition of Wincanton in the second quarter. This deal exemplifies our M&A strategy. In Wincanton, we've acquired a platform to expand our presence in target verticals across the UK and Europe, including aerospace & defense and industrials.

We have acquired Wincanton at an attractive valuation. We look forward to accelerating our future organic growth with this acquisition, as we have done with our expansion in Germany.

In both our Europe and UK markets, we're seeing our customers grow more confident, and launch new and larger projects. This bodes well for our future growth, along with our acquisition of Wincanton. For North America, while we're currently seeing softer demand for goods, we've signed record new business wins in the first half of this year. Our long-term contractual business model gives us confidence in delivering our 2027 targets of $15.5 to $16 billion dollars of revenue, and $1.25 to $1.3 billion dollars of adjusted EBIT-D-A.

And with that, I'll pass you to Baris to walk you through the quarter.

Baris, over to you.

Baris Oran – Chief Financial Officer

Thanks, Malcolm. Good morning, everyone.

In the second quarter, we generated record revenue of $2.8 billion dollars, growing 19% year over year, of which 2% was organic. Our organic growth was driven by strength in diverse parts of our business, including aerospace, data center support and omnichannel retail, led by cold storage supply chain.

Our Adjusted EBIT-D-A this quarter was $187 million dollars, and we delivered $31 million dollars of Free Cash Flow. Our Operating Return on Invested Capital remained above our target at 32%, as we continued to invest in high-return projects to fuel our organic growth.

Our financial position remains rock solid, and we are committed to maintaining our investment-grade balance sheet. Our net leverage was 3.1x as of the end of the second quarter. We are expecting leverage levels of about 2.5x by the end of the year, and less than 2x by the end of next year. We have no debt coming due in 2024.

Our sequential acceleration in organic revenue growth in the second quarter reflects that we have seen an inflection point in our business.

As Malcolm mentioned, we also completed our acquisition of Wincanton this quarter. We are thrilled to have acquired this business at an attractive valuation and we are well positioned to quickly deliver on our synergy targets of $55 million dollars. We expect the acquisition will be accretive to earnings this year, with double-digit accretion to adjusted diluted Earnings Per Share once we fully integrate the two companies. Beyond cost synergies, we look forward to leveraging Wincanton's expertise to accelerate our growth in the aerospace & defense, and industrial verticals in the UK and Europe, in line with our M&A strategy.

Turning to our guidance, as Malcolm mentioned, we are reaffirming our view for the rest of the year. For the full year of 2024, we expect to deliver:

- Organic revenue growth of 2 to 5%
- Adjusted EBIT-D-A of $805 million dollars to $835 million dollars
- Adjusted EBIT-D-A to Free Cash Flow conversion of 30% to 40%
- And adjusted diluted Earnings Per Share of $2.73 to $2.93.

We also expect to continue to deliver an Operating Return on Invested Capital of above 30%.

While we are seeing many improving trends in our business, the tone of our customer conversations continues to reflect prudence in near-term growth expectations.

Looking to 2025, we expect the synergies from the Wincanton integration and the automated solutions we are underwriting to drive increased profitability.

GXO is executing well on the long-term strategy. We are uniquely positioned in a highly fragmented industry, and due to our long-term contractual business model, we have a multi-year organic growth runway ahead of us. We are generating strong Free Cash Flows, enabling us to invest in our organic growth and strategic M&A. And we will continue to allocate capital in the best interests of our shareholders.

With that, I'll hand the mic to Kristine, our new Chief Strategy Officer.

Over to you, Kristine.

Kristine Kubacki – GXO Chief Strategy Officer

Thanks, Baris. Good morning, everyone.

I'm excited to have joined GXO in April as Chief Strategy Officer. I've previously worked in investor relations, and prior to that, spent 17 years on the sell side. I've met many of you already, and I look forward to keeping you updated on how we're building the supply chain of the future.

Malcolm and Baris have already reviewed our excellent progress in the quarter and the ways that we're adding value for our customers. I'd like to drill down on our automation and tech leadership – the key differentiator that is going to enable GXO to keep expanding our lead in the market.

I've now visited several of our highly automated sites in different countries. As an engineer by training, I'm excited by the level of tech in our operations, both because I understand the value proposition and because I recognize how difficult it is to do what we do. The combination of our automation expertise and our approach to developing automated solutions is clearly our differentiator.

GXO has helped shape the industry for years, and we continue to redefine the role logistics plays in the modern economy.

You may have seen the video we released this morning highlighting our progress in piloting humanoid robotics to work alongside our associates. We are the first to deploy humanoid robotics in our live sites. And while this technology is a few years away from full deployment, our engagement today with leading developers is helping shape the supply chain of the future.

We're also creating enormous value by deploying AI across our operations. The insights we're gaining from applying AI to optimize fulfillment are changing the way we run our sites. Our implementations of AI are skyrocketing, with ten times as many sites in deployment for 2024 vs. last year.

Our role in research and development of supply chain automation is to serve as an operational incubator. We partner with developers of cutting-edge technology and help them shape their prototypes to address practical use cases, with a focus on financial results.

Our combination of disciplined capital deployment and operational expertise means that we can identify which technologies will create operational value and deliver financial returns, and which ones won't.

This approach is part of our strategy of efficient capital allocation. It de-risks our innovation while affording us a first-mover advantage and the opportunity to trial emerging technologies, without disrupting our operations.

GXO has consistently delivered operating return on invested capital above 30%. And it is this focus on innovation and disciplined capital allocation that underpins our confidence on delivering our 2027 targets.

Along with today's earnings release, we've also issued an updated investor presentation on our website, which outlines our value creation framework, including:

- Long-term growth driven by secular tailwinds
- Our global scale
- Our leadership in tech and automation
- And a laser focus on our customers

As you can tell from today's announcement, the core fundamentals of GXO's business model are strong. And our relentless focus on these priorities, combined with our capital allocation strategy, results in a compelling long-term growth algorithm for GXO.

We look forward to keeping you updated on our progress.

And with that, I'll turn the back to Malcolm.

Malcolm Wilson – GXO Chief Executive Officer

Thanks, Kristine.

We've built on our momentum from the first quarter and delivered record revenues in the second quarter. With our pipeline at a twelve-month high, we have a clear line of sight to sign a record amount of new business this year, underpinning our confidence about accelerating our growth in 2025 and beyond.

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

Question & Answer Session

Operator

Thank you. The floor is now open for questions. If you would like to ask a question, please press star-one on your telephone keypad at this time. 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. Again that's star one.

Today's first questions come from the line of Stephanie Moore with Jefferies. Please go ahead.

Stephanie Moore – Jefferies

I was hoping you could maybe talk a little bit more about just maybe the recovery that you're seeing in the U.K. and Europe. What you think is driving that in particular? And then thoughts about when you would expect to see the U.S.

starting to improve some or maybe other levers that you can pull with your U.S. customers given what kind of remains a weaker environment?

Malcolm Wilson – GXO Chief Executive Officer

Stephanie, it's Malcolm here. Let me just cover that point then. So, when we look across, in fact, all of our regions right now, what we're seeing is modest improvements in customer volumes compared to the last quarter.

Core volumes though do remain relatively sluggish generally flat year-over-year. But we have got some areas now where we can see definite improvements coming through. When we look in the different regions, as you point out, definitely U.K. and Continental Europe, they've remained stronger. It's about 2/3 of our business.

And while we're not yet seeing that return to growth in the North American market, it's still a little uncertain. What we are seeing is a tremendous amount of new business activity. In fact, we signed more new business in our North American business recently than for a long time. I think we're on target for a record in our North American activity for new business signings.

Inventory levels also, we definitely started to see those returns. So, from that low point of the end of last year, I think that was really the inflection point for inventory levels across all of the regions. Definitely, we're seeing inventory levels coming back. Customers already know starting, I think, to prepare for this year's holiday season.

Most pleasingly, as we just talked about, sales have been strong. We've seen tangible improvements over the last quarter, and in fact, year-over-year, in terms of every region, our sales pipelines, pre-pipeline, they're really very, very strong. The time to convert is quick. Deal sizes are getting bigger. Duration of contracts are getting bigger.

So, the recent announcements that we made about the Levi's contract, where we are commissioning right now and going live in Germany, for the operation of a large automated site, more and more of these kind of deals, we're seeing more and more transformative deals are coming into our sales pipeline.

So, on top of the $0.5 billion of new business that we've already closed won during this year, the second half of the year, looks really promising, and that bodes well for our growth in the second half of this year and indeed, going into 2025. And I think the last point, it's an important point. Just to come back on alongside all of these innovations, we really catapulting now, we're really accelerating the deployment of a lot of technology across the business. And in particular, we're very pleased that the way our trials are going, with the very latest tech, these humanoid robotics, where we're coupling them and we're bringing them into our operations across a real wide range of AI-driven initiatives, across a wide range of applications.

So, I think definitely, in Continental Europe, U.K., we feel that the business is in a very good trajectory of growth. And really, we'll see that also in the second half of the year and into '25. North America is still a little bit uncertain, but we do see all the signs of an improving situation later in the year, not least the fact that we've got the holiday season ahead of us.

And this year, we can see, although it's very early in the cycle for planning with our customers, we'll know much more by the end of August. But we can see that our customers, particularly the consumer-focused customers, they are starting to plan out really now for the holiday season. Last year was a very disappointing holiday season. Right's now, we feel this year's period will be a better period for us than last year.

Stephanie Moore – Jefferies

Very detailed answer. I appreciate it. Just for my follow-up here. I wanted -- maybe Baris, if you could talk through some free cash flow considerations for the second half? I realize the guidance has remained unchanged, but it does imply a bit of a step up in the second half versus the first half. So, if you could walk through some of those puts and takes, that would be great. Thank you.

Baris Oran – GXO Chief Financial Officer

Our free cash flow was $31 million in Q2, up $28 million year-over-year. Our strong first half, which was up $56 million year-over-year, puts us on a track to achieve our 30% to 40% EBITDA to free cash flow conversion. Our working capital management continues to be strong in 2024, and we expect that we are investing more and more in automation that will accelerate, but we are comfortable with our guidance for the year. And as you would recall, our cash flow tends to be second half tilted every year. So, our guidance is reflecting that.

Operator

We'll move on to the next question from Scott Schneeberger of Oppenheimer. Please go ahead.

Scott Schneeberger – Oppenheimer

I want to follow up on transactional volumes. It sounds like there's a bit of a geographical difference where you're still seeing the sluggishness that keeps you cautious in North America.

Baris, I guess it's for you. Is it still a sequential improvement to third quarter to fourth quarter? That's what it sounded like in the answer to the last question. But just between the back two quarters of the year, how should we see that trend and maybe with regard to year-over-year consideration as well?

And then I guess, Malcolm, if you want to follow that, just how much lack of visibility is there in North America? You mentioned maybe later this month, you'll get a sense for the holiday season, but it sounds like your concern is broader than that. So maybe touch on some other verticals in North America. In addition to retail or if it is just retail, that's kind of the thing that has you a little bit on pause.

Malcolm Wilson – GXO Chief Executive Officer

Thanks, Scott, let me cover the second part of your question first. This is Malcolm, and then I'll hand you over to Baris to cover the detail on the numbers.

So, in fact, you're right. I think we have all year had a stronger outlook for our European business. That bodes well. Clearly, obviously, we've just concluded on the M&A of Wincanton. And that's going to strengthen still further because it's going to expose us into a number of new verticals. So, we're very, very pleased about that.

In North America, I guess what we're seeing is in our industrials business, our Euro-based business, tech business, generally, things that are directly linked somehow to the consumer I think there's still a degree of uncertainty.

When we're talking to our customers, they anticipate this year that they are going to have more of a pronounced holiday season than what we saw in '23. '23 was very disappointing, I think, for everyone. This year, I think on the back of improving levels of inventory, inventory levels are growing in our warehouses and the planning that's taking place right now. But also remembering one of the things that is directly within our control, highly predictable for us, is the actual implementing of that new business that we won. And we can see that our new business wins in North America have been very strong.

So, whilst the here and now has a degree of uncertainty, what’s really directly controllable by us. So, the new business that we've won and how we will implement that and the timing of those implementations, that's much more pronounced. So, it does give us a better feel for the second half of the year.

I don't believe quarter three is going to be a significant change over quarter two, but I definitely do see that when we look at our implementations of new business, what we're hearing right now from our customers and what we're seeing in our facilities, I do think we will see a noticeable change as we move into quarter four and as we exit this year in '25 momentum as it were. But maybe, Baris, you can put a little bit more detail around.

Baris Oran – GXO Chief Financial Officer

Sure. When you look into Q2 and then you look at our existing facilities and include network consolidation and the macro impact, our volumes were still down, but they are less down compared to the fourth quarter of last year.

We feel confident that we have passed the bottom, as Malcolm highlighted, we are expecting a better peak compared to Q4 of 2023, which was really, really low. And we are already seeing this environment reflected in our current business.

Furthermore, as Malcolm highlighted, we see higher new business wins that will support our continued growth in the back half, especially in Q4 and the profitability in the back half, especially in Q4. Remember, Q4, we had easier comps.

Scott Schneeberger – Oppenheimer

Great. For my follow-up, I want to delve into a bit of the pipeline and the duration of contracts. So, in the deck, you cited, and I think it was a new – something new in the deck, that the second quarter average contract duration of six months – I think, six years. And so that's impressive. And I assume Levi's is in that. So just curious, is a lot of this all-time high or very long-time high pipeline is a lot of this longer duration contracts?

And just curious, Malcolm, if you back out Levi's, assuming that's what's driving that so high in the second quarter, how does the overall portfolio look as far as long-term contracts because you have been winning a bunch of them – is that looking longer now the total portfolio than it did just a few years ago? And how much has that moved up and more importantly, looking at the pipeline, do you see more of these long-duration contracts to come?

Malcolm Wilson – GXO Chief Executive Officer

Yes, Scott. Definitely, what we're seeing is the duration length of contracts that we sign is gradually getting larger. And I think what's driving that is just the amount of technology that goes into the solutions that we're designing for customers. Many customers are coming to us because – well, they look at us, they see a very trusted partner that's very tech-forward thinking. So, they're eager to benefit from the solutions that we can design for them that are really driving more efficiency, more productivity, higher quality.
With that generally comes automation technology, whether that's goods to person, collaborative robots, deep seated in building robotic activity or indeed, what will be in the future these very latest batch of technology, humanoid type of robotics.

So generally, that's what's driving this longer-term of duration. It's very good for us as a business because it gives us a huge planning horizon. Already now, we're seeing business continuity with customers stretching out right into the next decade. So, I think contract duration, increasing deal size, really getting bigger. Customers are seeking to outsource more and more of what they traditionally might have done themselves, and that's driving just a larger scale amount of outsourcing.

So, for us as a business, it's really a very good news aspect. It's something that gives us a lot of confidence when we're planning out our business beyond '25 and even into '26 and '27. It's one of the reasons why we're really feeling very strong, very confident about the midterm '27 plans that we announced earlier this year. We've got a lot of confidence coming from just the sheer level of new business that's coming to us.

Obviously, we're hopeful that our core business and the economic environments in all the regions will improve from where it is right now, but a good deal of what we're referring to is directly under our control when it comes to just actually the new business that we're entering into with customers.

Operator

The next question is coming from Chris Wetherbee of Wells Fargo. Please go ahead.

Chris Wetherbee – Wells Fargo

Hey, good morning guys. I guess I wanted to talk a little bit about the guidance and just sort of make sure I understand the cadence for the rest of the year, particularly from an EBITDA contribution perspective. It seems like maybe 3Q is a little lower than what we thought might have could have been and were maybe a little bit more 4Q weighted now than we were previously.

So, can you talk through a little bit of what we should see over the course of the next couple of quarters? And what sort of drives that seasonality, which I guess maybe is slightly different than what we've seen before? Presumably, maybe Wincanton has got a little bit different seasonality.

Baris Oran – GXO Chief Finance Officer

Chris, this is Baris here. You're right. There is a peak period in Wincanton that's going to have an impact. PFS also has a sizable peak that's going to have an impact. And also, we are seeing more contribution from our new business wins.

In this quarter, in Q2, we had roughly 8% of our growth coming from new business wins, and we expect that to grow to 9% towards the end of the year in

Q4. That's going to have an impact. And remember, Q4, we really didn't – we really had a low peak period last year. So, we are having really easy comps in Q4 of this year. That's reflected in our numbers.

Chris Wetherbee – Wells Fargo

Okay. All right. That's helpful. And then maybe if you guys could sort of opine to some extent on what we're seeing from a demand perspective. This is more of a U.S. question than it is European question. And your thoughts on whether or not some of the activity we're seeing is pull forward from a peak season with people concerned about potential disruptions, maybe its port issues or if there are other factors kind of playing in. There's some tariffs that went into effect in early August. So just kind of curious, the relative strength of imports, particularly from a U.S. perspective, is that something that you think persists? Or do you feel like your customers are talking at all about pull forward?

Malcolm Wilson – GXO Chief Executive Officer

Chris, it's Malcolm here. Right now, we don't actually see that the inventory levels, that we're seeing is a result of a pull forward. I mean there's different activities in different verticals. We saw in the last year, as an example, and in fact, in early parts of this year, some of our customers in different industries tangibly bringing products in earlier, tangibly bringing product in earlier from a safety perspective in terms of nearshoring and other activities like that.

But in terms of our consumer-driven business, right now, I think we are just naturally seeing an elevating return to a more normalized level of inventory holding in our warehouses to support a normal kind of business planning cycle that our customers are having. And clearly, right now, we're seeing early input of inventory getting ready for the holiday season, which I think will be a very traditional holiday season.

I know you mentioned about possible disruptions, port disruptions. Our industry, I think, now accepts and lives in a disrupted environment. I think our customers are very familiar with the fact that they have to think outside of the box. And clearly, in working with GXO, they're working with a partner that really is, well we have a huge experience of being able to assist them in that cause.

And again, one of the important aspects, we are deploying a ton of automation and technology into our businesses that does allow us to actually transact a lot of volume in a much shorter window of time. So, it's an added degree of safety for our customers as we head into the holiday season.

Operator

The next question is coming from Brian Ossenbeck of JPMorgan. Please go ahead.

Brian Ossenbeck – JP Morgan

Hi, good morning, thanks for taking my question. So, I just wanted to ask a little bit more about the composition of the recent wins and how that might impact margins with start-up costs and things like that for the rest of the year into next year. So, it looks like new business wins were a smaller portion of the book this quarter compared to last one. So, it looks like a lot more outsourcing.

Does it have an appreciable impact on the cadence of earnings here when you think about start-up costs and investments? And I guess more specifically, why the shift between those two quarter-to-quarter? Is that just lumpiness because of the contract? Are you seeing some underlying changes in the behaviors here?

Baris Oran – GXO Chief Financial Officer

Brian, this is Baris here. The delta is coming from the large outsourcing contracts we have signed. These are the large automated facilities that we took over from an in-house operation, and we are automating. And of course, the contribution from these vastly automated solutions is higher. The margin delta is higher from automation. And you'll see that in play as we take over the site and the ramp-up of activity in these new facilities.

Overall, as a trend, roughly half of our business has been coming from the first-time outsourcing, but we do see quite a lot of demand, especially in the e-commerce as well on the demand for new facilities.

And we are still gaining market share from some of the smaller players as we are seeing opportunities for consolidating network of our customers into more scaled operations. So, we are gaining market share from the smaller players as well. So, this quarter, I would say, is a unique quarter by itself.

Over the longer term, you should see the takeover in place still continuing, but we see new facilities, especially in the e-commerce. The demand for e-commerce facilities has been somewhat robust recently, and we're seeing a lot more in our pipeline as well. So, that's going to be more balanced as we look forward.

The profitability contribution, of course, on this automated facilities is higher, and we'll have them reflected in the next couple of quarters as we ramp them up and into next year as well.

Brian Ossenbeck – JP Morgan

Got it. That's helpful. Just as a follow-up. Baris, again, maybe you can talk a little bit more about how the investments in productivity in sales force that you're talking about to start the year? How those impacted the second quarter? How those have been implemented? They're getting the sort of returns you expect because ultimately, I know there's some seasonality into 3Q, but wanting to see just how much of a tailwind that's going to turn as you go from 2Q to 3Q?

Baris Oran – GXO Chief Financial Officer

Thank you. We have sizable invested in our sales teams. In fact, that was a margin drag in our Q2 around 10 basis points. These facilities do take up some time up to ramp it up and operationalize, but we are seeing a huge opportunity.

Our pipeline is very robust. Our pipeline is turning faster as well as well as our win rates have improved. Therefore, we are definitely seeing a huge benefit of investing in our sales teams and our capabilities. The results are not in our numbers yet. You will see them more vividly in the next couple of years.

Operator

The next question is coming from Ravi Shanker of Morgan Stanley.
Please go ahead.

Ravi Shanker – Morgan Stanley

Maybe I can start with a question on the humanoid which you referred to a few times on this call because it's a pretty interesting area of research and lots of new developments there. How do you see that kind of ramping and playing out? Kind of who are the players out there who can supply you with these humanoids? How does that coexist with cobots? How – what do you see as the future of automation?

Kristine Kubacki – GXO Chief Strategy Officer

Ravi, it's Kristine here. Existing robotic solutions have matured in recent years, and they're somewhat limited in what they can – that they can only perform specific functions, and this is really where the humanoids come in.

They have the capability of performing dynamic tasks in a human way, and they are developed to make human-like decisions. They're also highly suitable for it to perform some repetitive heavy lifting type tasks and really work along with our associates.

We believe that the humanoid category will really explode over the next couple of years. And therefore, we're really leaning into the humanoid space via our operational incubator program. We've even this morning, just released a short video on the progress that we're making with humanoid.

So, I would say stay tuned. There's a lot going on in this space. We're certainly very excited about the opportunities. And really, at the end of the day, it's going to drive efficiency for our customers, and we're excited about that and it's going to accelerate GXO's growth.

Ravi Shanker – Morgan Stanley

Great to here. Very exciting. And now for a more mundane follow-up. Just to kind of confirm your message on what you're seeing out there. Because you have heard from some of your customers even like consumer brands, that there is some weakness out there. You see it in some of the retail results that are pretty weak.

You're saying that you aren't seeing that as much. I mean you did say that the U.S. is a little bit softer. What is the message on what do you think the inventory situation and demand environment is going to look like in the back half?

Malcolm Wilson – GXO Chief Executive Officer

Yes, Ravi, it's Malcolm here. Let me cover some of that, and I'll ask Baris to also comment on it. I think there's two things to consider. This kind of here and now. So obviously, we work with our customers for the second half of this year. And within that, clearly, the holiday season, roughly about 50% of our business is really consumer focused. It's directly to the consumer.

So, in that regard, second half of the year, it's going to be influenced by the here-and-now thinking. What we can see is in the discussions that we're having with customers, they are planning for a holiday season. Maybe there will be this year, unlike last year, a little bit more promotional activity, maybe even a bit of discounting, who knows. But definitely, that's the here and now.

But I think the other aspect is so much of what we do, and as we've just talked a lot about, the high levels of new business that is coming into GXO, these are really projects for the future. We're kind of not a transactional kind of business, we're really a longer-term – long-term arrangement with our customers.

So, we're looking out beyond '24, into '25, into '26. That aspect of our business, I think, is very strong. So that's the customers really kind of having to replan out and redesign out their own supply chains. And clearly, we're at the heart of that. We saw many of these big blue-chip customers.

Baris, can you add?

Baris Oran – GXO Chief Financial Officer

Yes. The revenue growth in the second half of the year, the delta is primarily coming from the new wins that we are implementing. And when you look into the underlying volume and network consolidation assumptions, in Q2, clearly, we were negative. And in Q3, we will – we expect a similar trend and somewhat easing up into Q4, reflecting an easier comp in the Q4 of – versus the Q4 of last year, which was a bottom for us. But again, this reflects a negative volume and network consolidation environment that we are forecasting for the entire year.
Despite that, our growth is accelerating because of our new business wins.

Operator

The next question is coming from Jason Seidl of TD Cowen. Please go ahead.

Jason Seidl- TD Cowen

I wanted to delve a little bit into the contract length. I think expanding makes it a lot more predictable for your earnings power over time. You mentioned about half of the contracts that you're signing are newly outsourced customers. Are those customers pushing out the longer term as well? And also, as we think about these longer term, some of the deals that you signed are sort of in the double-digit years, is there any difference in how we should think of the profitability of those contracts or how they're structured?

Baris Oran – GXO Chief Financial Officer

Yes. Roughly, this quarter, half of the new business wins came from outsourcing, and that does include a number of automated facilities as well. Then you have an automated facility to make it work, to make it economically feasible, you need to have a longer-term contract. Because it takes time to set it up. It takes time to operate and you're putting a lot of resources.

You have to make sure software, hardware and people work together to achieve the benefits. And those do end up, they are high-value and higher-margin contracts for us. And the customers are relying on our expertise and basically trusting them – trusting us with their brand to achieve those objectives and profitability.

Jason Seidl- TD Cowen

So higher margin over time, but some start-up costs?

Baris Oran – GXO Chief Financial Officer

Higher margin over time. Of course, there's a ramp-up period of automation. But once it comes at a mature level, it is quite profitable and it's very efficient.

Jason Seidl- TD Cowen

Okay. That sounds great. I wanted to just follow up here. As I look into some of your end markets, everyone grew, but food and beverage, which to me was interesting because that's the one that everyone would think of as more sort of steady state. What's going on in that category?

Baris Oran – GXO Chief Financial Officer

It's basically reflecting the noise in the market as far as consumer companies are concerned at the moment. But on the other hand, we have seen a nice pickup in our omnichannel retail on our frozen network which has been quite robustly performing.

So, it's basically reflecting the consumer environment that we are living in right now. Remember, in Q2, we still are facing negative volumes plus network consolidation impacts, and that will ease as we get into Q4 because of the comp effect. And despite that, we are extending our growth because of our wins.

Jason Seidl- TD Cowen

So, it sounds like food and beverage will be positive in the back half of the year?

Baris Oran – GXO Chief Financial Officer

We do expect a better outcome from our food and beverage customers at the back of the year, and our frozen network is quite robust at the moment.

Jason Seidl- TD Cowen

Appreciate the color, nice work.

Baris Oran – GXO Chief Financial Officer

Thank you.

Operator

The next question is coming from David Zazula of Barclays. Please go ahead.

David Zazula- Barclays

Hey, thanks for taking my question. I'm wondering if you could talk a little bit, I know you've discussed briefly before, the impact of the Wincanton acquisition on margins in the second half. I know they have a primarily open book contract structure. So, how you're expecting that to impact? And how your conversations with customers have gone as far as how they want to keep their contract structure in place, at least initially?

Baris Oran – GXO Chief Financial Officer

This is Baris. Let me take the margin question, and I will refer to Malcolm on the regulatory process because there are certain limits on what we can discuss and what we can contribute to Wincanton at the moment.

Wincanton is an open book business, smaller in size compared to GXO. Although, it's a high return on invested capital, it's a temporary margin drag until they start the integration. Once we have completed the regulatory process and the peak is over, we start the integration process.

This quarter, it was a drag in our margins and I expect that drag to slightly increase into Q3 and Q4 as more and more period of Wincanton is consolidating our operation. This will turn into a tailwind to 2025, given the roughly $55 million of cost synergies we are targeting once we start the integration process at Wincanton.

As far as the regulatory process, Malcolm, anything you would like to add?

Malcolm Wilson – GXO Chief Executive Officer

Yes. Thanks, Baris. Well, in terms of regulatory process, it's a normal process in the U.K. We know it very well. We undertook it very positively with the Clipper deal. We anticipate that regulatory process being complete during September, October, Clearly, the Wincanton business, it does have a holiday season, and it's straight into the holiday season at that time, as indeed is the existing GXO holiday season.

So will really commence the full-blown integration of the two businesses from January onwards. And as Baris was indicating, I think it's quite likely that the majority of our synergy benefits we'll see being actioned and coming through into our numbers during the course of next year – during the full year basically.

In terms of some other points about Wincanton, I mean we've had incredibly positive feedback from the customers. They like the fact that Wincanton is becoming part of a much larger global business. Today, it's been primarily a U.K. organization. The team members that we've had contact with our very good, superstars. We're very pleased to be welcoming those team members into our business.

So overall, although it's far too soon to start putting numbers around revenue synergies, we do anticipate realizing some very healthy growth coming from the existing verticals. But importantly, also, Wincanton operates in a number of verticals that GXO is not present in right now in Europe. Verticals such as public expenditure, defense, aerospace, a lot of different industrial activity. These are areas that today, GXO is not as prevalent in. So, it will help balance out our portfolio. But many of these customers are, in fact, global customers.

So far, clearly unable to take the benefit of working with Wincanton because they're really a U.K.-centric business. But in future, we can see a lot of opportunity of transporting those business relationships, not just across U.K. or Continental Europe and even here into North America, particularly on some of the aerospace and industrial type of customers that they're working with.

So overall, it's a very interesting, very exciting time for our U.K. business teams. I know the two teams, whilst we do operate separately right now, which is in alignment with the regulatory rules, I know they're looking forward to coming together towards the end of the year and really being able to maximize the benefits that will come out of this deal that has been done.

David Zazula- Barclays

Very helpful. If I could squeeze in just one more. You reiterated the cash flow guidance, which I think calls for some sequential acceleration in cash flow in the back half. At the same time, it sounds like you're expecting maybe modest volume acceleration. Maybe you could square the two as to how you are expecting good cash flow in the second half?

Baris Oran – GXO Chief Financial Officer

Our cash flow generally tends to be tilted in the second half. So far, on a year-to-date basis, we are better than last year. So, this gives us a lot of confidence that we'll be able to achieve the guidance range of EBITDA to free cash flow conversion.

And as I highlighted, as far as the volume impact is concerned, last year, Q4 was really the bottom. We've seen very, very low inventory levels and low inventory – low volume levels, and we are going to be comping them out in Q4.

So, we do expect an acceleration into Q4 in our organic growth range coming from the volume. But beyond that, remember, we are expecting higher contribution from our new business wins that's going to be operational in Q4 as well. So, we are looking positively into the second half of the year.

Operator

Thank you. And the next question comes from the line of Kevin Gainey with Thompson Davis & Company. Please proceed with your question.

Kevin Gainey – Thompson Davis & Company

I wanted to maybe go into talk about the AI deployments that you guys are doing. What's the – what is the customer demand for that? And how are you guys planning that integration? And maybe if there's like a line of sight of what the opportunity is for you guys to capitalize on there?

Kristine Kubacki – GXO Chief Strategy Officer

Kevin, it's Kristine here. Just to talk a little bit about AI, AI is really an exciting point for GXO. And as I mentioned, our AI deployment are up 10x year-over-year in 2024. And we're using AI to add value in a variety of use cases within our existing operations. And some of those cases include optimizing picking, managing inventory flow, predicting SKU replenishment modes and all of which, really reduces our cycle time, and this improves really dramatically the efficiencies for our customers and improved capacity that I think Malcolm talked about earlier.

So, I think we're – GXO, we're the leader in the automated supply chain solutions. But I would say on AI, we're really, really just getting started. And the predictive power of AI is already changing the way that we run our existing sites, and this will – AI will further enhance this advantage. So, I would say watch this space. We'll certainly have a lot more to update you on our progress as we go forward.

Kevin Gainey – Thompson Davis & Company

And then maybe if you guys – this is a more M&A style question. When you guys make acquisitions, do you typically integrate them wholly? Or do you still consider them like subsidiary? And how does that affect how you guys run those businesses?

Malcolm Wilson – GXO Chief Executive Officer

Yes. Kevin, it's Malcolm here. No, we tend to have a strategy whereby we integrate all of them because we feel that drives the best environment for our customers. It's the best environment for our teams. Obviously, as a business, I think we're very well known for our very good way of working with all of our business associates, our team members.

This year alone, we've kind of already promoted around 2,000 people into new roles, homegrown talent as it was. So, when we integrate businesses, of course, new employees, new colleagues coming into the Company, gaining all of these benefits, but first and foremost, as all – as well. We've been very successful. We have a very strong track record. We do what we say we'll do when it comes to making very smooth integrations of business. Our customers value the fact that we do that thoughtfully. We don't disrupt any business.

But in doing that also, it means we're able to leverage the strength of all of the business that we have in one particular geography, and that's what drives a high degree of synergy – cost synergy benefits that we're able to achieve, improved procurement buying powers doing things in the most smartest way, in the most efficient way. And that's what gives us confidence.

We've done this several times. It's what's giving us a high degree of confidence in terms of the synergy savings that will come from the Wincanton deal. And really from, I believe, January onwards, that integration will start in earnest, and we'll purposely make sure it's done very smoothly, very well, but to the best effect ultimately of our team members and, of course, our customers, and in the end, in the best interest of our shareholders.

Kevin Gainey – Thompson Davis & Company

Appreciate the color on that, Malcolm. And then if I could squeeze one more in for Baris. How are you guys thinking about capital allocation in the back half of the year?

Baris Oran – GXO Chief Financial Officer

We are focusing on generating cash. Our first priority is as growth enterprise to continue to invest in our new business opportunities, organic growth. And we are in the process of deleveraging. Our first priority would be organic growth. Once we go through the regulatory process, we will start integrating Wincanton, and we'll capture more cost synergies.

And we are really excited about the new business opportunities, the teams working together, can create for us in industrials, in aerospace and defense. Everybody is getting ready for that, but we need to get the approval from the regulatory bodies first. So, our priority would be integrating, growing organically and paying down debt.

Operator

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

Malcolm Wilson – GXO Chief Executive Officer

Thank you, Donna, and thanks for hosting our call today. We really appreciate that. We're pleased with the progress that we've made through the second quarter.

We've delivered strong business wins, look forward to even more to come through our bigger sales pipeline, and we're also looking forward to going live on a number of new exciting sites in the second half of this year. We've seen a return of larger, more complex projects into our sales pipeline.

As Baris mentioned, the return also of a lot of e-fulfillment type of projects. It's very pleasing to see. We're leading the industry with a growing number of innovative and game-changing technologies, which are all being proven right now in our sites, including the latest batch of humanoid type of robotics.

And while, as Kristine mentioned, just a whole host of AI initiatives, that's becoming a norm in our business. It's really a very exciting time for all of our teams working in the facilities. As a company, we're excited to continue to deliver these great shareholder returns from the exciting growth that's ahead of us.

So, with that, I'd like to wish everybody a great rest of the day, and thanks very much for joining us and your attendance on our call. Thank you.

Operator

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