**SMART Global Holdings, Inc. (SGH) Q4 2023 Earnings Call Transcript**

Oct. 12, 2023 8:06 PM ET[**SMART Global Holdings, Inc. (SGH)**](https://seekingalpha.com/symbol/SGH?source=content_type%3Areact%7Csection%3Amain_content%7Csection_asset%3Ameta%7Cfirst_level_url%3Aarticle%7Csymbol%3ASGH)

**Q4: 2023-10-12 Earnings Summary**

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EPS of $0.35 misses by $0.10 | Revenue of $316.66M (-27.65% Y/Y) misses by $58.37M

SMART Global Holdings, Inc. (NASDAQ:[SGH](https://seekingalpha.com/symbol/SGH?hasComeFromMpArticle=false&source=content_type%253Areact%257Csection%253Amain_content%257Cbutton%253Abody_link)) Q4 2023 Earnings Conference Call October 12, 2023 4:30 PM ET

**Company Participants**

Suzanne Schmidt - IR

Mark Adams - CEO

Ken Rizvi - CFO

Jack Pacheco - COO

**Conference Call Participants**

Kevin Cassidy - Rosenblatt Securities

Sidney Ho - Deutsche Bank

Brian Chin - Stifel

Tom O'Malley - Barclay

Quinn Bolton - Needham

**Operator**

Welcome to the SMART Global Holdings Fourth Quarter and Full Year Fiscal 2023 Earnings Call. My name is Victoria and I'll be your moderator today. [Operator Instructions]

I would now like to pass the conference over to your host, Suzanne Schmidt, with Investor Relations. Thank you. You may proceed, Suzanne

**Suzanne Schmidt**

Thank you, operator. Good afternoon, and thank you for joining us on today's earnings conference call and webcast to discuss SGH's fourth quarter and full year fiscal 2023 results.

On the call today are Mark Adams, Chief Executive Officer, Jack Pacheco, Chief Operating Officer, and Ken Rizzi, Chief Financial Officer.

You can find the accompanying slide presentation and press release for this call on the Investor Relations section of our website. We encourage you to go to the site throughout the quarter for the most current information on the company. I would also like to remind everyone to read the note on the use of forward-looking statements that is included in the press release and the earnings call presentation.

Please note that during this conference call, the company will make projections and forward-looking statements including statements about the company's growth trajectory and financial outlook. Forward-looking statements are based on current beliefs and assumptions, are not guarantees of future performance, and are subject to risks and uncertainties, including, without limitation, the risks and uncertainties reflected in the press release and the earnings call presentation filed today, as well as in the company's most recent annual and quarterly reports. The forward-looking statements are representative only as of the date they are made and except as required by applicable law, we assume no responsibility to publicly update or revise any forward-looking statements.

We will also discuss both GAAP and non-GAAP financial measures. Non-GAAP measures should not be considered in isolation from as a substitute for or superior to our GAAP results. We encourage you to consider all measures when analyzing our performance. A reconciliation of the GAAP to non-GAAP measures is included in today's press release and accompanying slide presentation.

As a reminder, on June 13, 2023 we entered into an agreement to sell an 81% interest in our SMART Brazil operation. The transaction is expected to close at the end of calendar '23 or early '24 subject to required regulatory approvals and satisfaction of customary closing conditions.

Accordingly, SMART Brazil operations are classified as discontinued operations in our financial statements where all periods presented in the following discussion of our financial results relates to our continuing operations, which excludes SMART Brazil unless otherwise noted.

And with that, let me turn the call over to Mark Adams, CEO. Mark?

**Mark Adams**

Thanks, Suzanne.

Over the last few years, we have been on a journey to transform SGH from a memory module company into an enterprise solutions company focused on high performance, high availability solutions for our valued customers. I am proud of what we accomplished in fiscal 2023, and I look forward to sharing how we are positioned for the opportunities ahead.

In fiscal 2023, two important transactions furthered our transformation. In the beginning of this fiscal year, we acquired Stratus Technologies, a leading provider of high availability, fault-tolerant computing platforms, software and services. This transaction expanded our IPS offerings at the edge and core, added to our large-scale global customer base and delivered significant high-margin recurring services revenue.

In June 2023, we announced an agreement to divest an 81% stake in SMART Brazil. SMART Brazil manufactures high-volume standards-based memory products for consumer electronics sold in Brazil. The completion of this transaction would further align our resources and investments towards developing high-performance, high-availability enterprise solutions. And, from a reporting perspective, because we anticipate closing the Brazil divestiture in calendar 2023 or early 2024, we are now reporting results of the Brazil business as discontinued operations for all periods presented in today's earnings announcement.

Our commentary today, including comparisons to past period, will focus on SGH excluding Brazil, which we will refer to as our continuing operations. Ken will provide more detail. As we enter fiscal 2024, we are continuing our transformation. At the time of SGH's IPO in May 2017, Memory Solutions represented a 100% of our revenue. Today, we have significantly expanded beyond memory.

Of the $1.44 billion in total SGH sales for fiscal 2023, 52% came from IPS, 31% came from Memory Solutions and 17% from LED Solutions. In addition, services revenue is now a much larger portion of our total revenue. It has grown from $148 million or 11% of our overall sales in fiscal year '22 to $248 million or 17% of SGH sales, inclusive of Stratus Services in FY '23.

Gross profit margins have also improved as we prioritized growing customer engagements where we provide differentiated solutions. Non-GAAP gross margins increased from 29.2% in FY '22 to 31.7% in FY '23, a record for SGH.

As part of our strategy to provide high-performance, high-availability enterprise solutions, we are aligning each of our three businesses to best serve our customers. For IPS, we design, build, deploy and manage high-performance, high-availability computing solutions that span the Edge, Core and Cloud. We continue to build our capabilities internally and through partnerships to meet our customers' advanced computing needs.

For our Memory Solutions business, we provide customers with high-performance, high-reliability memory solutions for specialty markets such as telecom, datacom, storage, data center, industrial and other applications. We are making investments in technologies such as Compute Express Link or CXL and High Bandwidth Memory or HBM, to capture opportunities in the most advanced memory applications.

For LED solutions, we are focused on delivering high-performance, high-reliability LEDs to our enterprise customers, leveraging our commitment to innovation, research and development and our strong intellectual property portfolio.

Now let me turn to our results for the fourth quarter. Sales totaled $317 million, excluding Brazil. Non-GAAP gross margin was 31.7%, up 460 basis points from the year ago quarter and non-GAAP diluted earnings per share totaled $0.35. We generated approximately $38 million in cash flow from operations in the quarter and exited Q4 with a strong balance sheet, including cash and cash equivalents and short-term investments of $391 million.

Now let me review each of our business lines. Starting with IPS, which is made up of our Penguin Solutions and Stratus Technology product lines. We design, build, deploy and provide managed services for both high-performance computing and high-reliability fault-tolerant solutions on-premise, at the Edge, and in the Cloud. Our business model centers on building customer relationships, where we serve as a trusted advisor, providing solutions for customer-specific workloads and IT environments.

Our goal is to sell a total infrastructure solution from planning, all the way through post-installation managed services. As we have discussed on prior calls, our revenues may fluctuate from quarter-to-quarter depending on factors such as customer engagements, deployment schedules, product scope, supply-chain lead times and capital budgets. We also can have revenue move between quarters from time-to-time.

For example, we received an IPS order in the first week of fiscal 2024 rather than in the last week of fiscal 2023 as we had previously expected. In the fourth quarter, IPS sales totaled $145 million, which represented 46% of total SGH sales. Our services revenue, the majority of which is generated at IPS, represented 19% of total SGH revenue in the quarter.

Our services include point-in-time services such as design and implementation, as well as longer-term managed services that are typically subject to renewal after an initial term of a year or sometimes longer. Penguin Solutions continues to focus on expanding its customer reach and mix in markets such as UltraScale, financial services, government, health care, education, research and oil and gas.

Across each of these verticals, we are seeing interest in next-generation AI platforms, and we believe Penguin is positioned to provide these solutions, given our extensive experience in HPC, partnering with some of the leading companies in AI. As an example of our strong partnerships, last month, Penguin Solutions was named a channel partner by NVIDIA under the NVIDIA DGX-Ready Managed Services program. Through this program, Penguin Solutions will be able to help customers deploy and manage advanced supercomputing platform for large-scale AI deployments. Customers will benefit from the leadership class performance of DGX platforms, combined with an innovative customer-first, service-oriented approach that Penguin Solutions strives to deliver.

Moving on to Stratus Technologies, which continues to perform well with new customer wins for the ztC Edge product, a secure, rugged and highly automated computing platform that runs business-critical applications quickly, reliably and efficiently. Additionally, a new-generation of Stratus fault-tolerant computing platforms is targeted for launch later this calendar year. Looking ahead, Stratus is well-positioned to leverage its long-standing expertise in advanced, highly reliable Edge Computing to develop AI solutions at the Edge.

As I've mentioned on prior calls, our IPS business, specifically with regards to HPC is lumpy in nature with high customer concentration. While we continue to deeply engage with our existing customers, we are also focused on reducing customer concentration over the next few years. We are prioritizing driving higher-quality revenue through a customer-focused products and services approach. We anticipate IPS revenue will be somewhat weighted towards the second half of fiscal year 2024 based on our current visibility, which is affected by factors such as timing of customer deployments, supply chain challenge and customer capital budgets.

Shifting to memory. Our Memory Solutions Group, which operates under the SMART Modular brand is focused on enterprise Specialty Memory applications. As a reminder, my comments today are limited to our continuing operations, and therefore pertain to Specialty Memory only, excluding Brazil. In the fourth quarter, Specialty Memory revenue came in at $105 million or 33% of total SGH sales, and was relatively flat with the third quarter.

While we are starting to see some early signs of price stabilization in the memory markets going into the first quarter of fiscal 2024, demand for specialty products is lower than expected. Inventories are elevated at a number of our key customers and lead times are lower, affecting customers' buying patterns and making forecasting difficult. That said, qualifications of new products are progressing both for our 64-gigabyte DDR4 and our 32-gigabyte DDR5 very-low-profile or VLP RDIMM products.

Our growth strategy remains in place to focus on hyperscalers and data centers, in addition to our current customer base, and more specifically, AI, machine learning and data analytics applications where high-performance memory is essential. CXL remains a key technology standard for memory expansion and memory pooling, facilitating breakthrough performance for data-intensive usage models.

One example of how we are leveraging our know-how is SMART CXL Type 3 memory products, which address the industry's need for more memory per processor core. This approach allows for a more flexible and scalable memory architecture, where memory devices can be added or removed as needed without the need to replace or upgrade the entire system. We are also releasing new specialty products for the data center, including SMART's DC4800 data center SSDs, a family of PCIe Gen4 data center class drives designed to the Open Compute Project or OCP standards.

This design expands the base of potential customers and helps drive a greater level of standardization for data center and even classic enterprise storage applications. Despite continued headwinds in memory overall, we believe our Specialty Memory business performed well financially, achieving 14% operating margins in the fourth quarter.

Now turning to our LED Solutions Group, which operates under the Cree LED brand and produces application-optimized LEDs for specialty lighting, video screens, gaming displays, horticulture, outdoor and architectural lighting.

For the fourth quarter of fiscal 2023, LED Solutions totaled $66 million or 21% of overall SGH sales, and were up 3% sequentially. We continue to see customer design activity improving heading into fiscal year '24. In particular, the product launch of our XLamp XP-G4 is another innovation in a long-line of high-performance LEDs from Cree. The XP-G4 provides improved performance for a wide range of both indoor and outdoor directional lighting applications, requiring precise light control, long-term reliability and exceptional color-over-angle performance.

With Cree LED's commitment to customer-focused innovation, we are confident that our technology leadership, strong IP and capital-light outsourced manufacturing model, combined with a disciplined expense management has positioned the business to succeed as the market recovers.

Before I hand it over to Ken, I'd like to call your attention to our third annual ESG report, which was published last week and is available now on our website. I am proud of the team's progress towards achieving our goal of net zero carbon emissions by 2030.

And now, Ken will provide a more detailed review of our fourth quarter and full year fiscal 2023 financial performance and our guidance for next quarter. Ken?

**Ken Rizvi**

Thanks, Mark.

As a reminder, we anticipate completing the sale of 81% of our SMART Brazil operations by the end of this calendar year or early 2024 and have classified our SMART Brazil operations as discontinued operations for all periods presented. I would like to address a few items related to our discontinued and continuing operations before moving on to our results.

First, our fourth quarter and fiscal year 2023 results were impacted by a number of GAAP items related to the contemplated sale and migration of SMART Brazil into discontinued operations. These items include the write-down of SMART Brazil's assets and recognition of a one-time non-cash loss primarily related to the historical FX cumulative translation adjustments at SMART Brazil.

Second, in our earnings release and on our website, we have provided a table showing historical financials for our continuing operations back to fiscal 2021 by quarter. We believe recasting our historical financials to show continuing operations provides supplementary information that our investors may find useful in comparing our results to prior periods. Additionally, information regarding our historical continuing operations will be included in our 10-K, which we will file later this month.

And finally, in the fourth quarter, in our continuing operations and on a GAAP basis, we recognized a one-time non-cash income tax benefit of approximately $70 million from the release of our valuation allowance on our U.S. deferred tax assets. As a result, our ending net deferred tax assets on our balance sheet for continuing operations as of the end of our fiscal year is approximately $74 million versus the $1 million we had at the end of the prior year.

Given our financial performance and expected financial performance going forward, we expect to generate future taxable income to be able to recover and use our deferred tax assets. This tax benefit for U.S. valuation allowance release is excluded in our non-GAAP results for the fourth quarter and for fiscal 2023.

I will now focus my remarks on our non-GAAP results for continuing operations, which are reconciled to GAAP in our earnings release tables and in the investor materials on our website. I would like to begin by reviewing some historical financial data, recast on a continuing operations basis to exclude SMART Brazil to aid in the comparison of our fiscal year 2023 results to prior periods.

Net sales, excluding SMART Brazil were $1.06 billion in fiscal 2021, $1.4 billion in fiscal 2022 and $1.44 billion in fiscal 2023. Non-GAAP gross margin, excluding SMART Brazil was 24.4% in fiscal 2021, 29.2% in fiscal 2022 and a record 31.7% in fiscal 2023. And non-GAAP operating margins, excluding SMART Brazil, were 7.9% in fiscal 2021, 12.7% in fiscal 2022 and 12.5% in fiscal 2023. Non-GAAP earnings per share, excluding SMART Brazil, were $1.23 in fiscal 2021, $2.65 in fiscal 2022, and $2.52 in fiscal 2023.

And our sales mix was as follows: for fiscal 2021, IPS was 33%, Memory 46% and LED 21%. For fiscal 2022, IPS was 32%, Memory 40% and LED 29%. And for fiscal 2023, IPS was 52%, Memory 31% and LED 17%.

Net sales from products, excluding SMART Brazil, were as follows: $959 million in fiscal 2021, $1.25 billion in fiscal 2022 and $1.19 billion in fiscal 2023. Net sales from services, excluding SMART Brazil, were as follows: $96.2 million in fiscal 2021 or 9.1% of net sales, $148.4 million in fiscal 2022 or 10.6% of net sales, and a record $248.4 million in fiscal 2023 or 17.2% of net sales.

Our historical financials recast to exclude SMART Brazil highlight the strong gross margin progression in our continuing operations over the last two years, with gross margins exceeding 30% in fiscal 2023. In addition, we have seen significant growth from services revenue, which totaled close to $0.25 billion in fiscal 2023.

Now let me turn to our fiscal 2023 full year and fourth quarter 2023 results from our continuing operations. Overall revenues for fiscal 2023 were up approximately 3% from fiscal 2022 to $1.44 billion, up from $1.4 billion in fiscal 2022, driven by the strong growth in our IPS segment offset by some headwinds in our memory and LED segments.

Yearly sales by business unit were as follows: IPS, $750 million in fiscal 2023, up from $441 million in fiscal '22 and IPS benefited from the inclusion of Stratus, which contributed $173 million of sales in fiscal 2023. Memory, $443 million in fiscal 2023, down from $552 million in fiscal 2022. And as a reminder, this excludes SMART Brazil. LED was $248 million in fiscal 2023, down from $403 million in fiscal 2022. This translates into a sales mix of approximately 52% IPS, 31% Memory and 17% LED.

Our overall product and services were as follows: Products, $1.19 billion in fiscal 2023 versus $1.25 billion in fiscal 2022, down approximately 4% and services at $248 million in fiscal 2023 versus $148 million in fiscal 2022, up approximately $100 million or 67%.

As previously noted, our services revenue includes longer-term services as well as point-in-time services such as logistics and implementation services. The growth of our services revenue in fiscal 2023 highlights our continued focus on delivering value added solutions to our enterprise customers.

Non-GAAP gross margins in fiscal 2023 were 31.7%, up from 29.2% in fiscal 2022, driven by margin improvements from IPS and memory. And in fiscal 2023, our non-GAAP diluted earnings per share from continuing operations were $2.52 down from $2.65 in fiscal 2022, and adjusted EBITDA was $209 million up from $199 million in fiscal 2022.

In addition, we exited the year with a strong balance sheet, including year-end cash, and short-term investments of $391 million. As a reminder, this excludes any cash at SMART Brazil, which was reflected in our discontinued operations.

Now let me turn to our fourth quarter results from continuing operations. Total SGH revenues were $317 million, and non-GAAP gross margin came in at 31.7%. Non-GAAP diluted earnings per share were $0.35 per share for the fourth quarter.

In the fourth quarter, our overall services revenue totaled $60 million up from $31 million in the year ago quarter helped by the inclusion of Stratus which we acquired in the beginning of our fiscal 2023. Product revenues were $257 million.

And fourth quarter revenues by business unit were as follows: IPS $145 million, memory $105 million, and LED at $66 million. This translates into a sales mix of approximately 46% IPS, 33% memory, and 21% LED.

Non-GAAP gross margin for SGH in Q4 was 31.7%, up from 27.1% in the year ago quarter, primarily driven by IPS. And non-GAAP operating expenses for the fourth quarter were $70 million, up from $66.7 million, primarily due to third-party spend, and personnel-related expenses.

And operating expenses were up from $56.5 million in the year-ago quarter, primarily due to the inclusion of Stratus. Non-GAAP diluted earnings per share for the fourth quarter of 2023 was $0.35 compared with $0.63 per share in the year-ago quarter. An adjusted EBITDA for the fourth quarter of 2023 was $38 million or approximately 12% of sales compared with $47 million or 13% of sales in the year ago quarter.

Now turning to our balance sheet highlights. For working capital, our net account receivables totaled $219 million compared with $222 million last quarter. And day sales outstanding came in at approximately 48 days up from 41 days in the last quarter, primarily due to the timing of invoicing and collections.

Inventory totaled $175 million at the end of the fourth quarter, down from $204 million at the end of the prior quarter. The decrease in inventory was driven primarily by a reduction in IPS and memory inventories in the fourth quarter. Inventory turns were 7.5 times in the fourth quarter, approximately flat versus the 7.6 times in the prior quarter.

And consistent with past practice, net accounts receivables, day sales outstanding, an inventory turnover are calculated on a gross sales and cost of goods sold basis, which were $418 million and $326 million respectively for the fourth quarter.

As a reminder, the difference between our gross, and net revenues related to our logistics services, which is accounted for on an agent basis, meaning that we only recognize the net profit on logistics services as revenue.

Cash and cash equivalents and short-term investments totaled a record $391 million at the end of the fourth quarter, up $44 million compared with $347 million at the end of the prior quarter.

Fourth quarter cash flows from operating activities totaled $38 million compared with $33 million in the prior quarter. And for those of you tracking capital expenditures, and depreciation, CapEx was $7.7 million in the fourth quarter, and depreciation was $7.3 million.

And for fiscal 2023, capital expenditures were approximately $39.4 million versus $20.4 million in fiscal 2022. For reference, SMART Brazil's sales totaled $185 million for fiscal 2023 and $32 million in the fourth fiscal quarter. The transaction is expected to close by the end of calendar year 2023 or early 2024, subject to required regulatory approvals, and satisfaction of customary closing conditions.

Now let me turn to our first quarter 2024 guidance, which excludes our discontinued operations for SMART Brazil. We expect that revenues for the first quarter of 2024 will be approximately $275 million at the midpoint plus or minus $25 million.

Our guidance for the first quarter reflects the following: for IPS, which has variability related to factors like the timing of hardware sales, deployment schedules, and longer lead times, we expect revenues to be down sequentially at the midpoint.

For memory, which excludes Brazil, we expect revenues to be sequentially down as we are seeing headwinds from continued market softness, as well as certain customers working through finished goods inventory.

And for LED, we currently expect revenues to be up slightly in Q1. Our GAAP gross margin for the first quarter is expected to be approximately 28.5% at the midpoint plus or minus 1%. Non-GAAP gross margin for the first quarter is expected to be approximately 31.5% at the midpoint plus or minus 1%.

And our non-GAAP operating expenses for the first quarter are expected to be approximately $67 million, plus or minus $1 million, and down from the prior quarter. GAAP diluted earnings per share for the first quarter is expected to be approximately negative $0.16 plus or minus $0.15.

However, on a non-GAAP basis, excluding share-based compensation expense, intangible asset amortization expense, debt discount and other adjustments, we expect diluted earnings per share will be approximately $0.15, plus or minus $0.15.

Our GAAP diluted share count for the first quarter is expected to be approximately 56 million shares, based on our current stock price. Our non-GAAP diluted share count is expected to be approximately 54 million shares as it includes the benefit of our convertible note capped calls.

Cash capital expenditures for the first quarter are expected to be in the range of $4 million to $6 million and approximately $20 million to $25 million for fiscal 2024. Our non-GAAP taxes for the first quarter are expected to be in the 25% range, as we have fully consumed the majority of our available U.S. tax attributes in fiscal 2023.

Our forecast for the first quarter of 2024 is based on the current environment, which contemplates the global macroeconomic headwinds and ongoing supply chain constraints, especially as it relates to our IPS business. This includes extended lead times for certain components that are incorporated into our overall solutions impacting how quickly we can ramp existing and new customer projects.

We continue to manage our operations in a prudent manner as we navigate a challenging environment while also continuing to invest in our long-term growth. Please refer to the non-GAAP financial information section, and the reconciliation of GAAP to non-GAAP measure tables in our earnings release for further detail.

Now, let me turn it over to Mark for a few remarks prior to Q&A.

**Mark Adams**

Thanks, Ken. In closing, I want to thank the over 3,000 employees at SGH for their efforts. At a time when some of the semiconductor industry's largest companies are operating at a loss, the team was able to deliver another quarter of profitability.

We are optimistic that we are well positioned to deliver long-term value to our shareholders, based on our strategy of providing high-performance, high-availability solutions to enterprise customers to capitalize on the growing AI, machine-learning and data analytics end markets, while continuing our strong operating discipline during these challenging economic times.

With that, operator, we are now ready for Q&A.

**Question-and-Answer Session**

**Operator**

[Operator Instructions] Our first question comes from the line of Kevin Cassidy with Rosenblatt Securities. Your line is now open.

**Kevin Cassidy**

Yes, thanks for taking my question. Just the questions around IPS and the demand that you're seeing, and maybe Mark, I missed it. Did you say there was a booking that was going to happen in the third quarter and it happened in the fourth quarter? When would that be deployed? Then also the inventory coming down in IPS, is that suggesting that visibility is still fairly low?

**Mark Adams**

Hi, Kevin, thanks for the question. Yes, on the first question, we had an order billing that we got on actually the first week of Q1 of '24 that did not get registered in Q4 of '23. And so that's confirmed, that's what I commented on in my earlier comments.

And secondly, around IPS inventory, yes, these are times like where, as I commented on our last call, that visibility is a little choppy right now for certain components. I think Ken mentioned that in his script, but I'll let him also talk to this.

**Ken Rizvi**

Yes, so Kevin, on that fold, you know, I would expect actually as we move through Q1 that our inventories will start to increase a little bit. That will be a use of working capital that you should expect in terms of networking capital throughout Q1.

**Kevin Cassidy**

Okay. Maybe just as a follow-up on that, you know, It's pretty well known that the NVIDIA GPUs are sold out. How much is that affecting some of your visibility?

**Mark Adams**

I think out longer term, we think that can smooth out a little bit. Right now, Kevin, as you're suggesting, it's a little bit constrained, and it's affecting a little bit in the short term. But as is, just to be kind of repetitive here, the selling cycle we're involved in is somewhat longer from a solutions perspective than just people buying and selling hardware. And so, some of that is our selling cycle and the timing of our customer engagements being a little bit off what you'd like to see in quarterly reporting perspectives.

So some of it is what you're just identifying. It's not just the GPUs. It's also some networking components, as you know. And all that combined, as I mentioned, and we saw this coming into our quarter, our Q4, and I commented on the last call, just the visibility is a little choppy and that's what kind of led into our guidance today.

**Kevin Cassidy**

Okay, thanks.

**Mark Adams**

Thank you.

**Operator**

Thank you for your question. The next question comes from the line of Sidney Ho with Deutsche Bank. Your line is now open.

**Sidney Ho**

Great, thanks. Just a quick clarification. If I look at the fiscal 4Q guidance, the results, and even if you exclude Brazil, it's still a little bit weaker than I would have expected. Is that mostly reflecting the IPS order being pushed out by maybe a week or two weeks? Is there any other dynamics at play?

**Ken Rizvi**

Actually, yes, Sidney, that's a good question, and let me try to address that here for you. So you are correct. When we had originally guided, we had Brazil as part of our continuing operations and continuing business. We moved that into discontinued ops and as we highlighted on the call, the revenues were about $32 million. Reality is as we were heading into our Q4 into the guidance, we were anticipating a much higher revenue stream from Brazil, and so we were expecting that to be a bit higher. In addition to that, there was a miss, as we talked about, in terms of IPS and some of the orders moving from Q4 into Q1. So those are the two factors relative to our original guidance for Q4.

**Sidney Ho**

Okay, that's helpful. Thanks. Maybe just a follow-up on the IPS question from Kevin. Talking about visibility into fiscal of 2024, you can talk about being more weighted towards the back half of the year. Just curious what - if you can add any color on the trends you're seeing, whether it's by end market, by size of customers. Maybe is there a kind of growth rate that you are now expecting for the full year based on your current visibility?

**Mark Adams**

Sidney, this is Mark. I would just suggest that, for us like trying to peg a certain growth rate is kind of difficult giving the lumpiness of the business. We're encouraged by the level of customer engagements that we're having. And as we convert those, you know, kind of into proposals and closing business, we'll have better visibility. Obviously, there's a lot of market enthusiasm for AI. The deployments are kind of in front of us, it's early innings, and what I would say is as we go through this, it's hard to just pick a number, this is what our growth rate will be like, we see some positive signs on our engagements that lead us to believe that the second half will be stronger than the first half.

**Sidney Ho**

Okay. Maybe one last question from me. If I look at the announcement you talked about with NVIDIA DGX-Ready Managed Services. Can you walk us through the advantages of being certified with them? Does that expand your TAM? Does that replace some of the services that you already provide to your customers? And how should we think about that partnership showing up in your financials? Thanks.

**Mark Adams**

Well, again, our strategy of how we engage with customers, we come at it from a kind of total solutions. And when we say design and build, deploy and manage, and I've talked about this before, we're just not - we're not a company that deals in hardware only approach to go to the market. And these type of initiatives, like the one you asked about in terms of our managed service announcement, it gives us a chance to actually focus on customers who buy into that and require that.

And that's really where we're leaning. We're not in a position that we're going to be selling things sub 20% gross margins. That's just not a good business model for us. And quite frankly with the experience that Penguin has over more than two decades of HPC that apply to all the learnings we've had in more recent years on AI initiatives, the services that we have, the lessons learned that we've incorporated into helping our customers deploy these systems, it's a real advantage for us.

And so if you factor in how that shows up for us, it shows up in gross margin, and it'll show up in terms of how we expand our customer base in the near to long term. These things take time and we've talked about the customer concentration, we've talked about lumpiness repeatedly, but we're optimistic because of the level of excitement and investment into long-term AI that we're in a good position.

**Sidney Ho**

Great, thank you very much.

**Mark Adams**

Thank you.

**Operator**

Thank you for your question. The next question comes from a line of Brian Chin with Stifel. Your line is now open.

**Brian Chin**

Hi there, thanks for letting us ask a few questions. Maybe a couple of things, maybe to start off with, Ken, if we include Brazil in the fiscal 4Q and fiscal 1Q outlook, what would the top and bottom line results and guidance have looked like?

**Ken Rizvi**

Yes, so for Q4, we outlined that Brazil represented $30 million for actual sales as before. Now, what I just mentioned on the prior question was that coming into quarter we were anticipating Q4 sales for Brazil would have been higher than that number, but they seem a bit light. We're not guiding the business, the Brazil business going forward in Q1. This is now a part of discontinued operations and is therefore guiding for what is continuing operations, which is now inclusive of IPS, specialty memory.

**Mark Adams**

Yes, I mean, just to further clarify that Brazil comment, I just didn't add a lot of colors, as Ken mentioned. The consumer memory market and the demand for the end product phones and desktop notebooks, the global basis is down dramatically. And then we saw it down even more than initial forecast for the quarter, and that was a substantial change in the performance. And as Ken said, that changed and that impacted if you included them in our Q4 number, how we came in kind of around the bottom end of the guidance.

**Brian Chin**

Okay. And then in terms thank you and then in terms of physical 1Q and the outlook, it seems to suggest maybe memory, especially memory and IPS down somewhere kind of in the mid to upper teens, something like that, Q1Q, maybe one of those businesses is a little softer sequentially. Do you feel that those levels, revenue run rates for those two segments? Do you feel those are at bottom relative to sort of the commentary around inventory burn-off on the memory side of customers, and given the oscillations of projects in IPS?

**Mark Adams**

Let me take that first and I'll let Ken add as needed. If I take the memory part first, as you can tell from the semiconductor players in the memory business, I'm not going to single out anyone, but across the board they're still operating at a significant loss. And I'm hearing and we're seeing initial signs of price stabilization. But I also know that this takes a little time to get through the market.

Now, we haven't seen as much of a price impact per se as we've seen demand soften a bit as we head into Q1, as you know, kind of as we're in the quarter now, we've seen that really some of our key customers' inventory levels are relatively high, and the indication is that - that'll burn down, burn off in the next quarter or so. And we just have to stay close to that to see how that plays out.

But the other side of it also is, and we talked about this from the get-go back in early times in 2020, 21, this is not a revenue play only for us. And that's why I'm really proud of the team for generating an operating income of 14% at a time that the innovators, the technology innovators in this category are operating a loss. We run the business pretty well.

And I see, yes, I can't really call the timing per se, but pricing seems to be stabilizing a little bit, so that's early, and we think the inventory burn-off will be in the next quarter or two and should be back - in good shape. On the IPS side, for us it's a little bit of a different story. It's just more of the - it's a combination of the customer concentration, and the lumpiness, and the timing of some of our engagements with a little bit of visibility challenge in the supply chain.

If you combine all that, it's just where we ended up for the quarter in that business. We still are very enthused about the business, like our place in the ecosystem of offering differentiated value services, and being able to deploy complex systems.

**Brian Chin**

Okay, maybe if I can ask one more thing related to the comment of sort of a physical second half snapback or improvement on the IPS business. Obviously physical first half, this upcoming fiscal year versus last year, pretty difficult comparison given the timing and strength in some of the IPS deployments. But what kind of backlog or pretty firm indications do you have in hand or close to it to give you that confidence that you'll see the snapback in fiscal second half, and probably for the year, IPS revenue can't be up for the fiscal year, but do you see year-over-year growth in the fiscal second half in IPS?

**Mark Adams**

Brian, we're not able to forecast per se at this point, and that's something we haven't done. We're just going to keep forecasting for the quarter in advance. But let me just give you a couple things. We have visibility to a run rate business, and then we also have increased our efforts in bringing new resources to drive new customer acquisition. And I can say qualitatively speaking, the customer engagements are pretty exciting.

And so converting that into revenue, and then also trying to predict when that's going to land, it'll get clearer as we go through Q2, Q3. But right now we're going to stay away from forecasting out there. But as I said, you know, there's a lot of enthusiasm around AI. What I would say is it seems like a lot of technologies, hardware is being sold, and a lot of people are now looking for capabilities and assistance in deploying it.

And that's where I think you're going to see us focus our efforts. And as we gain successes, we'll be able to communicate them. Just a data point, I can't get into really more specifics, but in this last quarter we added two significant logos in terms of the brand name, in one in aerospace and one in education, and a couple of others that are not signed, but looking very favorable that we can communicate on our next call in the quarter.

But it's still kind of in flux as far as when that timing will be. And that's just what we're dealing with, a little bit uncertain around recognizing the timing. But again, the customer engagements are ones that we're really excited about helping these people - helping companies deploy AI in their own environment.

**Brian Chin**

Great. Sounds good. Any of those synergies with Stratus by any chance, customer synergies?

**Mark Adams**

Early stages in terms of being able to quantify that for you, what we are seeing is that the customer interest in some of Stratus' products more around the edge twofold. There is a kind of a super early stage belief in AI at the edge. And when you think about some of these markets, oil and gas or financial services or even retail.

The ability to have autonomous unmanned computing out in the field is something that plays a Stratus' strength. And as more applications are able to be delivered generating potential AI applications at the edge, I think we're going to be pretty well positioned.

**Brian Chin**

Okay. Thank you.

**Operator**

Thank you for your question. The next question comes from a line of Tom O'Malley with Barclay. Your line is now open.

**Tom O'Malley**

Hi, good afternoon guys. Thanks for taking my question. You gave the LED business up slightly in the November quarter. Could you just give a little more color between IPS and memory solutions sequentially on what gets you to your guidance? Thank you.

**Ken Rizvi**

Sure, yes, so you're right, Tom. The LED business should be up a little bit, Q4 into Q1, and then, you know, we don't specify by IPS or memory, but if you look at the guide, they're down in that kind of mid-teens level, plus or minus combined, to get to that 275 midpoint of guidance.

And there's a little movement, and that's part of the reason why we provide a range in terms of how projects can land for IPS or on the memory side, how things go through the rest of the quarter. But that gets you towards that midpoint.

**Tom O'Malley**

Okay. And then just a little clarification. So you mentioned a project move from Q4 to Q1 on timings in terms of booking, I would expect that Q1 would be a little higher on the IPS side just given the change in timing. Can you just talk about what's going on in that business such that even X that deal moving that you're seeing such weakness there both in August and November?

**Mark Adams**

Sure, I think it really goes back to my commentary, Tom, about the lumpiness and customer concentration that we've had in that business. If you take a step back, this is a business that was doing less than $50 million a quarter when I joined. And the team has done a fantastic job building up the business. And that doesn't exclude us from the lumpiness and HPC and the customer concentration that we do have.

And we've been pretty clear about that. And this is a time that the deployments are lining up as such and kind of all considered as part of our forecast. As I said to one of the earlier questions, we think this is a quarter where that's occurring, but we're still very bullish on the business long-term. And our recent interactions with - our existing customers, and new targeted customers lead us to be cautiously optimistic in the long-term.

**Tom O'Malley**

And just one more. When most peers generally don't take out businesses until the full sale is complete. You guys decided to move the Brazil business into discontinued operations. Can you just walk through the rationale for that decision, inter quarter? Thank you.

**Mark Adams**

Yes, sure, Tom. So a couple things. One, there's kind of a two-step process. One, we look at held for sale and look at the asset as such. And then there's another step in terms of looking at the significance and likelihood to close the transaction. And those are the two factors from an accounting standpoint that drives this business migrating towards so to discontinued operations.

And that's part of the reason why in Q4 it is now discontinued operations. And that's part of the reason also why we've recast the historicals and the go-forwards for the continuing operations of the business.

**Tom O'Malley**

Thank you.

**Mark Adams**

Thanks, Tom.

**Operator**

Thank you for your question. The next question comes from the line of Quinn Bolton with Needham. Your line is now open.

**Quinn Bolton**

Hi guys, thanks for taking my questions. I guess just thinking through the comments, obviously you've talked about based on customer budgets and visibility, think IPS is probably stronger the second half of the fiscal year versus the first. Your comments around inventory burn on memory, you know, taking another quarter to make me think that memory solutions probably also better in the second half versus the first half, but wondering if you would comment on that. And then similarly, the Cree or the LED business looks like it's more stable here in the near term but do you have any sort of first half versus second half commentary you can give on the LED business.

**Mark Adams**

Let me start again. I'll have Ken jump in. Let me just tackle memory first. Memory pricing, vectored into the memory reporting public reports on earnings and what have you. Memory pricing is reflected as down significantly. And revenues at the memory players down, some is down as much as over 50% revenue in negative gross margins and negative EPS. When we see memory pricing stabilizing, it takes a little time to flow through to the performance. And so I think on the memory perspective, while we're not going to forecast the number, we would agree with your sentiment that second half could potentially be better than the first half.

LED, similarly is trending better for us than, say, Q2 of '23, and we're hopeful that that will continue. I think we do see that sometimes there is a little bit more cyclicality in the LED business given some of the regional holidays and how they line up and the likes, speaking more towards, again, not forecasting, but just the trends we've seen in the past in Q2.

But again, that business is recovering. We've seen back-to-back quarters of some incremental growth, and we're favorable on the design improvements with some of our customers. So again, that's what we're counting on and then hopeful for that the LED business will continue to rebound from where it is today.

And then on IPS, the market is favorable that way and given the lumpiness of the business and the timing of deployments and some of the variables that go in, including things like supply chain, yes, we're signaling that our current view of the world is that the second half will be better than the first half.

**Ken Rizvi**

Yes, and the only thing there on the LED side, Quinn, is that if we looked in 2023, we did see the distribution network reduce inventories quite a bit in the neighborhood of call it $18 million. And that is now at a more normalized level. So that's helping us and it's a healthy entry point as we head into 2024 for LED specifically.

**Mark Adams**

Yes, I guess I would also add, as I listened to Ken's commentary, that inventory level is not contributing at all to any of the revenue growth that Cree's generating from Q2 to Q3, Q3 to Q4.

**Quinn Bolton**

Got it. Okay. But the second question maybe for Ken, now that you've classified the Brazil, SMART Brazil as discontinue operations, can you give us sort of new targets for long-term gross margin and an op margin excluding SMART Brazil?

**Mark Adams**

Yes, so we haven't outlined the long-term margin expectations. I think the thought will be as we move into calendar year '24, we'll outline that once that transaction closes. But I think what you can see, and even if you look at the recasting of our historicals, is that in the last year, we're running north of that 30% margin level, which is a substantial improvement relative to where we were a couple of years ago, inclusive or exclusive or excluding Brazil.

And so the business is just a much different business model today, not only from the overall margin perspective, but also if you look at the services component, which last year was running close to a $0.25 billion, that margin profile is in that 55%, 60% range, plus or minus a bit as well. So that's fairly healthy. And that provides some stickiness in the sense that we have reasonable visibility on a large portion of that services revenue up to a year and sometimes a bit longer.

So we will, as we are able to execute and finalize the Brazil transaction, we'll come back to investors after that and we can outline where our targets are. But I think based on where the business is, we'd shoot for something higher than where we are today. And as revenues grow, we would expect that we can also scale not only the gross margins, but have reasonable fall through down to the op income margins as well.

**Quinn Bolton**

Got it. And then lastly maybe a longer term question, you mentioned CXL and the prepared comments. Is there any way that you guys could size that opportunity you know, do you think it ramps with CXL 1.1, you know is those processors ramped. Do you need to wait for CXL Version 2 with [Granite Rapids] next year before you start to see, you know, that business really beginning to ramp any thoughts on timing as to when you start to monetize the CXL opportunity. Thanks.

**Mark Adams**

Well, yes, based on our - first of all, I think we're in a really good position, a very unique position for us to drive revenue growth. I think as I think about it, your question is a really good one around is there kind of an overnight sensation or is it an evolution to new product development and revenue recognition? That's how I interpreted your question and what I would say is it's probably more evolutionary in '25, '26, meaningful revenue. We've got some good early qualifications on products, on test products. And we're encouraged by where we sit in terms of the development timeline but because of processor and memory delivery and some of the new memory architectures that are needed to support this, Version 1, Version 2, Version 3 of CXL will only add to what I think will be a growing TAM.

And I'll let Jack, if you have any other comments around it, go ahead.

**Jack Pacheco**

No, just a quick thing with this - we do need to get to CXL 2.0 right before we'll start seeing any kind of meaningful revenue out of CXL. We'll ship some revenue this year. We'll actually release our first CXL product coming up here this year, but we won't change anything sizeable until our fiscal '25 and then it will grow as we get into 3.0 as well after that.

**Mark Adams**

So again, more of an evolutionary approach to how that market to grow and I think we have a good roadmap to support that.

**Quinn Bolton**

Thank you.

**Operator**

Sorry about that. There are no more questions waiting at this time. I would now like to pass the conference over to Mark Adams for further remarks.

**Mark Adams**

Well, thank you all again for joining today. We look forward to updating you on our next earnings call.