S&P Global
Market Intelligence

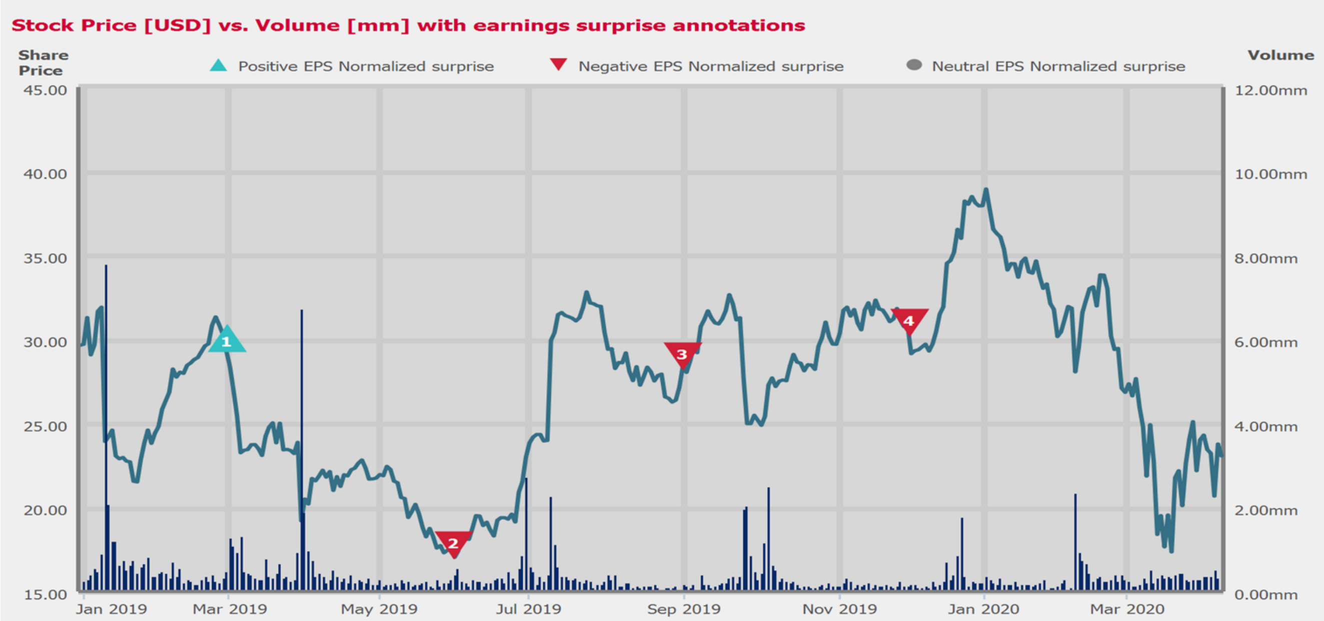
SMART Global Holdings, Inc.
NasdaqGS:SGH
FQ2 2020 Earnings Call Transcripts

Tuesday, April 07, 2020 8:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2020-	-FQ2 2020-		-FY 2020-	-FY 2021-
	CONSENSUS	CONSENSUS	SURPRISE	CONSENSUS	CONSENSUS
EPS Normalized	0.73	0.50	▲4.00	2.67	3.78
Revenue (mm)	279.30	268.71	▲1.24	1122.46	1286.02

Currency: USD
Consensus as of Apr-02-2020 10:06 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2019	0.75	0.77	▲1 2.67 %
FQ3 2019	0.37	0.34	▼2 (8.11 %)
FQ4 2019	0.67	0.50	▼3 (25.37 %)
FQ1 2020	0.73	0.55	▼4 (24.66 %)

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Call Participants

EXECUTIVES

Ajay B. Shah
Chairman, CEO & President

Jack A. Pacheco
Executive VP, COO & CFO

Suzanne Schmidt
Investor Relations Officer

ANALYSTS

Blayne Peter Curtis
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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the SMART Global Holdings Second Quarter Fiscal 2020 Earnings Call. [Operator Instructions] Please be advised that today's conference may be recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Ms. Suzanne Schmidt with Investor Relations. Please go ahead.

Suzanne Schmidt
Investor Relations Officer

Thank you, operator. Good afternoon, and thank you for joining us on today's earnings conference call to discuss SMART Global Holdings second quarter fiscal 2020 results. Ajay Shah, Chairman and Chief Executive Officer, will begin the call with a discussion of the market and the business; followed by Jack Pacheco, Chief Operating and Financial Officer, who will review the financial results in more detail and provide the forward guidance, after which we will open the call to your questions.

As a reminder, our earnings press release and a replay of today's call can be accessed under the Investor Relations section of SMART's website at smartgh.com. We encourage you to go to our website throughout the quarter for the most current information on the company, including information on the various financial conferences we will be attending.

Before we begin the call, I would like to note that today's remarks and the answers to today's questions may include forward-looking statements. Any statement that refers to expectations, projections, or other characterizations of future events, including financial projections and future market condition is a forward-looking statement. Actual results may differ materially from those expressed in these forward-looking statements. For more information, please refer to the risk factors discussed in the documents we file from time to time with the SEC, including our most recent Form 10-K. We assume no obligation to update these forward-looking statements which speak as of today.

Additionally, during this call, our non-GAAP financial measures will be discussed. Reconciliations for those directly comparable GAAP financial measures are included in today's earnings press release.

With that, I will now turn the call over to Chairman and CEO, Ajay Shah.

Ajay B. Shah
Chairman, CEO & President

Thank you, Suzanne, and welcome to everyone on the call from, I assume, all of you at home. It is the most amazing time that we find ourselves in and our fiscal second quarter has been one of the most difficult we have seen in a long time given the environment around the world. However, our team at SMART has stepped up to the challenges and delivered strong operational and financial results with both revenue and non-GAAP earnings per share above the midpoint of our guidance range in spite of some delays we experienced in component availability from China and from some customer operations in China.

[Technical Difficulty]

Operator

Ladies and gentlemen, please stand by, your conference call will resume momentarily. [Operator Instructions]

Mr. Shah is reconnected now.

Ajay B. Shah
Chairman, CEO & President

I'm sorry. I apologize for the difficulties that we had. I will start, again, since I was right close to the beginning. And as I was saying, our fiscal second quarter has been one of the most difficult we've seen in a long time given the environment around the world. However, our team at SMART has stepped up to the challenges and delivered strong operational and financial results with both revenue and non-GAAP earnings per share above the midpoint of our guidance range in spite of some delays we experienced in component availability from China and from some customers' operations in China.

The emergence of the COVID-19 crisis has clearly created operational challenges and macroeconomics uncertainties. But considering the circumstances, we've proactively taken the necessary steps to, first and foremost, prioritize the safety and well-being of our global workforce at SMART while, at the same time, keeping the company's operations functioning and serving our diverse customer base to ensure their continued success.

In the second fiscal quarter, our performance also benefited from a good macro environment for memory products and also from stability in Brazilian policies and the economy there. Furthermore, our acquisitions from fiscal 2019 are showing improved performance and increased potential with a robust pipeline of new business in place.

Finally and importantly, the convertible debt refinancing that we completed in early February this year is accretive to earnings and significantly strengthens our balance sheet and cash position to be able to better weather the challenges ahead and also to take advantage of the opportunities that will be created in this changing environment.

Today, we have our team around the world working from home or working in our manufacturing facilities, providing the essential services and products our customers need from us. While manufacturing operations continue in all of our facilities around the world so far, in some manufacturing locations, we are operating at reduced levels to keep within local guidelines and to maintain employee safety. Overall, we've been able to prioritize requirements with our customers and keep them satisfied.

In support of this effort, we were undertaking steps to secure our supply chain, properly reallocate our resources and device contingency plans to aggressively meet the challenges facing all of us today. From a supply chain perspective, we're functioning fairly well despite the disruption from COVID-19. As the crisis continues, we're running numerous contingency scenarios to mitigate these challenges as much as possible. In addition, our leadership team in all our locations around the world are engaging with their local communities and hospitals to support urgent needs in the areas.

Turning now to the review of each of our lines of business. In the second quarter of fiscal 2020, approximately 41% of revenues came from our Specialty Memory Products business, 36% from our Brazil business and 23% from our Specialty Computing Products business.

Starting now with Specialty Memory, which represented 41% of overall revenue and achieved about $111 million in revenues in the quarter. Our revenues in this quarter were 8% higher than the previous quarter despite some supply shortages and some shutdowns by our China-based suppliers. During the quarter, we introduced some of the first of a range of specialty SSD products based on our own recently developed firmware and controller technologies. Also, we're seeing a strong pipeline of new opportunities as we ramp up our sales efforts focused on a broader base of customers in new areas such as medical, industrial, defense and security.

During the second quarter, we had one of our strongest performances in terms of new design wins that resulted in additional customers and orders, some of which will start shipping as early as the third and fourth quarters of fiscal 2020. For example, the increase in IoT processing at the edge of the network is driving more demand for storage. And we won a new customer in the area of body cameras, a market segment where we were not present before. In addition, we had a very strong bookings quarter for our NVDIMM products, which offer a low-density alternative to 3D Crosspoint technology-based products.

Moving on now to our Brazil business, which grew by 4% over the previous quarter to reach $98 million in revenue approximately, 36% of our overall revenue. Brazil outperformed our expectations in what is normally a seasonally weak quarter due to calendar year-end shutdowns and holidays. Our mobile memory products experienced higher selling prices as we saw significant increases in the average density of mobile memory products shipped in the period. We've also had some exciting new mobile memory product introductions and products and qualification at our customers. Also, our DRAM products in Brazil performed well in the quarter and pricing held steady.

In Brazil, with the new manufacturing rules in place as of July last year and with our customers now clear about the new tax incentives that were signed into law at the end of December last year, we're now getting longer-term forecasts, and we are also participating to a greater degree in the higher-density product demand. Another new area of progress for our business in Brazil is the introduction of a line of LoRa-based IoT products for smart cities applications. We've received the first trial orders for some of these products. As you may know, LoRa is a long range, low power wireless technology that's become a de facto technology for IoT networks worldwide.

While it's difficult to anticipate the effects of COVID-19-related effects on the economy and operations in Brazil as well as the significant weakening of the Brazilian real versus the U.S. dollar that has happened recently, longer term, we remain optimistic about the prospects for profitable growth from this part of our business.

Our Specialty Computing line of business totaled $63 million of revenue in the quarter, representing approximately 23% of overall revenue. While this is also a seasonally weak period for this line of business, revenues in the quarter were further lower than expected due to delays of certain government-related orders. However, we've made significant progress in improving gross margins through operational improvements, integration and an improved mix of business with an increasing share of revenues coming from services in this business.

You may recall that this business can be lumpy and is dependent on large projects, particularly those for government agencies. The quarter was also notable in terms of our strong bookings of multiyear managed services contracts, which led to our strongest booking quarter ever in this business in terms of total contract value. During the quarter, we introduced the first of our solution sets for different vertical applications, utilizing GPU, or graphics processors, and CPU technologies, integrated with our networking and cluster management software tools for AI, HPC and other modeling and analytics applications. These solution set offerings are now leading our new systems bookings.

We're entering the second half of our fiscal year with a robust pipeline for new business across Specialty Compute and a solid competitive position post the recent industry consolidation, which has happened. And this has put us in a -- put us forward as a strong alternative for many large projects. Additionally, more and more applications are emerging driven by AI, edge computing and also, we're seeing new applications in our wireless computing products where we continue to win new designs in partnership with Qualcomm. We remain optimistic about the longer-term prospects across all of our specialty computing areas.

To further drive our efforts in these areas, we've integrated the management and many engineering, services and sales organizations across Embedded Computing and Penguin Computing businesses. This will help to drive further operating cost improvements as well as a broader set of product offerings to the marketplace and a stronger go-to-market effort.

In conclusion, these are clearly challenging times for all of us to navigate and indeed to forecast. However, the long-term underlying business trends point toward an increasing need for more data center, cloud and AI-related capabilities as well as greater requirements for specialized application-specific memory solutions, all of which leave us confident in our position to meet these demands in the future.

Finally, in examining our portfolio, our lines of business have very limited exposure to affected end markets such as automotive, travel and hospitality and real estate. We do have some exposure to oil and gas, and particularly in Brazil, to the consumer market. That said, we have a significant position in stronger end markets such as enterprise and infrastructure computing and communications, AI and HPC, government and defense applications and in enterprise computing -- in enterprise storage. We're in a strong financial position with over $140 million in cash and minimal current debt.

We have indeed run many financial simulations and scenarios and feel comfortable with our ability to withstand a prolonged downturn. As I said before, this should enable us to weather this storm and to be well positioned for the opportunities that will emerge.

With that, let me turn the call over to Jack for a review of our financials and our guidance. Jack?

Jack A. Pacheco
Executive VP, COO & CFO

Thank you, Ajay. Overall, gross revenue for the second fiscal quarter was $420.9 million, while net sales were $272 million. As a reminder, the difference between gross revenue and net sales is related to our Supply Chain Services business, which is accounted for on an agency basis, meaning that we only recognize as net sales the net profit on Supply Chain Services transaction.

A breakdown of net sales by end market, the second fiscal quarter was as follows: mobile and PCs, 34%; network and telecom, 24%; servers and storage, 11%; industrial, defense and other, 31%.

Now moving to the rest of the income statement. Non-GAAP gross profit for the second quarter was $52.9 million compared with last quarter's $55.7 million, primarily due to product mix. Non-GAAP operating expenses were $35.6 million compared with $37.5 million in the previous quarter as we had lower audit stocks as well as trade show-related expenses. Non-GAAP net income for the second quarter was $12.8 million or $0.52 per diluted share compared with $13.4 million or $0.55 per diluted share in the previous quarter, and adjusted EBITDA totaled $22.3 million compared with $23.5 million in the prior quarter.

Turning to working capital. Our net accounts receivable totaled $217.4 million compared with $228.8 million last quarter. Our days sales outstanding decreased to 47 days for this quarter compared with 50 days last quarter. Inventory totaled $161.4 million at the end of the second quarter compared with $160 million at the end of the first quarter. Inventory turns remained flat at around 9% for both quarters. Consistent with past practice, accounts receivable, days outstanding and inventory turnover are calculated on a gross sales and cost of goods sold basis, which were $420.9 million and $369.4 million, respectively, for the second quarter.

We entered the second quarter with $141.9 million of cash and cash equivalents compared with $111.4 million at the end of the prior quarter. Second quarter cash flow from operations totaled $23.3 million compared with $25.3 million in the prior quarter. We exited our second quarter with a very strong balance sheet as well as a vastly improved capital structure.

We issued $250 million of convertible notes on February 11, 2020, and used $204.9 million of the proceeds to pay off our existing term loan, thereby extending our debt maturity out to 2026, which means we do not have any term loan debt payments for 6 years. We also used $21.8 million of proceeds to purchase capped calls, which is expected to reduce dilution to the shareholders upon conversion of the notes.

The maturity of our $50 million revolving line of credit was also extended out 5 years. We did not have any revolver drawdown at the end of Q2 nor do we anticipate during the third quarter as we expect to continue to generate cash during our third quarter. Completing our debt refinancing reduces our cash spend on interest as well as our interest expense booked each quarter by over $3 million per quarter. And this, along with eliminating our cash spend on amortizing our debt each quarter, which was approximately $5.6 million, will save us over $9 million in cash per quarter, beginning in our third quarter. For those of you tracking CapEx and depreciation, CapEx was $4.2 million for the quarter and depreciation was $6 million.

And now let me touch on some of the financial and operational dynamics we are currently facing. At this time, all of our manufacturing facilities across the globe are operating and servicing our customers, as Ajay mentioned earlier. We're still seeing strong demand from our customers in our third quarter, and our guidance reflects this current view of the quarter. We have analyzed and continued to assess our customers and their end markets for weaknesses and strength, i.e., oil and gas is expected to be weaker, while our networking, telecom, server and storage businesses, which are some of our largest end markets, looks to be performing stronger due to the increased demand for cloud, Internet services and telecom.

The worldwide crisis due to COVID-19 has also further weakened the Brazilian real to new levels. We are not seeing this impact consumer spending yet but believe it could have a negative impact on the Brazilian economy, which had expected positive GDP growth for 2020. We have taken a number of steps to minimize its impact on the company by having foreign exchange forward contracts for accounts payable, which we believe should minimize FX losses from payments. As a reminder, we price in U.S. dollars, and we convert to the real when we invoice in order to minimize any negative impact to us. We will continue to monitor the situation in Brazil very carefully and work to minimize any resulting impact to our business.

With that as a backdrop, let me now turn to our guidance for the third quarter of fiscal 2020. We currently estimate that our third quarter net sales will be in the range of $270 million to $300 million. The midpoint of which represents an increase of 5% sequentially. Gross margin for the quarter is estimated to be approximately 20% to 22%. GAAP earnings per diluted share is expected to be approximately $0.33 per share, plus or minus $0.05. On a non-GAAP basis, excluding share-based compensation expense and intangible asset amortization expense, we expect non-GAAP earnings per diluted share will be in the range of $0.68, plus or minus $0.05, the midpoint of which represents an increase of 31% sequentially.

The guidance for the third fiscal quarter does not include any view on the foreign exchange gains or losses or a mark-to-market adjustment for our capped call and includes an income tax provision expected to be in the range of 14% to 18%. The number of shares used to estimate earnings per diluted share for the third fiscal quarter is 24.6 million. Capital expenditures for the third fiscal quarter are expected to be in the range of $4 million to $6 million.

Please refer to the non-GAAP financial information section and the reconciliation of non-GAAP financial measures to GAAP results and reconciliation of GAAP net income to adjusted EBITDA tables in our earnings press release for further details.
Operator, we are now ready to take questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Blayne Curtis with Barclays.

Blayne Peter Curtis
Barclays Bank PLC, Research Division

Obviously, the backdrop here, I think most companies are lowering numbers, you had some good results. I'm curious, kind of a couple of things on that front. One, if you can just talk about where you saw shortages, if there's any quantification on kind of how much that impact was. And then I'm kind of just curious as you're looking forward here, you kind of have 2 opposing factors. Seems like you probably would benefit from some work from home, which could be a near-term boost. But then obviously, you have a big consumer business in Brazil. And I am no expert on COVID exposures in Brazil, but I think most people assume that's going to get worse. So I was just kind of curious how you're handicapping that?

Ajay B. Shah
Chairman, CEO & President

As you know, Blayne, Jack and I are in different places. So we will try to give you a coordinated response. I will start, and Jack can fill in. To come back to your question about -- let me start at the end with respect to Brazil. So Brazil has, by the way, many of the same restrictions in place today as we do in most of the United States. So in other words, we have stay-at-home restrictions as well as retail and travel are significantly limited. And so effectively, what you have is most of our staff are working from home, except for manufacturing, which is not possible to do from home. We are seeing some of our customers have slowdowns and shutdowns for temporary, maybe because they had a case of positive of COVID. And so it is an uneven environment and less predictable. But as you pointed out, some of the benefits we are seeing are from the -- particularly the PC and the server market, PC laptop server, not as much in the mobile phone market.

The mobile phone market, at least for now, we can see production levels are down, and that was, to some degree, driven by component shortages. But now I think we are going to see a different effect, which is factories are also slowing down because of shutdowns and some temporary situations at certain customers, not all customers. So it is a fluid situation. But we've been obviously looking at our backlog and what we've shipped already. And as a result, we're pretty comfortable with where we are in terms of our Q3 estimates. And obviously, we have backlog by this stage for much of what we're talking about. Barring some significant incidents, which causes us to shut down operations or something like that, we're pretty confident in our estimates.

Now to come back to the beginning of your question, which is shortages from China, which was a little earlier in the quarter, we had shortages and they rippled through all the way to the supply chain. Mostly, what we buy in China is our circuit boards and passives. But Jack, you might care to elaborate further on that.

Jack A. Pacheco
Executive VP, COO & CFO

Sure. Real quick, Blayne, to also -- some of our customers had a component shortage, if you're going that way with the question. Seems like even in Brazil, when Ajay mentioned that we didn't ship some mobile memory because of component shortages, it was our customers who couldn't get parts, not us. So the phone guys couldn't get enough parts to build phones so they shut down for a little bit during the quarter. As far as us, we didn't really have an issue of getting our parts, but we had customers who couldn't get some of their parts out of China. And then we had the Chinese contract manufacturers shut down for 5 weeks or so in the quarter. So yes, there was a minimal impact to us in the quarter, but it wasn't anything dramatic in our Q2.

Blayne Peter Curtis
Barclays Bank PLC, Research Division

And just one last one, if you could just -- the gross margin improvement into May, what's driving that?

Jack A. Pacheco
Executive VP, COO & CFO

Sure. I mean a lot of it is that Specialty Compute, which is the highest gross margin segment of the business, is going to -- projected to have a better quarter in Q3. Remember, in Q2, we talked about the governments that have got pushed. So that got pushed into Q3. And so the performance there will improve the margin somewhat in the quarter.

Operator

Our next question comes from Raji Gill with Needham & Company.

Rajvindra S. Gill
Needham & Company, LLC, Research Division

A question on the memory market. My understanding is that the lead times have kind of stretched out for memory and both for DRAM and NAND, and we're starting to see increased pricing in Flash and DRAM. Wondering if you could kind of comment on your thoughts on that dynamic that you're seeing in the market and how that's kind of bleeding into your business?

Jack A. Pacheco
Executive VP, COO & CFO

Sure. I could start and maybe Ajay can come in and finish a little bit. Yes, we're seeing -- we are definitely seeing DRAM lead time stretch out. We've seen those get out to 12, 15 weeks. We're seeing Flash, still longer, especially in caps and resistors. So we're kind of back to a situation now where customers are placing orders earlier to get their parts, which is helpful to us. And Ajay mentioned earlier we have a backlog for most of our business during the quarter. And so we're getting more backlog again from customers as they have to order farther out to make sure that they get their parts. So far, it's not hurting us from a revenue or margin standpoint. It gives a little bit better visibility.

Rajvindra S. Gill
Needham & Company, LLC, Research Division

Okay. Got it. And you talked about some of the end markets, oil and gas being weaker, offset by network storage, telecom. You kind of lumped PC and mobile together at like 34%. It seems to me that there could be some issues in mobile given the production problems. Wondering if you could kind of break out the mobile and PC a little bit finer? It seems like enterprise PCs will be okay, networking, telecom will be okay and storage. I'm just trying to see what the -- to pinpoint the exposure.

Jack A. Pacheco
Executive VP, COO & CFO

Sure. So most of the mobile and PC, all -- pretty much all of that's in Brazil. The only place we really play in the consumer markets are in Brazil. So that's really all Brazil exposure. So it's not a worldwide kind of phenomenon there. And so there, you're probably still looking at -- 2/3 of that is probably mobile, 1/3 of that would be PCs.

Rajvindra S. Gill
Needham & Company, LLC, Research Division

Okay. And in terms of just the weakening the real. So you talked about putting FX contracts to try to minimize your AP payments. But you have not seen the impact yet on actual end demand. So I'm just wondering what would -- when would you see that? And would it be just obviously in just lower sell-through for these phones?

Jack A. Pacheco
Executive VP, COO & CFO

Yes. I mean we should see it in our -- we should see it from our customers, right? We would start getting lower forecast from the cell phone guys in Brazil, say, the Lenovo and LG that their 6 months forecast for us will start to decrease if their sell-through was going down. And so far, we haven't seen that yet in Brazil.

Ajay B. Shah
Chairman, CEO & President

As you might imagine, Raji, this is a point that we're particularly focused on because we can see the effects of a 20% change in the exchange rate on the end price of the product. And to top it all off, you have significant slowdowns in retail, right? And there are quite a few phones sold through retail. So meanwhile, online is, even in Brazil, growing much faster. And so if we sound like we're not able to give you an extremely clear answer, it's because we are not in that we -- the forecasts we're getting, as recently as this week, are continuing to show pretty -- not showing any significant drop-off. I mean there's changes, but not significant. What we are seeing are the effects of factories shutting down for a week, 2 weeks because of issues with infections.

Operator

Our next question comes from Sidney Ho with Deutsche Bank.

Shek Ming Ho
Deutsche Bank AG, Research Division

A couple of them, I -- for the Specialty Computing business, I wonder if you can double-click on that and give us some color what portion of that business you consider as stable and what is more like GDP-driven that may get impacted in the macro environment we're in, particularly interested in your view on some of the government projects. And kind of related to that, Ajay, you talked about increasing -- you're seeing an increasing potential from the 3 acquisitions. Maybe can you get into a little more color what those potential could be.

Ajay B. Shah
Chairman, CEO & President

Sure, Sidney, thank you. I'll start, and maybe Jack can add to it. The -- starting with the sectors, we have a fair amount of business, as you noted, with government and government labs and different government agencies. And we don't see any drop-off in activity there. If anything, the spending has increased, as you've noted in the press, I'm sure. We do have a fair amount of business with financial services, with -- mostly from an analytics point of view with medical, particularly analytics and trials and that business seems all right. We have a fair amount of business with social media, and that business seems pretty well all right. We have some business in that entire segment related to telecom. And so far, that's good. We have some business related to industrial, and frankly, it's a small segment, but we could see a little bit of push out in the industrial segment. And as you -- as I think I noted in my comments, we have some business related to oil and gas. And that oil and gas business, frankly, it's kind of -- I'm speculating when I say we expect it to get weaker because we have not seen it get weaker yet. But maybe that's because they're all working from home and haven't yet got to the point where they've decided to relook at their CapEx. So I'm speculating. I don't really know. I'm guessing that one would expect the oil and gas-related large installations to be weaker going forward. Much as our business today, it doesn't seem to be showing that.

And finally, we have, in our wireless computing area, some consumer-related exposure, which is actually doing extremely strongly. And then we have some enterprise related, which we are not quite sure how it's going to pan out. But when we combine all that and take into account the seasonality of that business, at least in our third quarter and from what we can see going forward, we have a pretty strong position and not a lot of weak ones.

Shek Ming Ho
Deutsche Bank AG, Research Division

Great. And in terms of -- you talked about this increasing potential that you're seeing from the acquisitions. Can you give us a little more color on those?

Ajay B. Shah
Chairman, CEO & President

Well, those are what we're talking about in Specialty Compute. All of our acquisitions have been in that line of business, the Specialty Computing and Storage line of business. So that is what I was talking about. And one area which we acquired, Penguin Computing, high-performance computing, that's doing pretty well. Another area is Embedded Computing and there, we have a fair amount of government-related business and defense-related business, and that's doing pretty well. And then we have wireless computing, which are doing really well because that's growing very significantly with both existing customers that are growing and new customers. So hopefully, that's in line with your question.

Shek Ming Ho
Deutsche Bank AG, Research Division

Yes. Great. Maybe a follow-up question. I appreciate the gross margin color you guys provided in the quarterly filings. As we look forward, how do you think about the gross margin for the Specialty Computing business? I think it has improved, like at least 10 points from a year ago. Is that something you can think about a 3-handle? And then which of the 3 businesses do you expect to see the most upside potential from where they are today?

Jack A. Pacheco
Executive VP, COO & CFO

Sure, I can jump into that one. I mean the reason you've seen the big increase of Artesyn, right, when we bought Artesyn, we said that was like a 40% gross margin-type business. So the purchase of Artesyn has really bumped up the gross margins as to why you see that Specialty higher now. I think going forward, as we've been talking about, we think we can continue to improve the Penguin margins. So I think go forward, the biggest improvement in this area will be the Penguin margins, especially as we get more and more managed services in that business. I mean, Ajay talked about this quarter was our best quarter for bookings, and a lot of that was in kind of some of the managed service areas, we continue to improve that business. And if our managed services business grows, we'll continue to see the gross margins in those business grow.

Shek Ming Ho
Deutsche Bank AG, Research Division

Great. If I can squeeze in one more question. Go ahead. Go ahead, Jack.

Jack A. Pacheco
Executive VP, COO & CFO

Sure. No, no. And you might see a 3-handle sometime for that business in the future certainly.

Shek Ming Ho
Deutsche Bank AG, Research Division

Great. One last question for me. Are you -- in the guidance, are you expecting any onetime charges, whether that's in cost of goods sold or operating expenses related to logistics-related costs? Ajay, you mentioned component availability from China, operational challenges in China. Anything specific that is a onetime thing that may come off in the following quarter?

Jack A. Pacheco
Executive VP, COO & CFO

No.

Ajay B. Shah
Chairman, CEO & President

Well, maybe, again, not knowing exactly what you're referring to. So the convertible debt, we had a significant number of onetime expenses related to that offering and to -- related to the extinguishing of our term debt. So you see that already in our financial statements, if that's what you mean. The other question...

Shek Ming Ho
Deutsche Bank AG, Research Division

Yes, I was thinking more on the operational side.

Ajay B. Shah
Chairman, CEO & President

Yes. On the operational, and it's a question as to whether you would call it operational. I mean, the depreciation of the real, the Brazilian real may -- it's been a very rapid depreciation. Exactly how that's going to play through, we're still trying to figure out. Obviously, it reduces our local costs, labor and facilities and so on. But meanwhile, it means that prices in local currency are higher. How that's all going to play through? We don't know. But no, we're not anticipating any very specific onetime costs related to operations, if that's your question.

Operator

Our next question comes from Brian Chin with Stifel.

Brian Edward Chin
Stifel, Nicolaus & Company, Incorporated, Research Division

And maybe the first question, just to level set, go back to just your outlook for the May quarter, 5% sequential growth at the midpoint. Can you maybe walk us through your thinking in terms of how Brazil is going to do there relative to the guide, Specialty Memory as well as Specialty Compute?

Jack A. Pacheco
Executive VP, COO & CFO

Sure. I can kind of take it to a high level. At a high level, we would expect our Brazil business to be maybe fairly flat kind of quarter-over-quarter. We would expect both Specialty Compute and Specialty Memory to grow in Q3. And Specialty Compute will probably a little bit faster than Specialty Memory in the Q3 quarter.

Brian Edward Chin
Stifel, Nicolaus & Company, Incorporated, Research Division

Got it. Okay. That's helpful. And then maybe a couple of follow-ups. First, in terms of Specialty Memory, obviously, strong solid growth there in the February quarter, growth again for the May quarter. Yes. I know that a lot of your production, I believe, is sort of Malaysia, Southeast Asia and probably your neck of the woods, in Newark. But when those shelter-in-place measures started to become more acute sort of mid-March, if you will, early in the quarter, I'm curious, it sounds like you haven't really seen an impact on your business from a production side. I'm curious if your customers what was sort of their reaction when that happened? Was it kind of maybe to buffer up more product? Do you see a change in terms of their behavior?

Jack A. Pacheco
Executive VP, COO & CFO

I mean, I think in the Specialty Memory section, the customers were just, one, wanted to make sure that we were going to operate to support them, right, because a lot of our customers that we have in Specialty Memory are in the critical infrastructure, some in the medical and in the defense area. And so they're all critical, potential business as well they need to operate. So it's more coming to us to making sure we were going to operate, which we were, and then just wanted to make sure that we could meet their schedules that they have. And most of the products right now, as we had talked earlier, the lead times have lengthened out considerably. And so they want to make sure that we're still going to be able to ship what we've committed to for the quarter. It's mainly not -- mainly is making sure that we can ship what we are going to -- we've already committed to in the quarter during this time.

Brian Edward Chin
Stifel, Nicolaus & Company, Incorporated, Research Division

Got it. Okay. Then maybe...

Jack A. Pacheco
Executive VP, COO & CFO

Was that an helpful?

Brian Edward Chin
Stifel, Nicolaus & Company, Incorporated, Research Division

Yes, that's helpful, Jack. Yes, walking over to Brazil then. Again, it sounds like -- maybe you can help out. One, is there -- based on customers, like you said, the kind of funnel impact here of shutting down production relative to sort of the virus outbreak. Are you seeing any impact in your fiscal 3Q in terms of that? You said Brazil having kind of flattish revenue, but are you seeing any impact there in that Flash? And then secondly, on the demand side of that, to what extent have you seen the weaker real sort of customers actually adjust their product pricing, your customers in terms of them selling to the consumers out there? Has that adjustment been made? And is that maybe part of the lag here? And kind of from a timing perspective, if you did see sort of the rolling forecast revisions maybe trend down, do you have a sense on timing? Is that sort of like a mid-year or calendar year event? Or any sort of color you could provide there would be helpful.

Jack A. Pacheco
Executive VP, COO & CFO

Sure. I'll take part of that, maybe Ajay can answer a part, too. I mean as far as the customer forecast, so we have customer forecast pretty much every week -- every 2 weeks from the customers. And they're kind of constantly looking out at the future and adjusting them. So we don't wait like 6 months to get a whole new forecast of pops and things change. And so they've been slowly adjusting their forecast. But as Ajay mentioned earlier, we haven't seen any major change from our customers in Brazil yet on their forecast due to demand. Their demand seems pretty good. We've had some ups and downs, as Ajay mentioned because somebody might have shut a factory down for a week or 2, another back up and running, so there's been little blips like that but nothing from a long-term forecast.

And as I mentioned, we really haven't seen the impact of the real weaken their demand yet. And I think they've been putting through price increases on their products. They're not eating the weakness in the real. And based on our forecast, consumers must still be buying them at this -- at the higher price. The interesting fact in Brazil is that a lot of people finance products, even phones in Brazil. Even though the real has weakened a little bit, the bank for lending rate, the government lending rate is really low right now. So you have lower interest rates you've had in a long time. So that might be impacting -- it might be going the other way from a weaker real, they could finance it cheaper. So maybe their overall spend hasn't been changed that much. I don't know.

Ajay B. Shah
Chairman, CEO & President

Yes. I mean, to be honest with you, I -- we totally get your question. And we've been asking exactly the same question of our team in Brazil and trying to check in with customers as well because we can see what's happening. And if prices go up by 20%, and -- wouldn't we expect that to affect demand? And so we can't assure you that it's not going to. We really -- I wish I could. But what we can tell you is that we've been checking on that. And so far, our customers are not telling us. In fact, we're asking kind of aggressively, "Are you sure your forecast is real?" because what we don't want is a repeat of an inventory buildup followed by cliff. And they assure us that they have recalculated their forecast based on the demand that they're seeing now. And based on that, these are their forecasts. So we're blessed with only so much visibility into this, and that's what we have so far.

Brian Edward Chin
Stifel, Nicolaus & Company, Incorporated, Research Division

Maybe just to wedge one more thing in relative to -- so the units could -- the forecasts still are maintained. We'll kind of see what headwinds evolve there. But in terms of the content, I think you did allude in the prepared remarks, you're seeing some content improvement maybe in terms of like MCPs or whatnot. Maybe if you can kind of comment on maybe what you might be seeing in terms of content pickup.

Ajay B. Shah
Chairman, CEO & President

We've mentioned before that in Brazil, there is a system that went into place in July last year that has local content measured in points and we mentioned at the time that if you think about it from our customers' point of view, they have a significant benefit in certain commodities from the point because they can now pick and choose which commodities they want to emphasize in their purchases of local -- locally produced product. And it turns out memory provides some of the best advantages. So what you're seeing really is a flow-through of exactly that, which is that for our customers, memory provides some of the best way by which they can meet their local content requirements. And as I was also saying, as of the end of December, literally the very end of December, there's a new law in place, which went into effect April 1. So it's a law that is effective roughly a week back. And this law very clearly spells out how tax benefits will work going forward for all these companies, including for ourselves. And so as a result, customers are comfortable that they know how to operate in this environment.

For a year now -- for maybe 6 to 9 months, I should say, there was a fair amount of uncertainty, but now I think that that's cleared up. And that's helping customers to be very clear about their strategies, and therefore, they give us a longer-term view of their business. And also, it's helping them in that both the average densities are going up. I mean that's just happening across the world. Products are consuming more memory, I mean, I'm talking about smartphones. And they're giving us a greater share of the higher density product mix. So that's what we're seeing. And I think it has a lot to do with the fact that there's less, I don't know, confusion or uncertainty about what the regulations are.

Operator

Our next question comes from Suji Desilva with Roth Capital.

Suji Desilva
Roth Capital Partners, LLC, Research Division

A lot of conversation about Brazil, but I wasn't sure if you covered it. Can you talk about why Brazil in the quarter you reported was outperformed seasonality? Were there pull-ins potentially?

Ajay B. Shah
Chairman, CEO & President

No. Mostly, it was higher-density products in the mobile area. And in DRAM, PCs have been fairly strong. But clearly, higher-density product units were a little lower compared to the previous quarter as expected because you have a 2-week shutdown at Christmas and then a slowdown related to Carnival that comes in a little later. But in spite of that, we had a good quarter above our plan, particularly because of mobile product entities.

Jack A. Pacheco
Executive VP, COO & CFO

Yes. I mean, ASPs were up about 60% in the mobile area from Q1 to Q2. So they're turning back up as the densities of the products are growing again.

Suji Desilva
Roth Capital Partners, LLC, Research Division

Got it. Okay. Then my other question is on the SSD part of the business. Is there a percent of revenue or material part of the revenue you would call out that SSD is expected to provide in the next 4 to 8 quarters to get a sense of how big you think that business could be?

Jack A. Pacheco
Executive VP, COO & CFO

When you say SSD, are you talking about Specialty Flash? Are you talking in Brazil, I guess?

Suji Desilva
Roth Capital Partners, LLC, Research Division

No, no, no. Specialty Flash.

Jack A. Pacheco
Executive VP, COO & CFO

I mean, we've talked about that the growth engine of Specialty Memory as a whole, so I mean, that continues to grow. But we don't have a firm number to -- this is going to be half the business, 3/4 of the business. We keep getting wins. And -- but we've added a lot of big wins in the Specialty -- in the DRAM business. This was a great quarter for DRAM as well. So even though the Specialty Flash SSD business is growing with a new controller, we're getting new design wins, we had a very good quarter in NVDIMM design wins, as Ajay mentioned, and just memory design wins. So the whole business as a whole had a very good quarter and is ramping up and continues to grow, as you see in our numbers.

Operator

And our last question comes from Mark Lipacis with Jefferies.

Mark John Lipacis
Jefferies LLC, Research Division

I was on, but my line dropped, and so I apologize if the question was asked. The -- so I guess some investors that I speak with are concerned that as the virus moves around the world, that is going to impact different supply chains. And I think most people believe that China has been coming back, but some other places are starting to get hit and have been shutting down. I was wondering if there is like a -- if you could just review briefly like how your supply chain, what geographies you're most exposed to.

Ajay B. Shah
Chairman, CEO & President

Sure. Do you want me to start that off, Jack?

Jack A. Pacheco
Executive VP, COO & CFO

Sure, if you want to.

Ajay B. Shah
Chairman, CEO & President

Yes, Mark, the -- we have essentially 3 major manufacturing locations, and then we have a number of other smaller ones. The major ones are in Malaysia. Our main Asian center is in Malaysia. And then, of course, we have the Brazilian one, which we've talked about quite often. And finally, we have in the Bay Area 2 manufacturing facilities: one primarily focused on the high-performance computing, the large systems; and the other one, a mixture of components and boards and systems. And Malaysia was relatively unscathed in the early part of this crisis since, say, January when China was going through a particularly difficult levels of shutdowns, January and then parts of February. That has clearly improved, meaning China has improved.

Now Malaysia, meanwhile, had a number of cases, and the government got quite restrictive in terms of any gatherings of people, including for work or manufacturing. However, this has now been a very specific discussion with the Malaysian government by what is called the American Chamber of mostly technology companies. And there, as a result, an agreement that is in detail, and it details what we can do in terms of number of staff and so on and details what we can't do. And we get checked on that. So we think that, in a way, it's a good thing because we're clearly regulated, if you will. And we're operating under those regulations at less than full strength. That's already true today. Now this is a changing world, and I can't assure you that, that will be the case 2 weeks from now. But I think that the government has showed that if we take reasonable measures and make sure -- and we are really, really focused on the safety of our staff, first and foremost. We will not take a risk that puts them at in harm's way. So in Malaysia, I think we're okay.

In Brazil, we operate a factory, which is really a clean room, lots of very heavy air flow, and we've put in place a whole lot of procedures to make sure that social distancing works. And so far, we haven't had any issues. And finally, in -- we operate in Alameda County, and we've had discussions with the Alameda County health authorities and showed them exactly what we're doing. And they've been satisfied with it and have continued to let us operate as an essential business. Maybe a long answer to your question. I'm not sure if that's what you wanted.

Mark John Lipacis
Jefferies LLC, Research Division

No, it's actually what I was hoping to get. Yes, sorry, Jack, go ahead.

Jack A. Pacheco
Executive VP, COO & CFO

No problem. That's good.

Mark John Lipacis
Jefferies LLC, Research Division

So I had a follow-up, if I may. We've been doing a lot of checks in the supply chain. And I think the thing I've been most surprised about, if not shocked about, is how little that we're hearing about material order cuts. In fact, sometimes the opposite. And it's in the quarter you just reported and the outlook is a personification of that. And it seems that you might share that kind of perspective of surprise. And I guess my question is, to what extent do you think this is coming from that we just finished an inventory correction in the supply chain and so the supply chain inventories had gotten leaned out already versus the fact that you guys are in the "good" end markets or versus is this something that's just going to come? I know that's an impossible answer to have -- or a question to have an answer to, but I was hoping you might share your view on that.

Ajay B. Shah
Chairman, CEO & President

Is it possible, Mark, for me to ask you that question?

Mark John Lipacis
Jefferies LLC, Research Division

I'm in. I can send you my report on this.

Jack A. Pacheco
Executive VP, COO & CFO

We've been listening to your webcast too, Mark, trying to get information from you.

Ajay B. Shah
Chairman, CEO & President

Yes. It's a very uncertain time. But we think there is elements of all of what you said. Meaning, first and foremost, the sectors we serve are the sectors that are actually doing almost, to a degree, being pushed forward by this crisis like, for example, the communications area, both telecommunications and enterprise communications. The other areas that we serve also seem pretty strong. So that maybe is one issue. The other might be an inventory issue, and it could be in 2 forms. It could be what you sort of suggested, which is a previous inventory lean-out that's now being filled back up or it could be a little bit of overbuying to make sure that they are not short. And we try very hard to keep an eye on that, but I can't tell you we have perfect visibility into that. So at least those 2 things are strong in our favor.

Operator

And that will conclude today's question-and-answer session. I'd like to turn the call back to Mr. Shah for closing remarks.

Ajay B. Shah
Chairman, CEO & President

Thank you, operator. Well, we look forward to reporting on our progress in the coming months, it's going to be interesting. Thank you all again for joining us today. Goodbye.

Operator
Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.