25-Jan-2023

Flex Ltd. (FLEX)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

David A. Rubin
Vice President-Investor Relations, Flex Ltd.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

OTHER PARTICIPANTS

Steven B. Fox
Analyst, Fox Advisors LLC

Shannon Cross
Analyst, Credit Suisse Securities Research

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Jim Suva
Analyst, Citigroup Global Markets, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for standing by. Welcome to Flex's Fiscal Third Quarter 2023 Earnings Conference Call. Presently, all participants are in listen-only mode. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] As a reminder, this call is being recorded.

I will now begin and turn the call over to Mr. David Rubin. You may begin.

David A. Rubin
Vice President-Investor Relations, Flex Ltd.

Thank you, JP. Good afternoon and welcome to Flex's third quarter fiscal 2023 earnings conference call. With me today is our Chief Executive Officer, Revathi Advaithi; and our Chief Financial Officer, Paul Lundstrom. Both will give brief remarks followed by Q&A. Slides for today's call, as well as a copy of the earnings press release and summary financials are available in the Investor Relations section at flex.com. This call is being recorded and will be available for replay on our corporate website.

As a reminder, today's call contains forward-looking statements which are based on our current expectations and assumptions. These statements involve risks and uncertainties that could cause actual results to differ materially. For a full discussion of these risks and uncertainties, please see the cautionary statements in our presentation, press release or in our most recent filings with the SEC. Note this information is subject to change, and we undertake no obligation to update these forward-looking statements.

Unless otherwise specified, we will refer to non-GAAP metrics on the call. The full non-GAAP to GAAP reconciliations can be found in the appendix slides of today's presentation, as well as in the summary financials posted in the Investor Relations website.

On January 13 of this year, we publicly filed a registration statement on Form S-1 with the US Securities and Exchange Commission relating to Nextracker's proposed initial public offering. In connection with the proposed offering, Nextracker intends to list under the ticker symbol NXT. The timing, number of shares to be offered and the price range for the proposed offering have not yet been determined. This offering is determined – this offering is subject to market and other conditions. For more information, please refer to the S-1 filing. Following SEC regulation remain in a quiet period, and we'll not make any further statements or answer additional questions on the Nextracker filing at this time.

With that out of the way, I'd like to turn the call over to our CEO. Revathi?

Revathi Advaithi

Chief Executive Officer & Director, Flex Ltd.

Thank you, David. Good afternoon and thank you for joining us today. So by now, you've all probably seen the S-1 public filing for the Nextracker IPO. As I said from the very beginning of this process, the first step in creating value for our shareholders and to unlock the full, long-term potential of Nextracker is for it to operate as a standalone company. This process was, of course, delayed by the supply chain crisis brought on by the pandemic.

Despite all of the challenges during this time, we have maintained discipline and achieved multiple quarters of improving growth and margins. Along the way, we partnered with TPG Rise Climate, a team who's making a real difference in the renewable energy transition.

So now, we're moving forward. That said, renewable energy is one of the most important global technology transitions ever. It also represents a robust, long-term growth opportunity for a number of technologies including solar trackers, and Flex will continue to be involved to help drive this critical sector.

Moving to our results. Please turn to slide 4. Overall, fiscal Q3 was another fantastic quarter for Flex and another validation in the resiliency of our diverse portfolio. Revenue grew 17% year-over-year with adjusted operating margin at 4.8%. And the strong performance overall drove solid results of adjusted EPS at $0.62, up 24% year-over-year.

Turning to slide 5. Many of the positive dynamics in fiscal Q2 continued through the quarter, but with a few ongoing challenges that I'll touch on in a minute. We see strong growth driven by secular trends with technology transitions in EV and ADAS, in renewables and factory automation along with cloud expansion and strong automotive backlog. We're also seeing demand in communications, network security and many of the industrial applications we touch.

Consumer end markets remained weak which shouldn't be a surprise, and we expect that weakness to continue in the current environment. Similar to last quarter, the overall supply chain and logistic situation continues to improve on a global level. However, shortages in the large node semiconductors remain a challenge particularly within higher liability applications such as automotive, industrial and some healthcare products. We have talked before about how this causes inefficiencies and underabsorption of costs, and this golden screw effect is also the primary driver of higher working capital requirements.

We remain very bullish on the long-term growth opportunities and Reliability, so we have made additional near-term operational investments to support this growth including increases in higher skilled labor. The net result this quarter was additional pressure on Reliability operating margins. However, these investments will benefit our longer-term market positioning and is worth the focus as Reliability has and will be the bigger driver of our long-term growth story.

The Agility team had great execution, meeting strong demand in CEC and delivered another quarter of growth in lifestyle, but also demonstrated very effective cost management given the broader consumer turndown. We continue to recognize the benefits of both the operational improvements and portfolio changes we have made over the last several years.

It is important to highlight the power of a well-diversified and balanced portfolio. We remain in a challenging macro environment and yet delivered growth in five of six core business units and accelerated growth at Nextracker.

Now looking to slide 6. Paul will discuss our guidance in a minute. But assuming Q4 revenue comes in as expected, we remain on track to deliver 16% year-over-year growth in fiscal 2023. As you can see in the chart on the left, this also means we will have beat our previous revenue high watermark before we pruned a substantial amount of lower quality business.

Adding in our operational initiatives, you can see a steady and consistent path of margin expansion, and all of this reflects the improvements we have made as a company. With the evolving macroeconomic uncertainty, it's still a highly dynamic environment out there. However, I want to share an early view into what we're seeing as we look to our fiscal 2024.

At this point, demand indicators are holding up for many of the multiyear trends we've been talking about, including renewables, next-gen mobility, cloud and healthcare. We believe these are strong enough to offset headwinds like consumer-related weaknesses and slowing enterprise IT spending. So at this point, we thought it was important to state we expect to grow next year in fiscal 2024. We will discuss our full fiscal 2024 guidance on next quarter's call.

Turning to slide 7. Lastly, taking a step back, as I look at the fiscal 2025 financial framework we gave you in our Investor Day last year, we said high-single-digit revenue CAGR which will lead to 5-plus percent adjusting operating margin in core Flex, which is without Nextracker, with mid-teens adjusted EPS growth getting us to $2.65 for core Flex and 80% adjusted free cash flow conversion. It is a combination of strong multiyear drivers, coupled with our focus on the right growth areas and our execution that will get us to these targets.

With that, I'll turn it over to Paul to take you through our financials. Paul?

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Okay. Great. Thanks, Revathi, and good afternoon, everyone. I'll begin on slide 9 with a review of our third quarter results. Please note, all results provided will be non-GAAP, and all growth metrics will be on a year-over-year basis, unless stated otherwise. The GAAP reconciliations can be found in the appendix of the earnings presentation.

Revenue growth was strong, up 17% at $7.8 billion. Gross profit totaled $595 million and gross margin improved to 7.7%. Operating profit was $372 million with operating margins at 4.8%, improving 30 basis points year-over-year. Lastly, earnings per share came in at $0.62 for the quarter, an increase of 24%.

GAAP EPS came in at $0.50, up 4% year-over-year. But if you recall, in Q3 of last year, we had a number of small non-operating gains that we non-GAAP-ed out, creating the difficult comp. Overall, we're pleased with our performance this quarter. The strong growth is a result of the resiliency of our diverse portfolio and the compelling value proposition that Flex brings to the markets we serve.

Turning to our third quarter segment results on the next slide. Reliability revenue increased 19% to $3.2 billion. Operating income was $143 million, up 6%. And operating margin for the segment was 4.4%, impacted by persisting semi shortages and some increased operational investments made to support future growth. In Agility, revenue was $4 billion, up 13%. Operating income was $181 million, up 11% with an operating margin of 4.5%.

Finally, Nextracker revenue came in at $516 million, up a very impressive 53% year-over-year. Operating income at Nextracker was $60 million, up 225% with operating margins now at 11.7%. That's over 2.5 points of sequential improvement and three sequential quarters of significant margin expansion.

In Reliability, despite macro concerns, auto inventory is still low and customer backlog is stable. However, semi shortages impacted efficiency and contributed to increased expedite costs, tempering profitability. Industrial demand was solid, with notable strength in renewables, automation and other specialty programs. Demand in the healthcare space remains steady, and we continue to invest for future growth.

Looking at Agility. Our Lifestyle business was up slightly in the quarter despite the ongoing consumer-related weakness. We've now seen multiple quarters of this outperformance driven by significant share gains.

As expected, Consumer Devices was down similar to what we saw last quarter with continued soft end markets. And finally, CEC again showed excellent overall performance driven by strong execution and a continuation of trends in cloud and network infrastructure.

Moving to cash flow on slide 11. Q3 net CapEx totaled $157 million, on target at approximately 2% of revenue. Free cash flow was $202 million in the quarter. With the golden screw situation continuing to the degree it has and given our visibility today, we expect free cash flow in the fourth quarter to be on par with what we delivered in Q3 which would put us below our previous target of $550 million for the full year.

We are, however, beginning to see trends inflect. Inventory net of working capital advances decreased 3% sequentially, and we flattened the curve on gross inventory, up only 1% sequentially. So it's nice to see that we are starting to see some progress on inventory. Lastly, we returned $40 million to shareholders this quarter through share repurchases.

Please turn to slide 12 for our segment outlook. For the fourth – fiscal fourth quarter and for our year-over-year growth expectations. For Reliability Solutions, we often talk about the longer-term secular tailwinds, but they're also playing out in the near-term. Industrial continues to benefit from regionalization opportunities and trends in factory automation. And while the industry awaits further clarity on the IRA, the overall renewable energy transition is a positive driver.

Health Solutions remain strong with outsourcing trends providing more opportunities to grow, and we continue making progress on program ramps. And in Auto, the EV and ADAS transition remains a dominant theme. Collectively, these trends should contribute to overall growth with Reliability revenue up high-single digits to mid-teens.

For Agility Solutions, revenue will be relatively flat. CEC is expected to grow based on healthy underlying fundamentals, particularly within cloud and communications, but we expect both consumer devices and lifestyle to be down driven by the weakness in consumer product end markets.

On to slide 13 for our quarterly guidance. We expect revenue in the range of $7 billion to $7.4 billion with adjusted operating income between $315 million and $345 million. Interest and other is estimated to be around $60 million. We expect the tax rate to be around 14% this quarter, and we expect adjusted EPS between $0.48 and $0.54 based on approximately 460 million weighted shares outstanding.

Now, let's go over our full year guidance on the following slide. We increased our fiscal 2023 revenue expectations to $29.9 billion to $30.3 billion which would result in mid-teens growth year-over-year. We expect adjusted operating margins to be around 4.7%, consistent with what we told you before. And adjusted EPS is up from last quarter's guidance and is now between $2.27 and $2.33 a share.

Before we begin Q&A, I want to just echo Revathi's thoughts that I remain excited about the opportunities ahead of us. As our results demonstrate, we are able to slow – to continue to deliver growth despite facing macro pressures and industry-wide challenges. The resiliency of our portfolio has been strengthened by our diversification, strategic investments in key growth areas and operational excellence. There are a number of external factors still at play, but our team is executing against our strategy, and we remain focused on meeting our long-term targets and delivering value for all Flex stakeholders.

With that, I'd like to turn the call over to the operator to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer portion of today's call. [Operator Instructions] Your first question comes from the line of Steven Fox from Fox Advisors.

Steven B. Fox
Analyst, Fox Advisors LLC
Q

Hi. Good afternoon. Can you hear me okay?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.
A

Yeah, we can hear you.

Steven B. Fox
Analyst, Fox Advisors LLC
Q

Okay. Thank you. First of all, I was wondering if you can provide a little more color on the margin pressures on Reliability Solutions. Can you quantify the hit from sort of investing for the future and also the semiconductor area and talk about what kind of path you see going forward for the margins for that segment? And then I have a follow-up.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.
A

Yeah. Steven, I'll start and then Paul can weigh in if he feels like. I'd say, first is, Reliability is seeing tremendous growth, as you're aware. We're very pleased with our growth around 19%. And with growth comes all kinds of challenges.

I'd say, first is, the supply chain issues and underabsorption continues in pretty much all three segments of the Reliability business. And because to support the growth we have this year and then what we continue to see moving forward, driven by all the macro trends we have talked about regionalization, et cetera, we decided to continue to make some operational investments that supports multi-year program growth and also try to pull forward some program ramps we could and put in some front-end costs when we can afford to do it, right?

And like I said in my opening remarks, the diversity of our portfolio and how the company is performing gives us the room to make those decisions. Remember, those nuances also, of course, for Reliability that you know well, Steven, is that the skilled labor market is tight. And so we have to continuously find ways to keep that labor available and hire the right kind of labor in different regions of the world that provide some pressure.

But we feel very good about kind of the trajectory of how Reliability margins comes out of this. I think these are decisions we choose to make because of how bullish we are about the long-term sector growth itself. We feel like, overall, the longer term growth driver of margin expansion and all of that has – and the longer cycle program ramp hasn't changed. So the strategy is intact. But we have room to make some decisions and invest extra that we chose to do. But I feel very good about the commitments I've made for Reliability longer term.

Steven B. Fox
Analyst, Fox Advisors LLC
Q

Great. That's helpful. And then, just as a follow-up, I was wondering if there's anything you would highlight, say, over the last 90 days or so related to that regionalization theme. There's been a lot of headlines, good and bad, in China, India, related to electrification, et cetera. Is there anything you would call out that's either playing more or less on that theme than you would have thought versus a quarter ago? Thank you, very much.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.
A

Yeah. Steven, I would say, if anything, this only continues to accelerate. I would say, it doesn't matter the ups and downs of the conversation on China, whether it is regionalization or whether the country is opening up now or what you're hearing going on in India.

We are just supporting quite a significant amount of programs right now that is driven by that regionalization trend, which is driven by reducing resiliency in this – increasing resiliency in the supply chain, particularly in Mexico, in US, are kind of our two biggest growth areas, and then some in Southeast Asia. So haven't seen the trajectory change. If anything, it's accelerated. We're trying to kind of absorb this beast and really figure out how much more we can do moving forward. So the pressure is on from customers to do more and do it quickly is what we're seeing.

Steven B. Fox
Analyst, Fox Advisors LLC
Q

Great. That's helpful. Thank you.

Operator: Your next question comes from the line of Shannon Cross from Credit Suisse. Please ask the question.

Shannon Cross
Analyst, Credit Suisse Securities Research
Q

Thank you very much. Can you talk a bit about cash flow? And what I'm wondering, I mean you're holding to 80% of cash conversion over a longer period of time. But what are you doing internally to, I don't know, maybe improve your visibility, manage inventory better? Because I know some of what's gone on, obviously, has been the golden screw. I'm guessing some of it has been working capital-related, so just the growth that you've had. So I'm just wondering, as you look at how the business has changed over the last couple of years, how you're going about managing this so that you can get back to the 80% because I think that's one of the few knocks on your stock right now is your cash conversion.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.
A

Yes. I would say, first, I'd start with, Shannon, that I really feel good about kind of the trajectory change that we're starting to see overall with working capital and how we are managing our customers. And I'm happy with the things we're seeing.

I'd say, overall, inventory is flattening out. And while we still have this whole incomplete kit issue, I would say, because we have a part missing here or there, particularly in Reliability, I feel good about the general underlying trends that we track to see the right direction in inventory. So we do think that slips, and you're seeing that kind of the start of this quarter in terms of our overall cash flow, and we think that continues to improve. That is the reason why we feel comfortable with sticking with kind of our cash flow conversion target because, obviously, coming out of this, this business is going to generate cash.

I'd say in terms of longer term, Shannon, my view is we have – the thing about Flex that we have done really well the last four years is we have taken every burning platform and become more disciplined with it. So underlying theme across the company is we have become more disciplined in planning. We're helping our customers get more disciplined with it. And that will have longer term implications in terms of how supply chains are managed, not for us but all the customers that we touch, right? This is near and dear to my heart, supply chain and planning. And we think that this will really make us a better company. And my aspiration will be to be better than 85% at some point in time. But I think we're seeing good inflection points here, and that makes us comfortable with sticking to these targets.

Shannon Cross
Analyst, Credit Suisse Securities Research
Q

Okay. Thank you. And then just sticking on cash, can you talk a bit about cash utilization? You have Nextracker out there. I understand you're not going to talk about it necessarily. But just in terms of cash generation, assuming you move back, you'll have excess cash. So maybe can you talk a bit about what the landscape looks like in terms of potential acquisitions? Obviously, you've been buying back stock, but just in general, your approach to returning cash to shareholders. Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.
A

No problem, Shannon. So first, I'll just say, I think if you look at our performance over the last few years, you've seen us to be disciplined and judicious when it comes to capital allocation.

Specific to M&A, we have a robust process and a robust pipeline. But in terms of prioritization, when it comes to capital allocation, I would say, number one priority right now is supporting very strong organic growth whether that's with some working capital or if it's internal investments or CapEx, very high priority, because we have a very clear path ahead of us for solid top line growth over the next several years, and we want to make sure that we've funded the business for that. So that's one.

Stock buyback has been a priority for us the last couple of years. I think we've been pretty vocal about our views on valuation, and we've leaned into that. And so, I guess, I would put M&A last, although again, we remain disciplined. We're going to be opportunistic. We have a pipeline, but at the moment, that's probably our lowest allocation priority.

Shannon Cross
Analyst, Credit Suisse Securities Research

Q

Thank you.

Operator: Your next question comes from the line of Mark Delaney from Goldman Sachs. You may ask your question.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Good afternoon. Thanks very much for taking the question. In the CEC segment, the company, if I heard correctly, was guiding for growth there. I think a number of companies have been reporting pretty broad-based weakness in the comms infrastructure market. So maybe elaborate a little bit more on what Flex has seen in the comms infrastructure markets. And perhaps, is there share gain or something else that's a tailwind for Flex that other companies perhaps are not benefiting from?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. No, I'd say, first, there's two things that are happening, right? If you think about the three segments in CEC, cloud, communications and enterprise, we're still seeing growth in all three segments of it, while you are seeing a lot of noise about enterprise segment and how that is performing.

But for us, a couple of things happening. In cloud, we've clearly – while people have talked about the rate of growth changing, it is still pretty significant growth, and that's important. And along with that and market share gains, it has helped us show continued growth for cloud, and we see that playing forward.

I would say, in the communications space, similarly, we have seen share gain that has happened with specific customers, and we're supporting that growth. But we're also seeing there's enough backlog being cleared in that business that is also supporting underlying growth.

So, overall, I'd say, CEC, the story of share gain is a big story there, particularly in communications and cloud. And we feel like if the rate of change of growth switches a little bit, overall, it's still a very positive growth story for us.

Paul, you'd add anything?

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

No. I think that was clear.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Thanks, Revathi. And my second question was on the China market. I was hoping you could elaborate a bit more on what Flex has been seeing operationally in China given the unfortunate COVID dynamics in recent months. And also, when you talk to your customers, are they expecting demand to pick up this coming year given the potential reopening that's occurring in China? Thanks.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

No problem, Mark. So the way we thought about this a couple of months ago was, as things started to open up, we expected there to be a sort of a big COVID spike in the November-December timeframe. And then post-Chinese New Year, our thought was we'd see another one. I'll just kind of tell you how that played out.

COVID cases were very high as we moved through December, particularly the back half of December. That probably had a little bit of effect on us, but I think we were able to manage it. But absenteeism was quite high in December. Too early to call on what's going to happen here post-Chinese New Year, but we track this stuff every day. And I'm pleased to say that people returning to work has been very, very high, higher than what we had originally anticipated coming back from Chinese New Year. And I think by the end of this week, we're going to be at 100%. So that's good news. Hopefully, that's some color that helps, Mark.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thank you.

Operator: Your next question comes from the line of Matt Sheerin from Stifel. You may ask your question.

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yes. Thanks. Good afternoon. I wanted to ask another question on the Reliability segment where you've got good growth and it sounds like you're confident in most of those subsegments in terms of growth and program ramps where you're hearing about some incremental weakness in some of those broader industrial markets particularly semi-cap. I know you have some exposure but not as much as some of your peers. So could you talk about those end-markets demand versus program ramps? And any pockets of concern there?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. So, Matt, across Reliability, we have really good, strong demand driven by the underlying fundamentals of the end markets we're in, but also kind of continued market share gains. We have very little in semi-cap, so that's a good thing. And so we don't see the fluctuations of the up and down in that, and that doesn't affect our overall portfolio.

In Industrial, we're seeing very strong growth in renewables, and we have a lot of opportunities to continue to grow in renewables. We're seeing really good growth in areas like automation. So industrial between renewables, the basic power business there and automation, the fundamentals are very strong, and we don't have much exposure to semi-cap equipment.

And then in auto, EV and ADAS is – EV particularly is very, very strong because we have a lot of new program ramps going on there. And even while dealer lot inventory maybe getting filled up a little bit more, we see a very strong path forward in terms of year-over-year growth for automation. And health is going along as we predicted, right? So pretty steady growth rate and is going well. So we are really – are on the other side of this equation. We have a lot of growth in Reliability. We just have to execute to that.

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thanks for that. And then on the margins within that business which I know have been under pressure for the reasons that you explained, how do we get to that? You're talking about a 5%-plus margin for the whole company which would imply nice margin expansion within Reliability because I assume that the Agility business is going to be sort of in that range. So what's the timing there? And in terms of these investments playing off or these other issues like logistics and supply issues, when do we start to see those margins move up?

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah. It's a good question, Matt. I look back to the February-March timeframe when we're putting together the framework that we ultimately shared with you with our Investor Day. And in a spreadsheet, we always plan for a nice, gradual acceleration of margins, nice, even smooth line. But I don't think any of us anticipated going into this year that inflation would be as sticky and persistent – as large and sticky as it has been nor did we anticipate the semiconductor shortage is persisting as long as it has. And so both of those have put pressure on the business, including Reliability of course. And I would say more so with Reliability because what we've talked about before.

The stops and starts on that larger node technology where you have resources idled, waiting for components definitely puts pressure on margins. And so I look at both the inflation effect and the component shortage effect and, ultimately, how that impacts factories as sort of being one-time items. All else equal, I think you would have seen better margin performance out of the core Flex business. And, I think, as we look ahead, we'll slowly start to see those things abate and we'll see the margins accelerate.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

And, Matt, I think all the more reason to feel bullish about our long-term target, right, because if we are at core Flex target, where we are today, performing with Reliability margins under pressure, the upside is clear from that. So long-term targets remain intact. If anything, we feel really good about it.

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thanks very much.

Operator: Your next question comes from the line of Ruplu Bhattacharya from Bank of America. You may ask your question.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Hi. And thanks for taking my questions. Revathi, I wanted to ask you about how you're thinking about risk management. When you look out into the next 12 months, what is it that gives you the most concern?

And you just reiterated the long term – or the medium-term target of high-single-digit revenue growth. Can you talk about what are some of the things that are giving you confidence in that, assuming if we have a recession this year, if the consumer phasing end markets are weaker than what you think?

Can you maybe talk about, like, some of the levers you have that if one part of the business, the Agility part, is weaker? I mean, do you think that the other part can offset that? So tell us here like what is giving you the most concern and what is giving you confidence in the medium term on revenues. And then I have a follow-up on margins.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.
A

Yeah. Ruplu, I'd say, first is, our portfolio has changed significantly, if you look from history to where we are today, that we have in a very smart and planful way, we have looked at our portfolio and moved it forward in terms of being in the longer and more resilient cycles of the overall economy.

And so that itself, and we have shared those numbers with you, right, in terms of how the overall Flex portfolio looks, says that we are in the end markets that have good, long-term trajectory and the macro is in our favor, right? Whether it is regionalization or continued technology transitions, all of those are really in our favor.

And that's why when we look forward, we are really focused on that we need to have Reliability growth continue to be supported because that's going to be the long-term trajectory. Agility, the way the portfolio is, we'll always have some ups and downs, but we have really minimized that pretty significantly, right?

As you can see the last few months, we took the comps on consumer markets and still grew. So the diversity of our portfolio really makes it the real story of why we feel very strong about kind of committing to this longer-term growth. And we have delivered on that.

If you look about the last four years, Ruplu, doesn't matter if it is trade crisis and exiting large portfolios, or whether it is COVID, or supply chain crisis, is we've really executed on being able to get to this growth trajectory with how we have built up this business. So the diversity of the portfolio is what I really say is the big reason why we are very comfortable with making this commitment.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.
Q

Okay. Thanks for the details there, Revathi. If I can ask a follow-up on margins. So I think you just talked about the Reliability segment being 4.4% and Agility 4.5%. So you're pretty much at the mid-4s, right? And if we take out inflation pass-through, I mean those margins are likely like 10 basis points to 20 basis points higher already. So when I look at the long-term target of 5% for fiscal year 2025, I mean that seems a little bit conservative. I mean, if you look over the past two years, you've done like 40 basis points of margin improvement. This would be more like 20 basis points. So maybe can you talk about some of the levers that you have for the margin improvement over the next two years? Is it getting harder to get the margin improvement? Or how – where is that margin improvement going to come from? And what – why wouldn't it be higher than 5% is what I'm trying to get at.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.
A

Yeah. I think, Ruplu, a little bit of this I answered in the last question about – and you hit the nail on the head, right, that even with kind of Reliability margins, we were able to make decisions on investment for the longer term of the business because we could afford to make those investments, right? And so obviously, as we try to – as we taper those off, we expect that the longer term margin commitment is one that we can definitely commit to.

In terms of what is the next upside to that 5%, I think you have to wait and see in the next Investor Day. I think it's too early to commit. But I see lots of room for what we can continue to drive. I'd say manufacturing productivity is big for us. There's tons more to do. I see all kinds of opportunities there.

I'd say driving efficiency around program growth and how we do that, there's lots of room for efficiency there. The mixed-up story continues to be important for us. That hasn't changed, right? We're continuing to drive that in all the six business units. And of course, like you said, if you take inflation out, the 10 basis points to 20 basis points of upside on that does help. So I have to agree with your thesis. I just don't want to make any commitment. I would say we are sticking with the long-term commitment we're giving you.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Okay. Thank you for that. If I can – since you mentioned efficiencies, I can sneak one more in. If we talk about manufacturing efficiency, I'm just looking over the past four years, right, your revenues have grown $4 billion, but your total manufacturing square foot has not increased that much. So I mean, technically, the revenue per square foot is looking much better. So I mean you had – ever since you've come in, you've driven a lot of efficiency in the factories.

Can you talk about, like, as you think about the fiscal year 2025 target, how much more – how should we think about CapEx? How much more revenue can the existing infrastructure support? And can you talk about any manufacturing efficiencies? Are there more efficiencies to be had? And where do they come from?

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure. Well, first of all, thank you, Ruplu. Do more with less, that's the goal. A couple of things. Will there be incremental PP&E expenditures? Absolutely. We're going to have to facilitize for growth. Revathi talked about the regionalization trends, significant growth in the US, significant growth in Mexico, significant growth in Malaysia this year. You'll see in the K in another few months. But those regions are going to be growing probably 2x the overall Flex growth rate. So there will be some pressure to invest. But that's a high-class problem. And again, we remained laser-focused on factory productivity and high, high asset utilization.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Thanks for all the details. Appreciate it.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah. Thanks, Ruplu.

Operator: [Operator Instructions] Your next question comes from the line of Paul Chung from JPMorgan. You may ask your question.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for taking my question. So just on Anord Mardix, so you've had this acquisition for about a year. Can you talk about how that business has performed kind of on revenues and margins? And what have been some of the benefits of cross-sell and how material has the acquisition been to kind of winning other deals in the space?

And as we think about future complementary kind of acquisitions, where are you looking to find incremental value? And which specific verticals should we be thinking about that can kind of see the same playbook from an Anord Mardix?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. I'd say, Paul, is the acquisition has gone very well. If you recall, the strategy was we wanted to get bigger in the power space. And we particularly wanted to focus on data centers, both colo and hyperscale, and expand our portfolio in that, because we felt it's a long-term macro for us that was important.

And Anord Mardix, in terms of revenue growth, has done really well, and they have a strong backlog. We're more focused on expanding their footprint and really helping them grow their business faster.

And in terms of how it has helped us win overall business, I would say, in hyperscale and in colo where the focus is really on schedule and delivery of schedule, it really helps to have a more comprehensive portfolio to be able to offer to our customers. And we see that as a differentiator that nobody else has in our space.

And so the conversation has definitely changed with data center space in terms of how we're focused on power and on the IT sector whether it is racks and enclosures and servers and storage.

So we're seeing the effect of it. It's playing out exactly how we thought it would, and you see that in our cloud expansion and our overall growth there. So really good asset, I would say, for us, and the growth story has been fantastic.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Okay. Great. And then just a follow-up on cash flow, which end markets are you having kind of the most issues with golden screws? And how do we think about some of the timing of conversion there on cash?

And are you taking advantage of more customer deposits to kind of partially offset as well? And then, I know it's early, but can we see more meaningful conversion in 2024 and get close to that 80% mark in your view? Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure. So, I think three questions in there. First, on the end markets, the older technology or the larger node technology have been the biggest headwind of late. Things have gotten a little bit easier and so more the commoditized, more consumer end markets.

But automotive and industrial, to an extent health solutions, have continued to face pressure from those shortages, and that has not been helpful. You see it manifesting itself in the P&L as we talked about earlier today. But you're absolutely right, Paul, that also has an effect on inventory and, ultimately, cash flow.

I think the second part of that was what are the things that we can do to offset that. Well, working capital advances and support from the partnerships we have with our customers has definitely been helpful. You probably heard in our prepared remarks, I was very pleased to see that, for the first time in a long time, we saw the trends of net inventory, and I say net as in gross inventory less advances from customers, actually came down sequentially. So that was a source of cash and great to see.

Is there a light at the end of the tunnel? I don't know, but I'd certainly like to see that trend. So we are getting some support from the customers. I think Shannon asked a question before about the – over the last couple of years, what's changed? Well, that would be one change: I think better partnership with our customers in supporting a very voracious appetite for inventory.

And then the third, looking ahead to 2024, it's a little premature to guide on that. Long-term, I think everybody understands that this is a timing issue. And ultimately, yeah, I mean, inventory should come down as all these shortages start to abate. But I would balance that with a comment on organic growth. Look, Flex is probably going to grow 16% this year. That definitely puts some pressure on working capital, but it's our job to manage that. So a little early to target on 2024, but I think overall, this is – it's really just timing.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Great. Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah. Thanks, Paul.

Operator: Your last question comes from the line of Jim Suva from Citigroup. You may ask your question.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much. This is more of a strategic bigger-picture question. Revathi, as you load more onshoring facilities, whether it be Guadalajara or North America or South America or Europe ones, facilities, and you build on a cost-plus model, now that those factories are better utilized plus the labor rate is a little bit higher which you passed to the end customer, doesn't this also help out your long-term operating margin goals to be accretive also? I just wanted to make sure or maybe it doesn't work that way.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

I would say first, Jim, that I think the areas you've picked out are all the right ones that we have said Mexico, parts of the US are definitely our biggest growth trajectory, some in Malaysia, Southeast Asia. So those are all the right areas that we're growing.

The way I think about it, I mean you see this in Reliability now, right? When we start to execute these programs, there's always some challenges with it because they are big, complex programs. And what you see particularly in

Mexico and US is very few people can execute these type of complex programs, and we are choosing to take those on. So you see that execution pressure which challenges some of our Reliability margins as you see now. But as you say, as those programs mature and we get to a more efficient model, I won't call it just a cost-plus model but a more efficient model that we work with our customers, we do expect that to be a tailwind for margins. And that's why I keep answering the question of the 5% as it's something that we feel good about, right? There's a lot of different ways this industry is monetizing and expanding margins and that is definitely one of them. So I agree with you.

Jim Suva
Analyst, Citigroup Global Markets, Inc.
Q

Great. Thank you so much for the clarification and details and congratulations to you and all your teams.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.
A

Thanks, Jim.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

Okay. So thank you, everyone. I just want to close by saying that on behalf of the Flex leadership team, sincere thanks to our customers and to all our shareholders for their support and, of course, to the Flex team across the world. Your hard work makes this possible. We wouldn't be here today without you all. So thank you so much and see you soon. Bye.

Operator: This concludes today's conference call. Thank you for joining. You may now disconnect.