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Flex Ltd. (FLEX)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for standing by. Welcome to Flex's Fiscal First Quarter 2023 Earnings Conference Call. Presently, all participants are in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. I'd like to remind everybody that today's call is being recorded.

I'll now turn the call over to Mr. David Rubin. Please go ahead, sir.

David A. Rubin

Vice President-Investor Relations, Flex Ltd.

Thank you, Michelle. Good afternoon and welcome to Flex's first 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 the copy of the earnings press release and summary financials are available on the Investor Relations page 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 the risk factors section 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 slide of today's presentation as well as in the summary financials posted on the Investor Relations website.

As we previously disclosed, the draft registration statement on the Form S-1 relating to the proposed initial public offering of Nextracker's Class A common stock remains on file with the US Securities & Exchange Commission. The initial public offering and its timing are subject to the SEC, market and/or other conditions. Following SEC regulations, we will not make any further statements or answer additional questions on the Nextracker filing at this time.

Now I'd like to turn it over to our CEO. Revathi?

Revathi Advaithi

Chief Executive Officer & Director, Flex Ltd.

Thank you, David. So, good afternoon and thank you, everyone, for joining us. Our fiscal Q1 was another strong quarter and I want to start off by thanking our teams for their incredible performance and delivering for our customers. I am very proud of what the team has accomplished and their consistent commitment to achieve our vision to be the most trusted technology, supply chain and manufacturing partner.

Now looking at slide 3, our revenue grew 16% year-over-year, driven by continued strong demand and our ability to deliver in spite of ongoing component constrains. Our adjusted operating margins came in at 4.5% and the overall solid performance led to another quarter of record adjusted EPS at $0.54, up 17% year-over-year.

So, as I look across our portfolio, along with the forward-looking signals, our demand remains strong in most business units. And I would say, at this point, constraints from the ongoing shortage and lagging in semiconductors remains the biggest limiting factor. We currently expect this trend to continue. Now not surprisingly, we are seeing indications of slowing in some consumer-related markets. However, we have been anticipating this change, and it is within our current expectations for the full year.

Looking at just a few examples of the continued overall demand, we saw broad demand across our Industrial business unit, along with multiple new ramps in renewables and power-related products. I want to point out that these products are separate from our Nextracker solar tracker business and include inverters, EV charging, energy storage and grid-edge, all tied to Flex's core technology strengths.

Now given our wins in this category, our renewables business is now on a run rate to be over $1 billion this year, making it a sizable portion of our Industrial revenue. We see the long-term growth drivers continuing, which gives us confidence in this category. Bookings in Automotive were very impressive this quarter. In fact, the wins this quarter alone were nearly as much as all of last year's bookings. And over 60% of these wins are in our next-gen mobility category.

With the U.S. dealer lot inventory in June still only at 28 days versus 67 in 2019, we're still seeing end-market inventory well below demand. For us, much of our business is being driven by OEM expansions, new product lines, and technology transitions. These multiple drivers give us confidence in our long-term outlook.

Now, growth in our cloud business remains very strong, driven by longer-term trends, including continued enterprise cloud migration and growth in digital services. Our differentiated capabilities that address several critical areas across the data center include power solutions, racks and enclosures, make us well-positioned to address this growing market.

Our Lifestyle business continues to deliver solid results. We have created a very compelling proposition by expanding our vertically integrated capabilities and leveraging our global scale to regionalize supply chains and facilitate geographic expansions. This combination has directly led to share gains and new wins with premium durable goods customers. Our strategy has also resulted in a more sustainable supply chain for our customers and a more resilient business for Flex.

Again, these are all just a few examples, but they also highlight how our portfolio and business drivers have evolved.

Now going to slide 4, at our Investor Day, we showed you this slide on how we change our geographic and customer concentration in our portfolio mix. This progress is just since fiscal 2028 (sic) [fiscal 2018] (00:06:05). This change would be even more dramatic if we look back over the last 10 to 15 years.

We have purposely deemphasized the most volatile and shorter-cycle businesses. As an example of this, how our consumer device revenue went from about 17% of revenue back in 2018 to now only 10% in fiscal 2022. Instead, we focused on improving our portfolio mix aligned with our core capabilities and targeted large end markets with strong long-term drivers. We have built a balanced global footprint that can support our customers' changing needs. These investments have created a more resilient foundation, a more diversified portfolio, and a more agile company.

The macro environment remains highly uncertain, and none of this is to say we're immune to it, but we have effectively navigated the challenges over the last couple of years, and we have continued to adapt and improve. I'm very confident in our long-term strategy and the solid foundation we have built. So we will remain focused on consistent execution to be agile and continue to invest in the future of Flex.

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. Thanks. Thanks, Revathi, and good afternoon, everyone.

I'll begin on slide 6 with a review of our first 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.

Our first quarter revenue came in at $7.3 billion, up 16% with solid growth on strong execution. Gross profit totaled $542 million and gross margin was 7.4%. We saw nice operating profit dollar growth in the quarter, up 14% at $330 million, with a little pressure on operating margin rate at 4.5% due to the pass-through of abnormal inflation costs. As a reminder, we have protections in our contracts that allow us to recover inflationary costs, which are often passed through dollar-for-dollar. So that creates some natural pressure on operating margin percentage but not dollars.

Lastly, earnings per share came in at $0.54 for the quarter, an increase of 17%.

Turning to our first quarter results – segment results on the next slide, Reliability revenue was $3 billion, an increase of 15% year-over-year. And throughout the quarter, demand remained strong across the segment.

Operating income was $147 million, up 2%. Although demand remained robust, output was constrained by continued component shortages, which pressured operating margins at 5%.

In Agility, revenue was up $4 billion, up 16%, driven by strong continued growth in CEC and in Lifestyle. Operating income was $171 million, up 25%, with operating margin up 30 basis points to 4.3%. The solid margin expansion was driven by our team's ability to execute exceptionally well against new project ramps, while overcoming challenges brought on by supply constraints.

Finally, Nextracker revenue was about $400 million, up 16% year-over-year, and adjusted operating income was $30 million. Operating margin increased to 7.6%, and that strong sequential margin improvement was nice to see after a difficult fiscal 2022.

Moving to slide 8, net CapEx for the quarter totaled $91 million or 1.2% of revenue. Free cash flow was an outflow of $53 million for the quarter, driven by continued pressure on inventory. We anticipate free cash flow for the year to be back-end loaded as inventory begins to slowly unwind.

We repurchased over 11 million shares in the quarter, totaling $181 million of spend and representing approximately 2.5% of the shares outstanding. Over the last 12 months, we have taken share count down by 8%.

Inventory levels remain elevated, and we closed the quarter with inventory of $7.2 billion. This is a function of high demand, coupled with continued supply constraints in key components. I think you all are well aware of the golden screw phenomenon. And as Revathi mentioned, we continue to closely monitor demand indicators, but our focus right now is on delivering our customer backlogs.

Please turn to slide 9 for our segment outlook for the fiscal second quarter and our year-over-year growth expectations. For Reliability Solutions, we have good line of sight to meaningful revenue growth this quarter, potentially as high as 20%, driven by healthy demand across several key markets. We expect broad-based strength to support significant organic growth in Industrial, particularly within renewables and grid-edge. And in Auto, we're seeing our next-gen mobility products such as EV and scalable compute continue to gain tremendous interests from our customers.

Turning to Agility Solutions, revenue is expected to be up high-single digits to mid-teens, predominantly driven by overall cloud and communication strength within CEC. Lifestyle should trend flat and Consumer Devices will be down, consistent with our expectations. Flex's regionalization capabilities continue to provide growth opportunities, and we expect the softening pockets of demand in some of the consumer markets will be more than offset by considerable growth in CEC.

On to slide 10 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 $52 million, and the tax rate should be in the 13% to 15% range. We expect adjusted EPS between $0.48 and $0.54 based on approximately 468 million weighted average shares outstanding.

On the following slide, we have updated our fiscal year 2023 guidance. We increased revenue expectations to $28.4 billion to $29.4 billion based on inflation recoveries and continued strong end-market demand, while also anticipating some softening in consumer end markets. We now expect adjusted operating margins to be around 4.6% to 4.8% and continue to expect adjusted EPS between $2.09 and $2.24 a share.

And just to wrap up with a couple of comments before we start the Q&A session. Despite the very dynamic macro backdrop over the last few years, you've seen a very resilient Flex. Our goal has been to deliver consistency, and we have. Adjusted EPS is up 28% in fiscal 2021, 25% in 2022, and we continue to expect double-digit EPS growth in 2023. We've enhanced our portfolio and the mix continues to improve with better geographic diversity, more balanced end-market exposure and with a greater emphasis on high-growth industries. Overall, Flex is operating from a stronger position today than we ever have.

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

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer portion of today's call. [Operator Instructions] As a reminder, we ask that you please limit yourself to one question and one follow-up. One moment please for your first question. Your first question comes from Steven Fox of Fox Advisors. Please go ahead.

Steven B. Fox
Analyst, Fox Advisors LLC

Q

Thanks. Good afternoon and congrats on the quarter and outlook. Two questions, if I could. First off, can you give a little more color on the CEC strength that you're seeing? How much is seasonal? And then maybe if you could force rank where it's coming from most versus least, how much is new programs, et cetera?

And then secondly, I was curious what kind of discussions maybe you're having with customers that you're producing for in Europe about risks related to this year around an energy crisis? Any kind of plans you're making or how you just sort of see the landscape for later this year for producing in Europe? Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure, Steven, and thanks for the compliments. Let me just start with the CEC question. So we didn't spike out CEC specifically, but I'll tell you, very strong growth, double-digit growth for CEC in the quarter. If I were to sort of rank them from lowest growth to highest, I would say, enterprise was probably the slowest grower but still up double digit. Communications was up double digit, really nice to see continued strength there. And then cloud, as we had indicated back in the Analyst Day, that was up triple digit, and we still expect that business to more than double here in 2023.

Just looking ahead for, I guess, those three components, on the enterprise side, it'll probably soften a little bit in the back half of the year, but we still expect pretty robust growth. I was just talking to our CIO and you sort of get the chatter in the industry, we're going to continue to see strong spending on things like security. And whether it's on-prem, compute or something done in the cloud, there continues to be just this insatiable appetite for data and data analytics. So I really don't see that going away. It's sort of like squeeze the balloon. If it's lower in enterprise, it's probably going to be higher in cloud.

Comms continues to look pretty good with 5G rollouts, and we love where we are with cloud. Again, it'll be up triple digit this year, more than double. And then you asked about program wins, that's where it's coming from, I mean, CEC, where we've got some nice share gain in that cloud segment of the business and feel really good about that.

With respect to Europe, look, hard to say. I mean, we've kind of been talking about the regionalization strategy that we have, which is customers want proximity of facilities to be closer to end-market demand. You've seen we facilitize in Europe to support that. I guess I can't comment specifically to energy challenges, but if things get tight this winter, Flex has the ability to redirect production from one region to another, and we would be working to be as fleet of foot as possible to support that to make sure we're meeting our customers' demand.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

And, Steven, the only thing...

Steven B. Fox
Analyst, Fox Advisors LLC

Q

Great.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

I'd add, first is thanks for the comments on the performance. On the energy issue, I'd add is that two things. One is from an energy inflation cost, we continue to kind of put that together to look at how we pass those costs on, But in terms of energy availability itself in Europe, we are looking at all our kind of alternate plans, whether we have to – how much of this can come from true reliance on some independent alternate energy strategies. We're working with local utility providers to see how we can partner up on that. So we are looking at all the options.

Of course, if it gets more difficult than where it is now, it's hard to predict. But I think we have a good resiliency plan right now from the current line of sight that we have.

Steven B. Fox
Analyst, Fox Advisors LLC

Q

Great. That's super helpful. Thanks again.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Thanks, Steven.

Operator: Your next question comes from Mark Delaney of Goldman Sachs. Please go ahead.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Good afternoon. And thank you very much for taking the question. First on the revenue outlook, if I take the strong first half of the fiscal year on revenue the company has reported and guided to, and also take into account the full-year revenue guide, I believe it implies at the midpoint that the second half of the fiscal year revenue could be down a little bit compared to the first half. Maybe you could talk about to what extent that moderation is the change in the mix away from consumer and to what extent it's potentially some slowing in demand given the macroeconomic issues. And then, if it is macroeconomic issues, is that something that you guys are seeing reflected in customer orders, or are you just trying to be proactive given some of the headlines that we all see out there? Thanks.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. So, Mark, what I'd say is, first, let me start with the fact that if you look at our current Q1 performance and our guide for Q2, our first half would be up 16%. So, a very, very strong kind of first half.

Looking at second half, I think you'd probably be able to calculate that it's going to be around 7%. But I think we've taken a lot of factors into consideration on this. I'd say most importantly, looking at fiscal Q4 for us, which is first quarter calendar for most companies, we're being a little more prudent about our assumptions. We're assuming that the consumer markets will be somewhat slower. We've kind of baked that into our assumption and that's kind of what's driving a more prudent look in second half.

We think the interesting dilemma like for most people, Mark, including us, is our demand is very, very strong for the full year, but we are trying to give a guidance that we think is prudent and makes sense. So we've baked in some kind of slowness in demand in consumer products for Q4 of our fiscal year from what we can see today, but actually we don't see any demand slowness across any of our end segments. So it's a little bit of a trick to figure it out, but we'd rather be prudent than not.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

No, that's very helpful. Thanks. And my follow-up question is on the updated EBIT margin guidance. Again, revenue overall is coming in very well and the company took up the full-year revenue guide. But despite the higher revenue, you did slightly adjust the EBIT margin guidance lower. So if you could, just clarify what the factors for that are. Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure, Mark. So, as you saw, we dropped through the good news from – the top line good news from Q1. Some of that top line came from inflation recovery. And so, as I had mentioned in the prepared remarks, that inflation recovery is essentially dollar-for-dollar offsetting cost growth.

But like Revathi said, kind of with respect to the revenue question, we're trying to have a prudent second half. I thought given the dynamic macro environment, we'd rather not get over our skis and start taking up EPS for the full year. So we're holding the estimate on right now.

Look, record operating profit in Q1, love where we are there. We have great line of sight to another strong Q2, likely with operating profit kind of dollar-for-dollar the same, and we softened expectations a little bit – or trying to soften expectations a little bit for the second half, but overall, we feel really good about where we are.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Mark, I think the story to take away here is – first is obviously fantastic performance top line, bottom line for Q1, right? And Q2 guide also will be another record in terms of operating income dollars the way we've guided right now; so, strong performance on that, too. I'd say like most people, we talk a little bit about supply chain constraints and the added costs and pressure that drives, and we continue to kind of be thoughtful about how we assume that's going to flow through for the rest of the year.

So, that's kind of our thinking around how we're doing margin guidance. But with our very consistent and record performance on revenue and margins and our operating income dollars, we feel comfortable. And then, most importantly, Mark, it's only Q1 for us. So it's a little early in the year for us to change a whole lot, which is also part of some more of our prudent guidance.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Makes sense. Thank you.

Operator: Your next question comes from Ruplu Bhattacharya of Bank of America. Please go ahead.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Hi. Thank you for taking my questions. It looks like inventory was up 10% sequentially. How should we think about a normal level of inventory going forward? And how should we think about cash conversion cycle? And is the expectation for free cash flow still $550 million for fiscal 2023?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. Ruplu, let me start, and then I'll hand it over to Paul. One is, I would say, I have been very clear at Investor Day when I gave our kind of longer-range guidance that our expectation is to be 80-plus percent free cash flow conversion. And we know we're coming into unusual times and – or we have been in unusual times. And so, we are seeing some investment in inventory, which to meet our record demand with 16% growth and with the unusual circumstances of the supply chain, kind of not knowing what's available, it's the right thing to do.

You're hearing that from all our customers in terms of supply chain constraints still exist, and we are part of that, right? So we need to have the right inventory to deliver the demand, and we want to do what's right for our customers. And we've kept that consistent in terms of how we have talked about it and also how we have partnered with our customers on this.

I would say the way to think about inventory moving forward is we do think our inventory performance will come back in line as you look forward. Now, I don't want to give an exact prediction when, but our longer-range forecast will be to bring free cash flow back to where we were when we left fiscal 2021, and that's our commitment to make that happen.

As we look forward, we do see some supply chain constraints easing. We have talked about that. We have a very strong demand forecast. All of that bodes well, right, in terms of inventory and free cash flow. So I feel very, very confident in our ability to execute this. We have shown that consistently in all our financial metrics. And we feel very comfortable that looking forward we'll bring all this back to normalcy as these unusual circumstances ease through.

And with that, I'll turn it over to Paul. Anything else you'd add?

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah, just maybe some a couple of data points. I mean, you're right about the sequential inventory change, Ruplu. You look at working capital advances and deferred revenue, they were up 20%. So did that dollar-for-dollar offset the growth in inventory? No. But I continue to like that we're getting support from our customers who are willing to make significant cash deposits for the inventory growth. And so we are getting some help there.

Net inventory, when you net off working capital advances, days of inventory is about 72, and it wants to be 15 to 20 days less than that. And I think, as Revathi pointed out, as this situation slowly unwinds, we will see those inventory levels come down.

You asked a specific question on free cash flow, $550 million, yes, that's the plan. We're driving towards $550 million. It has taken longer than what we had hoped for this inventory challenge to abate. And so it'll probably be a back-half loaded free cash generation year. But, again, we are holding to the $550 million right now.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Okay. Thanks for all the details on that. For my follow-up, maybe I'll ask a higher-level question. So, inflation and recession are obviously on top of mind of investors. Can you remind us, I mean, how do customers behave during periods of recession and inflation? And do customers tend to outsource more or do they take manufacturing in-house?

And if I look at your results in the Agility segment, you've really outperformed your guidance for the first quarter, revenues were up 16%. If that sustains, then that's one thing, but if it doesn't and if you see a greater, deeper recession, how would your playbook change, what would you do different and how do you think Flex would fare in the next recession? Thank you.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. Thanks, Ruplu. I'll start and then Paul can jump in. I'd say this is obviously top of mind to everyone. I'll first start by reminding that Flex is a very different company today, right? Even from three years ago, I showed that slide in my opening and that we shared at the Investor Day, and from the last recession, which was in the 2008-2009 cycle, we're a very different company.

As an example, Consumer Devices was 60% of the company then and today it's 10% of the company, so significantly different, right? Our portfolio has changed. We're a much more kind of – the exposure to volatile businesses has changed to shorter cycle. The Reliability business, a big part of our portfolio. Even within the Agility business, if you look at CEC and the Lifestyle portfolio, the types of customer mix and our product portfolio has changed.

And then I'll move on to a good example of how you think about us moving forward has to be how we have performed in the last few years, because we took out a pretty significant portion of our revenue as we went through portfolio changes and we went through the COVID reductions which was pretty significant that happened in 2021. So – and we performed extremely well through that, right?

If you remember, our COVID projections first quarter, I think revenue was down like 17%, 18%, but we had a great, fantastic full year in terms of our EPS performance and our margin performance. So I'd say we're a much more different portfolio company. We are more agile and more disciplined in how we execute, so our playbook is very, very strong. We know how to manage the ups and downs really well.

And then most importantly, one thing I feel very good about is the number of new programs and share gains that we have in our demand backlog right now, which makes me feel very good about my forward-looking forecast. Now that being said, not everybody is immune to the macros, right, and things could change.

So, to your question of how would customers behave in this in terms of outsourced or more in-house, I would say so much has changed, Ruplu, from 2008 to 2009, right? The whole supply chain resiliency conversation has significantly shifted. There's very few customers who would be thinking about their supply chain strategy the way they were thinking about it in 2008 and 2009. That resiliency question is top of mind. And most CEOs will know today that whatever recession that you go through is going to be temporary, and they want to come out of it with a stronger supply chain because I think the bruises everybody has sustained in the last two, three years is significant.

So I feel very confident that the outsourcing strategy and the dependency on EMS and contract manufacturers, if anything, is going to grow through a recessionary cycle and through – because of the supply chain issue.

In terms of Agility itself, yeah, 16% is a very strong and very high revenue growth. Very, very proud of what they are accomplishing here. If the macros change significantly, Agility is going to change like the rest of the businesses. But currently our demand is up not only because the market is up, because we've won a lot of new businesses both in Lifestyle and in our cloud business and CEC. So we feel good about our revenue growth there, and – but we are like everyone else, if there's any significant change, we think it'll have an impact on us. But we feel very confident in our ability to be agile to deliver our kind of operating profit that we're talking about. So, that we feel very good about.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Thanks for all the details. And congrats on the strong execution.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Thanks, Ruplu.

Operator: [Operator Instructions] Your next question comes from Matt Sheerin of Stifel. Please go ahead.

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

Q

Yes. Thank you. I wanted to just ask another question regarding the Automotive strength that you've talked about. Revathi, you referred to the next-gen area as a hyper growth area. But what about the core business, particularly what you're seeing in terms of recovery in Automotive production perhaps by region and the outlook that you're seeing two to three quarters out from those customers?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. So, Matt, thank you for that. So I'll give you a little bit of detail. First, starting with kind of this quarter itself, right? Our Automotive business had strong double-digit growth. If you look at comparison for the kind of light vehicle production, I think it was flat for the quarter. So we've done really well against kind of what the industry itself has seen.

I would say, if you look at this current quarter and the next two quarters, our customer demand and our backlog remains very, very strong right now. And some of it is to do with kind of supply chain constraints are most significant in the Automotive segment and dealer lot inventories are down. So we're feeling really good about Automotive looking forward the next two, three quarters that we have a lot of revenue to deliver.

And in terms of geographies itself, it's pretty consistent, I would say, across all geographies. I'd say those shortages and the revenue backlog opportunity that exists is pretty consistent. It's not as though one is better than the other. And so, overall, looking – I'd say, big growth looking forward, but the next year is very strong, and you've heard that from many of our automotive customers, too, that backlog is high and we need the supply chain constraints to clear for that backlog to be delivered.

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

Okay. Thank you for that. And I wanted to just ask a question regarding the input costs that you've seen gone up, particularly component costs, semiconductor costs. I know most of that is a pass-through to your customers. And in some cases, they're paying multiples of the face value of those parts. Are you seeing some customers sort of push back at some point? And are the expectations for normal price-downs once we get past these lead time issues and back to a more normal supply environment?

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

Well, I'd say, Matt, we haven't seen any pushback at all on it, and we don't expect that to change because the business model is set this way. And that has never been an issue, I would say, and hasn't changed even in this condition. I think that's the big plus for our business model, right? And our customers have partnered up with us very well on that, not just on labor inflation, but in all kinds of inflation. And we expect that to continue. That really hasn't changed ever in this industry, and we don't expect that will change now.

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

Okay. Thanks very much.

Operator: Your next question comes from Jim Suva of Citigroup. Please go ahead.

Jim Suva
Analyst, Citigroup Global Markets, Inc. Q

Thank you. A pretty basic question, and maybe it's because I'm not the smartest person or maybe I don't do good math. But you're raising – you just beat and you're raising revenues for the full year, but not EPS. What's the disconnect? Or can you help me bridge that? I guess I just don't get it, maybe as much details around why there's a disconnect, that'd be great.

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

No problem at all, Jim. So, as you know, we beat Q1. A portion of that revenue beat came from inflation pass-through. As I think you know, inflation pass-through is usually dollar-for-dollar without a markup. And so, that's low-calorie revenue growth.

As we look ahead to Q2, we'll see some of that continue. Inflation remains a bit high, and we're passing through those dollars. And so, as I think about the full year, we took up the midpoint by about $700 million on the top line. We took up OP dollars about $10 million up, and then we – a little bit of pressure on interest cost, interest expense, given higher interest rates.

And we were really trying to, to use Revathi's words, just give a prudent guide. We still have three quarters to go. There's a lot of uncertainty out there. We want to put an EPS number out to the Street that we are confident that we can deliver on. And at $2.16 at the midpoint, we feel pretty good.

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

And Jim, I think you just have to look at our track record, right? Look at how we've done this quarter, look at the guide we've given for next quarter, and it seems that when you're sitting in a fiscal Q1 and you're looking forward at a very strong demand pipeline, you're looking at good – the ability to start clearing supply chain constraints, but you're still hearing a lot of noise from the economy and all the noise around you. It doesn't feel like it's the right time to be kind of giving an upward guide on our profit and EPS yet. We – but if you look at our track record, we've always delivered well. And I think that's what you should take to the bank. We just feel like it's not the right time to do it.

Jim Suva
Analyst, Citigroup Global Markets, Inc.
Q

Well, Paul and Revathi, thank you so much for the details and additional color. That does bridge the gap. Thank you so much.

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

Thanks, Jim.

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

Thanks, Jim.

Operator: Your final question comes from Melissa Fairbanks of Raymond James. Please go ahead.

Melissa Fairbanks
Analyst, Raymond James & Associates, Inc.
Q

Hi. Thanks very much. I'm glad I could squeeze in. Congratulations on the great quarter and guide. And I'll echo that, thank you for the detail on the inflation recovery. That's really helpful. Are you able to quantify how much of a tailwind that was to revenue at this point? And also, is that a factor in driving the dollar value of the inventory as well?

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

It certainly is driving some inventory, much to my chagrin. There definitely is an inflation element in inventory. As I think about Q1 op margins, we probably had, I don't know, 10, 20 basis points of margin rate headwind because of inflation pass-through. I guess that's one way to think about it.

Melissa Fairbanks
Analyst, Raymond James & Associates, Inc.

Q

Okay. Okay, perfect. And then kind of back to the inventory, as we're seeing some of the demand drivers shift away from some consumer and towards some of the more strategic verticals, your long-term key markets, is there any risk of obsolescence in the inventory? Or is there some commonality among the components, you can redirect that inventory as the demand drivers shift?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

I'd say, Melissa, not for us, right, because most of our agreements are with our customers. We buy on behalf of our customers. So, excess obsolescence, all of that is borne by them. And so we work very, very closely with our customers to give them a lot of help with their forecasting capabilities and intelligence around that, so we can minimize that to the best we can on their behalf, but we don't take that liability. It sits with our customers.

Melissa Fairbanks
Analyst, Raymond James & Associates, Inc.

Q

Okay. Excellent. Great to know. Thanks very much.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

Okay. Thanks, Melissa. Okay. So, thank you, all. I'd like to just say thanks on behalf of my leadership team to our customers and our shareholders. Thanks for your support. And then, of course, most importantly, to my colleagues around the world, thanks for all your contributions and your commitment to Flex. Thank you, all. Bye.

Operator: Ladies and gentlemen, this does conclude your conference call for this afternoon. We would like to thank everyone for participating and ask that you please disconnect your lines.