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Flex Ltd. (FLEX)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for standing by. Welcome to Flex's Fiscal Third Quarter 2022 Earnings Conference Call. Presently, all participants are in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. As a reminder, this call is being recorded.

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

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

Thank you, Grace. Good afternoon and welcome to Flex's third quarter fiscal 2022 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 a Q&A. This call is being webcast and recorded. And if you've not already received them, slides for today's presentation are available on the Investor Relations section of our flex.com website.

As a reminder, today's call contains forward-looking statements which are based on our current expectations and assumptions and are subject to risks and uncertainties, so actual events and results could differ materially. Also, such information is subject to change and we undertake no obligation to update these forward-looking statements. For a full discussion of the risks and uncertainties, please see our most recent filings with the SEC.

This call references non-GAAP financial measures for the current quarter. The GAAP reconciliations can be found in the appendix slides of today's presentation, as well as on the Investor Relations section of our website.

Lastly, with regards to Flex Nextracker business, as we've previously discussed, we announced that we confidentially submitted a draft registration statement on Form S-1 of the US Securities and Exchange Commission on April 28 relating to the proposed initial public offering of its Class A common stock. The initial public offering and its timing are subject to market and other conditions and the SECs review process. We made this announcement in accordance with Rule 135 under the SEC. Following SEC regulations, we will not make any further statements or answer additional questions on the Nextracker filing at this time.

With that, I'd like to turn the call over to Revathi, our CEO. Thank you.

Revathi Advaithi

Chief Executive Officer & Director, Flex Ltd.

Thank you, David. Good afternoon and thank you for joining us today for our fiscal Q3 earnings call. Please turn to slide 3, and I'll briefly review our results.

We had another strong performance in our fiscal Q3 despite the anticipated challenging supply chain environment. We achieved revenue of $6.6 billion, up 6% sequentially and above the top end of our previous guidance range. I want to emphasize that this outcome was more about strong execution than easier than expected macro challenges.

Total Flex adjusted operating margin came in at 4.5%, also better than previously anticipated. Adjusted EPS was $0.50, up from $0.49 in Q3 of last year. By the way, that's another new quarterly record for us. Adjusted free cash flow came in at $31 million.

I would just add that our results this quarter demonstrate the major progress we've made in our ability to adapt and overcome macro challenges quickly. Of course, our deep and longstanding relationship with our suppliers definitely helps us during times like these. We are proud of our strong performance, and it's another yet important win for the team.

The consistency and continued acceleration of our performance the last couple of years is driven by the diversity of our portfolio along with our disciplined execution. Strong sequential growth in our cloud, communications and industrial businesses is the result of our bookings growth and successful ramps of these new businesses. Our investments in optical and 5G technology, electrification products and data center solutions are also helping to accelerate our growth this year.

We also recently welcomed Anord Mardix to the team. This acquisition adds to our overall data center portfolio, which is a high growth vector for us. We're excited to see the combination of these investments and strong secular growth trends really drive our performance going forward.

I will come back at the end and talk about our growth drivers in a little bit more detail. But now, I'll turn it over to Paul to take you through the full financials and the guidance.

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Great. Thank you, Revathi, and good afternoon, everyone. Let me just start by saying how impressed we all are with the team's execution and commitment to delivering the best possible service for our customers in such a challenging environment. So, thank you all for the hard work.

Beginning on slide 5, please note I will focus my remarks on the non-GAAP results. The GAAP reconciliations can be found in the appendix of the earnings presentation.

Flex revenue was $6.6 billion in the quarter, down 1 point year-over-year, but up 6% sequentially. Adjusted operating income was $298 million, down about 4% year-over-year and up 4% sequentially. Adjusted net income was $238 million, down 5% from the prior-year period and up about 3% sequentially. And finally, adjusted earnings per share was $0.50, an increase of 2% year-over-year and 4% sequentially.

On slide 6, our third quarter adjusted gross profit was $498 million, down $16 million year-over-year. Q3 gross margin of 7.5% was about 10 basis points lower compared to last year. In total, adjusted SG&A came in at $200 million, down $3 million from our prior-year period and at 3% of sales is at the better end of our targeted range of 3% to 3.2%.

Overall, adjusted operating income was $298 million, resulting in a 4.5% adjusted op margin, down slightly, but strong performance considering the continued tightness in the supply chain and at the top end of our guidance.

On slide 7, Reliability revenue was $3 billion, up about 5% year-over-year. Demand was strong across each of the end markets. Adjusted operating income decreased 14% to $154 million with a 5.1% adjusted operating margin rate.

In December, we were very happy to welcome the Anord Mardix to the team. Impact to the financials was immaterial in the quarter, but we are quite upbeat about the potential and the impact it will have on growth in our fast-growing data center business. We continue to expect it to be accretive to adjusted EPS and deliver mid-teens EBITDA margins in fiscal 2023, which begins this April.

Automotive revenue decreased mid-single digits in the quarter, with healthy underlying demand, offset by continued supply challenges. Health Solutions revenue was better than expected, but down slightly compared to the prior year, driven by tough comps related to last year's COVID-related critical care peak.

Lastly, Industrial sales were strong, up mid-teens, with strong growth across the board, including at Nextracker, where we saw sales up high-teens. Due to the global logistics headwinds, margins have been pressured at Nextracker, but we view it as temporary. The cost pressure in Nextracker is largely what drove the decline in Reliability margins. Fundamentals remain strong.

Moving to Agility, segment revenue was $3.6 billion, down about 6.5% year-over-year. In total, the Agility segment delivered $163 million of adjusted operating income, a year-over-year increase of 7%, which led to a record 4.6% operating margin.

Within Agility, CEC demand was very robust, particularly in cloud, 5G and optical. But upside in the quarter was limited by component constraints which led to a modest sales decline. In Lifestyle, revenue was up slightly despite the difficult comp, driven by new product ramps, customer wins and healthy underlying demand. And finally, as we indicated last quarter, Consumer Devices revenue was down double digits caused largely by a planned project completion.

Turning to cash flow on slide 8. Our net capital expenditures for the quarter totaled $119 million, and adjusted free cash flow was $31 million. This quarter, we paid out a net $523 million in cash at the closing of the Anord Mardix acquisition on December 1.

We had two changes to our debt profile in the quarter totaling $709 million. In both cases, we took advantage of regional opportunities at very low rates to support our business expansion and approaching maturities.

During the fiscal third quarter, we repurchased 5 million shares totaling $90 million. In total, for fiscal 2022, we have spent $580 million repurchasing roughly 32 million shares. At the end of the quarter, we had approximately $600 million remaining on our current board authorization.

Inventory at the end of the quarter was $6 billion. Inventory turns were 4.4, down from 4.8 turns last quarter. While we expect inventory to remain high in the near term, I'll reiterate Revathi's comments about strong end market demand. Chip shortages have customers waiting to fulfill demand, and delivering on customer demand remains a high priority. So as shortages abate, so will higher than usual inventory levels.

All things considered, we're pleased with our free cash flow generation over the last several quarters totaling $340 million fiscal year-to-date. And we continue to target free cash flow of approximately $500 million for fiscal 2022. Cash generation remains a priority. And in alignment with our stated capital allocation strategy, we'll continue to invest in key areas that will position Flex to capture growth.

On slide 9, our segment outlook. We expect Reliability Solutions to be up mid to high-single digits, with demand continuing to outstrip supply, leading to trends in the business similar to Q3. Automotive will be marginally down and Health Solutions essentially flat, with strong double-digit growth in Industrial.

Agility Solutions revenue is expected to be relatively flat year-over-year. We expect mid to high-single digit growth in CEC based on strength in cloud and 5G. Lifestyle revenue should be up slightly, following similar trends to last quarter. And Consumer Devices in line with Q3 due to the aforementioned planned program completion, setting up a difficult compare.

Full year guidance on slide 10. You'll see that we've updated and narrowed our full year guidance range. Our new guidance reflects revenue of $25.4 billion to $25.8 billion or 6% year-over-year growth at the midpoint. At the midpoint of the range, adjusted EPS of $1.88 would be up 20% year-on-year. The updated guidance, now at the top end of the previous range, reflects the combination of the improving strength of our results, our execution trajectory, and the strong secular trends we continue to see.

Turning to slide 11. We expect fiscal fourth quarter revenue to be in the range of $6.2 billion to $6.6 billion, with adjusted operating income between $265 million and $305 million. Interest and other expenses is estimated to be roughly $40 million. And the tax rate should remain at the high end of our 10% to 15% guidance range.

We expect adjusted EPS to be in the $0.05 range of $0.41 to $0.46, excluding the impact of stock-based compensation expense and net intangible amortization, with about 474 million weighted shares outstanding.

With that, I'll turn the call back over to Revathi.

Revathi Advaithi

Chief Executive Officer & Director, Flex Ltd.

Thank you. As you can see from Paul, another strong quarter and improved guidance for our fiscal 2022. In early 2020, when COVID was just unfolding, we held our first Investor Day since I came into the company. In the midst of uncertainty, we shared with you our long-term financial framework.

As you can see here on slide 12, we said we would deliver organic growth above GDP and get to mid-single digit operating margins and EPS growth of 10-plus percent. Looking at our full year guide of FY 2022, you can see we have accelerated growth even while lapping a major portfolio change in FY 2020. And we have delivered on our long-term margin and EPS goals.

Turning to slide 13. We plan to have an Investor Day in late March, where we will discuss how the combination of our investments in commercial and technology capabilities, coupled with strong secular trends, will accelerate our growth potential.

Technology transitions like 5G, optical, electrification and point-of-care diagnostics continues to be a major driver for most of our customers, and Flex investments in these technologies have helped us win major programs and continues to position us strongly in these markets.

In addition to these technology transitions, the challenges of the last several years have solidified the need for robust global supply chains so companies can deliver their products to market and meet customer commitment. Many companies have found that they can't effectively manage this by themselves. This need is expanding the total available market for supply chain and advanced manufacturing services.

Now, the desire to manufacture products closer to local demand is also becoming a priority. Again, only a few companies have the capabilities to accomplish this efficiently and on a global scale, and that is driving strong new business wins for us.

Other secular trends we're bullish about are digitalization, data center growth and infrastructure investments driving growth in the energy sector in both residential and utility scale. Now, these secular growth drivers have been fueling our pipeline and bookings growth, as you can see in this year's results.

As I said earlier, the combination of our investments in commercial and technology capabilities have positioned us well to capitalize on strong secular trends and has accelerated our growth potential going forward. Now, combined with our track record on operational execution, this will create strong shareholder value in the years to come.

On behalf of the entire leadership, I want to thank our employees for their contributions and strong execution, and, of course, our customers and suppliers for their trust and partnership, and our shareholders for your continued support.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer portion of today's call. [Operator Instructions] One moment, please, for the first question. Your first question comes from the line of Ruplu Bhattacharya from Bank of America. Your line is open.

Ruplu Bhattacharya
Analyst, Bank of America Merrill Lynch

Q

Hi, thank you for taking my questions. My first question is on Nextracker. Based on the disclosures you've given so far, looks like for the first three quarters of fiscal 2022, revenues for Nextracker are growing very strong, around 10% year-over-year, which compares to the full year fiscal 2021, you had reported only 2% growth. So the first part of the question is what is driving that strong growth and do you think that this growth rate can sustain going forward?

But then, on the margin side, it's a little bit – you're suffering from, I guess, the freight costs and logistics costs. Looks like for the first three quarters, operating margin for that business is 7% versus 15% for the full year. So it's about half of last year. So is it just the logistics cost that's impacting that? You mentioned that you think this is temporary. Why do you think that? Is this a business where you can pass on the cost? Does it take longer to pass it on? So if you can just kind of give us your thoughts on revenue and – revenue growth and margin improvement in that business? Thank you.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah, Ruplu. I'll start and Paul can jump in. I'd say first is I'll start with on the growth question. Yes, obviously, strong growth comparison this year. And, of course, last year, with COVID and things like that, things did get to a little pause in terms of solar and utility-grade installation. But I would say that the pipeline and bookings for that business has been very strong even through COVID times. And then, now, as installations are coming back, you're seeing that reflected in our growth rates.

And we continue to be very bullish for that sector, not just because everything you hear about kind of energy projects that is going on around the globe, but also the infrastructure investments that are being committed to this country. So, pipeline is strong. Bookings are even more strong. Growth rate's expected to continue, if not accelerate from where we are today. So feel very, very good about it.

In terms of margin, first, as I'll point out, is that our performance is much better than all the peers in the sector. So, that's one. Second is, I would say, we have talked about this before that we are able to pass on not just kind of steel inflation costs and things like that, but freight and logistics costs also. But there is a timing issue involved with passing those on. And what you've seen happen with freight and logistics, Ruplu, is, of course, the inflation has gone up quarter over quarter over quarter. So as we are passing that on, there's also catch up that's required as we continue to see this inflation, including the availability of things like shippers and all of that.

So, I think that is a challenge we're facing, but we're very, very comfortable that that is transitionary and that we will improve the margins of this business as we move forward. Our fundamentals are very strong. This is like any other business that has time in terms of passing this on through their system. So, it's very similar to that. And we feel very comfortable that the fundamentals are strong and they will catch up in terms of their margin rates as they move forward.

Ruplu Bhattacharya
Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks for the details on that. My second question is on the CEC business, specifically on the cloud portion. You mentioned that the demand from cloud was very strong this quarter. Some of your peers have seen in that business customers move to a consignment model, and that has impacted their revenues. Are you seeing anything like that from your customers? Or from Flex's standpoint, are you building the whole rack? Do you think that that business can continue to grow as we look out into the next couple of quarters? Thank you.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

So, first, I would say is, our CEC business, if you recall, a couple years ago, we did some kind of pruning and correction in the CEC business. In the last year, we have invested a lot in terms of growing the cloud and the 5G business, and you are seeing all that kind of play through in our growth associated with cloud and 5G. So, we're feeling very good about our investments in the cloud business with all the major hyperscalers and colos. So feeling really good about that.

I'd say in terms of the model itself, we usually let our customers drive kind of what is the right engagement model. It's usually a partnership approach to figuring out where is the best value, because whether it's consignment model or not consignment model really depends on kind of where is the value driven, right? And so, if we find that we are not having any value, then consignment model is the right one to do. So, we like to have a partnership with our customers in a collaboration to come up with the answer of what is the right model. So, it's a balanced approach.

And we don't have a business where we kind of move that around at a pretty significant scale, as you've seen some others do it. I think we are very consistent in our approach to this. And we allow our customers to really figure out and work with us as to what is the model, who drives the best value. And then, based on that, we make the decision.

Ruplu Bhattacharya
Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks for all the details and congrats on the strong execution.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Thank you, Ruplu.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Thanks, Ruplu.

Operator: Thank you. Your next question comes from the line of Mark Delaney from Goldman Sachs. Your line is open.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Good afternoon and thanks very much for taking the questions. First question was on supply chain. Hoping you can provide a bit more clarity on what Flex is seeing. I realize there has been supply chain challenges for quite a while now. At the same time, there is now Omicron variant. So any incremental details you can share on what the company is seeing currently and any expectations for how that may progress going forward?

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Mark, I love this question because, obviously, my crystal ball is as good as yours in this. But I'll say in terms of – we see a ton of data coming in, right, and that helps us process some thoughts on this. You've seen suppliers and customers give anywhere from thoughts on, hey, late 2022 to 2023, you start to see the supply issues abate. And I would say that our thinking is in line with that because, frankly, now we haven't seen that abate in any significant way. We feel like those supply challenges are still there and consistent. So, we have a very, very big supply chain team, right, 10,000 people, and we're able to really work with our suppliers to get our demand fulfilled in a way that makes sense for us and customers.

But looking forward, I would say that kind of the second half of 2022 and 2023 seems to make sense based on kind of capacity investments that suppliers are committed to having made. So we're kind of in line with where all the industry is in terms of looking forward and thinking this is probably a late calendar 2022, going into 2023 type of situation.

I would say, in terms of Omicron, Mark, the impact to our kind of performance itself wasn't significant at all because one of the reasons is we have 85% of our 165,000 employees fully vaxxed, and around 93% of them with at least with one dose. So we have just driven a culture of focusing on understanding why this is important to you and your family, which has really helped us take this a long way. And because of that, we've really been able to hold our performance through these kind of COVID ups and downs that you've seen recently.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

That's very helpful. Thank you. And my follow-up question was around the EV business, and you alluded to it a couple of times in the prepared remarks, not just in the Automotive business, but also Industrial with charging. I was hoping you could elaborate a bit more on what you're seeing in EVs and the outlook there, and is it getting to a point where you can size how much of the company's revenue is coming from EVs? Thanks you.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. Mark, we will talk more about this in our Investor Day. So we'll go deeper into kind of big growth drivers like electrification for us. If you think about EV and autonomous, both together, we've been spending a lot of technology dollars into developing our own portfolio of solutions on converters, really looking for partnership for high-voltage inverters, our own battery management solution, and then also investing with copartners in terms of long-range battery solution. So we're really putting a lot of money into technology on electrification.

Autonomous, you already knew that we had a pretty strong working relationship with almost large autonomous players and it was a matter of time before those started to ramp up. We will talk more about it in our Investor Day. It is starting to become a larger and larger part of our business. And as we look forward, we'd say kind of as ICE vehicles start to kind of reduce in terms of overall volume, we do see that electrification and autonomous will drive an unfair share of growth.

If you look at our bookings this year, it has been all pivoted a lot towards electrification mainly. And then, what I really like about this, Mark, even more is the geography. Because we're also winning electrification in China, as you know, which is one of the largest growth market. So we've really doubled our effort to say we want to win in electrification in China because that provides the scale, but we also want to do that in kind of Europe and North America.

So the geography of our distribution is really good. We're not just tied to one player and one geography; we really are more distributed across the globe. So feeling very good about it. And we'll share more details in March in our Investor Day. This will be one of our macro growth themes for sure.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Thank you. Your next question comes from the line of Shannon Cross from Cross Research. Your line is open.

Shannon Cross
Analyst, Cross Research

Q

Thank you very much. I have two questions. I'm curious as we've moved past the holiday season, are you seeing any improvement in customer lead times? Have buying behaviors changed overall? Do you see customers able to plan a little bit better? I'm just balancing maybe a little bit slower non-holiday demand with, obviously, Omicron and everything else that's happened. And then, I have a follow-up.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure. Maybe start with lead times, and then I'll just talk about stocking levels because I think that's kind of an interesting phenomena too, Shannon. Particularly, in the Lifestyle's business, as we've moved out of the holiday season, I would see no significant change to customer lead times. But what we are continuing to see is inventory at the customer or at the channel level continues to be very, very low. Our customers, particularly in Lifestyle business, would like to see, I don't know, six to eight weeks' worth of inventory and they have somewhere between zero and two.

So we do expect – as I mentioned in the prepared remarks, we continue to see strong demand signals in that business in particular. And I think that coupled with the need to replenish inventories is going to be a positive tailwind for us over the next couple of quarters.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

And then, Shannon, the only other thing I would add is, that segment, the consumer segment, the Lifestyle as we call it, also has a lot of the reshoring work going on, right, in terms of [audio gap] (00:28:17) that you have, capacity available close to kind of the end consumer. So that is also driving a lot of program and bookings ramp for us.

So I would say holiday lead times maybe kind of being managed better as ports are clearing, though they're all backed up again. But I'd say, in general, Paul's answer that inventory levels are still depleted and then program changes like reshoring is driving a lot of the demand there, too.

Shannon Cross
Analyst, Cross Research

Q

Okay, thank you. And then I'm curious, Paul, if you think about how you are managing working capital and specifically inventory, which is obviously up. But just, in general, given everything that's happened in the last couple of years, should we assume working capital needs to run at a higher level going forward with the more distributed manufacturing? Or is there a way over time to kind of work working capital back down again maybe as things normalize?

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah. I do, to your point. I mean, inventory is running hot and I think that will continue. But as we move into 2023, I do see inventory levels starting to normalize. I'll say our big priority right now is just meeting customer demand, and we need a higher level of inventory just to do that. But again, I think you'll see that ramp down as the supply constraints improve as we move through our fiscal 2023 with inventory starting to come down then.

And, I guess, I would also point to cash flow. Look, inventory is elevated, but we continue to generate positive cash flow and hold fast to our roughly $500 million of free cash flow this year. So I think we're managing it pretty well.

Shannon Cross
Analyst, Cross Research

Q

Great. Thank you so much.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Thanks, Shannon.

Operator: Thank you. Your next question comes from the line of Steven Fox from Fox Advisors. Your line is open.

Steven B. Fox
Analyst, Fox Advisors LLC

Q

Thanks. Good afternoon. Two questions. First, on the Lifestyle business, I was wondering if you could give us some more color around the new logos and portfolio expansion you talked about in the slides.

And then, secondly, Paul, I understand seasonality in the March quarter, but as demand is exceeding your ability to supply right now, why isn't the March quarter guidance closer to what you just posted in terms of December revenues? Thanks.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yes. So maybe I can take the seasonality question, and Revathi can talk to the labels. On seasonality, just some data points for you. Historically, as we move from Q3 to Q4, it's, in the past, been about a 10% step, down from Q3 to Q4. That's based on, I don't know, the last 10 years or so.

At the midpoint right now, we're looking at about a 3% sequential decline, better than what we've done historically, I think, driven by a couple of things, hopefully some improving component shortages, but also driven by some customer ramps. So, I think we feel pretty good about our Q3 to Q4 step.

To your point, if we had unfettered access to chips, Q4 would be much, much higher. But we just, much to my chagrin, don't see this shortage challenge going away immediately here as we move into the first part of this calendar year. It's going to take several quarters to work our way out of it.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

And Steve, the way I think about it is, when we talked about Q3, while we were able to estimate a large part of what we were going to get from suppliers, we were able to do some work to pull in things for our customers, but also to be able to do some resourcing and things like that, which really helped kind of Q3 and which we thought would happen in Q4, right? And so, we'll do the same in Q4.

So, we're giving you a revenue guide based on what we think our supply situation will be. But we're working absolutely hard with our suppliers and our customers to do better than that, but it's hard to kind of pin down a commitment that is easy to make these days, right? So, we think it's a good guide based on where we see things, but obviously we're working our suppliers all the time to be able to do much better than that.

In terms of logos itself, when we, again, did our portfolio changes in FY 2020, we really focused on – earlier we were doing a lot of small logos and startups and things like that and we've really refocused our business on kind of large logos where we have clear value add from a technology perspective. So, our focus on is not just adding new logos, we're very clear on where we want to add logos, but also to have a deeper penetration with our existing logos.

So, as an example, we are focused very much on winning kind of dispensing fluids kind of on Lifestyle on all large logos because we feel our manufacturing process capability on what is a very technical problem of managing the quality of dispensing liquids is important. So, we want to focus on adding logos on that space.

The same with floor care. As you know, we're one of the world's largest manufacturers of floor care. We feel like we have process, manufacturing, technology capability that gives us an advantage. That, we are really focused on adding logos there. We already have a large market share.

So, our growth of Lifestyle as you – fantastic growth, right, the last few years, has really been with deeper penetration with existing logos, which is providing them more geographies of growth, adding more kind of services business as they're looking for a more kind of holistic lifecycle support. And then, really focusing on technology and manufacturing capabilities where we feel like we should penetrate other logos.

So, that's kind of where we've really focused our Lifestyle business, and it's really working. I mean, fantastic growth performance from that business the last couple of years.

Steven B. Fox
Analyst, Fox Advisors LLC

Q

Great. That's really helpful. Thank you so much.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Thanks, Steven.

Operator: Thank you. Your next question comes from the line of Jim Suva from Citigroup. Your line is open.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much. I think it was Revathi on her prepared comments, she mentioned how pleased she was with the execution of the team and specifically stated, if I heard right, it was more a function of strong execution more than easing supply chain challenges.

If I got that right, Revathi, can you help us understand how do you know about that that's the case? And is it just because the lead times are still really long to getting supply? And why were you able to, I don't want to say leapfrog, but jump and get the parts and components while other OEMs seem to struggle with securing components? Thank you.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Thank you, Jim, for that question. And yes, I think you've nailed it, absolutely right, in terms of why we're able to manage this. One is, I would say, my statement is absolutely correct because you haven't seen anything change in supply or demand, right? Supply is still pretty bottlenecked across, I would say, all major kind of material components that we're looking at. And demand is very, very strong, right, and that is still the fact.

So, there are two things that really helps us in an environment like this. One is our scale, of course, significant scale which helps us have deep relationship with our suppliers. We work very closely with our customers to really understand how we prioritize, what we prioritize within the quarter, what we can bring in, what we should push out. And really work with our suppliers to say is there a resubstitution, should we be looking at qualifying something different. All of those really helps with our scale, right, 30-plus countries, 100-plus factories. Every supplier we call will lift up the phone and give us top priority.

So we work in a real partnership between our suppliers, customers and ourselves in a very complex environment, right? Hundreds and thousands of lines that we're moving around every single day. And then, on top of that, what happens is the stuff we plan for it to arrive, Jim, doesn't arrive. What we weren't expecting to arrive arrives because a boat stopped somewhere or a supplier didn't meet their commitment.

So the factories have to be super, super nimble in terms of stop/start and doing all of that. So that is also another fantastic capability we have. Our factory execution machine, I would say, is unbelievable, is like no others that I have seen. And so, they're able to take and execute. If we have the parts, there's no question that we can get it done. So they're able to do that and also be efficient at the same time, as you can see with our results.

And, Jim, that's why I feel very comfortable saying that supply/demand hasn't changed. We are very focused on resourcing, redesigning for our customers, doing all of that as we adapt to the supply situation. And then, our factories. I mean, what can I say about our factory execution, they have just – the last couple of years, they have just kind of blown it away with their fantastic execution. And so, that's what it comes down to.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you so much.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Thanks, Jim.

Operator: Thank you. And our last question comes from the line of Paul Chung from JPMorgan. Your line is open.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Hi, thanks for taking my question. So just on – follow-up on free cash flow. Should we kind of expect more outsized generation maybe in the first half of 2023 kind of relative to 2022, or expect a little bit more normalization towards the end of 2023? How should we think about kind of seasonality of cash flows? I know it's difficult to predict.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah. So if you think about the inventory levels that we're at right now, Paul, as I had kind of mentioned to Shannon, they are a bit elevated. And we'll see that ramp down over the next several quarters moving into 2023. The good news here is that we have, in many cases, cash advances from customers that have helped to offset the burden of that inventory growth. And mechanically, the way it will work is, as inventory levels come down, so do the customer cash advances. And so, there is a little bit of an offset there.

And so, the way I'm thinking to 2023, and we'll talk more about this at the Investor Day in March, I suspect, but I'm thinking seasonality won't be too much different than what we've seen in the past. You look back over the last several years, we tend to be more back half-loaded, and I think 2023 will probably be much the same.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

And then, Paul, the only thing I would add is, a strong balance sheet, right? We're still in a fantastic position. Our focus is on meeting demand, as we have said, for our customers because we just want to really focus on delivering our best for them. And in that time, I would say, we're doing yeoman's job and fantastic job in terms of managing our cash flow, of course, with a lot of support from our customers who fully understand what we're trying to get done for them.

So really pleased with where we are with it, and we think it stabilizes as the situation balances out. So really pleased with where we are.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Great. And then, last question on component shortages. How are you kind of prioritizing certain customers? Are you prioritizing certain higher-margin segments? How are you dealing with those dynamics? And if you could also talk about kind of some of the pricing dynamics. I believe you're passing on most of the costs, but is there any kind of incremental margins you're capturing for prioritization of certain customers? Thank you.

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

Yeah. I'd say, Paul, a really important question, right? I would say in terms how we prioritize, we have a very in-depth analytical and focused approach with our customers and on our suppliers that really drives prioritization. We don't prioritize based on margins or stuff like that. We really focus on can we get the product in. If we can get the product in from our suppliers, we will absolutely deliver the end product to the customers.

Obviously, medical always gets attention from all our suppliers. That's just been the way it has been. But our prioritization is really focused on what can the supplier give us, based on their capacity and their capability. And we work very closely with our customers in terms of making sure that they understand the prioritization.

I'd say in terms of price, the way I think about it really is there is – the last year has had tremendous cost changes, whether you think about freight or material prices associated with semiconductors and all other materials, right? And we have a very collaborative approach with our customers. We really focus on sharing cost with them. They understand that we drive efficiencies very, very well. But they also have a role to play in terms of cost. And they want us to do what's the right thing for running our business and running their business.

So it's a partnership approach, I would say, in terms of how we share costs with our customers. That's how this industry works. And at this time like this, you have to be more tied at the hip so our customers understand kind of what are the things we're saying and what is the role they have to play. And then, where are the places we can drive efficiency and be better in how we run. And all of those is working and you see that in our results, even in the last six months with costs escalating. And we continue to use that same playbook with our customers and our suppliers.

Paul J. Chung
Analyst, JPMorgan Securities LLC
Q

Great. Thank you.

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

Thanks, Paul.

Operator: Thank you so much, presenters. And ladies and gentlemen, this concludes today's conference call. Thank you all for joining. You may now all disconnect. Goodbye.