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Flex Ltd. (FLEX)

Q2 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

David A. Rubin
Vice President-Investor Relations

GAAP AND NON-GAAP FINANCIAL MEASURES

- Please note, unless otherwise stated, all results provided will be in non-GAAP measures and all growth metrics will be on a y-over-y basis
- 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 on the Investor Relations website

Revathi Advaithi
Chief Executive Officer & Director

BUSINESS HIGHLIGHTS

Revenue and Adjusted Operating Margin

- Starting off with our results on slide 4, we had a solid Q2 with revenue of $6.5B and market trends in the quarter were largely in line with our prior expectations, with strength in cloud, power and medical devices
- Our adjusted operating margin came in at a record 5.5%, based on the strong mix and effective cost management, and we delivered $0.64 of adjusted EPS, also a quarterly record for Flex
- As mentioned last quarter, we have multiple large program ramps programs across Flex, including cloud, power and auto
    - These ramps are progressing well, which contributed to our margin improvement, and we expect this to continue in the back half of the FY.

- I'm proud of our strong execution this quarter as the team continues to operate in a dynamic macro

Longer Term Strategy

- Now, turning to slide 5, at our Investor Day back in May, we laid out a longer term strategy to expand our unique portfolio of advanced manufacturing capabilities, innovative power and compute products, and life cycle services, with an ongoing focus towards higher value markets with strong secular trends
- We call this our EMS + Product + Services strategy
    - We continue to make progress on the strategy across our diverse portfolio
- Within each of our six business units, our teams are focused on improving the mix and driving operational productivity of their core manufacturing businesses
- Each business unit is also looking for opportunities to add value to our customers through additional services

Lifestyle Business

- Our lifestyle business was where we initially proved the value we can create through vertical integration and circular economy solutions
- The result is deeper customer relations and improved margins, even through the down cycle in durable goods
- From this experience, we extended the strategy to CEC with similar results, including the strong growth in our cloud business
- In some end markets, such as auto and, of course, cloud, we have built out our own product portfolio
    - This creates even more value in our relationships
- There's been a lot of interest in how our EMS + Products + Services strategy applies specifically to the transformation in the data center, so let me briefly explain
- Flex is the only provider that delivers customized, fully integrated data center rack solutions and power infrastructure solutions

Data Center Power Portfolio

- Our data center power portfolio spans from the facility power, all the way down to components that power the server boards
- So, our power portfolio is truly grid to chip
- You're already seeing the impact of this strategy in our results
- For example, in Q2, our data center portfolio, which is a combination of cloud and data center power business, grew 40% y-over-y vs. our expected 20% long-term CAGR, and we were also up against a more difficult comp this quarter
- Of course, we're constantly working to improve our capabilities, develop innovative products, and expand our services
    - It's been a busy quarter
- So I want to talk about some of our progress
- We announced our partnership with Musashi Energy Solutions to enhance our Flex design Capacitive Energy Storage Solution, or CESS.
- Our solution now the leading technology to mitigate the massive power spikes that are disrupting data centers as they add new AI clusters

Open Compute Summit

- At this year's Open Compute Summit, we had a few critical announcements highlighting how Flex enables cloud service providers to address power, heat, and scale challenges
- We allowed our next generation compute reference design for AI and high-performance compute applications
- We announced our partnership with JetCool to expand our direct-to-chip liquid cooling capabilities, which is able to handle the most advanced AI server specs
- Lastly, we showed our liquid-cooled Flex rack solution integrated with our power shelf, power supply, and busbars, all designed for the higher demands of emerging workloads
  - This demonstrates a truly vertically integrated solution for our cloud customers that we can manufacture at speed and scale

EMS + Product + Services Strategy

- Now there's a deeper takeaway from these product and capability announcements
- Because of our expertise in both power and compute, we are working with our customers early on their technology road map
- Because of that, Flex has the opportunity to drive leading-edge innovation and, in this case, help solve some of the most critical power issues in the evolving data center
- As I mentioned, our EMS + Product + Services strategy is about finding higher-value opportunities in diverse end markets, and every team at Flex has a role to play in this strategy
- Along those lines, we recently announced the acquisition of Crown Technical Systems

NORTH AMERICAN POWER DISTRIBUTION MARKET

- There is a strong synergistic effect here
- First, Crown has a significant position in the North American power distribution market, which is being driven by grid modernization and data center power trends
  - Their expertise in medium voltage switchgear also enhances our data center power portfolio, and we believe it will support growth in our modular power pod business, particularly in the US market
- This acquisition is another great example of our strategy to grow in higher value markets tied to our core competencies, and ultimately create long-term shareholder value through margin expansion, EPS growth, and cash generation

Jaime Martinez
Interim Chief Financial Officer

FINANCIAL HIGHLIGHTS

Revenue and Gross Profit

- Starting with our second quarter performance on slide 7
- It was another solid quarter
- Second quarter revenue was $6.5B, in line with our expectations
- Gross profit totaled a record quarterly level of $554mm, and gross margin increased to 8.5%, up 90BPS
- Operating income was $358mm, with operating margins at 5.5%, a substantial y-over-y improvement, up 80BPS.

- And as Revathi mentioned, both were record quarterly levels for Flex
- And EPS increased 12% y-over-y to $0.64 for the quarter, also a record level

Reliability and Agility

- Turning to quarterly segment results on the next slide
- Reliability revenue was $2.9B, in the expected range, with continued strength in power and medical devices
- Operating income was $159mm, and operating margin for the segment improved both sequentially and y-over-y to 5.4% on mix and solid execution
- In Agility, revenue was flat at $3.6B, with strong cloud offsetting softer non-cloud related to networking and enterprise IT
- Operating income came in at $218mm with a record 6.1% operating margin, based on continued mix improvement in each of the three business units, along with strong execution and effective cost management

Cash Flow

- Moving to cash flow on slide 9
- Q2 net CapEx totaled $100mm, and we expect to maintain our target of 2% of revenue for the full year
- Net inventory was down again this quarter, similar to Q1, down 6% sequentially and 21% y-over-y
- Inventory days, net of working capital advances, have finally reached a more normalized level in the high 50s, so we feel much better about where we are
- FCF in the quarter was strong again at $219mm
    - That puts us at $451mm YTD, on track to reach our full-year target of $800 million-plus

Share Repurchasing

- In Q2, we repurchased $300mm worth of stock, totaling approximately 10mm shares
- FY to date, we have repurchased over $750mm
    - We exit Q2 with cash balances of $2.6B
- Some of that will fund the Crown acquisition expected to close by December

Reliability Solutions

- Please turn to slide 10 for our segment outlook for the fiscal third quarter
- For Q3, Reliability Solutions, we expect revenue will be flat to down mid-single digits
- As we recently mentioned at the Goldman Sachs conference, we have seen some macro-related slowing in auto that is muting growth in H2, although we still expect to outperform our industry unit expectations in FY2025, based on new wins and content gains
- Core industrial demand is a little softer than previously expected
    - However, the strength in power and medical devices is expected to continue
- Agility Solutions revenue is expected to be down low- to high-single digits, with continued strong growth in cloud, other end markets, remaining as expected

Quarterly Guidance

- On to slide 11 for our quarterly guidance

- For total Flex, we expect Q3 in the range of $6B to $6.4B, with operating income between $335mm and $365mm
- Interest and other expense is estimated to be around $50mm
  - We expect the tax rate to be around 17% for the quarter
- All that translates to adjusted EPS between $0.60 and $0.66, based on approximately 400mm weighted average shares outstanding

FY GUIDANCE

Revenue and Adjusted Operating Margin

- Looking at our full-year guidance on the following slide
- Given some macro pressures, we now expect full-year revenue between $24.9B and $25.5B
  - However, adjusted operating margin is expected to be between 5.4% and 5.5%, which at the midpoint will be up about 70BPS year on year, and adjusted EPS is now expected to be between $2.39 and $2.51
- You can see in our results and guidance how much Flex has changed over the last several years, shifting to higher value business and improving operations through the cycles, and this is resulting in continued margin improvement and double-digit EPS growth
- We believe our EMS + Products + Services long-term strategy represents the best opportunities in the history of Flex, so we're very excited about our future

QUESTION AND ANSWER SECTION

Ruplu Bhattacharya
BofA Securities, Inc.

Q

Revathi, I wanted to ask you about the power business. Strong growth this quarter of 40% year-on-year. Is that sustainable? And how do you plan to grow this business? Is it going to be through more M&A or is there organic growth possible and who is the target customer?

And just on that, I think you said you wanted to create long-term shareholder value. So, should investors think that this power business is integral to Flex, or can this be thought of as a standalone business that over time could be a candidate for spin off like Nextracker?

Revathi Advaithi
Chief Executive Officer & Director

A

Ruplu, thanks for the call. First is I just – I want to make sure I clarify that the 40% growth is for our overall data center business, which includes both our CEC business, which is IT solutions, EMS integration and our power business, that includes kind of end-to-end power, embedded power, and infrastructure power. So that makes up the 40% growth.

And in terms of the question of is that growth sustainable, I would say the first thing, Ruplu, to step back and say, you just have to listen to everybody talking about data center growth and how significant that's going to be from all the capital investments announced over the next decade. So, we feel pretty good about that macro.

I'd say, the second thing is that it's not just about data center growth. It's about how critical power is going to be as part of that data center growth overall. And that, I think, is really, really important, because we're the only company that can truly go from embedded power that directly impacts power to the chip to the infrastructure power that goes around the grid. So, that's important. So, that's a unique capability. And as power needs gets more complex, this will be more and more important for the overall capability that customers are looking for.

So, if you step back, I would say, Ruplu, being the only company that delivers both power infrastructure and IT solutions integration, that puts us in a very unique position to get good long-term growth. We have said long-term growth of 20% CAGR. We, obviously, are beating that hands down quarter after quarter, because not only do we think that our unique position gives us a share advantage, but we also think that we have technology advantage that puts us in a unique position. So, I feel quite good about the long-term growth characteristics of the data center segment.

In terms of organic or M&A, we just announced the M&A deal of Crown Technical, which adds new power capability for us in North America, both in the medium voltage segment and overall power pods integration. This is really, really important, because remember the ease of use of creating those gigantic power pods, putting them full of equipment, and then sticking them next to a data center so you can start them up quickly is really important.

So, we'll continue to do smart M&A, like we have done before, to help our overall data center portfolio. So, I will say it'll be a combination of both. But we feel very good about the 40% that we've had this quarter, 60% last quarter, and then our long term of 20%.

Ruplu Bhattacharya
BofA Securities, Inc.
Q

And just on the issue of whether this is an integral part of Flex, or can we think of this as a business that is a standalone unit and that could potentially be spun off?

Revathi Advaithi
Chief Executive Officer & Director
A

See, I would think – Ruplu, I would step back and think about Flex as a portfolio of products, right? So, in our $25B, $26B of revenue we have, we have many different segments that are growing in different rates, right? Automotive is growing at a different rate with different characteristics; health solutions the same way; data center, the same way.

We have created a unique position for ourselves in data center, and what we are doing – planning to do in almost every segment is create these moats of products, services, EMS capability that makes us unique in that portfolio. So I would think of it as overall synergistic to Flex across the board. This is what we're doing in every segment within Flex. This just so happens to be at a growth rate that is pretty significant and in an end market that makes it in the news a lot. But I would say, overall, it's very synergistic to the Flex portfolio.

Ruplu Bhattacharya
BofA Securities, Inc.
Q

Got it. And just for my follow up, if I can ask a question on margins. So, even though revenues are challenged in the near term, you seem to be pretty confident on full-year operating margin, which is the range is kept at 5.4% to 5.5%. So, Jaime, can I ask, what is giving you that confidence? For example, you said you have ramps happening in automotive. But if the volumes are lower, are you concerned about under absorption of cost? And basically what is giving you confidence on margins? Thank you so much.

Jaime Martinez
Interim Chief Financial Officer

A

Yeah, Ruplu. Thank you for the question. And I would say that for H2, as you mentioned, right, ramps continue to progress well. And that supports our margin, despite even there may be some revenue erosion in some of the projects. The fact that the ramps are going well, that helps to raise the margins, given that it's in our automotive portfolio or data center.

And that's the beauty of portfolio, right? The mix of our portfolio continues to be better and continues to be strong, whether it's in data center or cloud, power and also health solutions. Medical devices is mixing up better for us. So that's a key strength in our performance. And we continue to manage our costs very well, right, through operational execution and efficiencies, and that supports our margin expansions and makes you feel very comfortable with that double-digit EPS growth that we're putting out there.

Q

So my question, firstly, is around the order trends that you're seeing related to your data center exposure, like in compute and power business. So, like are you seeing any acceleration in terms of order trends or are you seeing the same order trends relative to 90 days ago?

Revathi Advaithi
Chief Executive Officer & Director

A

Yeah. I would say in terms of – we don't talk much about forward-looking orders. But I would say that we are very comfortable with what we have shared as revenue growth, right? Last quarter was 60%. This quarter is 40%, obviously, in very difficult comps, right, and much higher than what the market overall sees.

So, I feel very good about our pipeline of projects that we have and what we are executing to, and I have no concerns about that. I think it fits very well with our longer term thesis that this is a very robust business. So we don't specifically give order trends. But I think that our 40% growth rate should give you a pretty good indication that we have very strong backlog and orders to execute to.

Q

Okay. I have another follow-up on your margin performance. So like we were able to offset the decline in the outlook for full year in terms of revenue by better margin. So I was just wondering like, if the outlook were to deteriorate further in terms of automotive or industrial, like how much leverage do we have in terms of increasing operating margins to still maintain the tailwind in the EPS guidance or when we will start to see a hit on EPS for if the revenues for full-year outlook start to deteriorate more?

Revathi Advaithi
Chief Executive Officer & Director

A

I will tell you that we are very comfortable with our EPS outlook. And the real thing that you see happening here is the evolution of our transformation that is playing through, where we can perform through cycles. And it happens due to two reasons. One is our mix. We're really growing in high-value segments at a really fast rate. So that's fantastic. And you see that flow through our P&L. And the second is we're great at managing volumes' ups and downs in terms of cost efficiency and productivity.

So you put those two together, I would say we are very comfortable with our forward looking EPS guidance and we feel like we're always very conservative in terms of our revenue and EPS guidance and we feel like we have pegged it right in terms of where the end markets are. So I would say I have no issue with what we are guiding so far and we expect no erosion from where we are.

George Wang
Barclays Capital, Inc.

Q

Hey, Revathi, just to double click on this cloud ramp, obviously, a very impressive 40%. Strong double-digit vs. the long term 20% growth. And just high level, obviously, you guys don't guide a quarter-to-quarter kind of full run rate. Just how to think about the cadence for this double-digit growth for the next couple quarters, especially as you think about opportunity, whether it's the new logos within the hyperscale rack integration or whether that's colocations. And maybe you can address some of the potential new logos you guys could be working out or still kind of a bigger sized opportunity and the wallet share within the existing top two hyperscale?

Revathi Advaithi
Chief Executive Officer & Director

A

Yeah. Thanks, George, for the question. I would start by saying, I'll step back and remind everyone of the portfolio that we have in data centers, right? So, in the IT solution EMS space, we do IT integration of racks, servers, storage products, networking products, all of that, for hyperscalers, and we participate across the spectrum there.

And I think what's really important to remember is we are very well vertically integrated in that portfolio, not just in terms of building the racks, making them ourselves and having all the services associated with that. So, it's a very well vertically integrated IT solution portfolio that the hyperscale just has to hand it over to us and we hand it back to them.

And then on the power products side, we touch everything from what's on the chip itself, the power that actually drives the chip, to the infrastructure around it. So, we build all of that. So, again, a very unique portfolio that really nobody in the industry has puts us in a very unique position. So, that takes us to growth, right?

What is helping us grow at this clip, I would say, is the fact that we have this portfolio that is unique, right? The IT solutions is growing across the board, and so is the power products. And we participate across colos and hyperscalers.

So, George, I wouldn't think about it in terms of new logos, because the universe of colos and data centers is a pretty holistic universe and we know most of them and all of them by now. So it's all about expansion of wallet share, not just through new technologies and new products, better schedule, better services. So, just increasing wallet share across the board is the way to really grow this business. So, I feel really good about the organic growth rate here that we are delivering.

And then, of course, George, we just announced a new acquisition in this space adding to our power products. So we're also adding through acquisitions. And that's how I would think about the overall kind of growth rate there.

George Wang
Barclays Capital, Inc.

Q

Great. Yeah. Just a quick follow-up, if I can. I just want to double-click on the owned IP product, much higher margin, could be double-digit margin, and especially liquid cooling side. At OCP you guys unveiled this reference design with the liquid cooling partnership with JetCool. Maybe putting some of your design as well in the data center side aside from, obviously, the power you guys talk about. So, maybe you can talk high level a little bit more just on the outlook in terms of embedding some of your own design into the data center, traditional data center rack integration, and then how to think about the margin profile in terms of the accretion vs. corporate average. Thank you.

Revathi Advaithi
Chief Executive Officer & Director

A

Yeah. So, I'd start with the partnership with JetCool itself and how I think about the reference design we talked about. See, for us, this is a natural progression, right, because we make the power that actually works with the chip itself. So, now it's all about cooling the chip and the power products that go together in it. So, that makes it very appropriate that we think about cold plates and CDUs associated with the product, right, which really leads us to the JetCool partnership as JetCool has a very unique cold plate design that we feel really fits well with what we are trying to do to solve the toughest problems around cooling. And that really drove our partnership with them.

And that really gives us our own IP in terms of the reference design that we're using and really solving for both the power needs in the chip itself and the integrated rack solution, which we can make all of it end to end. So, that's what really drove that partnership and it really makes it very appropriate for Flex, considering we're the only ones who have the power needs. We make the rack integration fully end to end. And then now we have the cooling reference design.

In terms of margin, I would say these are all accretive to Flex overall. Obviously, you see that in our mix, right, and what we are delivering, margin growth through these cycles. The 40% growth in data center really mixes us up in a big way. So, they're margin accretive to Flex, which is really good, because that's what you want your transformation to be about, is that you're mixing up in the right portfolio, where you have strong growth and higher margins, which is what we're doing in data centers.

George Wang
Barclays Capital, Inc.

Q

Okay, great. Congrats again on the strong growth in the AI side. I'll go back to the queue.

Christian Zyla
KeyBanc Capital Markets, Inc.

Q

First question, you guys have differentiated yourself from your EMS peers with M&A. Thanks for the earlier comments on the data center portfolio. But as you think about other subsegments outside of data center, are there capabilities that you'd be interested in adding, specifically thinking about maybe the next-gen mobility portfolio, but others as well?

Revathi Advaithi
Chief Executive Officer & Director

A

Yeah. Christian, I would say that we've been very clear in terms of our acquisition targets will always be things that help from a technology perspective, and that'll help in terms of completing a portfolio that we're really interested in. So the other area we have talked about a lot is automotive in general, right? That it has to be a fit with what we're looking to achieve in our automotive portfolio. But so far we have not needed any acquisitions in that space. We have a fairly comprehensive portfolio that provides a complete EV platform, EV hybrid platform to our automotive customers. So we feel very comfortable to that.

And then we continue to look for acquisitions around services capability that'll help any particular portfolio of ours deliver more vertically integrated services. But we're very thoughtful about acquisitions because, financially, yeah, as you have seen us, whenever we have announced a deal, it has been financially a good deal for us, and that is also an important part of the overall capital allocation strategy. So that's how I think about M&A.

Christian Zyla
KeyBanc Capital Markets, Inc.
Q

Great. And then I guess going on to the margin side, so operating margin expansion has been pretty steady on its upward trend for you guys. And some peers in the industry have hinted at goals of 6% plus. If your Reliability sub-segments begin to recover, do you think that target is reasonable? And what are the puts and takes that you think about that could get you there? Thank you so much.

Revathi Advaithi
Chief Executive Officer & Director
A

Yeah. Christian, I'll quickly comment and give it to Jaime. I mean, we've already given our long term target of 6-plus-percent. So we're obviously well in that range, as you can see from where we are today. And we had given that in our last Investor Day, and we said that comes through improved mix, improved portfolio, services expansion, all of that. But, Jaime, anything you'd add to it?

Jaime Martinez
Interim Chief Financial Officer
A

No, I think, Revathi, you said most of it. I think it's important for us that we're seeing our performance, certainly in Reliability, coming much better. Mix in power and in medical device, as I mentioned earlier, is helping us. And we, as an example, right, this quarter, we saw a revenue reduction of 11%, but we still grew 20BPS on a y-over-y basis. So that gave us confidence that we are managing much better through the cycle there. And Agility continues to perform well through our portfolio of opportunities that we're driving there with higher value, and the addition of value add services. So all in all, we feel very comfortable with our long-term range of achieving that 6% plus.