26-Oct-2022

Flex Ltd. (FLEX)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and thank you for standing by. Welcome to Flex's Fiscal Second 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. As a reminder, this call is being recorded.

And I would now like to turn the call over to Mr. David Rubin. Sir, you may begin.

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

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

As a reminder, today's call contains forward-looking statements, which are based on our current expectations and assumptions. These statements involve risks and uncertainties that could cause actual results to differ materially. For a full discussion of these risks and uncertainties, please see the cautionary statements in our presentation, press release or in 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 slides of today's presentation as well as in the summary financials posted on the Investor Relations website.

As 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 other conditions. Following SEC regulations, we will not make any further statements or answer any additional questions on the Nextracker filing at this time.

With that, I would like to turn the call over to our CEO. Revathi?

Revathi Advaithi

Chief Executive Officer & Director, Flex Ltd.

Thanks, David. Good afternoon and thank you for joining us today. So jumping right in, fiscal Q2 was another strong quarter for Flex. Looking at slide 4, revenue grew 25% year-over-year with growth in five out of six of our core businesses. As expected, consumer device was the only business down year-over-year. Overall, we continue to see a combination of strong demand in many of our served markets and sustained strength in customer backlog.

Adjusted operating margin came in at 4.8% which was a nice improvement versus last quarter. This strong performance overall drove another quarter of record adjusted EPS at $0.63, up 31% year-over-year.

Turning to slide 5, as we've focused the portfolio, we are confident in our market position and the macro and secular tailwinds remain in our favor. We're seeing continued strength in many of the end markets we participate in, where demand continues to outpace supply. Now, this is a very dynamic environment, so we continue to closely monitor demand signals and we are engaged with our customers and suppliers to navigate what is still a very unusual time.

Recently, we've all seen headlines talking about the improving supply chain. And overall, it has improved. Total shortages have been cut roughly in half compared to this time last year. Now, that being said, we continue to face shortages in certain areas, primarily the larger geometry node semiconductors, which mainly impact our Reliability end markets such as Automotive, Healthcare and Industrial. We expect constraints to continue to be a challenge as demand and supply remain out of balance.

Now, looking past the cyclical concerns, the longer-term trend is still towards increasing semiconductor content in almost every device regardless of the industry. This is primarily driven by OEMs who want to create products with digital features that customers highly value. They also want more agility and resiliency in manufacturing, and products that are made more sustainably.

This trend of technology transition is driving increased product complexities, consistent with the industry growth themes we laid out at our Investor Day earlier this year. We also talked about regionalization as it relates to customers moving their production closer to demand and improving business resiliency. Now, our ability to deliver along these themes has already directly led to share gains and expanding business for us.

Now, let me just give you one example. Last quarter, we mentioned that we baked in weakness in our consumer device and Lifestyle outlook, assuming they would be the most sensitive to the macro environment. Now, this is still the right conservative assumption. However, our Lifestyle business grew again this quarter year-over-year despite weaker end markets. Now, this is a result of our advanced capabilities, our ability to navigate complexity, and our ability to expand production in multiple regions across our geographic footprint.

Our renewables business inside our Industrial group is another great example, where our unique capabilities and global footprint align really well with both secular technology transition and regionalization needs.

I would say that the Inflation Reduction Act will also contribute to the strong growth opportunity in renewables as companies now look to move to domestic production to capture the tax credits as well as increase their resiliency. Again, we have the expertise and the footprint to help our customers take advantage of these opportunities.

Now, speaking of solar, looking at Nextracker segment, revenue growth reaccelerated this quarter due to strong demand. Margins also improved again as we slowly worked through those contracts that were impacted by the surge in shipping costs during the onset of the supply crisis. Now, obviously, renewable energy overall is a very exciting area to me and we are seeing very strong growth.

Now, not to be cliché, but it's also important to remember that energy transition is a marathon and not a sprint. The industry is still dealing with near-term solar panel and component shortages, which could also limit the speed for some program ramps. Regardless, we see this as a strong multiyear growth opportunity and we're very excited about it.

Now, moving to slide 6, we had several notable industry accomplishments this quarter. Now, one in particular, our team in Sorocaba, Brazil was selected by the World Economic Forum as a new member of the Global Lighthouse Network. This is our second facility to be selected, as you may recall, our team in Althofen, Austria was recognized last year. This recognition is important for us, because it demonstrates our industry leadership, our technology innovation and the many talented people in our company.

We are proving that you can deploy leading-edge automation to improve safety, data technologies to improve operational efficiency, and at the same time, you can upskill employees to increase their opportunities. Building on our automation and data technology skills, deploying solutions inside of Flex has become a virtuous cycle. As partners and customers see our expertise, this leads to new product wins such as advanced robotics which is also a fast-growing area for us.

We are very focused on achieving zero waste by prioritizing sustainability as part of our operations, which helps our customers see our circular economy solutions in action. And this is just a part of the story. I am very excited about these advancements and we will continue to push the boundaries of what our manufacturing and services can accomplish.

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

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Great. Thanks, Revathi, and good afternoon, everyone. I'll begin on slide 8 with a review of our second quarter results. Please note, all results provided will be non-GAAP and all growth metrics will be on a year-over-year basis, unless stated otherwise. The GAAP reconciliations can be found in the appendix of the earnings presentation.

Revenue came in at $7.8 billion, that was up 25%. Gross profit totaled $599 million and gross margin was 7.7%. We had another quarter of impressive operating profit dollar growth, up 31%, at $375 million with operating margin at 4.8%, improving 25 basis points year-over-year. Lastly, earnings per share came in at $0.63 for the quarter, an increase of 31%. Collectively, solid execution and growth across the portfolio contributed to the strong results. And overall, we're pleased with our performance this quarter.

Turning to our second quarter segment results on the next slide, Reliability revenue was $3.3 billion, an increase of 34% year-over-year. Operating income was $175 million, up 38%, and operating margin for the segment was 5.3%. In Agility, revenue was $4 billion, up 16%. Operating income was $170 million, up 11%, with an operating margin of 4.3%.

Finally, Nextracker revenue came in at $473 million. That was up 40% year-over-year. Operating income at Nextracker was $43 million, up 76%, with nice sequential operating margin expansion up to 9.1%. Overall, demand was resilient across most end markets, but semiconductor shortages persisted in the quarter, especially at the larger nodes. These constraints primarily affect businesses in our Reliability segment and tempered growth and margins.

Still in Automotive, customer backlog remained robust and we gained ground in AEV, power electronics and ADAS, consistent with the themes we outlined at our Investor Day. Industrial had a great quarter with healthy demand across our focus markets and demand in the healthcare space remained strong.

As I mentioned, Agility revenue was up 16% despite some consumer-related weakness, as expected. Consumer Devices was down against softer markets. And in Lifestyle, the consumer-related slowdowns were more than offset by new program wins and ramps. Finally, CEC delivered another strong quarter led by triple-digit growth in cloud and solid double-digit growth in comms and in enterprise.

Moving to cash flow on slide 10, Q2 net CapEx totaled $187 million or 2.4% of revenue. Free cash flow is an outflow of $84 million for the quarter and we continue to anticipate free cash flow for the year to be back-end loaded. We returned $72 million to shareholders this quarter through share repurchases.

Please turn to slide 11 for our segment outlook for the fiscal third quarter and our year-over-year growth expectations. For Reliability Solutions, we expect secular trends to support growth and share gains with revenue up mid- to high-teens. A great example of this is within Industrial, where investments, based on longer-term cloud expansions, renewables and automation, should continue.

The Health Solutions pipeline is strong. And in Auto, we expect to see solid growth as customers increasingly favor our next-gen mobility products that support new technologies. And we continue to expect to see growth in content per vehicle.

For Agility Solutions, revenue is expected to be up mid-single digit to low-teens, driven by sustained strength in CEC, particularly within cloud and communications. We expect Consumer Devices to be down in Q3, driven by continued weakness in consumer end markets. And we'll see some of this in the Lifestyle business as well, but we expect share gains to partially offset the softer consumer spend.

On to slide 12, for our quarterly guidance, we expect revenue in the range of $7.3 billion to $7.7 billion with adjusted operating income between $345 million and $375 million. Interest and other expenses is estimated to be around $55 million. We expect the tax rate to be closer to 10% this quarter, driven by the timing of a few discrete items. And we expect adjusted EPS between $0.57 and $0.63 based on approximately 460 million weighted average shares outstanding. In general, our outlook for the fiscal third quarter anticipates similar demand trends to what we saw in the September quarter with a supply situation remaining the gaining factor.

Now, let's go over our full year guidance on the following slide. In short, our expectations for the second half of the year are the same as what we talked about last quarter, around 8% year-over-year growth. With that in mind, given our strong performance for the first half of the year and our current outlook on the third quarter, we increased our fiscal 2023 revenue expectations to $29.1 billion to $30.1 billion. We expect adjusted operating margins to be around 4.6% to 4.8% and adjusted EPS between $2.20 and $2.35 a share.

In closing, although we're navigating a complex macro environment, our first half performance shows that our strategic focus on high growth and profitable end markets is the right one. As you know, over the last several years, we changed our portfolio mix, purposely deemphasizing the most volatile and shortest cycle businesses. We strategically focused on aligning our portfolio mix with our core capabilities and large diverse end markets with strong long-term growth drivers. And importantly, the trends supporting these growth opportunities are unchanged. We're confident the consistent execution that we've demonstrated these last few years will continue as we remain focused on capturing these opportunities and delivering on our long-term commitments.

With that, I'd like to turn the call back 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] Your first question will come from Mark Delaney of Goldman Sachs. Please go ahead.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Good afternoon. Thank you very much for taking the questions and congratulations on the strong results. First question, just hoping to better understand the company's comments on the end market trends and the macroeconomic environment and what's implied in your guidance. If I understood the comments by end market, consumer is one of the only markets where there has been some softness observed so far. But if I look at the guidance on a sequential basis going forward, I think next quarter and implied in the fiscal fourth quarter as well, there is some sequential revenue moderation quarter-over-quarter in both quarters.

So, it seems even though demand trends that the company is seeing are pretty strong, you're trying to bake in the potential of orders to slow more broadly given the macro economic backdrop. But if you could elaborate a little bit more on how you're trying to handicap some of these weaker macroeconomic data points and what the company could see going forward, and then how you put that into your guidance, that would be helpful.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah, you're spot on, Mark, and good question. And I would say what I like about the Flex portfolio right now is it's so broad and diverse. To your point, we're definitely seeing some softness in the more consumer-type end markets. Both Consumer Devices and Lifestyle end markets a little bit soft. You heard in the prepared remarks, though, we managed to offset that weakness within the Lifestyle business with share gain. So, that's a nice net plus. But without that, we would have probably seen a decline in that business as well.

The other four, right now, they're firing on all cylinders. And so, you sort of contrast soft consumer end markets with things like continued growth in the cloud, continued growth in renewable energy, continued growth in Automotive, not just with IHS being up 26%, but with content per vehicle going up as well. So, we feel pretty well balanced. No one is immune to softening markets, but we like where we are and we think that the breadth of the portfolio has helped to insulate the business a little bit from softening elsewhere.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Mark, the only thing I'd add is, first is we're coming off like strong quarters after quarter, right, 24% year-over-year growth this quarter, which is fantastic. We're still guiding to a very strong Q3. And I think you all will know that we like to be somewhat prudent in our assumptions and particularly with all the macroeconomic noise going on. But what's really great about it is what Paul just said, five out of our six core businesses and Nextracker, all growing year-over-year, which is great in the midst of what you're hearing across other businesses. And what we think the reason for that is, of course, all the macro stuff we talked about, but also the share gain we are seeing even in areas like Lifestyle.

So, I would say you have to think about our future guide that there is some amount of prudence in our guide and we need to do that with all the noise you're hearing. But we feel very good about the growth we just posted, and the guide we're giving you for Q3, we feel really good about that, that overall it will be a strong growth year, [ph] even (00:19:18) the second half for us.

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

That's helpful. And my second question was just on the IRA, and maybe you could elaborate a little bit more on what you've seen from end markets where there's potential tailwinds from the IRA as that goes into effect and perhaps how that evolves. But if you could also perhaps comment on to the extent Flex is manufacturing products in the US that should be eligible for certain tax credits, do those credits flow to Flex, do they flow to the customers, or do those gets shared? Thanks.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah, I'd first start with saying that we think there is very good tailwind from IRA for us not only in our Nextracker business, but in terms of our overall renewables business, which is part of our Industrial group. We've talked about that in the past. So, let me start with Nextracker to begin with. Obviously, Nextracker's growth continues to be really strong and they will continue to have tailwind from the IRA. There'll be some sort-term things like solar panels shortages and things like that, but we expect backlog to continue to grow and a good tailwind and growth for Nextracker as the IRA kicks in.

I would say in terms of credits and who gets tax credits, I think those are still being worked out. We have a lot of conversations going on in terms of what we manufacture, where we manufacture and how do we move things into the US. But I'd say there is a lot of noise in the system in terms of how the tax credits work out and who gets the best benefit. We expect that's revenue upside for and some profit upside for Flex through it.

In terms of overall renewables, the same way, our renewables business whether it is in invertors or in storage, which is part of our Industrial business, is growing very strong and we expect that to continue to be the case with the IRA. We are in deep conversations with our customers in that and we're also already launching manufacturing strategies here in the US to help support them. And I'd say the same thing on tax credits markets that that is still being worked out as to who gets the credits for it and how it plays through the system. But overall, plus-plus, it's a tailwind. Whether it's revenue or for profit, it's a good thing

Mark Delaney
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

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

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Thank you for taking my questions and congrats on the quarter. My first question is on margins. You reported 4.8% operating margin. What was the impact from inflation pass-through? And the full year, you're raising revenue $700 million, EPS $0.11 and keeping the 4.7% operating margin. So, what is factored into the full year guide from inflation pass-through impact, if you can give us any quantification on that?

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure. No problem, Ruplu. So, maybe first on the second quarter, so the 4.8%, probably, maybe a little bit of pressure from that low-calorie pass-through from inflation, just to kind of give you an appreciation for the magnitude of that in Q2. Of the 25 points of sales growth we saw in the quarter – 25% sales growth, 5 points or so of that was inflation-related pass-through. So, there is going to be a little effect. Margins could have been a little bit better if it weren't for that low-calorie pass-through, but still quite pleased with 25 basis points of margin expansion year-on-year in the quarter. So, happy to see that.

If you look at the second half guide right now, and maybe Q3 specifically, here's how I'm thinking about Q3. Q3 will largely be the same as Q2. Composition of the business, mix of the business, margin profile of the business, they'll be very similar quarters. And at 4.8% in Q3, that's another 30 basis points of margin expansion. So, that's kind of how I think that one will play out. We have some inflation pass-through in our second half guide, but it's minimal.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Got it. Thanks for the details on that, Paul. And if I can, for my follow-up, ask you a question on inventory and free cash flow. Looks like inventory was up 6% sequentially in the quarter and free cash flow was negative slightly. Are you still maintaining the full year at $550 million of free cash flow and how should we think about that? And specifically, I think you called out for the Reliability segment, you're still having issues with getting semiconductors. Is part of the inventory build because of that segment?

So, can you just talk a little bit about how you think inventory unwinds over the next couple of quarters, if it does, and how should we think about free cash flow for the third quarter and fourth quarter? Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah. So, cash flow in Q3 and Q4 will be positive. We're still expecting $550 million for the year. A little color on Q2, it shouldn't be a surprise, the free cash flow is a bit negative in the second quarter. We had messaged that. Reason for the negative cash flow was incremental CapEx spend. Our CapEx rate, as we moved from Q1 to Q2, was about double the rate we're investing in a number of next-gen ramps that supports the top-line growth that we're seeing right now. So, that 25% top line does come with a little bit of incremental investment, both in working capital and some CapEx. So, that was kind of the pressure there.

To your point on Reliability and chips, some of the larger nodes or larger, I can say, lagging-edge technology does more affect the Industrial, Automotive and Health Solutions businesses. And so, we really haven't seen the constraints abate as much there as what we have in some of the more – the Agility-type businesses. We saw [ph] clear to build (00:25:32) improve a bit in the quarter in CEC, for example, that was nice to see. But we still have some pretty significant constraints particularly in Automotive and in Health Solutions.

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

I think Ruplu, the only thing I would add is, first is you have to think about just the fantastic growth we're having this year, right. First quarter, 16%; this quarter, 24%, 25%; and a Q2 guide is 13%, obviously can be a lot more of supply chain constraints clear. So, our focus really is on meeting demand for our customers. And right now, demand is strong across most of our end markets. And so, that has to be the most important factor for us as we are bringing in inventory and trying to clear demand.

And we talked about Reliability, which is the most impacted. Even though they had a fantastic growth quarter in Q1 and Q2, they're still the most impacted. You've been hearing from automotive, you've hearing from other health companies in terms of how supply chain is impacting them. So, demand is strong, backlog is super strong. You can see Reliability margins continue to improve quarter-over-quarter, year-over-year. So, it's all focused on let's make sure that we are able to meet the demand for our customers, because that's what they are looking for us to do and we're uncomfortable our inventory will flush through as we work through that.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.
Q

Okay. Thanks for all the details and congrats again on the strong results.

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

Thanks, Ruplu.

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

Thanks, Ruplu. Appreciate it.

Operator: Your next question comes from Steven Fox of Fox Advisors. Please go ahead.

Steven B. Fox
Analyst, Fox Advisors LLC
Q

Thanks. Good afternoon. I was curious about two end markets in particular. During your prepared remarks, you talked about triple-digit growth in cloud. I was wondering if you could dig into what's going on there. And then, secondly, how long do you think that you can sort of stay ahead of the weakening Lifestyle demand trend with new programs? Is this sort of something that continues only for another quarter or so as you ramp these new programs or is there more behind that? Thank you.

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

Yeah, so what I'd say, Steven, let me start with the cloud to begin with. We talked in our Investor Day also about our focus on cloud not just in CEC, but across our portfolio, because we also support hyperscale customers and data centers from our Industrial portfolio, both from Anord Mardix and our base power business. So, we have a very comprehensive portfolio that supports data centers and cloud, not just from our CEC business. So, we have been really focused on building share and taking advantage of the full market opportunity for cloud. And we expect that to stay on track, because I think despite what you hear in kind of end markets in terms of maybe cloud growth slowing down, you have to remember it's still a very big market that's not growing at 40%, it's still growing at 35-plus. We have a lot of share gain to do. Our backlog is strong.

So, we feel really good about our cloud capabilities, not only the fact that it's so differentiated from where traditional EMS is, because we have such a power portfolio also on top of the traditional storage networking portfolio. So, we feel really good about our focus on cloud and how that is growing and we feel the end market really supports kind of continued growth for cloud.

I'd say, in terms of kind of consumer Lifestyle business, what we did a few years ago, Steven, if you remember, is we really focused on kind of the big brands in Lifestyle, really wanted to build a portfolio around kind of higher end product, more complex products, and that's paying off, because we've really gained share across some major customers and also taken advantage of the whole regionalization strategy and the whole kind of circular economy work around these customers. So, the share gain is really what's driving that business in terms of continuing to grow in the midst of all those noise in that business. And we feel pretty good that we will be well above the market in that and continue to manage through that over the next few years because we're very confident in our program ramps and how our backlog is looking for that business.

Steven B. Fox
Analyst, Fox Advisors LLC Q

Great. That's really helpful. Thanks so much.

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

Jim Suva
Analyst, Citigroup Global Markets, Inc. Q

Thank you. Maybe my observation is wrong, but it seems like all the contract manufacturers, or I guess specifically to you, Flex is seeing operating margin improvements that actually look quite sustainable and not just a supply chain driven shortage boost. Can you help us confirm that or not? And is onshoring turning in from more now just discussions to actual a reality and that could help you out with some of your utilization at some of your other factories? Thank you.

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

Yeah, Jim, I'll start and I'm sure Paul has a lot to say on this. I would say, first is we're very pleased to see the industry as a whole continue to improve in terms of operating margin improvement. I think, Flex, we started talking about this three, three and a half years ago and it's really great to see the whole industry go in the right direction in terms of focused on growth, the right kind of growth and that drives operating margin improvement for us and for the industry as a whole.

We feel that we – very comfortable that it's sustainable margin improvement because one is for us our mix is definitely changing. The types of end customers that we're going after who want to pay for our services is definitely changing. So, that is one reason we feel really good about the continued margin improvement. And our story is not just based on, hey, good growth and good absorption, but mix shift is significant part of why you see our margin continuing to improve.

And then, I'd say, on the onshoring discussions, I think it has become a reality in the last couple of years. A lot of our programs are related to either new products being ramped up in a different area, or existing products being moved around and distributed to create resiliency. So a lot of programs are driven by this whole onshoring opportunity that's going on and bringing it close to consumer. So Paul, would make any other comments on the margin improvement?

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Just maybe a proof point on your comment on regionalization, which is what we saw in the Lifestyle business this quarter. And we talked about softer consumer end markets, but Lifestyle actually grew, and a large part of that was the regionalization phenomenon that we've been talking about over the last year or so.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. So, Jim, I think you're spot on. I think both of those things bode well for the industry and for Flex, good macro, I would say, tailwind in terms of growth due to onshoring, but margin improvement we feel very good about. I think we've been on that track record now for almost four years and we continue to show great room for improvement.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you for the details and congratulations to you and all your teams.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Thanks, Jim.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Thanks Jim.

Operator: [Operator Instructions] Your next question will come from Shannon Cross of Credit Suisse. Please go ahead.

Shannon Cross
Analyst, Credit Suisse Securities Research

Q

Thank you very much. To go back to your growth this quarter and just ongoing for the year, can you talk a bit about maybe on a segment basis, how much of the growth is from new customers, how much of the growth is coming out of current programs, and maybe how much of the growth is coming out of customers that have a program with you and are expanding it? Is there a difference between your segments or is it sort of just strong growth across the board? And then, I have a follow-up.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure. So, first of all, Shannon, nice to hear your voice on the live mic again.

Shannon Cross
Analyst, Credit Suisse Securities Research

Q

Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

As for growth, let me give you a slightly different cut on the 25%, and because I think if you look market by market, it's a really wide range. We talked about consumer on one end of the spectrum, you got Automotive on the other and probably up in the 20s, I think the overall market. If I look at the 25% we saw this quarter, we had a couple of points that came from inorganic and that was the Anord Mardix acquisition. We had a couple of points just from Nextracker. Nextracker, as you saw, that was up 40% year-over-year, so that was a nice contribution to the overall Flex. We had about 5 points from inflation, which is – that's the low-calorie cost-for-cost pass-through. So, that's 9%. The remaining 16% came from a combination of share growth and market.

We think the market, overall, across the whole portfolio, was up mid-single digit, which means the rest came from share. And so, there is a lot of new labels, there is a lot of new products that are all contributing to that sales growth, hence, comments about ramps and some other things. Again, if you look at the end markets, mid-single-digit broad, boy, there is a wide range. You have down in some consumer markets and you have very strong market growth in others. A good of example that would be IHS data from light vehicle production in the automotive space, which I think was up 26%.

Shannon Cross
Analyst, Credit Suisse Securities Research

Q

Great. Thank you. That's actually really helpful. I was wondering also if you could talk to some of the investments you've made in maybe advanced manufacturing technologies, whether it's AI and ML or 3D printing, robotics. I'm just wondering as the larger EMS companies get bigger and have more capabilities, is there going to just continue to be more of a differentiator when you go out to sign new contracts versus maybe some of the smaller players or, frankly, even some of the insourcing opportunities where they don't have the same capabilities? Thanks.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah, Shannon, thank you for the question. First is, I love the opportunity that exists in manufacturing as you go in not just factory automation, but like you talked about AI/ML, which is just to use good data to run our factories better. I still believe that where manufacturing is today is really has tremendous runway to grow. So, one way is just factory automation, what do you do in a smarter way, whether it's through robotics, or cobots and all of that.

But the AI/ML layer, which is how do you overlay smart software to run your machines better, to have more proactive decision making, all of that will be a huge part of the kinds of investments that we are making today that continue to pay off in the future. And they are a big differentiator, because our customers will say that they rather like to come to Flex because the way we can deal with redesigning their product, or way we can deal with running their product more efficiently to solve some complex issue they have. It's just much better than everybody else.

So, whether that comes because of our capabilities or because of the AI/ML layers that we're building into our manufacturing systems and thinking is a big part of that. So, I feel like everything we've talked about in terms of Lighthouse Network and Industry 4.0 and on all that is just the starting of the conversation in terms of what big manufacturing companies will do around automation and really taking advantage of full manufacturing capability. So, a lot to come on that. It will be a big storyline for what drives our productivity and our margin improvement. And it definitely helps, if you're a big company and you can invest more, right. So, I think those are all part of a very strong storyline.

Shannon Cross
Analyst, Credit Suisse Securities Research

Q

Great. Thank you so much.

Operator: Your next question comes from Paul Chung of JPMorgan. Please go ahead. Mr. Chung, your line is open. Please proceed with your question.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for taking my questions. Sorry, I was on mute. So just on the operating margin improvements here, you've seen kind of big step up here in Agility over the years, but also some step down in Reliability. So, can you talk about the dynamics there? And is there a path for Reliability to kind of rebound back to north of 6%? Just talk about the dynamics there, would be helpful.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Sure. So, first of all, Reliability was up year-over-year in the quarter. So, I was very happy to see that. But to your point, that business overall wants to be a whole lot more than low-5-something margin. We've struggled a bit with that business over the last couple of quarters, as we've discussed, because of the stops and starts from the supply chain. We continue to have some pressure there. And what that means is you'll have a factor that's all ready to go, but missing components. And so, you have absorption headwind. And we've seen that over the last couple of quarters, as we have indicated before.

But that's a great business and that's a business that if you look at the – kind of going back to the narrative from the Investor Day, Flex margins will continue to grow – Flex core margins will continue to grow over the next few years because of that Reliability business mixing up. So, I can't tell you with rifle shot precision when we're going to see a 6-handle on Reliability margins here, which quarter it will be. But the Reliability margins want to be better. And I think as we clear inventory, as this component shortage continues to improve, we should see better margins in Reliability.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

And Paul, the thing I'd say is, one is our storyline on overall kind of how operating margin improves for this company has been very consistent. We started this story four years ago. We talked about how we'll build our operating model for how we'd run these businesses on improving mix, on how the kinds of customers we'll go after. In Agility, that is a lot easier to do than it's in Reliability, because Reliability is long programs take a long time. And we've made a very conscious decision that we'll go after complex automation, complicated products in these end markets, because those are the ones we feel are good for our businesses long term.

So whether it's in Automotive, we have our own designed EV products; or in Health, where we have very complex things that we make for our customers. So, it's a combination of what Paul said, which is lots of stops and starts happening there now, which is hard to do with higher capital intensity, but also the continued investments. But we just stand by our goal that our goal is for longer-term margins for Agility; and for Reliability, to keep going up. We said 5-plus for Flex, we said high-single digits for Reliability, and that's kind of what we're pushing towards and we're very comfortable that it's heading in the right direction for that.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Great. Thanks. It's very helpful. And then, just a follow-up on inventory levels, they're at their highest levels ever. It kind of makes sense given the growth you're seeing and some component constraints. But how should we think about kind of the pace of harvest here or are we at some kind of new elevated level of inventory? And then, any update on some of the golden screw issues you were mentioning. Are you finding it a little bit easier to source some of those components now? Thank you.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

A

Yeah. So, Paul, I'll start with kind of supply issues and what we're seeing. We're definitely seeing supply constraints start to clear in parts of the Agility business. So, Consumer, Lifestyle, our CEC business have more clearing off semiconductor availability that's happening and that's consistent with what we are hearing, and we're excited that that's what's driving a lot of our growth for Agility.

On the Reliability side, where we have kind of the more lagging-edge semiconductors, those are still struggling. You're hearing that from Automotive customers, you're hearing that from Health customers that those investments have not come up as they were planned and there's still delays, so we expect that those will continue to be challenged all through kind of next year calendar year.

And so, I would say that way we're thinking about it is that we have great relationships with these end suppliers and we work to get our share of them for our customers. And that's why our growth is still very strong in Reliability. But is there going to be continued backlog in those businesses, I would say absolutely.

So, in terms of inventory and clearing inventory, our focus is really on this growth opportunity that we have to take advantage for our customers is the single most important thing. They're very comfortable that the inventory we buy is on behalf of our customers and we will clear that as the backlog starts to clear more in Reliability than we have seen before. So, really comfortable with the pace of the change we're seeing. And we'd say, as kind of the growth continues, we'll manage the inventory down in the coming quarters.

Paul J. Chung
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you.

Operator: There are no further questions from the phone lines. At this time, I will turn the conference back to the CEO for any closing remarks.

Revathi Advaithi
Chief Executive Officer & Director, Flex Ltd.

Well, thank you so much. Thanks, everyone, for joining. I would just take a minute to thank my leadership team, of course, all our customers, right, and our partners and our shareholders for your support; most importantly, to the Flex team for working so hard through these complex times. So, thank you for your contributions and their commitment to Flex. Thanks, everyone. Thanks for joining.

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