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Flex Ltd. (FLEX)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to the Flex Fourth Quarter Fiscal Year 2021 Earnings Conference Call. Today's call is being recorded and all lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

At this time, for opening remarks, I would like to turn the call over to Mr. David Rubin, Flex's Vice President of Investor Relations. Sir, you may begin.

David Rubin

Vice President, Investor Relations, Flex Ltd.

Thank you, Denise. Good morning and welcome to Flex's fourth quarter fiscal 2021 earnings conference call. With me today is our Chief Executive Officer, Revathi Advaiti; and our Chief Financial Officer, Paul Lundstrom. Both will give brief remarks followed by Q&A. This call is being webcast and recorded. And if you have not already received them, slides for today's presentations 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 period. 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, a word on our Flex Nextracker business. On April 28, we announced that we confidentially submitted a draft registration statement on Form S-1 with the US Securities and Exchange Commission 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 SEC's review process. We made this announcement in accordance with Rule 135 under the Securities Act. 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 our CEO, Revathi.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

Thank you, David. Good morning and thank you for joining us today for our Q4 earnings call. I hope you and your families are all safe and healthy. Before we discuss our results, I want to start by thanking our Flex colleagues for their incredible dedication and contribution in getting us through a very unusual year.

So, let's talk about business. Throughout our last fiscal year, Flex proved that it was able to deal with the global health and humanitarian crisis. We continue to adapt and improve, first, in ramping our health and safety levels to protect workers, enabling work-from-home orders and, most recently, deal with the global component shortages and logistical disruptions.

Flex's people, processes and systems have proven to be very resilient, and the entire Flex team has done an amazing job at overcoming these unusual obstacles and supporting our customers. Our procurement and supply chain teams especially have made a truly herculean effort to track down every component and every shipping container to keep our factories running and supporting our customers.

Now let's turn to slide 3 to review some of our key financial highlights from the quarter. Our revenue was \$6.3 billion, down 6.8% sequentially, better than typical seasonality and up 14% year-over-year. Our adjusted operating margin came in at a record 4.9%. This figure includes the absorption of costs related to the challenging component supply and logistics environment. Our adjusted EPS was \$0.49, up from \$0.28 in Q4 of last year. This is the third quarter in a row of record EPS. Our adjusted free cash flow came in at \$135 million.

Now for our fiscal 2021 results, please turn to slide 4. Our full-year revenue was \$24.1 billion, essentially flat year-over-year despite all the challenges this year. We achieved a record full-year adjusted operating margin of 4.3%, a 60-basis-point improvement year-over-year. Our adjusted EPS for the year was \$1.57, a 28% year-over-year improvement. And through this year, we generated adjusted free cash flow of \$677 million.

Now moving on to the next slide. A year ago, we laid out our strategy for a multi-year transformation. Over that time, we have overcome significant challenges. While it's still too early to sound the all-clear, particularly regarding the global component constraint situation and continued pandemic, we think these are transitory challenges and there is much to be excited about the future.

We made tremendous progress in our long-term strategy, redefining our end-market focus, continuing to improve our mix, improving our operational execution and cultivating an inclusive high-performing culture. Through all of this, we delivered record results, improved our quality of earnings and strengthened our cash position.

Redefining our end-market focus particularly, since we have large end markets, has helped us focus to win in areas where our combined capability of technology, commercial excellence and operational execution gets rewarded by customers. As we said before, we will combine this with continued investment in certain technologies and products using the strength of our balance sheet.

This combination allows us to specialize and expand in targeted sub-markets that have significant long-term secular drivers. The leverage and scale of this combination along with the Flex delivery model creates lasting competitive advantage that will only strengthen over time.

We are seeing the early fruits from this strategic shift. Our work has already led to successes manifesting in both program expansions with current customers as well as wins with new customers. These successes continue to strengthen customer trust and expand our experience and portfolio of offerings, creating a virtuous cycle.

Now a little bit detail on our segments. In our Health Solutions business, we talked about focusing on medical equipment, devices and next-generation drug delivery. Earlier this year, customers came to us with a challenging and dire request. We quickly ramped multiple ventilator programs in one of the fastest large-scale medical device ramps in history. While this was a temporary project, it demonstrated our versatility and ability to operate at scale and speed. When global supply chains were in chaos, our customers needed us and lives were at stake, we delivered. And our improved model allowed us to do so in a physically responsible way.

I would also point to our global leadership in chronic care-related medical devices, where we have executed on multi-year, truly paradigm shifting medical device manufacturing program. This success shows the market we can manufacture highly complex essential products at scale. I am very proud to say our previous success has led to significant new long-term program wins in the chronic care-related space that we have begun to ramp.

Now, Automotive is a sector that is going through significant transformations. The steady shift to electrification and inevitable move towards autonomy means increased complexity and new modes for value creation. We are focused on where the market is going with our emphasis on autonomous, connectivity, electrification and smart systems, what we refer to as our ACES focus. And that has paid off with wins this year in all four of these business pillars.

This quarter alone, we ramped several new programs in auto connectivity. In fact, strong execution by our Automotive team, supported by our exceptional supply chain and logistics teams, delivered above-market results in both our Q4 and the calendar year, based on the IHS data.

In Automotive, we highly value our long-term customer partnerships and look forward to deepening these relationships as we enable their technology transformations. We're also broadening our partnerships with new industry players because of our leading edge capabilities.

One recent example of this was the announcement of our partnership with Inceptio, supplying their L3 autonomous driving controller for trucks scheduled for production by the end of 2021. You may also recall our collaboration with LeddarTech, focused on supporting their automotive front LiDAR solution and open sensing platform, as well as our collaboration with EV manufacturer, NIO. The latter resulted in an Innovation Partner (sic) [Partnership] PACE Award in 2019.

Actually, on that note, I also want to offer a big congratulations to the Automotive team as they were recently named the finalist for this year's PACE Award for not just one, but two product innovations: one in the electric vehicle space and another in the autonomous driving space.

In our Industrial business, we focused on industrial devices, on capital equipment, power systems, renewables and grid edge. We continue to increase our business in these sub-segments, but our focus on specific areas has led to wins in new verticals such as next-generation robotics that we're ramping this year.

In our Agility segment, you will recall we previously discussed our two-pronged strategy for driving productivity and cost discipline as well as wins in key growth markets with long-term secular drivers such as 5G, cloud and increasingly complex consumer durable products, where we think Flex can provide differentiated value to our customers.

The teams have made exceptional progress on all of these goals and as you can see it in our results, as evidenced in the growth in Lifestyle and CEC, as well as the very strong margin improvement from the entire segment. I am very proud of the Agility team's work here.

So the key takeaway here is that our strategy of having defined and focused end market segment is working. While our end markets are large, we have picked the sub-segments we want to win in and are investing to improve our share in those areas. Our eye is on the demand environment too, which looks positive in both the near-term and the longer-term.

There are some near-term challenges, but we're experts at navigating uncertainty and we'll control the things we can. The teams are all executing very well, and this was another strong quarter showing the potential of our company as we continue down our transformative path.

Now, turning to the next slide. I want to cover one more thing before I turn the call over to Paul. Last quarter, I mentioned I'd talk more about our ongoing ESG efforts. I want to point out our ESG focus is certainly nothing new for Flex. We've been at this for nearly 20 years. These years of effort and accomplishments are reflected in our improved performance in our Dow Jones Sustainability Index scores and being included in the S&P Sustainability Yearbook for the second year in a row.

What we have done moving forward is to set out even more ambitious goals across all aspects of ESG for 2030, building on a broad foundation that we have set. In the spirit of consistently raising the bar, Flex was recently accepted into the very rigorous Science Based Targets initiative. We're excited to join this ambitious global effort to drive meaningful reductions in greenhouse gas emissions across the value chain.

I encourage you all to visit flex.com to see our 2030 environmental, social and governance goals, and look for our new Sustainability Report in June to see the details of our full sustainability efforts and results, as well as our upcoming 10-K and proxy statement for the additional progress and commitments to human capital management and, of course, inclusion and diversity.

With that, I'll turn the call over to Paul, who'll walk you through our results in more detail. And then, I'll share some closing remarks. Paul?

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Okay. Thank you, Revathi, and good morning, everyone. I'm on slide 8. Flex revenue was \$6.3 billion in the quarter, which was up 14% year-over-year and down 7% sequentially, better than our typical Q3 to Q4 seasonality. Adjusted operating income was up 50% year-on-year to \$310 million, with 110 basis points of margin

expansion. Profit growth was bolstered by improved year-over-year volume, better mix, and continued productivity gains.

We did have some headwinds in the quarter, namely the continued cost pressure from COVID-19, as well as some incremental costs associated with ongoing challenges in the supply chain. As a result, our adjusted net income was \$248 million, with adjusted earnings per share of \$0.49. Year-on-year, those were up 73% and 75%, respectively.

Reconciling to GAAP, fourth quarter GAAP net income of \$240 million was \$8 million lower than our adjusted net income due to \$18 million of stock-based compensation and \$13 million in net intangible amortization, partially offset by a net credit in restructuring and other costs.

Restructuring charges were \$26 million. However, we had a gain from a facility exit and a favorable adjustment on the tax line, which more than offset restructuring costs in the quarter. Global restructuring costs for the year were \$101 million, but again, as I mentioned, with some nice offsets from other items.

On slide 9, our fourth quarter adjusted gross profit was \$505 million, up \$113 million year-over-year. Strong discipline and operating performance drove 1 full percentage point of adjusted gross margin expansion to a record 8.1% in the quarter.

In total, adjusted SG&A spending came in at \$195 million, up \$10 million from a year ago but at 3.1% of sales, down year-on-year and inside our targeted range of 3% to 3.2%. So, for the quarter, adjusted operating income of \$310 million led to a record 4.9% adjusted op margin rate.

Turning to slide 10, we saw a top line strength in both Reliability and Agility in the quarter, with year-on-year growth in both and with the typical seasonal Q3 to Q4 contraction better than we anticipated. Flex Reliability revenue was \$2.8 billion in the quarter, down 2% sequentially and up 11% compared to a year ago.

Q4 performance for all three business units within Reliability were up. Automotive revenue was up 20% year-on-year, with strong execution against the industry's continued global recovery as well as several new program ramps. This was the strongest top line quarter in three years for the Automotive business and a pleasant surprise given the global parts shortages the industry continues to struggle with. Credit to the Flex supply chain organization for very solid execution through a difficult period.

Health Solutions revenue was up 25% year-over-year this quarter. Critical care continued to operate at heightened levels due to persistent COVID challenges. However, we also saw the beginnings of a return to normalcy in areas such as elective procedures. We continue to progress with our ramps in chronic care-related products and the long-term outlook remains strong.

Lastly, Industrial returned to growth this quarter with revenue up low-single digits compared to the prior year. Core Industrial improvements remained steady and our prior customer-specific headwind in power is behind us. Renewables was down in the quarter with difficult year-on-year comps related to ITC Safe Harbor.

Turning to profitability, Flex Reliability Solutions generated \$190 million of adjusted operating profit and a 6.7% adjusted operating margin, which was up 20 basis points year-on-year due to tailwinds from continued improvements in productivity and mix, but tempered slightly by new product ramps in Health Solutions.

Moving to Agility, both revenue and profit were up sharply from the prior year with sales growth across all three business units. Segment revenue of \$3.4 billion was up 17% year-over-year and down just 10% quarter-over-quarter. CEC was up 11% year-over-year led by continued strength in cloud infrastructure, 5G rollouts and enterprise IT spending showing improvement as well. Lifestyle was up 22% year-over-year with new business ramps and continued demand strength for high-end durable goods with premium brands in audio, floor care and appliance end markets. Lastly, Consumer Devices benefited from continued recovery in consumer spending and grew 24% year-over-year, albeit on an easier compare.

Turning to profitability, the Agility segment generated \$136 million of adjusted operating profit and a 4% adjusted operating margin for the second consecutive quarter. This margin expansion was driven by new business wins at accretive margins, tailwind from productivity programs and continued cost management from our Agility operating model.

Turning to slide 11, we wanted to look back on 2021 and share with you some supplemental business unit disclosure. So, for the year, total Flex revenue ended flat in spite of the many challenges. You can also see that our segment mix continues to shift towards our higher margin Reliability segment.

Our Reliability segment revenue grew around 5% year-on-year, driven by strong growth in Health Solutions which grew 25% year-on-year to \$2.5 billion based on strong critical care demand, a rapid ventilator project ramps earlier in the year, as well as continued growth in chronic care. Automotive revenue was down 7% year-on-year to \$2.5 billion, with substantial disruptions from the industry's production shutdowns in the June quarter of last year.

Lastly, Industrial revenue grew 3% year-on-year to \$5.6 billion. That Industrial number, I'll add, includes about \$1.2 billion in revenue for the Nextracker business and around a 15% EBITDA margin. Nextracker grew about 2% last year on a tough comp from ITC Safe Harbor. This will be the full extent of our commentary on Nextracker for now.

For Agility, due in part to COVID-related impacts in the first half of the fiscal year, our Agility segment revenue declined 4% year-over-year to \$13.5 billion, but returned to revenue growth and margin expansion in the second half. For the year, a 25% decline in Consumer Devices was driven by a combination of strategic disengagements we've discussed before as well as the COVID impact. This was partially offset by growth in CEC and Lifestyle. CEC revenue grew 2% year-over-year, driven by cloud and infrastructure spending. Lifestyle was up 5% year-over-year due to strong bookings with new customers and continued market strength driven by work, learn and live-from-home trends.

Turning to slide 12, for the quarter, adjusted free cash flow of \$135 million was up slightly compared to the prior year. All things considered, adjusted free cash flow for the year was strong at \$677 million. If you recall, we spoke before about targeting 80% or greater free cash flow conversion on an adjusted basis. For the 2021 year, we finished at 85%. And adjusted free cash flow to GAAP net income was 110%. So, all things considered, I would say strong conversion and high quality of earnings for the year, particularly given the component shortages we're seeing in the industry.

Looking ahead to 2022, although I'll say it's a little early to call, we expect adjusted free cash flow on a dollar basis to be roughly in line with 2021.

Back to Q4, we closed Q4 with inventory of \$3.9 billion, which was up 5% sequentially and 3% year-over-year, resulting inventory turns of 6.1 times, down from 6.8 turns last quarter, but up from 5.5 turns a year ago. We

continue to see component shortages in the supply chain. And although it was manageable in Q4, we do expect continued working capital pressure over at least the next couple of quarters.

Our net CapEx for the quarter totaled \$31 million, which was light in the quarter due to cash inflow from a building sale as part of a facility exit. Proceeds from that sale were about \$60 million and drove the gain I mentioned just a couple minutes ago. For the year, CapEx was lower than usual, driven by some delays created by COVID-19 and also the natural ebb and flow of large projects.

But looking forward to our fiscal year 2022, we have a number of high-priority investments lined up for the business and do expect to grow CapEx this upcoming year. CapEx of roughly 2% of sales is a reasonable expectation. And as we've said before, we remain committed to responsibly invest in our strategic growth plans by increasing our technology and capabilities in the higher value end markets, as Revathi has outlined.

One last comment on cash, share repurchase remains an important consideration in our capital allocation strategy and we did step up our buyback program in the back half of the year. Our spending was \$146 million in the quarter, which bought back 8.1 million shares.

On to guidance on slide 13, we see two notable potential headwinds moving forward, namely component shortages and persistent waves of COVID-19. That said, all our fundamental demand indicators remain strong. So we'll continue to monitor the risks and adjust as necessary, as you've seen us do before.

Starting with Flex Agility Solutions, we expect fiscal Q1 to be up low- to high-teens year-over-year on continued improvements, but also against an easier comp. Lifestyle is expected to grow 30% to 40% year-over-year in Q1. CEC should be up low- to mid-single digits year-over-year for the quarter, with continued cloud and 5G demand along with improved enterprise IT spending. Lastly, Consumer Devices is expected to be up 25% to 35% year-over-year in Q1 on an easy compare. We expect Consumer Devices to be one of those end markets most sensitive to industry component constraints.

Turning to our Flex Reliability Solutions segment, we expect revenue to be up 15% to 25% year-over-year. First quarter Automotive revenue will nearly double year-over-year as this comps against last year's global auto production shutdowns.

Health Solutions will be flat to up mid-single digits year-over-year against a very difficult comp, reflecting continued strong demand. Lastly, our Industrial business will be up mid to high-single digits year-over-year from steady improvements and an easier compare.

On to slide 14. Overall, we expect Flex Q1 revenue to be in the range of \$5.9 billion to \$6.3 billion. Our adjusted operating income is expected to be in the range of \$240 million to \$280 million. Interest and other should be roughly \$40 million. And we expect our tax rate in the quarter to remain at the higher end of our 10% to 15% guidance range.

Adjusted EPS guidance is in the range of \$0.34 to \$0.40 per share based on weighted average shares outstanding of about 507 million. Our adjusted EPS guidance excludes the impact of stock-based compensation expense and net intangible amortization. As a result, we expect GAAP earnings per share in the range of \$0.26 to \$0.32 per share.

With that, let me turn it back over to Revathi.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

Thank you, Paul. So now, turning to slide 15, we'd like to give some guidance for fiscal 2022. Please note we're doing this with some uncertainty in the market due to component constraints and some countries still battling COVID.

Based on our current visibility, we believe these uncertainties are baked into our guidance. Our fiscal 2022 revenue will be somewhere between \$25 billion and \$26 billion, at around a 4.4% to 4.6% adjusted operating margin. And full-year adjusted EPS will be in the \$1.60 to \$1.75 per share, with GAAP EPS in the range of \$1.30 to \$1.45 per share.

At our Investor Day just a year ago, we gave our long-term financial framework also on the slide. Even with COVID and the portfolio shifts we're making, we believe our performance this year and our guidance keeps us on track to reiterate our targets. Of course, these targets assume no further investments using our strong balance sheet beyond what we were planning at that time.

So summarizing all this in the last slide, I have to say I'm proud that we've validated and executed our strategy well in a difficult year. Our results clearly demonstrate the path we're taking is correct. We'll continue to executive with discipline, invest to maximize value, and deliver profitable growth.

So on behalf of the entire leadership team, I want to thank our customers for your trust and partnership and our shareholders for your continued support.

With that, we'll start our Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Shannon Cross with Cross Research. Your line is open.

Shannon Cross
Analyst, Cross Research

Q

Thank you very much. I had a question on IT spend. Just got off the CDW call and talking with some of the other OEMs, it seems as if data center should start to improve in second half and, obviously, you've got some 5G benefit in there as well. How are you thinking about where enterprises are at and the opportunity for spend?

And then my second question is, with regard to stimulus, how should we think about the opportunity for stimulus to run through your model as we look to 2022 and beyond, given all of the dollars that will be out there fairly soon? Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Yeah. Sure. So thanks, Shannon, and good morning. So first on enterprise spending. As you heard us point out, CEC was up 11% in the quarter. So that was nice to see. I'll say that a large portion of that growth came more from the comms side and from cloud. Enterprise spending was up, which is great, but up mid-single digit.

As you kind of look at it, I'd kind of joked a quarter or two back about CFOs not wanting to spend a whole lot on enterprise with everybody still working from home. But I guess our more macro view would be that will pick up as we move forward over the next several quarters. And so, I would say, I'm bullish on the space, albeit maybe only seeing green shoots now at that mid-single digit up, as I just mentioned.

In terms of stimulus spending, look, rising tides lift all boats and we're certainly hopeful that we'll see some of that. But I don't see a direct correlation at this point in time.

Shannon Cross
Analyst, Cross Research

Q

Okay. Thank you.

Paul R. Lundstrom
Chief Financial Officer, Flex Ltd.

A

Absolutely.

Operator: Your next question comes from Paul Coster with JPMorgan. Your line is open.

Paul Coster
Analyst, JPMorgan Securities LLC

Q

Yeah. Thank you for taking my question. People are curious as to the kind of role you believe you will play in the auto vertical moving forward, Revathi. Is it that you will sort of be a sub-component, an EMS company to the – sort of deep inside the supply chain or do you actually expect to be a direct OEM supplier moving forward?

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

Yeah. Thanks, Paul. The way I'd answer it, if you think about our Auto business even today, Paul, I'd say a part of our Auto business does kind of pure contract manufacturing. A part of our Auto business does joint design and manufacturing, which is a pretty important part of our offering. And then a part of our Auto business does our own design, as you hear from the PACE Awards that we are winning last year and this year. So I'd say we – already quite a mix in terms of the Automotive business itself.

And how I see – there is change going on in the auto space, as you're all aware, in terms of all the tiers of manufacturing with increased electronics content both in electric vehicles and autonomous. It gives us the opportunity to play a more significant role in our own designs and joint design. And so, we think that we'll continue to move up the value chain in the auto sector, particularly ramping up our presence in the EV space.

We already have a very strong presence in the autonomous space. And we'll do that by being more of a component player to the automakers directly, but we'll continue to support them in any EMS projects that we already do. So it will be a mix, but it will be trending towards more of an EV autonomous, more our own product technology focus.

Paul Coster

Analyst, JPMorgan Securities LLC

Q

Great. And if you were to sort of look at the pipeline opportunity there, is it really with traditional OEMs or with the new – there's been a proliferation of new logos recently?

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

Well, it's definitely with both, Paul, because it's hard to be in the auto space and not do what some of the newer players that you're hearing and seeing. We just recently also announced a win with one of the newer players. So you're definitely seeing a mix of both. One of our PACE Award winners or nominees this year is for a project that we're doing in China with more of a newer automotive player. So it's a mix. We think it's important to participate in the traditional and in the new space.

Paul Coster

Analyst, JPMorgan Securities LLC

Q

Excellent. Thank you so much.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

Thanks, Paul.

Operator: Your next question comes from Steven Fox with Fox Advisors. Your line is open.

Steven Fox

Analyst, Fox Advisors LLC

Q

Thanks. Good morning. And thanks for all the color with the guidance. Two questions, if I could. First of all, just big picture, Revathi, you and Paul both used the words quality of earnings a couple of times during your prepared remarks and obviously there's things you can point to for this year. As you think about maybe improving quality of

earnings next year, what would sort of be the input focus there and what would you say we would look at as key metrics to saying that there's a higher quality of earnings in fiscal 2022? And maybe I'll stop there and then I'll ask my follow-up.

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

A

Yeah. Sure. Maybe I'll take a stab at that one. And maybe just a broad indictment on the industry over the last decade, and I think people have sort of talked about EBBS as earnings before bad stuff. And I don't love all the adjustments that I think the industry is sort of tossed into the P&L. And the economic reality is, whether it's non-GAAP earnings or GAAP earnings, eventually all those adjustments ripple through cash and has an economic effect on the company.

And so we're going to push really hard to be extremely sensitive to that and print high-quality earnings quarter after quarter after quarter. And you saw it over the last couple of quarters with restructuring costs fortunately offset by some one-time gains. Maybe a comment on the restructuring outlook. You heard us give guidance here for 2022. We didn't make any comments on restructuring. What we're non-GAAPing out is stock comp and intangibles.

Our hope would be that as restructuring projects arise, perhaps there's one-time offsets. So it doesn't sort of muddy the waters so much. That said, we're going to continue to focus on this multi-year margin expansion journey that we're on here and that includes some investments in restructuring. So, as the opportunities arise for high-return restructuring, we're certainly not going to hesitate.

Steven Fox

Analyst, Fox Advisors LLC

Q

Great. And then just as a follow-up, can you sort of talk to the Q1 guidance? It's flat to down off of what was a very big beat in the Q4 and pretty broad set of good demand drivers. Why is it – why wouldn't it be growing quarter-over-quarter? Thanks.

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

A

Yes. So, sequentially, we are off a little bit as you pointed out. I would say Q4 was particularly strong. I think you had some pent-up demand in there and really, really strong Q4. And one of the benefits that we saw in Q4 was favorable mix. You saw that – you certainly saw that within the Agility segment with some really nice mix within that business unit and strong, strong margin growth.

As we move from Q4 to Q1, look, there's – mix is kind of going to go the other way. And I would say the combination of some adverse mix, just if you look at the midpoint of our guidance, Steven, the Reliability business is down about 5%, the Agility business is flattish, and so that gives us a little bit of mix headwind. I'll also say we do have some headwinds, profit headwinds moving from Q4 to Q1 from all the challenges that we're seeing in the supply chain. These component shortages are requiring us to spend incremental dollars that ripple through profit unfortunately for things like expediting fees and freight and logistics costs and all the inefficiencies of stops and starts. So we are seeing a little bit of additional cost pressure as we move into Q1 versus the Q4 quarter.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

I'd say the most important takeaway there, Steven, is that seasonality always drives kind of 1% down for us quarter-over-quarter, right? And I think it's a prudent outlook based on just including shortages and managing COVID in certain countries. But year-over-year it's still a very, very strong performance. Even though it's on easier comps, we think that it's a prudent outlook, take seasonality and shortages into account for the guidance.

Steven Fox

Analyst, Fox Advisors LLC

Great. That's all very helpful. Thank you.

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Thanks, Steven.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

Thanks, Steven.

Operator: And your next question comes from Ruplu Bhattacharya with Bank of America. Your line is open.

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Yeah. I've got two questions as well. Just to follow up on the prior question on margins, so I mean, between the third quarter and the fourth quarter, you had a revenue headwind of about \$450 million sequentially and yet you had very strong performance. Paul, is the 60 bps sequential op margin decline in fiscal 1Q, is that related all to mix? And if I look at the full year, I think you're guiding 4.5% operating margin for the full-year fiscal 2022. Should we then think of fiscal 1Q as a trough for operating margin and then sequential improvements for the rest of the year?

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Yeah. Sure. Appreciate the question, Ruplu. So, first, on Q4, Q4 a very strong quarter. I think everything was firing on all cylinders here in the fourth quarter. Mix was a benefit. I think we really put the squeeze on spending to make sure we had a strong finish to the year and we got that benefit.

I guess, my comment on Q1 would be, yes, we certainly have mix headwind going from Q4 to Q1, as I had mentioned to Steven. We do have some incremental costs associated with pressure from component shortages. Some of the things that I had mentioned before, freight and logistics, inefficiencies from turning lines on and turning lines off, all that sort of ripples into the P&L and gives us some pressure. What I will say on Q1 is, at the midpoint of our guidance, we're at 4.3% op margins, which would be the strongest Q1 in the history of the company. So we're quite pleased with the outlook.

In terms of the remainder of the year, you're right, at the midpoint of our full-year guidance, op profit would be 4.5% or so I think Revathi had said. We're doing our best to be prudent. There's still a lot of global uncertainty. COVID is popping up unfortunately all over the place in important countries like India where we have operations. And so there's the potential for disruption there and we're certainly not out of the woods when it comes to these

component shortages. And although I think a lot of it is timing, we do have some P&L pressure that we just have to – we have to watch.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

And Ruplu, the way to think about this with six very distinct end segments is that I think sequential change does change significantly with mix, right, because each segment behaves differently in terms of a quarter-over-quarter shift. So I think, like Paul said, mix shifts do play into that. But, again, it's a strong guide. It will be record margins for us for Q1 and then, of course, some prudent thinking in terms of shortages and managing that type of cost pressures associated with it.

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Q

Okay. Thanks for all the details on that. And then, Revathi, may be as a follow up to what you just said about the six segments, what are your thoughts about investments in fiscal 2022 in those segments? If I look at the numbers you gave for Nextracker, it looks like the business in the Industrial segment ex Nextracker is actually growing faster at about 3.3% for the last year. So, I mean – but you also have other in the Agility segment, you had Lifestyles which grew 4.5%. So, just your thoughts on that business mix between Agility and Reliability for fiscal 2022, any preferences for which segment you want to invest in? Thank you.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

Yeah. I'd say what we – Ruplu, I'll just start by saying that we want, and I've said this before in prior conversations as well, we want every segment, because their end markets are pretty large, is to find the right mix of customers within that segment which drives continued year-over-year and long-term improvement in their performance. That's how we want to think about every individual segment within our business. So we want each segment to hold their own in terms of their performance.

In terms of investments, we're super proud of how the Agility team has executed, changed their mix and delivered in execution with our new Agility model and driven profitability for that business. Our large CapEx investments and any new M&A that we do is being considered more in the Reliability segment because that's the nature of the business. If you think about core industrial and the power side, we expect to add investments there. Automotive definitely with our focus on improving our content on electric vehicle, more product R&D investments, CapEx investments and any new M&A investments will be there. And also on Health Solutions, right, very robust growth, lot of large program ramps, and we are continuing to look to add new investment to that space. So, that's how we expect our investment profile to be, more headed towards the Reliability side, but with strong support to grow Agility and improve their overall margin performance.

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Q

Okay. Thanks for all the details. Thank you.

Operator: Your next question comes from Jim Suva from Citigroup Investments. Your line is open.

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much. And great results and outlook. My question is more on the full-year outlook. We're in a world of COVID, we're in a world of semiconductor shortages and increased shipping costs and uncertainty, and it sounds like you prudently put them into your outlook. But the bigger question I had is what's the kind of real catalyst, a rational or reason you want to give a full-year outlook when some companies aren't even giving one quarter outlook? Is it you've got the commitments or the visibility, or you think consensus is mis-modeling the improvements? I'm just kind of curious about why you'd give a full-year outlook.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

Yeah. Jim, first, thanks for your comments on performance and outlook. I'd say in terms of why we're giving outlook, and I've been at this only for two years, first year was all about kind of all the trade issues with China. Even then we kind of gave an EPS range as an outlook. Last year, we didn't because of COVID.

We think that it's important to give an indication of how we see the year, and we think it's a practice for good businesses to be able to do that. So we want to benchmark ourselves to the best of the best in the industry. And that drives some of the prudent outlook, but we think that it's a range that we can defend and hold. And so, while COVID is still out there, while component shortages is still out there, we think that we have enough visibility to take those into account as we provide the outlook, so.

And, Jim, as you know, it's been a mixed bag in terms of people who are giving an outlook and people who aren't. So we wanted to lean towards providing some outlook to our full-year performance, and we think we have enough visibility of it.

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Q

And then my quick follow-up is on the outlook, the four quarters, as we progress, anything that we should be mindful of that deviates from typical normal seasonality, because it seems like it's been a while since we've been in a world of normalcy?

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

A

Yeah. I think the biggest thing is just we're going to be lapping some very unusual comps here in Q1. As you guys are all well aware, we'll still have some unusual comps going into Q2. And as you look ahead to Q3, Q4, it does normalize. Perhaps you have a little bit of back half pent-up demand impact in that. I think Q3 and Q4 of 2021 were particularly strong and comps maybe get a little bit harder. But we are expecting things to normalize. And, Jim, frankly, we're pretty upbeat.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

So I'd say...

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

...nothing unusual. We've turned to normal comps, Jim.

A

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Yeah.

A

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Thank you. And congratulations to you and your full teams.

Q

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Thanks, Jim. Appreciate it.

A

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

Thank you, Jim.

A

Operator: Your next question comes from Matt Sheerin with Stifel. Your line is open.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Yes. Thank you. Good morning. The first question just regarding the strength that you've been talking about in the cloud segment of the business for the last two or three quarters. Could you talk about the growth rate specifically and customer concentration? We're seeing your peers also talk about strength there. So just broadly speaking, are you seeing some market share shifts from the traditional ODMs in Asia, for instance? And is there anything that kind of you bring to the party that gives you an edge in terms of continued market share gains?

Q

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

Yeah. What I'd say in terms of overall growth in cloud, it's a large enough space, Matt, that it's important to be focused on the customers that we think we can provide value to and that actually grow, and grow profitably. I think that's really important in the cloud space. So our look is not to win from ODMs coming from Asia. I don't think that's a place we wanted to compete in. We're really focused on winning with a few key customers where we think that the margin and balance sheet supports the kind of hurdle rates we're looking for. And that's the most important thing.

A

And then, of course, in cloud, in general, all the right trends are there, right? A lot of usage, data center growth. All of that supports the demand and the growth we're seeing. But it's a large space. We believe that we have to pick where we want to win, and that's where we're driving to. So we have new customer wins, but we're very focused on a sub-segment of that overall market.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thank you for that. And, Paul, just a question regarding your free cash flow projections for next year, which is basically flattish, which seems fairly impressive, given the fact that you've got pretty strong revenue growth. And you would think that the working capital requirements also go up here, given the supply constraints that we're seeing. So could you walk us through that?

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

A

Sure. So appreciate the compliment, by the way. We're going to have to scratch and claw to make that happen. But what I had said was cash flow on a dollar basis, essentially in line with 2021. And so, if you just do the math, at the midpoint of our guidance here for 2022, that would put us at about 80% conversion.

And to your point, Matt, the pressure we're seeing in supply chain right now is certainly there. I'd kind of talked about some of the P&L headwind we're going to have. What I didn't quantify for everyone was the working capital impact that we will likely see in at least Q1, Q2 from an inventory standpoint.

And the challenge for us right now is that we're required to carry some buffer stock; some of that contractual, some of it not. And certainly for things like the automotive industry, where you really don't want to be the bad guy shutting down a line, you need to make sure that you can deliver on time when they need hardware. And so, the challenge for us is that that has put a little bit pressure on working capital. But, look, we stand by the \$680 million or so that we telegraphed for 2022, and we're going to scratch and claw to make that happen.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

And, Matt, I'd point to our balance sheet is in the strongest position ever, have a fantastic cash balance. We will have inventory pressure. I think that'll be our big focus that we'll continue to watch through the year. But we think that we have to have the right blend of carrying the inventory and delivering to our customers, but also delivering our overall free cash flow. So I think we have got a good mix of things to work on there.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you for that. Are you seeing customers – are you asking customers for deposits again to serve that inventory?

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

A

Absolutely, absolutely. To the extent we can minimize our cash flow impact with advances or prepay, heck yeah. Unfortunately, not everyone is willing to write checks. So we take it where we can get it. But, unfortunately, it's not a one-for-one.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

But Matt, this is like everything else we talked about, whether it's in the pandemic or managing shortages, our focus is on doing everything with discipline, right? Even the shortage situation, how we bring in inventory, who

pays for it, all of that is managed with very good discipline coordinated by thousands of employees across the world. And so, based on that, we think that our cash flow guidance still holds, but lots of things to work on.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Okay. Great. Thanks so much.

Paul R. Lundstrom

Chief Financial Officer, Flex Ltd.

Thanks, Matt.

Operator: Your next question comes from Mark Delaney with Goldman Sachs. Your line is open.

Mark Delaney

Analyst, Goldman Sachs & Co. LLC

Yes. Thanks very much for taking the questions. A number of companies have talked about trying to be agile and doing procurement, given how tight the global supply chain is. And I'm curious if Flex has perhaps been able to take any market share because of that, given all of the expertise and focus Flex has had on managing through some of these difficulties. I'm curious either in the short-term are you able to maybe take some market share or perhaps at least get some new engagements underway that could lead to market share longer-term?

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

Yeah. Mark, absolutely. I'm in a lot of calls with CEO customers. Our teams are doing a lot, our supply chain teams in terms of not only providing second source, re-qualifying sources, or finding inventory in this system. And you can just see that from our performance, right, just see our Q4 performance compared to kind of most people in the industry. We've navigated the shortage situation extremely well both on revenue and in terms of margin. So I would say we're just getting kudos all over for our supply chain effort and being able to really kind of move every stone in keeping our customers running the best we can under the situation.

And then I'd say kind of moving forward, as inventory dries up in the system and those things become harder, which is part of what we're saying about moving forward, but absolutely agile. I'd say lots of customers and suppliers would say that Flex has just shown world-class procurement supply chain capability in navigating this.

Mark Delaney

Analyst, Goldman Sachs & Co. LLC

That's very helpful. Thank you. And for my second question was related to margins. And being disciplined on pricing and getting paid for value, that's been a big focus of this management team, and clearly we're seeing that in the results. And I recognize you're going to see some added cost pressure with the supply chain environment you're dealing with around components and shipping.

But I am wondering if there's any areas where perhaps pricing is abnormally strong. And I don't know if potentially Flex is able to get unusually high pricing, given how tight supply chains are for physical goods more holistically. And do we need to be thoughtful about perhaps this margin improvement we've been seeing moderating a bit at some point in the future if global supply-demand starts to ease? Thanks.

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

I'd say, at the end of the day, Mark, in all these kind of pricing pressures or kind of changing cost pressures on the value chain, it all ends up being like who ends up paying for this, right? And there's been enough conversation on this to know that you have to be able to pass on these prices, you have to be disciplined about that, and so those are important, right? And I'd say we're navigating that really, really well.

And I think it's important to think about like just the Flex core margin even with the factory shutdowns and due to shortages or due to COVID outbreaks and all that. We expect that the core Flex operating margins for the year will still have a fore handle. And so, continued margin improvement even with these changes. But then you have to add to that that we expect that our productivity efficiency continues to improve also through the upcoming year and the future. So we have a pretty strong pipeline how we continue to keep our margin rates up and keep that moving in the right direction. We're bullish about that.

Mark Delaney

Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Your last question comes from Christian Schwab from Craig-Hallum Capital. Your line is open.

Christian David Schwab

Analyst, Craig-Hallum Capital Group LLC

Q

Thanks for squeezing me in. I just have one more question just on your ability to give guidance for the year, given all the challenges that everybody is aware of that's going on in the world. Is this – should we be thinking about this as kind of a proof point of management's plan a couple of years ago to become a preferred supply chain partner and prune the portfolio of highly volatile businesses and focus the programs on more predictable, more important products to the end customer, and that's kind of leading to backlog and pipeline of work that gives you a sense of high conviction level to go out that far? Is that fair or am I thinking about that wrong?

Revathi Advaiti

Chief Executive Officer & Director, Flex Ltd.

A

No, Christian, I think it's totally fair. You've definitely summarized all our key points really well in terms of how we are thinking about it. Our view is that we have good visibility for end segments. We are reducing the volatility within these segments. And we also believe that it's important that good businesses give guidance. And so, putting all that together, we feel more and more comfortable in providing a longer-term outlook.

That being said, you'll see our guidance as prudent. And so it does bring into question things like shortages and things like that, right? So our pipeline is extremely strong. We're not seeing any cancellations or anything like that. We see demand signals are pretty strong. We have a lot of new program ramps going on with kind of regionalization. So we think that it's the right thing to do in terms of how we signal about the strength of our business. And we feel we have the visibility to do it. And you summarized it very elegantly.

Christian David Schwab

Analyst, Craig-Hallum Capital Group LLC

Q

Great. I don't have any other questions. Congrats on the great quarter and a very good outlook.

Revathi Advaiti
Chief Executive Officer & Director, Flex Ltd.

A

Great. Thanks, Christian.

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Operator: And I'd now like to turn the call back over to Revathi Advaiti for closing remarks.

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Revathi Advaiti
Chief Executive Officer & Director, Flex Ltd.

Yeah. Thank you all for joining us. So, I'm super excited and confident about the future for Flex. And then, of course, I wish all of you remain safe and good health, and we'll speak to you in the next quarter. Thank you.

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Operator: This concludes today's conference call. You may now disconnect.

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