

28-Mar-2023

TD SYNEX Corp. (SNX)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

Liz Morali

Head-Investor Relations, TD SYNEX Corp.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

OTHER PARTICIPANTS

Keith Housum

Analyst, Northcoast Research Partners LLC

Joseph Cardoso

Analyst, JPMorgan Securities LLC

Tim Long

Analyst, Barclays Capital, Inc.

Ruplu Bhattacharya

Analyst, Bank of America Merrill Lynch

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Shannon S. Cross

Analyst, Credit Suisse Securities (USA) LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning. My name is Abby and I will be your conference operator today. I would like to welcome everyone to the TD SYNEX First Quarter Fiscal 2023 Earnings 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.

And at this time, for opening remarks, I would like to pass the call over to Liz Morali, Head of Investor Relations. Liz, you may begin.

Liz Morali

Head-Investor Relations, TD SYNEX Corp.

Thank you. Good morning, everyone and thank you for joining us for today's call. With me today are Rich Hume, CEO; and Marshall Witt, CFO. Before we continue, let me remind you that today's discussion contains forward-looking statements within the meaning of the federal securities laws, including predictions, estimates, projections or other statements about future events, including statements about strategy, plans and positioning, as well as our expectations for future fiscal periods. Actual results may differ materially from those mentioned in these forward-looking statements as a result of risks and uncertainties discussed in today's earnings release in the Form 8-K we filed today and in the Risk Factors section of our Form 10-K and our other reports and filings with the SEC. We do not intend to update any forward-looking statements.

Also during this call, we will reference certain non-GAAP financial information. Reconciliations of GAAP to non-GAAP results are included in our earnings press release and the related Form 8-K available on our Investor

Relations website, ir.tdsynex.com. This conference call is the property of TD SYNEX and may not be recorded or rebroadcast without our permission.

I will now turn the call over to Rich. Rich?

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Thank you, Liz. Good morning, everyone and thanks for joining us today. Our flexible business model and broad industry-leading portfolio allowed us to capture growth in Q1 across Advanced Solutions and high-growth technologies despite a rapidly changing market environment. Our team showed the ability to execute well, remaining flexible to market conditions and pivoting to areas of growth. This allowed us to grow revenue for the quarter on a constant currency basis, expand margins, deliver non-GAAP EPS growth towards the high-end of our previously guided range and return meaningful cash to our shareholders.

Relative to our expectations, the macroeconomic environment impacted demand for PCs and related products during the quarter, and the market declined in North America more sharply than we had forecasted. From a regional perspective, the demand declines in both Europe and Asia-Pacific/Japan were less pronounced.

Looking forward, many of our top vendors indicate that we could anticipate a more stable Endpoint Solutions portfolio in the second-half of the year, with drivers such as the post-pandemic refresh cycle and the government and education spending season fueling PC demand. Nevertheless, this quarter highlighted the strength of our strategy to invest in diversifying our portfolio. Our investments across data center and networking infrastructure, along with the buildout of a robust set of offerings for hybrid cloud, cybersecurity, data analytics and hyperscale infrastructure are paying off, and we are pleased with the momentum we continue to see in those categories in Q1. In total, our basket of high-growth technologies, including Hyve grew in the mid-teens for the quarter. This growth highlights the strategic importance of these projects to our customers and their end-users and is aligned with our longer-term growth rates we've discussed previously for this category.

Overall strengths in Advanced Solutions and high-growth technologies help to offset the declines in Endpoint Solutions and the overall business saw 4% constant currency growth in gross billings in the first quarter. It is worth noting that IDC and CONTEXT reports for North America and Europe that we used to track our distribution market participation indicate the overall market share in those regions grew in fiscal Q1. From a supply chain perspective, we continue to see improvement in the quarter and we experienced decline in our backlog across the board quarter-over-quarter. While there remain a few isolated areas of constraint, our overall backlog levels are approaching historical levels. The normalization is a positive sign as a more balanced supply chain environment allows us to serve the demand for our customers in a more timely fashion. We continue to make excellent progress on our ERP systems migration. And as I have mentioned previously, we deliberately have taken a measured and steady approach to reduce the risk of disruption to our customers and vendors.

I'm pleased to report that more than 75% of our North America distribution business is now transacting in CIS. Customer and vendor sentiment around the transition has been positive and we will continue to migrate the remaining portions of our business throughout the year. Also during the quarter, we were very proud to publish our first corporate citizenship report, demonstrating our commitment to being a responsible corporation. We have set clear environmental and social goals as described in the report, and we look forward to continuing to update you on our progress in these important areas.

As we enter the second quarter, which is our seventh post-merger quarter, we are confident in our ability to navigate the rapidly changing market dynamics in our industry. We believe our variable cost structure, diversified

portfolio and commitment to investing in high-growth technologies allows us to succeed in any market conditions. In closing, we expect to see a continuation of the trends we saw in the first quarter play out in our fiscal Q2 with demand for Endpoint Solutions likely seeing continued pressure and opportunities for continued growth in Advanced Solutions and high-growth technologies. We are confident in our ability to navigate the dynamic environment by leveraging our broad portfolio to pivot towards pockets of growth and margin expansion.

I'll now turn it over to Marshall for some additional comments about Q1 and our Q2 outlook. Marshall, over to you.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

Thanks, Rich, and thanks to everyone for joining us today. Before I review our quarterly performance, I wanted to highlight a new measure that we introduced in our filings today. Beginning this quarter, we have added gross billings as one of our disclosures. We believe gross billings is an important metric to consider when evaluating our business as it represents our total book of business, including the sales that get netted down in the reported revenue line. As a reminder, for many of our virtual offerings across software, cloud and security, the net revenue we report represents only the gross profit we earn for the services we have performed, thus the totality of growth across those businesses is not captured in the reported net revenue line. As a larger portion of our revenue moves to software and services that will be reported on a net basis, we believe providing gross billings and the associated growth rate will allow investors to fully appreciate underlying trends and the scope of our business. This new disclosure was also in response to requests from our investors who value this metric from a reporting perspective. As you heard from Rich during the February quarter, we saw softer-than-expected demand across several Endpoint Solution (sic) [Solutions] (00:08:59) technology categories, particularly in North America. Despite this additional pressure, our broad diversified portfolio, coupled with our focus on margin-accretive, high-growth technologies allowed us to grow gross billings and revenue on a constant currency basis and expand margins despite the lower-than-expected revenue growth in the quarter.

Now, moving to Q1 results. Worldwide, gross billings came in at \$20.2 billion, up 1% year-over-year and up 4% in constant currency, while net revenue was \$15.1 billion, down 2% year-over-year and up 1% in constant currency. From a regional perspective, Americas revenue declined 4% year-over-year while Europe increased 5% and APJ increased 26%, all in constant currency.

In Americas, we saw a significant deceleration in demand for Endpoint Solution (sic) [Solutions] (00:09:57) products, partially offset by strength in Advanced Solutions and high-growth technologies, including Hyve. In Europe, the growth came from outperformance in Advanced Solutions, partially offset by less severe declines in Endpoint Solutions.

In APJ, the region outperformed our forecast, driven by growth in Advanced Solutions, services, and high-growth technologies. Non-GAAP gross profit was \$1.01 billion, which is our second consecutive quarter greater than \$1 billion and non-GAAP gross margin was 6.68%, up 26 basis points year-over-year. The improvement in gross margin was driven primarily by an increased mix shift to Advanced Solutions and high-growth technologies.

Total adjusted SG&A expense was \$568 million, representing a 3.8% of revenue. Non-GAAP operating income was \$443 million, up \$11 million or 2.6% year-over-year. And non-GAAP operating margin was 2.93%, up 14 basis points year-over-year, primarily driven by increased mix shift to high-growth technologies and cost synergy attainment. On a constant currency basis, non-GAAP operating income increased 5% year-over-year. Quarter one non-GAAP interest expense and finance charges were \$78 million, \$5 million above our outlook. For Q1, the non-GAAP effective tax rate was approximately 23%. Total non-GAAP net income was \$279 million and non-

GAAP diluted EPS was \$2.93, which was at the high-end of our previously communicated guidance range for the quarter.

Now turning to the balance sheet, we ended the quarter with cash and cash equivalents of \$539 million and debt of \$4.4 billion. Our gross leverage ratio was 2.4 times and net leverage was 2.1 times, which is in-line with our investment-grade profile and approaching our previously communicated target of 2 times gross leverage ratio. Accounts receivable totaled \$9.36 billion, down from \$9.42 billion in the prior quarter and inventories totaled \$8.37 billion, down \$694 million or 8% from the prior quarter. Net working capital at the end of the first quarter was \$4.2 billion, an increase of approximately \$390 million from Q4 due to seasonal trends. The cash conversion cycle for the first quarter was 26 days, up three days from quarter four and cash used in operations in the quarter was \$103 million. From a shareholder return perspective, for the current quarter our board of directors has approved a cash dividend of \$0.35 per common share, payable on April 28, 2023 to stockholders of record as of the close of business on April 14, 2023.

During the quarter, we paid \$33 million in dividends and continued executing on our share repurchase program by buying approximately \$115 million of our stock. We had approximately \$900 million remaining on our three-year share repurchase authorization and expect to continue further share repurchases through the year, aligned with our cash flow generation. We continue to make good progress on the remaining merger-related cost synergies, recognizing an additional \$25 million in the quarter and, to-date, we have achieved over \$170 million of our total \$200 million target.

Now, moving to our outlook for fiscal quarter two. As Rich had mentioned, we expect to see a continuation of the trends we saw in the first quarter with a stronger weighting towards Advanced Solutions and high-growth technologies. We expect gross billings of \$18.7 billion to \$20 billion, approximately flat on a year-over-year basis and constant currency at the midpoint. We expect total revenue to be in the range of \$14 billion to \$15 billion, which equates to a year-over-year decline of approximately 4% on a constant currency basis at the midpoint. The 4% decline in net revenue is driven by an incremental growth to net adjustments year-over-year as we continue to grow in Advanced Solutions and high-growth technologies. This outlook also reflects the impact of year-over-year foreign exchange headwind of approximately \$200 million to revenue and \$250 million to gross billings. Our guidance is based on a euro-to-dollar exchange rate of \$1.07.

Non-GAAP net income is expected to be in the range of \$214 million to \$261 million and non-GAAP diluted EPS is expected to be in the range of \$2.25 to \$2.75 per diluted share, based on weighted average shares outstanding of approximately \$94.2 million. Non-GAAP interest expense for quarter two is expected to be approximately \$76 million and we expect the tax rate to be approximately 24%. Our guidance is inclusive of headwinds year-over-year from interest expense and euro devaluation, which collectively represent a \$0.27 per share headwind to non-GAAP EPS versus quarter two fiscal of 2022. Excluding these discrete items, our outlook implies non-GAAP EPS growth of approximately 2% at the midpoint as our underlying business continues to perform solidly.

Regarding our thoughts for the full-year of 2023, the market continues to be volatile, which may impact our business but we believe that our differentiation in the market and ability to pivot to pockets of growth is clear in our performance this quarter and in our guidance for Q2. We are seeing stable and consistent margins to the fiscal year outlook we provided last quarter and continued to feel confident we will deliver on our previously guided \$1 billion plus in free cash flow, a large portion of which we expect to be returned to shareholders through continued share buybacks and dividends.

I will now turn the call back over to the operator to begin the Q&A session. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we will take our first question from Keith Housum with Northcoast Research. Your line is open.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Good morning, guys. Appreciate the opportunity here. In terms of the strength that you saw in Europe and Asia-Pacific specifically. Marshall, can you please [ph] address (00:16:46) or talk a little bit about some of that strength. Are you guys taking share there? Is there a feeling of that or is it just the market there is stronger than what you're seeing here in North America?

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Yeah. So Keith, in the prepared remarks – well, first of all, good morning and thanks for the question.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

I'm ready to jump in right away.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

So, first, in our prepared remarks, I had commented on market share in Europe and in North America, absent APJ. And the reason for that is we don't have a service in APJ that readily reports our market position. But clearly, as stated in the remarks, we feel as if we've grown our market participation in North America and Europe and obviously the top-line revenue strength in APJ was quite good. So, that's the first point.

If I were to characterize the European performance, we have this theme for our company globally where we had said that we had a declining Endpoint and we had growing Advanced Solutions. And in Europe, on the Endpoint, let me just say that it declined less and on the Advanced Solutions, it grew more. Part of the Endpoint declining less is due to the mix of that Endpoint segment. You might recall we have mobility as part of the Endpoint segment in Europe as an example, so therefore some of those things in terms of the mix of the Endpoint were why we had declined less. So that's really the major overlying theme.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Okay. Appreciate that.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

[indiscernible] (00:18:33) and Keith, one thing that you'll see in the press release on the regionals is that off-income for Europe did decline. That was more about high-growth technology tough compares year-on-year.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Okay. Appreciate that. And just following up, Rich, on that Endpoint device commentary there. You noted that the vendors expect a second-half improvement in Endpoint devices. I guess my question is – I guess do you and your customers agree with that assessment that you'll see an improvement in the second-half?

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

I would say that generally, yes, Keith. There's a couple of parameters here that I think are important. So, first, if you think about the government buying season, what we had experienced is that in the prior year, there was a pretty tepid government spending season because of the huge COVID purchase the year or two before that. So we believe there'll be a rebound there.

The second is, well, we all know about the post-pandemic refresh cycle and Windows 11. So we'll start to see some of that kick in. And the third is, candidly, the back-half of the year was when the declines had begun so the compares are easier. And they basically will begin to wrap starting in the third quarter overall.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

All right, guys. Good luck. Thank you. Appreciate it.

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

Thank you, Keith.

Operator: And we will take our next question from [ph] Sameer Kalucha (00:20:13) with RBC. Your line is open.

Q

Hi. Can you hear me okay?

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

Yes.

Q

Okay. Great. Thanks for taking my question. So when you give the guidance for the full-year last quarter, the outlook was underpinned by a flattish GDP outlook. I was curious what are your views on GDP from where we are right now given the market conditions are a little bit different from what we saw in the beginning of the year? So that's number one.

And number two, given all the rage about new technologies like generative AI, I'm curious how big are they as part of your portfolio in the high-growth solutions in the AI/ML part and how do you expect them to drive growth going forward? Thanks.

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

Yeah. Well, thank you for your comments. So, first, as it relates to GDP, as you're well aware, I mean I think there's been some real-time events that have played out in the last couple of weeks that probably aren't yet reflected in the reports that exist for GDP. So, we'll have to wait and see when those things flow through and the economists do their job as to what that outcome might be. Last reported, we thought that GDP and the markets that we participate would be flattish. So, we'll see where things go from there.

And then on your second question, when we think about our strategy, we talk about high-growth technologies, which includes hyperscale infrastructure, cybersecurity, and then data and analytics. And data and analytics, at its core, becomes the foundation, if you will, for a lot of the AI work that's going on. I would say sort of looking backward the predominance of our sale has been more around analytics, pure analytics. And we now see the emergence of artificial intelligence, although it really hasn't become a material or meaningful part of our entire revenue stream or portfolio yet.

My experience has been that when new technologies emerge to the market, they'll manifest themselves in first-of-a-kind offerings first, and then through time they get packaged to make their way down through what I'll call the medium or smaller customers, which is where most of our engagement with our customers is directed. As you well know, when you get into AI, it's all about the data and the accuracy of the data. So my expectation is we might go through this similar cycle of being deployed first as a custom project and then making its way into packaged solutions. But I believe that that whole development cycle will be greatly condensed given the emergence of a lot of the new artificial intelligence in the market.

Q

Got it. Thank you.

Operator: And we will take our next question from Joseph Cardoso with JPMorgan. Your line is open.

Joseph Cardoso

Analyst, JPMorgan Securities LLC

Q

Hey. Thanks for the questions, guys. So just one for me. We've seen some positive data points in the PC supply chain over like the last one to two months at least as it relates to inventory levels. Just curious to hear what you guys are seeing as it relates to channel inventory?

And then just on the demand side, you suggested some of your partners suggesting a recovery into 2H on those various kind of data points. I'm just – are you actually seeing any of that to-date and at least conversations that you're having with your customers? Or should we think about that becoming more tangible later in the year?

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

Thanks for the question. And when I had discussed the PC ecosystem earlier off of Keith's question, I had left out the fact that there was a lot of visibility brought by vendors broadly to, I'll call it extra inventory within the channel. And fundamentally or I should say anecdotally, I believe that's true. We don't have visibility with precision with regard to all of the inventory that's held by our resellers. But anecdotally the evidence was there to – through the

discussion, we were led to believe that there was an inventory work-down. So, I do believe that that's part of the realignment, if you will, for the second-half of the year.

To answer your question explicitly, have we seen the green sprouts yet? No, we haven't. I do believe they are months ahead as opposed to beginning currently.

Joseph Cardoso

Analyst, JPMorgan Securities LLC

Q

Got it. Appreciate the color. Thanks.

Operator: And we will take our next question from Tim Long with Barclays. Your line is open.

And, Tim, your line is open. Please check your mute button.

Tim Long

Analyst, Barclays Capital, Inc.

Q

Oh! Sorry about that. Sorry about that. Two questions here if I could. First, if you could talk across the device business in the Advanced technologies businesses, the impact of pricing and price changes. Obviously, PCs were inflated. And then if you look at the server and storage market, we're seeing pretty meaningful memory cost decline. So curious if you're starting to see any of that showing up in your numbers?

And then secondly, maybe Marshall if you can talk a little bit about cash conversion cycle and how we think about that through the rest of the year? Thank you.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Okay. I'll – thank you for the question. I'll handle Part A, and then Marshall, Part B. So this varies a little bit by region but we have seen price activity in PC given the supply situation we spoke about earlier. Expectation is that as supply stabilizes that there'll be lesser activity, if you will, around the PC segment. We have, consistent with your thoughts around some of the commodity prices coming down which obviously are a big part of the bill of materials within Advanced Solutions, we have seen price activity begin to emerge. It's been a good long time since we have seen that. But, yes, there has been price reductions and we would anticipate price reductions as the flow-through of those commodities occur.

The other question that should go along with that that kind of put it in the category of too early to tell is a lot of times when these commodity comes down, the ASPs get held while customers take, I'll call it, more rich configurations. So the question will be will we see that or will we see customers given the economic circumstance accept leaner configurations. I don't have enough evidence or information on that yet but that's something that probably will play out in the next 90 days.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

And on the cash conversion cycle question, you saw for quarter one we were around 26. I expect that to improve by a couple of days in Q2 to about 24-ish. And then similar to what we had said at the beginning of the year, I do expect that to continue to decline or improve for the rest of the fiscal. Ideally, if we can get to around 20 days-ish that would be great. In my comments, you saw we did reiterate the confidence around our free cash flow being at a \$1 billion plus. We still feel, given the working capital improvements, the earnings power of the organization, an

assumption that supply chain remains stable and the inventory channels continue to clear I think we're going to be good to hit that.

Tim Long*Analyst, Barclays Capital, Inc.*

Okay. Thank you, guys.

Q

Marshall W. Witt*Chief Financial Officer, TD SYNEX Corp.*

Thank you.

A

Richard T. Hume*Chief Executive Officer & Director, TD SYNEX Corp.*

Thank you.

A

Operator: And we will take our next question from Ruplu Bhattacharya with Bank of America. Your line is open.

Ruplu Bhattacharya*Analyst, Bank of America Merrill Lynch*

Hi. Good morning. Thank you for taking my questions. Rich, it looks like you had another strong quarter for Advanced Solutions and that probably also benefited margins. So how much did Advanced Solutions benefit from backlog reduction in the quarter and what do orders look like? And if Advanced Solutions weakens in the second-half, what would the margin trajectory look like and do you see the need for incremental cost structure changes?

Q

Richard T. Hume*Chief Executive Officer & Director, TD SYNEX Corp.*

Lots of questions there. So let me take it one at a time. First, certainly I do believe that as the backlog has been running down that it has assisted in our growth for Advanced Solutions. Second, when you think about when Advanced Solutions really began to have higher growth rates overall, it approximately was in the back-half of last year. So, therefore the compares in the back-half will be a bit more challenging for Advanced Solutions. So we would expect that the growth rates wouldn't be as they were previously.

A

As it relates to cost actions, we've talked on the last couple of calls relative to us being very, very focused in every region of the world to make sure that we're being very prescriptive as it relates to all of our discretionary spend, all of our new hire spend and ensuring that every single dollar is measured. We look at our – and think about our cost structure on a continuous basis and we'll look forward to understand the ebb-and-flow of economic change and adjust accordingly as we think about the back-half of the year.

So that's the way Ruplu we think about it and thanks for the question.

Ruplu Bhattacharya*Analyst, Bank of America Merrill Lynch*

Okay, Rich. Thanks for the details there. Marshall, I have a question for you on ROIC but before I ask that I just wanted to ask the clarification, maybe I missed this. But last quarter you had talked about full-year 2023 revenue growth to be 3% to 5% on a reported basis. Did you confirm that also in this quarter? I may have missed that. If you can just clarify that.

Q

And then my question on ROIC is I guess you reported 10.6% this quarter. A year ago, it looks like it was in the mid-teens. It may not be an apples-to-apples because maybe it wasn't on a combined company basis. So, the target of 2% to 4% [ph] above WACC (00:32:11), I mean what needs to happen for you to get to the high-end of that ROIC range and how should we think about ROIC in the long-term? Thanks.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Sure. I'll address the ROIC first, Ruplu. The mechanics around how that is calculated, we do a five-quarter average for that as we have come further away from the merger. Invested capital continues to grow. The denominator is growing, which is expected. So the 10.6% is in-line with our expectation.

To your question on WACC, I mean clearly interest rates have increased. So that has increased our WACC. We're at a WACC of roughly around 8.5% to 9%. And a lot of that again is just due to rising interest rates. It hasn't changed our overall requirement of returning 200 to 400 basis points above our weighted average cost of capital. That continues to be the threshold that we look at when we make investments in the business and we make investments externally in terms of M&A opportunity.

To touch on the question about what we gave guidance for and what we didn't, you're right, we did not give guidance for revenue for the second-half of the year. A lot of that has to do with what Rich said in his prepared remarks just around the uncertainty and volatility that we're currently experiencing. We certainly want to see this quarter play out, see how it does, and then come back with a rethought for our guidance as we get into the end part of Q2 and into Q3.

Ruplu Bhattacharya

Analyst, Bank of America Merrill Lynch

Q

Okay. Thank you for all details. Appreciate it.

Operator: And we'll take our next question from Adam Tindle with Raymond James. Your line is open.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Q

Okay. Thanks. Good morning. Marshall, I want to expand on that guidance point that you just made. I understand, maybe not expanding on the revenue piece of it but stripping out gross versus net and all that sort of stuff and just looking at the actual earnings of the company, I think you would have come to a conclusion of an earnings for around \$12 for the year based on your comments of 3% to 5% growth, 2.6% to 2.8% operating margin. That's kind of where we all landed for the year. Obviously, you're tracking below that on a year-over-year basis for the first-half of this year. So just wondering maybe if we could switch that question to more of an earnings question to see what has changed since you last gave that guidance. And if we look at the current run rates, we're probably going to be closer to low-11s in terms of the earnings for the year. Is that something that makes more sense to you based on what you're seeing right now? Thanks.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Yeah. I'll start and then allow Rich to provide commentary. I think we'll start with just what we said about what we experienced in the quarter, Endpoint Solutions softer and down on a year-on-year basis in the majority of the regions that we performed. So I think revenue itself is probably the biggest driver of, we call it the operating

income decline. As we said, we feel good about the margin profile and structure of our business being in that 2.6% to 2.8% range. We like the position of where we're at strategically within the organization. We're proud about the market share that's either at or better than what it was. To us, it certainly implies that during these uncertain times, our position in the market is allowing and providing for our partners to spend more with us and use us more as they are also trying to figure out ways to be more efficient in this uncertain economic situation.

Rich, I don't know if you want to anything else to that?

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yes. The only thing that I'd add and it's a bit repetitive is that, as Marshall has stated, the financial profile and the engagement model as it's been – as we talked about our market participation I think is very strong, and this is a more macroeconomic challenge as opposed to anything else. And with all of the uncertainty, we just don't feel comfortable with providing a view with regard to 2H at this time.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Q

All right. Maybe then as a follow-up since that might create some volatility, Marshall how you're thinking about capital allocation and cash flow? And I guess maybe more specifically you talked about \$1 billion for the year, the cadence of that and any kind of buckets that that's coming from, how that should layer out through the remaining quarters and what gives you the confidence.

And secondly, on capital allocation, I think you said it'd be aligned with cash generation. Presumably that's going to increase going forward given you were negative in Q1 and talking about \$1 billion for the year, might that translate to more share repurchase? Just how we can think about that would be great. Thanks.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Sure. Yeah. I'll first answer the question just on the cadence of cash flow. Typically, Q1, as you saw, it tends to consume cash is what we saw of just over \$100 million. That begins to reverse itself. And as I mentioned on a previous Q&A, we think cash days improves probably a couple of days in Q2. I would expect that probably to end up being similar improvements in three and four Adam so I think you could think about it from that perspective of being positive cash flow on some form of equal basis Q2, Q3 and Q4.

And thinking in regards to the capital and our allocation, overall goals and strategies, that hasn't change as you know, our cash flow and how we allocate that free cash flow between reinvestments back in the business and returns back to shareholders. We still feel good about that 50/50 allocation. For 2023, our desire is to continue to stair-step up to that 50% attainment and hopefully we'll reach around 40% for 2023. And as you had mentioned and we mentioned, historically it is certainly aligned with cash flow generation. We feel positive about where we expect to be for this year. And if we do exceed our initial expectations, we certainly will look at opportunistic repurchases going forward.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

Thank you.

A

Operator: We'll take our next question from Matt Sheerin with Stifel. Your line is open.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Yes. Thanks and good morning, everyone. Rich, my first question just another demand question and you talked about the weakness in North America. Could you drill down a little bit in terms of those various channels that you sell into, the large resellers versus VARs, selling it to SMB versus public sector and what you're hearing from those customers in terms of when they think it's stabilizing? And the same thing on the Advanced Solutions side because your comment was that it's growing but not as strong as in Europe?

Q

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Yeah. Thanks for the question, Matt. I'll share this with Marshall. I would tell you that I think that as we evolved through the years so far, we have seen a bit of a change in sentiment relative to our customers to words like a bit more cautious, words like things elongating in terms of the sales cycles. So, I think that as the sort of the economic circumstance is playing out, there is a bit of a change in sentiment. So that is what we see from the macro level.

A

As it relates to are we seeing any differences between particular channels, I would say no, not so much that that overlying sentiment seems to be fairly consistent. But Marshall maybe you can provide some insights right from the numbers?

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

Yeah. Matt, so when we look at our bar allocation between public sector; large, medium, small retail and all the aspects that go with it, the percentage of those buckets have remained fairly consistent which is great. So SMB, as you know, is a very important aspect of our portfolio and it's stayed resilient throughout this market. I would say, as Rich said, across the board there's probably just generally less spend [ph] done yet (00:40:43). But if you look at how we've been allocated, it stayed fairly consistent over these last two to three quarters.

A

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Yeah. The one exception from – I was jogging my memory as Marshall was talking I think we see government spending a bit more robust relative to the other segments but that's sort of the only outlier.

A

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Okay. Great. If I could just sneak in a couple of quick ones. One, it sounded like you said that Hyve was up double-digits year-over-year, if you could clarify that and what you're seeing there? And then also on the interest expense line, Marshall should we be modeling that you're closer to \$80 million or so through the year? Or do you expect to work that down with your free cash flow and bringing down short-term borrowings or anything like that?

Q

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Hyve for quarter one performed great, above expectation, around 15% in terms of revenue performance and margin profile, as you know, for that business has been strong. With that said, part of the reason why there's a decline quarter one to quarter two is we're guiding somewhat lower expectations for Hyve in quarter two. Still growth, still good margins but we saw some good performance in quarter one. It breaks down into three categories and there's more that Hyve provides. But you think about the design part of the Hyve business that continued to perform at or better than expectations. You look at the – think about the assembly type of work that performed well as we saw the quarter play out. And then finally the distribution-like services, whether that's strategic buys, if it's loose parts and spares, those programs continued to perform well. They're very resilient. In our hyperscale community, data center and power continued to be of shortage or constrained. So there still is some demand out there for us to fulfill.

And then just getting to the interest expense, yes, it's been elevated. You can see that it almost doubled in Q1 year-on-year. It's quite meaningful. It gets a little bit better in quarter two but still up \$30 million-ish at \$76 million. Now, I think I would assume the cash flow generation expectation and the paying down of the revolver that we tapped throughout the quarter probably brings down that interest expense somewhat in the second-half of the year but I wouldn't take much off of that.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Fair enough. Thanks so much.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yeah. I just want to add we had a – particular around Hyve there but high-growth technologies grew mid double-digit and continue be greater than 20% of our overall portfolio. And as that becomes more meaningful, this is why we're beginning to refer to gross billings overall because obviously when we think about gross billings, we think about the productivity of the entire organization.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thank you.

Operator: We will take our next question from Shannon Cross with Credit Suisse. Your line is open.

Shannon S. Cross

Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you very much. I had a couple as well. First, can you talk a bit about end verticals and what you're seeing? I'm just wondering, obviously where I'm at there's challenges in the financial sector, there's challenges in the tech sector with the layoffs. I'm just wondering within your conversations with your customers, what they're hearing from some of their customers in terms of demand and if you're seeing any – or hearing of any pockets of growth as well and then I have a follow-up. Thank you.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yeah. So Shannon, we don't have a maniacal focus on end verticals in particular within our planning system. Anecdotally, what I would say is that there's a fairly common theme around constraint and making sure that people are very careful with their purchase. Perhaps the outlier around that and it's not really an end vertical would be the hyperscale infrastructure and then all of the high-growth technologies for each of the customers that are in more demand than what I would call the foundation or the foundational technologies than the rest of the set. So, dynamics around digital transformation-type offerings would be – it's more of a horizontal statement, seems to be uniform around all of the end-markets.

Shannon S. Cross

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you. And then I'm just curious in terms of inventory. Can you be a little more specific in terms of what drove the decline in inventory and where you think maybe normalized inventory levels for you are? I know you're getting close I think, but was it more PCs or was it because you had strength in Hyve? Just kind of wondering about the composition of what you have there. And I guess also do you see any opportunities for maybe some strategic inventory purchases given where component costs are maybe on the Hyve side? Thank you.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Yeah. I'll start with the last question first on inventory scrap purchases, well, on all sides of the business. So clearly that's an aspect and element, primarily North America around scrap buys. They're a little bit larger. Those haven't stopped. We continue to have the same kind of discipline around the requirements of what that is needed for us to purchase and how fast that sells through.

Shannon, to your question about scrap purchases within Hyve that continues to play out, they're still flowing and producing quite well. So I think that will continue for the rest of this year. If I think about overall inventory demand, it was somewhat elevated as we came into quarter one. I think that will start to work itself down. The answer to were there any pockets that saw elevation or improvements? I think it was a fairly consistent improvement across the board and that's in Americas, Europe and in Asia comment. And then what we had said last quarter and it's still true in our expectations in regards to Hyve is that we do expect that the Hyve inventory will continue to unwind as we made some larger investment decisions last year that are starting to be collected or, excuse me, billed and collected in Q2 and Q3, Q4.

Shannon S. Cross

Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Thanks, Shannon.

Operator: And there are no further questions at this time. I will turn the call back to Mr. Rich Hume for closing remarks.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Well, thank you very much. I'd like to thank our 23,500 coworkers around the globe for their focus and dedication in helping our customers and vendors and partners perceive each and every day. And I'd like to thank you. We appreciate your interest in TD SYNnex, and thanks for joining us today.

Operator: That concludes today's conference call. You may now disconnect. Have a nice day.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2023 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.