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TD SYNNEX Corp. (SNX)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the TD SYNNEX Second 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.

At this time, for opening remarks, I'd like to pass the call over to Liz Morali, Head of Investor Relations. Liz, you may begin.

Liz Morali

Head-Investor Relations, TD SYNNEX 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, demand, 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.

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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.tdsynnex.com. This conference call is the property of TD SYNNEX 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 SYNNEX Corp.

Thank you, Liz. Good morning, everyone, and thank you for joining us today. Second quarter proved out the resilient business model we've been highlighting over the last several quarters as we saw a continuation of many of the trends from the February quarter. Our unparalleled line card and diversified portfolio allowed us to realize growth in Advanced Solutions and high-growth technologies, while year-over-year growth rates for Endpoint Solutions were impacted by short-term weakness in the demand for PC products post pandemic.

We expect this PC demand decline to abate over time as customers upgrade an aging installed base of devices, allowing them to run the latest operating environments and leverage key security features, and we're encouraged by the improving macroeconomic sentiment and stable supply chain conditions that are mostly back to historical profile levels. Although the pace of the recovery remains uncertain, we believe that gross billings and net revenue in fiscal Q2 and the outlook for Q3 represent the trough levels for Endpoint Solutions.

The breadth of our technology offerings again proved to be a differentiator for us as we were able to offset deeper than anticipated declines in Endpoint Solutions technology demand with growth in Advanced Solutions and high-growth technologies. Our teams delivered solid execution, shifting to pockets of growth, and on a year-to-year basis, we believe we maintained our overall market share position in the Americas while growing market share in Europe. The resilience of our business model, along with strategic investments that we have made, augment our capability in the fastest growing areas of the market, and helped us to expand margins in the quarter. Working capital improved with lower revenues, which is a reflection of the counter-cyclicality of our business model.

From a regional perspective, the Americas experienced the largest impact from the post-pandemic decline in demand with year-over-year declines for PC ecosystem products. Americas Advanced Solutions saw continued growth, driven by demand for cloud and datacenter-related technologies. From a customer perspective, declines were primarily in the largest customer segment, while SMB and MSP customer segments have grown. Europe continued to show resilience with smaller declines in the Endpoint, given our broad technology footprint and diverse product line, including mobile phones and a very strong growth in Advanced Solutions offerings and specialized solutions.

The Asia-Pacific/Japan region also saw strength in high-growth technologies and specialized solutions, partially offset by smaller declines in Endpoint Solutions. At a company level, we continue to see solid momentum across the high-growth technology areas that we've chosen to focus on, which include cloud, security, data, AI, IoT, and hyperscale infrastructure. These areas continued to see growth in the low-teens on a year-to-year basis. Our customers are prioritizing projects in these areas, given the critical nature of these IT investments and their strategic importance in minimizing cyberattacks, enabling digital transformation, and driving cost optimization. Investing in these technologies is one of our four strategic pillars and foundational to our evolution from a traditional distribution partner to a solutions aggregation and orchestration partner.

Let me take a moment to provide some perspective on the steps we've made towards our goals in this area. We are well into the solutions aggregation phase where we build, integrate, and facilitate edge-to-cloud IT solutions

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for our customers. Our role is to help our customers solve complex market challenges by aggregating multi-vendor solutions and delivering easily deployed business outcomes. We do this through our Solutions Factory methodology where we build comprehensive, repeatable solutions that include some combination of hardware, software, and cloud licenses. A recent example of this involved an IT solution provider and a consulting firm that wanted to provide a better backup solution for their clients.

Maintaining, warranty and software support on proprietary backup appliances can be costly for end users, and they wanted to begin recommending pure cloud backups where applicable. This provider was able to utilize the TD SYNNEX Solution Factory and our cloud-based Click-to-Run solutions along with provisioning a preconfigured cloud solution built by TD SYNNEX within minutes. This enabled the provider to deliver a solution to their end users more rapidly, while reducing configuration and deployment process times by 75%. We have many examples like this and currently have over 7,500 of these solutions deployed, including offerings for software-defined data centers, hybrid cloud, hyper-converged infrastructures, analytics, and security. We look forward to continuing to share updates with you on this important work.

Now, moving on to our merger integration efforts. As we approach the two-year mark since we became TD SYNNEX, I'm pleased to report that we have realized our goal to achieve $200 million in merger-related cost synergies ahead of schedule. This is an important milestone and is a result of much hard work and effort by the teams across the company. As we move forward, we expect to realize an additional $50 million in cost optimization over the next several quarters. From an ERP systems perspective, we have made additional progress toward the completion of transitioning the Americas business to one system. Approximately 80% of our Americas business is now on CIS and we remain on track with our transition goals. Importantly, this progress opens the door to realizing merger-related revenue synergies and to continually enhance our business. While we know that some revenue synergies have already begun to be realized, we believe this remains a more significant opportunity toward the end of 2023 and into 2024.

This month, we were honored to receive our updated Fortune 500 rating being named Number 64 on the list for 2023. This is a testament to the strong relationships that we maintain with our customers and vendors. During Q2, we were privileged to be recognized with several awards, including being named HP Partner of the Year, North America Distributor of the Year by Dell, HPE and Veeam, in addition to other regional awards. We also had the distinction of having 19 of our leaders recognized by CRN as Top Women of the Channel last month, a well-deserved achievement and recognition of their significant contributions to our company and industry. We are proud of their achievements and continue to be committed to gender diversity as part of our overall DE&I strategy, with the goal of increasing representation of female coworkers to 40% of leadership roles by 2030.

We also closed on several new vendor partnerships during the quarter, including Gong, an AI-driven revenue intelligence platform, and GitLab via an exclusive partnership to address DevSecOps and application modernization in Asia-Pacific/Japan. These wins are indicative of our investment and commitment to grow in new technology areas, enabling us to continue offering our customers the most complete portfolio in the industry. Since the beginning of the fiscal year, we have added nearly 100 new vendors to our line card.

In closing, as we contemplate fiscal Q3, while there remains some uncertainty in the macroeconomic environment, we are encouraged by the early signs of stabilization with the resolution of the US debt ceiling, reduced banking sector concerns, and a serviceable supply chain. We expect PC ecosystem demand declines to reduce following the past couple of years of intense buying by our customers and driven by the factors I mentioned earlier. We remain well positioned to navigate the demand environment as highlighted by our performance this quarter and we believe that the long-term drivers of IT spending remain intact.

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I'll now turn it over to Marshall for some additional comments about Q2 and our Q3 outlook. Marshall, over to you.

Marshall W. Witt

Chief Financial Officer, TD SYNNEX Corp.

Thanks, Rich, and thanks to everyone for joining us today. Our earnings and cash flow profile remained strong this quarter. We delivered non-GAAP EPS of $2.43 per share within our previously guided range and generated over $700 million of cash flow from operations for the quarter, demonstrating the countercyclical nature of our business model. Our Q2 revenue performance was at the low end of the outlook range we provided in March and is a result of a demand environment that vary greatly between Endpoint and Advanced Solutions technologies. As customers prepared for the rapid shift to hybrid work over the past few years, growth for PC ecosystem products was well above historical trends.

As Rich mentioned, demand for Endpoint Solutions is now declining, with customers digesting the increased investments made over the past couple of years. At the same time, Advanced Solutions technologies continued to see solid demand as customers focused on projects for datacenters and continued to prioritize their cloud migrations. Given our broad portfolio and progress in high-growth technologies, we were able to leverage the areas of growth in Q2, increasing our market share for these technologies in North America and Europe.

Worldwide gross billings were $18.7 billion, down 4% in constant currency, while net revenue was $14.1 billion, down 7% year-over-year in constant currency. Given that a greater percentage of our sales came from Advanced Solutions in the quarter, more of the revenues were shown on a net basis in the quarter. If normalized for these additional gross-to-net adjustments, which primarily occur in Advanced Solutions, the year-over-year net revenue decline in constant currency was 4%. We continue to see solid growth in the high-growth technologies of cloud, security, data, AI, IoT, and hyperscale infrastructure. And collectively, these areas grew in the low-teens on a year-over-year basis and represented greater than 20% of our gross billings in the quarter.

Non-GAAP gross profit was $969 million and non-GAAP gross margin was 6.9%, up 45 basis points year-over-year. The improvement in gross margin was driven by a mix shift to Advanced Solutions and high-growth technologies. Total adjusted SG&A expense was $593 million, representing 4.2% of revenue, up $8 million year-over-year as we continue to make investments to enhance our capabilities in the strategic growth areas of the market. We expect SG&A expenses as a percentage of net revenue will return to the 3.5% to 4% range in the second half of fiscal 2023 as we begin to realize the cost optimizations that Rich mentioned earlier.

Non-GAAP operating income was $376 million, down 5.6% year-over-year, and non-GAAP operating margin was 2.7%, up 6 basis points year-over-year. On a constant currency basis, non-GAAP operating income decreased 5% year-over-year. Q2 non-GAAP interest expense and finance charges were $72 million, $4 million better than our outlook, and the non-GAAP effective tax rate was approximately 24%. Total non-GAAP net income was $229 million and non-GAAP diluted EPS was $2.43, within our guidance range. Non-GAAP EPS for the quarter was down 11% year-over-year, and excluding the impact of higher interest expense and FX translation, it would have been down 2% year-over-year.

Now, turning to the balance sheet. We ended the quarter with cash and cash equivalents of $852 million and debt of $4.1 billion. Our gross leverage ratio was 2.3 times and net leverage was 1.8 times, in line with our investment-grade credit rating and approaching our previously communicated target of 2 times gross leverage ratio. Accounts receivable totaled $8.4 billion, down from $9.4 billion in the prior quarter, and inventories totaled $7.8 billion, down from $8.4 billion in the prior quarter.

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Net working capital at the end of the second quarter was $3.8 billion, down from $4.2 billion in Q1 due to declines in AR and inventory, and partially offset by a decline in AP. The cash conversion cycle for the second quarter was 24 days, down 2 days from quarter one, which was consistent with expectations and typical seasonal patterns. Cash from operations in the quarter was $708 million and free cash flow was $677 million as the business demonstrated the benefits of its countercyclical balance sheet.

During Q2, we returned $93 million to shareholders via dividends of $33 million and share repurchases of $60 million. For the quarter, our board of directors has approved a cash dividend of $0.35 per common share, which equates to a dividend yield of approximately 1.5% payable on July 28, 2023 to stockholders of record as of the close of business on July 14, 2023. As Rich had mentioned, we are happy to report that we met our merger-related cost synergy target ahead of schedule, realizing $30 million of incremental savings and over $200 million cumulatively. Despite our success in achieving merger synergies, there is more work to do to optimize our cost structure, especially given the unprecedented swing from strong market momentum exiting fiscal 2022 to the year-over-year declines in revenue for the first half of fiscal 2023.

Over the next three quarters, we will be pursuing cost optimizations that will drive SG&A costs lower by approximately $50 million on a run rate basis. The cost savings will in part be enabled by the integration of our two ERP systems into one enterprise platform in the Americas. This opens up our full capabilities to dynamically manage and respond to where the market is going, and provides us with confidence in realigning our cost structure to market conditions and to fully leverage cross-sell revenue opportunities.

So, with this as the backdrop, let me now share our outlook for fiscal Q3 and high-level thoughts regarding Q4. We believe we will continue to see demand for PC ecosystem products improve and believe that fiscal Q2 and Q3 represent the trough levels for Endpoint Solutions, gross billings, and net revenue. For fiscal Q3, we expect gross billings of $18 billion to $19.3 billion, representing a 7% decline on a year-over-year basis in constant currency at the midpoint. We expect total revenue to be in the range of $13.5 billion to $14.5 billion, which equates to a 10% decline year-over-year on a constant currency basis at the midpoint. Our guidance is based on a euro-to-dollar exchange rate of $1.09.

Non-GAAP net income is expected to be in the range of $206 million to $253 million, and non-GAAP diluted EPS is expected to be in the range of $2.20 to $2.70 per diluted share based on weighted average shares outstanding of approximately 93 million. Non-GAAP interest expense is expected to be approximately $72 million, and we expect the tax rate to be approximately 24%. We believe market sentiment reflects a modest recovery beginning towards the latter part of Q3 and continuing into Q4, and would expect to see a seasonal sequential improvement in revenue of approximately 8% in Q4, as well as easier compares as we enter fiscal 2024. As a reminder, in Q4 of fiscal 2022, we had a benefit of approximately $0.33 to non-GAAP EPS due to high margin recoveries which we do not expect to repeat.

In closing, I'd like to provide some comments regarding capital allocation. Given strong free cash flow generation in Q2 and our continued confidence in generating over $1 billion in free cash flow for fiscal 2023, we are focused on deploying cash opportunistically. We returned $241 million of capital to shareholders in the first half of the year and expect to increase that pace for the back half of the year by approximately $100 million, bringing our expected capital return for the back half of the year to approximately $340 million and the all-in total for fiscal 2023 to $580 million. We will continue to be opportunistic with regards to capital allocation, while adhering to the general framework we have previously communicated to the market.

With that, we are now ready to take your questions. Operator?

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Adam Tindle with Raymond James. Your line is open.

Adam Tindle
Analyst, Raymond James & Associates, Inc.

Q

Okay. Thanks. Good morning. Rich, I just wanted to start with maybe a macro question, and as we think back, one of your largest customers had a surprising end to their March quarter and a sizable cut to their forecast. The question that investors are wondering this morning is the weakness that you've seen here on revenue, is that reflected in the data point from March, because your quarter includes that month of March or have trends continued to weaken. And if you could maybe touch on what's going on in the month of April, May, and how June is shaping up, it would be very helpful. And then, I've got a follow-up on cash flow for Marshall.

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

A

Sure. So, first of all, obviously, we were to the low end of our revenue guide for the second quarter. So, the demand in primarily the PC ecosystem or Endpoint Solutions were a little bit softer than we had anticipated. We did have some offsets from the Advanced Solutions business and the high-growth technology business as it was stated in our prepared comments. We do see a little bit more volatility month-on-month as we had moved through Q2. I would say that it was bumpier, lows and highs relative to what we might see, so it felt as if it was a little bit more volatile. And I think Adam that this discontinuation of realigning, if you will, the PC ecosystem inventory across the entirety of the supply chain was perhaps a contributor to those Endpoint Solutions volumes being a little bit lower than anticipated.

As we had stated, our view for the remainder of the year is that we'll see lesser declines in Q3 and Q4 moving forward. But we do believe that digestion continues and as you know that, as we move through time, there still are some reasonably tough compares and they get easier as we move into next year. So, we think that, clearly, there is improvement on a year-over-year basis moving through time, but still sort of a declining environment with lesser and lesser declines as we move through time. So, that's kind of the summary.

Adam Tindle
Analyst, Raymond James & Associates, Inc.

Q

Okay. That's helpful, Rich. And maybe, Marshall, as a follow-up, acknowledging cash flow, very impressive in the quarter. And your decision to talk about deploying cash opportunistically, if I recall, it's been a little bit more programmatic on share repurchases and smaller in the past. So, first part of that question would be, maybe just taking us into the discussion in what's changing here from a qualitative perspective to move to this opportunistic stance.

And then, secondly, if you could touch on the timing of cash flow over the next future quarters and for fiscal 2024. There's been times in these models where we have these strong cash flow quarters that are followed by reversals. So, I'm just wondering on the sustainability of cash flow from here. Thank you.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

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Yeah. Thanks for the question, Adam. So, programmatically, we will have in place the 10b5-1 program, and what that allows us to do is just have in place during all periods, quiet and open, to buy at various pricing levels based on what we believe to be the appropriate intrinsic value of the stock. The opportunistic aspect of that, Adam, will be, when we see price changes in our stock and our ability to take advantage of that, we will. So, that will be more of a case-by-case and day-by-day decision in the second half.

And thinking of the cash flow and timing, quarter one, we were at 26 days; quarter two, we improved that to 24 days, so good improvement. That was expected seasonally, but also at the same time, we did see some structural improvement that we think will hold. Thus, now we look for Q3, our expectation is for us to come down, an improvement of probably about one cash day. And then, Q4, based on our comments about the seasonality recovery of 8% sequentially, sometimes that does consume working capital. Difficult to tell today, but still allows us to have confidence to achieve the $1 billion plus cash flow for 2023, and thus, the increase in the second half of share repurchases by $100 million.

And then, your question about going into 2024, we have said in our Investor Day and along the last couple of quarters that we still feel that that medium term target of being able to generate free cash flow of $1.5 billion is still reachable and attainable. I do think that coming out of 2022, we were quite elevated on inventory, I think we acknowledged that, and that we would expect some of that inventory to unwind. We have experienced that to date for the first half. We do expect that to continue to improve in the second half of 2023.

Adam Tindle
Analyst, Raymond James & Associates, Inc.
Q

Okay. And into 2024 [indiscernible] (00:27:08) I'm just seeing that you're under 2 times net leverage, you've got over $5 billion of liquidity, and if cash flow is going to continue like this, I would imagine the capital return story doesn't end here, but I don't want to put words in your mouth.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.
A

That's correct. And as you know, it's not always linear. The indication of us increasing our share repurchase is not indicative of anything we're doing on the M&A front. So, we're always going to take that with a balanced approach.

Adam Tindle
Analyst, Raymond James & Associates, Inc.
Q

Thank you.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.
A

Thank you.

Richard T. Hume
Chief Executive Officer & Director, TD SYNNEX Corp.
A

Thank you, Adam.

Operator: The next question is from Michael Ng with Goldman Sachs. Your line is open.

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Michael Ng
Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good morning. Thank you for the question. I just have one on SG&A. Given that OpEx is 65% variable, I was surprised to see it up year-over-year. I know you mentioned the investments in the strategic growth areas that drove the elevated SG&A in the quarter. I was just wondering if you could talk a little bit more about that, what areas of growth were most impactful. And then, could you talk a little bit about the glide path towards coming back to that 3.5% to 4% range in the back half? Is it evenly split, more back weighted towards the fiscal fourth quarter? How you're thinking about that? Thank you.

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

A

Yeah. Thanks for the question. So, first, I'll handle the first part and Marshall can assist on the glide path of the back half year. So, first, when you think about areas of investment, we point towards the high-growth technologies. This would be cloud, analytics, cybersecurity, and then, our hyperscale infrastructure business. And you've been noting that those have been performing quite well for us over time. So, that's sort of the first data point.

The second data point is when we think about our SG&A structure, there clearly has been an impact with inflationary measures across most of the SG&A category, whether it be labor and logistics centers or whether it be some of the logistics and supplies like activities which exist within that framework as well. That being said, we've done a pretty good piece of work to think about where we're headed for the back half of the year and then FY 2024, and have realigned, if you will, the trajectory of our spend to be consistent with getting us back to an overall business profile. And I'll let Marshall comment a little bit on that.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

Yeah. Thanks, Rich. So, just a few things to add. As we said in our prepared remarks, the near completion of our ERP in North America certainly enables us to drive a lot more opportunity for efficiencies across all areas, and that's not only just within SG&A, but that's margin optimization, pricing, scale, et cetera. So, I think that gives us additional confidence to know that deployed under one system, we've got an opportunity to drive it down. Specifically to the $50 million in cost optimization, the way we see that play out in general terms is we'll start to feel that benefit in Q3, roughly around $10 million of incremental SG&A takeout. We think there'll be another $15 million or so in Q4 incremental. So, call that $25 million for the rest of 2023. And then, for fiscal 2024, Q1, we expect an incremental $25 million in Q1. So, that's how we expect it to play out.

I think, just as Richard said, there's lots of things we need to consider that will be continued investments going forward, higher SG&A as it relates to our high-growth technologies will continue to be important to us. You probably experienced and seen in the past when we have some heavier SG&A, typically that bears fruit two to three quarters down the road in terms of better returns, higher margin, and cash flow coming back in through the door. So, that's how we expect it. In terms of the glide path for Q3, we'll probably be right around 4% in Q3 for SG&A as a percentage of revenue, and then we'd expect to be between, call it, 3.6% to 3.8% as we enter Q4.

Michael Ng
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thanks, Rich. Thanks, Marshall. That's very helpful. I'll hop back into the queue.

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

A

Thank you.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

Thank you.

Operator: The next question is from Joseph Cardoso with JPMorgan. Your line is open.

Joseph Cardoso
Analyst, JPMorgan Securities LLC

Q

Hey. Good morning and thanks for the question. Just one for me as well. As it relates to your AS business or your AS and high-growth technologies business, just curious to get some more granularity around the trends that you're seeing there. Specifically, is that – I guess, there are some broader concerns from the investment community around maybe seeing a pullback as you kind of digest some of the backlog in that business. I guess, can you just touch on whether you're seeing trends track ahead of your expectations 90 days ago? Are you seeing any pullback in terms of current demand trends or order trends? Just curious to see how that business is tracking relative to your expectations 90 days ago. Thanks.

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

A

Yeah. A couple of things. Thanks for the question, Joe. So, first, AS has been growing at a reasonably robust pace. There's – for sure, that growth rate has benefited from some backlog runoff. We are starting to reach sort of profile levels of backlog. Generally speaking, there are some very isolated pockets. So, the way I kind of see it, just to give you a trend here, is I think that the AS growth rate will be coming down, but they'll still be growth for the back half of the year, but at a bit of a lower growth rate.

So, if you think of the dynamics of our business, we talked about lesser declines in the PC ecosystem moving forward. I think we then have lower growth rates moving forward in the AS business. And then, as well, the back half of last year, we had a very strong Hyve business and we talked about the lumpiness of Hyve over the annual periods. And we think that Hyve will have less growth or perhaps decline as well in the back half of the year. So, there is a changing dynamics going on within the portfolio.

I want to be clear that I think all of these are within the dynamic of the macro, and as we move forward and the macro gets healthier, I believe that the overall business, all boats rise, so to speak, when we find ourselves at that point. And as we stated in the commentary, the trends here recently have been, I think, quite positive relative to the macro, but they could ebb and flow as well. So, we talked about clarity on the debt ceiling. We talked about the concern around the banking crisis or the banking issues kind of reducing quite significantly. And then, there's the continued narrative around unemployment being low and GDP continuing to chug along. So, we'll see how all of that plays out. But longer term, we absolutely are confident that IT will realign with its sort of normal growth attributes once we clear through this macro.

Joseph Cardoso
Analyst, JPMorgan Securities LLC

Q

Yeah. Appreciate the color, Rich. I'll jump back in the queue. Thank you.

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Operator: The next question is 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 wanted to ask about the revenue guidance. If PCs are getting a bit better, and yet at the low end, revenue would be lower. Like, what went into, I guess, the range that you provided in terms of your thinking? And then, I have a follow-up. Thank you.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

Hey, Shannon. I'll go first. So, typically, what we do every quarter is do a bottoms-up review and that's by product, by region, by leader. No different than what we've done in the past. So, as we pull that together, we have a range of outcomes that typically we then take, and Rich and I will look at that to get a sense of the range of guide, and that's really how we formulate it. It's no different. And we did articulate last quarter that it was a little bit more difficult, given just the uncertainty that we saw in the second half of the year. So, it very much is an informed perspective, and you can appreciate the Americas dynamics are different than Europe, and those are different than high-growth and those impacts. For us, clearly, the high-growth continues to be the leader, and Endpoint, now it's a matter of trying to determine how that recovers. So, Rich, I don't know if you want to add anything.

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

A

Yeah. Shannon, if I think sequentially here for a second, first of all, just a reminder that we had a very strong back half of the year. From memory, we had a 14% and 15% growth, respectively. But if you think about it sequentially, I think the dynamic is lesser of a decline in PC than lesser of a growth rate in AS, as sort of the backlog piece that fueled a little bit extra revenue growth is coming down a little bit. And then clearly, Hyve, back half of the last year, had some really big numbers. So, it's really a remixing across the portfolio of those revenue dynamics that lead to the range of the guide that Marshall had provided.

Shannon S. Cross
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you. And then, I'd probably remiss not to ask about AI. Curious, can you talk about what you're thinking internally as well as what you're hearing from your customers and how maybe that can grow as part of some of your more solutions-oriented sales? Thank you.

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

A

Yeah. Sure. I actually read this morning a piece on AI in one of our vendors that was released by you and your team. So, thanks for those insights.

Shannon S. Cross
Analyst, Credit Suisse Securities (USA) LLC

Q

Oh, [ph] why don't you opt (00:37:46) for a call on that soon.

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

A

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So, three buckets here. So, first in core distribution and I'm thinking now in terms of offerings, right. We fundamentally believe that we're going to see many offerings now AI-infused. So, there's not – obviously, there will be applications out there that might sell sort of AI as a service, but we kind of see the embedded AI as being something that will lift the entire offerings portfolio, almost end-to-end, and you had the piece talking about how AI might influence PC ecosystem. So, as we move through time, I think offerings become more intelligent, more robust, and likely will have an influence on some of the ASPs as we move through time.

Second, from a high perspective, we all know that the hyperscalers are going to be building out a pretty [ph] big tranche (00:38:51) over time of, I'll call it, AI-tuned or AI-optimized servers and storage and networking and the entire sort of datacenter category. So, that will be an opportunity for us to compete, to continue to win business within that category. And lastly, from an operations perspective and productivity, obviously, we've been on a journey around machine learning and automation, and now, we get a little bit supercharged with what I'll call more advanced AI capabilities. And candidly, we're really learning to determine where the best pursuits are for our operation in terms of using that new technology within our franchise overall. So, those are the three sort of categories that we think about AI in.

Shannon S. Cross
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you very much.

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

A

Thank you.

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

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Hi. Thank you for taking my questions. My first question is regarding the pricing environment. Are you seeing suppliers lower prices as commodity costs have come down, and are your own customers buying leaner configurations given the uncertain macro? So, can you give us your thoughts on your ASPs?

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

A

Yeah. So, Ruplu, to be clear, I'm going to address the ASPs predominantly within the PC ecosystem space. I mean, obviously, when you get into datacenter, following the configurations and the ebbs and flows, it makes it a bit more difficult. But actually, ASPs were up in the quarter, which might be a bit of a surprise. This is for our business, but we see ASPs actually increasing. So, therefore, I think we see inflationary impacts priced in and/or richer configurations. And at the same time, the volume declines were a little bit larger to get us to sort of the average unit revenue, if you will. So, ASPs are holding up. However, within that higher ASP sort of band, there clearly is a continued level of price competition that's healthy. So, that's how I would describe it as, there is definitely very healthy price competition out there. But at the same time, the ASPs have gone up a little bit on a year-to-year basis. Marshall, I don't know if you have anything to add.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

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Yeah. Just some color sequentially, Ruplu. Rich is right in terms of the ASP holding and improving. Year-over-year, clearly down in the PC ecosystem, but sequentially, we saw overall revenue improve, and so that was one of the reasons we also felt like there was some form of recovery underway. So, just wanted to highlight that. From a quarter-to-quarter perspective, we are starting to see the Endpoint Solutions grow for Americas and Europe.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Okay. Thanks for the details there. For my follow-up, let me ask you a question on revenues and specific to the Americas region. This quarter, you had revenues decline 10% year-over-year in constant currency. Can you give us your view on North America IT spending growth this year in 2023? And I think you said Endpoint Solutions, you expect to trough in fiscal 3Q. So, let me ask you a little bit more detail on that. I mean, why do you think 3Q is the trough? Why not 4Q? I mean, what is giving you confidence in that 3Q will be the trough? And the last part of that question is, Advanced Solutions, I think you said would be slower in the second half. Is there any way to quantify that? Is that just because of tough year-on-year compares or how much slower versus the first half year-on-year growth versus the second half, any color you can give? Thanks.

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

A

Ruplu, thank you for the multipart question. Let me see if I can handle each one of those. Our experience in the Americas is that the challenge is clearly within the PC ecosystem. And for one reason or another, it has been more magnified than in the rest of the world. Now, part of that is because in Europe as an example, we have a broader Endpoint segment, which is inclusive of mobile phones, which we don't have within the Americas. So, that would be number one. Number two is, as it relates to Advanced Solutions and the slower growth as we move through, I see it as predominantly the backlog moving towards the profile and not having the increment on the revenue that we had in, I'll call it, the last four quarters with backlog assisting to provide an extra jolt to that growth.

And then, as it relates to PCs and why we see lesser of a decline and we think the trough would be, we say, in Q2/Q3. It's truly because, number one, the inventory clearly has been digested across the supply chain. Number two is we're beginning to see real stability in that backlog overall. Then, the third part is we all read within the industry about the aging profile of the installed base out there and some of the benefits of the new OSs, which are available in the market. And then, some of those OSs we know have an expiration date sometime in calendar 2025. So, generally speaking, the installed base starts to move when it gets aged, and when there are productivity and mostly security benefits with some of the new offerings, and then that coupled with the expiration date and, oh, by the way, the compares begin to get easier. So, all of those things together are – and then, discussions clearly with vendors and customers, all those things together would lead us to sort of feeling as if the trough is Q2/Q3.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Got it. Thanks for all the details.

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

A

Hopefully, I answered all your questions.

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Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Yes, you did. Thank you.

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

A

Okay. Thank you.

Operator: The next question is 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. Rick, maybe perhaps touch a little bit based on the sales cycle. We're hearing a lot from the resellers and competitors that sales cycle has just been elongated across the board. But I really don't think we've heard too much of that here from this discussion here. What are you guys seeing in that in terms of for the quarter and for the rest of the year expectations?

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

A

So, I think, it's part of the decline that we've seen in PC and then moving forward to the lesser declines. And then, the AS growth rates that we talked about. And then, even within our Hyve business, we have tough compares in the back half of the year, and know that we'll be challenged from an overall sales perspective there. All of these things have multiple factors, Keith. I think it starts with the macro and I talk about the macro and Marshall has a couple of time. And you know what, certainly, one of the outcomes of the macro are elongated sales cycles, more scrutiny, if you will, around the purchase, more on absolutely limiting the purchase to what's needed now as opposed to what can be foregone for a period of time. So, I didn't – maybe I didn't directly state that, the protracted sales cycle time is an outcome, but certainly, I see it as tied to sort of the macro and a natural reaction given the macro.

Keith Housum
Analyst, Northcoast Research Partners LLC

Q

Great. I appreciate it. And just as a follow-up, with the additional cash flow that's available as a reduction of the business and putting that capital to use, how do you guys see the M&A environment today and your opportunities available to you?

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

A

So, I think, M&A is something that we always have an active pipeline on and we continue to engage on that pipeline. Things come in. Things fall off. I would tell you that our M&A interests are pretty consistent with what they have been over time. As you well know, within this industry, there's the ability to grow organically, predominantly driven in the new technology areas and there's the ability to grow inorganically. And over the continuum, I think that both of those tools will be utilized in order to continue to drive our enterprise.

Keith Housum
Analyst, Northcoast Research Partners LLC

Q

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Great. Thank you, guys.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

Thank you.

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

A

Thank you.

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

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yes. Thank you and good morning. I had a question on the gross margin. Marshall, the implied gross margin guide is roughly 6.7%, so down 20 basis points sequentially. You talked at the end of your comments – your opening comments about Hyve having some – I guess some catch-up in some pricing with customers in that there was sort of a onetime positive impact. So, could you talk about your expectation for gross margin, particularly as you get into the back half of the year with Advanced Solutions slowing and client devices picking up, and particularly, your consumer business also picking up seasonally, should we expect gross margin to be down again in Q4?

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

Yeah. So, I'll address the second half, and then Rich certainly can chime in. So, we think the gross margins probably come down slightly. Most of that, I think Matt is just due to seasonality. As you know, quarter four tends to be a little bit more PC weighted, and with that, it tends to have a little bit lower gross margin profile. But you're right, we had some onetime items that won't repeat themselves in Q4 for Hyve and that definitely did benefit last year's quarter four margin, gross margin. But generally said, the majority of the uplift, if you think about the year-over-year compares on gross margin are primarily due to the mix shift between AS and ES, Matt, and also the increased amount of gross versus net that's taking place within the enterprise. We roughly have about a 3% higher grossing of those revenues year-on-year. So, it does actually artificially or mathematically increase the margin profile, while gross profit dollars stay relatively consistent or constant relative to overall revenue volatility.

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it. Okay.

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

A

I have nothing to add. I think Matt, as Marshall had said it, maybe marginally with the anticipation would be a sequential kind of down a couple of basis points along the way, but fairly stable I think in Q4 then.

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

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Okay. Thank you. And then, another question on macro and what you're seeing. You talked, Rich, about the enterprise being the weakest end market segment and SMB holding up relatively well. Is that your expectation or SMB may be lagging this cycle, and they may get more cautious in terms of spending as you get into next year? And any insight or any visibility there?

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

A

Yeah. So, clearly, I think for the first half of the year, we've seen this trend. We talk about the – I'll say, the larger customer set being where we see the biggest challenges, and then SMB and MSP offering a better outcome as it relates to productivity. I think, Matt, it's a difficult question to answer and I'll tell you why. Part of this is because I believe there's a disproportionate consumption of new technologies, predominantly cloud, and as a service based solutions that you follow technology cycles, they hit first in enterprise and then kind of make their way down.

So, I think that my speculation is the growth rates of sort of cloud-oriented things are higher in SMB now than they are in enterprise, because there's a bit more of a saturation. So, I think there is a benefit relative to the portfolio consumption in SMB kind of following the evolution, if you will, of some of these newer technologies being consumed there. And then, you get into what happens with the macro and we find ourselves in a situation where when SMBs might be thinking of slowing that we have sort of an improvement in the macro. So, it's sort of those things that might allow for a better transition within SMB and MSP as opposed to what we've seen in the – I'll call it, the larger end customers.

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Great. And if I can squeeze in a third question, just regarding your comments on Hyve and the fact that that's going to be weaker in the second half. Could you just talk about – I mean, I know that there's lumpiness in that business, but how you're positioned sort of as you get past this digestion period or this slow period, how you're looking going into next year?

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.

A

Hey, Matt. So, yeah, it's a tough compare. The second half of 2022 was exceptionally strong for Hyve and it was contributed for kind of three equal reasons. The racks themselves continued to show strong demand and our distribution network enabled us to perform those type of services for our hyperscale customers, and then spare parts, et cetera. It was just extremely healthy in the second half, so it just makes it a really tough compare. Sequentially, if you think about the behavior of Hyve from Q1 to Q2, good quarters, strong, good margin profile, those expect to come down a little bit in the second half. I think a lot of it is just connected to the overall thoughts of high-growth technology still having above average compared to core growth rates, that will continue, but it should abate.

I think to your question about when does that digestion period end, we think we exit 2023 and find ourselves in 2024 kind of back in a normal growth rate pattern. It's hard to determine if that's a 5% growth, 10% growth, but we do think it's positive. And I will just reiterate that second half of this year, we expect Hyve to be down year-over-year, primarily just due to the tough compares.

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

A

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Yeah. So – and I would summarize Marshall's comment very simply by saying that my point of view is the Hyve's ebb and flow here is strictly related to the macro. We're executing quite well in that business. We are participating in a lot of new design opportunities for the future. The business is executing solidly, and I think that this is sort of more of a macro as opposed to anything else and the execution engine is quite strong.

Marshall W. Witt
Chief Financial Officer, TD SYNNEX Corp.
A

And then, the final thing I'll say which we say quite often to you, Matt, is that if you look at the annualized trailing 12 performance of Hyve for the last three years, they continued to show growth in top line and bottom line.

Matthew John Sheerin
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. Very helpful. Thanks a lot.

Operator: Our final question today is from Ashish Sabadra with RBC Capital Markets. Your line is open.

Q

This is [ph] Patrick Jackson (00:56:54) on for Ashish. Thank you for taking the question. In Europe, it's great to hear about the continued share gains. Could you share a bit more how trends have developed across Advanced Solutions and Endpoint in that region? And for your mobile distribution business in Europe that you mentioned earlier, could you talk about how demand has trended in the quarter and what you have seen from a supply chain perspective? Thank you.

Richard T. Hume
Chief Executive Officer & Director, TD SYNNEX Corp.
A

Sure. It's been an ongoing narrative for our business that the impacts of the PC ecosystem or Endpoint Solutions have been more significant in the Americas versus Europe. So, although Europe has experienced declines in Endpoint Solutions, they have been much lower declines than in the Americas. As it relates to the mobile phone piece, it has been performing reasonably well. We have two providers that we are engaged with over there, and I'd say the demand has been reasonably solid over time, and we wouldn't anticipate any major change in that trajectory moving forward.

And then, lastly, from an Advanced Solutions perspective, the benefit of good growth in Advanced Solutions is sort of consistent globally, where each one of the regions are seeing that trend. So, I wouldn't say that it's out of the norm, Europe versus the rest of the world there. But I would say, just being a little bit repetitive that, in the last – in the first half of the year, the outsized declines in PC ecosystem have been within the Americas.

Q

Thank you.

Richard T. Hume
Chief Executive Officer & Director, TD SYNNEX Corp.
A

Thank you.

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Operator: That would conclude our question-and-answer session. I'll turn it over to Rich Hume for any closing comments.

Richard T. Hume

Chief Executive Officer & Director, TD SYNNEX Corp.

So, first, thanks to all of you for attending the call today. In closing, I want to thank our coworkers around the world for their persistence and can-do attitude in staying focused and making sure that we keep at the forefront the success of our vendors and customers, which we rely upon to drive our business moving forward. Thanks to all of you for joining and I hope you have a great day.

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

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