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TD SYNEX Corp. (SNX)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Brianna, and I'll be your conference operator today. I would like to welcome everyone to the TD SYNEX Second Quarter Fiscal 2024 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 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; Patrick Zammit, COO; 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 demand, positioning, growth, cash flow and shareholder return, 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, including gross billings. 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 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 thank you for joining us today. On today's call, I will provide some thoughts regarding the industry and the drivers of our performance in Q2, followed by comments on the planned CEO transition we announced last week, then Patrick will speak briefly, then we'll close with commentary on our Q2 financial performance and Q3 outlook from Marshall prior to the Q&A session.

Starting with our Q2 performance, I will focus my comments on three areas. First, our markets have continued to stabilize and we remain confident in our improving revenue and gross billings growth prospects for the back half of the fiscal year. Second, we delivered strong financial results and robust shareholder returns. And third, we believe AI is a meaningful opportunity for the company over the foreseeable future. The IT spending market continued to improve, and after a prolonged period of challenging market conditions and transformation, which we navigated well, we returned to positive year-on-year gross billings growth in the quarter. Gross billings were up 3% coming in at the high end of our guidance range. This growth came through all areas of our business, including Endpoint Solutions, Advanced Solutions and Strategic Technologies, which now represent 25% of our total business.

And as we enter the second half of the fiscal year, we continue to expect further acceleration in gross billings and revenue growth fueled by PC refresh cycle, customer investments in data center and cloud deployment, increased hyperscale capital spending to meet the needs of both traditional and AI-enabled workloads, and continued expansion in software, security and data analytics. Our fiscal results in 2Q were strong with gross and operating margin expanding double digit growth in non-GAAP earnings per share and robust capital returns to shareholders. Our broad end-to-end technology portfolio enabled us to capture growth in both the core and strategic areas, and we remain disciplined on costs, holding our expense to gross billings ratio flat sequentially.

This strength, coupled by our confidence with an improving market environment, allowed us to return over \$520 million to shareholders through the first two quarters of this fiscal year, already representing nearly 70% of the total return to shareholders in fiscal 2023. As we go forward, we remain committed to our balanced capital return framework. Since our last earnings call in March, the technology industry has continued to unveil a multitude of AI-related products, services and announcements. As I've mentioned previously, I believe AI will be the next great transformative era for the technology sector.

During my career, I've witnessed the advent and evolution of several other groundbreaking advancements, such as the Internet, mobility and cloud computing. We are just at the beginning of the AI era, and by industry analyst accounts, the potential associated TAM expansion over time is significant. A portion of that spend will come through business partner ecosystem and we expect our business will benefit across components, devices, data center, cloud storage and networking, as well as the related software, applications and services. With our deep vendor partnerships, long tenured customer relationships and service capabilities, we are well positioned to

participate in this growth as the market evolve and are already seeing momentum in investments from our vendors and increased interest from our customers.

During the quarter, we launched the IBM watsonx Gold 100 Program to accelerate AI opportunities for partners through enablement, training, business planning, sales acceleration, marketing, demand generation, expert services and pre-sales support. As part of this collaboration, we will establish IBM watsonx Centers of Excellence in four locations around the globe where partners will be able to experience watsonx proof of concept solution. We were also honored to be named Microsoft's Global Copilot Seats Champion for the quarter, a testament to the successful Copilot launch we enabled earlier this year. Lastly, we were pleased to announce our High-Growth Technology Center of Excellence, where partners can learn how to become a partner of the future, integrating AI with cloud, cybersecurity, data analytics and modern infrastructure.

As I'd mentioned at the start of the call, I would like to make a few comments about the CEO transition we announced last week. First, let me take a moment to congratulate Patrick Zammit, who will succeed me as CEO of TD SYNnex upon my retirement in September. Patrick has a long track record of success in our industry, having joined Avnet more than three decades ago. And he has been an excellent partner to me since becoming part of the company in 2017. During his tenure, he has excelled at driving growth and operational excellence across the organization. His business acumen and deep industry expertise, coupled with his interest and dedication in building world-class cultures, make him the ideal candidate to lead TD SYNnex into the future.

Since becoming our Chief Operating Officer earlier this year, Patrick has already accelerated the progress on our strategic initiatives and has fostered an even greater focus on driving profitable growth while continuing to deliver increased value to our customers, vendors and coworkers. As I look back on my career and the many accomplishments and milestones along the way, I can safely say that it has been an absolute privilege to lead the company, and I look forward to continuing to work with the team as a member of the board of directors. I am incredibly proud of the company's achievements and the culture that we have built over the years.

I will now pass it over to Patrick so he can make a few comments. Patrick?

Patrick Laurent Zammit

Chief Operating Officer, TD SYNnex Corp.

Thank you, Rich. And thank you for your leadership and guidance as CEO. I am honored to have been selected to lead TD SYNnex and look forward to continuing the legacy of success and partnership across the channel that Rich has established, along with cultivating the vibrant and servant leadership based culture that we are known for. I am fortunate to inherit a best-in-class team who deeply understands our purpose, mission, vision and values.

TD SYNnex has an industry leading set of capabilities and an unmatched ability to deliver value to our most critical stakeholders. We excel at helping to accelerate broad adoption of technology with our efficient go-to-market motion, and we constantly look to innovate, challenging the status quo and increasing our value proposition. I look forward to building on the foundation we have established and continuing to accelerate our strategy and digitalization efforts to ensure we are constantly delivering the greatest value to our coworkers, partners, vendors and shareholders.

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

Thanks, Patrick. In closing, the pace of change across the IT industry continues to accelerate, necessitating partnerships across the channel and we are solidly positioned with the industry's leading and emerging vendors and over 150,000 customers. This rapid pace of change requires us to stay agile and nimble, anticipating the needs of our partners and constantly increasing the value we deliver to them. We continue to see opportunities for growth across our business and geographic regions and have made solid progress in transforming our portfolio and margin profile with greater focus on accretive strategic technologies. Our capital structure is healthy and we are committed to maintaining a balanced approach to capital allocation going forward.

Since this will be my last earnings call, I want to personally thank all of you for your support, ideas and interest in our great company. I wish all of you a healthy and prosperous future. I will now turn it over to Marshall for additional commentary on Q2 and our Q3 outlook. Marshall?

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

Thanks, Rich, and good morning to everyone on today's call. Let me also offer my thanks to Rich for his leadership as CEO and specifically his guidance through the merger, and congratulations to Patrick as he succeeds Rich.

Now turning to our results. We had a strong performance in fiscal Q2 with results in line with our expectations, aided by an improving IT spending environment with gross billings growth in Endpoint Solutions, Advanced Solutions and Strategic Technologies. We were pleased with our continued expansion in both gross and operating margins and strong EPS growth. Importantly, as Rich mentioned, we believe we are well positioned to benefit from accelerated growth in the back half of the fiscal year as the IT spending market has continued to rebound.

Total gross billings were \$19.3 billion, up 3% year-over-year and toward the upper end of our guidance range, driven by a 1% increase in Endpoint Solutions and a 5% increase in Advanced Solutions. Importantly, as Rich mentioned, we returned to positive gross billings growth following a prolonged period with challenging market conditions, an encouraging proof point supporting our thesis that the IT spending market is rebounding. We have made investments that we believe will position us well to meet the new opportunities that this dynamic market is creating.

Net revenue was \$13.9 billion, down less than 1% year-over-year. Gross to net revenue adjustments again increased year-over-year as software as a service offerings continued to represent a greater portion of our overall business. This dynamic alone negatively impacted our net revenue by 4% on a year-over-year basis, but improved our gross margins by 27 basis points. Given this continued trend in the industry and in our business, we believe the best measure of our top line growth is gross billings, which is not subject to these apples to oranges comparisons. For quarter two, from a technology perspective, approximately 75% of gross billings were from hardware, 19% from software and 6% from services. This was aligned with our expectations as Endpoint Solutions, which is primarily represented in hardware, returned to growth, and comprised a greater proportion of our total business.

Strategic Technologies experienced year-on-year growth in the mid-teens with strength across cloud, data center, AI and security, and with robust hyperscale infrastructure growth driven by the accelerated ramping of new business at Hyve. Strategic Technologies now represent 25% of total gross billings, up from 22% in the year ago period. Non-GAAP gross profit was \$974 million, and non-GAAP gross margin was 7%, up 9 basis points year-over-year. As expected, our gross margin came down from Q1 level as Endpoint Solutions represented a greater portion of the overall business mix.

Total non-GAAP SG&A expense was \$586 million, down \$7 million year-over-year, or 3% of gross billings, as we exhibited good cost discipline while balancing investments in strategic growth areas. Another metric we utilized internally to assess our SG&A investments is SG&A as a percent of gross profit. For quarter two, we came in at 60.1%, an improvement from 61.2% in the prior year period. Non-GAAP operating income was \$388 million and non-GAAP operating margin was 2.78%, representing a year-over-year improvement of 11 basis points. Interest expense and finance charges were \$77 million, and non-GAAP effective tax rate was approximately 23%. Total non-GAAP net income was \$237 million, and non-GAAP diluted EPS was \$2.73, approaching the midpoint of our guidance range.

Now turning to the balance sheet, we ended the quarter with cash and cash equivalents of approximately \$1.2 billion and debt of \$4.6 billion. Our gross leverage ratio was 2.6 times and net leverage was 2 times, elevated from the prior quarter due to the timing of our recent debt issuance. We expect to pay off the \$700 million of senior notes maturing in August with cash on hand and would expect our gross leverage ratio to be around 2.3 times by the end of the fiscal year. Accounts receivable totaled \$8.9 billion and inventories totaled \$7.1 billion, both consistent with the prior quarter. For the second quarter, net working capital was \$3.6 billion, up from \$3.2 billion in quarter one and the cash conversion cycle was 23 days, up 2 days from quarter one.

Cash used in operations in the quarter was \$115 million as Hyve, which is part of our Strategic Technologies, experienced strong growth due to new business ramping. Excluding these additional working capital requirements, our free cash flow generation was approximately \$190 million. We returned \$288 million to shareholders in quarter two with \$254 million of share repurchases and \$34 million in dividend payments. For the current quarter, our board of directors has approved a dividend of \$0.40 per common share, representing a 14% increase on a year-over-year basis, which will be payable on July 26, 2024 to stockholders of record as of the close of business on July 12, 2024. Thus far this fiscal year, we have returned over \$0.5 billion to shareholders.

Moving now to our outlook for the fiscal third quarter. We expect non-GAAP gross billings of \$18.9 billion to \$20.1 billion, representing growth of 5% on a year-over-year basis at the midpoint. We expect total revenue to be in the range of \$13.3 billion to \$14.9 billion, up 1% on a year-over-year basis at the midpoint. Our guidance is based on a euro-to-dollar exchange rate of \$1.08. Non-GAAP net income is expected to be in the range of \$219 million to \$261 million and non-GAAP diluted EPS is expected to be in the range of \$2.55 per diluted share to \$3.05 per diluted share based on weighted average shares outstanding of approximately 85 million. Our non-GAAP tax rate is expected to be approximately 23%.

Interest expense is expected to be approximately \$75 million. As we look to the second half of the fiscal year, we continue to expect gross billings to grow in the mid- to high-single digit range, driven by continued improvement in the market environment. We still expect to generate approximately \$1.2 billion of free cash flow for the fiscal year and remain committed to our capital allocation target to return 50% of free cash flow to shareholders, both with dividends and share repurchases.

In closing, we believe we're in a strong financial position as we head into the second half of our fiscal year with ample liquidity and an optimized balance sheet to fund the expected growth and investments in Strategic Technologies while capturing opportunities in our core business.

We're now ready to begin the Q&A portion of the call. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now open the line for questions. [Operator Instructions] Our first question comes from Michael Ng with Goldman Sachs. Please go ahead.

Michael Ng

Analyst, Goldman Sachs & Co. LLC

Q

Hey, good morning. Thank you very much for the question. I just have one on AI devices and AI PCs. I was wondering if you could expand a little bit more around some of your comments regarding increased customer interest. When do you expect that to flow through? Do you have any views on AI PCs as a share of total PCs and any high level commentary that you may have on AI PC pricing relative to general PC? Thank you.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

So, good morning. Patrick Zammit, I'm going to take that question, Mike. So, I mean, at the moment, what we see is the ramp-up of AI PCs. I mean, when you refer to the market data, we got market data for distribution for both North America and Europe. I mean, you see that it's still in the low-single digit of the total PC market. You see also that this is at the moment the AI PCs are primarily ARM-based PCs, so more high-end PCs, okay. So when you look at from a pricing standpoint and, again, I'm positioning my remarks with the fact that these are high-end PCs, I would say that the delta price is between 5% and 10% for the high-end PCs. But, the expectation going forward is that this is going to accelerate. We are waiting for the PC manufacturers to accelerate the launch of the AI PCs and so the adoption rate is for sure going to increase. And so we continue to be very confident on the prospects of that segment of the market.

Michael Ng

Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you so much for the color, and congratulations on the new role.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

Thanks for that.

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

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Q

Hi. Thanks for taking my questions. I'd like to congratulate both Rich and Patrick; Rich for his long, successful career; and Patrick, congrats on the new assignment. Maybe...

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

Thanks for that.

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Q

...I'll start with you, Patrick, for a question. Since you're going to take on the new role, can you talk about your top focus areas for the next 12 months? For you, is it more important for SYNEX to have revenue growth or focus on profitable growth, which is a focus on margins?

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

Yeah. So the focus of course is on growth. And I think that when you look at the mix of our business, I mean that growth is also going to generate more profits. When you look at the coming quarters, I believe that the technologies who are going to drive the growth will have a positive margin, okay. So the mix should be going forward more favorable because of that. Hyve, of course, is going to continue to contribute to that growth.

So again, from a top line standpoint and from a margin quality standpoint, I think we have some very nice opportunities. Then if I move to the costs side, I also would like to make a few comments here. I mean, we just accomplished two major milestones in both North America and Europe. I mean, we upgraded our IT platform, which means that we can now focus on process and system efficiency. And so what it means is that from a cost management standpoint, it gives us the opportunity to redeploy resources to fuel the growth on the high growth categories, but in total continue to reduce our cost to GP as we did it in Q2. So in summary, I see very nice prospects for not only growth but really profitable growth and basically the drop-through of the GP increase positively impacting the operating income.

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Q

Okay. Patrick, you mentioned a couple of things. Maybe if for my follow-up, if I can ask you, you mentioned Hyve. So how should we think about Hyve revenue growth? Since you are ramping a new customer, how should we think about revenues as well as the inventory requirements for that business and potential free cash flow?

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yeah. Ruplu, maybe I'll step in and help with the Hyve question. So as we had commented in our remarks, we had very robust growth in Hyve in the quarter. As we look at the technical frame, we believe that that growth will continue. Obviously, there's good demand within the hyperscaler space, but we've talked before about customer number two is now in a very healthy ramp and doing quite well. So we're really pleased with the performance of our Hyve business overall.

You bring a good point, as we get outsized growth within Hyve, there will be working capital needs that get generated. Those working capital needs manifest themselves in AR as well as inventory, but obviously good cholesterol here because we're positioning ourself for a good growth when we see that, that working capital increment occur.

And so that's the summary. I think that from a cash flow perspective, we have our balance for the year, we're still committed to \$1.2 billion. To the extent we get outsized growth, then maybe that's impacted a bit. But again, just want to emphasize that that would be healthy cholesterol.

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Great. Thanks for all the answers. Yeah, sorry. Go ahead.

Q

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

Ruplu, sorry, this is Marshall. And I apologize, I'm recovering from a cold. Just to follow up on Rich's comment about Hyve and the growing business from the new ramp, we did see that that did impact free cash flow in quarter two, as I've said in my prepared commentary, we expect that to reverse in quarter three. The other thing that we wanted to call out is that in many cases, when Hyve is onboarding new customers, there's quite a bit of investment that we do up-front on that, that does serve as a headwind to margins. But over the course of the coming quarters, in the second year of the programs, that's typically when we make that – the margin and we get the returns for the program of the partnership that we've set or established with our customer. And with the case with this one, what typically happens with Hyve is as we grow the businesses, we start to see a more sticky relationship with our customers. That's a great attribute and strength of the Hyve team. We expect the same thing with this customer that we're ramping today.

A

Ruplu Bhattacharya

Analyst, BofA Securities, Inc.

Got it. Thanks for all the details, Rich. Congrats to you and look forward to keeping in touch. And Patrick, look forward to working with you.

Q

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

Thanks a lot.

A

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Thank you, Ruplu, for your kind words.

A

Operator: Our next question comes from Joseph Cardoso with JPMorgan. Please go ahead.

Q

Hi. Thank you for taking [audio gap] (00:27:53). This is [ph] MP (00:27:57) on for Joe Cardoso. I just wanted to ask your thoughts on the magnitude of PC recovery into the second half and how material [indiscernible] (00:28:07) PCs will be towards that side. Thank you.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

Yeah. So I'm going to take that question. So again, we are – quarter after quarter we see sequential improvement of the PC market. I mean, this quarter we were back to growth. And so we are expecting that growth to continue to improve quarter after quarter. So we are confident for the second half. We believe the PC market should continue to benefit from three tailwinds. The first one is the refresh of the PC bought during the pandemic. The second is Windows 11. And then, as I mentioned before, the AI PCs are ramping up. We will see an acceleration

A

in the second half of the launch of new AI PCs also at the lower price point, and that should benefit the PC market in the second half.

Q

Thank you.

Operator: Our next question comes from Adam Tindle with Raymond James. Please go ahead.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Q

Okay. Thanks. Good morning. And my congrats to both Rich and Patrick. Patrick, I wonder if we could maybe zoom out and see if you could share a few words on your overall vision for the company, particularly around your capital allocation philosophy. Do you think that there's more near-term opportunity for shareholder return or potential M&A and speak to sort of the trade-off between those? As I know you've been in the industry a long time and seen a lot of different capital allocation decisions, so would love for you to share some of your philosophy.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

Yeah. So, again, in terms of overall, I would say, prospects, I mean, first, one of the – our big differentiator is we are positioned on all the critical technologies in the industry and we know that for the coming years, especially thanks to AI, I mean, most of those technology sectors are going to benefit from AI. So end to end portfolio, that's a big, big strategic advantage for the future. Second, we are global and obviously our position in the various markets differ, we have countries where we have a low share. So again, we will continue to invest in those countries where we see nice prospects. Good example would be India, an accelerator. And third, it's in services. I mean, we believe that there are opportunities in services, again to support our resellers, but I see some positive prospects which obviously will be accretive.

In terms of capital allocation, for the moment, as you know, I mean, our plan is to return 50% of cash flow to the shareholders. So for the moment, I would say I'm very comfortable with it.

In terms of M&A, I see M&A as an opportunity to accelerate our growth plans. I mean, we've always been extremely diligent, okay. So we have financial metrics when looking in M&A, but I mean, I can see in some geographies, again, in – particular in APJ or in Latin America to some extent also in Europe and for some specific technologies, there are some M&A opportunities. And clearly, if we can, I mean, work on one of those opportunities, that will be favorable to it. But if you exclude M&A, I mean, I think today the 50% capital allocation and return to shareholders is a good start. And yeah, we will review it in the future based on how the situation evolves.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

And Adam, this is Marshall, just to add a couple things around our capital allocation framework. For the first half of the year, we had quite a bit of a participation in the Apollo secondaries that elevated our first half share repurchases to about \$450 million, when you add the dividends for the first half, we came in around \$520 million in return to shareholders. We expect to match the overall expected cash flow for the year of \$1.2 billion, so there

will probably be about \$50 million to \$60 million between dividends and share repurchases by quarter in the second half putting us right around that \$610 million to \$630 million range for the full year.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Q

Got it. That's helpful, Marshall. I hate to pick on you, I'm sorry that you're not feeling good right now. But on the Hyve situation here, it was very helpful for you to outline that use of cash in the quarter. I think if I did the math here, it's about a \$350 million swing factor related to Hyve. And if I compare that to your typical working capital to revenue ratio, it seems like that could be a pretty meaningful revenue driver going forward from that investment. It's not quite evident to us based on the Q3 guide, but I wonder if you might speak to some of the future timing and magnitude of the financial benefit from the investment that you're making in Hyve right now or have made in the quarter?

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Sure. So, I'll go back to my comments I made a little bit ago about in many of our partnerships that we have with onboarding accounts, and as you know, this is a significantly meaningful opportunity for us, we do make investments that create a little bit of a headwind on the margin profile of the business. And we do expect that to expand as we get into the second year. If I think about the overall growth attributes for Hyve, quite surprised in a positive way in terms of what we initially thought for the quarter, I think we had said that we thought Hyve revenue year-on-year would be down and it was up referencing back to our Strategic Technology (sic) [Strategic Technologies] (00:34:09) portfolio's growth of 15%, Hyve was north of that. So, we really do like the momentum. We see that momentum continuing as we enter into the second half of the year.

If I think about the overall profit profile or margin attributions of Hyve, it does move around quite a bit. As you know, we have what I call [ph] disty (00:34:32) like attributes to Hyve, they're quite meaningful to the stickiness of the relationship. We've got our design and our build attributes, we have the customer design in our build and we have supply, spares and loose, which is in essence a great opportunity to us for fulfill the needs of our hyperscale customers. And finally, there's quite a bit of strategic purchases that we do in advance of demand.

One of the things that I think we'll continue to see is a requirement for us to buy forward on future needs much beyond quarter three and into quarter four and into Q1. Historically, we have seen this in the past whenever there has been growth associated with hyperscale opportunities. So I would say that there is still an overall accretion benefit to the Hyve margin returns. There could be some delays in the cash flows as we continue to invest in our partnership with our customers. And then finally, we still see quite a bit of diversification of our customer base. As you know, it's a slow on ramp, it's a slow sell process, but we're quite positive about where that's heading as an organization.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Q

Do you think that means earnings are going to be flat year-over-year in Q3 based on your guidance, should we kind of continue to expect sort of flat year-over-year trend into Q4 and Q1 based on this?

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Yeah. I think that's a fair assessment. As you know, when we exited fiscal 2022, we had a large inventory position that unwound itself kind of evenly throughout 2023 and with Hyve, a lot of what we carry on the behalf of our

customers, we get paid incremental margin for that carrying cost. And as we sell it through, there's a little bit – more richness associated with that margin that'll make Hyve a tough compare from an overall profit perspective in Q3 and Q4. But if I just think about the actual quality of margin and the growth attributes, I think it's quite positive as we get into fiscal 2025.

Operator: Our next question comes from George Wang with Barclays. Please go ahead.

George Wang

Analyst, Barclays Capital, Inc.

Q

Oh, hey, Patrick, congrats, and looking forward to working with you. And also congrats for Rich as well. I just have just quick question on the margin. Just you guys talked about kind of the impact from netted down revenue and then also potentially, yes, coming for bigger mix as PC grow in the second half. So how should we model kind of the gross margin, operating margin kind of on a sequential basis in the second half [audio gap] (00:37:10) gross margins will come down sequentially from 3Q versus from 2Q? Just how to think about kind of margin, also the kind of expense versus gross billings overall for the second half?

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Let me take that first.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Marshall, why don't you take that one?

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Sure. Yeah. First, as you know, in quarter one, we provided kind of our first next level down of transparency around ES and AS and the margin profiles and we're still kind of getting our sense of what that volatility or a range of outcomes could look like from quarter to quarter. They were fairly consistent for both ES and AS whether it's on a gross billings basis or on a net revenue basis. But as we think about the full year and we commented on this last quarter, we do expect that in the second half of 2024, we will see an increasing proportion of mix tilted more towards Endpoint Solutions, which has a lower gross margin profile. And we would expect that gross margins, whether it's net or gross billings or operating margin, whether it is compared to net revenue growth, should decline around 20 basis points just given that mix shift.

But I want to emphasize within the portfolios themselves quite a bit of healthy structural optimism and quite a bit of normal outcomes that we're seeing. It's just that now we disclosed that it provides a little more transparency in the way that those margins can ebb and flow within those two portfolios. And again, the last thing I would say, which is important to emphasize is our growing Strategic Technology (sic) [Strategic Technologies] (00:38:54) portfolio is now at 25% of gross billings. That's on all-time high. Underneath, when you look at the components which is cloud, security, data analytics, IoT or hyperscale, those tend to grow faster than the overall core business and over the longer term tend to have higher margin attribute.

George Wang

Analyst, Barclays Capital, Inc.

Q

Great. Thank you. I'll go back to the queue.

Operator: Our next question comes from David Vogt with UBS. Please go ahead.

David Vogt

Analyst, UBS Securities LLC

Q

Great. Thanks, guys. And Rich, congratulations. And Patrick, congratulations. Look forward to working with you. Two, if I may, since I know you've said one, but the first question is on Advanced Solutions. Can you kind of flush out some of the commentary around the demand drivers? I think you particularly called out networking being tough. Just want to get a sense for where do you think you are from a normalization perspective relative to what sounded like backlog [ph] flush (00:39:52) last year? And any other comments on any of the categories like storage?

And then one for you, Marshall, maybe digging a little bit deeper on the gross margin commentary, it looks like your markets Endpoint versus Advanced Solutions were basically relatively consistent quarter to quarter and netted down I think you mentioned contributed 27 bps [indiscernible] (00:40:13) gross margin. Just trying to think through kind of what under the surface went on because looks like gross margins only up 9 basis points. So any color there would be helpful, to kind of get a sense for margin profile trajectory in some of the categories. Thanks.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Sure. Do you want me to take that first, Rich and Patrick, and then you can answer the demand drivers?

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Sure.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

Sure.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Let me first address the overall portfolio range or outcomes. As I've said, probably the two biggest drivers to the margin profile. And again, I'm describing it as gross profit as a percentage of gross billings, it came down about 14 bps. The first is the comment I made about the ramping up of our new customer that we won in quarter four but building out and saw some significant ramp, that had some margin pressure as we made some significant investments in that partnership that over the course of the next few quarters and next year should benefit and increase.

And the second, which I'll let Rich and Patrick speak to, is that networking remained soft in general, networking has a higher gross margin profile. So I wouldn't call it kind of a second big contributor, but it certainly was contributor to some of the softness in gross margins for the quarter.

David Vogt

Analyst, UBS Securities LLC

Q

Got it. And then on the trends?

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yeah. This is Rich, if I could. When we look across the Advanced Solutions, actually, when we take a look across the entirety of our business, we've been pretty pleased with seeing flat or growth in just about every category. The only exception to that is the networking. Now, the comments that I would make on networking and we talked about this previously is that from a supply chain perspective, it was the last area to recover. So their backlog runoff went further into last year versus, for example, server, storage, which had good growth in the quarter. So I don't think there is anything systemic around networking, but rather they just have to get through that ramp. But the rest of the advanced technologies for each major category performed pretty well.

David Vogt

Analyst, UBS Securities LLC

Q

And Rich, can you just remind us again where that ramps? Is it this next quarter?

[indiscernible] (00:42:43)

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Throwing the dart at the board, probably October, November.

David Vogt

Analyst, UBS Securities LLC

Q

Okay. Great. Thank you.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

Just very rapidly again, I mean, Q3 last year was very strong in networking because we continued to see the – I mean, basically the backlog converting into billings. Q4 is when we started having a more normalized situation. So I guess the comparables will be easier in Q4. Second thing I wanted to mention is that we see the bookings nevertheless coming back, which is a positive.

David Vogt

Analyst, UBS Securities LLC

Q

Great. Thank you very much, guys.

Operator: Our next question comes from Matt Sheerin with Stifel. Please go ahead.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yes. Thank you. Good morning. And I echo my congratulations to Rich and Patrick on your new roles. I'd like to ask kind of a bigger picture question. I'm hearing relatively positive commentary about demand and outlook, yet you did come in below consensus by more than \$100 million in top line and you're guiding below consensus and guiding just up about 1% sequentially. And given that you're expecting Hyve to be up, it just seems like a demand overall more on the sluggish side. We're hearing that from some peers and suppliers as well. So, I'm trying to reconcile that with your commentary and expectations of a stronger second half. And given that you're guiding just

flat or modestly in August, how should we think about seasonality in the November quarter and how that plays out? Thank you.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yeah. So Matt, thank you for the question and thank you for the kind comments. A couple of things. Again, when we think about the performance of the business relative to sales performance, we really would encourage everybody to focus on gross billings to get away from the netting that takes place when we get back down to net revenue. When you look at the Q2, the actual gross billings growth was about 3% overall and we're guiding in Q3 at the midpoint at about a 5% billings growth overall. So we do see this chronology as we move quarter, quarter, quarter of improvements, improvements, improvements on the top line.

To be candid, I think when we started the year and we were on the call way back in January and we think it could be a little bit higher in Q3 like instead of 5% at the midpoint, maybe 6% or 7%. Yeah, probably, but so it might be a little bit slower trajectory than originally anticipated. But we kind of see 5% at the midpoint as being pretty solid and kind of building from there. So, Marshall, I don't know if you have anything to add.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

No. No, just a couple of things. One, and just to reaffirm what you said, Matt, if I think about quarter three at that 5%, we see ES being a little bit above that in terms of its growth rate year-on-year and AS being a little bit below that 5%. And I just want to make sure that I'm clear on a response I said back to Adam in regards to overall OI or profit portfolio for Hyve. I was speaking to the Hyve attributes for Q3 and Q4, not speaking to the portfolio or the worldwide attributes for TD SYNEX. So I just want to make that clear, respond to that and to close that out, usually what we'll see in terms of Q3 to Q4 seasonality behavior on margin profile is anywhere from a 15-basis-point improvement to a 35-basis-point improvement. We don't see any reason why we wouldn't fall back into that expectation in terms of that sequential margin improvement that typically we experienced between those two quarters.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. If I can just ask a quick follow-up and thank you for that. Just regarding Hyve and you talked about ramping that second customer, could you talk about your existing large customer there and the relationship there? I know it seems like you haven't been growing much. Could you talk about that?

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yeah. Maybe I'll get started and then Marshall could comment. Clearly having growth in our customer number one, clearly seeing design opportunities with regard to new technology, a healthy relationship with customer number one, really no need to – we wouldn't be concerned at this point. We think it's quite a good relationship and we'll continue to take advantage of servicing that customer and winning new business as we move forward.

Matthew John Sheerin

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thanks a lot.

Marshall W. Witt

Chief Financial Officer, TD SYNnex Corp.

Yeah, nothing else to add to that, Rich.

A

Operator: Our next question comes from Keith Housum with Northcoast. Please go ahead.

Keith Housum

Analyst, Northcoast Research Partners LLC

Good morning, guys. And once again, I want to echo what everybody else said here. Rich, it's been a pleasure working with you. Congratulations on the retirement. And Patrick, looking forward to working with you. Maybe just clarification before I ask the question, but Marshall, did I hear you say that gross margins were impacted by 14 basis points due to the investment in that Hyve customer number two this quarter?

Q

Marshall W. Witt

Chief Financial Officer, TD SYNnex Corp.

That was one of the drivers.

A

Keith Housum

Analyst, Northcoast Research Partners LLC

Okay.

Q

Marshall W. Witt

Chief Financial Officer, TD SYNnex Corp.

[indiscernible] (00:48:27) the other was the softer network portfolio. And we knew there would be a tough compare from backlog. But the demand themselves continued to be soft. So it's really, first, the margin profile of the ramping of the new customer, and secondarily, it's the softness in network. And as Rich said, the rest of the portfolio, just in terms of the product lines we're at or above in terms of growth in gross margin.

A

Keith Housum

Analyst, Northcoast Research Partners LLC

All right. That's helpful. I appreciate that.

Q

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

Yes, Keith. Keith...

A

Keith Housum

Analyst, Northcoast Research Partners LLC

Yeah.

Q

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

...it's not uncommon on the front end when you have a big ramp to have some inefficiencies because everything is new and on time. We're pretty confident that, that margin will get efficient and optimized. So it's not sort of a systemic thing, but rather just a ramping thing.

A

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Yeah. All reasonable in my eyes. I appreciate that. I guess Patrick or Rich or whoever wants to take the question, as we think about AI PC, they are still relatively new coming out here. Is there a risk that perhaps customers will put off the purchase of a PC refresh until they start looking at AI PCs and deciding which way they need to go?

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

Patrick?

Patrick Laurent Zammit

Chief Operating Officer, TD SYNnex Corp.

A

Yeah, yeah, I will take it. So again, so at the moment there aren't enough products being launched. So I would say we have the choice – the customers have the choice between, I mean, replacing the existing PCs with, I would say, normal PCs or going more high end. But as, I mean, the lower end AI PCs come to the market, I think that's going to unblock many of the purchases, or at least the customers waiting to see what offerings will be available, that's going to accelerate in the second half. And yeah, that's the way I look at it.

I would add one more thing, which is that when you look at from a software standpoint and Copilot is a very good example, I mean, the workloads which will be enabled, but AI are going to increase and many will run at the edge. So AI PC is really a consideration for the end users today as they think about replacing, I would say, the PCs they bought three, four years ago. So that's the way I look at it.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Okay.

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

Yeah, Keith...

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Thank you.

Richard T. Hume

Chief Executive Officer & Director, TD SYNnex Corp.

A

...at the risk of being repetitive here, so anecdotally, I underline that word, we believe that there is a bit of a gate right now to purchase based on folks waiting until there are more of the OEMs with their products in market, which, as Patrick said, is in the back half of the year. So, there very likely is some constraint on purchase right now until I'll say a larger portfolio becomes available, which we would anticipate, probably in calendar Q4 timeframe.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

So I guess just kind of restating what you're saying here, yes, there's probably some customers out there that are perhaps pausing their investment, but that pause should be relatively short term, we're talking three, six months, not longer term, correct?

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

Agreed.

A

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

That's correct. That's the way we would project it.

A

Keith Housum

Analyst, Northcoast Research Partners LLC

All right. Thanks, guys. Appreciate it. Good luck, Rich.

Q

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Yeah. Thank you, Keith.

A

Operator: Our next question comes from Vincent Colicchio with Barrington Research. Please go ahead.

Vincent Alexander Colicchio

Analyst, Barrington Research Associates, Inc.

Yes. Congrats, Rich and Patrick, and Marshall, feel better. And in terms of PC demand in the quarter, how was the performance by vertical? How should we think about demand by vertical in the second half?

Q

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

Yeah. Maybe I can start and then Patrick can comment. Certainly, from a vertical perspective, we saw, I'll call it, public sector and federal in particular being a little bit slower as they sort of work through budget approvals, et cetera. We do believe that now that that has been cleared up, that there'll be a bit of an opportunity to catch up overall. And I would say that the other verticals are fairly consistent and uniform relative to their digestion or purchase of PCs overall. And long story short, the only one that stuck out a little bit was the public sector with the comments that I'd make. Patrick, I'll turn it over to you for any additional comment.

A

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

Yes. I just would like to add that we see the demand being driven by enterprise and SMB. So these are the two customer segments plus public sector which are driving the demand as we speak.

A

Vincent Alexander Colicchio

Analyst, Barrington Research Associates, Inc.

Okay. Thank you, gentlemen.

Q

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Thank you.

Operator: Our next question comes from Ashish Sabadra with RBC Capital Markets. Please go ahead.

Ashish Sabadra

Analyst, RBC Capital Markets LLC

Q

Thanks for taking my question. Congrats again to both Rich and Patrick. Just one quick clarifying question. Should we still expect the netted down to be 25% to 26% for the full year? And then on the trend, I was wondering if you could discuss the trend, what you're seeing by geos particularly in Americas, Europe and APAC. Thanks.

Marshall W. Witt

Chief Financial Officer, TD SYNEX Corp.

A

Yeah, I'll start with that. We had forecasted for the quarter about 26.5% growth versus net but it came in at 27.5%. So we continue to see the expansion of the netting down of revenues. In my prepared remarks, I had noted that it was about a 400 basis point deterioration or increase in the netted down year-on-year. So it remains quite meaningful.

If I think about what Q3 should look like, I would put about a 27.5% netting down and I would also expect that to be a little bit lower in Q4. Seasonality wise, in Q4, we tend to see just in normal times a little more resurgence of Endpoint Solutions this year because of the way that we're seeing Endpoint Solutions rebounded response from prior year performance. It probably leads me to a 27% to 27.5%. For exact as that that bounce, we continue to just see the expansion of the netting down, but I would go with that 27% to 27.5%. Now I'll turn it over to just commentary for Patrick or Richard around the geo movements.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

Yeah. I just would like – so just to add on the gross to net, when you look at the market trends and we are perfectly aligned with those market trends, software as a service, service will continue to be more and more important in our sales mix. So the gross to net adjustments, I think, will continue to increase over the years because of that trend.

Back to the geography, so in fact, North America and Europe more or less performed the same way with – I mean, slight growth. Europe was interesting because Europe entered into the, so to say, correction a little bit later than North America, but at the moment is basically more or less aligned with the trend in North America. So it's flat to – I should say, low-single digit in those two regions. If you look at APJ, I mean, here we are experiencing double digit growth driven in particular by data center, lots of investments in data centers in, I would say – I would call them the Tier 2 CSPs, which benefit us in the region.

Ashish Sabadra

Analyst, RBC Capital Markets LLC

Q

Thanks. Thanks a lot.

Operator: Our final question comes from Alek Valero with Loop Capital. Please go ahead.

Alek Valero

Analyst, Loop Capital Markets LLC

Q

Hey, guys. Thanks for taking my questions. This is Alek on for Ananda. My question is, what is a good way to think about the GenAI impact to SYNEX's revenue or revenue growth over the next few years from PCs, phones [indiscernible] (00:57:07) and other offerings? And additionally, if you can quickly touch on its impact to margins and the cash conversion cycle as well.

Patrick Laurent Zammit

Chief Operating Officer, TD SYNEX Corp.

A

So maybe I start. So I mean, GenAI requires a lot of compute and a lot of optimization of your infrastructure. So I mean, not only in software, of course, we're going to see the benefits, but basically companies will have to upgrade their servers, their switches, their storage. So we see the impact of GenAI being very pervasive across most of our technologies, which obviously is going to be a very nice prospect for the future. So yeah, very – again, GenAI I think is a very nice opportunity for the IT industry in general and of course for us in particular.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

A

Yeah. Alex (sic) [Alek] (00:58:09), thanks for the question. As we had said, I think a quarter or two ago, the big opportunity for AI for us will be seen in what I would call the legacy products that are now made more intelligent by AI. And that, as Patrick said, is going to likely lead to more robust configurations across the board and could cause a bit of an acceleration over a continuum for demand because people will want to get to the newest technology. Sort of as it relates to the working capital and how what dynamics play out there, I believe that we'll continue pretty much with the current terms and conditions that we have. So not to say that this won't change in the future, but there's not anything that is immediately visible to us which would say that there's going to be a paradigm change in business model.

The last comment that I would make, it's a general rule of thumb. So we'll see if it carries forward here. But generally, as vendors move to new technology, there usually are two phenomenon. The first is, there's – as they skill there people and get them prepared for those new sales, they generally move some of the legacy things that might have existed more into the channel. So we've historically seen a shift, if you will, of where the legacy technologies to be served more broadly by the channel.

And then the second phenomenon is that generally, in order for the business partner ecosystem to really get focused in making sure that we're enabling the entire business partner ecosystem properly, generally there are premium incentives to motivate the entire ecosystem to move there. Too early to tell right now, let's see what happens. But those would be the comments around what the future might look like.

Alek Valero

Analyst, Loop Capital Markets LLC

Q

Awesome. Very helpful, guys. Thank you very much.

Operator: This concludes the question-and-answer session. I will now turn the call back over to Rich for closing remarks.

Richard T. Hume

Chief Executive Officer & Director, TD SYNEX Corp.

I would like to thank all of our TD SYNEX coworkers around the world for all that they do in dedicating themselves to our customers and vendors and shareholders. Obviously, they're the ones that make it happen day in and day out. And again, thanks to all of you who have been on the journey with us, and we really appreciate your continued engagement and interest in TD SYNEX. And with that, I wish you all a great day. Thank you very much.

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

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