SMART Global Holdings 4th Quarter Fiscal 2021 Earnings Call
October 12, 2021

Thank you, operator. Good afternoon and thank you for joining us on today's earnings conference call and webcast to discuss SGH's fourth quarter and full year fiscal 2021 results.

Joining me today are Mark Adams, Chief Executive Officer, Jack Pacheco, Chief Operating Officer, and Ken Rizvi, Chief Financial Officer. We opened the webcast today with a corporate video that highlights our newly launched SGH brand. To learn more about our new identity, visit SGHCorp.com. In addition, you can find the accompanying slide presentation and the earnings press release for this call on this new website. We encourage you to go to this site throughout the quarter for the most current information on the company, including information on the various financial conferences we will be attending.

Before we begin the call, I would like to remind everyone to read the forward-looking statements information that we have included in the earnings press release and the earnings call presentation. Please note that certain of the statements made today may constitute forward-looking statements and that these statements are our present expectations, and that actual events or results may differ materially. We will also discuss both GAAP and non-GAAP financial measures. Non-GAAP measures should not be considered in isolation from, as a substitute for, or superior to our GAAP results. We encourage you to consider all measures when analyzing our performance. A reconciliation of GAAP to non-GAAP measures is included in today's press release.

We will begin the call with CEO, Mark Adams, who will provide a business update, and then Ken Rizvi, CFO, will review the financials and forward guidance, after which - we will take questions. Mark?

Thank you, Suzanne and to all of you for joining us today. I am pleased to report that we completed fiscal 2021 with outstanding fourth quarter results and are entering fiscal 2022 with strong momentum.

In many ways, fiscal 2021 was a milestone year for SGH. We closed the acquisition of CreeLED, and with that, reorganized the company into three lines of business: Intelligent Platform Solutions under the Penguin brand, Memory Solutions under the Smart Modular brand, and LED Solutions under the Cree LED brand.

Our three businesses share a common operating model in that they all deliver custom solutions that address the requirements of the niche markets they serve, leveraging core capabilities in engineering, manufacturing, managed services and quality.

I couldn't be more proud of our team; that in a year of unprecedented macro challenges – from the COVID pandemic to microelectronic supply chain constraints – our businesses rose to the challenge and were able to deliver outstanding results.

Let me share a few highlights from the fourth quarter and our fiscal year 2021:

- Total revenue was $1.5 billion in fiscal 2021, an increase of 34% year-over-year,
- Non-GAAP gross margins reached 22%, up 240 bps from the prior year. And in Q4, we recorded gross margins of 26.4%!
- We achieved a more diversified mix of business, with Memory Solutions accounting for just 53% of Q4 revenue, down from 77% one year ago.
- Each of our individual businesses achieved outstanding results, from record revenues at Penguin, to new customer wins in new vertical markets at Smart Modular, to significant gross margin expansion at Cree LED.
- On the governance side, in the midst of our long-time largest shareholder, SilverLake, divesting of their ownership position, we appointed Sandeep Nayyar as lead independent director on the Board. In addition, with the recent announcement of Penny Herscher joining the SGH board, we are reinforcing the company's commitment to greater independence, diversity, and public company board experience
- We've also made great progress on our ESG initiatives and released our inaugural ESG report for 2020, highlighting what we've accomplished to date and our long-term commitment to creating a sustainable future.
- And as some of you may have noticed, we've launched our new "SGH" brand and website, to more accurately reflect our mission of powering growth and expanding possibilities in everything we do.

We made great progress in the execution of our growth and diversification strategy in FY 2021 and believe our go forward investment thesis is compelling! We have built an outstanding leadership team and are well positioned across each of our lines of business by driving innovation in the specialty markets we serve. We are pleased by the progress to date but even more excited by the tremendous opportunities for profitable growth that lie ahead.

I will now provide some more detail of our Q4 performance from each line of business:

Starting with the **Intelligent Platform Solutions Group**, or **IPS**, which turned in another strong quarter and record revenue of approximately $98 million - 46% higher than the same quarter a year ago. Gross margins were up sequentially due primarily to a higher mix of managed services.

As a reminder, we've previously discussed the potential variability of IPS revenues and gross margin percentages due to the timing of deployments quarter-to-quarter. The IPS team continues to make progress on its managed services growth initiatives, with total software and managed services revenue growing by 40% in Q4 FY21 vs. Q4 of last year.

Turning to customer highlights, we received two awards from the Department of Defense High Performance Computing Modernization Program totaling $68M for the Navy and Air Force Supercomputing Resource Centers. For both awards, we will deliver Penguin Computing's TrueHPC platform, plus managed services and high-performance storage. TrueHPC systems are complete solutions, equipped with the most advanced processing technology coupled with the latest memory solutions, making them ideal for HPC simulation applications in tech research.

Our systems will be among the most powerful supercomputers in the DoD's portfolio. This win is an example of the progress we continue to make in expanding our engagements with existing and new customers in the federal, ultra-scale, financial, and oil and gas sectors.

In Q4, Penguin Computing released major updates to Scyld ClusterWare, Scyld Cloud Manager, and Scyld Cloud Workstation software solutions. These software enhancements focus on performance scaling and security to deploy and manage complex HPC solutions.

We are seeing customer demand continue to grow -- with a bias towards complete solutions. IPS is well positioned to meet this demand with our hardware and software expertise, 20 years of experience in HPC and AI, and our cloud and services offerings. We are excited about the solid performance of IPS and continue to strengthen our new business funnel to drive more growth potential going forward.

In our **Memory Solutions Group**, revenues grew by seven percent q4 FY 21 vs. q4 FY20, to reach $247 million. Excluding the impact due to the customer revenue reclassification from a gross to net basis, that we discussed on the Q3 call, revenues would have been up 23 percent from the year-ago quarter on an apples-to-apples basis.

The team continues to make progress expanding our customer base and developing new vertical market solutions. One such success is the work we are doing for a large hyper-scale data center customer where memory requirements are becoming more critical to overall system performance.

The specific design requirements from large data center companies play to our strengths stemming from our long history of developing highly focused, engineering driven and application specific solutions. In this instance, we delivered a high-performance accelerator card that provides memory expansion and offloads selected algorithms from any Host CPU by moving the compute processing near the data, enabling parallel execution with very low latency.

We continue to invest in new memory-based products and technologies. In Q4, we delivered first samples of memory modules based on the new CCIX standard to a leading server manufacturer. CCIX is an emerging standard that improves performance by offloading certain compute functions to the memory module. The CCIX module is designed for emerging applications such as AI and machine learning.

In our Brazil business, we successfully concluded our Internal Gen 4 SSD qualification and began our Gen5 SSD qualifications process. In addition, we launched our high density uMCP solution for 5G Smartphones, which is our first product in Brazil utilizing the UFS interface for lower power and greater storage capacity.

Now turning to our **LED Solutions Group**, which had an outstanding quarter. Revenues grew to $123M in Q4 in what is historically a strong quarter for the LED business. Gross margins were higher in the quarter as we were able to both meet the increased demand in the specialty markets we serve as well as advance on the execution of our manufacturing transformation, moving from silicon carbide to sapphire wafers and from a captive manufacturing model to an outsourced capital lite model.

Cree LED's technology portfolio is a key competitive advantage. Our focus on the high performance and specialized portions of the LED market, including the High and Mid-Power general lighting segment, Video and Specialty Lighting segments, reinforces our market leadership position. We are investing in new technology areas where tomorrow's growth will come from. Examples of emerging trends we are following include improving lumen density, human-centric, or "natural" lighting, and UV-C LEDs for disinfection and purification.

On the product front, the team continues to deliver innovative application-optimized LED's enabling a variety of lighting designs while achieving the best system value. Recent highlights of these efforts include;

- the launch of our 3rd generation Extreme High Power, or XHP, products with improved optical performance,
- Next, the introduction of our brighter XPG3 White S line products, which are optimized for directional, high lumen lighting applications such as roadway and horticulture, and
- the expansion of our J-series line to deliver application specific horticulture and architectural solutions.

As this is our first full quarter of Cree LED as part of SGH, I would like congratulate Claude, his team and all of the Cree LED employees worldwide on the great results. The complexity of a carve out acquisition, while in the midst of a transformation in manufacturing at the scale we are talking, makes their performance even more impressive.

In closing, fiscal 2021 was indeed a milestone year for SGH. Our top line grew both in our existing businesses and at our recently acquired Cree LED business. Our gross margins improved dramatically with contributions from each of our businesses. We also demonstrated good financial discipline at the operating expense level; all of which led to outstanding bottom line results.

As strong as FY 2021 was in term of overall performance, we are even more excited about FY 2022. We are developing and attracting outstanding talent. We are investing in new capabilities to provide more value for our customers. And we are targeting high growth market segments such as AI, Machine Learning, Data Analytics, In-Memory Compute, Edge Computing and Advanced LED lighting technologies. Clearly, our future at SGH is bright!

At this time, I'll hand it over to Ken for a more detailed review of the financials and our guidance for next quarter. Ken?

Thanks Mark.

We exited the year with another strong quarter of results as well as a great year of overall performance. As Mark mentioned earlier, we have focused on three businesses, our Intelligent Platform Solutions Group, our Memory Solutions Group and our LED

Solutions Group. As of our fiscal year end and going forward, we will be reporting along these three segments externally at both the revenue and operating income level and will be providing our gross margins at the overall SGH level only. The fourth fiscal quarter of 2021 demonstrates how our strategy is continuing to play out with strong performance across all our three businesses.

Now turning to our fiscal 2021 and fourth quarter results. I will focus my remarks on our non-GAAP results, which are reconciled to GAAP in our press release tables.

As Mark mentioned earlier, we reported a strong year of performance in our fiscal year ending August 2021. Revenues for fiscal 2021 were up approximately 34 percent to a record $1.5 billion, driven by strong performance across all of our businesses. Intelligent Platform Solutions grew by approximately 30 percent on a year over year basis to a record ~$345 million. Memory Solutions grew by approximately 9 percent on a year over year basis to ~$932 million. In addition, LED solutions contributed approximately $225 million in sales during our fiscal 2021.

Non-GAAP gross margin in fiscal 2021 was up by approximately 240 basis points to 22.2% from prior year non-GAAP gross margin of 19.8%, driven both by our accretive LED Solutions acquisition and IPS.

For fiscal 2021, non-GAAP diluted earnings per share was $5.22 up from $2.59 in fiscal 2020 and adjusted EBITDA was $188M up approximately 80 percent from $104 million in fiscal 2020.

Let me now turn to our fourth quarter results. We reported another strong quarter in our fiscal fourth quarter with all key metrics above the mid-point of our guidance range. Net Sales for the fourth quarter were approximately $468M, a record for the company and an increase of 57 percent year-over-year from the fourth quarter of fiscal 2020, and up 7 percent sequentially. In addition, non-GAAP gross margin came in at a record 26.4% and non-GAAP diluted earnings per share was a record $2.16 for the fourth quarter, both above our guidance.

Turning to our non-GAAP operating highlights. On a year over year basis, total SGH revenues grew by approximately 57 percent in the fourth quarter, helped by the incorporation of Cree LED into SGH, which added approximately $123M of sales in the quarter. Excluding Cree LED, our revenues grew by approximately 16 percent on a year over year basis, mainly driven by IPS which grew by 46 percent and Memory Solutions which grew by 7 percent.

For the fourth quarter, IPS had quarterly revenues of approximately $98 million, a record for that business. As we have discussed in our previous earnings calls, the IPS business will continue to have quarter to quarter variability in revenue and gross margins based on the timing of hardware, software and managed services in any given quarter.

Our Memory Solutions Group had revenues of approximately $247 million in the fourth quarter. Revenue grew primarily from continued growth of our Specialty Memory business.

Our LED Solutions group had revenues of approximately $123 million in the fourth quarter. This growth was driven by stronger overall demand for our high power products and the benefit of an additional week for the LED business versus the 12 weeks in the third quarter based on the timing of the transaction close in March. In the fourth quarter, we also had a one-time catch up in revenue, as we were able to fulfill pent up demand with an easing of a specific supply chain constraint. As we head into the first quarter of fiscal 2022, we anticipate revenues for LED Solutions to come down sequentially to a more normalized level. We continue to migrate towards a fab-lite structure, enabling a more flexible operational model to better manage fluctuations of demand and supply. As discussed at our Analyst Day, we continue to expect this business to grow at a mid-single digit CAGR on a longer term basis, but anticipate some seasonality and variability quarter to quarter.

Non-GAAP gross margin for the fourth quarter was a record 26.4 percent, up from 21.9 percent in the prior quarter, and up from 19.5 percent in the fourth fiscal quarter of 2020. Gross margins for SGH were helped by stronger margin performance from the LED Solutions Group as well as IPS which benefited from higher margin software and managed services mix in the fourth quarter. As we have discussed in the past, our IPS business will have variability in its gross margin profile quarter to quarter based on the mix of hardware, software and managed services. In addition, in the fourth quarter, we did have a one-time benefit to gross margin within LED solutions, related to the sale of previously reserved parts.

Operating expenses for the fourth quarter were approximately $57.0M up from $29.4M in the fourth quarter of 2020. Operating expenses were up primarily due to the inclusion of LED Solutions, continued investments in IPS, as well as increased bonus in the fourth quarter of 2021. In addition, operating expenses benefited from approximately $7.8 million in financial credits in Brazil. This helped offset our Brazil R&D spending, which is required to realize this credit. As discussed during our last earnings call, the current law related to these specific financial credits is expected to expire in the beginning of calendar year 2022.

Non-GAAP diluted earnings per share for the fourth quarter of 2021 was 2.16 cents per share, compared with 1.39 cents per share in the third quarter, and up 163 percent from 82 cents per share in the fourth quarter of 2020.

Adjusted EBITDA for the fourth quarter of 2021 was $75.9M, or approximately 16 percent of sales, compared to $33.0M or approximately 11 percent of sales in the fourth quarter of 2020.

Our breakdown of net sales by **end market** for the 4th quarter of 2021 was as follows:

Mobile & PCs	23%
Network & Telecom	11%
Servers & Storage	12%
AI/Data Analytics/Machine Learning	13%
Advanced Lighting	26%
Industrial, Defense and Other	15%

Turning to working capital. Our net accounts receivables totaled $313.4 million compared with $274.9 million last quarter. Days sales outstanding came in at 39 days, flat with last quarter on a days basis.

Inventory totaled $363.6 million at the end of the fourth quarter, compared with $289.0 million at the end of the prior quarter. This growth was driven by additional inventory for our Memory Solutions Group, including our supply chain business where we are not the risk taker for inventory purchased on behalf of our customers. In addition, we built up inventory for our IPS business in the fourth quarter to support shipments early in our fiscal first quarter. Inventory turns were 6.8 times in the fourth quarter, versus 7.7 times in the prior quarter.

Consistent with past practice, accounts receivables, days outstanding and inventory turnover are calculated on a gross sales and cost of goods sold basis, which were $738.5 million and $620.7 million, respectively, for the fourth quarter.

As a reminder, the difference between gross revenue and net sales is related to our supply chain services business, which is accounted for on an agency basis. Meaning that we only recognize as net sales, the net profit on a supply chain services transaction.

Cash and equivalents totaled $223 million at the end of the fourth quarter, which was $34 million higher than the previous quarter.

Fourth quarter cash flow from operations totaled $48.0 million, compared with $49.3 million in the prior quarter. For fiscal 2021, cash flow from operations totaled $153.4 million.

For those of you tracking cap ex and depreciation, cap ex was $47.6 million for the year and $7.6 million for the quarter, and depreciation was $9.4 million for the quarter.

And now turning to our fiscal first quarter 2022 guidance. We expect our net sales for the first quarter of 2022 will range from approximately $440M to $480M.

Our GAAP gross margin for the first fiscal quarter of 2022 is expected to be between 24 and 26 percent. Non-GAAP gross margin for the first quarter of 2022 is expected to be approximately 25 to 27 percent as we expect a higher mix of software and managed services related to our IPS business which is expected to help SGH's overall gross margins for the quarter.

Our non-GAAP operating expenses are expected to be in the range of $54 to $59M in the first quarter of 2022.

GAAP diluted earnings per share is expected to be approximately $1.20 cents plus or minus 20 cents. On a non-GAAP basis, excluding share-based compensation expense, intangible asset amortization expense, convertible debt discount and other adjustments, we expect non-GAAP diluted earnings per share will be approximately $2.00 cents plus or minus 20 cents.

Cash capital expenditures for the first fiscal quarter are expected to be in the range of $10 to $12M. Cash capital expenditures for fiscal 2022 is expected to be approximately $60 to $65 million, and includes approximately $10-15M of integration related capital expenditures for LED Solutions.

Our GAAP diluted share count for the first quarter of fiscal 2022 is expected to be approximately 27 million shares, based on our current stock price. Our non-GAAP diluted share count for the first quarter of fiscal 2022 is expected to be approximately 26 million shares as it includes the benefit of our convertible note capped calls.

Our forecast for the first fiscal quarter is based on the current environment, which contemplates the constraints in the global supply chain.

Please refer to the non-GAAP financial information section and the reconciliation of GAAP results to non-GAAP financial measures and the reconciliation of GAAP net income to adjusted EBITDA tables in our earnings press release for further details.

Let me turn the call back to Mark for some concluding comments before we open the call to questions. Mark?

Thanks Ken.

Prior to when I became CEO of SGH over a year ago, I was aware of the long history the company had in memory; both the specialty business as well as our Brazilian operations. What I didn't have as much of an appreciation for, until I joined, was the opportunities in our computing business, now called Intelligent Platform Solutions. When you factor in the acquisition of Cree LED on top of that…we truly are a much different company!

Today, we are literally installing one of the largest high performance computer systems in the world. Our LED technology is making the world safer enabling lighting solutions for the emergency vehicles segment. Our specialty memory solutions are at the core of high bandwidth networks enabling access to data anywhere in the world in an instant. There are many more examples of how SGH is powering growth and expanding possibilities.

We set record revenues in Q3 and Q4. We achieved gross margins of 26% in Q4 up by almost 700 basis points compared to the same quarter a year ago, ultimately leading to a q4 EPS of $2.16. Our team at SGH feels we are building something very special and couldn't be more excited about our future.

Thank you all again for joining our call. Operator, please open the lines for Q&A