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JBL.N - Q1 2021 Jabil Inc Earnings Call

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OVERVIEW:

Co. reported 1Q21 net revenue of $7.8b, GAAP operating income of $314m and GAAP diluted EPS of $1.31. Expects FY21 core EPS to be $4.60. Expects 2Q21 total Co. revenues to be $6.2-6.8b, core operating income to be $210-260m and GAAP diluted EPS to be $0.60-0.82.

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PRESENTATION

Operator

Greetings and welcome to the Jabil First Quarter of Fiscal Year 2021 Earnings. (Operator Instructions)

As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Adam Berry, Vice President of Investor Relations.

Adam Berry - *Jabil Inc. - VP of IR*

Good morning, and welcome to Jabil's First Quarter of Fiscal 2021 Earnings Call. Joining me on today's call are Chief Executive Officer, Mark Mondello; and Chief Financial Officer, Mike Dastoor.

Please note that today's call is being webcast live, and during our prepared remarks, we will be referencing slides. To follow along with the slides, please visit jabil.com within our Investor Relations section. At the conclusion of today's call, the entire call will be posted for audio playback on our website.

Before handing the call over to Mark, I'd like to now ask that you follow our earnings presentation with the slides on the website beginning with the forward-looking statement. During this conference call, we will be making forward-looking statements, including, among other things, those regarding the anticipated outlook for our business such as our currently expected second quarter and fiscal year net revenue and earnings. These statements are based on current expectations, forecasts and assumptions involving risks and uncertainties that could cause actual outcomes and results to differ materially. An extensive list of these risks and uncertainties are identified in our annual report on Form 10-K for the fiscal year ended August 31, 2020, and other filings. Jabil disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

With that, it's now my pleasure to turn the call over to Mark.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Thanks, Adam. Good morning. I appreciate everyone taking time to join our call today. I'll begin by offering my sincere gratitude to all of you here at Jabil. And thanks for hanging in there during these trying times, while making safety your #1 priority. At Jabil, we're fundamentally in the people business. The manner in which we care for and accept one another is truly what makes us who we are today, and again, thank you.

Let's please turn to Slide 5, where we'll look at our results for the first quarter. The quarter came in well ahead of expectations. As the team delivered core operating income, of $365 million on record revenue of $7.8 billion, resulting in a core operating margin of 4.7%. The 4.7% margin is a 100 basis point increase year-on-year, Q1 '21 to Q1 '20, which, as a reminder, was a pre-COVID quarter occurring in September, October and November of 2019. Moreover, I'm really pleased with the financial makeup of the quarter, well-balanced contributions from our EMS and DMS segments, supplemented with substantial upsides from our cloud computing, connected devices and mobility sectors. Q1, overall, gives us excellent momentum to what looks to be another outstanding year. As is customary, Mike will provide more detail around our Q1 results, during his prepared remarks.

Moving to Slide 6. You'll see a terrific illustration, which underscores the effectiveness of our team. When I look at this slide, what gets me most enthused is the fact that we get 1 + 1 = 3 in so many ways across our 2 business segments. One example of this are the financial goals and objectives for each segment. Our DMS segment focuses on expanding margins while offering reliable cash flows, while our EMS segment focuses on expanding cash flows while offering reliable margins; perfect complements that fortify our financial results. These 2 segments play side by side, underpin our resiliency, especially when an individual product or product family is faced with a macro disruption cyclical demand or unforeseen market dynamics.

Speaking of a macro disruption. Today more than ever, I look at Jabil as an essential business and a trusted partner. Essential and trusted in a sustainable sense, knowing that Jabil is a primary manufacturing partner that supports a few trillion dollars of market value. Day in and day out, we deliver high-quality products, while solving and simplifying complex challenges for the customers we so humbly serve. Add to this, the collaboration embedded in our model, plus the deep domain expertise and a long-standing culture of always doing what's right. It's a proven formula, which stimulates progress.

And since we're on the topic of progress, let's turn to Slide 7, where we see management's outlook for the year. Not only is the company well positioned to exceed our financial goals around margins for the year, but we're now predicting core earnings per share will be in the range of $4.60, up 15% compared to 90 days ago and up 55% to 60% when compared to fiscal year '20. This meaningful increase to earnings is largely driven by 2 catalysts. The first being our well-diversified commercial portfolio, which gives us a firm and steady foundation on which to operate our business. And the second, being the reduction of our net interest expense, driven by proactive steps we've taken over the past 9 to 12 months.

I'd like to offer another round of thanks to our employees. Your stamina and collective efforts in placing the needs of the customer first has enabled an additional $1 billion of revenue for the year, a wonderful mix of revenue and leverage, allowing us the opportunity to raise our core margin by 10 basis points to 4.1% for the year. A clear reflection of our actions, specifically, when it comes to margin expansion, and growth of earnings. Furthermore, we'll give continued attention to core areas of differentiation and investment. Areas like our homogenous IT framework, factory automation and machine learning, back office data analytics and specialized supply chain tools, all in the name of greater efficiencies and performance.

In closing this morning, I do want to share a thought that encompasses our team. Delivering for shareholders and serving our customers is a must. But we'll only do so by respecting our environmental and social responsibilities, while also safeguarding Jabil's workplace to ensure every Jabil employee can be their true self, with acceptance of individual differences. With that, please keep safe, and I wish all of you a peaceful holiday.

I'll now turn the call over to Mike.

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Thank you, Mark, and good morning, everyone. Q1 was an exceptional quarter. The team delivered record results on 3 fronts: revenue, core operating income and core diluted earnings per share. We saw broad-based strength across both segments, which allowed us to deliver financial results that came in above what we expected in September.

Our overperformance in the quarter was largely driven by 3 factors. For starters, our multiyear journey to both diversify and reposition the company continues to pay dividends. During the quarter, our health care, automotive and semi cap businesses all performed at or near the high end of our expectations for the quarter. Consequently, these results alone would have put us near the top end of our guidance range for Q1. On top of this, during the quarter, a few of our highly regarded strategic customers in our mobility, connected devices and cloud businesses experienced unexpected high levels of demand in Q1, which caused revenue to come in much higher than expected. Clearly, our value proposition across key end markets continues to resonate with customers as a result of our unique set of capabilities in design, engineering and global supply chain and manufacturing.

And then finally, our interest and tax expense came in better than expected. The proactive steps we've taken over the last few quarters to bolster our balance sheet afforded us the flexibility to efficiently access the debt capital markets, thereby reducing net interest expense during the quarter. The compounding effects of higher-than-expected revenue and the associated leverage, along with lower interest and tax expense, allowed us to deliver record revenue, core operating income and core diluted earnings per share in Q1.

With that, I'll now review our Q1 financial results. Net revenue for the first quarter was $7.8 billion, $800 million above the midpoint of our guidance range. On a year-over-year basis, revenue increased by $300 million or 4% despite our strategic shift to a consignment model within our cloud business. GAAP operating income was $314 million, and our GAAP diluted earnings per share was $1.31. Core operating income during the quarter was $365 million, an increase of 32% year-over-year, representing a core operating margin of 4.7%, a 100 basis point improvement over the prior year.

I am particularly pleased with solid operating leverage as a result of our optimized cost structure and strong demand. As I mentioned a moment ago, our net interest expense came in better than expected at $34.4 million, approximately $13 million better than expected and our core tax rate was also better than expected at 25.7%. Core diluted earnings per share in Q1 was $1.60, a 52% improvement over the prior year quarter.

Now turning to our first quarter segment results. Revenue for our DMS segment was $4.2 billion, an increase of 13% on a year-over-year basis. As I mentioned earlier, the strong performance in our DMS segment was extremely broad-based. Core margins for the segment improved 70 basis points over the prior year to 5.7%. It's worth noting, during Q1, we saw an abrupt and unanticipated intra-quarter strengthening of the renminbi versus the U.S. dollar, which weighed on our DMS core margins by an estimated 50 basis points. Nonetheless, an incredible performance by the team. Revenue for our EMS segment also came in strong at $3.6 billion, reflecting robust demand in semi cap, digital print and cloud. Core margins for the segment came in at an impressive 3.4%, 100 basis points higher than the previous year and well above expectations.

Turning now to our cash flows and balance sheet. In Q1, inventory days came in better than expected at 55 days. Cash flows provided by operations were $65 million in Q1 and net capital expenditures totaled $242 million. We exited the quarter with cash balances of $1.1 billion. We ended Q1 with committed capacity under the global credit facilities of $3.8 billion. With this available capacity along with our quarter-end cash balance, Jabil ended Q1 with access to more than $4.9 billion of available liquidity, which we believe provides us ample flexibility. During Q1, we repurchased approximately 1.5 million shares for $50 million.

Turning now to our second quarter guidance. DMS segment revenue is expected to increase 22% on a year-over-year basis to $3.5 billion. This is mainly due to strong end market outlook and a favorable year-over-year comparison. EMS segment revenue is expected to be $3 billion, a decrease of 8% on a year-over-year basis, reflective of our previously announced transition to a consignment model in the cloud business. We expect total company revenue in the second quarter of fiscal '21 to be in the range of $6.2 billion to $6.8 billion for an increase of 6% on a year-over-year basis at the midpoint of the range.

Core operating income is estimated to be in the range of $210 million to $260 million, with core operating margin in the range of 3.4% to 3.8%. Core diluted earnings per share is estimated to be in the range of $0.83 to $1.03. GAAP diluted earnings per share is expected to be in the range of $0.60 to $0.82.

Next, I'd like to take a few moments to highlight our balanced portfolio of businesses by end market. Over the last several quarters, we've repositioned our business to serve critical and long life-cycle products, while also providing the foundation for predictable, yet strong cash flows and margins. As part of this journey, we've reshaped and will continue to reshape the portfolio, further improving the mix of our business.

Our DMS business is in incredibly good shape today, headlined by a nearly $5 billion health care and packaging business, which serves many of the most critical health care, medical device and consumer packaged goods companies in the world. The convergence of technology in our daily lives, expedited by 5G and remote work and learn environments continues to drive our mobility and connected devices business.

With over 50 years of experience serving the automotive industry, including a 10-year partnership with the world's leading electric vehicle manufacturer, we are well positioned for continued growth. Jabil has made an intentional and early shift towards supporting technologies that enable autonomous, connected and electrified vehicles. Our investments and expertise in these areas have allowed us to capture new business with some of the world's leading OEMs and Tier 1s.

In EMS, we participate in the design, product development, industrialization and manufacturing of some of the most sophisticated tech products in the marketplace today. Supporting these markets requires an ability to manage large, complex material supply chains with sophisticated IT systems that enable us to manage change and mitigate potential risk to our customer supply chain at a rapid pace. Today, our EMS business serves a diverse plan of end markets and areas that provide us with confidence in future earnings and cash flow generation.

In summary, I'm extremely pleased with the robust start to the year. For the year, we now anticipate revenues will be up roughly $1 billion from prior guidance, and core operating margin has increased 10 basis points to 4.1%. This improved outlook translates to core earnings per share of $4.60 for the year. And importantly, despite the stronger-than-expected growth and associated working capital, we remain committed to delivering free cash flow in excess of $600 million for the year.

We've been working extremely hard as a team to grow margins, cash flows and positively impact our interest and tax. I am very pleased with our team's exceptional execution of our strategy on all fronts. I would like to wish each and every one of you a safe and happy holiday.

With that, I'll now turn the call over to Adam.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Thanks, Mike. As we begin the Q&A session, I'd like to remind our call participants that per our customer agreements, we cannot address any customer or product-specific questions. We appreciate your understanding and cooperation.

Operator, we're now ready for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today is from Adam Tindle of Raymond James.

Adam Tyler Tindle - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Okay. Congrats on the strong results and outlook. Mark, I wanted to start on the outlook, the $460 million for the full year and go into this question with acknowledging you've done what you said you're going to do, have a very good track record. But I think that incremental $0.60 implies an increase in the back half of the fiscal year. I know you're getting some benefit in the first half, but still an increase in the back half of the fiscal year. And just wanted to ask what gave you the confidence to raise that far out? Imagine we're going to get some investor questions with the context that mobility seems like an unusual potential cycle, uncertain ending. There's something different about this fiscal year level of visibility that you had versus years past where ending of the cycles has surprised the supply chain.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

I don't know that I look at a time frame change. I mean we -- in September, we talked about the full year at $4. So we felt compelled to address the $4 or a change to it. So I don't think anything has changed in terms of confidence of the business relative to September.

If I break the answer up into a couple of things: one, we've been on this 6-, 7-year journey where we've really focused -- we focused a number of years on driving the top line because our strategic belief in a business like us, when we're a service business, the more diversified we become, the more resilient, the more predictable, the better the company is. And so it was all hands on deck.

And what's interesting, Adam, about that is the proof is in the pudding. One could say, "Geez, you guys chased a lot of growth." That's true. But we went through a period of time from fiscal '16 to I think even fiscal '19, maybe fiscal '15 to '19, where through a lot of the period of time when we were diversifying, the margins of the corporation at an enterprise level were around 3.5. And I would contend that we must have done a pretty good job of the diversification, not only diversifying the different end markets, but the quality of revenue we brought into the company, which has allowed us largely to come into this year and offer $4 a share.

The second part of your question in terms of the $4.60. I think what I just said gives us confidence in the $4.60. We had a midpoint of about $1.25 for 1Q. We delivered $1.60. So you take a look at the spread on that to start the year, and that spread going from the $1.25 to $1.60 was really broken down, I think, into 3 parts: one was there was a few areas of our business that we saw very strong demand; number two is just the overall construct of the portfolio; number three is Dastoor, Sergio and our finance team have done a wonderful job over the last 6, 9 months or so, working the balance sheet. And so we're starting to see some foundational positive changes to interest expense.

So you shake that up to start the year. And then we -- I think with our 2Q guide, I don't know, consensus was around high 80s, and I think our midpoint is $0.92, $0.93. So we took Q2 up $0.05. And that, we're in the middle of 2Q now, so we've got reasonable visibility to that. And then as we look at the back half of the year, Adam, if I just think about revenue, so back in September, we thought the year would be about $26.5 billion, maybe $27 billion. Now it's looking more like $27.5 billion. About $800 million, $900 million of that is in the front half, $100 million to $200 million is in the back half, which I think addresses your point in terms of it's a reasonable blend throughout the year. And again, when I think about the $0.60 delta, I think about a combination of, again, the strong portfolio and then I also think about the foundational change to interest and tax, probably leaning more towards interest and tax. I would say of the -- going from $4 to $4.60, $0.25 to $0.30 is kind of foundational interest in tax, which is, I think, a huge positive. And then the balance of that would be the portfolio itself.

Something else, I think, is worth noting. We thought long and hard on how do we -- we felt compelled to update the year, right, and because we started with a look to the year in September. So we talked long and hard on how conservative do we want to be. And we just kind of laid out the numbers, and we went over this multiple times and to us, $4.60 feels like a good number. But I think what's really, really important for this call is to suggest that as a leadership team, that $4.60 and the 4.1% that we've now put out there is our outlook for the year. I think a very important element of that is the $4.60 and the 4.1% are now kind of foundational for us to build off of for fiscal '22. So I think that's -- I don't think that point should be lost.

Adam Tyler Tindle - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

That's helpful. Yes, that definitely doesn't stop there. Mike, I wanted to -- just on a follow-up on CapEx. Mobility is upsiding, forecasts are increasing. In the past, as this happened, CapEx crept up over the course of the year. Just curious, you talked on the last call about keeping CapEx flattish year-over-year. I think you maintained your free cash flow guidance this year. What's enabling this up-cycle to be different than previous cycles where CapEx increased? How can you maintain share if you don't increase capacity?

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Adam, that's a good question. I think we've been -- I'm extremely pleased with the discipline that we're showing on the CapEx front. The entire team is being extremely thoughtful about CapEx, and we're pushing back on customers where we feel that the CapEx is not warranted. So good discipline, Adam, I would sort of think of CapEx at a 3 percent-ish rate on revenue. I think we've been 2.9%, we've been 3.1%, we've been 3% in the last 4, 5 years. But I think a 3% sounds like a good sort of gauge for CapEx going forward.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Hey, Adam, if I could comment on something that I think you hit on. I also think I wouldn't want loss because there's a lot of numbers, good numbers on the -- on this call. On the -- as we were growing the business and focusing on diversification and I would now contend, we're well diversified. So it's journey, but I think the company is very well diversified at the moment, again, a result of a lot of hard work and effort.

But 2 things happen when you're in that type of mode: number one is we got a little bit fluffy in terms of headcount and overhead, and we dealt with a lot of that this past summer, that's coming through in the results; number two is the working capital management. And the working capital management I've seen out of our team in the last 6 to 9 months has been absolutely fabulous. And I think the fact that we're looking, our outlook reflects another $1 billion of revenue for the year and we're still keeping cash flows north of $600 million speaks volumes of that in terms of us being very, very intentional on working capital and working capital management.

Adam Tyler Tindle - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Yes, seems like a structural change.

Operator

The next question is from Jim Suva of Citigroup Investment Research.

James Dickey Suva - *Citigroup Inc., Research Division - MD & Research Analyst*

Congratulations to you and your team and for being safe as well as delivering results. My question is, again, on your capital discipline and big upside, the question I have is, any commentary you could give about like utilization rates or machine optimization rates or something like that? Because it just seems like you're getting more and more efficiencies out of your plant and equipment. If I understand it correctly, because it sounds like you're not having to really invest a significant more amount of capital and therefore, returning more cash flow. Can you comment a little bit on that? Because I think some people may wonder, are you maxing out and not able to fit any more business into your sites, whether it be health care, whether it be packaging, whether it be DMS? Any commentary would be great.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Thanks, Jim. I'll try it a couple of different ways. One is, as Mike said, I think it's -- I think a good proxy for modeling going forward is CapEx to be about 3 points of revenue, plus or minus. Some quarters, it will be less, some quarters, it would be more.

Here's what we can, I think, assure you on. If CapEx goes up a bit, actually look at that as a good thing because with the disciplines we've put in, with the company being well diversified, the pipeline that we have today on an organic basis is probably about $3.5 billion, $4 billion of top line, which, by the way, we absolutely will intentionally walk away from some of that. So the -- kind of the purposeful nature of bringing additional top line into the company, I think, is as high as it's ever been. If CapEx were to go up to 3.1% or 3.2% or something like that, again, you could be rest assured that, that's going to be accretive, both to cash flows and margins going forward. And by the way, in a relatively short term, basis in terms of bringing the business on. So that's kind of one.

Number two is getting back to your question specifically around factories, what our operational people have done. The genesis of what we do for a living is we build stuff. We have -- everybody is important. Our finance group is important, HR is important, commercial -- but our operational people are at the very core of what we do, Jim. And what they've done in terms of navigating COVID, keeping our factories up and running -- I said something in my prepared remarks around the fact that COVID has proven to us to be an essential business, but I think of essential 2 ways.

One is, essential around COVID, but on a more sustainable basis. We're an essential business because when you sit back and think about our size and scale today and the fact that we kind of build a little bit of everything, we really do help support and partner to a few trillion dollars of market cap. And what our operational team did, getting back to your question around factory utilization and efficiencies through COVID was miraculous. And oh, by the way, we did that with a de minimis amount of COVID cases. And by the way, I want to be careful with that statement because those where COVID did impact them was very binary. But when I think about factory utilization through this pandemic, a huge shout-out to our operational teams.

As I look forward, Jim, for the balance of the year, our factories are running at what I would call very normalized utilization rates. And there's nothing there that gives me pause that says that CapEx is going to have to go to 4% or 4.5% of revenue because there's going to be some big step function in terms of additional capacity.

And the last thing I'd like to comment relative to your question is we've also been talking for the last 3, 4, 5 years on the OpEx investments that we're making, which our OpEx investments are probably $100 million a year. And that's kind of what I would call progressive IT, factory of the future, machine learning, data automation, much of which affects our factory floors in terms of productivity and efficiencies. So I think it's a combination of all that stuff.

James Dickey Suva - *Citigroup Inc., Research Division - MD & Research Analyst*

And as my follow-up, in the past, many of the supply chains have talked about component shortages, whether it be microprocessors or memory or capacitors or something like that. Have the component shortages completely worked itself out? Because I know now you have a strong position in cloud as well as mobility. Any thoughts around component shortages? And is that backlog completely worked through? Or is there still some shortages out there that could have actually given you more upside?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

I'll give you a 2-part answer to that. Number one, I'll give -- that's a great opening for me to give a shout-out to our supply chain folks. If you -- as you do, Jim, you know us around the industry. We have the -- I think we have fundamentally 1 of the most respected supply chain global teams in the world, and they do a fabulous job for us when markets get tight and otherwise. With that being said, of the 100 or 200 things at that store and I worry about day in and day out with our team as we sit today, supply shortage isn't one of them.

Operator

The next question is from Ruplu Bhattacharya of Bank of America.

Ruplu Bhattacharya - *BofA Merrill Lynch, Research Division - VP*

Congrats on the strong results and the strong guide. I have 2 questions, one on DMS and one on EMS. Maybe on the diversified manufacturing side, can you give us some guidance on seasonality and margin progression during the year, given that automotive is now part of that segment? And in mobility, if we have -- if we continue to have 2 launches of phones every year, should we still expect that the third quarter would be the lowest margin quarter for DMS? Or any guidance on quarter-to-quarter seasonality and margin progression would be very helpful.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Okay, Ruplu. If I don't give you a complete answer, shout back at me because there was quite a bit there, and I was kind of thinking through it as you were talking. I think -- I don't know what order I'll get this in, but let me try a couple of things.

I think foundationally, fundamentally, however you want to look at it, the thing -- we talked a lot about diversification. And I know your question was largely around DMS, but if I could for a moment. The most amazing thing today about the construct of the company is, is if you extrapolate out the numbers that we've given today, you could -- DMS will be in the range of about $15 billion for the year, top line. EMS will be in the range of about $12.5 billion, top line. That's with the new model on our cloud services business.

And then you look at these complementary segments, Ruplu, DMS today -- and again, this isn't hard and fast guidepost, but it's directionally how we think about the business and behave. Our DMS segment, so the $15 billion is -- the way to think about that is it's about expanding margins and ensuring good reliable cash flows. The complement to that on the EMS side which, is the $12.5 billion is really about expanding cash flows while being sure that they focus on reliable margins. And those complements, as I said in my prepared notes, is I really think we get 1 + 1 = 3.

More specific to your question, when I think about kind of the year overall, I -- Q1, we saw -- in Q1, we saw strength across the entire business other than maybe 2 or 3 pockets. So say, out of 10 to 12 pockets of business, let's say, 2, 3, 4 were neutral to slightly down. But it was just one of these quarters where everything kind of connected, whether it be mobility, connected devices, cloud, automotive transport, health care packaging, semi-cap, even network and storage. So -- and then pockets of industrial as well. And again, it's just another illustration of the real promise of being diversified.

As I think about the year going forward, I would think we'll continue to see reasonable strength across most -- all of those end markets unless there's a big macro disruption, and we'll see what happens today with the -- or this week with the stimulus plan.

But -- and again, I think that leads us to why we have a degree of confidence in the $4.60. And then there was another part of your question, I believe, Ruplu, specific to our mobility sector. In terms of shape of the year for the company, I would say, we just printed a 4.7% margin in 1Q. I would say that 2Q and 3Q will probably be sub 4%. And then there's an opportunity in the fourth quarter to get enterprise margins back towards the 4%. You shake all that up on a blended basis, you get the 4.1%, which is aligned with our guide today. And then your question specific to DMS, because of the dramatic increase we've had in health care and packaging, plus the contributions on connected devices, automotive transport, all combined with mobility. If I had to guess today, Ruplu, we just printed in DMS, a 5.7% core margin for 1Q. I think that there's a good opportunity for both the second quarter and the third quarter to remain above 4%. And then with investments and things like that, maybe fourth -- the fourth quarter, just shy of 4%, something like that.

Ruplu Bhattacharya - *BofA Merrill Lynch, Research Division - VP*

Okay. That was very helpful. Maybe I'll ask a different question for my follow-up, which is how do you think about uses of cash? Given where we are in the economic cycle, is it relevant? Is it -- would it be meaningful for Jabil to look at acquisitions, maybe look at inorganic growth? And how would you prioritize that against buybacks maintaining the dividend and any debt paydown? So if you can just give us your thoughts on use of cash and your strategy on inorganic growth.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. Thanks, Ruplu. This is a (inaudible) store question, but let me jump in because you started with M&A. And then Mike can complement it if I don't get this all correct. But I think what Mike did in September, if I remember, he laid out kind of our capital allocation construct. It was a single slide, I don't remember all the details on the slide. We reviewed that and talked about that a bit coming into this call. That structurally hasn't changed. And I think that -- and I've said this a number of times before, in my opinion, and opinions certainly differ, I think we've been a very reasonable and reasonably friendly to shareholders in terms of our capital allocation strategy, where -- because our belief in the company and where we were headed, we've been reasonably aggressive in our buybacks since June 2016, which in a few months, we'll be coming up on 5 years of that type of behavior.

I think that will continue for a period of time. When I think about growth, I mentioned earlier, Ruplu, that right now, our organic pipeline, a pipeline that will be at or accretive to margins is probably $3.5 billion, $4 billion. Again, we'll selectively walk away from some of that. But for sure, organic growth is by far, the most optimized growth for shareholders.

When we think about M&A, we do -- we typically buy 4 to 5 companies a year. It's typically around engineering and engineering talent. What we pay for those is more on an asset basis. It doesn't cost us much more, and at times, it's less expensive than just hiring the people. And then and then we're always looking at strategic types of things like strategic patents that we like and whatnot. So as we sit today, at least for the balance of '21, I don't think there's going to be any behaviors of big acquisitions for the company, strategic or otherwise.

Mike, you got anything to add?

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Yes. From a buyback basis, Ruplu, we have a $600 million authorization out there. We'll continue to be thoughtful. We'll continue to be opportunistic. As things start returning to normal, once the vaccine takes hold, we might accelerate some of that purchase that we did in Q1. We're taking it slowly right now, but we'll accelerate that if circumstances work.

Operator

The next question is from Steven Fox of Fox Advisors.

Steven Bryant Fox - *Fox Advisors LLC - Founder & CEO*

I had 2 questions. First of all, on the cloud business. Can you -- I understand that there's a lot going on that's Jabil-specific, and it's providing upside. Can you talk about sort of how much of that is reflected in what you did in the quarter and you're thinking for the rest of the year? And also your ability to sort of diversify among service providers? And then secondly, Mark, you've mentioned a couple of times now, some of the investments in machine learning and automation. Can you talk about how much of that is sort of table stakes versus maybe creating other areas for you to generate some operating leverage going forward?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. So first part of your question, I don't want to get into a lot of details, Steve, on our cloud business. I can say, at a high level, we started down this journey 2 years ago, 2.5 years ago. The service that we provide, again, is asset-light, geo-centric. We've been very consistent on that. The adoption and the acceptance of that model by the end market has been very, very good. There's little indication that, that's going to change in the near term.

As we said before, I think we continue -- we'll continue to invest in that. As long as we've got a service and a solution that's well embraced. I think we derisked the downside to that business. So again, overall, I just -- that's all the detail I'd like to provide at the moment because, again, I think we've got continued momentum in that space.

In terms of operational investments, so machine learning, IT, automation, flexible automation, data analytics, et cetera, I would say, 30%, 40% of investments are table stakes where technology is going. And I would say, 50%, 60%, maybe a little more is differentiation and has to do with, again, if you look at fiscal '16, '17, '18, throughout fiscal year '20 with COVID. But we're talking about uplifting margins on a $27 billion, $28 billion, $29 billion, $30 billion base company, we're talking about uplifting margins by 60 basis points, 70 basis points. We'll see what '22 holds.

A material contributor to that is the methodology to which we've invested in IT and machine learning and different things to help us optimize our factory floors. I do think what's fact is we have 50-plus million square feet of manufacturing space around the world. We have some of the most incredible systems in terms of supply chain. Both of those areas -- so when you think about the core of what we do as a living, we build stuff, the barrier to entry to building stuff is getting higher and higher because of the scale of the investments, the global nature, the risks, et cetera.

And when I think about the 2 things that are most profound at our core: one is building stuff; two is supply chain. And I would suggest that the investments we continue to make there are differentiated. And 1 data point on that would be, I don't know of any other company of our scale in terms of the manufacturing services and solutions world that has 50 million square feet of manufacturing space connected on a holistic IT system and I would contend that one example gives us a definitive competitive advantage. And I could go deeper, but I won't on the same thing on supply chain.

Operator

The next question is from Paul Coster of JPMorgan.

Paul Chung - *JPMorgan Chase & Co, Research Division - VP & IT Hardware Analyst*

It's Paul Chung on for Coster. So your outlook in DMS is seeing raises in every segment. Is this kind of a function of pent-up demand? Kind of more market share gains or expanding business with existing customers or all 3? And then has COVID structurally changed manufacturing strategy for many of your customers? Are they accelerating the shift from in-house to outsourcing?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. Thanks, Paul. I think that -- I think it's all 3. I think that as we look -- and I think your question was specific to DMS, although I think part of my answer would be for the whole corporation, inclusive of EMS. But I would say, again, some market share gains, some expansion of growth and being side-by-side with our current customers, participating in their growth. So we've got market share gains for sure. We've got growth with our current customers for sure. And then again, as I mentioned earlier, robust organic pipeline, a decent amount of that is brands that we don't currently serve. So I would say the outlook on DMS, again, I think in fiscal '20, our DMS revenue was just a hair over $13 billion. I think this year, it will be a hair over $15 billion. And all 3 of those things would contribute.

There was a second part of your question.

Paul Chung - *JPMorgan Chase & Co, Research Division - VP & IT Hardware Analyst*

Oh, yes, just COVID accelerating the shift.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. So I -- our observation would suggest that, let's say, February, March time frame of this year through probably spring of '21. I actually think COVID has put a halt on most fundamental strategic shifts and decisions by many corporations in terms of what they want to do with their manufacturing structurally. Although my guess is and having participated in some of this, there's lots of discussions. But much like our Mike Dastoor was alluding to, I think a lot of companies have battened down the hatches in terms of preservation of cash. Everybody kind of wants to see where COVID goes, does this vaccine work, what's the vaccine distribution look like, what's the timing of the vaccine taking hold, et cetera, et cetera.

If there's any good news in what has been a horrific pandemic, it's that as we get to middle of calendar '21, back half of '21 and into '22, I think what has been kind of discussion points through COVID ends up converting to some actions once people feel like COVID has stabilized or somewhat behind us. So I think that would be a good thing.

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

If I can just add, I think more than COVID per se, if you look at the convergence of technology that's been expedited by 5G, some of it is expedited by the work and learn-from-home environment, which probably extends beyond COVID as well. I think that's driving this big push into technology. And I think we're seeing the benefits of that. I think it's a very long legged sort of approach on that one. And I think we're in the right spaces right now and all the right end markets. And I think we're seeing the fruits of all of that.

Paul Chung - *JPMorgan Chase & Co, Research Division - VP & IT Hardware Analyst*

And then my follow-up is on free cash flow. All your metrics on revenues and op margins have increased, but your free cash flow was reiterated of exceeding $600 million. But I assume the magnitude of the exceed is larger today than it was in 4Q. First, is that kind of a fair assumption? And second, what can swing free cash flow higher as we kind of navigate through fiscal year '21? Any puts and takes you want to call out?

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Right. So we did have -- we did see a bit of an increase in revenue that comes with some working capital. We still feel strongly that our free cash flow will be above $600 million. I talked about discipline in CapEx. I think Mark alluded to our working capital discipline. The team is fully engaged, fully focused. So there's a number of levers that we're focused on in that free cash flow bucket, so to speak. And I feel, over time, that just keeps getting more and more attention, that keeps getting higher and higher. So I think right now, we feel good with the $600 million plus, and I think I'd highlight the plus there. And I think the focus that we have continues to bear fruit again.

Operator

The next question is from Shannon Cross of Cross Research.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

I was just wondering in your conversations with your customers and obviously, COVID has played into it, but just in general, have things changed in terms of their desire to onshore or diversify the countries where they manufacture? And I'm just wondering, we obviously have a new administration coming in, have things shifted at all in terms of the conversation over the year? Or do you think people are -- sort of remain on track thinking that maybe onshoring a bit more as well as diversifying is the way to go?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Thanks, Shannon. I think the -- I think there's been lots of conversations over the last 2, 2.5 years between trade tariff and COVID. I think -- and again, lots and lots and lots and lots of discussions. And the one thing is, is when you do what we do, you're in the middle of all those discussions, because we're the primary manufacturing partner to so many outstanding customers and brands. But when it comes to actioning on those, I just -- I don't think there has been a lot of change.

There's -- we've talked about this many times over on calls. We've had -- we had some customers that have wanted to derisk Mainland China. That's been the exception, not the rule. We've been there for them. One of the benefits you have when you have a partner like Jabil is, we have a really, really optimized footprint all over the world. If I add COVID on top of that, again, lots and lots of discussions. But in the end, I think that the manufacturing and value supply chain ends up following the dollars and following end market consumption based on a product-by-product basis. And largely, I don't see that changing.

Shannon Siemsen Cross - *Cross Research LLC - Co-Founder, Principal & Analyst*

Okay. And then I'm just curious, during the quarter, in terms of linearity, were there -- anything to point out within your segments maybe that improved during the quarter versus weakened toward the end of the quarter?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

No. Actually, this quarter, 1Q had really nice linearity.

Operator

The next question is from Matt Sheerin of Stifel.

Matthew John Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

Just another question on DMS and the upside to guidance across those sectors, specifically in health care. Could you update us on how J&J programs have been ramping? And are you beginning to see that as a contributor to the strong operating margin expansion you've seen year-over-year in that segment?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Thanks, Matt. Yes, I won't go too deep into the J&J relationship, specifically JJMD. I'd just say that we've talked about this at a high level when we first engaged. We kind of laid out a path forward. What's been really nice is, is the path we laid out is the path that we've realized, which is a huge acknowledgment both to J&J and our team. And yes, I think the JJMD relationship is getting to a scale where, for sure, it's a contributor to our health care and packaging business. And through all this, JJMD has been a wonderful partner for us.

Matthew John Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

Okay. And then on the cloud business, you talked about the strength that you're seeing from customers there. And I know you've gone through that transition to a consignment model with the largest customer. Is that largely in the numbers now? And Mike, were there any near-term impacts to cash flows because of that transition?

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

I think it's all part and parcel of our strategy, Matt. We've been working on that for a while. There will be pros and cons to that. I think largely pros, obviously, working capital improves, margins improve. So the consignment piece is strategic in nature. It wasn't something that just happened to us. It's something we've been working on now for a while. And over the year, over the coming few quarters, it will hopefully get fully implemented.

Matthew John Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

Okay. But you're not quite there yet?

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Not fully. We're still working on some paths.

Operator

The next question is from Mark Delaney of Goldman Sachs.

Mark Trevor Delaney - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Congratulations on the good reports. Mark, thanks for all the comments you made around sustainability and Jabil's efforts there. And I was hoping to just better understand Jabil's ability to offer more environmentally-friendly manufacturing. Can you talk about some of the business implications from that, both in terms of what it may mean for some of the customer relationships and your ability to sustain good market positions? But then to the extent there is any added cost to implement cleaner manufacturing and clean energy, how does that impact margins? And is that something customers pay for? Or is that more of a shared expense?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. Thanks, Mark. First comment at kind of a macro level and then maybe break it down a bit. I try to express either through these Q&A sessions or more on a prepared remarks basis, the financial results are super important. They're really important to shareholders. But to me, the results themselves are really an output of us taking great care of customers and obsessing around our customers. And along with obsession around our customers that drive these financial results, we also spend I think just a tremendous amount of time as a leadership team talking about approach because results can be derived in many different ways. And when we think about approach inside the company, one is about an amazing culture that we have; two is about kind of carrying about people and foundational beliefs around diversity and inclusion for all; and then the other one, certainly, Mark, is more core to your question, which is around the ESG social and environmental.

I think Jabil -- the best thing we can do for our customers, our suppliers, is lead by example. We made a comment -- I made a comment in September that said we're committed to reducing our gashouse emissions in -- across the company in the next 5 to 6 years by 25%, 30%, and we're on a path to do that. I would suggest that -- where people get -- I think, get confused is, geez, that's going to cost us a lot of money. In reality, it's the timing of the cost, but all of that ends up being a net pickup because running the company with lower greenhouse gas emissions, clean energy has a really nice ROI to it.

So one, the best thing we can do is lead by example by walking the walk versus just talking about it. We also said in the September call, something like, we would like to lead our industry, not only in financial returns but also an approach in terms of ESG, in terms of areas of safety, water usage, hazardous waste.

And then the other thing is Jabil purchases like $20 billion of stuff every year, and we believe we can have a very positive influence on the entire supply chain in terms of leading by example and also kind of mandates that we put on our strategic and key suppliers. And then if I broke that down even further, Mark, Jabil is firmly in the renewable value chain. And if I had to guess today, depending on how we characterize that, I would say we're in the renewable value chain well into the billions of dollars. When I think about what we do for electric vehicles, what we do for wind, what we do for solar, what we do for smart meters, what we do for power efficiency, what we do around energy storage.

Another one that we're spending a lot of investment dollars on and attention is sustainable consumer packaging. And then also, when I think about 3D additive and all the investment dollars there, when you think about the additive process, especially with metals and then certainly with polymers, that's also something that's squarely in ESG-type category.

And then lastly, Mark, we have thousands of engineers, and we have a whole subset of engineers that are focused specifically around ESG type of stuff, one example being we have a dedicated group of engineers around power and power efficiency. So that's kind of how I see how we play in that whole marketplace.

Mark Trevor Delaney - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

That's very helpful. And thanks for everything the company is doing with those efforts. My follow-up question was on financials, and Mike and Mark, you both talked about some more structural savings you think are going to be sustained around interest expense and tax rate. Is the right way to think about what the levels may mean is to use the guidance for fiscal 2Q and expect those sorts of levels to continue? Or is there a better way for us to be thinking about interest expense and tax rate beyond the second quarter?

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Yes, I would sort of estimate interest to be in that $40 million-ish range. I think we delivered about $35 million in Q1. I'd feel better if the estimates going forward are in the $40 million. That's sort of substantially lower than what we thought at the beginning of the quarter. And similarly for tax, I think I'd go with a 26-ish percent tax rate. Again, that is about so 100 basis points lower than we actually indicated at the beginning of the year.

Operator

There are no additional questions at this time. I would like to turn the call back to Adam Berry for closing remarks.

Adam Berry - *Jabil Inc. - VP of IR*

Thank you, everyone, for joining our call today. If you have any follow-up questions, please reach out to us. Other than that, please stay safe, stay healthy.

Thank you. Bye.

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Thank you.
