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JBL.N - Q3 2022 Jabil Inc Earnings Call

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**OVERVIEW:**

Co. reported 3Q22 revenue of approx. $8.3b, GAAP operating income of $321m and GAAP diluted EPS of $1.52. Expects FY22 revenue to be approx. $32.8b and core EPS to be in the neighborhood of $7.45. Expects 4Q22 total revenue to be $8.1-8.7b, GAAP diluted EPS to be $1.78-2.18 and core diluted EPS to be $1.94-2.34.

## CORPORATE PARTICIPANTS

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

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

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

## CONFERENCE CALL PARTICIPANTS

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

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

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

**Ruplu Bhattacharya** *BofA Securities, Research Division - Director & Research Analyst*

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

## PRESENTATION

**Operator**

Greetings. Welcome to Jabil's Third Quarter Fiscal Year 2022 Earnings Call. (Operator Instructions). Please note, this conference is being recorded.

At this time, I'll turn the conference over to Adam Berry, Vice President of Investor Relations. Adam, you may now begin.

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

Good morning, and welcome to Jabil's Third Quarter of Fiscal 2022 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 entirety of today's session will be posted for audio playback on our website.

I'd now like to ask that you follow our earnings presentation with 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 fourth 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, 2021, 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, I'd now like to turn the call over to Mark.

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

Thanks, Adam. Good morning. I appreciate everyone taking time to join our call today. I'll begin by saying thanks to all of our people here at Jabil. Thank you for the tireless attention you offer our customers, and thank you for the manner in which you care for and accept one another.

Let's now turn to Slide 5 and review our third quarter results. Q3 was another strong quarter, driven by double-digit revenue growth and outstanding execution. Altogether, the team delivered core earnings per share of $1.72 on revenue of $8.3 billion. This resulted in a core operating margin of 4.2%, a 40 basis point increase year-on-year.

All in all, I'm quite pleased with the quarter. We're carrying good momentum as we start to think about FY '23. And when I think about momentum, I think about the primary catalysts behind our business, that being the makeup and scale of our commercial portfolio, which I'll now address on the next slide, Slide 6.

The pie chart shown here reflects Jabil's commercial portfolio, which our team has built over the past 5 to 6 years. In essence, a large-scale, well-diversified foundation from which we run our business today. And the resulting output in having built this business is threefold.

One, a higher level of resiliency for the corporation, either during trying times of macro and geopolitical disruptions or during more typical times when we're simply faced with never-ending demand fluctuations. Two, Jabil's presence in new markets, markets that include 5G, electric vehicles, personalized healthcare, cloud computing and clean energy, markets that we believe will drive earnings growth, especially when combined with the continued refinement and improvement of our traditional businesses. And finally, the third resultant output of our team's hard work is the assembly and collection of our many capabilities, capabilities that allow us to simplify the complex for many of the world's most notable brands as we lean into a massive market where things need to be built and supply chains need to be developed or modified.

Moving to Slide 7. You'll see management's outlook for the year. We're anticipating core earnings per share to be $7.45, an increase of 33% year-on-year. As for revenue, fiscal '22 now looks to be $32.8 billion, while our outlook for core operating margin remains steady at 4.6%, a 40 basis point improvement year-on-year. In addition, we remain committed to delivering a minimum of $700 million in free cash flow for FY '22.

Altogether, this year is a terrific blend of reliable margins and sustainable cash flows. And although we're navigating a tough environment, we have ample opportunities to consider as we formalize our business plan for fiscal '23. With this in mind, we look forward to hosting our fifth Annual Investor Briefing. And consistent with past years, the briefing will be held in late September. Adam will be confirming an exact date later this summer.

We'll open the session by reporting our fourth quarter and full year results. We'll then follow with a complete review of our priorities, and explain how these priorities will guide us through FY '23. Management will also share how we plan to further expand our core operating margin while sharing observations on end markets. And wrapping up the September session, Mike will share our capital return framework for FY '23 and FY '24. We have lots to share and a wonderful story to tell financially, operationally and commercially.

With that, let's look at my final slide, where I'd like to talk about the importance of purpose. At Jabil, we act with purpose. And with purpose comes expectations, expectations around certain behaviors, behaviors such as keeping our people safe, protecting the environment, giving back to our communities and ensuring a workplace of tolerance, respect and acceptance. Within Jabil, these behaviors have never been as important as they are today. I'm proud of our team as they embrace our purpose and, in doing so, their conduct is exceptional.

In closing, I like the decisions we're making. At Jabil, we build stuff, and we do it really, really well. It's why we welcome the challenges put forth by our customers. And when addressing these challenges, we do our best to make the world a little bit better, a little bit healthier and a little bit safer each and every day.

As I alluded to earlier in my prepared remarks, the world is a bit messy at the moment. What I do believe is Jabil executes well when times are steady, but I'm even more passionate in my belief that Jabil executes really well when times are difficult.

Thank you for joining our call, and thanks for your interest in Jabil. I'll now turn the call over to Mike.

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

Thanks, Mark, and thank you for joining us today.

Our third quarter was a great illustration of our diversification in action. I'm really pleased with the resiliency of our portfolio and the sustainable momentum at the enterprise level. In spite of a challenging supply chain environment and well-publicized shutdowns in China, the team still delivered exceptional results in revenue, core operating margin and core diluted earnings per share.

For the quarter, revenue was approximately $8.3 billion, ahead of our forecast, driven by very strong demand within EMS, partially offset by sporadic COVID challenges within DMS. Altogether, on an enterprise level, revenue grew by 15% year-over-year and 10% sequentially as demand across end markets remain well ahead of supply.

In Q3, our GAAP operating income was $321 million, and our GAAP diluted earnings per share was $1.52. Core operating income during the quarter was $352 million, an increase of 27% year-over-year, representing a core operating margin of 4.2%, up 40 basis points over the prior year. Net interest expense in Q3 came in above expectations at $45 million due to a combination of higher working capital and rising interest rates. Core diluted earnings per share was $1.72, a 32% improvement over the prior year quarter.

Now turning to our third quarter segment results on the next slide. Revenue for our DMS segment was $3.8 billion, an increase of 7% on a year-over-year basis. Although upside in the quarter was limited in Automotive, Healthcare and Mobility, we still experienced year-over-year growth in every end market within DMS. Core margin for the segment came in at 3.8%.

Revenue for our EMS segment came in at $4.5 billion, an increase of 23% on a year-over-year basis and well ahead of our plans for March. The stronger year-over-year performance in our EMS segment was extremely broad-based, with strength in our 5G Wireless & Cloud and Networking & Storage businesses, where we gained additional share during the quarter as a result of our ability to execute in complex supply chains and deliver critical parts and components. Core margin for the segment was 4.6%, up 80 basis points over the prior year, reflecting exceptional cost control on higher-than-anticipated revenue.

Turning now to our cash flows and balance sheet. In Q3, inventory days came in at 85 days, down 1 day sequentially and above our expectations in March, mainly due to the shutdowns in Shanghai, which also impacted upstream and downstream supply chains. We offset a portion of higher inventory levels with inventory deposits from our customers, and these deposits reside within the accrued expenses line item on the balance sheet. Net of inventory deposits, inventory days were 70 in Q3, down 1 day from the previous quarter.

As a quick reminder, our business model is designed such that we do not take risk on inventory in anticipation of sales. All inventory orders require a customer purchase order before triggering a purchase request within our MRP system. The majority of our inventory continues to be mainly associated with raw materials as a result of kitting issues and timing of components. At the end of Q3, finished goods represented a very small level at approximately 11% of inventory, consistent with Q2.

Our third quarter cash flows from operations were $545 million, and net capital expenditures totaled $324 million. From a total debt-to-core EBITDA level, we exited the quarter approximately 1.3x and with cash balances of $1.1 billion. During Q3, we repurchased approximately 3.6 million shares for $203 million, and for the year, we've repurchased 7.9 million shares for $475 million as we remain committed to returning capital to shareholders.

Turning now to our fourth quarter guidance on the next slide. DMS segment revenue is expected to increase 14% on a year-over-year basis to approximately $4.5 billion, while the EMS segment revenue is expected to increase 11% on a year-over-year basis to approximately $3.9 billion. We expect total company revenue in the fourth quarter of fiscal '22 to be in the range of $8.1 billion to $8.7 billion. Core operating income is estimated to be in the range of $390 million to $450 million, representing a core margin range of 4.8% to 5.2%. At the midpoint, this is an improvement of 80 basis points over the prior year.

In Q4, GAAP operating income is expected to be in the range of $367 million to $427 million. Core diluted earnings per share is estimated to be in the range of $1.94 to $2.34. GAAP diluted earnings per share is expected to be in the range of $1.78 to $2.18. The core tax rate in the fourth quarter is estimated to be approximately 17%.

Next, I'd like to take a few moments to highlight our dynamic and resilient portfolio of businesses by end market. Across the majority of our end markets, demand has been extremely resilient and continues to outstrip supply across our business, particularly in end markets that continue to benefit from strong secular tailwinds, markets such as electric vehicles, personalized medicine and healthcare, clean and smart energy infrastructure, 5G infrastructure, cloud and semi-cap.

These end markets represent a large majority of the overall Jabil portfolio today, and we believe sustained growth in these markets will continue, even if overall global economic growth slows from the solid levels over the last few years. The end markets we serve that may be more susceptible to economic slowdowns have been strategically positioned within the portfolio as we partner with market-leading brands to provide key capabilities that are critical and hard to replicate. This product diversification provides resiliency to our portfolio.

In summary, Jabil is not only well-diversified, but also markedly more resilient due to our multi-year proactive efforts to diversify our business and align to tomorrow's trends. As a result, we feel the outlook for our business is strong and anticipate demand to be resilient for the balance of this year and into FY '23..

All in all, our performance during the first 9 months of FY '22 gives us excellent momentum as we look to close out another strong year. We're now anticipating core EPS will be in the neighborhood of $7.45 per share on revenue of approximately $32.8 billion. Notably, we see income and cash flow coming through with the increase to revenue. We now expect strong core margin and free cash flow of 4.6% and $700 million, respectively.

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

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

Thanks, Mike. Before we move into Q&A, I'd like to remind all participants that we cannot address customer or product-specific questions. Thank you for your understanding.

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

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from the line of Ruplu Bhattacharya with Bank of America.

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**Ruplu Bhattacharya** - *BofA Securities, Research Division - Director & Research Analyst*

Congrats on the strong execution in the quarter. My first question, Mark, is on revenue growth. Revenues in EMS looks like it saw a much stronger growth than you had expected. Was there any pull-forward of revenue from a fiscal 4Q? Or did you just see higher demand in all end markets?

And the same question for the DMS segment, where revenue growth was 7% versus your guidance of 17%. Looks like you've reduced your estimate for fiscal year Mobility and Auto revenues a little bit. So do you see lower end market demand? Or is it that supply constraints are limiting your ability to fulfill the demand?

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

Ruplu, so those are, I think, 2 fundamental questions for the quarter, and there's a lot there. But if I missed something, bring me back to it.

I'll start with EMS. The EMS business, overall, I think if you're looking at comps relative to what we thought we'd do at the beginning of the quarter, which is, I think, where you're indexing your numbers from. One, we're probably a little bit conservative in our guide at the beginning of the quarter with everything going on. Number two, the execution through the quarter was exceptional, and it was really broad-based.

So I know I use that term in other conversations as well. But if you take a look at -- maybe a good data point for you. If you go back and look at our blue-green slide from March and you look at it, what we presented today, it's kind of the annual numbers on the EMS side are reflective of where we saw some strength and where our execution, I think, was exceptional for the year.

So I think it's a combination of, A, a little bit conservative at the beginning of the quarter with everything going on. Number two, execution was great. There was a little bit of uptick in demand. And I don't know if I'd say pull forward, I would say that in this environment, customers are -- have a really good appreciation of our ability to help in the supply chain situations and navigating some continued supply chain issues. And I think that allowed us to pick up some share during the quarter. So that's kind of EMS.

I also think, on the EMS side, if I speak to it on a relative basis, Ruplu, I said something in my prepared remarks about the world being a little bit difficult at the moment. The EMS side of our business, we were saying, internally, I think we did a good job controlling the controllables. And that's just what Jabil does really, really well at our scale is the execution side, whether it be the factory or supply chain.

On the DMS side, I think it was threefold: one, it was a bit on Healthcare; two, it was a bit on Auto; and three, it was a bit on Mobility. And although, again, we were somewhat conservative in our guide, we certainly didn't anticipate the length of time in terms of the shutdown in Shanghai.

Although we're doing -- on a general basis, if you look at the enterprise results overall for the quarter and what's stacking up to be a very good year in a really tough environment, there were some challenges, again, with some specific silicon, probably impacted us mostly on Auto but not in a vacuum. And then there were some timing and shifts going on in volumes with Mobility.

So I would say, that's kind of a summary of what happened with the results in terms of EMS and DMS in terms of our guide back in March.

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**Ruplu Bhattacharya** - *BofA Securities, Research Division - Director & Research Analyst*

Thanks for all the details there, Mark. That's helpful. And can I ask, given all the strengths that you're seeing in various EMS end markets and also in DMS, how should we think about CapEx this year? And which specific areas are you -- do you think you need to invest more in this year?

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

Well, this year's about over. So I think CapEx is going to be what it's going to be this year. I think it will be, I don't know, somewhere between 2.5% and 3% of overall revenue. It's probably closer to 2.5%, and I think we talked about that back in September. So the way we're managing CapEx, I think, is exceptional. I actually have an opinion, too, on the fact that I think our overall capital allocation throughout the year has been quite good.

We'll get into CapEx for FY '23 during the upcoming Investor Day in September. I would expect, in terms of indexing CapEx off of revenue, FY '23 will look similar to FY '22. And in terms of the last part of your question, we'll continue to invest in areas that have great cash flows, sustainable businesses and help drive our margins to 5%.

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**Ruplu Bhattacharya** - *BofA Securities, Research Division - Director & Research Analyst*

Congrats again on the quarter.

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

Thank you.

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**Operator**

The next question comes from the line of Matt Sheerin with Stifel.

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

Yes. I just -- a question just regarding the guidance, and specifically on the margins. It looks like you're guiding margins to, call it, 5% or so. And is that driven by mix? Do you expect gross margin to improve here or continued OpEx leverage? And you're talking very strong leverage on OpEx in the last couple of quarters. So what is driving those margins?

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

Well, I think, one, it's -- again, it's a little bit of a mix across the business, which I think is a big thesis of our story around where the company is today. I think we see -- quarter-on-quarter, we'll see decent strength in Auto. I think we'll see -- assuming Shanghai doesn't shut down hard again, we'll see relative strength in Healthcare & Packaging. Q4 always ends up being a strong quarter for us because of mix, not intentional on our EMS business.

And the EMS business is substantial in the fourth quarter. And I think, if I step back and I look at the bigger picture, it's the overall health of the business and it's the overall execution. I mean, I think Q4 is a good marker for the business on where we want to take it further for '23 and '24, again, in driving the entire enterprise on an annual basis to 5% op margins.

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

And Matt, if I could just add. DMS and EMS businesses have slightly different gross margin profiles. I think the EMS, which outperformed in Q3, which should have a good quarter in Q4 as well, the gross margin can be low, but the SG&A OpEx can be lower as well, and vice versa. On the DMS side, where your gross margin is higher, but your SG&A percentages are higher because of FDA qualification requirements because of regulated industries, sort of the regulations that go around that.

So it's a very different gross margin profile for EMS and DMS. I would encourage folks to look at operating margin. That's what we, as a management team, look at internally. We're marching towards 5% and beyond, and we'll continue to deliver that. Gross margin profiles will go change up and down quarter-by-quarter, depending on the mix. So I'll just encourage you to focus more on operating margin than gross margin.

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

Okay. And then regarding the supply chain headwinds that hit most of your DMS businesses, are you seeing any signs of easing there, either on the semiconductor supply side or the COVID-related restrictions? And how is that impacting your guidance? In other words, would you have even more upside if there were more available supply or production?

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

I've been saying this the last couple of quarters. First off, there was multiple variables that impacted DMS. And by the way, demand remains strong. So I think that's an interesting takeaway from this call. And our -- the DMS delta relative to our guide wasn't all supply chain at all. Again, it was a timing and shift in volumes in Mobility. It was, again, the number of weeks of our shutdown in Shanghai. And then I did say and acknowledge that we had some issues with some very specialized silicon, and that impacted probably auto more than other end markets.

But I think -- I continue to think that, as a whole, across the company, our supply chain challenges are getting better. The overall supply chain is getting better. And I'll caveat that as I did, I think, in the March call and the December call, which is, when we think about supply chain, it's not just semiconductors, it's not just the last golden screw. We have everything from resins to metals in our precision machining to just run the gamut of everything that we buy.

So again, I think supply chain continues to get better. I thought and have said that I thought supply chain normalizes towards the end of this calendar year. That may push a bit into '23. But overall, A, supply chains are getting a bit better. There's still some hard constraints around some select components. But I would also say that one of the things that played for us in the third quarter and is also helping us drive the 5% margins in the fourth quarter is our ability to navigate supply chain on a relative basis better than most.

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**Operator**

The next question is from the line of Steven Fox with Fox Advisors.

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

Two questions, if I could. First of all, when you think -- I know you don't want to give too much on next year, but your operating margins are up 80 basis points year-over-year. I think you mentioned some of that was because of mix. Can you just sort of talk about how much more is left in terms of improving margins just based on your sales mix? And then I have a follow-up.

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

You're right. We don't want to say much about '23 at the moment. I think we'll go deep into that, Steve, in our Investor Day in September.

I just -- I guess, I'd look at it and say, a few years back, we ran about a 6-year stretch where we were growing the heck out of the company and diversifying and building the platform we have today, and the op margin line was around 3.5%. And then in '21, we took it up substantially to 4.2%. This year, we're going to deliver around 4.6%. I guess, I would say, and maybe I alluded to some of this in my prepared remarks is, I think -- sitting here today, I think FY '23's margins will be greater than FY '22's margins.

And I think Q4 is a little bit of a proxy in terms of kind of where the company is headed. So overall, there's a lot of things going on around us at the moment. We're navigating them reasonably well on an absolute scale, I think very well on a relative scale. So more to come in September.

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

That's helpful. And then just as a follow-up, you mentioned some market share gains on some of the more mature product areas. I'm just curious if there's any other color you can provide on that? And do we think about that as being sustainable? Or were you feeling sort of an interim gap?

And before I forget, I guess I'll wish the Lightning luck in the rest of the Stanley Cup finals.

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

I was hoping you were going to say that. You know what, your Rangers are an awfully good team. And I think they're going to be really, really good the next 3 to 4 years. So thanks for that. And we're rooting them on. They had a tough loss last night. But we appreciate the -- we appreciate the Ranger fan converting to a Lightning fan, at least for the next couple of weeks. Thank you.

On the share gain, I would -- I don't know how to handicap that. We did a number of customers some favors by navigating supply chain and helping them out when they needed some help. Is that sustainable? I don't know. Some of it will be, some of it won't.

I do think, though, if you take a look at the blue-green slide, and I know the one that we post in the deck kind of gives you relativity: FY '20, FY '21, FY '22. But if you pull the blue-green slide out of your last deck from the March call and you take a look at what we said in March versus where we sit today, again, for the year, I think -- I don't remember the exact numbers, but I think Digital Print & Retail is up from what we said 90 days ago; 5G Wireless & Cloud is up from what we said 90 days ago; Networking & Storage.

So I think that's a good proxy of where we picked up some share, again, largely around our ability to execute supply chain and getting product to factories for customers. Will some of that stick with us? I think so. And I think you'll hear about some of that in September.

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**Operator**

Our next question is from the line of Mark Delaney with Goldman Sachs.

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

The first one is on the macroeconomic environment. And Mark, you commented on some of these uncertain headlines that are out there. And I'm curious, is this just something you guys are seeing in terms of the economic data points that are being reported? Or are there actual customer schedules for 6 to 12 months out that are starting to slow? And if there are actual customers that are indicating things may be slowing, are there any end markets you can point to?

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

Well, I'm not going to get into customer data. I would say that -- I would say, what's good news is, if we go back to -- so again, the world is a tough place, and it's a tough place for any large corporation at the moment. But boy, I like our chances.

If you go back in a tough environment with everything, I think in September, if I remember right, we thought the year would be like $31.5 billion or something like that, and now we're up at $32.8 billion. So again, I think that's reflective of our ability to execute in a tough environment. And again, I think it speaks to how we're positioned with the portfolio we have.

In terms of what -- we always see puts and takes. Are some of those puts and takes maybe, I don't know, peak to trough? Peak to trough. Are some of those maybe more abrupt in an environment like this? Maybe. But again, as I step back and I look at -- if you take our current guide and look where the year is going to end up, I feel pretty good about the year overall.

So -- and I think the other thing we've been talking about, and I think it gets way overspoken on earnings calls and people talk about secular this and secular that, but what I think is very real is we have some wonderful opportunities for '23 and '24 that have started to come through the P&L this year. And we talked about electric vehicles. We talked about personalized healthcare. We talked about some of the changes and advancements in connected devices.

I think about what's going on in terms of automation in the retail space. I think about what's going on with new fabs being built in our Semi-Cap business. I think about what's going on in the 5G build-out. So they're certainly not -- those types of businesses, if we get into a massive recession, will have impact to the negative.

But all things being equal, when you look at those businesses, and then I also think about how we've refined and improved what you might think of as our more legacy business, all in all, I feel good about the fourth quarter. And again, I think we'll have some reasonably good things to say in September.

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

Okay. That's helpful. My second question is on the China region. And we're seeing some headlines of business resuming post some of these shutdowns in different parts of China. Could you better characterize to what extent things are back open, maybe relative to March when Shanghai, for example, went into lockdown? To what extent are things back to those sorts of levels? Or is it still 70%, 80%? And if it's not back at full volumes, when do you think you may be back to full volumes in China?

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

I think we'll be back to full volumes in China now. And we've handicapped that a little bit in the fourth quarter. But our assumption is, is that China runs at, say, let's -- let me just -- let me say something to you illustratively and don't pay too much attention to the numbers, but you'll get what I'm trying to say.

If you take our overall China capacity, and let's just say that we assume that, that capacity is going to run at 80%, 85%, when things do get shut down or things go bump in the night, we have enough residual capacity there, if you will, to make things up pretty quickly. I would say, for 4Q, we're assuming that our capacity is going to run at 80%, 85%, and all indications are that's a good assumption set. And things -- we're not assuming things will be quite as difficult as they were in Q3. By the way, I think that's also a variable in why the margins Q3 to Q4 are up.

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

That's very helpful. Congratulations on the good results.

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

Thank you.

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**Operator**

Our next question is from the line of Paul Chung with JPMorgan.

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

So just on free cash flow, pretty steady guidance here despite tough macro backdrop. Talk about some of the puts and takes there on offsetting some heavy investments in inventory. And then you mentioned some normalization later this year, but are you expecting some structural step-ups here on working cap offers maybe moving forward?

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

So Paul, thanks for that question. I think if you look at our earnings, earnings are up. It's up from the beginning of the year. It's up again quarter-over-quarter. I think the inventory number was slightly higher than what we expected. Working capital was up a little bit. I think the reasons for those are very clear. It's a complex sort of supply chain, the COVID shutdowns didn't help.

But overall, we still feel we can get to our free cash flow number. We will see some reduction in working capital in Q4. In fact, if you look at our free cash flow this year versus last year, at this point in time, we're actually ahead of what we were last year. So I feel good about that $700 million free cash flow number, Paul.

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

Great. And then just a follow-up on the automation side. So where are you seeing kind of incremental opportunities for CapEx and M&A to kind of enhance the firm's capabilities? It seems like you have some momentum here at Badger, from what I can see. I know that part of the business is small, but how are you kind of leveraging some robotics technology across the business?

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

I think we're doing a really good job of that. One of the things that we spend a lot of time internal about is, A, control what we can control. And if you think about our business, at the very, very core of our business is we build stuff, and it's that simple.

And if we're going to build stuff, we should have the best factories in the world. I would say, of our overall factory network today, we're really, really proud of about 80% of our factories. And we got 20% of the factories that operate really well. So far from perfect.

But also, I would say the OpEx investments we've made, along with the CapEx investments, both in IT, operations, automation, AI, data analytics, et cetera, are starting to come through in the factories. And we think that will carry through for '23 and '24. And I think, overall, we're going to be able to continue to do more with less. And I think that's also reflected in our overall SG&A numbers as well, which I think is a good thing.

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**Operator**

We've reached the end of the question-and-answer session. I'll now turn the call over to Adam Berry for closing remarks.

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

Thanks, everyone, for joining. This now concludes our call.

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**Operator**

This will conclude today's conference. Thank you for your participation.

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