

Company Participants

Timothy Perrott - VP, IR

Diego Scaglione - EVP & CFO

Gerry Smith - CEO & Director

Conference Call Participants

Michael Lasser - UBS

Operator

Good morning, and welcome to The ODP Corporation's First Quarter 2023 Earnings Conference Call. [Operator Instructions]. At the request of the ODP Corporation, today's call is being recorded. I would like to introduce Tim Perrott, Vice President, Investor Relations and Treasurer. Mr. Perrott, you may now begin.

Timothy Perrott

Good morning, and thank you for joining The ODP Corporation's First Quarter 2023 Earnings Conference Call. This is Tim Perrott, and I'm here with Gerry Smith, our CEO; and Anthony Scaglione, our Executive Vice President and CFO. During today's call, Gerry will provide an update on the business, focusing much of his commentary on our accomplishments for the first quarter of '23, including our operational performance and the progress we are making on all of our initiatives to drive shareholder value. After Gerry's commentary, Anthony will then review our first quarter financial results, including highlights of our divisional performance. Following Anthony's comments, we will then open the line for your questions. Before we begin, I need to inform you that certain comments made on this call include forward-looking statements, which are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements reflect the company's current expectations concerning future events and are subject to a number of risks and uncertainties that could cause actual results to differ materially. A detailed discussion of these risks and uncertainties are contained in the company's filings with the U.S. Securities and Exchange Commission. During the call, we will use some non-GAAP financial measures as we describe business performance. The SEC filings as well as the earnings press release, presentation slides that accompany today's comments and reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures are all available on our website at investor.theodpcorp.com.

Today's call and slide presentation is being simulcast on our website and will be archived there for at least 1 year. I will now turn the call over to Gerry Smith. Gerry?

Gerry Smith

Thank you, Tim, and good morning to everyone on the call. We really appreciate you joining our call today, and we're excited to be here with you this morning to discuss our first quarter 2023 results. As you can see in the earnings release that we issued this morning, we're off to a terrific start to the year, delivering better-than-expected results in a mixed demand environment as we made significant progress accelerating our platform under our new four business unit structure.

As highlighted on Slide 4 of our presentation, our continued commitment to operational excellence and our low-cost model approach, again, position us to deliver strong results in the quarter, despite an overall challenging macroeconomic backdrop. We improved on nearly all of our operational KPIs in the quarter, driving strong increases in operating income, EBITDA, earnings per share and cash flow. And we delivered this strong performance while continuing to execute on our \$1 billion share repurchase authorization, buying back over \$200 million of our shares during the quarter and over \$350 million since we launched the program in Q4.

This is all made possible through the tremendous efforts from all of our team members. I'd like to recognize our team for remaining focused on delivering these strong results, which is a true testament to our team's

unrelenting commitment to operational excellence, placing us well on the path of achieving the long-term goals we identified during our Investor Day meeting.

Before I highlight our major accomplishments and performance in the quarter, I'd like to take a moment to reflect upon our transformation and the value that we are creating through our new four business unit structure. Over the past several years, we have created a much more dynamic and capable company with a realigned structure that allows us to more fully utilize our assets, provide greater transparency into the value of our business and create new avenues for growth.

We are a new ODP, and we're on a path to unlocking the full potential of our business and setting us apart from others in the industry. We believe we are only in the early stages of unlocking our potential through this transformation, which is only beginning to be recognized externally. As I look back, we are a vastly different and more dynamic company today compared to when I joined over 6 years ago.

We have streamlined our cost structure, specifically reducing costs in our operations with over \$500 million removed from the business from an SG&A perspective, realigned our assets to drive stability and long-term growth and embedded our 5C Culture through the organization, driving better performance across all our business. This has resulted in a stronger foundation and has positioned ODP to pursue new and exciting growth opportunities.

This is shown on Slide 5. Let me start with ODP Business Solutions. ODP Business Solutions is a large and growing B2B distribution business with over \$4 billion in annual revenue, serving enterprise-level companies as well as medium and small businesses. It serves over half the Fortune 100 and provides customers with a highly curated procurement solution, delivering core business products, along with growing categories in adjacency products such as Jan/San, Cleaning & Breakroom, Tech, Workspaces and Copy & Print products and services.

In fact, our Jan/San business alone generates about \$700 million on an annual basis, making us one of the larger distributors of Jan/San-related products in the U.S. As highlighted during our Investor Day, ODP Business Solutions is focused on growing its business, expanding to new product categories and growing its margin profile back to pre-pandemic levels was a goal of 5% plus EBITDA margins, along with strong cash flow conversion. This is a highly valuable B2B distribution business with a solid path for long-term growth.

Next is Office Depot, our most familiar brand name, which, for the first time, is now a true omnichannel consumer business with a profitable retail footprint and award-winning eCommerce platform. Office Depot continues to be a cash generation engine for ODP. And with our focus on 4-wall risk-adjusted positive contribution, we've generated strong consistent EBITDA and cash flow, while also improving the customer experience with one of the highest NPS scores in the industry.

Next up is Veyer Logistics. While a relatively new brand name, Veyer has been the making for over 30 years and is our world-class supply chain services and sourcing provider. Veyer is one of the largest and unique supply chain operations in North America with a capability to serve 90.5% of the North American ZIP codes with next-day service, along with capability delivered directly to the desktop for our enterprise customers.

Veyer serves its internal customers ODP Business Solutions and Office Depot with best-in-class, low-cost efficient service, while also leveraging its existing capacity to provide logistics services to third-party customers. We have just begun to unleash Veyer's unique and valuable assets and capabilities. These include a large private fleet of approximately 600 vehicles, over 9 million square feet of distribution and logistics space, a national network of approximately 100 facilities, including distribution centers, cross docks and import facilities, a global sourcing presence and numerous long-standing relationships with international and national carriers, including last mile providers.

I would highlight that our global sourcing office and presence in Asia is a key differentiator and a unique asset that provides us with a significant presence in the region allowing us to stay on the pulse of the manufacturing market and supply chain dynamics. There also has been modernizing and building additional capabilities in the management information systems that eases to run its business. We're partnering to deploying a Gartner Magic Quadrant level tech stack that is allowing us to more effectively manage our business, improve service levels and provide flexibility to deliver services to external third parties.

For example, we implemented our flow path cost technology, providing critical cost intelligence to optimize our operations. We've also begun to deploy our new warehouse management system, supporting our operations and

automating tasks as well as implementing our direct inject capabilities, both improving our ability to integrate and provide services to third-party customers. We have implemented transportation management tools, providing intelligence for low tendering and routing and other analytic tools that helps us optimize our service levels and improve our ability to provide supply chain and logistic services to third parties and internal customers.

The enormous capabilities we've developed and the value of these assets alone would be very challenging to recreate in today's market. We've transformed Veyer from a cost center into its own focused business and profit center to capture the full value of these unique assets today and to help drive a new narrative for ODP and our shareholders, driving value in this business. Veyer already driving success, adding new external customers as well as its way to achieving the goals we identified during our recent Investor Day meeting.

And finally, Varis. Varis is a transformative digitally native B2B procurement platform business that we've been creating over the last couple of years. As a category creator, Varis is focused on transforming the complete procurement ecosystem for buying organizations and the suppliers who serve them aligned for a more modern, frictionless consumer-like experience for B2B buyers and suppliers.

The market potential for Varis is huge. Over \$4 trillion in gross indirect transaction volume exists within our target market. While we're still in the early stages having recently launched this platform at the end of last year, Varis is making good progress, adding customers to its platform, enhancing its tech capabilities. Overall, our realigned business model is a game changer for ODP and its shareholders, allowing for greater asset utilization, more transparency into the value of each of our business units and new avenues to pursue profitable growth.

Combining these attributes with our disciplined capital allocation strategy, ODP is in an excellent position to drive strong long-term value and returns for shareholders. And we're executing upon this new foundation to what I call our Three Horizon Strategy, as shown on Slide 6. Our Three Horizon Strategy puts into perspective how we will drive our business in order to unlock the underlying value of our business, build long-term sustainable growth, expand our EBITDA multiple and maximize shareholder value.

Let me briefly highlight this approach. Our first horizon focused on continuing to drive Office Depot's strong operating performance, excellent customer service, Net Promoter Scores and most importantly, strong EBITDA and cash conversion. Office Depot as a cash generation engine, and this horizon continues that focus getting the most out of this engine. We will continue to optimize and nurture this business, adding new product assortment aligned with customer needs, while continuing to provide value to small business, education and home office customers.

Office Depot meets the needs of our customer base across the consumer, small business and education markets, and we're excited about the capabilities that we now have under our omnichannel approach. In fact, we recently began testing and expanding our product assortment, launching both our and College Dorm Packages, further leaning into both party essentials for the home and office as well as product featuring furniture fixtures, further supporting parents and students in their educational journey. I'm excited about these initiatives and their potential.

Our second horizon is focused on continuing to drive our B2B distribution business. ODP Business Solutions, driving growth, margin expansion and cash flow. This is a business with a solid runway ahead for profitable growth and over time, should command a higher multiple in line with other B2B distribution businesses. As you can see in our release this morning, we are moving well along that path to doubling its operating income from a year ago. Our team is executing upon this horizon, gaining traction with current and new customers, expanding its products and services and expanding its margins, all aligned with our long-term targets. We believe that, as we continue to execute, the market will begin to recognize the value of this higher multiple business, and this will be reflected in ODP's overall value. Our third horizon is building value and pursuing higher long-term growth opportunities through both Veyer and Varis. Both of the business units represent significant long-term growth and multiple expansion opportunities for ODP.

Veyer, as a growing supply chain and logistics company with long-term EBITDA growth, inventory procurement management remains a key focus, and we will use the strength and agility of our supply chain to chase demand. As I said earlier, Veyer is off to a great start and well its way to meeting or exceeding the goals we established during our Investor Day meeting. And Varis serving as a high-growth, high multiple component to this long-term horizon. Varis represents the largest addressable market opportunity for ODP with a scalable business model in a very large target market.

We're excited about the path that Varis is on and the numerous opportunities to pursue growth, scale the business and drive further value to our shareholders. So overall, executing along our Three Horizon Strategy will allow us to continue to drive our near-term cash flow engines, while positioning us to pursue both mid- and long-term growth and higher multiple businesses, which we believe will create significant value for our shareholders.

Of course, this is all anchored in our low-cost business model focus and capital deployment plans, driving both EBITDA and EPS growth and continuing to live our 5C Culture. Lastly, we will continue to demonstrate our operational excellence, which is fundamental to our success. Now turning to the highlights of our key accomplishments for the first quarter, as shown on Slides 7 through 13.

First, we drove strong overall operating performance in the first quarter. While revenue was down slightly largely due to fewer stores and service and lower traffic, we delivered strong increases in adjusted operating income, EBITDA, earnings per share, which is up 40% over last year and a significant increase in cash flow. Our commitment to operational excellence and our low-cost model approach, combined with flexible pricing and distribution strategies, helped drive the strong performance against the ongoing challenging macroeconomic backdrop, hampered by high inflation and sluggish consumer growth.

I can't say enough about our team's continued focus and discipline in achieving these strong results in the quarter. Anthony will provide more of these details on the drivers in his prepared remarks later on the call. Next, we continue to aggressively execute upon our \$1 billion share repurchase authorization that our Board of Directors put in place in November of last year. During the quarter, we repurchased approximately 4 million shares for just over \$200 million.

And since the beginning of the authorization, we have repurchased approximately 7.6 million shares in total for approximately \$354 million. Putting this activity into context, over the past 2 quarters, we have bought back nearly 20% of the market value of the company. Moving forward, we will continue to be disciplined monitoring market and economic conditions and continue to prioritize capital allocation while prudently managing our forward business unit model.

Next, our business units continue to deliver strong performance and KPIs that indicate we are making progress against the goals we set during our Investor Day meeting. These highlights are shown on the following few slides. ODP Business Solutions grew its top line 3%, improved its margin performance and doubled its operating income over last year. Adjacency penetration was 44% of division revenue, and revenue retention rate remained high at 98%. This was an incredible performance for the team, especially in light of certain onetime COVID-related test kits that occurred in Q1 of last year.

Office Depot continued to generate strong margin performance and cash flow generation despite lower overall revenue largely due to fewer stores and service and lower omnichannel traffic. We are in the early days of omnichannel efforts and remain optimistic but are monitoring the state of the consumer, while leveraging our key segments in education and small business. Veyer delivered strong performance in the quarter, maintaining cost-effective services for its internal customers, while generating revenue and EBITDA growth from external customers. Veyer continues to be a shining example of operational excellence and continues to deploy and use business management systems to more effectively drive its business.

In the quarter, Veyer continued to improve upon its service level metrics while driving efficiency throughout the network utilizing route management tools to optimize the network, driving more capacity to our own presence fleet and balancing capacity among our 3PL partners. We also continue to make progress on our tech stack deployment and capabilities, improving our position to serve external third-party customers and improve internal operations. We started go live with what we call Direct Freight Inject, which provides greater capabilities and intelligence to more efficiently integrate and provide third-party freight services.

We also began to deploy our new Warehouse Management System technology or WMS in our Dallas facility, which aims to streamline our operations and provide greater capabilities to serve third-party customers. and Veyer Intelligence, a technology that helps us improve inventory management. So overall, we're very excited by the progress we are making for the future of Veyer. Veyer continue to make progress in providing services to external third parties during the quarter. Relative to last year, sales and EBITDA generated from third-party customers were up over 50% and nearly 100%, respectively. Veyer is well on its way to double its EBITDA from third-party customers in 2023 and on a path to meet or exceed its longer-term goals.

And Varis has continued to onboard and ramp new customers on its recent launch platform, driving transaction volume to suppliers during the first quarter. Varis is making excellent progress, enhancing its capabilities and onboarding new customers to the platform. We also hosted a demo of the platform back in March, allow investors to see firsthand the capabilities of the platform and its consumer life experience. We are excited about the path that Varis is on, and look forward to providing more updates in the future. So overall, our business unit performance in the quarter provides strong evidence that we are well on our way to reaching our long-term goals.

Next, on Slide 13, we continue to invest in the future of our business, enhancing our digital platform and eCommerce capabilities as well as our supply chain network to more effectively provide logistics services to external third-party customers. And as I mentioned, we have and continue to evaluate selective category expansion opportunities in both our B2B and consumer divisions. Additionally, we expanded our relationship with Microsoft to include Microsoft Azure OpenAI service, Advanced Artificial Intelligence technology to evaluate ways we can enhance our customer experience, drive operational efficiencies and more effectively pursue growth opportunities. We're excited about this technology and how this can help further transform our business and drive additional efficiencies aligned with our low-cost model.

And finally, subsequent to the quarter end, we completed the sale and partial leaseback of our headquarters building. This was a significant accomplishment for our team and a great example of prudent asset management, which will result in additional operational efficiencies and a leaner structure moving forward. I am still proud of our team and all the accomplishments in the quarter.

Looking ahead to the balance of the year, we remain cautiously optimistic as we continue to navigate that challenging macroeconomic environment and its related negative impact on consumer activity. We've maintained our previously issued guidance for the year and remain in a position of strength with a low-cost business model mindset, diverse routes to market and a strong balance sheet.

As we move through the year and monitor consumer activity, we will continue to prioritize capital allocation, while prudently managing our four business unit model, remain focused on delivering strong shareholder returns. With that, I will turn the call over to Anthony for a review of our financial results.

Diego Scaglione

Thank you, Gerry, and good morning to everyone on the call today. I'm happy to be here today to provide more detail on our financial results for the first quarter. As I begin, I'd like to say thank you to our entire team for remaining focused and delivering strong performance, while navigating through the effects of high inflation and an evolving macroeconomic environment.

As we stood up our four business units late last year, this is the first full quarter to start our fiscal year under the new structure. In the quarter, we drove improvements in the majority of the KPIs we identified during our Investor Day meeting last fall, resulting in strong financial performance in Q1. Compared to last year, we drove double-digit percentage increases in operating income and net income, including a 40% increase in adjusted earnings per share. Our performance was as a result of our operational excellence and our capital allocation focus, a combination that will continue to enhance value to our shareholders. And to emphasize what Gerry said earlier, we have repurchased over \$350 million of our stock since putting the new plan in place back in November of last year.

This represented nearly 20% of our market value. Overall, our strong performance and disciplined capital allocation in the quarter is a clear demonstration of our focus and continues to be a testament of our winning 5C Culture. We remain excited about our new four business unit structure and how this positions us to more fully utilize our assets and pursue greater opportunities for long-term growth. We are making progress along the path we set during our Investor Day meeting. ODP Business Solutions continues to gain momentum. Veyer is now positioned to pursue new third-party services, Office Depot continues to leverage its omnichannel capabilities to meet customer needs and drive strong cash generation and Varis has launched its network and is onboarding new customers while continuing to enhance its capabilities.

We are a new ODP. And these 4 BUs pursuing growth independently and working in concert should drive significant shareholder value over time. As you heard from Gerry, the macro environment remains challenging, not just for us, but for the majority of businesses in nearly all industries. Inflation remained at record highs, outpacing wage increases, placing additional strain on consumers.

For ODP, high inflation continues to impact the average cost of goods sold via our product baskets, along with other input costs of the business. And as widely reported, slowing GDP growth and higher interest rates has reduced consumer activity, negatively impacting nearly all companies with consumer exposure. Supply chain conditions have improved from the peaks of last year, but continue to remain challenging, although we expect them to be a tailwind in 2023.

Overall, our ability to execute and navigate this challenging environment is a testament to the investments we have made over the years and is a core strength in our foundation. Our diverse routes to market illustrates the value of our platform. While it's still early in our journey to show how we are creating differentiated value for our customers, which will drive shareholder value, I feel our best days are still ahead as we execute across our long-term strategy.

Now turning to the highlights of our financial results, as shown on Slide 15. Consistent with previous quarters, we have provided our results both on a GAAP and adjusted basis. Turning to the specifics of our results. We generated total revenue of \$2.1 billion in the first quarter, down 3% versus Q1 of last year. The reduction in revenue was primarily driven by lower sales in our consumer business, Office Depot, partially due to 73 fewer stores in service compared to last year, coupled with lower traffic, lower eCommerce sales and lower comparable sales for products previously and higher demand last year in the later stages of the pandemic.

This was partially offset by stronger sales in ODP Business Solutions as return to office trends and business activity remained strong in the quarter. In addition, ODP Business Solutions overcame approximately \$50 million in onetime COVID-test kit sales in the prior year that didn't repeat. So overall, growth in Business Solutions was really impressive. GAAP operating income in the quarter was \$95 million, up 25% from Q1 of last year. Also included in operating income with a net \$4 million of charges associated with noncash asset impairment, primarily related to the right-of-use assets associated with our store locations.

Adjusted operating income for Q1 was \$99 million, up from \$88 million last year. Unallocated corporate expenses were \$23 million Adjusted EBITDA of \$131 million for the quarter compared to \$125 million in last year's first quarter. This includes depreciation and amortization expense of \$30 million and \$34 million in the first quarter of 2023 and 2022, respectively. Excluding the after-tax impact from the item mentioned earlier, adjusted net income for the first quarter was \$75 million or \$1.78 per diluted share compared to adjusted net income of \$64 million or \$1.27 per diluted share in the prior year period.

This represents a 40% increase in adjusted EPS, driven by both higher net income and a reduction in share count as a result of our strong execution under our share repurchase program. Turning to cash generation. In the quarter, we drove very strong increases in cash flow. We generated operating cash flow of \$157 million, which includes about \$5 million related to restructuring items. Overall, we were up significantly compared to operating cash flow of \$30 million last year.

Capital expenditures in the quarter were \$27 million compared to \$21 million in the prior year period, reflecting targeted growth investments in our digital transformation, supply chain and distribution network and eCommerce capabilities, partially offset by lower CapEx in our retail division. Adjusted free cash flow in the quarter was \$133 million, a significant increase from \$16 million in the previous year.

I want to thank our entire team for being laser focused on managing our working capital and driving the strong increase in cash flow. Our cash generation in the quarter was a result of our overall stronger operating performance and influenced by the timing of certain working capital items, which were more impactful this quarter. This was primarily related to our management of cash flow items at the end of the calendar year, which as we described on the last call, happened to be aligned with our fiscal year-end.

As a result, Q1 cash flow benefited from some of the shift, and as we move throughout the balance of 2023, we will remain disciplined as we manage through the seasonal effects of cash in our business, specifically as we build inventory in the coming quarters and in advance of the back-to-school season. Overall, excluding some timing elements, we remain focused on cash conversion as a key enterprise metric, and I couldn't be prouder.

Now I would like to cover our business unit performance, starting with our ODP Business Solutions division on Slide 16. ODP Business Solutions continued to deliver improving results as return to the office trends maintain traction, generating revenue of just over \$1 billion in Q1, up 3% in the quarter relative to Q1 of last year. As I highlighted, this revenue increase is even more impressive given we are comping over a very large onetime PPE order that was included in last year's first quarter results that did not repeat this year.

Overall, looking at ODP Business Solutions, our core contract business, our Grand & Toy business in Canada and in particular, our Federation Companies, all delivered year-on-year growth. As a reminder, our Federation Companies are the regional tuck-in acquisitions we have been executing over the past few years, including a regional acquisition in Texas this year, expanding our distribution reach and continuing to leverage our distributed infrastructure. We have been successfully executing this strategy in growing this business, which now generates well over \$500 million in revenue on an annual basis.

This independent dealer market continues to be highly fragmented and our disciplined approach gives us tremendous runway to keep growing our platform strategically over time. From a product and services standpoint, we saw stronger demand across the board for core supplies as well as in certain adjacency categories, including Workspaces and Technology. Our adjacency product categories as a percentage of total revenue, a key KPI for ODP Business Solutions, remained at 44%. This percentage may toggle from quarter-to-quarter, but our long-term objective is to consistently grow adjacencies both on an absolute dollar and percentage basis as we expand our value proposition and continue to leverage our strength in core categories.

For 2023, we expect this percentage to be flat to slightly up as compared to fiscal 2022 as core categories continue to have good growth from the rebound in back-to-office activity. And consistent with our Investor Day meeting, ODP Business Solutions is on a path to drive its EBITDA margins back to pre-COVID levels with an opportunity to expand long-term margins beyond this level by staying true to our low-cost business model.

ODP Business Solutions continue to make great progress on this goal throughout the quarter, generating operating income of \$39 million, doubling last year's Q1 results. This represents a nearly 200 basis points margin improvement as a percentage of sales. This is a huge accomplishment and places ODP Business Solutions well on the path to meeting and over time, exceeding its long-term goals.

Strong sales of core supplies, efficient operations and pricing discipline helped to mitigate inflationary pressures and positioned us to drive these strong results. I would add that the work that we started early last year utilizing our data-driven approach and performing line level reviews of customer contracts continues to contribute to our success.

Now turning to our Consumer Division results, as shown on Slide 17. Our Office Depot Consumer Division continued to provide excellent service, strong NPS scores and a compelling value proposition to its small business, home office, education and consumer customers. NPS scores remained at over 70%, some of the best satisfaction scores in the industry. Reported revenues in the quarter were down 8% to \$1.1 billion, driven largely by 73 fewer retail stores in service this year versus last year related to planned store closures as well as lower traffic in both our retail and eCommerce channels as more customers return to the office.

On a same-store sales basis, sales were down approximately 3%. Sales per shopper was down slightly, mostly due to lower average order volumes, partially offset by higher conversion rates. Lower sales for product categories previously and higher demand during the window of the pandemic contributed to lower year-over-year revenues, as did lower omnichannel sales. A good example of this is protective equipment and cleaning products as well as tech. Partially offsetting lower demand in same-store traffic in the quarter with continued strong demand for our Copy & Print services, a key traffic driver.

Like most other large consumer businesses and as evident in media reports, consumer activity in the quarter remained sluggish, contributing to lower overall omnichannel sales. This is an area we are continuing to monitor very closely as we move throughout the year. From an operating perspective, we continue to deliver solid operating margin performance in the quarter, despite the lower traffic and higher supply chain and inflationary costs.

On lower revenue, we maintained margins at 8% compared to last year, resulting in operating income of \$85 million in the quarter compared to \$96 million last year. Lower operating income compared to last year was primarily driven by lower sales and higher costs related to inflation. We remain excited by the launch of our new Imagine Success campaign, which highlights how we are a destination for small business, home office, education and consumer customers, who can rely on us to meet their growing needs.

And as we mentioned during our Investor Day meeting, our KPIs for Office Depot are focused on improving our same-store sales comp and driving eCommerce sales. For the year, we're focusing on delivering same-store sales comp in the range of negative 2% to negative 3% on a comparative basis, which is a slight improvement

over fiscal 2022. We also expect that our online penetration will be a source of strength as we continue to execute on the full potential of our omnichannel strategy.

Now turning to Slide 18. I want to highlight financial results to provide insights into Veyer's operations. As Gerry mentioned earlier, we have separated Veyer into its own business and its own reporting unit. Veyer specializes in B2B and consumer business service delivery with core competencies in distribution, fulfillment, transportation and procurement, which includes our global sourcing operation in Asia.

As we outlined at Investor Day, Veyer serves the internal needs of its primary customers, Office Depot and ODP Business Solutions, as well as third parties through our procurement and supply chain business. As a reminder, our intercompany agreements between Veyer and the business units stipulate the cost and fees charged for procurement of goods and supply chain services.

Veyer's mission is to be an efficient supply chain provider to Office Depot and ODP Business Solutions, which in turn will drive the best enterprise results upon consolidation for our entire enterprise. Therefore, as Veyer undertakes actions to drive efficiencies, including strategically optimizing working capital and distribution effectiveness, the intercompany revenue and corresponding allocated profit to Veyer could fluctuate over time.

As an example, as Veyer successfully pursues new sourcing activities that should reduce the inflationary impact we have seen in certain categories, therefore, benefiting the total ODP enterprise, the fees Veyer collects from the sourcing component of the intercompany transactions could be lower, resulting in lower allocated operating profit at Veyer.

Therefore, as we proceed throughout this year and going forward, it will be helpful to provide investors with transparency as to the fluctuations in Veyer's operating results from these intercompany activities, ensuring that we provide optimal cost to the business, while continuing to leverage the infrastructure for third-party growth.

Regarding its financial results for Q1, Veyer drove sales of \$1.4 billion, predominantly supporting the purchasing and supply chain operations of ODP Business Solutions and Office Depot, which are effectively eliminated upon consolidation. Excluding intercompany sales, Veyer drove approximately \$7 million in sales to external parties, up over 50% compared to the same period last year.

From a bottom line perspective, Veyer's total operating income for Q1 was \$15 million compared to \$8 million last year, primarily due to the aforementioned intercompany transactions, mix and third-party activity. Specifically, as a key metric that we identified during our Investor Day meeting, we are beginning to see solid early traction in EBITDA generated from third-party customers. And while still small, this is one of our key metrics going forward.

In the quarter, we generated about \$2 million in EBITDA from third-party customers, a significant increase over prior year, positioning us well on our way to more than double EBITDA from third-party customers in 2023 compared to 2022.

Now turning briefly to Varis on Slide 19. As you heard from Gerry, Varis is our digitally native B2B procurement platform that aims to provide a more modern and convenient experience a consumer-like experience, connecting buyers and suppliers in a way that solves the pain points that exist in B2B procurement today. While just launched, Varis is continuing to add customers and suppliers to its network, with the goal of driving gross transaction volume, or GTV, which is both merchandise and services volumes through the network.

While in the early stages, this is a KPI we identified at Investor Day. In the quarter, Varis is ramping its first wave of customers and beginning to drive transaction volume to Varis suppliers. Keeping in mind that the platform only recently launched from a results perspective, Varis generated about \$2 million in revenue in the quarter, primarily from subscriptions derived from existing customers.

As we previously announced, we expect that 2022 was the peak investment year for Varis as we prepared and launched the platform and position the business to scale for the future. Related to this effort, Varis' operating loss was \$17 million in the quarter, down slightly sequentially from Q4 of last year. It's still early days, but we remain excited about the opportunities of this platform.

Now briefly turning to our balance sheet highlights, as shown on Slide 20. We ended the quarter with total liquidity of over \$1 billion, consisting of \$343 million in cash and cash equivalents, which includes cash held internationally of \$117 million and \$803 million in availability under our asset-based lending facility. During the quarter, we drew down \$100 million to help fund the timing related to the share repurchase from HG Vora and for general working capital purposes.

And at the end of the quarter, we repaid \$60 million of that draw. As a result, total debt at the end of the quarter was approximately \$222 million. As Gerry previously mentioned, we have been aggressively buying back shares under our buyback plan we put in place in November of last year. In Q1, we repurchased about 4 million shares for approximately \$200 million. Adding this to our activity since the program began, we have retired about 7.6 million shares for approximately \$354 million.

We continue to maintain a strong balance sheet, allowing continued flexibility to invest in our business and repurchase shares. Additionally, subsequent to the quarter, we successfully completed the sale and partial leaseback of our headquarters building, a transaction that helps lower our annual operating expense, better meets our team's workplace needs and improves our overall liquidity profile.

Now turning to our 2023 guidance, as shown on Slide 21. As I mentioned at the start, we are off to a great start to the year and remain cautiously optimistic regarding the balance of the year. We're enthusiastic about the opportunities ahead to pursue long-term profitable growth by driving our four business unit model, executing along our Three Horizon strategies as Gerry identified and remaining focused on prudently deploying capital to maximize shareholder value.

That said, overall, we are carefully proceeding with caution, given some of the weaker consumer activity that we have recently witnessed. Considering this, we are maintaining our previously issued guidance for the year as follows. We are expecting to generate sales in the range of \$8 billion to \$8.4 billion, which includes the impact of closed stores, annualized and expected. We're expecting to deliver adjusted EBITDA between \$400 million to \$430 million and adjusted operating income between \$270 million to \$300 million.

We are aiming to drive adjusted earnings per share between \$4.50 and \$5.10 per share. This range assumes the effect of our activity under our share repurchase program. We are targeting adjusted free cash flow between \$200 million to \$230 million and CapEx between \$100 million and \$120 million. A few additional comments about the guidance. Our guidance assumes stabilization in overall economic trends throughout 2023. While we are encouraged by our strong start to the year, we are prudently reaffirming current guidance as we remain cautious on the state of the consumer and general macroeconomic conditions.

Our guidance also assumes continued activity under our share buyback authorization, a similar pace of store closures at Office Depot and a continued top line and margin improvement at ODP Business Solutions. Additionally, we are assuming a stable supply and procurement environment at Veyer and revenue growth and lower OpEx burden at Varis.

In summary, I could not be more excited about the new ODP. Collectively, there is a new sense of enthusiasm within the organization as we stay committed to what has been our core strength in operational excellence, while maintaining our disciplined approach to capital returns. I feel we are in the early stages for what's to come with our newly defined 4-BU structure and overall platform. And with that, operator, I will turn it over for questions.

Question-and-Answer Session

Operator

[Operator Instructions]. And our first question comes from the line of Michael Lasser with UBS.

Michael Lasser

Anthony, I wanted to dig into the comment that you just made about recent consumer weakness. Can you elaborate on that? Is that -- it's been something that you witnessed in your own retail business along with the businesses of your customers?

Diego Scaglione

Michael, I think it's a general comment around the state of the consumer. As you think about our diverse route to market, we're continuing to see strength in our B2B channel exhibited with the results in Q1, but we're remaining cautious on the B2C side. Now one of the things that I'd like to highlight is, if you look at our B2C channel, we're not just exposed to the consumer. Our B2C channel also works with small businesses, education, but staying cautiously optimistic for the remainder of this year. On the consumer side, I think it's a prudent way that we're looking at the business at this point.

Michael Lasser

And my follow-up question is on the gross margin. What drove the gross margin expansion in the quarter? How much of that was simply seeing a benefit from lower supply chain costs as key inputs like container rates and diesel fuel come down?

Gerry Smith

Michael, this is Gerry, and thanks for your comments. And so I'll answer the first part and flip it over to Anthony. But I think disciplined pricing has been very important. We continue to drive our operating excellence in a low-cost model. So you're seeing improvements from an SG&A perspective as well as procurement costs, but Anthony will comment on the supply chain piece.

Diego Scaglione

Yes. So Michael, if you think about -- and great question. We've seen reductions in both our ocean freight and other input costs like diesel. On the ocean freight side, it clearly has come down significantly from the peaks that we saw and some of the challenges that we face, along with others in the industry around the ocean freight side.

As we think about the cost side of that, it's really about landing the new products, turning those products. So generally speaking, in Q1, we saw modest improvement in costs related to the product side as well as the ocean freight side, but we feel like, as we go through the remainder of the year, we should start to see some of that benefit flow through.

Michael Lasser

Got it. On the B2B business, what was the trend in orders per same customer? So how much did new business contribute new business wins not only within the Federation strategy but also the rest of the business as well as trends on the legacy business on the same customer basis?

Diego Scaglione

Yes. So just to make clear, we had a small acquisition in the quarter contributed less than \$10 million. So most of the growth in BSD was organic. And as I mentioned on the call, we had a very large onetime. I don't like picking onetime because we always have onetime, but I thought it was important to note that last year, we had a very large COVID-test kit in the quarter that when you back that out and you comp BSD had a really good quarter. And that was a combination of existing customer growth as well as new customer acquisition.

Gerry Smith

I think we have a...

Michael Lasser

Sorry, go ahead.

Gerry Smith

I was just going to add that we -- again, 45% of the business is noncore, it is adjacency product. And I think across Federation, across data has multiple routes to market. And so I think that the strength across the business of the diversification is very helpful on that.

Michael Lasser

Got it. I think with respect to the Veyer business, you mentioned that a lot of the growth is coming from -- or a lot of the revenue right now is coming from existing customers. When can we start to see the contribution from new customers who are signing up on the platform?

Gerry Smith

Well, we're excited that -- John has almost a dozen. I mean, I won't give specifically the number, but across multiple industries. So we're already seeing that direction. He's ahead of plan from a -- to hit his \$30 million external target. We're confident in this target for this year as well. So we're seeing a lot of momentum, which we're excited by. And we've had some -- and we continue to build out the tech stack like we talked about.

Our Warehouse Management System is the new implementation, working with [indiscernible] on that. We're excited. Our work on our direct inject freight, which allows us to bifurcate freight and bring it into our facilities. That went extremely well from our pilot facility. So -- and we have a number of -- it's early days, but we have a number of Gartner Magic Quadrant type of software partners that are really helping us build that capability out. But very bullish on the future of this, early days, but the momentum is there.

Michael Lasser

Amazon recently announced that it's going to increase its focus on the B2B segment. How do you see that potential impact for Varis? And then I have one last one.

Gerry Smith

Well, actually, I don't think there's any impact because that team came from Amazon business. It's a completely different market. They are a tail span, loose span, no contracts in place. And so I think it's a big market, but the customer is also asking for exactly what we're doing with Varis, which is a private marketplace, contractual relationship. It's direct between buyer and seller. There's compliance, there's ability to use Amazon-like type of tech platform. But we think this is an enormous opportunity.

Customers are asking for this, and we think that Amazon can operate successfully in their space, and we think we can create this new category that we think is a giant white space, and that's being affirmed with -- and we're focused on ramping revenue, ramping customers and our value proposition is being proven. So we're excited.

Michael Lasser

Got it. And then lastly, Gerry, you highlighted some of the actions that ODP Corp is taking with respect to artificial intelligence and generative AI. This has obviously been increasingly in focus and what this means for the broader state of the workforce. So as you look at it, how are you sizing up in your mind the impact of generative AI and artificial intelligence more broadly as a friend to the business and the positive implications of this versus the negative implications as it displaces workers in our economy, especially white collar workers that serve at core of the customer base that ODP is serving?

Gerry Smith

No. We feel, Michael, as a huge positive. We started talking about it last November with our CTO, Carl Brisco, and Andy Perry, our CIO. We jumped on it early. I love the relationship we have with Microsoft. So I got to shout out to them. We have our own OpenAI private instances within our secure firewall, which is really important. And we're already implementing across many parts of the business to drive. We think it's an accelerator of productivity. We have job descriptions that we have all kinds of road level work being done by the ChatGPT, and we have the Office Depot Assistant now that helps people from a productivity perspective as well.

So we think it's a -- we believe in operational excellence, we think that's going to drive operational efficiency. We really think it's going to give our people more time to focus on what's most important is the customer and driving the most efficient business model across the business. So we're going to be diligent on governance. And our Board and I [indiscernible] talked about that in great detail. We think there's a huge opportunity to make every one of our workers more productive.

And again, more time to sell, more time to focus on the customer commitment, more time to focus on what's the right business model. We think it's a game changer, and we're going to continue to invest in. And obviously, and be cautious from a -- because it's behind our firewall, we think that makes a huge difference from a compliance and governance perspective as well.

Operator

I'll now turn the Q&A over to Tim Perrott, Vice President, Investor Relations and Treasurer.

Timothy Perrott

Great. Thanks, Andrew. I appreciate that. We just had a call -- sorry, a question that's come across on the web here that I would like to maybe pose to Gerry. So the question is, you guys have done a great job of getting cost out of the business. But just how much juice is left in that low-cost model going forward?

Gerry Smith

Yes, I don't want to really emphasis on our investor base. There's a lot of juice left. There always is. The mentality here is the low-cost model wins. We never stopped. We didn't stop at \$100 million. We didn't stop at \$200 million. We're not stopping at \$500 million. And we're going to -- we have a target this year, which I won't disclose, but it's aggressive. We're going to drive it. We've proven over the last 6 years that we do this, but we will never stop driving costs in this business.

And I think the great question for Michael on OpenAI and how ChatGPT is a great one. But we always look at the business model, the opportunities to drive efficiencies across the business. And we spoke to all our leadership about transforming their business, being their own CEO of their business unit, and we're going to drive that mentality across the entire organization, and we'll continue to drive that and show the success we've had.

Right. Well, Tim, there's no more further questions. I want to thank everyone for joining the call today. You have our commitment as a leadership here, and we'll continue to focus on operational excellence. Obviously, continue to focus on in our commitments for the year as well as driving our capital allocation plan in a balanced way, making sure we keep our strong balance sheet, our focus on cash, our focus on driving top line and operating income as well. So thank you, everyone, for joining the call, and I'll turn it back to the operator.

Operator

Thank you and thank you all for your participation. This concludes today's call, and you may now disconnect.