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PLXS - Q2 2014 Plexus Earnings Conference Call

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## OVERVIEW:

Co. reported 2Q14 revenues of \$558m and diluted EPS of \$0.53. Expects 3Q14 revenues to be \$600-630m and diluted EPS to be \$0.69-0.74.



## CORPORATE PARTICIPANTS

**Angelo Ninivaggi** *Plexus Corp. - SVP, CAO, General Counsel & Secretary*

**Dean Foate** *Plexus Corp. - Chairman, President & CEO*

**Ginger Jones** *Plexus Corp. - SVP & CFO*

**Steve Frisch** *Plexus Corp. - EVP & Chief Customer Officer*

## CONFERENCE CALL PARTICIPANTS

**Shawn Harrison** *Longbow Research - Analyst*

**Matt Sheerin** *Stifel Nicolaus - Analyst*

**Sherri Scribner** *Deutsche Bank - Analyst*

**Steven Fox** *Cross Research - Analyst*

**Jim Suva** *Citi - Analyst*

**Brian Alexander** *Raymond James - Analyst*

**Mark Delaney** *Goldman Sachs - Analyst*

**Sean Hannan** *Needham & Company - Analyst*

**Ruplu Bhattacharya** *BofA Merrill Lynch - Analyst*

## PRESENTATION

### Operator

Good morning, ladies and gentlemen, and the welcome to the Plexus Corp. conference call regarding its fiscal second-quarter 2014 earnings announcement. My name is Dawn and I will be the operator for today's call. At this time all participants are in a listen-only mode. After a brief discussion by management we will open the conference call for questions. Please note that this conference is being recorded. I will now turn the call over to Angelo Ninivaggi Plexus, Senior Vice President, Chief Administrative Officer, General Counsel and Secretary. Angelo, you may begin.

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### Angelo Ninivaggi - Plexus Corp. - SVP, CAO, General Counsel & Secretary

Thank you, Dawn, good morning and thank you, everyone, for joining us today. Before we begin I will remind everyone that statements made during our call today that are not historical in nature such as statements in the future tense and statements that include believe, expects, intends, plans, anticipate and similar terms and concepts are forward-looking statements.

Forward-looking statements are not current (inaudible) inherent difficulties in predicting future results and actual results could differ materially from those expressed or implied in the forward-looking statements.

For a list of major factors that could cause actual results to differ materially from those projected, please refer to the Company's periodic SEC filings, particularly the risk factors, in our Form 10-K filing for the fiscal year ended September 28, 2013, and the Safe Harbor and fair disclosure statement in yesterday's press release.

Plexus provides non-GAAP supplemental information such as earnings, or margin excluding special items, return on invested capital and free cash flow. We present information excluding special items because it provides a better indication of core performance for purposes of period-to-period comparisons.



ROIC and free cash flow are used for internal management assessments because they provide additional insight into ongoing financial performance. In addition, we provide non-GAAP measures because we believe they offer insights into metrics that are driving management decisions as well as management's performance under the tests that it sets for itself.

For a full reconciliation of non-GAAP supplement information please refer to yesterday's press release and our periodic SEC filings. We encourage participants on the call this morning to access the live webcast and supporting materials on the Plexus website at [www.Plexus.com](http://www.Plexus.com) by clicking Investor Relations at the top of the page and then events calendar.

Joining me today are Dean Foate, Chairman, President and Chief Executive Officer, in Ginger Jones, Senior Vice President and Chief Financial Officer. Todd Kelsey, Plexus' Chief Operating Officer is not in the office today. His father passed away a few days ago. We extend to Todd and his family our deepest sympathy.

With Todd's absence Dean has asked Steve Frisch, Executive Vice President and Chief Customer Officer, to also be available for today's call to assist with questions relating to our customers and our market sectors. Let me now turn the call over to Dean Foate. Dean?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Thank you, Angelo, and good morning, everyone. For those following along on the slides we are going to be on slide 3. Earlier today we reported results for our fiscal second quarter of 2014. Revenues were \$558 million, above the midpoint of our guidance range, and up 4% over the prior quarter. Non-GAAP diluted EPS of \$0.60 was at the midpoint of our guidance and excluded a \$0.07 net detriment during the quarter.

Ginger will cover the puts and takes to tie out GAAP and non-GAAP EPS during her comments. Return on invested capital is 14.1%, down from the prior quarter due to the anticipated lower margin performance, but still 310 basis points above our weighted average cost of capital.

Let's advance to slide 4. Overall revenue performance was consistent with guidance, but our sector performance was mixed as our network communication sector improved to flat while our Industrial/Commercial and Defense/Security/Aerospace sectors both underperformed loftier expectations. Our Healthcare/Life Sciences sector was in line with expectations.

Our go-to-market teams delivered \$159 million in new manufacturing wins above our target. Our Engineering Solutions group experienced an exceptionally strong quarter of new program wins with results at \$26 million. Again the strength was largely in Healthcare/Life Sciences.

We completed our Fox Cities facility consolidation project and are now focused on improving performance and productivity in our new site. The construction of our new lease facility in Guadalajara Mexico remains on track for completion this summer.

During the quarter we announced we would be closing our facility in Juarez, Mexico and relocating the programs to our new facility in Guadalajara, Mexico. When comparing our results to our second fiscal quarter of last year our revenue performance was essentially flat.

Confirming that we had replaced approximately \$92 million of revenue for Juniper Networks that we recognize for that comparable period, our operating margin improved 30 basis points versus the prior year quarter. Our full-year revenue outlook improved modestly during the quarter.

Please advance to slide 5 for some insight into our performance of our market sectors during our fiscal second quarter of 2014 as well as our current expectations for Q3.

Our Networking/Communications sector was flat sequentially in fiscal Q2, an improvement over our expectations for high single-digit decline in revenues. While demand was soft for the majority of our network communication customers coming into the quarter eight of our top 10 customers improved their forecasts as the quarter unfolded with two notable improvements related to specific product strength.

Looking ahead to fiscal Q3, we currently anticipate strong performance for our Networking/Communications sector as newer program ramps should deliver sequential revenue growth of better than 20% for this sector. Our Healthcare/Life Sciences sector was up 1% sequentially in Q2, in line with our expectations.

Looking ahead to fiscal Q3, while we anticipate mixed performance among our Healthcare/Life Sciences customer base, we currently expect strength in our larger customers to deliver overall sector growth in the low- to mid-single-digits.

Our Industrial/Commercial sector was up sequentially above 7% in our fiscal Q2. This result was weaker than our expectations for low teens percentage growth as eight of our top 10 customers missed earlier forecasts. We currently anticipate that our Industrial/Commercial sector will be up in the high-single-digit percentage range in our fiscal Q3.

We continue to experience modest strengthening of customer forecast in conjunction with new program ramps. Our Defense/Security/Aerospace sector was up 20% in Q2 a good result, but we had expected an even stronger performance as several customers underperformed earlier forecasts. We currently expect Q3 to be up in the mid-single-digit percentage range as we experience mix performance among our Defense/Security/Aerospace customers.

Turning now to new business wins on slide 6. During the quarter we won 41 new programs in our Manufacturing Solutions group that we anticipate will generate approximately \$159 million in annualized revenue when fully ramped in production.

This quarter we had relatively strong performance in new business wins into our EMEA and APAC regions where the dollar value of the wins represented a significant percentage of regional quarterly revenues. Both of these regions are presently operating below corporate average capacity utilization.

Slide 7, our manufacturing wins performance trend remained strong with a trailing four quarter performance as shown by the blue bars at \$731 million. Our wins performance in fiscal Q2, as shown by the overlaid green bar, was down sequentially from Q1 but was still above our quarterly target of approximately \$150 million.

As a reminder, we believe that trailing four quarter wins performance at 25% of trailing four quarter revenues is sufficient to deliver growth consistent with our longer-term target. Our funnel of new business opportunities pulled back to \$2.1 billion versus the \$2.3 billion last quarter, but remains healthy and sufficient for growth.

Turning now to our guidance on slide 8, we are establishing fiscal third-quarter 2014 revenue guidance of \$600 million to \$630 million. The midpoint of this guidance range suggests that our fiscal third-quarter revenue would be up approximately 10% sequentially with revenue growth anticipated in all four of our market sectors.

We are guiding diluted EPS in the range of \$0.69 to \$0.74; our EPS guidance includes approximately \$0.10 of stock-based compensation expense, but excludes any special charges. With that I will turn the call over to Ginger for a more detailed review of our financial performance. Ginger?

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**Ginger Jones** - Plexus Corp. - SVP & CFO

Thank you, Dean, and good morning, everyone. Our fiscal second-quarter results are summarized on slide 9. Second-quarter revenue was \$558 million, slightly above the midpoint of the guidance range for the quarter. Gross margin was 9.5% for the fiscal second quarter; this was in line with our expectations and slightly below the fiscal first-quarter results.

Selling and administrative expenses were \$27.8 million, in line with our expectations for the quarter. SG&A as a percentage of revenue was 5% in the fiscal second quarter, slightly above the fiscal first quarter.

Both gross margin and selling and administrative expense were impacted by anticipated additional structural costs during the fiscal second quarter including merit increases for employees implemented at the beginning of a calendar year and the reset of payroll taxes for US employees. Operating margin before special charges was in line with our guidance range at 4.5%.

Diluted EPS of \$0.53 includes two special items during the quarter. First, we saw an \$0.18 per share detriment as a result of restructuring and impairment charges in the amount of \$6 million. \$5.5 million of the charges related to the closure of our manufacturing facility in Juarez, Mexico that was announced on February 5, 2014.

The remaining \$0.5 million of charges was the completion of the consolidation of manufacturing facilities in the Fox Cities, Wisconsin. Offsetting these charges was a discrete tax benefit of \$3.7 million or \$0.11 per share benefit.

The discrete tax items were generated by the release of reserves from the closure of federal and state tax audits as well as the expiration of the statute of limitations in several jurisdictions. Excluding the \$0.07 net detriment of the special items non-GAAP EPS of \$0.60 was at the midpoint of our guidance.

Turning now to slide 10, I would like to spend a bit more time highlighting the progress of our operational initiative. Our manufacturing solutions, supply chain and go-to-market organizations have made significant strides on productivity initiatives. As a result we were able to expand non-GAAP operating margins from 4.0% in Q1 of F 2013, to 4.8% through Q1 of F 2014.

When comparing Q1 F 2014 operating performance to Q1 of fiscal 2013, we generated 80 basis points of improvement and operating profit margin on essentially the same revenue.

While we experienced the expected seasonal headwind in our progress in Q2 F 2014, our recent results from our operational initiatives provide confidence that we will have the improved operating performance necessary to achieve our financial goals. This operating performance initiatives are designed to bring us more in line with our targeted operating margin goal of 5% as we exit F 2014.

Turning now to the balance sheet on slide 11. Return on invested capital was 14.1% for this fiscal second quarter of 2014, a 40 basis point reduction from the prior quarter and 310 basis points above our weighted average cost of capital for F 2014 of 11%.

During the quarter we purchased 185,000 of our shares for approximately \$7.6 million at a weighted average price of \$41.18 per share. The shares were purchased under the \$30 million stock repurchase program authorized by the Board of Directors on August 19, 2013. We expect to complete the authorized repurchases on a relatively consistent basis over the remainder of fiscal 2014.

During the quarter we generated \$16 million in cash from operations and spent \$8.8 million in capital expenditures with approximately half of that capital for footprint expansion in Guadalajara, Mexico. Resulting free cash flow during the quarter was \$7.2 million.

Please turn to slide 12. Our cash cycle for the fiscal second quarter was 62 days, in line with our expectations and consistent with our results in the fiscal first quarter. In total working capital increased by approximately \$14 million during the quarter. Inventory increased by approximately \$22 million to support the ramp of new customer programs offset by an \$11 million increase in accounts payable.

As Dean has already provided the revenue and EPS guidance, I will now turn to some additional comments on the fiscal third quarter of 2014 which are summarized on slide 13. We expect restructuring costs of approximately \$400,000 to \$500,000 in the fiscal third quarter related to the Juarez to Guadalajara transition. These costs are excluded from the guidance discussed today.

Gross margin is expected to be in the range of 9.4% to 9.6%. We expect SG&A costs to be higher than in the fiscal second quarter in the range of \$29 million to \$30 million.

At the midpoint of our guidance range for revenue this will result in approximately 4.8% SG&A as a percentage of revenue. This increase from the prior quarter is a result of investments in staff and systems to support expected revenue growth and higher accruals of incentive compensation

on improved revenue outlook for fiscal 2014. This results in expected operating margin of approximately 4.6% to 4.8%, up from our results in the fiscal second quarter.

A few other notes. Depreciation and amortization expense is expected to be approximately \$12.5 million in the fiscal third quarter, up from the \$12 million in the fiscal second quarter. We are estimating a tax rate for fiscal 2014 of 8% to 10%, above our fiscal 2013 rate of 3.2%.

Our expectations for the balance sheet or for working capital dollars to be up from the fiscal quarter. Based on the forecasted levels of revenue we expect these changes will result in cash cycle days of 62 to 64 days for the fiscal third quarter of 2014. This increase in working capital reflects increased investments to support expected higher levels of revenue in the remainder of the fiscal year.

Our capital spending forecast for fiscal 2014 remains at approximately \$75 million. The majority of this capital is equipment to support new program ramps and the leasehold improvements for our leased facility in Guadalajara, Mexico. I will now turn the call back to Dean for some wrap-up comments.

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

All right, thank you, Ginger. All right, before we turn the call over to questions I just thought I would share with you a few of the near-term items that we are focused on so now we are on slide 14. We have done a good job keeping up the pace new business wins and importantly delivered meaningful new revenue into regions where we have ample capacity for growth namely EMEA and APAC regions.

We need to keep up the pace. As part of the EMEA new business wins we are beginning to build momentum into our Oradea Romania facility, we can't back off of that effort. Our new facility in Guadalajara, Mexico will be nearing completion by the end of our fiscal third quarter.

We've made substantial progress building a leadership team for the site; the first priority is to flawlessly transition the business from our site in Juarez to Guadalajara. The second priority is to close on some of the new business opportunities developing in our funnel that are targeted for Guadalajara.

Four, we remain intently focused on improving our operating margins quarter over quarter through fiscal 2014 in our quest to achieve our 5% target. And finally we need to continue to enhance our brand for customer service excellence by making meaningful progress on our global operational excellence initiatives will continue to expand our value stream solutions. With that, operator, we will turn it over for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Shawn Harrison, Longbow Research.

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**Shawn Harrison** - Longbow Research - Analyst

Dean, really just I guess first on the networking comp business. Do you think the underlying programs that you have have kind of settled down now moving into the third quarter? And is all of this growth going into the third quarter new program ramps or is any of it just the base business strengthening?



**Dean Foate** - Plexus Corp. - Chairman, President & CEO

No, it is a combination of both of those. We are seeing -- like I said, we kind of had a bit of a reset I think coming into Q2, which actually was kind of surprising to us how broad-based it was, but nonetheless that is what the customer forecast showed. And as I said in my comments, we saw a fairly broad strengthening of those forecasts as we came through the quarter.

So clearly the customers were maybe less confident coming into the quarter than how things ended up. But we also are experiencing some really strong growth amongst specific product lines for customers. And these customers have some strong -- I guess just strong products in the marketplace and those specific products are driving some real strength here as we move through the year.

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**Shawn Harrison** - Longbow Research - Analyst

If we were to look at that 20% growth though for the third quarter, how much of that is base business versus ramps? Is there a way to split it out?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Yes, and Steve is sitting here, he may have an opinion on kind of where we are at from a mix standpoint.

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**Steve Frisch** - Plexus Corp. - EVP & Chief Customer Officer

Yes, Shawn, this is Steve. I think we have several customers that have ramped newer projects in the last few quarters and I would say that a significant amount of the strength is coming from stronger market acceptance of those new products and what they anticipated. So it is a little bit of a balance between would you call it a new product or existing business. I think it is just stronger end markets with acceptance of these new products.

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**Shawn Harrison** - Longbow Research - Analyst

Okay, very helpful. And then just -- maybe I'm digging into this too much. But 41 wins, \$159 million of revenues the contribution per when is a little lower than you have seen historically. Is that something maybe that we should expect maybe more number of wins going forward with a lower dollar contribution or was this order just an anomaly?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

No, I think that is a really good observation and I think there will be some volatility to that obviously because sometimes individual programs could kind of skew that number. But generally with the markets that we are focused on, the path to growth in those markets means you have to win a lot of programs.

And so these -- the average -- when you come into a package with a customer many times there will be six, eight individual product lines that are in that bid package. And you can win some or all of those programs. So they really are individual programs within a package so you end up with this larger program count.

But I think -- you are going to see this I think as fairly indicative of where we are -- the sectors that we are focused on and how you grow in those sectors.

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**Operator**

Matt Sheerin, Stifel Nicholas.



**Matt Sheerin** - *Stifel Nicolaus - Analyst*

Just a follow-up on the question regarding the strength that you are seeing in networking. As those volumes improve does that mix at all change the margin profile -- drag at all on gross margin, for instance? And getting to that 5% goal, does mix impact that at all?

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**Steve Frisch** - *Plexus Corp. - EVP & Chief Customer Officer*

Matt, this is Steve. We are not anticipating any margin erosion with the ramp of these new wins.

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**Dean Foate** - *Plexus Corp. - Chairman, President & CEO*

Yes, I think as we look at how we price these programs and where they are at competitively they are not -- there is a mix of kind of technologies and the space some of which are more commoditized and others which are not. And fortunately for us I think the growth that we are seeing or the strength that we are seeing is among some the more difficult technologies to manufacture with special processes.

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**Matt Sheerin** - *Stifel Nicolaus - Analyst*

Okay. And can you quantify the relative strength of the telecom infrastructure versus traditional networking?

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**Dean Foate** - *Plexus Corp. - Chairman, President & CEO*

Well, some of the strength is actually in support of the cable marketplace and communications there. So I don't have the split in front of me, but that is where a meaningful amount of the strength is.

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**Matt Sheerin** - *Stifel Nicolaus - Analyst*

Okay, and just lastly, as you do get to that 5% EBIT margin threshold, is that more a function of gross margin because you talked, Ginger, about certain costs going up. But as you layer in those costs will you have leverage on top of that so that just SG&A as a percentage will come down and that is going to drive it?

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**Ginger Jones** - *Plexus Corp. - SVP & CFO*

Well, I think it comes from both, Matt. So with -- we are getting think both investment -- we are seeing investments in the SG&A to support this revenue, but with the top line coming up we are seeing leverage. So it is up to us to continue to manage those SG&A investments prudently. And we are on a path to improve gross margin as well through the operation initiative that we laid out. So I think it will be a combination of both.

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**Matt Sheerin** - *Stifel Nicolaus - Analyst*

Okay, thanks a lot.

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**Operator**

Sherri Scribner, Deutsche Bank.

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**Sherri Scribner** - *Deutsche Bank - Analyst*

I wanted to dig a little bit into the weakness or the relative weakness in industrial and the defense segment. I'm just curious, do you think that is specific to the programs you guys have or are you still seeing general macro weakness? I would be curious to hear your thoughts on customer sentiment right now.

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**Steve Frisch** - *Plexus Corp. - EVP & Chief Customer Officer*

Sherri, this is Steve. We saw across several customers a little bit of a decline. There was one more significant and that was really do more to a program brand that did not materialize the way they anticipated. They are forecasting that ramp to continue, it has just slid out to the right. So I would say the I/C is more focused around one customer.

Specifically on D/S/A, probably the biggest analogy I would say here is that there was a significant amount of engineering changes that came in through the quarter. So that kind of hampered the top-line revenue. We are working through those engineering changes and I don't think we see anything broad-based that is driving that number down into the future.

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**Dean Foate** - *Plexus Corp. - Chairman, President & CEO*

I think it is interesting -- I certainly wouldn't want to call the markets robust here, but I think we are clearly seeing kind of longer-term improvement in customer forecasts generally in D/S/A as we look further out. So it appears that we are starting to see some of the effects of stronger economic activity in that sector.

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**Sherri Scribner** - *Deutsche Bank - Analyst*

Thanks, Dean, that is helpful. And then, Ginger, I just wanted to -- oh, I'm sorry, did you have more comments?

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**Dean Foate** - *Plexus Corp. - Chairman, President & CEO*

No, I just said thank you.

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**Sherri Scribner** - *Deutsche Bank - Analyst*

Ginger, I wanted to dig into the income statement a little bit in the gross margin. I know your long-term target is 10% gross margins and we are sort of in the middle of the 9% at this point. Do you think that the gross margins can improve to 10% as we move forward and do you have a sense of when that will happen with the cost actions you are taking? Thanks.

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**Ginger Jones** - *Plexus Corp. - SVP & CFO*

Yes, I actually think where we are focused on is the overall 5% operating margin and I believe over time we are going to get there with more leverage on SG&A and probably gross margin slightly below 10%, so in the high 9%'s. So my long-term model is gross margin in the high 9% and SG&A in the high 4% allowing us to deliver the 5% operating margin.

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**Sherri Scribner** - *Deutsche Bank - Analyst*

Okay, perfect. Thank you.



**Operator**

Steven Fox, Cross Research.

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**Steven Fox** - *Cross Research - Analyst*

My first question was regarding some of the new wins. Dean, you mentioned some more momentum in the engineering services and also you guys conveniently have also seen some better wins in EMEA and Asia. And I know you guys were talking about that back in September as sort of something that could happen. I was curious if the near-term trend in that reflects any strategic initiatives on your part, anything specific with timing or is it just sort of part of that longer-term trend?

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**Dean Foate** - *Plexus Corp. - Chairman, President & CEO*

No, let me start out on this and then I am going to kick it over to Steve. I would just say that clearly what we have been trying to do -- we have been investing in EMEA, so let me just talk about that region for a second and I will talk about the Manufacturing piece initially.

And that we initially entered with a lower cost solution in Oradea, of course we saw some early success there and we built a significant facility now that enables us to handle some long-term growth.

But we have been very conscious of the importance of building a strong brand for execution in that marketplace. And so we have been bringing programs into that facility very deliberately, making sure that we execute really well, build up the experience of the team and really set the stage then to get after the market in a more aggressive way.

So some of what you are seeing now is a concerted effort now to start to accelerate program growth into that facility. And of course that region is obviously not in its entirety operating at where we need it to be from an operating performance. So we need the revenue into that site and into our site up in [Kelso] in order to deliver.

So with that I'm going to turn it over to Steve because you also asked about engineering as well.

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**Steve Frisch** - *Plexus Corp. - EVP & Chief Customer Officer*

Yes, the engineering strength was broad-based across the globe, significantly driven by the Healthcare/Life Sciences sector strength there. And to comment on what Dean said, significant strength in the EMEA region, the Darmstadt facility in Germany brought in a couple of new customers that we were denied access to in the past.

As those engineering programs work through the design cycle we expect those to ramp into our Oradea facility, which is giving us more confidence about the value proposition. So from an overall strategy standpoint we think EMEA is working well and then from an engineering standpoint we just see broad-based strength across the globe in terms of customers ramping new projects.

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**Dean Foate** - *Plexus Corp. - Chairman, President & CEO*

Steve, did you ask about Asia as well, APAC?

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**Steven Fox** - *Cross Research - Analyst*

Yes, I did.



**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Yes, I think APAC is -- of course we created a pretty big hole from a revenue perspective in APAC with the exit of our large networking customer last year. And of course we did what we could to redeploy assets and people, but we certainly had significant floor space for growth. So of course it was really important for us to get after it and get some new business ramped up there as well.

So we are starting to see, I think, maybe -- it is always kind of hard to steer completely, but as our go-to-market teams are out in the market is driving growth and those factors, we're doing a better job I think trying to balance and prioritize what we are after so that we can get the growth moving into the regions the way we need it.

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**Steven Fox** - Cross Research - Analyst

Thanks, that is very helpful. And then just a quick follow-up on the demand picture. In some of the markets you talked about sort of customers missing forecasts but then increased confidence for the coming quarter.

I guess I was trying to understand how much sort of that swing quarter to quarter was just due to push outs versus whether there has been a material change in how customers are looking at some of the products you are producing for those?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Yes, Steve already talked about one of them that was Industrial/Commercial that clearly slid and so we are just seeing the ramp starting up a little bit later than they originally thought.

I don't know that I can read too much into it other than I believe we are starting to see customers have a little bit more confidence in longer range forecasts for growth. We are seeing some choppiness obviously as you come in the quarters. In the near term, but kind of the outlook seems to be a little bit more confident, in my view.

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**Steven Fox** - Cross Research - Analyst

Thank you, that is very helpful.

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**Operator**

Jim Suva, Citi.

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**Jim Suva** - Citi - Analyst

Thanks, and Dean and Ginger, congratulations to you and your team there at Plexus. A question for Dean and then one for Ginger. Dean, can you comment at all with Obama care now kind of being rolled out and stuff, are you seeing any changes?

You guys are very strong in medical, are you seeing any changes by your medical customers like are they seeing more pressure to move medical stuff out at the hospital into the home? Or changes from OEMs as far as pressures to lower cost or push back on the supply chain, there has been some taxes and change, the just kind of whole medical sector overall has been going through a lot of evolution say to a couple of years ago. If you could just update us on that.



And then, Ginger, on the tax rate, Plexus has always had a long history of low tax rate and you gave some guidance. I think if I heard correctly was that more near-term guidance? And if so how should we think about tax rate long-term going forward as you have some factories changing, some factories ramping and things like that? Thank you.

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Well, thanks for the note of congratulations, Jim. We have certainly worked hard to try to get the ship course corrected after the hit on networking that we took. Relative to healthcare, I am tempted to just say, yes.

All of the things that you went through are in fact what we are seeing in the marketplace and of course obviously the healthcare cost issue from a P&L standpoint for us is directly impacting in terms of the cost of employee headcount in the US as we are starting to see significant increases in cost there.

But from a customer and market perspective, there is -- the market -- I'm just going to talk about the marketplace generally and I'm going to talk to Steve because he is itching to talk about this a little bit. But when you read about the growth rate now overall in that marketplace it is tempered right now because of the uncertainty.

Now the expectation is that over the long term as more and more US citizens get insured through the Affordable Care Act that you will see an increase in the number of participants in the healthcare marketplace and that is then going to drive growth for the medical equipment companies. But it's -- we are not seeing that yet. So longer-term it should be a good thing.

In the near term though the marketplace and the equipment companies you could make adjustments to how they go to market with their products, where they are going to see growth at least in the near term in emerging markets. I think right for the moment I think Life Sciences and the innovation that is taking place there on the near-term may be offers some interesting opportunities and with that I will turn it to Steve.

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**Steve Frisch** - Plexus Corp. - EVP & Chief Customer Officer

You know, Jimmy, you asked a couple of questions and from our perception the Medical Device Tax caused several companies to take a look at their cost structure internally and make adjustments, so we saw a fair amount of that early on. I think that has calmed down now is probably the way I would say it from our perspective.

In terms of driving things to more of a home use or engineering solutions team is having more discussions with customers about how to get products further into -- down the stream so to speak in the consumer's hands.

And in terms of growth and low-cost, I think again going back to the adjustments that were made earlier, I think people have come up with a strategy now it is a bit more stable in terms of looking at the global footprint of where they need to design and deliver products.

So from our perspective things have calmed down in terms of what has happened to that industry. They do see -- what we are hearing is more of a stable, steady growth as opposed to maybe some of this volatility that we have seen in the past. So I think people will work the system in terms of what it means to them and I think going forward it will be a little bit more steady state.

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**Ginger Jones** - Plexus Corp. - SVP & CFO

Okay, and then I will address the tax question, Jim. Yes, that guidance of 8% to 10% is for this fiscal year. And just as a reminder for people on the call, we have had a historically low tax rate because we have a significant amount of our taxable income in a jurisdiction in Malaysia where we have a zero tax rate; we have a tax holiday through 2024. So that has driven the very favorable tax rates we have.

Looking forward I would expect the tax rate to come up modestly. We have made a lot of investments in the Americas, both in Wisconsin and in Mexico, and over time we expect those regions to become more profitable. And so, that would drive proportionally higher tax.

But my guess is -- for the midterm I would guess a tax rate of -- in the low to mid teens. And I think that would be several years out. My guess is we will be around this 10% range in F 2015 as well as in F 2014.

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**Jim Suva** - Citi - Analyst

Great, thank you very much and congratulations.

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**Operator**

Brian Alexander, Raymond James.

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**Brian Alexander** - Raymond James - Analyst

As more of the growth billing forward potentially comes outside of the US based on where your program wins are occurring, are there any margin implications that we should consider in terms of margin profile in the US versus outside the US? Just curious if there are any structural differences there or if you effectively hold the regions accountable for the same financial goals?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Yes, I don't think there is really any -- in terms of the way we price business. I mean clearly when you think about the EMEA region and its underutilization to the extent that it is, revenue growing in there quarterly starts that allow us to get some leverage out of the investments that we have there.

So I think it is important from an investor's standpoint to track our progress giving the EMEA region to some reasonable capacity utilization. Otherwise relative to the other regions it's more to what you said which is they are all held accountable to certain goals that we have for profitability. I don't think that you should think about it materially shifting Plexus' kind of margin profile as -- if APAC experiences outside growth or something to that extent.

I would continue -- the thinking though around the Americas is that we're going to have this site in Guadalajara come on, we have been communicating what we think the cost of that would be to us. We have got that sort of baked into our longer-term view.

But it is going to be -- there is going to be a significant chunk of capacity there. We are going to have a nice warm start with some customers that we are transitioning in there. We have got -- out of Juarez we have some new programs that are slated for that site. We need to demonstrate a meaningful trajectory of growth into that facility where we had struggled historically to see any meaningful kind of long-term growth into Juarez.

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**Brian Alexander** - Raymond James - Analyst

So I guess given the lower utilization in EMEA along with the stronger revenue outlook overall for the Company, should we expect greater improvement in margin performance over the next few quarters than what you have described? Or are you basically reiterating the 5% goal as you absorb some of these ramp costs in Guadalajara? And you are effectively saying what you have been saying, which is we are trying to get to 5% and hold it there?



**Dean Foate** - Plexus Corp. - Chairman, President & CEO

That is exactly correct. We are trying to get to 5% and hold it there. And part of getting to 5% was us -- our expectation of driving some new revenue into the EMEA region to lift it up as well as a number of other initiatives that we had in the plan.

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**Brian Alexander** - Raymond James - Analyst

Got it. And then just finally, any additional observations, Dean, in terms of customers perhaps accelerating their willingness to outsource production in any of the markets that you serve? Or would you say the rate of outsourcing is pretty consistent with where it has been? Just curious what kind of the tone from customers is?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

I am not saying an acceleration. I think that it is consistent and steady. There have been a number of customers that we have been talking to over a long period of time that have -- that are finally starting to make some progress as to unwinding facilities. We believe we will benefit from some of that.

So, I think it is just kind of steady as you go. There seems to be a facility shutdown or two that happen a few times a year here. So, I think that is the way it is going to stay.

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**Brian Alexander** - Raymond James - Analyst

Okay. All right, thank you very much.

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**Operator**

Mark Delaney, Goldman Sachs.

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**Mark Delaney** - Goldman Sachs - Analyst

I was hoping first you could elaborate a little bit more on the commentary for operating margins getting to 5% exiting fiscal 2014. Should we think about that as a run rate for maybe the last month of the September quarter that you are going to be hitting that 5%? Or should we think about a 5% operating margin for the fourth quarter overall?

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**Ginger Jones** - Plexus Corp. - SVP & CFO

Yes, Mark, we are certainly focused on that 5% margin goal. And as you have seen, we have demonstrated really good ability to improve our margins and we expect that to continue. With that said, this is a really difficult business and we work really hard to deliver these results.

So we -- as Dean said, we reiterate the 5%. I think there may be challenges in any particular quarter that might cause us to come up a little bit shy of that, but we continue to focus on that as our long-term goal.

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**Mark Delaney** - Goldman Sachs - Analyst

Okay, that is helpful. For my follow up question, can you give us an update on the industry dynamics in terms of competitive pricing? Are you seeing any increased -- pricing competition from any of your competitors or is it just getting better, or is it about the same?



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**Steve Frisch** - Plexus Corp. - EVP & Chief Customer Officer

This is Steve, Mark. It is about the same. we are not really seeing any significant difference in any of the sectors.

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**Mark Delaney** - Goldman Sachs - Analyst

Thank you very much.

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**Operator**

Sean Hannan, Needham & Company.

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**Sean Hannan** - Needham & Company - Analyst

A number of my questions have been answered, but just I guess a few trailing ones here. So first, if we can think about our customer base now today as you look at say where you are growing your share of wallet at some of your top or emerging customers. Are there any at this point now where you have some visibility where some of these guys could be putting themselves closer to a consistent 10% versus say the types of dynamics that we have seen in the past?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

It is possible. It just depends on the longer-term program growth rates that are on some of these customers. But generally we were mindful of trying to grow the base of business across the customers and keep ourselves from getting into the situation where we have any kind of really significant concentration with an individual customer.

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**Sean Hannan** - Needham & Company - Analyst

That is great. And I think that is pretty consistent with what you folks have been talking about. But, Dean, could you elaborate though, what segment would you be seeing that type of potential?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Well, there is always the question of we have certain customers that are in multiple segments. So when you -- like GE for example, GE in an overall book of business to us could come up and approach 10%. Where it could happen quickly would be in network communications just because of the nature of those programs and how quickly they can grow versus the growth rates in some of the other sectors. But at this point it would be hard to necessarily suggest that we are going to see that.

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**Sean Hannan** - Needham & Company - Analyst

Okay, that is great. And then lastly here, in terms of the longer-term outlook, I realize you are not feeling we are necessarily robust, but we are getting some indication of stronger economic activity.

As you take a look at the longer-term build plans from customers that -- those at least that provide longer-term forecasts for you, can you elaborate a little bit on what segments have been particularly firming or what aspects of say your customer portfolio are giving you perhaps better relative strength in being able to provide confidence in that longer-term outlook? Thanks.



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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Yes, I think it's -- I would only suggest that at least Industrial/Commercial it is reasonably broad-based and I would say again in Healthcare/Life Sciences is just as (inaudible), it's a pretty steady kind of longer-term growth portfolio, nothing that is accelerating. Although we would expect it to at some point as the whole marketplace works through the Affordable Care Act and we get more insured.

But specifically where we see obvious strength, we've talked about this in the past, is in -- particularly in commercial aerospace, we see that as a good strong longer-term trend we are forecasting to hold up really well. We are seeing it with some of our network communication customers. Some of it is on the network, some of it is in the cable market where we are seeing good -- you to be a stronger longer-term.

The other is as well, it is kind of -- I don't want to say spotty, that is maybe not the right word, but we are not seeing it consistent among all customers is in semiconductor capital equipment. We are seeing some of that strength beginning and we expect that to I think be more consistent among multiple customers that we are engaged with as we come into next fiscal year as we start to see that investment cycle pick up ahead of steam. Other than that, do you have any adds to that, Steve, that you can --?

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**Sherri Scribner** - Deutsche Bank - Analyst

No, I think you have covered them all.

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**Sean Hannan** - Needham & Company - Analyst

Okay, great. Thanks so much for the color.

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**Operator**

Wamsi Mohan, Bank of America-Merrill Lynch.

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**Ruplu Bhattacharya** - BofA Merrill Lynch - Analyst

Yes, good morning, it is actually Ruplu filling in for Wamsi. Dean, I wanted to start by asking you I think last quarter you had said that of the \$282 million of revenues from Juniper in fiscal 2013, at that time you had replaced about 50%. Where does that percent stand now in terms of how much you have replaced of that Juniper revenue?

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Yes, as I commented, we replaced it all. So we are in good shape and then some because we are obviously expecting some top-line growth this year.

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**Ruplu Bhattacharya** - BofA Merrill Lynch - Analyst

Okay, great. And then I think on the call you also said that Europe and Asia Pac are slightly below the corporate average capacity utilization. Can you just give a little bit more color on that, what is the corporate average utilization and where are Europe and Asia Pac compared to that?





**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Yes, I think we are -- overall we are in the low 70%s, kind of 73%, 74%. I will just say that those two regions, APAC and EMEA, EMEA being the lowest I would say overall at this point because we are in an early investment cycle. But I am reluctant to give out a specific number because it probably implies a higher level decision than is really there.

I will say the highest utilization right now is in the Americas, then APAC and then EMEA in that order in terms of utilization. But obviously you have got to also contemplate where the concentration footprint is -- the footprint is largest in APAC. And smallest in EMEA. So you can move the needle more quickly when you win business into EMEA.

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**Ruplu Bhattacharya** - BofA Merrill Lynch - Analyst

Okay. Yes, that makes sense. And then one for Ginger. What are your free cash flow expectations for the year for fiscal 2014? I think you talked about working capital picking up slightly next quarter or did I hear that correctly and you think you can positive in terms of free cash flow for the year?

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**Ginger Jones** - Plexus Corp. - SVP & CFO

It is a little early to call, Ruplu, for the full year partly because we have the significant revenue increases and will be investing working capital. My goal is to generate a modest amount of free cash flow for the full year, and that would be a trend that would be consistent in a year where we are growing revenue a lot we are going to have lower free cash flow than in other years. So, my goal is to be a modestly positive free cash flow.

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**Ruplu Bhattacharya** - BofA Merrill Lynch - Analyst

Okay, great. Thank you so much.

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**Operator**

Thank you. We have no further questions at this time. Thank you, ladies and gentlemen. This concludes the Plexus Corp. conference call regarding its fiscal second quarter 2014 earnings announcement. Thank you for participating. You may now disconnect.

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**Dean Foate** - Plexus Corp. - Chairman, President & CEO

Thank you.

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