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PLXS - Q2 2015 Plexus Corp Earnings Call

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OVERVIEW:

Co. reported 2Q15 revenues of \$651m and diluted EPS of \$0.69. Expects 3Q15 revenue to be \$670-700m and diluted EPS to be \$0.71-0.79.



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PRESENTATION

Operator

Good morning and welcome to the Plexus Corp. conference call regarding its fiscal second quarter 2015 earnings announcement. (Operator Instructions). I would now like to turn the call over to Mr. Angelo Ninivaggi, Plexus' Senior Vice President, Chief Administrative Officer and General Counsel. Angelo?

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

Thank you, [Lauran]. Good morning, everyone, and thank you for joining us today. Before we begin, I should remind everyone that statements made during our call today and information included in the supporting material that is not historical in nature, such as statements in the future tense and statements that include believe, expect, intend, plan, anticipate and similar terms are forward-looking statements.

Forward-looking statements are not guarantees since there are 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 factors that could cause actual results to differ materially from those discussed, please refer to the Company's periodic SEC filings, particularly the Risk Factors in our Form 10-K for the fiscal year ended September 27, 2014, and the Safe Harbor and Fair Disclosure Statement in yesterday's press release.

Plexus provides non-GAAP supplemental information such as return on invested capital, economic return and free cash flow because such measures are used for internal management goals and decision-making and because they provide additional insight into financial performance.



In addition, management uses these and other non-GAAP measures such as adjusted net income and adjusted operating margin to provide a better understanding of core performance for purposes of period to period comparison. For a full reconciliation of non-GAAP supplemental 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 at Plexus' website at www.plexus.com, by clicking on Investor Relations at the top of the page and then Event Calendar.

Joining me today are Dean Foate, Chairman, President and Chief Executive Officer; Todd Kelsey, Executive Vice President and Chief Operating Officer; and Pat Jermain, Senior Vice President and Chief Financial Officer. Also joining us today is Steve Frisch, Executive Vice President and Chief Customer Officer, who will be offering additional insight in to our market sectors.

Let me now turn it call over to Dean Foate. Dean?

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

Thank you, Angelo, and good morning everyone. Please advance to slide three. Yesterday after the market closed we reported results for fiscal second quarter of 2015. Revenues were \$651 million above the midpoint of our guidance and down approximately 2% from the prior quarter. Relative to the comparable quarter last year, revenues increased about 17%. Second quarter diluted EPS of \$0.69 was a penny above the midpoint of our guidance range.

Please advance to slide four. Before Pat and Todd provide further context and details regarding our performance this quarter, I will summarize a few notably items. While we guided quarter-over-quarter contraction in our Networking/Communications and Healthcare/Life Sciences sectors, both outperformed our expectations due to better than anticipated end-market demand. Our go-to-market teams delivered another strong quarter of manufacturing solutions wins. The \$209 million performance was well above our target of \$160 million, and brings r trailing four quarter results to \$852 million positioning us for continued growth.

Our operating performance WAS largely in line with expectations. Operating margins was 4.5%, consistent with our guidance but below our target range as we continue to invest in program transitions related to site consolidation initiatives. Our cash cycle improved to 59 days better than our guidance and a 13 day improvement over the prior quarter when we encounter unanticipated quarter end challenges. Our cash cycle improvement contributed to free cash flow of \$124 million. Return on invested capital was 14.5% resulting in economic return of 3.5%.

Advancing now to our fiscal third quarter guidance on slide five. We are establishing fiscal third quarter 2015 revenue guidance of \$670 million to \$700 million suggesting a 5% sequential growth at the midpoint of the range. At that level of the revenue, we anticipate diluted EPS of \$0.71 to \$0.79 including approximately \$0.10 per share of stock-based compensation expense but excluding any unanticipated special items. The midpoint of our EPS guidance suggests a 9% sequential increase over the prior quarter.

I will now turn the call over to Todd for some further comments about our market sectors and operating performance. Todd.

Todd Kelsey - Plexus Corp. - EVP, COO

Thank you, Dean. Good morning. Pleased advance to slide six for insight into the performance of our market sectors during Q2 of fiscal 2015 as well as our current expectations for the fiscal third quarter of 2015. Our Networking/Communications sector was down 10% sequentially in Q2, which exceeded our expectations of a decline in the mid-teens percentage point range. One of our top customers significantly exceeded expectation on the strength of new product demand while performance in the remainder of the sector was mixed. We expect our Networking/Communications sector to be up in the high single digits in fiscal Q3 as one of our top customers continues to show strength in the marketplace and several additional communications customers are projecting improved demand. While the sector remains volatility, we continue to expect healthy year-over-year growth in fiscal 2015.

Our Healthcare/Life Sciences sector was down 3% sequentially in Q2 slightly better than our expectations of a mid single-digit decline. Nine of our top ten customers outperformed expectations within the quarter continuing a trend of near-term demand strengthening. Looking ahead to fiscal Q3, we currently anticipate revenue in our Healthcare/Life Sciences sector to be down in the low single digits as eight of our top ten customers are forecasting quarter-over-quarter declines primarily as result of end-market softness. We expect to return to sequential growth in the sector as we exit fiscal 2015 on the strength of previously reported new program wins.

Our Industrial/Commercial sector was up 8% sequentially in our fiscal Q2 slightly above our expectation. Most of our semiconductor capital equipment customers strengthened in the quarter while performance in the remainder of the sector was mixed. We currently anticipate that our Industrial/Commercial sector will be up in the high single digits in our fiscal Q3 as a result of new program ramps and strengthening demand with a top customer. We expect sequential growth within our Industrial/Commercial sector throughout the remainder of F2015.

Our Defense/Security/Aerospace sector was up 4% sequentially in Q2 a result that was below our expectations of mid-teens growth. We experience transition delays, weaker end markets and operational inefficiencies within the quarter. We currently expect Q3 to be up in the high single digits as seven of our top ten customers show strong quarter-over-quarter growth. Fiscal 2015 is positioned to be a healthy growth year for the sector.

Next to new business wins on slide seven. During the quarter we won 25 new programs in our Manufacturing Solutions Group that we anticipate will generate approximately \$209 million in annualized revenue when fully ramps into production. From an absolute standpoint, our wins were predominately in our Americas region. When reviewing the trailing four quarter wins as a percentage of the trailing four quarter revenue, which is the line on the accompanying regional graph, each region is at a healthy ratio above our 25% goal. Our EMEA region has particular strong wins momentum leading the confidence that we will meaningful grow the region in future quarters.

Please advance to slide eight. This slide provides further insight into the wins performance of our market sectors. It is important to note that there is significant volatility in the data and longer term trends provide the most value in measuring sector performance. In fiscal Q2 our manufacturing solutions wins were particularly strong in the Industrial/Commercial and Defense/Security/Aerospace sectors. Our Industrial/Commercial wins included \$76 million as a result of the addition of the significant new customer recognize on the January call. Our Defense/Security/Aerospace wins included a sizable expansion with a new customer in the Americas region and a substantial win in the EMEA region. Our funnel of new business opportunities remains steady at \$2.2 billion. The funnel remains at a five quarter high and we view it healthy.

Now advancing to wins momentum on slide nine. Our manufacturing wins trend remains strong, and our trailing four quarter performance as shown by the dark blue bars is at \$852 million resulting in an improved trailing four quarter win ratio of 33% relative to trailing fourth quarter revenue. This is well above our target of 25%. While not included in the win results on the recent slide, we had a good quarter in engineering solutions with new project wins totaling approximately \$21 million. Our engineering wins remains strong in our Healthcare/Life Sciences sector while we continue to improve our wins performance in Industrial/Commercial and Defense/Security/Aerospace sectors.

Next I would like to turn to operating performance on slide ten. The midpoint of our Q3 revenue guidance range suggests meaningful sequential growth providing further evidence of the success of our go-to-market strategy and our focus on customer service excellence. Fiscal Q2 operating margin finished inline with expectations at 4.5%, as we continued investment in the startup of our new Guadalajara manufacturing site in our Aerospace & Defense Center of Excellence in Neenah. As these sites ramp revenue and new customers, we are committed to operational excellence. The midpoint of our fiscal Q3 operating margin guidance range, which Pat will discuss shortly, projects improvement in our operating performance. Our economic return remains in the value creation zone at 350 basis points.

Please advance to slide 11 for additional insight into our recent operating margin performance and future expectations. We consider operating margin performance from 4.7% to 5% to be our target range. Our 4.5% operating margin performance in Q2 of fiscal 2015 included a roughly 40 basis point drag as a result of the Guadalajara accelerated ramp, another 20 basis points due to the Aerospace & Defense Center of Excellence ramp and 25 basis points due to seasonal costs. During fiscal Q2 we made additional investments in our Neenah Aerospace & Defense Center of Excellence over those previously communicated in order to properly service our customers in this important market. The seasonal cost and additional investment in the Aerospace & Defense Center of Excellence impacting fiscal Q2 were largely offset by our ongoing operational improvement initiatives and the swing of our EMEA region to profitability.



As we move into Q3 our rapid revenue ramp in Guadalajara remains on track. We continue to expect to approach break even at the site in Q3, and achieve corporate margin expectations by Q1 of fiscal 2016 as our annualized run rate exceeds \$200 million. Moreover, our funnel of new business opportunities at the Guadalajara site, which is not included in these revenue projections, is very strong. In addition we have been recommended for ISO 1345 certificate at the site. ISO 1345 is an important Healthcare/Life Sciences quality standard, and our teams are leveraging this accomplishment to drive new business into the facility.

While we believe we are on a path to consistent profitability in the EMEA region, our progress is taking a one quarter pause from our improved results in Q2 as a consequence of soft end markets, transition delays and investments in new transition. We anticipate we will resume our profitability improvements in the region in Q4. We expect to recover our Aerospace & Defense Center of Excellence investments in Q4 of fiscal 2015 and earlier fiscal 2016. Overall, we still believe we'll be within our target operating margin range as we exit fiscal 2015. As we progress with these three priorities and obtain the improvements identified, we anticipate future investments and growth initiatives. As a result, we expect to maintain our target operating margin range of 4.7% to 5%.

I will now turn the call to Pat for a more detailed review of our financial performance. Pat?

Patrick Jermain - Plexus Corp. - SVP, CFO

Thank you, Todd, and good morning everyone. Our fiscal second quarter results are summarized on slide 12. Second quarter revenue was \$651 million which was above the midpoint of our guidance range for the quarter, 17% above the prior year's second quarter. Gross margin was 9.2% in line with our expectations and consistent with the fiscal first quarter. We overcame seasonal costs during the fiscal second quarter as result of operational improvements throughout our manufacturing site.

Selling and administrative expenses were \$30.3 million also in line with our expectation and slightly below the fiscal first quarter primarily due to lower variable incentive compensation expense. For the second quarter SG&A as a percentage of revenue was approximately 4.7%, which was consistent with the fiscal first quarter. Operating margin of 4.5% was consistent with our guidance range and diluted earnings per share of \$0.69 was slightly above the midpoint of our guidance. No restructuring charges were recorded during the second quarter.

I would also like to provide a few comments on our currency exposure and the impact to our European operations from the strengthening U.S. dollar. Currently a small portion of our revenue approximately 5% is denominated in currencies other than the U.S. dollar. The current quarter negative impact on revenue and earnings for our European operations was less than 1% of our overall results when compared to both our quarterly forecast and the prior year's second quarter.

Turning now to the balance sheet on slide 13. Return on invested capital was 14.5% for the fiscal second quarter. With a lower average invested capital base we saw a 10 basis points sequential improvement in return on invested capital. We generated an economic return of 3.5% based on our fiscal 2015 weighted average cost of capital of 11%. During the quarter we repurchased 192,000 for approximately \$7.7 million at a weighted average price of \$40.05 per share. The shares were purchased under the \$30 million stock repurchase program authorized by the Board of Directors on August 13, 2014. We have approximately \$15 million remaining under the authorization, which we plan to repurchase on a relatively consistent basis over the remainder of fiscal 2015.

During the quarter we generated \$131 million from cash from operations and spent \$7 million in capital expenditures. Resulting free cash flow during the quarter was \$124 million, which positions us for meaningful free cash flow generation for fiscal 2015. A significant portion of this quarter's free cash flow was generated through the \$87 million improvement to working capital.

Our cash cycle at the end of the second quarter was 59 days, which exceeded expectations, and was 13 days lower than our result in the fiscal first quarter. The 59 days is a return to a more normalized level after experiencing an unusual high level in the fiscal first quarter. Please turn to slide 14 for details on our cash cycle. Sequentially days and receivables decreased 4 days to 48 days, which was largely the result of a reduction in past due receivables. Days and inventory were 86 days sequential up 4 days primarily driven by the anticipation of higher revenue in the fiscal third quarter. The increase was mostly offset by a 3 day increase in customer deposit. Accounts payable days were 63 days sequentially up 10 days due to the timing of inventory purchases and supplier payments during the quarter.



As Dean has already provided the revenue and EPS guidance, I will now turn to some additional details on the fiscal third quarter of 2015 which are summarized on slide 15. Gross margin is expected to be in the range of 9.0% to 9.3%, comparable to the fiscal second quarter 2015 with higher expected revenue in the fiscal third quarter and a corresponding increase in variable incentive compensation expense. We expect SG&A expense to be slightly higher than the fiscal second quarter in the range of \$30.5 million to \$31.5 million. At the midpoint of our revenue guidance anticipated SG&A would be approximately 4.5% of revenue. A sequential decrease of 20 basis points resulting from improved operating expense leverage. Operating margin is expected to be approximately 4.5% to 4.8% for the fiscal third quarter. At the midpoint of this range I am pleased to see sequential improvement in our operating margin. However, we need to execute our near-term priorities outlined by Dean and Todd in order to achieve our targeted operating margin range of 4.7% to 5%.

A few other notes, depreciation and amortization expense is expected to be approximately \$12.4 million in the fiscal third quarter up slightly from the \$11.9 million in the fiscal second quarter. We are estimating a tax rate of 9% to 11% for both the fiscal third quarter and full year. Our expectation for the balance sheet is that working capital needs will increase sequentially on anticipated higher revenue for the third quarter resulting in cash cycle day of 60 to 64 days. We are currently forecasting free cash flow in the range of \$70 million to \$90 million for fiscal 2015. We continue to forecast capital spending at approximately \$50 million for fiscal 2015. The majority of this capital is for equipment to support new capabilities, new program ramps and the refresh of older equipment.

I will now turn the call back to Dean for some wrap up comments. Dean?

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

Okay. Thank you, Pat. If everyone would please advance to slide 16 for a review of our fiscal year financial goal. On the growth front our new business wins performance continues to be strong providing opportunities for market share gains. Additionally, while overall end markets can hardly be characterized as robust, we are benefiting from demand strength with specific customers. With our strong revenue growth guidance this quarter, we are now comfortable increasing our full year revenue expectations to a range of 13% to 14.5%. We continue to believe our business model is healthy with operating margins in the range of 4.7% to 5%. We anticipate delivering results in our target range as we exit the fiscal year.

In support of our higher revenue expectations for the year, we are adjusting our free cash flow guidance to a healthy but more conservative range of \$70 million to \$90 million. Our key measure for shareholder value creation is economic return. We are striving for 4% to 5%. Reviewing a key supporting initiative we currently expect that our new facility in Guadalajara will become profitable in our fiscal fourth quarter. Our funnel of new business opportunities for Guadalajara continues to strengthen providing excellent opportunities for continuing growth. We have projected our EMEA region would begin to sustain profitable in fiscal Q3 while our newer facility in Oradea remains on track, our overall softer revenue forecast in the region pushes our expectations for profitability improvement out to fiscal Q4.

As a reminder during the fiscal year we completed the consolidation of facilities in Neenah, Wisconsin and we consolidated our Juarez facility into our new facility in Guadalajara, Mexico. While we are making progress on our operational excellence initiatives, we still have meaningful opportunities to improve our overall performance metrics in our Americas region. Finally, our market sector forecast continues to offer mix performance with a paramount of inter-quarter volatility.

And with that, operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). And our first question comes from Sean Hannan from Needham & Company. Please go ahead.



Sean Hannan - *Needham & Company - Analyst*

Thanks, good morning. And thanks for taking my questions. Can you hear me?

Todd Kelsey - *Plexus Corp. - EVP, COO*

Yes, Sean, we can.

Sean Hannan - *Needham & Company - Analyst*

Okay, great. First to see if I can get some clarity on what I think is being communicated on the margins. Is 5% now officially no longer the hard bogey? Is this an official step down or revision within the model consider a 4.7% to a 5%? Any color around that and what fundamentally has changed in that perspective if that is the case versus last quarter and how we have been thinking about that part of your model. Thanks.

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

I will start with this, I think Sean last year we drew a very hard line in the sand for 5% and gave us no room to maneuver and also as a consequence of that we had some of the analyst take us up north of 5%, which also is not what we're trying to communicate. So we decided to give ourselves a little room to maneuver here and say that we feel good about the Company operating in a 4.7% to 5% range. We will continue to strive for the higher end of that range obviously. We think about 5% as being where we want to be, but we also want to acknowledge quarter-to-quarter depending upon how revenue growth unfolds, investments we might be making around the world that we would consider it to be healthy in that range. We have been trying to adjust our messaging around that so we stop apologizing if we're at 4.8% or 4.9%.

Sean Hannan - *Needham & Company - Analyst*

Okay. So it is a matter of setting expectations of, hey, we're going to have much more consistency in here?

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

That is correct.

Patrick Jermain - *Plexus Corp. - SVP, CFO*

Sea, this is Pat. I would add to that I think within that range of 4.7% to 5%, we can generate a really strong economic return close to that 500 basis points we are trying to strive for with good working capital management we can get there.

Sean Hannan - *Needham & Company - Analyst*

Sure. And with the growth that certainly seems supportive. Okay. Next question here, and I guess it is multi part, looking to see if you can address some color on the various facilities. So Oradea nice job there in terms of how that profitability is moving as well as the wins you are gathering there. But want to see if we can get a little bit more elaboration on how and what is going into that facility and how sustainable perhaps the upward trajectory can be there. And then Guadalajara, of course, we have gotten some delays there. I don't think we've heard a lot of color around some of the continued delays. It sounds like it is fairly manageable but if we can get some better detail on that push. And then lastly APAC. I don't think that in terms of the wins that you folks have communicated for that region that there is much to read there. I just want to get a perspective. I suspect that the quarter is perhaps perceivably down a bit because you had such an outsized quarter in December but any color on that would be great as well. Thanks.



Todd Kelsey - Plexus Corp. - EVP, COO

This is Todd, Sean. First of all with respect to Oradea, the Oradea customer base is a really nice customer base that has a lot of growth potential. So we added several new customers during the course of fiscal 2015, and had some that joined Plexus in fiscal 2014, so we are starting to see the ramp that we had anticipated from those customers. And it is progressing along the lines of our earlier expectations. The challenges I have mentioned in EMEA really result from our U.K. operational and really getting consistent revenue growth in our U.K. operations. So Oradea is progressing very well. We were profitable both at that site and in the region in Q2 although we'll take a slight step back in the region in Q3 before resuming our growth and profitable in Q4.

So stepping on to Guadalajara. Guadalajara we communicated last quarter that we would have a one quarter delay in the ramp in Guadalajara and we are on track to that revised schedule. So we had anticipated we would have fairly substantial losses within the site in both Q1 and Q2, which came to be true, and that we would approach break even this current quarter in Q3, which that is still on track, achieve profitable in Q4 and be near corporate margin expectations in Q1 of fiscal 2015. So that is all well on track. The transitions we had communicated earlier are moving forward and we are beginning to have some success from a new business development standpoint. The funnel is very strong. I talked about the medical certification that we are putting in place with respect to the Guadalajara site, and that is having an impact and I would expect that we will close some healthcare business in that site during the current quarter. Then with respect to APAC, the APAC wins were very strong last quarter and they dropped a bit in Q2. The reality is similar to what I talked about with the sectors that it is truly tough to judge and particular region or sector on a one quarter performance. You really need to look at the longer term trends So we feel good about the growth in our APAC region in fiscal 2015 as well as we look to fiscal 2016 that we're winning appropriate work for that region.

Sean Hannan - Needham & Company - Analyst

Great color. Thanks so much.

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

You're welcome. Thank you.

Operator

Thank you. And our next question comes from Brian Alexander from Raymond James. Please go ahead.

Brian Alexander - Raymond James - Analyst

Okay. Thanks and good morning. The revenue outlook for the June quarter looks like 10% growth year-over-year at the midpoint, so another quarter of double-digit growth potentially. But I think, Dean, you said 13% to 14.5% for the year which I think implies the September quarter revenue growth drops to mid single digits. So just given the strength in new programs in the funnel why the deceleration and do you consider that to be more temporary, when do you think you might be back to double digit growth? And I have one follow-up.

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

I think you are absolutely right, we did the arithmetic ourselves and wondered how folks would react to that. But I think just part of it is that we have seen again a very strong quarter this quarter. I'm not concerned about it at this point, because as you also pointed out that we have a very strong wins rate and we expect that to unfold. I also believe that again we're trying to communicate where we see the forecast today but we continue to see this volatility in forecast. And one of our sectors in particular continues to improve as the quarter unfolds. So the forecasts are

hardly confident I would say from customers out a quarter or two. And there is still an opportunity for that, I would say, to improve depending upon how the customers react inter-quarter. Do you want to add any further color to it, Todd?

Todd Kelsey - Plexus Corp. - EVP, COO

Just one thing I would add, Brian, is if you looked at our Q4 F2014 revenue it was very strong. So the comparable is a tough one for Q4 fiscal 2015.

Brian Alexander - Raymond James - Analyst

Right. No, okay, that makes sense. Then just a clarification and one more question. On the clarification I think last quarter you talked about the Industrial/Commercial win of \$100 million and I think you updated that \$76 million on this call. I'm just curious if I heard that right. And then the question would be, the mix of new wins changed. You had a drop in Communications and Healthcare/Life Sciences, but then you had the big win in Industrial and the big uptick in Defense and Aerospace, which sounds like that was really two large wins. I guess my question would be when you look at the new wins, are you finding that it is more dependent on a handful of large programs versus historically when it was maybe more spread out, more about a larger number of small deals or has nothing really changed in the lumpiness versus historical trends?

Steve Frisch - Plexus Corp. - EVP, CCO

Sean, this is Steve. I'll take the first part of that which was the Industrial/Commercial win. Todd mentioned on the last call we expect it to be about \$100 million. It still is about \$100 million, in fact it is \$110 million. We closed \$76 million of that in the quarter. There is about another \$35 million in our funnel that we're working through with the customer and we do anticipate to be able to close and win that as well. The reason for splitting it was the ramp for the \$76 million is quite quick, so we are ramping that even as we speak. The other \$35 million of a little bit slower so we're working through that with the customer. The other exciting part for me that we didn't really have in the details here is there is also engineering component of this. So part of that \$21 million in engineering wins also came from this customer. The value stream is working really well with them. And, Todd, I think I'll let you do the second part.

Todd Kelsey - Plexus Corp. - EVP, COO

Sure. A little more color around the wins data, Brian. First of all, if we go back to the sector performance, I believe we need to think about this more as a trend or longer-term performance as opposed to a current quarter performance. I think on any given sector basis we are going to see significant volatility within the given sectors. So for instance Healthcare/Life Sciences as you mentioned we had a weak quarter from a win standpoint this quarter in Q2 although we expect a very strong quarter in Q3. So I think when you normalize those two numbers once we get to the Q3 results you will find something that looks reasonably appealing in that sector as well too. With respect to the size of the wins and the size of the programs, I don't think we are really seeing anything different. We did have a few significant programs this quarter that happened to close that really brought up the average size per win. One being the Industrial/Commercial. One being -- the other being the two Defense/Security/Aerospace programs that I mention, but there were also a number of others that really brought that average down. And I think the program sizes tend to be similar. Although one trend I would say that we're seeing is more activity in Healthcare/Life Sciences around customers that are interested in making major changes in their outsourcing strategy. We see cross pressures building within that marketplace.

Brian Alexander - Raymond James - Analyst

Great. Great color. Thanks very much.

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

Thank you.



Operator

Thank you. And our next question comes from Amit Daryanani from RBC Capital Markets. Please go ahead.

Amit Daryanani - RBC Capital Markets - Analyst

Thanks. Good morning, guys. Just have a question to start off with I think on the operation margin of bricks that you guys have on slide 11, you have (inaudible) of headwind going forward from growth investments, not sure if I saw that on the prior slide. But maybe you can just talk about what those investment are centered around and how that may impact future growth going forward.

Todd Kelsey - Plexus Corp. - EVP, COO

Sure. Amit, this is Todd again. I will take you through that slide just a bit. And one of the reasons for adding the gross investment in there is I didn't want you to get above 5% to be candid here. But I mean the reality is we do expect to invest in the business. A couple of capabilities or services where we are making some investments right now and expect to accelerate that would be in after market services and expanding our capabilities there as well as Microelectronics. We are doing certain activities from an IT infrastructure standpoint or have them planned in the horizon around our HR systems as well as our manufacturing systems, and also around people. Really talented investment end people to be enable out future growth, automation within our facilities to continue to drive operational excellence and then again getting the right people and talent to drive a culture of customer service excellence within the Company. Those are areas we're thinking about. At this point there is no new sites in the horizon, but at some point that will come into play as well too if we can continue the growth path we're on.

Amit Daryanani - RBC Capital Markets - Analyst

Got it. If I could just follow up on your communications networking markets. I think some of your peers are being a bit more negative on in demand (inaudible) which you guys are talking about. What's the (inaudible) been like for you guys on that business and is this trend the up high single digit commentary that you guys have for next quarter more reflective of a couple of big wins or one big customer doing well or is it much more broad based?

Steve Frisch - Plexus Corp. - EVP, CCO

This is Steve I will try to address that. The Networking/Communications sector for us is very heavily weighted towards the communications side. The few network customers that we have including the one large one in that portion of the sector are seeing challenges similar to what you've seen from other places. The one difference for us is that customer has a couple of new programs that are ramping with us that are doing well, so although their overall business is a bit soft for Plexus it has been pretty good. And then on the communication side as Todd mentioned we have seen descent opportunities from that side of the sector, so not completely undifferentiated from what you're seeing elsewhere, but our mix and our position is just in a little bit different spot.

Amit Daryanani - RBC Capital Markets - Analyst

Perfect. Thank you very much.

Operator

Thank you. And our next question comes from Matt Sheerin from Stifel. Please go ahead .

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Thanks. Just wanted to ask regarding your commentary regarding EMEA. It sounds like you're seeing a little bit of a softness there and the profitability targets for the operation there are pushed out a quarter or so. What's behind that, is that more broad based weakness that you're seeing from customers there or is there one specific area such as industrial?

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

I'll try to comment on it this time around. I think the way to think about this is that as we communicated last quarter we delayed a little bit with our new facility in Oradea, but when you look at it overall Oradea is tracking quite well. I mean the growth curve there is satisfactory, and I would say appropriately within what you would expect for variety with a new facility coming up and the relative uncertainty of new programs as they ramp up. I don't think there is anything systemic in the marketplace there. I'm quite happy with the way that's coming up. The challenges as Todd pointed out is the overall marketplace is soft I would say across the region. And the difficulty that we're seeing from a revenue forecast standpoint affected to a greater extent our legacy facilities in the U.K. So the profit with the revenue coming down a little bit there that hampered the overall region profitability. I don't know that I would pin it on a particular sector, one of you two guys, Todd or Steve might.

Todd Kelsey - *Plexus Corp. - EVP, COO*

No.

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

I think it is generally speaking the marketplace there is overall soft. And that we feel at this point has delayed our expectation by a quarter. But we think at this point in better shape in Q4 and Q1 of our new fiscal year what would be our December quarter.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Okay. That is helpful. And then regarding the industrial markets in general that's another area where you're seeing some nice program wins which contrast certainly from a bunch of other companies out there seeing cracks in the industrial market particular oil and gas. What is the difference with Plexus, do you not have much exposure to some of those markets?

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

Well, we had more exposure but it has been down for a while. So I think what you are seeing from us is, yes, the impact of oil and gas and I would say the choppiness of the semiconductor capital equipment marketplace where we have some customers doing well, other customers not doing so well much of that has been reflected in our numbers now for a few quarters. So what you're really seeing from us is the impact of two things. One, the strong new business wins that we have had, and then just certain customer that have products that are running counter to the overall softness in the market, products that are getting good acceptance with specific customers in the marketplace.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Okay. Thanks a lot.

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

You're welcome.

Operator

Thank you. And our next question comes from Sherri Scribner from Deutsche Bank. Please go ahead.

Sherri Scribner - *Deutsche Bank - Analyst*

Hi, thanks. Most of my questions have been asked. But I wanted to ask about the CapEx investment, Pat. It looks like you are still expecting \$50 million in CapEx this year which suggests a pretty significant ramp up in the back half. I don't think it is for facilities, but can you give us more detail on what you guys are investing in? Thanks.

Patrick Jermain - *Plexus Corp. - SVP, CFO*

There is some facilities still going on with Guadalajara that will take place in the back half, but it is mainly equipment refreshes that we have going on in some of our U.S. sites APAC as well. So mainly upgrading equipment that is already out there.

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

One thing I would add too is there is some new capabilities going into certain sites too that are impacting the investment particularly around the APAC region.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay, great. And what would you expect for next year, is it going to stay at these levels or go up or down?

Patrick Jermain - *Plexus Corp. - SVP, CFO*

I think that is probably reasonable in the maybe \$40 million to \$60 million range.

Sherri Scribner - *Deutsche Bank - Analyst*

Thank you.

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

Thank you, and thanks for asking Pat a question he was getting a little (inaudible).

Operator

Thank you. And our next question comes from Mark Delaney from Goldman Sachs. Please go ahead.

Mark Delaney - *Goldman Sachs - Analyst*

Yes, good morning, and thanks very much for taking the question. First question is around some M&A activity. ARRIS announcing a deal to acquire Pace. I know it is still very early but given ARRIS is a material customer for you, if you have any initial thoughts about how that may impact that the Company?

Todd Kelsey - Plexus Corp. - EVP, COO

Of course, we're aware of the ARRIS of Pace, and I guess right now we would say we don't expect it to have much of an impact. One of the things that came out in the release is that ARRIS is basically controlling the company that will result, so we would expect that our relationship would stay very strong with ARRIS.

Mark Delaney - Goldman Sachs - Analyst

Appreciate that. Then for a follow-up question around the Networking segment wins. The last three quarters now the wins rate in the networking business has been running lower. Is that something that has been deliberate that you guys are maybe backing away from some of those programs maybe because of pricing or is there something else that is causing that. And then what are the lower wins rate in the Networking sector for the last three quarters imply about your ability to grow networking in fiscal 2016?

Steve Frisch - Plexus Corp. - EVP, CCO

Mark, this is Steve. I think we have communicated for several quarters actually even going back to last year that Networking/Communications sector is something we are deemphasising So it is deliberate and purposeful in terms of what we have done there. We are still aggressively going after communications in some select portions of networking. But we do see that as a sector that is going to stay within the portfolio but we are just being much more selective about what we go after.

Mark Delaney - Goldman Sachs - Analyst

Thank you very much.

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

Thank you.

Operator

Thank you. And our next question comes from Shawn Harrison from Longbow Research. Please go ahead.

Shawn Harrison - Longbow Research - Analyst

Good morning. I'll go back to Pat to make sure he's awake. I have a two-fold question on margin. I guess operational improvement of 30 basis points this quarter that's \$2 million if my math is right which is a lot. How did that come about. And then secondarily on margins, what exactly happen to increase the Aerospace cost? Was it challenges of inter grating business or is there more business coming in just a little bit more detail there?

Patrick Jermain - Plexus Corp. - SVP, CFO

You want me to?

Todd Kelsey - Plexus Corp. - EVP, COO

Do you want to take the first part?

Patrick Jermain - Plexus Corp. - SVP, CFO

On margin improvement? I think what I had mention Shawn is that we were offsetting the seasonal cost that we see from merit and payroll reset, and a lot of that is just from operational productivity improvements that we've got going on in the site. A lot of lean activity to drive out waste and improve productivity. So we saw pretty much even offset from the merit increases with those operational improvements.

Todd Kelsey - Plexus Corp. - EVP, COO

With respect to the Aerospace and the additional investments there, as we got into the quarter in Q2 we felt that with the new business that we had ramping there that there were other investments that we needed to make along a capital and human resources and a layout standpoint, process standpoint within the facility to really service those customers properly and ramp the business properly. So we made the call to make those investments and service our customers right. Now we still believe that as we get this business ramped and as we move to a more stable state that we'll recover all of the inefficiencies that we built in to the site.

Shawn Harrison - Longbow Research - Analyst

Just a follow-up on the that first response. So the 30 basis points it is productivity gains. Is that something we can expect every year? You should be able to offset some merit based inflation and other inflation you are seeing?

Patrick Jermain - Plexus Corp. - SVP, CFO

Yeah, I believe that is our goal is to offset that cost because we have that culture of lean end productivity improvements that we continue to drive, so the expectation would be that, yes, we can offset those costs.

Todd Kelsey - Plexus Corp. - EVP, COO

I think what Pat is really saying is that is really how we think about our annual operating plan. As you know we are in a marketplace where it is difficult to have any sort of ability to push through inflationary costs on to customers through price. So the expectation is that we try to offset all those inflationary costs by driving productivity and our sites and regions work on that throughout the year in terms of how they they're going to make that happen.

Shawn Harrison - Longbow Research - Analyst

And then another follow up question, there was a comment on medical that you are seeing customers look at ways to significantly alter their manufacturing because of a cost focus. Does that mean existing business with Plexus going to lower cost sites or does that mean you are going to see a large opportunity of incremental outsourcing break free?

Todd Kelsey - Plexus Corp. - EVP, COO

It is really more outsourcing, so it is not necessarily a movement of work within our facilities but I was referring to movement of business from customer facilities to our facility.

Shawn Harrison - *Longbow Research - Analyst*

I guess what is the time line that could happen, Todd?

Todd Kelsey - *Plexus Corp. - EVP, COO*

It is ongoing. We're are just seeing more opportunity there. We don't have anything to report right now. But there are activities that are in play that we are having discussion

Shawn Harrison - *Longbow Research - Analyst*

Okay.

Todd Kelsey - *Plexus Corp. - EVP, COO*

Unfortunately, these kind of things tend to be not so (inaudible)

Shawn Harrison - *Longbow Research - Analyst*

Are these going be big lumpy opportunities or are these going to be small trickle out?

Steve Frisch - *Plexus Corp. - EVP, CCO*

This is Steve. I think you'll probably see both. I think the ones Todd is referring to could be big and lumpy. But I think the other part to keep in mind here is these are medical devices so the regulatory requirements are also going to dictate some of the transition timing and you have to work through that to really try to understand what could possibly happen and what time frame.

Shawn Harrison - *Longbow Research - Analyst*

Very helpful. Thanks so much.

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

You're welcome.

Operator

Thank you. And our next question comes from Steven Fox from Cross Research. Please go ahead.

Steven Fox - *Cross Research - Analyst*

Thanks. Good morning. First question on your revenue growth. I was wondering if you can look at the quarter we are in and then maybe also the implied guidance for the September quarter and break down how much is related to new program wins that are ramping versus say end demand because you have the 11% and 8% growth roughly? And then how the new programs you have won are actually ramping, whether you're seeing any delays in certain markets or maybe accelerations? And then I had a follow up.



Todd Kelsey - Plexus Corp. - EVP, COO

Sure. Steve this is Todd. So from a standpoint of the growth it is primarily new programs. The end markets are relatively choppy. Now we are as we eluded to in prepared comments as well as earlier in some of the questions, they're certain customers that are performing well, but overall we would say the end markets are soft yet. And we're primarily benefiting from new programs. From a ramp standpoint overall the ramps have been pretty good, but the one area that we are seeing challenges is in the EMEA region. We are seeing some significant and consistent delays in program ramps within that region and that is leading to some of our Q3 challenges in the EMEA region.

Steven Fox - Cross Research - Analyst

Before I ask my follow-up, just on those comments why if the markets are soft, why are you still seeing new programs ramp as expected? I would think some of it is going to be tied together like you mentioned with EMEA. Is there anything you can point to that is allowing you to continue to ramp these programs while you have the uncertainty in demand?

Steve Frisch - Plexus Corp. - EVP, CCO

This is Steve. On the ones that we have been talking about these are relatively new products where I think the customers have done a decent job anticipating where the markets are going. So I think we are benefiting from the fact that they have hit the sweet spot in the market a little bit. And maybe their overall business is suffering a bit but the products we are ramping are the ones that they see as the revenue growth engines for them. So that is probably more of what -- in terms of what we're benefiting from in terms what we are benefiting from in terms of the customers drive in new product development for us.

Patrick Jermain - Plexus Corp. - SVP, CFO

And I would say it is not like the soft markets are something new. This is something we and certainly our customers have been dealing with now for a few years. So with the new program wins much of the softness generally speaking is already baked into the new revenue expectation for the wins.

Steven Fox - Cross Research - Analyst

Got it. That's helpful. Going back to the Com/Networking markets. I understand what you're saying about where you guys are playing versus where you are not playing. But if you sort of extend it out that commentary not just for the next quarter but say over the course of the next year in combination with the fact that the wins there maybe are less than in other markets, should we think of that market as maybe moving more towards flattish or do you have a more optimistic view that you can continue to grow in that segment overall?

Steve Frisch - Plexus Corp. - EVP, CCO

We anticipate it to continue to grow. This is Steve. The pie chart that we put up in terms of our sector splits we see that as trying to maintain that as a healthy mix of the business. We are definitely investing and we want to keep that sector at the same level that it has been running at. So it definitely is a growth area for us as well.

Steven Fox - Cross Research - Analyst

Great, thank you very much.



Operator

Thank you. And our next question comes from Jim Suva from Citi. Please go ahead.

Jim Suva - Citigroup - Analyst

Thanks, and congratulations to you and your team there at Plexus. Your win rate has been absolutely fantastic, and when we see the foreign currency exchanges, the rates changing and some of the EMEA commentary you have made today, can you help us -- I know you don't guide beyond the current year and stuff like that. But would it be fair to say you guys are going to be looking at above 15% growth next year, or should we need to layer in some of these concerns? Again because the win rate is super impressive and it is way above your growth rate line, yet I'm just kind of wondering to make sure people don't get ahead of themselves or is it these things have all been accounted for, for currency exchange, EMEA and things like that because the win rates are so strong? And they have been consistently strong so it is not like been a one quarter it has just been very consistent layering of good trends.

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

I wish I could convince you that we are going to be at double digit growth again next year, but it is just a little too early to look that far out in the future and make any sort of commitment yet at this point. I think as we come towards the end of our fiscal year, we'll have a better read on how this is going to unfold. But, Jim, there is no question that the out-quarter forecast from customers tend to be very conservative and it is challenging to kind of get more than a few quarters out in the future and have any sort of real confidence about where the numbers are going and, frankly, I don't know that the customer themselves spend a whole lot of time driving those forecast or trying to make sure they are accurate I think in some respects at least to us. Because I think that in some cases the MS industry has become more responsive and more agile to the customers, the supply chain dynamics are generally pretty good in terms of our ability to get the materials to fulfil. So I think the customers don't feel a need to really drive longer-term forecast necessarily (inaudible) supply chain and capacity. They believe that you're going to be able to respond to them in very, very short order, which makes long-range forecast really challenging. I mean if you just look at the arithmetic and if you would anticipate that we are going to hang on to all of our customers and we're going to see marginal growth in existing programs with the normal sort of programs going into life and then you layer on top new business wins it would suggest that next year could be really, really quite a good year, another year similar to this year. I would just feel uncomfortable yet trying to set the bar that high until we get a little closer to it.

Jim Suva - Citigroup - Analyst

Okay, great. And then as a follow-up is there any relation to the next quarter softness or uncertainty and the new business ramp dollar amount? Meaning it seems like the customers will adjust quarterly, but do the win rates in the forecast are they related and do we need to do some type of bridge there or are they two totally different isolated discussions and variables?

Steve Frisch - Plexus Corp. - EVP, CCO

This is Steve. It really is two different discussions especially when you look by sector. Those Industrial/ Commercial sector that we mentioned we are ramping that even as we speak. We just announced the win this quarter, and that will be ramped here within a quarter or two. If you look at some of the Healthcare/Life Sciences stuff we could win that and it would literally be -- it could be four quarters out before it started to hit any kind of descent volume. So it really is opportunity by opportunity that we have to look at it in terms of where we expect the ramp to be.

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

I think over a long period of time I think the wins rate as a percent of our trailer four quarters is a good barometer of the health of the business going forward, but to try to translate that directly into the forecast is kind of difficult.



Jim Suva - Citigroup - Analyst

Great. Thank you and again congratulations to you and your team at Plexus.

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

Thank you, Jim.

Operator

Thank you. And our next question comes from Todd Schwartzman from Sidoti & Company. Please go ahead.

Todd Schwartzman - Sidoti & Company - Analyst

Thanks, and good morning. Most of my questions have been asked already, and you may have touched on this also but can you discuss the puts and takes that lead you to lower the fiscal 2015 free cash flow guidance by I think it was \$10 million at the midpoint?

Patrick Jermain - Plexus Corp. - SVP, CFO

Todd, this is Pat. Really during the revenue outlook for the full year that is going to take additional working capital requirement for us so that is the main reason behind it.

Todd Schwartzman - Sidoti & Company - Analyst

And the tightening or the greater specificity of the revenue outlook for the year is just a function of time where you now have pinpointed that 13% to 14.5% number that is just a function of where we are in the calendar?

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

I think that is true. And it is also a function of stating the obviously. I think that we had been stating greater than 10% or double-digit revenue growth, and if you do the arithmetic on where we're at with the third quarter guidance it became clear that either we were going to be closer to moving toward 14% or so or we were going to end up with a flat or down quarter if we stuck with the 10% number. So it felt like we needed to make sure we weren't sending mixed signals about what was going to happen in Q4. So we fully expect that to be a sequentially up quarter, and of course, the arithmetic then suggests it is going to be closer to the new guide range.

Todd Schwartzman - Sidoti & Company - Analyst

Got it. Thanks a lot.

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

You're welcome.



Operator

Thank you. And I am showing no further questions at this time.

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

All right. With that, then we're going to wrap it up. I want to thank everyone for their questions. Hopefully you detected a reasonable amount of optimism here with the team. Coming through this year and achieving double digit revenue growth in the range we are seeing it is quite an achievement I think considering the overall marketplaces that our customers are participating in. While we are not quite happy with our operating performance I think you can since that from us as well, we believe we are going to get up into our target range here as we come through the year. And we are really focused on hanging on to performance in that range as we move through the new fiscal year. And we're hopeful as some of you were asking that we will see another strong revenue growth year in the coming year if the economies around the world cooperate at least in a reasonable way. With that, thank you very much.

Operator

Thank you. And thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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