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PLXS - Q3 2015 Plexus Corp Earnings Call

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OVERVIEW:

PLXS reported 3Q15 revenue of \$670m and diluted EPS of \$0.69. Expects 4Q15 revenues to be \$650-680m and diluted EPS to be \$0.64-0.72.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, and welcome to the Plexus Corp. conference call regarding its fiscal third-quarter 2015 earnings announcement. My name is Lorraine and I will be your operator for today's call.

(Operator Instructions)

The conference call is scheduled to last approximately one hour. 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 Corporation - SVP, CAO and General Counsel*

Thank you, Lorraine. Good morning, everyone, and thank you for joining us today.

Before we begin, I should remind everyone that statements made during the call today and information included in the supporting material that is not historical in nature, such as statements in the future sense 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 10K filing 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 those measures are used for internal Management [goals] in 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 comparisons. For a full reconciliation of non-GAAP supplemental information, please refer to yesterday's press release and our periodic SEC filings.

We encourage participants of the call this morning to access the live webcast and supporting materials at Plexus's website at www.Plexus.com and 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; Pat Jermain, Senior Vice President and Chief Financial Officer; and Steven Frisch, Executive Vice President and Chief Customer Officer.

We now turn the call over to Dean Foate. Dean?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

Thank you, Angelo, and good morning, everyone. Yesterday after the close of the market we reported results for our fiscal third-quarter of 2015. Revenue was \$670 million, with diluted EPS of \$0.69. Both results were consistent with our announcement of preliminary results on July 13. Relative to our original guidance issued April 22, our revenue was at the low end of the range while our EPS result was \$0.02 below the bottom of the range.

Before Todd and Pat provide further context and details regarding our performance this quarter, I will summarize a few notable items on slide 4. While our revenue results were disappointing versus our earlier expectations, we grew about 3% sequentially and we were up 8% versus the comparable quarter last year. Our \$670 million revenue result set a new record for the Company.

During the quarter, we experienced mildly weaker demand in both our Networking/Communications and healthcare life sciences sectors. The Networking/Communications weakness was more disruptive to results as it occurred late in the quarter with meaningful reductions in demand carrying into our fiscal Q4. While our miss in our Defense and Aerospace sector was a consequence of both modest in-market demand weakness and, more significantly, missed product shipments late in the quarter due to an unanticipated production process constraint in one of our focus factories.

While we didn't achieve the financial results we set out to deliver this quarter, I am pleased with our ever-improving focus on providing exceptional value and execution for our customers. As evidenced, our net promoter scores continue to rise and this quarter we are awarded six outstanding performance awards including Global Supplier of the Year of the year for GE Healthcare.

Additionally, we achieved AS9100 Quality Management System Certification for Plexus Engineering Solutions in Europe. This certification is in support of our strategy to support higher levels of engineering value add to customers in the European aerospace market.

We made a few significant leadership changes over the course of the quarter to better position us for growth and improved execution. Recently we announced the appointment of Oliver Mihm as President of Plexus EMEA. In his new role, Oliver assumed responsibilities for the strategy and execution of all the aspects of Plexus's business in the EMEA region. Oliver is a talented and versatile leader who possesses exceptional customer (inaudible) skills.

Ronnie Darroch, who was previously pulling double duty leading Plexus EMEA and Global Manufacturing Solutions can now focus his exceptional talents of strategy and execution of our Global Manufacturing platform. Ronnie has recently relocated to the United States.

Finally, Mike Running assumed leadership over our Global Engineering Solutions business. Over his long tenure at Plexus, Mike has held a number of leadership positions in our engineering organization and is well prepared to leverage his significant portfolio skills to grow this profitable business to the \$100 million level and beyond.



Adapting to our fiscal fourth-quarter guidance on slide 5. Looking forward to next quarter, we expect continuing in-market weakness in our Networking/Communications sector to largely offset anticipated sequential growth in our other three market sectors. We are establishing fiscal fourth-quarter 2015 revenue guidance of \$650 million to \$680 million. Achieving the midpoint of this range would bring our full-year revenue growth just shy of our 12% enduring goal with all four sectors growing year over year.

At this level of revenue, we expect diluted EPS in the range of \$0.64 to \$0.72, including approximately \$0.10 of stock-based compensation expense, but excluding any unanticipated special items.

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

Todd Kelsey - Plexus Corporation - EVP and COO

Thank you, Dean, good morning.

Please advance to slide 6 for insight into the performance of our market sectors during Q3 of FY15, as well as our expectations for the sectors in fiscal Q4 of 2015. Our Networking/Communications sector was up 6% sequentially in Q3, which was below our expectations of a high single-digit increase. Two of our top customers decommitted to earlier forecasts late in the quarter, while performance in the remainder of the sector was mixed.

We expect our Networking/Communications sector to be down in the high teens percentage point in fiscal Q4, a dramatic change from our expectations of just a few weeks ago. Several of our top customers are expensing recent weakened end-market demand, a trend consistent with what we have observed with our peers. While we are benefiting from new program ramps, the sector remains volatile and our expectations have changed significantly. Despite the recent contraction, we're still projecting double-digit percentage growth within the sector in FY15.

Our Healthcare/Life Sciences sector was down 6% sequentially in Q3, below our expectations of a low single-digit decline. This marked the first time in the last seven quarters that the Healthcare/Life Sciences demand did not strengthen within the quarter. Three of our top 10 customers underperformed to expectations within the quarter.

Looking ahead to fiscal Q4, we currently anticipate revenue in our Healthcare/Life Sciences sector to be up in the low single digits as we benefit from new program ramps. While end-market demand is muted, we expect a good growth year in FY16 within our Healthcare/Life Sciences market sector as a result of recent program wins.

Our Industrial/Commercial sector was up 10% sequentially in our fiscal Q3, slightly above our expectations. Seven of our top 10 customers grew sequentially in the quarter and we benefited from the large new program ramp we highlighted last quarter. We currently anticipate that our Industrial/Commercial sector will be up in the low double-digit range in our fiscal Q4 as a result of new program ramps and strengthening demand with a top customer. We are positioned for strong growth in the sector for FY15 and FY16.

Our Defense/Security/Aerospace sector was up 2% sequentially in Q3, a result that was well below our expectations of high single-digit growth. We experienced some production constraint in one of our Defense/Security/Aerospace factories that limited our ability to complete product shipments late in the quarter. We're working closely with our customers to implement solutions that will reduce further impact.

We currently expect Q4 to be up in the high single digits as we benefit from strengthening demand with a top security customer and new program ramps in Aerospace. FY15 remains a healthy growth year for the sector and FY16 is also positioned well.

Next to new business wins on slide 7. During the quarter, we won 34 new programs in our Manufacturing Solutions group that we anticipate will generate approximately \$147 million in annualized revenue when fully ramped in production. Our wins were balanced across our three regions.



When reviewing the trailing four-quarter wins as a percentage of the trailing four-quarter revenue, which is the line on the accompanying regional revenue graph, each region is at a healthy ratio above our 25% goal. Our EMEA region has particularly strong wins momentum enhancing confidence that we will meaningfully grow the region in future quarters.

Please advance to slide 8. 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 Q3 our Manufacturing Solutions wins were particularly strong in the Healthcare/Life Sciences market sector. The Team has performed well over the past three fiscal years, positioning us for growth in FY16 and beyond. Our Manufacturing Solutions wins included significant programs in microelectronics and aftermarket services, to differentiating and higher margin service offerings. Our funnel of new business opportunities remains healthy at \$2 billion.

Now advancing to wins momentum on slide 9. Our manufacturing wins trailing four-quarter performance as shown by the dark blue bars is at \$716 million. This performance results in a trailing four-quarter win ratio of 27%, relative to the trailing four-quarter revenue above our target of 25%. While not included in the wins results on the recent slides, we had another good quarter in Engineering Solutions with new project wins totaling approximately \$23 million.

Our engineering wins remained very strong in our Healthcare/Life Sciences sector where we continue to differentiate in the marketplace. Our backlog in Engineering Solutions is quite healthy and its operational performance has been very good.

Next I would like to turn to operating performance on slide 10. We achieved record revenue in fiscal Q3, affirming the success of our go-to-market strategy and our focus on customer service excellence. Operating margin finished disproportionately below expectations, primarily as a result of the revenue shortfall due to process constraints in Defense/Security/Aerospace coupled with additional investments we made in the focus factory to address manufacturing inefficiencies.

Our Q4 guidance suggests relatively flat revenue and modest improvements to operating margins. In fiscal Q3 our economic return remained well within the value creation zone at 310 basis points.

Please advance to slide 11 for additional insight into our recent operating margin performance and future expectations. Throughout this discussion, I will move from left to right on the slide. As we entered Q3, we focused on three operational improvement priorities: Guadalajara ramp, EMEA growth and Aerospace and Defense Center of Excellence ramp. Two of the three are progressing at or ahead of plan.

Entering Q3, we expected our Guadalajara site to approach breakeven. The site exceeded expectations and was profitable for the quarter. This had a 20 basis point positive impact to operating margin. We continue to expect to achieve corporate margins at the site by Q1 of FY16 as our annualized run rate exceeds \$200 million. Customer satisfaction at the site remains very high. Moreover, our funnel of new business opportunities at the Guadalajara site, which is not included in the revenue projections, is quite strong.

In addition, in fiscal Q3 we obtained ISO 1345 certification 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. As anticipated, our path to consistent profitability in EMEA took a one-quarter pause as a consequence of soft end markets, transition delays and investments in new transitions. We're still on track to resume our profitability improvements in the region in fiscal Q4.

Our operational results did not progress as anticipated in our Aerospace and Defense Center of Excellence within fiscal Q3. We experienced a production process constraint that limited our ability to complete product shipments late in the quarter. This had a 20 basis point impact on fiscal Q3 operating margin. We're working with our customers on solutions to the process constraint and expect to have this resolved in fiscal Q4.

We also made additional investments over those previously communicated which had a 20 basis point burden on our Q3 operating margin in order to address inefficiencies and properly service our customers in this important market. These investments are positively influencing our key



customer metrics which are trending favorably. While we expect to begin to recover our investments in the next two quarters, the complete recovery will occur over FY16.

Looking forward to Q4, we anticipate that we will recover the revenue impact of the production process constraints in our aerospace and defense factory; we will benefit from the revenue ramp in EMEA; and we will continue to recover our Guadalajara investment according to plan. However, much of these gains will be offset by under absorption of a fixed cost that, we put in place during fiscal Q3 to service the previously anticipated revenue growth in fiscal Q4 which was just recently reduced in our forecast.

We will work to remove or delay certain costs as the quarter unfolds. However, we anticipate regional sequential growth in the Networking/Communications and other sectors in fiscal Q1 of 2016. As a result of this increased leverage and continued progress in our three priorities outlined above, we expect improved operating margin in fiscal Q1 of 2016 as we strive to meet our operating margin target range of 4.7% to 5%.

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

Pat Jermain - Plexus Corporation - SVP and CFO

Thank you, Todd, and good morning. Our fiscal third quarter results are summarized on slide 12. Third-quarter revenue of \$670 million was at the low end of our guidance; however, 8% above the prior-year third quarter. Gross margin was 8.8%, which was below our expectations and below the fiscal second-quarter gross margin of 9.2%.

The lower gross margin primarily related to one of our Aerospace and Defense focus factories where missed shipments late in the quarter impacted fixed-cost absorption. We also made deliberate short-term investments in this focus factory to improve quality and manufacturing efficiencies.

Selling and administrative expense of \$30.5 million was consistent with our expectations and as a percentage of revenue was approximately 4.5%, which has been the lowest level we have seen in several years. This percentage has trended downward in recent history due to improved productivity and prudent management of SG&A expenses as we grow the top line.

Operating margin of 4.2% was below our guidance driven by the shortfall in gross margin. Diluted earnings per share of \$0.69 was consistent with the fiscal second-quarter and consistent with the preliminary results provided on July 13. Similar to last quarter, the current quarter overall impact on revenue and earnings from currency fluctuations related to our European operations was less than 1% when compared to both our quarterly forecast and the prior-year fiscal third quarter.

Turning now to the balance sheet on slide 13. Return on invested capital was 14.1% for the fiscal third quarter, reflecting an economic return of 3.1% based on our FY15 weighted average cost to capital of 11%. During the quarter, we repurchased approximately 170,000 shares for \$7.5 million at a weighted average price of \$44.40 per share. The shares were purchased under our \$30 million stock repurchase program.

We have approximately \$7.5 million remaining under the authorization, which we plan to repurchase on a relatively consistent basis over the fiscal fourth quarter. During the quarter, we generated \$15 million in cash from operations and spent \$10 million in capital expenditures, resulting in free cash flow of approximately \$5 million. Our cash cycle at the end of the third quarter was 62 days, which was in line with our expectations and three days higher than our results in the fiscal second quarter.

Please turn to slide 14 for details on our cash cycle. Sequentially days and receivables were flat, which again demonstrated our focus on managing receivables. Days in inventory were 88 days, sequentially up two days, primarily driven by the late quarter reduction in revenue compared to our forecast. Accounts payable days were 62 days, sequentially down one day due to the timing of inventory purchases and supplier payments during the quarter.

As Dean has already provided revenue and earnings-per-share guidance, I will now turn to some additional details on our fiscal fourth quarter of 2015 which are summarized on slide 15. Gross margin is expected to be in the range of 8.7% to 9.7% comparable to the fiscal third quarter of 2015,

with similar revenue expected in the fiscal fourth quarter compared to the third quarter. We expect sequentially consistent SG&A expense in the range of \$30 million to \$31 million. At the midpoint of our revenue guidance, anticipated SG&A would be approximately 4.6% of revenue.

Operating margin is expected to be approximately 4.2% to 5.5% for the fiscal fourth quarter. As Todd has discussed, we are forecasting continued improvement during the next few quarters with our European operations and with the rampup of our Guadalajara site. However, the abrupt reduction in fourth quarter revenue for our Networking/Communications sector will negatively impact operating margin from the under absorption of fixed costs.

We're mindful of the gap in operating margin and have a sense of urgency to achieve our targeted operating margin range of 4.7% to 5%. In order to do so, we need to recover our investment in our aerospace and defense focus factory, improve productivity levels and prudently manage our capital and SG&A spending.

A few other notes. Depreciation expense is expected to be approximately \$12 million in the fiscal fourth quarter, consistent with our fiscal third quarter. We are estimating a tax rate of 10% to 12% for both the fiscal fourth quarter and full year. This rate is increased slightly since last quarter based on the global distribution of our earnings.

Our expectation for the balance sheet is that working capital needs will increase slightly, based on changes in our market sector mix and the abrupt reduction in our fourth quarter revenue forecast. Cash cycle days are expected to be in the range of 63 to 67 days. We're now forecasting free cash flow in the range of \$40 million to \$60 million for FY15.

We expect capital spending to be approximately \$40 million for FY15. The majority of this capital is for equipment to support new capabilities, new program ramps and the refresh of older equipment. We anticipate maintaining a similar level for FY16.

With that, I will open the call for questions. We ask that you please limit yourself to one question and one follow-up. Lorraine?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Brian Alexander, Raymond James.

Brian Alexander - *Raymond James & Associates, Inc. - Analyst*

Wanted to start with the new business wins. I appreciate they were balanced geographically and across segments, but they were roughly 25% below the average we have seen over the last six quarters, and I think the funnel came down as well, so you didn't harvest as many as you had. Is it getting more difficult on the business development front in general? And are you seeing more competition for new programs from some of your larger EMS peers? And what is your outlook for new program wins over the next few quarters?

Steven Frisch - *Plexus Corporation - EVP and Chief Customer Officer*

Brian, this is Steve. In terms of the funnel itself, it's still healthy at over \$2 billion. I think in terms of the aggressiveness of competition, I don't think there's a fundamental difference in what we have seen. The EMS business is a competitive business. And, again, fundamentally I don't think there is a big shift that we have seen there.



As we look forward, we do expect Q4 to improve in terms of the quantity of wins, led significantly by the Healthcare/Life Sciences team. They are expecting some decent wins this quarter. The one thing we did do this quarter is we did sign a letter of intent with a large industrial commercial customer. However, we have to win the individual business units, so we're not recognizing any of those wins until we win each of the business units, so that will happen over the course of the FY16, as we court and win those pieces of business.

From our viewpoint, and as Todd mentioned and you mentioned, the funnel is healthy in front of the places where we want it to be, in EMEA and Guad. The number is down from where we would like it to be or, quite frankly, where you want to see it go. But fundamentally we do not see a big shift in the business in terms of what we're doing on the business development front.

Brian Alexander - *Raymond James & Associates, Inc. - Analyst*

Just to follow up on that on the Industrial/Commercial letter of intent, what is the max opportunity there if you were to be successful on the individual pieces?

Steven Frisch - *Plexus Corporation - EVP and Chief Customer Officer*

We believe it is north of \$100 million. In fact, the customer told us it's north of \$100 million.

Brian Alexander - *Raymond James & Associates, Inc. - Analyst*

Maybe for Dean or Todd, I'm trying to get a sense for how much of the weakness that you're seeing in your business in general, with the guidance for September being below expectations, how much of this is really demand-driven versus more Company specific and execution related? When I look at the big dropoff in the Communications business, the process issue in the Defense business, the consistent under performance on overall margins versus your own internal goals and the several changes you are making in leadership, it would seem, at least to us on the outside, that maybe there is some deeper issues at Plexus.

Can you talk about why that perception may not be warranted and what is really going on? Thanks.

Steven Frisch - *Plexus Corporation - EVP and Chief Customer Officer*

We certainly don't want to leave you with that impression.

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

I will let Todd address the first part of your question which relates to the drop off in Networking/Communications, and we talked about a somewhat modest softness and in-market demand with some of the other sectors.

Fundamentally, the leadership changes that we've been making have quite a bit -- have been, in the long term, in the making. Those that have followed Plexus know that we decided to invest in the EMEA region a number of years ago, in addition to the long legacy capability we had in the UK. That meant we had to begin to build out a team, we put a design center in Europe, we added a facility in Iradial, we were able to attract a very talented leader away from one of our competitors to take the leadership over that region.

That individual, Ronnie Darroch, also is an extremely talented operations leader and he has, as I said in my comments, been pulling double duty leading EMEA and driving performance across the globe for manufacturing. Of course, that was not a sustainable role, having him do both, so we have been developing Oliver into a number of different positions. He first led the engineering organization. Then we had him take on one of the market sectors to gain more understanding about manufacturing, get closer to growth in those sectors. And we then were ready to ask him to take the assignment to lead the EMEA region.



That was at least probably a two-year process to develop and ready him and free up Ronnie then to focus on operations. And, of course, I commented about Mike who has been with the Company for some time in various leadership roles. These things are really evolving as we look to grow in EMEA and as we look to get the better execution and better standards in terms of the way we execute across the globe in manufacturing. And those things, of course, are starting to pay some dividends in terms of our customer net promoter scores. And as I talked about just extraordinary number of customer performance awards that we won this quarter.

There is nothing -- this isn't a reaction. I would say this is more of a longer term strategy and a development of our people and building the Company to scale across the globe. I will turn it to Todd and he will talk about the first parts of your question.

Todd Kelsey - *Plexus Corporation - EVP and COO*

With respect, first of all, Brian, to the Networking/Communications sector, what I can say is that the sector as a whole is soft. We're basically not seeing strong growth anywhere and the growth that we are seeing is from new program wins. We do have a number of our top 10 customers were there's specific -- I would call it exceptional softness or greater, that are really driving the downturn in our fiscal Q4. As we look ahead to fiscal Q1, we do expect some significant sequential growth within the sector in fiscal Q1.

Operator

Mitch [Steeps], RBC Capital Markets.

Mitch Steeps - *RBC Capital Markets - Analyst*

I had a quick question on the Guadalajara facility ramps. I remember I think last quarter you were talking about 20 to 30 basis points improvement in Q4. But now when I look at the slide deck, it looks like you guys are delaying that to FY16. So could you provide some commentary what changed there and why the delay?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

There is not a delay in Guadalajara, and it is actually ahead of schedule. So what we talked about last quarter was overall a 40 basis point drag that was a result of the Guadalajara investments that we put in place to aggressively ramp the facility. We expected to recover that over a three-quarter period, Q3, Q4 and Q1. We recovered 20 of it already in Q3 because of the facility really ramping faster than expected, achieving profitability when we expected it to be at a slight loss in Q3, so we are ahead of plan. We still expect to make some further improvements in Q4 and be completely up to corporate targets in Q1.

Mitch Steeps - *RBC Capital Markets - Analyst*

If I could ask one more on the networking side. I'm sure you guys have answered a lot of questions on this, but is there any comment you guys can make on maybe next year, just because the quarters were so lumpy this year? And when we see year-over-year growth as a comparable to be -- are going to be pretty tough in the first two quarters?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

That is a tough one to answer right now, because we sure didn't see the stepdown like we just experienced into Q4. I guess at this point, we have got a forecast for next year, we see revenues coming up again in that sector as we come into the new fiscal year. Demand from the customers that we saw weaken has come back up.

We don't think that we're going to see the extraordinary strength from, in particular one of the customers that we have seen this past year, and I don't think they would suggest they would see that in that regard either in the near term. Definitely they were positioned such that they were first to market with a new technology and they made extraordinary progress penetrating that market. And, of course, the demand is going to normalize.

Now who knows what's going to happen with follow-on product technologies and all of those kind of things. But at this point, that marketplace for us, and for everyone, I think, is just really difficult to pin down in terms of what we think the kind of quarter-by-quarter linearity is going to be. It is going to be -- I think, continue to be somewhat volatile here.

Steven Frisch - *Plexus Corporation - EVP and Chief Customer Officer*

The one thing, too, that I would add, Dean, is that we are expecting strong growth and have a really solid forecast in our other three market sectors. So we feel really good about our prospects in those three sectors but the Networking/Communications in general has been so volatile it is tough to predict right now.

Mitch Steeps - *RBC Capital Markets - Analyst*

Got it. And just real quick, was [Eros] still a 10% customer in the quarter or did they drop off?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

We, Mitch, only report that on an annual basis so we will be reporting that in our year-end results.

Mitch Steeps - *RBC Capital Markets - Analyst*

Okay, got it. Thank you.

Operator

Matt Sheerin, Stifel.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Just wanted to ask some questions revolving around the production process constraints in your Aerospace Defense business. Was that specific to one customer? And could you give us more color in exactly what those issues were? I know it's been a drag on margins. Is it going to continue to be a drag over the next couple of quarters?

Todd Kelsey - *Plexus Corporation - EVP and COO*

Sure, Matt, this is Todd. I will take this one. With respect to the issue of the production process constraint, it was in our conformal coat function. So this is essentially back-end process that is utilized heavily in Aerospace. Occasionally in other market sectors, but primarily within Aerospace. What is particularly challenging around it is we have 17 chemistries that we currently have implemented right now of which three or four are the bulk of the volume.

Then within that conformal coating there is a certain -- to the typical method is to automate the processes around the coating, but there are certain products that have very manual intensive processes that become very error-prone. What we have been working with our customers on and what



we expected to have resolved within Q3 is to automate some of these more manual processes on products in particular where we have seen upside and also to really bring on third parties for the really obscure coat processes that we have in place.

Those did not occur within the quarter. We're working through those and we have the bulk of it resolved as of today, still a couple of things to resolve yet within the quarter, but we expect to clear that up in the quarter or well within the quarter, even within the month. And the impact is that we would recover that 20 basis point revenue impact that we had to operating margin as a result of not being able to get the product out late in the quarter.

Dean Foate - Plexus Corporation - Chairman, President and CEO

I would just add to that, to be clear we were pretty much ready to go. Unfortunately, the nature of the Aerospace technologies is such that it takes sometimes an extraordinary amount of time to get approvals to make production process changes. And we thought we were going to get those things approved and be able to have a higher throughput. And, unfortunately, that just didn't come about.

Matt Sheerin - Stifel Nicolaus - Analyst

Was that an impact from one customer or multiple customers? Was that revenue that you missed? Is that basically just pulled into the -- or pushed out to the current quarter, the September quarter?

Dean Foate - Plexus Corporation - Chairman, President and CEO

It is from multiple customers. And, yes, it is a push out.

Matt Sheerin - Stifel Nicolaus - Analyst

In terms of your 4.7% to 5% operating margin targets, you talked about the moving parts and the drags from the three main issues. What -- do you expect to reach those targets for all of FY16 or at what point during FY16 do you expect to hit those targets?

Dean Foate - Plexus Corporation - Chairman, President and CEO

I'm going to let Pat take a little bit of a swing at this. At this point, because of what happened with revenue, obviously we are clearly disappointed that we didn't live up to our commitment here, because we really thought we were going to be on top of it here in this quarter. We have some work to do here in the coming year to make sure that we get the revenue top line fine-tuned and get the cost structure right, if we don't see some of the revenue come back to the extent that it was.

I would be disappointed if we couldn't get after this and see it earlier in the year. I think we really need to do that. Otherwise it is going to be a significant -- it is already a significant disappointment, obviously, to the shareholders and to us. We feel a real sense of urgency to get the path back to get into that range.

Pat Jermain - Plexus Corporation - SVP and CFO

I would add to that, Matt, that we are right in the process of developing our plan for next year. And looking out, typically we always have a stepdown in our fiscal second quarter with merit increases and payroll resets. But to Dean's point, we're looking at our cost structure and what we can do to get to those levels as soon as possible. And whether we can get there for the full year, we wouldn't be in a position right now to comment on it.

Operator

Sherri Scribner, Deutsche Bank.

Sherri Scribner - *Deutsche Bank - Analyst*

I wanted to dig a little bit more into the networking weakness that you saw this quarter. And I want to confirm -- Dean, I think you said during the previous questions that customers that were weak this quarter have come back? I want to confirm that is what you said. And also I wanted to ask, in terms of the networking piece, how much of that weakness do you believe is related to weakness in China, which is something we have heard from other companies or is it not related to China at all?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

I will let someone else take the market question overall, but I would say -- I want to clarify what I said. It came down late in Q3 and disappointed and, of course, that weakness carried into Q4. We see improvement in Q1. But at this point not to the level that we are executing revenues with some of the customers that came down for the prior higher levels. We see it coming back some, but we're not -- I wouldn't say it is a robust forecast for that sector.

Steven Frisch - *Plexus Corporation - EVP and Chief Customer Officer*

This is Steve. I will take the market question. As Tom highlighted in his comments, we did see some extraordinary things happen with one or two customers with some new product ramps that came down and that magnified the thing for us. But in terms of the feedback we're getting from customers, there is end-market weakness that they are saying that I think you have heard from other people. There's a combination of the two things. One is we had the extraordinary dip due to a couple of product lines. And then just the overall general end-market weakness is something that is being reflected back to us as well.

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

It is not necessarily China, Sherri.

Sherri Scribner - *Deutsche Bank - Analyst*

Dean, just thinking about FY16, you indicated that most of the segments are going to see growth next year based on your funnel of business and wins. It looks like the street is forecasting growth of about 7% next year. Does that seem like a reasonable growth number for you for FY16?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

It's tough to start guiding 2016 just yet. Certainly the marketplace supports growth at that or better. I wouldn't want people to take their numbers up based on that statement yet because it is too early. But if we only grow 7%, that would be disappointing, quite frankly.

Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - Longbow Research - Analyst

I'm going to beat a dead horse. So we have got a lot of detail on Networking. Just want to be clear, so were these new products going into market that didn't ramp as expected? Based upon the last comment, was it an inventory correction? Was it new business you were supposed to ramp? Just trying to get that last detail.

Steven Frisch - Plexus Corporation - EVP and Chief Customer Officer

This is Steve. The detail is that the customer was forecasting stronger growth and strength in their product ramps and now it had been ramping nicely. Their end-markets didn't materialize the way they thought with those products in the quarter and they see a short-term dip that was more significant than what I think anybody anticipated.

I think Dean highlighted the fact that we do expect to see some of that come back in 2016 back to more normalized run rate. So there was a particular product line that took a dip for everybody here more than what anybody anticipated. And the exact end-market reasons for that, I think weakness in what was happening in that market sector surprised everybody in that market sector or that subsector.

Dean Foate - Plexus Corporation - Chairman, President and CEO

We're also cautious here about what we're saying, quite frankly, because we're out in front of the customers own -- our customers' earnings announcements as well. You know who some of our key customers are. I guess I'd just say hang on and listen to the calls and they will give you more detail. We don't want to be giving information that is contrary to what they might say in terms of direction.

Shawn Harrison - Longbow Research - Analyst

That's fair. I just needed the bounceback into the December quarter that implies there is excess inventory out there and that is why it would bounce back? Or is it stronger demand that you are getting from the customer in terms of the feedback?

Dean Foate - Plexus Corporation - Chairman, President and CEO

Generally, I don't think there's a lot of inventory in the channel. This stuff is pretty much direct fulfill, so there is some of that clearly but a lot of this is just their ability to make sales to customers and get the product moving out into the marketplace.

Shawn Harrison - Longbow Research - Analyst

Just as a follow-up, I know maybe -- I think it was Todd's earlier comments on a bullish view on Mexico into 2016. I know last quarter you talked about potentially very large programs breaking free. Is that what the bullishness in the medical sector is tied to or is there something else that could be breaking free and driving growth?

Dean Foate - Plexus Corporation - Chairman, President and CEO

The growth is we have three major customers that are ramping within that facility right now. And I would say that, by itself, is driving the bullish view. But we also have several other Healthcare/Life Sciences customers that we are beginning to grow as well too. And to be honest, we would view that as being upside to our projections in Mexico.

Shawn Harrison - Longbow Research - Analyst

But nothing incremental on large medical programs breaking free tied to the comment last quarter?

Dean Foate - Plexus Corporation - Chairman, President and CEO

Not into this facility at this point.

Operator

Steven Fox, Cross Research.

Steven Fox - Cross Research - Analyst

First question, with regards to the weakness in Networking/Communications, a broader question. The Company has had periods where it has disappointed the street and it seems to typically be related to customer or market concentration. Obviously you can't snap your fingers and just balance everything out overnight, but can you talk about, given this latest round of misses, what you are doing to maybe reduce some of this end-market risk or end-market dependency risk in the future?

Dean Foate - Plexus Corporation - Chairman, President and CEO

I think if you look at where we were at a number of years ago in terms of our overall concentration in Networking/Communication, obviously it was quite high. I think it was north of 50% at one point in time. I think we have done a nice job, not necessarily always in the way we would want to, but we have done a nice job growing the other sectors proportionately faster than we have the Network/Communications sector, so that is part of the strategy.

Part of the difficulty, obviously, with the customers in Network/Communications is they tend to have much bigger average program sizes than perhaps the other sectors. So even though you have a lot of volatility in Healthcare and you have volatility in Industrial/Commercial, with individual product lines the fact that you are building so many different products with such a great deal of mix, it tends to smooth out performance. But in Network/Communications, the customers tend to have these very significant programs that can have enormous volatility to them.

Our strategy is to try to pick the right customers where we can provide a lot of value add; grow in Networking/Communications because we think it is an important growth sector, but continue to grow in the other sectors faster to try to reduce some of that volatility. Clearly we are not always successful doing that. Like I would say, the hit we took in the coming quarter, obviously, is driven substantially by network medications. But we look at the miss in the prior quarter, this was somewhat self-inflicted as well with our inability to get product out in Defense/Security/Aerospace. It is not all Network/Communications that gave us the current issues.

Steven Fox - Cross Research - Analyst

Dean, that is fair. I guess one of the things I was getting at it is my understanding was that you guys have done a better job of diversifying within the segment in Networking/Communications. So maybe if you can give us an update on how well you diversified. There are some, obviously, with some industry consolidation that is going on there are some spending cycles that maybe are in more sync right now within that segment than usual. But how diversified would you say you are today within that big segment? Thanks.

Dean Foate - Plexus Corporation - Chairman, President and CEO

I don't have the percentages with me right now, but clearly we have a couple of very dominant customers. And, like I said, those customers, the revenue generated for Plexus with those customers tends to revolve around a handful of product lines. It is going to be volatile in that second quarter. It's not as stable as I think we would like. But, at the same time, these are great customers and great partners for us. And, of course, we are working to add additional customers into that sector to help grow with over a longer period of time and hopefully take some of the volatility out.



Operator

Andrew [Hun], B. Riley.

Andrew Hun - *B. Riley & Company - Analyst*

First I was wondering if we can go back a little bit to the wins and then specifically in the Americas, because I think in that specific geography there was a pretty big dropoff.

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

Todd, do you want to take that one?

In the Americas, if you go back and look over the last several quarters, it is actually similar to some of the sectors, there actually has been some volatility now. A couple of quarters ago we had a pretty decent win. In Q2 of F15, we were at \$133 million. Q1 of F15 we were at \$23 million, and this quarter we're at \$61 million. So from a volatility standpoint, I think what you will see is as you look quarter to quarter, you will see volatility in the regions just like you will in the sectors. And that's why we look at the trailing four quarters. And the trailing four quarters has been running relatively flat in that 25% to 30% range. So from our perspective, it is not anything that is abnormal. It is just normal volatility that we would see. And as Todd highlighted, I think we're pretty comfortable with what we have got sitting in the front end of each of the regions at the moment.

Todd Kelsey - *Plexus Corporation - EVP and COO*

What I would add, too, is from an absolute standpoint it's the largest of the three regions, even in the current quarter. It is a number that we feel comfortable with.

Andrew Hun - *B. Riley & Company - Analyst*

I think when you talked earlier, you mentioned there was this large industrial customer. Would that be -- going forward, would that be in the Americas region?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

No, the benefit of that customer is that it is a conglomerate that has several different business units, and we're actually quoting business in all three regions. And that is one of the reasons why it is a little bit more complex is that we're going to win each -- quote each business unit for the right targeted market. From that standpoint, we expect it to affect all three regions.

Andrew Hun - *B. Riley & Company - Analyst*

My next question is related to your December quarter. So I think historically, with the exception of last year, the Industrial/Commercial segment seems to take a pretty big downtick. So at this point, do you have any visibility on whether total Company revenue for the December quarter will be up or down sequential?



Dean Foate - Plexus Corporation - Chairman, President and CEO

Well, we would expect it to be up sequential. I would have to take a look at Industrial/Commercial. You are right that it (inaudible) that pattern. But we also usually see Healthcare/Life Sciences strengthen in that quarter because it's the fiscal year-end for some of our bigger Healthcare customers and they tend to have a stronger performance in that quarter.

At the moment, we've probably -- the fact that there would be a little bit of softening in that normal pattern would unfold in Industrial/Commercial, a little bit of softening, but more strength in Healthcare.

Andrew Hun - B. Riley & Company - Analyst

If I could squeeze in one housekeeping item. I think for your FY15 you actually cut your CapEx budget from \$50 million down to \$40 million? So maybe you could talk a little bit about that?

Pat Jermain - Plexus Corporation - SVP and CFO

Yes, we did, Andrew. This is Pat. What will happen as we traditionally go through a year is we have got a forecast coming in and typically we're not going to be able to get through all of the projects. We prioritize those. And we will see some reduction as we go through the year.

Yes, we are down \$10 million. And just being more mindful about our capital, given our circumstances. And that is why, going into next year, we see a similar level.

Operator

Mark Delaney, Goldman Sachs.

Mark Delaney - Goldman Sachs - Analyst

I was hoping first to talk more on the Industrial/Commercial segment and trying to better understand some of the dynamics with a couple of the larger program opportunities that the Company has talked about. I think on the last call the Company talked about a \$100 million opportunity. And I think you had already booked \$75 million or so of that, with maybe another \$35 million of that still to come.

How much of that has already shipped for revenue through the June quarter? And how should we expect the additional part of that program to layer on? The additional \$100 million opportunity that you were talking about, that you think you can book in Industrial, is that the same customer or is it somebody new and when can that turn into revenue?

Steven Frisch - Plexus Corporation - EVP and Chief Customer Officer

This is Steve. To answer your last question first, the customer I talked about is a new customer. It's not the same one. And in regards to the customer we talked about last quarter, the \$77 million will complete ramping this quarter and it is fully loaded for the F16 forecast. There we talked about an additional \$35 million in revenue. In this quarter we closed \$5 million of that additional, so that will be being loaded into the site forecast in F16. There is still an additional \$28 million to \$30 million that is in our funnel that we're still pursuing with the customer. I don't have an expectation exactly as to when that would close, but that is still in our funnel that we are pursuing with that customer.

Mark Delaney - *Goldman Sachs - Analyst*

With the new \$100 million opportunity that there's an additional customer, is that revenue opportunity in 2016 or is it more of a FY17 timeframe before you can close the business and ship for sales?

Steven Frisch - *Plexus Corporation - EVP and Chief Customer Officer*

It would be a mix. There is a piece of the business that we are talking with the customer about doing transitions, so that would have an impact in 2016. There's also opportunity that we're talking to them about new program ramps which would probably not impact 2016. And we're still deciphering exactly what that mix is.

Mark Delaney - *Goldman Sachs - Analyst*

Understood. Maybe more of a macroeconomic question about some of the trends the Company's seen and across the businesses and certainly relates in particular to Industrial, a lot of [semi] and the project companies have seen weakness in the industrial end-market. I know there's actually a few bigger programs that is allowing [patras] to do better in that business. But maybe help us understand, have you seen any slowdown in some of your industrial programs outside of these big wins? And if not, is that something that concerns you as you look in FY16?

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

I would just comment that we had -- we are experiencing slowdowns with certain customers in certain end-markets. We have certainly talked about the challenges in oil and gas. And, of course, that is already reflected in our numbers and our expectations. Semi-Cap has had fits and starts. Depending upon the customer, we have benefited some by just getting incremental programs, not so much because of the bullish end-market demand, by any stretch.

We keep talking about Healthcare/Life Sciences. Generally, I would say, it is softer than we would expect. And I think that is largely around the challenges of economic performance around the globe. So it clearly is meeting the overall business growth for our customers. And, of course, is reflected in our numbers. So sometimes difficult economic times can actually benefit EMS companies, not because you're going to get the expansion of growth of the existing product lines, but the economic pressure that it puts on the broader customer base in various markets, many times creates new opportunities that would become available had -- or maybe not become available as quickly without the economic pressures. So we see this as just continuing the secular trend toward global arts (inaudible) outsources, as long as this pressure continues.

Operator

Jim Suva, Citi.

Jim Suva - *Citigroup - Analyst*

When we think about your new business line, is there a reason why one should not then think about 12% (inaudible). And the reason I ask it, it (inaudible) above the 25% run rate (inaudible) rate to the Company. So I wonder (inaudible) to recalibrate that 25% (inaudible) fallen off more. How should we think about those (inaudible) the 25% (inaudible) the 12% (inaudible) run rate [base of one.]

Dean Foate - *Plexus Corporation - Chairman, President and CEO*

Thanks, Jim. It sounds to us like you may be on a mobile device or something because we're having a little bit difficult time completely piecing together your questions. So I'm going to try to interpolate between the various -- what I think I heard. I think you were asking about our 12% enduring growth rate. The target we have of 25% of trailing four-quarter revenues is being the target to support the 12% goal.

And excuse me if I'm not getting your question right, but I think that throughout the year now, for the past couple of years, we have done a pretty good job staying meaningfully above that 25% goal. If you look at this year, we're all sitting here disappointed how this has unfolded. We're still going to grow for the full year now, it looks like, just shy of that 12% enduring goal. So the arithmetic, in terms of our win rate and driving growth near 12%, I think holds off. And, in fact, all of our sectors are growing in FY15.

So I think we feel good about the growth. We thought we were going to be well above 12%. The difficulty is that the cost structure was out in front of 12%. The cost structure was starting to come in for higher levels of growth. And, of course, we also just have a couple facilities here that are putting a meaningful drag on our near-term results that we just have been, frankly, struggling to get them course corrected. And we will get them course corrected, but we've clearly struggled.

And so we haven't gotten the operating leverage in the EPS growth this year that we ought to be getting. Generally speaking, I think we still got the right model, I think we still got the right go-to-market strategy. We are winning the new customers, winning the programs.

Our issues aren't related specifically to pricing in the marketplaces or in the industry of collapsing. Our ability to generate profits is about us getting a couple of facilities course corrected and getting the growth into the new sites that we have invested in.

Jim Suva - Citigroup - Analyst

Thank you very much.

Operator

At this time, I'm showing no further questions.

Dean Foate - Plexus Corporation - Chairman, President and CEO

Clearly this isn't the outcome that we had expected. We expected just a quarter ago to have a much stronger result. We take our responsibility and our commitments to deliver numbers in our guidance range very seriously. Over the past 10 or 12 years, this is the only second time we have missed on our EPS guidance range. We are quite embarrassed by that, and we are even more disappointed here with the outlook here in the near term on Q4.

Again, we appreciate the questions from the sell side and we certainly appreciate the support that we have had from our shareholders. And we feel a sense of urgency to get the margin performance back where it needs to be and then get reacceleration of top-line growth here as FY16 unfolds. Thanks very much and I hope all of you have a pleasant day.

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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