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PLXS - Q1 2016 Plexus Corp Earnings Call

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OVERVIEW:

Co. reported 1Q16 revenues of \$617m and diluted EPS of \$0.42. Expects 2Q16 revenues to be \$600-630m and EPS to be \$0.47-0.55.



CORPORATE PARTICIPANTS

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Matthew Sheerin *Stifel Nicolaus - Analyst*

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PRESENTATION

Operator

Good morning, and welcome to the Plexus conference call regarding its first quarter FY16 earnings announcement. My name is Cory, and I will be your operator for today's call.

(Operator Instructions)

I would now like to turn the call over to Ms. Susan Hanson, Plexus' Director of Communications and Brand Management. Susan?

Susan Hanson - *Plexus Corp - Director of Communications and Brand Management*

Thank you, Cory. Good morning and thank you for joining us today. Some of the statements made and information provided during our call today will be forward-looking statements as they will not be limited to historical facts. The words believe, expect, intend, plan, anticipate, and similar terms often identify 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 filing for the fiscal year ended October 3, 2015, and the Safe Harbor and fair disclosure statement in yesterday's press release.

Plexus provides non-GAAP supplemental information such as ROIC, economic return, and free cash flow because those 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 this call this morning to access the live webcast and supporting materials at Plexus' website at www.plexus.com, clicking on Investor Relations on the top of that 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; Patrick Jermain, Senior Vice President and Chief Financial Officer; Steven Frisch, Executive Vice President and Chief Customer Officer. Let me now turn the call over to Dean Foate. Dean?

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

Thank you, Susan, and good morning, everyone. Consistent with past earnings calls, I will provide my summary comments before turning the call over to Todd and Pat for further details.

Beginning with our first fiscal first quarter results on slide 3. Yesterday after the close of the market, reported results for our first quarter of FY16. Revenue was \$617 million, with non-GAAP diluted EPS of \$0.47. The non-GAAP EPS result included \$0.10 of stock-based compensation expense, but excluded \$0.05 of restructuring costs that were recognized during the quarter. Both the revenue and earnings results were consistent with our guidance. As anticipated, our fiscal first quarter was challenging. In the later months of FY15, we experienced a rapid reduction in forecasted revenues that left us with a misaligned cost structure. During our FY15 year-end conference call, we communicated that we would take appropriate actions to improve our operating margin performance, in light of the lower revenue outlook.

Please advance to slide 4. In addition to our near-term cost reduction and control efforts, we announced our decision to disengage two lower margin programs, one in our networking/communications sector, and one in our industrial/commercial sector. At that time we emphasized that we would maintain a healthy relationship with our networking/communication customer on other programs. These two program disengagements are proceeding reasonably consistent with the revenue ramp down we outlined last quarter, although it now seems likely that we will execute a modest level of revenue for the networking/communication program in our fiscal Q3.

Subsequent to our fiscal year-end earnings call, we announced two facility restructuring programs. First, we communicated that we would exit and close our manufacturing facility in Fremont, California. Second, we communicated that we would reduce capacity, and cease volume manufacturing at our Livingston, Scotland facility. It is important to emphasize that we are retaining our engineering solutions and rapid prototyping capabilities in Livingston. Together, once completed, these two facility restructuring programs should deliver approximately \$8 million to \$9 million in annual savings. In addition to these very specific actions, we are driving productivity improvements across the enterprise, while being mindful to prioritize execution for our customers.

Please advance to slide 5. While we are pragmatic about the immediate need to align our cost structure to our near-term revenue outlook, we believe our value proposition puts us in a good position to gain share from our customers, particularly during challenging macroeconomic environments. During the quarter, we harvested approximately \$179 million in new manufacturing wins, while strengthening our funnel of opportunities to a two-year high level. New programs won during the recent quarters are ramping nicely and are forecasted to deliver 3% to 4% underlying growth in our fiscal second quarter, that is masked by the two program disengagements. Looking further ahead, we anticipate a return to quarter-over-quarter growth in the second half of FY16. Customer forecasts appear to have stabilized. The two program disengagements will be largely behind us, and we continue to benefit from new program ramps.

Advancing now to our fiscal second quarter guidance on slide 6. Consistent with the expectations we set last quarter, we are guiding our fiscal second quarter revenue sequentially flat at the midpoint of our \$600 million to \$630 million range. The midpoint of our \$0.47 to \$0.55 EPS guidance range suggests a \$0.04 improvement on quarter over quarter flat revenue. While we are pleased that our cost reduction efforts have offset the seasonal cost increases that we typically experience in our fiscal second quarter, the \$0.04 EPS improvement is largely a consequence of quarter-over-quarter foreign-exchange impacts. I'll now turn the call over to Todd.

Todd Kelsey - *Plexus Corp - EVP, COO*

Thank you, Dean. Good morning. Please advance to slide 7, for insight into the performance of our market sectors during Q1 of FY16, as well as our expectations for the sectors in Q2 of FY16. Our networking/communication sector was down 12% sequentially in Q1, which was better than our



expectations of down in the high teens. Four of our top five customers in this sector performed better than our expectations as we entered the quarter, while performance in the remainder of this sector was mixed.

Looking to Q2, we expect networking/communications revenue to be down in the mid single-digit percentage point range, as we continue to wind on the program we discussed previously. Excluding this program, there is modest underlying growth in the sector, primarily driven by an improving forecast from one of our top customers. Overall demand within the sector remains volatile, and we expect revenue from 7 of our top 10 customers to be down from Q1.

Our healthcare/life sciences sector was up 4% sequentially in Q1, slightly above our expectations of a low single-digit increase. Demand was relatively stable within the quarter. Looking ahead to fiscal Q2, we currently anticipate revenue in our healthcare/life sciences sector to be flat to Q1, as end market softness offsets the benefit of new program ramps. We expect sequential growth in the back half of the fiscal year as new programs mature.

Our industrial/commercial sector was down 14% sequentially in fiscal Q1, slightly worse than our expectations of down low teens as a result of broad-based end market weakness. 8 of our top10 customers were down sequentially in the quarter. We currently anticipate that our industrial/commercial sector will be up in the low single-digit percentage point range in our fiscal Q2, as we see modest near-term strengthening in the semiconductor capital equipment space, and benefit from new program ramps. As we look to the back half of FY16, we anticipate strong sequential growth due to significant new program ramps with multiple customers.

Our defense/security/aerospace sector was down 10% sequentially in Q1, a result that was below our expectations of a low single-digit decline. Several aerospace customers reduced demand from our expectations at the beginning of the quarter. We currently expect Q2 to be up in the mid single-digits, as new program ramps offset near-term inventory corrections. We remain positioned for solid growth within the sector in FY16.

While our forecast volatility over the course of FY16 varies considerably by market sector, our overall revenue forecast had remained remarkably consistent since the last earnings release. Our quarterly revenue expectations throughout FY16 remain largely unchanged from our outlook in October.

Next to new business wins on slide 8. During the quarter, we won 34 new programs in our manufacturing solutions group that we anticipate will generate \$179 million in annualized revenue when fully ramped in production. From an absolute standpoint, the wins for our Americas region were quite encouraging at \$108 million. In addition, when reviewing the trailing four quarter wins as a percentage of the trailing four quarter revenue, our EMEA region has particularly strong wins momentum. As a result, we expect meaningful growth in the region in FY16 and beyond.

Please advance to slide 9 for further insight into the wins performance of our market sectors. It is important to note that there is significant volatility in the quarterly results, and longer-term trends provide the most value in measuring sector performance. In fiscal Q1, our manufacturing solutions wins were robust in industrial/commercial and healthcare/life sciences market sectors. When reviewing the trailing four quarter wins as a percentage of the trailing four quarter revenue, the healthcare/life sciences, defense/security/aerospace, and industrial/commercial sectors all display wins momentum well below above our 25% goal, supporting our long-term growth, and continued transformation to a healthier, more defensible portfolio.

Now advancing to wins momentum on slide 10. Our trailing four quarter manufacturing wins, as shown by the dark blue bars is at \$702 million. This performance results in a trailing four quarter win ratio of 27% relative to trailing four quarter revenue, above our target of 25%, and consistent with the prior two quarters. Our engineering solutions wins totaled approximately \$22 million in fiscal Q2. Our engineering wins remain strong in our healthcare/life sciences sector, where our complete value stream of product realization solutions differentiates in the marketplace.

Please advance to slide 11. Our funnel of qualified manufacturing opportunities is at a two-year high of \$2.3 billion. On a sector basis, our healthcare/life sciences and industrial/commercial funnels are exceptionally strong, consistent with our goal of expanding share within these sectors in order to deliver a healthier portfolio.

Next I would like to turn to operating performance on slide 12. As expected, our fiscal Q1 revenue was down considerably from Q4 of FY15. Despite the revenue contraction, our operating margin finished above our guidance range at 3.7%, as a result of the solid initial progress associated with our cost reduction and productivity improvement initiatives. While we are guiding revenue essentially flat for fiscal Q2, our underlying book of business is up approximately 4% sequentially, when factoring out the two low margin program disengagements we previously discussed.

Please advance to slide 13 for additional insight into our future operating margin expectations. Consistent with our discussion last quarter, we have put in place plans to improve operating profit \$6 million to \$8 million per quarter by Q3 of FY16. We are currently modestly ahead of schedule. We achieved a 20 basis point improvement to fiscal Q1 operating margin, as a result of our immediate focused actions on reducing discretionary spending, reducing operating expenses, and achieving near-term productivity gains.

As we look forward to fiscal Q2, we will continue to make progress with our cost reduction and productivity improvement initiatives. However, much of these gains will be offset by the typical 40 basis points seasonal headwinds, inclusive of compensation adjustments, and United States payroll tax reset. Looking ahead to the remainder of FY16, we will recognize the benefits from our previously announced Fremont facility closure and Livingston facility restructuring, as well as the full impact of the productivity improvements in each of our regions. Inclusive of the seasonal costs, we expect cost reduction and productivity improvement actions will have a cumulative impact to operating margin of about 100 basis points.

We anticipate additional positive margin benefit in FY16 from our Guadalajara ramp, and sustained growth in the EMEA region. Our Guadalajara ramp continues to progress well, as the site is currently approaching \$200 million run rate with sustained profitability. Customer satisfaction at the site is excellent, and we continue to win new business. In addition, our funnel of new business opportunities at the site remains robust.

We currently expect reasonable sequential revenue growth in the second half of the fiscal year. However, we will continue to evaluate our cost structure as the year unfolds. We remain committed to achieving our target operating margin range of 4.7% to 5%, and are working diligently to achieve that goal within FY16. 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 first quarter results are summarized on slide 14. With strong end of quarter shipments in our networking/communications sector, first quarter revenue came in above the midpoint of our guidance at \$617 million. Gross margin of 8.1% was above our guidance range, primarily the result of productivity improvements, and greater fixed cost absorption from the added revenue.

Selling and administrative expense of \$27 million was consistent with our expectations, and as a percentage of revenue was 4.4%, representing the lowest level we've seen in several years. Operating margin before restructuring exceeded our guidance range at 3.7%. Included in operating margin is approximately 55 basis points of stock-based compensation expense. Diluted earnings per share of \$0.42 includes a \$0.05 per share detriment as a result of after-tax restructuring charges of \$1.5 million, related primarily to our previous announcement to close our Fremont, California facility, and our subsequent decision to end volume manufacturing in Livingston, Scotland. Excluding these restructuring charges, non-GAAP EPS of \$0.47 was at the upper end of our guidance.

We continue to see minimal impact to revenue and operating profit from currency fluctuations related to our EMEA operations. However, during the first quarter we incurred an after-tax loss of \$0.04 per share below operating profit, primarily related to currency volatility associated with our Chinese operations and certain unhedged balance sheet items. As a result, we are taking additional steps to refine our programs, and reduce foreign currency exposures.

Turning now to the balance sheet on slide 15. Return on invested capital was 10.8% for the fiscal first quarter, slightly below our FY16 weighted average cost of capital of 11%, and lower than the 14% we delivered in FY15 due primarily to lower operating profit. During the quarter, we repurchased approximately 227,000 shares for \$8.5 million, at a weighted average price of \$37.23 per share. The shares were purchased under the \$30 million stock repurchase program authorized by the Board of Directors last August. The Company expects to complete the authorized repurchases on a relatively consistent basis over the remainder of FY16.

During the quarter, we generated \$21.3 million in cash from operations, and spent \$11.8 million on capital expenditures resulting in free cash flow of \$9.5 million. This result exceeded our \$[20] million to \$40 million negative free cash flow guidance for the fiscal first quarter. Our progress on working capital initiatives led to an improvement in cash cycle days, and contributed to the positive free cash flow. Cash cycle at the end of the first quarter was 71 days, which was a 5 day improvement from the low end of our guidance.

Please turn to slide 16 for details on our cash cycle. Sequentially days and receivables were flat. Diligent attention to past-due accounts by our collection team across the globe offset higher receivable balances from late quarter shipments to several calendar year-end customers. Days in inventory were sequentially up 3 days. Inventory dollars were 4% lower than the fiscal fourth quarter, compared to the 8% revenue reduction from last quarter. With the abrupt reduction in fiscal first quarter revenue, we had guided a [6 day] increase in inventory days. Improvements in the procurement planning process by our supply chain team tempered the impact on inventory days from the lower revenue. Accounts payable days were sequentially down 1 day, however, improved 5 days compared to our guidance due to higher procurement activity to support early fiscal second quarter demand.

As Dean has already provided the revenue and EPS guidance, I will now turn to some additional details on the second quarter of FY16 which are summarized on slide 17. We expect additional restructuring charges related to our Fremont, California and Livingston, Scotland facilities of approximately \$2 million to \$3 million in the fiscal second quarter. These costs are excluded from the guidance discussed today. We expect all restructuring activities related to these actions to be completed in FY16, and to total \$5 million to \$7 million for the year.

Gross margin is expected to be in a range of 8.1% to 8.4% at the midpoint slightly above the first quarter of FY16. Our gross margin guidance includes seasonal compensation cost increases, and the reset of payroll taxes for US employees. This quarter we will see additional benefits from our restructuring activities, and expect gross margin to exceed 9% in the latter part of FY16.

As a result of tightly managing discretionary spending and pursuing opportunities for cost reductions, we expect SG&A expense in the range of \$27 million to \$28 million, slightly up sequentially due to the seasonal headwinds from merit and payroll tax expense. At the midpoint of our revenue guidance, anticipated SG&A would be approximately 4.5% of revenue.

Fiscal second quarter operating margin is expected to be in the range of 3.6% to 4%, which includes approximately 60 basis points of stock-based compensation expense. A few other notes, depreciation expense for the fiscal second quarter is expected to be consistent with the fiscal first quarter at approximately \$12 million. Before restructuring charges, we are estimating an effective tax rate of 12% to 14% for the fiscal second quarter, and 11% to 13% for the full year.

Our expectations for the balance sheet is a reduction in working capital from the fiscal first quarter. Based on the forecasted levels of revenue, we expect these changes will result in cash cycle days of 68 to 72 days for the fiscal second quarter. The decrease in days reflects continued advancement of our working capital initiatives, primarily focused on inventory efficiency. We expect free cash flow in the range of \$20 million to \$40 million for the second quarter, and reaffirm our expectation of free cash flow in the range of \$80 million to \$100 million for FY16. We are guiding FY16 capital spending of approximately \$40 million, which will be focused on maintenance capital, and capital to support new program ramps.

Finally, I want to mention that the two lower margin program disengagements that we announced last quarter continue to progress largely as planned, as well as our restructuring activities. Assuming stability with our FY16 second half revenue forecast, these actions combined with other productivity initiatives further our belief in achieving our target operating margin range of 4.7% to 5% as we exit FY16. With that, I will open the call for questions. We ask that you please limit yourself to one question and one follow-up. Cory?

QUESTIONS AND ANSWERS

Operator

Thank you.



(Operator Instructions)

And our first question comes from Mitch Steves. Mitch, your line is open.

Mitch Steves - *RBC Capital Markets - Analyst*

Hey, thanks for taking my questions, guys. So I guess, I will start on the networking side. It looks like you guys beat by a pretty material amount. Can you maybe provide some color, whether that was wireless or wireline? Or maybe on a product basis, what type of products were better than expected?

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

Certainly. I'm just trying to [surface] the data here (laughter).

Todd Kelsey - *Plexus Corp - EVP, COO*

Yes, so basically what we saw is some reasonable upside from a number of our customers within the quarter. So they finished just a bit more than we had anticipated, but particularly from some of the top customers within the sector finished stronger than expected. We are seeing a bit of that, with at least one of our customers into Q2, although overall, the Q2 demand in looking forward is quite volatile, on a customer by customer basis. Some are showing pretty significant upside, while others are showing rather significant downside, as we look out to the remainder of the fiscal year including Q2.

Mitch Steves - *RBC Capital Markets - Analyst*

Got it. So there is no real change between wireless and wireline?

Todd Kelsey - *Plexus Corp - EVP, COO*

Nothing really significant from a wireless, wireline perspective. And to be honest, I mean, our exposure into traditional networking products is rather limited right now. We've really done a nice job of moving the portfolio more towards a communications-based portfolio, where that's about three-fourths of our revenue within the sector.

Mitch Steves - *RBC Capital Markets - Analyst*

Got it. Okay. And then secondly, I noticed in your slide deck, you've got EMEA as a growth sector essentially, for the second half of the year. Can you explain why, why the confidence there? And then secondly, if that is related at all to the large industrial win that you guys had? You guys are up, I think [175]% of that, quarter for quarter.

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

What -- it's not related to the large industrial win. That opportunity is being executed in the US. I think our EMEA growth is largely around, just building out our go-to-market team and leadership in that market. It is underserved, I think, from a standpoint of our value proposition in the market, and our combination of our investments in engineering solutions there, and the whole cost manufacturing solution that we now have in [Oradea] is now beginning to build the brand in the marketplace.



Mitch Steves - RBC Capital Markets - Analyst

Got it. Thank you very much.

Dean Foate - Plexus Corp - Chairman, President and CEO

You're welcome.

Operator

Our next question comes from Shawn Harrison. Shawn, your line is open.

Shawn Harrison - Longbow Research - Analyst

Hi, morning, everyone.

Dean Foate - Plexus Corp - Chairman, President and CEO

Hi, Shawn.

Shawn Harrison - Longbow Research - Analyst

I wanted to go back some of the statements you made on the full-year last quarter, and I believe it was based upon program ramps, and at least the visibility you had. Healthcare/life sciences would be up double-digits for the year. Aerospace would be up double-digits, but now we've had the inventory correction here in the first half, and maybe industrial would be up modestly. I was hoping for an update, just in terms of that preliminary outlook from last quarter?

Dean Foate - Plexus Corp - Chairman, President and CEO

Yes, I think our view right now is that we are still going to -- we're -- industrial has strengthened quite a bit, industrial/commercial, and we expect to see very strong growth in that for the full-year. It could be double-digit or a little bit -- it's stronger into that range. Defense, we believe is going to be up in that range as well.

But to your point, healthcare didn't get the start that we had hoped. So it's likely to come in a little bit short, although there are a few opportunities now that could change that. We will see how it unfolds.

And of course, networking is, of course, going to be down obviously, because of the underlying of the significant customer that we have in that space, and because of the tough comp that we have, with a tremendously strong year with a couple of our customers last year.

Shawn Harrison - Longbow Research - Analyst

Okay. And the strength in industrial, is that mainly the Semi-Cap upside you are seeing right now, or is it broader based than that?

Dean Foate - Plexus Corp - Chairman, President and CEO

I will let Steve take that, but you're on to some of it for sure (laughter).

Steve Frisch - Plexus Corp - EVP, Customer Care Officer

It is broader based. The Semi-Cap is definitely something that we see coming up in the back half of the year, but we do see strength in a few areas as well, other areas as well. So a little broader -based.

Shawn Harrison - Longbow Research - Analyst

Okay. And to be clear, maybe I misheard, but I thought healthcare got off to a slightly better start, and aerospace got off to slower start. Or did I heard that incorrectly?

Dean Foate - Plexus Corp - Chairman, President and CEO

Yes, it is a little stronger, but the full-year is not quite what we thought. Again, I am not giving up on healthcare yet at this point though, because we did see some volatility in forecast there, and there is some nice opportunities. We've got a number of wins that are -- should give us good growth in 2017. The question is, whether any of that is going to get going a little bit earlier.

Patrick Jermain - Plexus Corp - SVP, CFO

One of the things I would add too, is we are seeing signs in the healthcare end markets, as we look out to FY16. So we are still are expecting growth and reasonable growth, but that is really driven all by new program wins. And we have some additional opportunities for other new programs to potentially get us back to where we had wanted to be. But right now, that end market softness is certainly having an impact.

Todd Kelsey - Plexus Corp - EVP, COO

Yes, and Shawn, the funnel of opportunities for healthcare/life sciences, really strong right now (multiple speakers).

Dean Foate - Plexus Corp - Chairman, President and CEO

As are the wins in engineering as well.

Shawn Harrison - Longbow Research - Analyst

That was going to be my follow-up question, guys, \$2.3 billion, so a two year high in that number. What should we take away from that, in terms of just the harvesting opportunities, how do you expand it? I know the old adage is when times are tough, more outsourcing occurs. But if you could just break down the upside in the win pipeline?

Todd Kelsey - Plexus Corp - EVP, COO

I think the takeaway is that the strength in the funnel -- you hit it spot on I think, which is in times when they get a little more challenged, I think more companies are looking for different opportunities, in terms of how to fulfill their manufacturing. I think that's what we are seeing. We definitely have more new targets coming into the funnel, in terms of people that had historically done manufacturing internally, looking for a partner. And our value proposition is lining up in, especially in the healthcare/life sciences, and industrial/commercial sectors really well.

Dean Foate - Plexus Corp - Chairman, President and CEO

Yes, I would just add on that, as I think when you contemplate -- Steve was focusing a little bit here on customers, OEMs that are looking to potentially outsource more or exit facilities. But when you also think about customers that use multiple suppliers, there is a number of motivations for why they might do that. Part of it might be enterprise risk. Some of it might be unique capabilities at different EMS partners, dissatisfaction with their current partners, a desire to have a competitive dynamic between multiple partners. Or it's just a condition of legacy, companies that are gone through M&A, and have all kinds of different partners in their supply chain.

And when you look at our position today, our value proposition is very strong around execution, quality, on-time delivery, and the agility in manufacturing, our ability to help our customers innovate on the front-end, our ability to service now products on the backend. And we have worked hard to get a fairly dominant share with our customers as well. So when those customers look to collapse their supply chains, we are in a very favorable position to take on new share. And some of that I believe is reflected in the funnel enlargement.

Shawn Harrison - Longbow Research - Analyst

Okay. Very helpful. Thanks so much.

Dean Foate - Plexus Corp - Chairman, President and CEO

You're welcome.

Operator

Our next question comes from Sherri Scribner. Your line is open.

Dean Foate - Plexus Corp - Chairman, President and CEO

Hi, Sherri Scribner.

Sherri Scribner - Deutsche Bank - Analyst

Hi, how are you? I just want to follow-up on Shawn's question a little bit, and then I have a second question. But it sounds like the delta versus your views last year for the full-year, would be networking is probably about the same as you had thought. Healthcare is a bit worse. Industrial is bit better, and defense is about where you thought, and good growth this year. Is that right?

Dean Foate - Plexus Corp - Chairman, President and CEO

Well, actually industrial is quite, quite a bit better.

Sherri Scribner - Deutsche Bank - Analyst

Okay.

Dean Foate - Plexus Corp - Chairman, President and CEO

And I think your read on the rest of the sectors is fairly accurate.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay. And then, just following up on the industrial piece, because I know there a lot of concerns in terms of macro concerns, market concerns about the industrial market. It's a bit surprising that your industrial business is so much better. Maybe you can remind us about your mix, and why do you think your outlook is a bit better than some other companies have commented?

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

Yes, I think first, we don't want to overplay the end markets, right. The end markets are somewhat challenged, with the exception of the semiconductor capital equipment folks are starting to indicate some strength, and that's reasonably new news. We're starting -- it used to be a discussion about, we will see it in the back half, and there really wasn't any evidence in the forecast.

Now we are starting to see some improvement in forecast. I think the real driver for us, is just new programs, stuff coming into Plexus that we didn't have before, that now is going to drive growth.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay. Thank you.

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

You're welcome.

Operator

Our next question comes from Matt Sheerin. Matt, your line is open.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Yes, thanks. Good morning. So first question, as it relates to the two programs that you are already exiting, you've talked about, as you look at the rest of the business, are there any other programs or pieces of business that may be on the fence, in terms of profit goals, or where you may be seeing more pricing pressure or competition? Or is that just an ongoing process at the Company?

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

Yes, I think it's important to understand that, it is a part of our normal process, to look at the programs that we have, seeing that they are playing out the way we thought. Are they customers that we can grow and gain additional share with? And it is just a normal process that we use to prune smaller pieces of business I'll say.

These are unique, in that they are quite large, certainly networking/communications. This has been part of our strategy here now, is to deemphasize kind of the pure networking, switching, routing business, much of which is just highly commoditized, and the cost pressures are just tremendous.

And, of course, the other one is in -- was in the automotive sector. Which early on there was some thinking that it was going to be so highly technologically sophisticated, that somehow it was going to magically maintain some sort of pricing, that turns out is really starting to converge toward typical automotive, which we're just not in a good position to succeed.



Some of our competitors are much better positioned. They've built out their platforms to service those kind of customers. And so, we just decided to exit that. And that is why we are so -- giving so much optics around those programs is because they are so significant.

Of course, these were things that were in our thought pattern for some time. When we saw a revenues kind of drop off suddenly, we decided, well, let's just get on with it, and get those pieces of business out, and put us in a better position as we come through the fiscal year.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Got it. And regarding the FX headwinds you talked about in Asia, could you elaborate on those issues, and measures you are taking to address that?

Patrick Jermain - *Plexus Corp - SVP, CFO*

Sure. Sure, Matt. There are two main drivers behind the loss this quarter. One revolves around balance sheet exposures, primarily in our Malaysia operations, that were not being hedged. And in order to hedge, you need onshore resources to put those -- to execute those transactions. So we are making the move to put those resources in place, and begin hedging our balance sheet exposures.

The second portion relates primarily to our Chinese operations, where we had some timing differences, between executing and settling our hedges, compared to our month ends, our fiscal month ends. There is a couple day difference between those two, and with the volatility we have seen with the renminbi over the last few months, we've experienced losses in the last couple of days. So going forward, we are better aligned with when we execute and settle the hedges, compared to our month ends.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Okay. And when you talked about onshore resources in Malaysia, what do you mean specifically?

Patrick Jermain - *Plexus Corp - SVP, CFO*

Well, Malaysia has a currency that, if you are going to execute hedges, they have to be executed onshore, as opposed to over here, and that's a statutory requirement. So we haven't been doing that here, because of the requirements, but we will start doing it with our Malaysia finance folks in Malaysia.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Okay, all right. Thanks a lot, Pat.

Patrick Jermain - *Plexus Corp - SVP, CFO*

Yes.

Operator

Our next question comes from Steven Fox. Steven, your line is open.

Steven Fox - *Cross Research - Analyst*

Thanks. Good morning. Just first question, just going through all the commentary, Dean, that you guys made. It seems like pretty much all the markets have pressure on them, and that the growth is predominantly coming from new wins. And so, I was wondering if you could step back, given everything that is going on in the economy, and give us a idea of comfort level around the new wins ramping this year? Where maybe there would be risk, and where you think things are [locked] down for whatever reason? And then I had a follow-up. Thanks.

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

Yes. I mean, when you reflect on what is going on with the equity markets in various countries around the world, it is kind of hard to -- in that view, sort of have great confidence looking out, looking forward. I think, all I can say is that the economic pressure is, of course, causing our customers to move more rapidly toward who they are going to do business with in this circumstance. Which I commented on earlier, was building the funnel, and has resulted in us achieving some new wins, as customers also have taken programs that are internal, and have decided to take cost out internal, and free up capital internal by outsourcing programs.

So I've got a reasonable amount of confidence in our year, I think somewhat, because we've got quite a number of programs ramping up. We've got reasonable visibility on those program ramps. We've got a reasonable understanding of the end market demand associated with them.

And the customer forecast, while they came down quite rapidly as we came into July, August time frame, the forecast seem to have gone through a pretty significant reset, and stabilized. We also know that part of the reset with our customers was taking inventory out of the channel, and now the inventories with some of those customers are very lean. And so, we feel if there is end market demand, we are going to see it pull through pretty nicely, as we come through the full-year.

I'm looking at my partners here, to see if any of them want to add anything to it.

Patrick Jermain - *Plexus Corp - SVP, CFO*

Well, what I would add is that if you went back, as Dean had referenced a quarter ago, that's when we saw the big reset from our customers. Now if you go ahead to this quarter, our forecast have been largely stable, with about the only exception being healthcare/life sciences which is softening just a bit.

Now as we look at our overall, outward look at our revenue in the remainder of FY16, that is being offset by some strength from additional new program wins in industrial/commercial. So our confidence in our number is reasonable, given the economic climate right now, because we have seen stability, throughout the course of the last three to five months, within our customer forecasts on aggregate.

Steven Fox - *Cross Research - Analyst*

Great. That is very helpful. And then, just one big picture question. A lot of your peer companies continue to move to be more vertically integrated, or even take a major step to start being vertically integrated. Can you just defend the model a little bit, and why Plexus can continue to thrive as predominantly as traditional EMS provider?

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

Well, I would just say, if I was them, I would be doing it. I mean, I think when you look at the end market exposure that they have to -- many of them compete, that's an appropriate path to go. I think that for us, because of the breadth of products that we manufacture, and the breadth of the supply chain that is required to support those products, we are just not going to get the benefit out of vertical integration.

So we're arguably the only pure play, mid to low volume, higher complexity manufacturer in this space. And as a consequence of that, I just don't think that vertical integration makes sense. And frankly, when you look through cycles, many of our competitors have been -- had a difficult time achieving good shareholder value with those vertically integrated models, unless those vertically integrated models really line up really well with the needs of end markets, consumer electronics, automotive electronics, things that have much higher velocity manufacturing.

Steven Fox - *Cross Research - Analyst*

Fair enough. That's very helpful. Thank you.

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

You're welcome.

Operator

Our next question comes from [Andrew B. Riley]. Andrew, your line is open.

Unidentified Participant - *Analyst*

So thanks for taking my question, guys.

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

You're welcome.

Unidentified Participant - *Analyst*

I think on the last question you had talked about \$28 million in cost savings, and that the Fremont closure would translate to about \$7 million. So I'm curious how much Livingston will save you on an annual basis? And then, what else do you have to get to the \$28 million for the full-year?

Todd Kelsey - *Plexus Corp - EVP, COO*

Sure. So this is Todd. I will take this, Andrew. From a Livingston standpoint overall, we look at that on an annualized basis at about \$1.5 million. So it's relatively smaller than the Fremont facility.

When we look at our efforts though, again what we are doing is we're targeting \$6 million to \$8 million per quarter. So the run rate could potentially be \$24 million to \$32 million on an annualized basis. And we are taking it really in three different areas, or three different areas of focus.

And first of all, the one where you are seeing the impact externally is around facilities. We evaluated our footprint strategy, how our footprint is aligned to our strategy, what their value proposition, as well as our capacity across the regions. And that's where we came to the conclusion that San Jose did not fit strategically with our footprint. And Livingston, we had an issue particularly from a capacity standpoint there.

So it's important to note with Livingston, we also have engineering solutions and rapid prototyping in that facility, and those remain intact. We believe they're really important solutions for that region, and they are doing quite well.



The second piece is within each of our regions we set productivity goals for each of our operating regions, that they needed to achieve, either through cost reduction activities or productivity improvement actions. And our regions are progressing really well on those goals. We are quite pleased with what they have been able to accomplish to date.

And then, finally, we are looking more at discretionary expenses, things that really fall within what we call our service centers or the SG&A type functions, of where do we have opportunities there, and reducing the expenses in that area as well too -- and those also have goals. And in aggregate, those goals really get us beyond the \$24 million to \$32 million target that we have on an annualized basis. But what we feel is, that gives us some room to be able to adjust as business conditions dictate, and still meet the targets that we set out to all of you.

Unidentified Participant - - *Analyst*

Got it. So like, when you look at those three sources, is it roughly about one-third each, in terms of the \$24 million to \$32 million?

Todd Kelsey - *Plexus Corp - EVP, COO*

No, you really can't think of it as one-third each. I would say it, really the regional productivity improvement goal is the biggest bucket within those three.

Unidentified Participant - - *Analyst*

Got it. Okay. And then, I think on the last earnings call, you gave a very specific wind-down expectations for the two programs. One, in industrial and commercial, and then one in networking and communications. I was just curious for the -- your first quarter, for your fiscal Q1, did the revenue come out as you had talked about, anticipated in the earnings call? I think for the IC customer, it was expected to be \$13 million, and then for the networking/communications customer, it was expected to be \$29 million?

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

Yes, I think they are largely in line with those numbers. I think what is changed, is something I talked about when I was in the script. And that, at least for the network communications customer, we thought we are going to be completely done by the end of fiscal Q2.

But at least for one of the products that is moving out within that the network communications customer, they asked us to build it through end-of-life. And so, as a consequence, we are going to have a little bit of a tail of revenue that's going to extend into Q3, maybe kind of a de minimus amount in our fiscal Q4.

So, again back to the industrial/commercial, that should be out by the end of Q2, pretty much right in line with what we said. And the network/communications is going to ramp down, reasonably consistent with a little bit longer tail into Q3.

Unidentified Participant - - *Analyst*

Okay. So (multiple speakers) Go ahead.

Todd Kelsey - *Plexus Corp - EVP, COO*

But I wouldn't think of it as a large amount.



Patrick Jermain - *Plexus Corp - SVP, CFO*

The one thing I would add too, is if you look the Q2 headwind of those two programs versus Q1, it's a little over \$20 million. So when you take into account that we are guiding essentially flat revenue, the underlying book of business is growing on the order of about 4%.

Unidentified Participant - *Analyst*

Right. That's what I was going to say. You actually have a decent amount of revenue to make up in order to get to flat rate so --.

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

Right. That's why part of our conviction about the full-year is reasonably strong.

Unidentified Participant - *Analyst*

Right. Okay. Thanks very much.

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

You're welcome.

Operator

And our next question comes from Jim Suva. Jim, your line is open.

Jim Suva - *Citigroup - Analyst*

Thank you, and congrats graduation to you, and your team there at Plexus.

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

Thank you, Jim.

Jim Suva - *Citigroup - Analyst*

Two questions. First of all, when we think about the wind-down of programs and all these other newer programs coming in, it sounds like the networking one is going to have a little bit longer tail to the end-of-life, meaning you are getting a little bit more business out of it, than what you thought from the wind-down. When you add that all up, can you help us kind of triangulate on what you now expect for the full-year?

I know that there has been a lot of puts and takes for the quarter, with industrial doing better than some of the other ones, not quite as strong and things like that. But for the full-year, what should we be looking at now? And then, if some of this business takes longer to wind off and we build our model out, then the following year I assume we have got to [peel] out some more for year-over-year comps? And then, I have a follow-up question.



Dean Foate - Plexus Corp - Chairman, President and CEO

Yes. I think that the way we are thinking about the year is, right now, we are striving to get back to flat, but our forecast doesn't support that yet. And so, we are down still probably 2%, 3%, maybe 4% for the full-year. But on the other hand, we should exit the year, if the forecast holds up, with a record quarter in the fourth quarter, from a revenue standpoint.

I think we are very close to that. So the run rate should be very strong coming out of the year. And of course, importantly, which we're really focused on, is to get the productivity and the cost projects done that Todd was talking about, in conjunction now with the revenue slope should to get us back into that operating margin range. We really firmly that we need to be there.

Jim Suva - Citigroup - Analyst

Okay. Got you. So down kind of 2% to 4% for this year. But then I assume then the following year, you'll still have to -- we'll have to remove some of the wind-downs from this year to make the following year also a little bit more challenging? Can you quantify, what this year you'll build for a dollar amount, that we won't have for the following year?

Patrick Jermain - Plexus Corp - SVP, CFO

So the full year number, do you know what the headwind is offhand, Todd, for the -- ?

Todd Kelsey - Plexus Corp - EVP, COO

It was on the order of (inaudible) -- let me see here, wasn't it total?

Patrick Jermain - Plexus Corp - SVP, CFO

Yes. I think it's somewhere in that -- I'm looking at it right now.

Todd Kelsey - Plexus Corp - EVP, COO

The one thing I'd add while --

Patrick Jermain - Plexus Corp - SVP, CFO

I think it was closer to --

Todd Kelsey - Plexus Corp - EVP, COO

[\$180 million] total.

Patrick Jermain - Plexus Corp - SVP, CFO

Yes, about [\$180 million] would be the headwind combined for the two programs that are unwinding.



Jim Suva - Citigroup - Analyst

Yes, for this year. Got you.

Patrick Jermain - Plexus Corp - SVP, CFO

Yes, it is important to note though, Jim, revenue would be out by fiscal Q4. So when Dean talks about, we expect to exit the year, as things stand right now in the forecast with a record quarter, that would be without any revenue from these two programs.

Jim Suva - Citigroup - Analyst

Got you.

Patrick Jermain - Plexus Corp - SVP, CFO

So the book of business should be pretty strong going into FY17, if things hold as they are.

Jim Suva - Citigroup - Analyst

Perfect. And then my follow-up question is, regarding in the past, Plexus has been pretty clear of -- your new business wins of say, 25% of trailing revenues should equate to about 15% of revenues, if I remember correctly. And that considers a more normal operating environment. Does that still remain true?

Or are we looking at now, Plexus will continually be doing some disengagements of lower programs? And why aren't those programs in it? Or do we need now to say, hey, it actually takes like a 30% new business wins, if they are going to be removing from some disengagements and things like that? I'm just trying to think about how that plays out?

Dean Foate - Plexus Corp - Chairman, President and CEO

Yes, I think, the big moves Jim, in terms of disengagements are largely behind us. I mean, we don't have anything in our portfolio right now that is of a significant size that we would look to prune out of the business. So that arithmetic that we've talked about, should hold up.

Now I hesitate, because it depends what our customers end markets are doing. In some of that, there was an assumption of at least some end market growth, as a consequence of stronger economic activity. But again, that kind of [target] that we look for, it should get us there, in terms of the 12% growth.

Jim Suva - Citigroup - Analyst

Great.

Steve Frisch - Plexus Corp - EVP, Customer Care Officer

Yes, this is Steve. As Dean said, it should get us there. The one other piece that we're also looking at, which is with the increase of wins in healthcare/life sciences and industrial/commercial, those programs last longer than what some of the traditional networking/communication programs did.

So as the NC wins -- network and communication wins comes down, that's not necessarily a bad thing, in terms of the longevity of the programs. So the volatility or the velocity of the wins as it relates to networking/communications needed to be higher, in order to support that number. So



we are taking a look at what does the healthcare/life sciences, industrial/commercial wins mean to that metric, because that actually strengthens it a bit.

Jim Suva - Citigroup - Analyst

Great. That's very useful. Thanks so much for the details, and congratulations to you and your teams.

Dean Foate - Plexus Corp - Chairman, President and CEO

Thank you.

Operator

We have no further questions at this time.

Dean Foate - Plexus Corp - Chairman, President and CEO

Okay. Well, I want to thank everyone for the questions. Obviously, the dialogue is always is good and helpful to us as well. I also want to thank any of the Plexus people that are still on the line.

We had to really get after it this quarter, in order to adjust the cost structure, and set ourselves in a stronger position going forward, and I really appreciate how everybody kind of really rallied together, and just got after it. So thank you very much, and everyone enjoy the day.

Operator

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

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