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PLXS - Q2 2016 Plexus Corp Earnings Call

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OVERVIEW:

Co. reported 2Q16 revenues of \$619m and diluted EPS of \$0.50. Expects 3Q16 revenues to be \$640-670m and non-GAAP diluted EPS to be \$0.73-0.81.



CORPORATE PARTICIPANTS

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Dean Foate *Plexus Corp - President & CEO*

Todd Kelsey *Plexus Corp - EVP & COO*

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PRESENTATION

Operator

Good morning and welcome to the Plexus Corp conference call regarding its fiscal second-quarter 2016 earnings announcement.

(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, Paulette. 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 seems 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 filing.



We encourage participants on the call this morning to access the live webcast and supporting materials at Plexus's website, plexus.com, 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 Steve Frisch, Executive Vice President and Chief Customer Officer. Let me now turn the call over to Dean Foate. Dean?

Dean Foate - *Plexus Corp - President & 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 fiscal second-quarter results on slide 3, yesterday, after the close of the market, reported results for our second quarter of FY16 revenue was \$619 million, largely in line with guidance, versus earlier expectations. Modest strength in our network communications sector more than offset the slight underperformance of our industrial/ commercial sector. I am pleased to report that our non-GAAP diluted EPS of \$0.55 was at the high end of our guidance range as we benefited from several of our cost reduction and productivity-improvement initiatives.

Advancing now to our fiscal third-quarter guidance on slide 4. We expect to return sequential growth in our fiscal third quarter as new program ramps more than offset the lingering revenue headwinds associated with the two previously announced program disengagements. While we are guiding fiscal third-quarter revenue in the range of \$640 million to \$670 million, suggesting 6% sequential growth at the midpoint.

With the excellent work by our teams to deliver on many of our cost reduction and productivity initiatives, we expect our operating margin will return to our target range of 4.7% to 5% in our fiscal third quarter, one quarter ahead of plan. Our substantially improved operating performance should deliver non-GAAP diluted EPS in the range of \$0.73 to \$0.81. The midpoint of our EPS guidance range suggests a \$0.22 or 40% improvement over the fiscal second quarter.

Now, I would like to take a few minutes to summarize what I believe will be some of the key takeaways today. Please advance to slide 5. As a team, we are confident in our commitment for further improvement in FY16 and optimistic about the momentum we are building for the coming fiscal year.

Our fiscal second quarter, while not great on an absolute basis, was a significant improvement over the prior quarter. We more than offset our seasonal cost headwinds with cost-reduction actions and productivity improvements to deliver quarter-over-quarter EPS growth 17% on essentially flat revenue. Our cash-cycle performance was better than anticipated and contributed to free cash flow of \$65 million.

While revenue was flat, keep in mind that the underlying growth was masked by revenue headwinds associated with the previously announced program disengagements. Our new business wins performance continued above our goal this quarter.

In our fiscal third-quarter, we expect a solid quarter on an absolute basis, as our operating margin returns to our target range. In addition, meaningful sequential revenue growth will return driven by new program ramps, despite the final revenue headwind from the program disengagements. Further, our funnel of new business opportunities is at a record level, providing ample prospects to build on the early growth momentum.

Looking ahead, as we exit FY16, we believe we can sustain our operating margin performance in our target range as we gain leverage from anticipated revenue growth while benefiting from continuing productivity initiatives. With property margin stabilizing in our target range and our focus on systemically improving our invested capital management, we expect our return on invested capital performance will meaningfully improve as we exit the year. Finally, free cash flow should improve over earlier expectations and approach \$100 million for the fiscal year.

Now I would like to call attention to a second press release that was issued at the same time as our fiscal second quarter earnings announcement. Please advance to slide 6 for a summary of the key points. I want to take this opportunity to congratulate Todd. The Plexus Board of Directors has appointed Todd Kelsey as Plexus's President and Chief Executive Officer, effective October 2, 2016, which just happens to be my birthday. Congratulations, Todd.

A well-managed executive development and succession plan made it possible for me, after 14 years as the Company's CEO, to retire at fiscal year-end. The Board has asked me to serve as Executive Chairman during FY17 to assist Todd in ensuring a smooth transition. It is anticipated that I will serve as non-executive chair thereafter. I will now turn the call over to Todd.

Todd Kelsey - Plexus Corp - EVP & COO

Thank you, Dean. Good morning, everyone. Before I get started, I would like to recognize Dean and thank him for his tremendous leadership over the past 14 years. He has strategically positioned the Company and has built a strong management team to enable our future success.

Please advance to slide 7 for insight into the performance of our market sectors during the second quarter of FY16 as well as our expectations for the fiscal third quarter. Our network and communication sector was flat sequentially in Q2 which was better than our expectations of down in the mid-single digits. Two of our customers outperformed prior forecasts, while results in the remainder of the sector were somewhat soft to expectations.

Looking to Q3, we expect networking/communications revenue to be down in the low single-digit percentage point range as we continue to wind down the program previously outlined by Dean. Excluding this program, we are expecting underlying growth within the sector during the quarter driven by an improving forecast from one of our top customers and new communications program ramps. Overall, demand within the sector remains volatile and we expect revenue from 6 of our top-10 customers to decline sequentially.

Our healthcare/life sciences sector was down 1% sequentially in Q2, essentially in line with our expectations of flat. Demand remained relatively stable throughout the quarter. Looking ahead to the fiscal third-quarter, we anticipate revenue in our healthcare/life sciences sector to be up in the mid-single digits relative to Q2 as we benefit from new program ramps.

Our industrial/commercial sector was down 2% sequentially in our fiscal second quarter, below our expectations of up low single digits. The results were driven by modest softening in the sector end markets and component constraints related to a customer order inside of lead time. As we look ahead to Q3, we currently anticipate that our industrial/commercial sector will be up in the high teens percentage point range on the strength of new program wins with top customers in the sector.

Our defense/security/aerospace sector was up 8% sequentially in Q2, a result that was above expectations of a mid-single digit increase. Much of the gain was a direct result of strong operational performance in our aerospace and defense center of excellence in Neenah. Four of our top five customers in the sector achieved quarter-over-quarter growth. We currently expect Q3 to be flat sequentially as new program ramps and end-market strength of a security customer are offset by seasonal weakness with a second security customer.

As we look to the fiscal fourth quarter and beyond, our revenue forecast for each of our sectors remain reasonably consistent from our earlier expectations. We continue to expect modest sequential revenue growth in our fiscal quarter.

Next to new business wins on slide 8. During the fiscal second quarter, we won 38 new programs in our manufacturing solutions group that we anticipate will generate \$174 million in annualized revenue when fully ramped in production, a result that is consistent with our last several quarters. The wins for our APAC region are quite encouraging at \$88 million. In addition, the wins in our EMEA region are consistent with prior quarters, maintaining the wins' momentum at an encouraging level. As a consequence, we expect meaningful growth in the EMEA region in FY16 and FY17.

Please advance to slide 9 for further insight into the wins performance of our market sectors. In the fiscal second quarter, our manufacturing solutions wins were robust in the industrial/commercial sector where we continue to expand our portfolio programs with a top customer. When reviewing the sector wins momentum, the networking/communications sector is well under the 25% level reflecting our planned intentional shift out of the traditional networking space.

In addition the healthcare/life sciences and industrial/commercial sectors continue their trend of wins momentum well above our 25% goal. These facts support our long-term growth goals and continued transformation to a healthier, more defensible portfolio.



Now advancing to manufacturing wins momentum on slide 10, our trailing four quarter manufacturing wins, as shown by the dark blue bars, is at \$667 million. This performance results in a wins momentum of 26%, above our target and relatively consistent with the prior three quarters.

Our engineering solutions wins totaled approximately \$16 million in the fiscal second quarter, a result that was below our expectations and our recent wins performance. However several opportunities were in the late stages of the funnel at quarter end and we expect our engineering solutions wins will be exceptionally strong in Q3. As we ended the fiscal second quarter, our engineering solutions funnel was at an all-time high.

Please advance to slide 11. Our go-to-market teams have generated and are actively working a \$2.5 billion funnel of qualified manufacturing opportunities which represents a record high. We anticipate the strong funnel will translate into increased wins in the upcoming quarters, fueling our growth. On a sector basis, our healthcare/life sciences and industrial/commercial funnels are exceptionally strong, consistent with our goal of expanding market share within these sectors in order to deliver a differentiated portfolio.

Next, I would like to turn to operating performance on slide 12. Our fiscal second quarter revenue, at \$619 million, was modestly up from Q1. Our operating margin finished above our guidance range, and up 40 basis points sequentially, at 4.1% as a result of noteworthy performance associated with our cost-reduction and productivity-improvement initiatives from our three manufacturing regions. As we look forward to Q3, we expect meaningful sequential revenue growth of 6% at the midpoint. We anticipate our fiscal third-quarter operating margin will be in our target range of 4.7% to 5% as we largely complete our near-term cost reduction and productivity-improvement initiatives.

Please advance to slide 13 for additional insight into our recent operating margin performance and future operating margin expectations. As discussed on previous calls, we put in place plans to improve operating profit \$6 million to \$8 million per quarter by our third quarter of FY16. We finished Q2 well ahead of schedule and expect to end Q3 at the high end of this range. As previously discussed, we achieved a 20 basis-point improvement to fiscal first quarter operating margin as a result of immediate focused actions on reducing discretionary spending, reducing operating expenses and achieving near-term productivity gains.

In our Q2, our operating margin benefited by 10 basis points as a result of completing the Livingston facility restructuring. We also achieved a 50 basis-point improvement as a result of the strong progress on our cost reduction and productivity initiatives, particularly within our manufacturing sites. Finally, we actualized a 20 basis-point benefit as our Guadalajara site reached corporate operating-margin expectations resulting from revenue growth and productivity improvements. These items more than offset the typical 40 basis-point seasonal headwinds inclusive of compensation adjustments and United States payroll tax reset, resulting in our operating margin of 4.1%.

Looking ahead to our fiscal third quarter, we expect to largely complete our near-term cost reduction and productivity improvement initiatives. We anticipate this will result in an additional 60 to 90 basis points of operating-margin improvement and position us in our target operating margin range of 4.7% to 5% one quarter ahead of earlier expectations.

Looking to the fiscal fourth quarter and beyond, we anticipate additional positive margin benefit as a result of finalizing the Fremont facility closer and achieving sustained growth in the EMEA region. These improvements will fund future growth initiatives while enabling achievement of our target operating margin range.

Including the negative impact of the Q2 seasonal costs, we expect to realize a cumulative operating margin improvement of 120 to 150 basis points as a result of our cost reduction and productivity improvements, positioning us well for future quarters. I will now turn the call to Pat for a more detailed review of our financial performance. Pat.

Pat Jermain - Plexus Corp - SVP & CFO

Thank you, Todd and good morning, everyone. Our fiscal second-quarter results are summarized on slide 14. Revenue of \$619 million was slightly above the midpoint of our guidance, while gross margin of 8.6% was above our guidance and 50 basis points above the fiscal first quarter. Our efforts to manage costs, improve productivity, exit low margin programs and ramp our Guadalajara facility all contributed to the margin expansion. The two lower margin program disengagements that we previously outlined, continued to progress largely as planned.

Selling and administrative expense of \$28 million was at the top end of our guidance, primarily due to higher variable incentive compensation. For the second quarter, SG&A as a percentage of revenue was approximately 4.5% which was slightly above the fiscal first quarter. Gross margin and SG&A expense were impacted by annual merit increases and the reset of payroll taxes for US employees.

Before restructuring, we delivered operating margin of 4.1%, which exceeded the top end of our guidance by 10 basis points. Approximately 60 basis points of stock-based compensation expense is included in operating margin. Diluted earnings per share of \$0.50 includes a \$0.05 per share detriment as a result of after-tax restructuring charges of \$1.9 million related primarily to the previously announced closure of our Fremont, California facility. Excluding restructuring charges, non-GAAP EPS of \$0.55 was at the top end of our guidance.

Fiscal second-quarter results include an after-tax loss of \$0.03 per share related to foreign exchange volatility primarily within our Malaysia operations. This quarter, we began hedging a portion of our balance sheet exposures in Malaysia and plan to expand the program in future quarters to cover a greater portion of our exposure.

Turning now to the balance sheet on slide 15, return on invested capital was 11.6% for the fiscal second quarter, an 80 basis-point improvement from the prior quarter and 60 basis points above our FY16 weighted average cost of capital of 11%. As we progress through FY16, we believe our stronger margin performance in combination with disciplined, invested capital management will continue to improve our return on invested capital performance.

During the quarter, we purchased approximately 209,000 of our shares for \$7.3 million at a weighted average price of \$34.88 per share. The shares were purchased under the \$30 million stock repurchase program authorized by the Board of Directors last August. We have approximately \$14 million remaining under the authorization, which we plan to use to repurchase shares on a relatively consistent basis over the remainder of FY16.

During the quarter we generated \$70 million in cash from operations and spent \$5 million on capital expenditures resulting in free cash flow at \$65 million. This result exceeded our \$20 million to \$40 million free cash flow guidance for the fiscal second quarter. Lower capital expenditures and continued emphasis on working capital management contributed to the improvements in free cash flow.

Cash cycle, at the end of the second quarter, was 66 days, a sequential improvement of 5 days and 2 days better than our guidance. Please turn to slide 16 for details on our cash cycle. Both days in inventory and accounts payable days were sequentially up 3 days, driven by the higher forecasted revenue for the fiscal third quarter. Inventory increased approximately \$14 million in support of the anticipated third-quarter revenue ramp offset by a \$16 million increase in accounts payable.

Sequentially, days and receivables were down 5 days. Three main factors contributed to the improvement. We experienced a positive mix change to customers with more favorable payment terms. We also experienced a better loading of revenue throughout the quarter as opposed to a high concentration at quarter end. Finally, our global collection teams continued their focus on reducing past-due balances which has also benefited our receivable days.

As Dean has already provided the revenue and EPS guidance for the fiscal third quarter, I will now turn to some additional details which are summarized on slide 17. We expect additional restructuring charges of approximately \$1.5 million to \$2.5 million in the fiscal third quarter, primarily related to our Fremont, California facility. These charges are excluded from the guidance discussed today.

Both the closure of the Fremont site and end to volume manufacturing at our Livingston, Scotland facility are advancing as previously communicated. We expect all restructuring activities related to these actions to be completed in FY16. Total restructuring charges are expected to be in the range of \$5 million to \$6 million for the year.

Gross margin is expected to be in the range of 9.2% to 9.5%. The midpoint of this guidance suggests a sequential increase of 75 basis points. With higher expected revenue in the fiscal third quarter and a corresponding increase in variable incentive compensation expense, we expect SG&A dollars to be sequentially higher in the range of \$29 million to \$30 million. However, at the midpoint of our revenue guidance, anticipated SG&A would be approximately 4.4% of revenue, a sequential decrease of 10 basis points resulting from improved operating expense leverage.

Fiscal third-quarter operating margin is expected to be within our target margin range of 4.7 % to 5%, which includes approximately 55 basis points of stock-based compensation expense. A few other notes, depreciation expense for the fiscal third quarter is expected to be approximately \$12 million, consistent with our fiscal second quarter.

Before restructuring charges, we are estimating an effective tax rate of 8% to 10% for the fiscal third quarter and 10% to 12% for the full year. The lower rate forecasted for the fiscal third quarter compared to the second quarter is largely attributed to changes in the geographic distribution of earnings.

Our expectation for the balance sheet is a sequential increase in working capital dollars to support expected higher levels of revenue during the second half of FY16. Based on the forecasted levels of revenue, we expect a cash cycle of 63 to 67 days for the fiscal third quarter. With a build in working capital to support the revenue increase, and added capital expenditures, we expect free cash flow in the range of \$5 million to \$15 million for the fiscal third quarter.

We are increasing our FY16 expectation of free cash flow by \$10 million at the midpoint. Our new range is \$90 million to \$110 million. We expect FY16 capital spending to be in the range of \$40 million to \$45 million, which is primarily focused on capital to support new program ramps.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matthew Sheerin, Stifel.

Matthew Sheerin - Stifel Nicolaus - Analyst

Good morning and congratulations on the promotion, Todd and to you as well, Dean. Just a couple of questions from me.

First, just regarding the networking communications segment which has been down, obviously, for reasons that you have stated, deselection revenue. At this point, are you happy with that portfolio in terms of its margin contribution to the Company or is there still some pruning left there?

Todd Kelsey - Plexus Corp - EVP & COO

Matt, this is Todd. First of all, thank you very much and I will take the question, obviously.

So with respect to the portfolio and the networking communications sector, we have been able to direct it heavily towards, communications and away from the traditional networking space. We are right now about 80% communications, about 20% networking, so we feel quite good about the portfolio itself and where it is headed in the future. We think this is at a good spot where it is defensible within our portfolio and contributes nicely to our expectations of the Company.

Matthew Sheerin - Stifel Nicolaus - Analyst

Okay. And just related to that, that segment has gone from a mid-30s percentage of revenue to mid-20s and it looks like, with the growth in the other segments, it is going to go down to perhaps 20% or below. And you are still sticking to that, still that 4.5% to 5% EBIT margin target that you



have had in place for the last couple years, but given that change of mix, is it possible to see that range going higher somewhat or is the business so tough that 5% is a reasonable target at this point?

Todd Kelsey - Plexus Corp - EVP & COO

Right now, we are committed to the 4.7% to 5% target; we think that is a reasonable range. We think it is a good mark within the industry and it is also something that we think is defensible with our customer base as well.

Matthew Sheerin - Stifel Nicolaus - Analyst

Okay. Great. Thanks a lot.

Todd Kelsey - Plexus Corp - EVP & COO

Thank you.

Operator

Sherri Scribner Deutsche Bank.

Sherri Scribner - Deutsche Bank - Analyst

Hi guys, congratulations to both of you on your changes in jobs.

Todd Kelsey - Plexus Corp - EVP & COO

Thanks, Sherri.

Sherri Scribner - Deutsche Bank - Analyst

Thinking about the guidance, with the 40% increase in EPS, that seems pretty high, considering your track record, and I know you walked through some of the cost savings, but how confident are you in the ability to reach that EPS number given it does seem to be a bit of a jump?

Pat Jermain - Plexus Corp - SVP & CFO

I guess we would not put it out there if we were not confident in it. You are right. It is a pretty dramatic change, but I think as both Todd and I walked through some of the key levers that are getting it there and, of course, some of it is the productivity cost-reduction efforts that we are working through the cycle and those sort of things that we start to realize as well as the mix shift in revenue and, in terms of the sectors, as well as the organic growth that we're going to see in the coming quarter. We are quite confident that we are putting out good numbers there.

Sherri Scribner - Deutsche Bank - Analyst

Okay. And it does look like your gross-margin guidance is higher for Q3. I assume that is related to mix, to some extent, and then some of that EPS improvement may be \$0.01 or \$0.02, seems to be the lower tax rate. Is that the right way to think about it?

Pat Jermain - Plexus Corp - SVP & CFO

Yes, that is correct, Sherri. Tax rate is benefiting us. The other component that is benefiting us is, I mentioned in the speech, that we had \$0.03 of foreign exchange losses which, as we continue to manage that exposure, I would expect that to come down; and we are expecting to see some of that reduction in Q3.

Sherri Scribner - Deutsche Bank - Analyst

Okay. Thank you.

Operator

Steven Fox, Cross Research.

Steven Fox - Cross Research - Analyst

Thanks, good morning. Congrats to Dean and Todd. So, first of all, can you walk through the comment about the fourth quarter not having much sequential growth? I think, if I look back on prior fiscal fourth quarters, there's been a decent amount of growth when markets have been relatively tame. I was just curious what is going into that thinking and then I had a follow-up.

Todd Kelsey - Plexus Corp - EVP & COO

Steve, this is Todd. What I would say, is that our quarters and our forecast has been relatively consistent over the course of the last three quarters. Obviously, we saw the big drop or reset in our forecast back around the June through September time frame. Multiple resets and it has stayed reasonably consistent. The projection is that we are expecting sequential growth, just not at the 6% quarter-over-quarter rate that we are expecting to see Q3 to Q2.

Steven Fox - Cross Research - Analyst

Is there one market within there which is contributing to a little bit more conservatism than other sources for fourth quarter?

Todd Kelsey - Plexus Corp - EVP & COO

In general, the markets are lackluster, I would say, with maybe the exception of aerospace. Markets, as a whole, are pretty much going sideways. Probably the networking communications, as a whole, is the most volatile, although we are seeing strength with certain customers within that market.

Steven Fox - Cross Research - Analyst

Great. And just as a follow-up, on the cost reduction side, I was wondering how much progress in Guadalajara might have had to pulling forward your targets by one quarter and, if that wasn't the case, can you give us a further update on how Guadalajara is progressing at this point?



Todd Kelsey - Plexus Corp - EVP & COO

Sure. Guadalajara, first of all, in general, with respect to the productivity and cost-reduction initiatives we really didn't include Guadalajara in there in any meaningful way. Now, with that said, the team at the site did an excellent job. They grew revenue to better than the \$50 million quarterly run rate that we had talked about. They also drove margins to a higher level than we had anticipated coming into the quarter.

So they had a really meaningful impact to our operating margin within the quarter and we would say that right now there at essentially corporate expectations, although there is certainly room to do more at the site as we grow the site, but we won't be talking about it in terms of it being a drag anymore on our corporate operating margins. And if we look at the site as a whole, the site is performing spectacularly.

We run a customer net promoter survey process and the Guadalajara site had a perfect score, every customer recommended them. They also have a funnel that is really on par; it is an exceptional funnel that is on par with any of our sites within the Company. We expect to continue to grow the site at a relatively aggressive basis.

Steven Fox - Cross Research - Analyst

Great. Thank you very much and good luck, everyone, going forward.

Todd Kelsey - Plexus Corp - EVP & COO

Thank you.

Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - Longbow Research - Analyst

Good morning, everybody and my congratulations to everybody, too. Two questions; I guess the \$2.5 billion funnel, if you could just break that down. Is it, there are larger programs in there? What is driving it, because it was at a two-year high last quarter, now at a record high. How do programs come out of that? Are you expecting to harvest a much greater number now over the next 12 month in terms of above this \$175 million run rate?

Steve Frisch - Plexus Corp - EVP & Chief Customer Officer

This is Steve. From a funnel breakup standpoint, it is definitely seeing significant strength in the healthcare life sciences sector. That team is doing a really good job driving opportunities in there.

From a size standpoint, I'm going to say that there is a significant change in the magnitude of the opportunities that are in there. There is a mix of decent size ones, medium-sized ones and smaller-sized ones.

As we go forward, the trailing four-quarters numbers, as you look back in time here, we had a soft quarter four quarters ago. And that one will be coming out next quarter. I do expect this quarter to be on par to maybe even a little bit stronger. So I would expect our trailing four quarters percentage to pop up a little bit.

From that standpoint, we continue to see a good win momentum going into the back half of the year here. And I would expect the wins to come out of there at on par with the rates that we have had in the past, maybe slightly a little better here in the near-term.



Shawn Harrison - Longbow Research - Analyst

Does a \$2.5 billion funnel mean that there is you over time will more? I guess the question I have is, at some point in time, does it step up so you are capturing a larger portion of that funnel?

Steve Frisch - Plexus Corp - EVP & Chief Customer Officer

The trailing four-quarters metric, the intention here is, as revenue grows, we do need to capture more out of it to keep the wins momentum going. So, to answer your question, yes, we do need to continue to pull more out of there to support the growth; and that is the plan.

Shawn Harrison - Longbow Research - Analyst

Okay. Pat, as you think about supporting more wins coming out of the funnel, some strong program ramps in the second half, I know there was a slide of investments being made and partially being offset by the restructuring actions, but, as you get into 2017, are you going to see an acceleration in OpEx that you have to put toward growing the business or something that could pressure margins?

Pat Jermain - Plexus Corp - SVP & CFO

I don't think, Shawn, necessarily from an OpEx standpoint. I think we can maintain this percentage around 4.4% to 4.5%. We are getting really good leverage with productivity improvements, continuous improvement efforts that we're making both at the sites and within the corporate office.

I think where we could see some growth is in CapEx, maybe towards the back end of 2017. If Guadalajara continues to be as successful as they have been, we may need to look for an additional site in Mexico in Guadalajara. You could see CapEx going up to support new program ramps and potentially a new site either later 2017 into 2018.

Shawn Harrison - Longbow Research - Analyst

Perfect and congratulations on the results, guys.

Pat Jermain - Plexus Corp - SVP & CFO

Thank you.

Operator

Jim Suva, Citi.

Jim Suva - Citigroup - Analyst

Thank you and congratulations to your results and Dean, you'll definitely be missed, but don't go way too fast. That being said, on the aerospace side, you mentioned a strength there. Can you mention is that commercial, is that Industrial? How should we think about that?

And then on the tax rate, I believe you had mentioned it is going to be lower for the next quarter. Do you think that is a permanent thing? Of course it depends upon your mix and things like that, but why would it not be kind of more sustainable re-occurring beyond one quarter as you have adjusted your footprint and things like that?



Dean Foate - Plexus Corp - President & CEO

Let's take the tax rate first, Pat.

Pat Jermain - Plexus Corp - SVP & CFO

Jim, it could be. It is kind of a unique situation. It really depends on where we are earning our profits around the globe. And obviously, there's different tax rates and some lower than others.

What is unique, is that we are seeing more profitability in the US, as we go forward, which one would think that would be maybe a negative thing because of the higher tax rate. But actually, for the next few years, that is a positive for us because we have got previous losses that we're offsetting future profitability with.

So we are not incurring any tax expense in the near term in the US. Now if we go out 5, 10 years from now, that could change and we could be at the corporate rate in the US.

To answer your question, I think it is probably sustainable at a lower rate for the next few years. But then eventually, at some point, we will see that ticking up as that profitability continues in the US.

Steve Frisch - Plexus Corp - EVP & Chief Customer Officer

This is Steve, in regard to the aerospace element, it is no secret that we had a couple of challenges this past summer in our center of excellence and those are past us. I think Todd mentioned in his script, the fact that a lot of the performance that we've achieved here in the last quarter is based on that team really delivering for our customers; so we expect basically to return to growth from those customers to kind of set on pause for a little bit. So, the momentum there is really driven just by our ability to execute and deliver for those customers.

Jim Suva - Citigroup - Analyst

Right. And is the demand more commercial aerospace or military or do you have the visibility there?

Steve Frisch - Plexus Corp - EVP & Chief Customer Officer

It is more commercial. Defense is, for us, it is something that there's a lot of conversations about it rebounding a bit more, but our aerospace growth is definitely more on the commercial side.

Jim Suva - Citigroup - Analyst

Thank you and congratulations to you and your teams.

Todd Kelsey - Plexus Corp - EVP & COO

Thank you.



Operator

Mitch Steves, RBC Capital Markets.

Mitch Steves - RBC Capital Markets - Analyst

Hey guys, thank for taking my questions. From an end-market perspective, it looks like the industrial is going to grow mid-teens next quarter, so I'm just wondering what kind of change this quarter you saw material to your uptick considering that it was a little bit lighter than you guys expected for the March quarter?

Todd Kelsey - Plexus Corp - EVP & COO

This is Todd, Mitch. From an industrial commercial standpoint, the big change in Q3 is new-program ramps. We have some significant new program ramps with multiple customers that are driving the revenue growth in Q3.

From a market standpoint, our end-market standpoint, I would say the industrial commercial markets, while it is very broad, they are kind of going sideways or are lackluster. We talked about the potential that semi-cap might be improving last quarter; that is not the case. It is really kind of back to lackluster or sideways, from our perspective; oil and gas continues to be weak. And really, our growth in being driven by new program ramps.

Mitch Steves - RBC Capital Markets - Analyst

Got it. So what segment are you seeing the program ramps? And, secondly, on the con side can you give us some more granularity on essentially what product lines you are seeing that are doing better? I know you guys can't give out customer-specific information.

Dean Foate - Plexus Corp - President & CEO

Go ahead, Steve.

Steve Frisch - Plexus Corp - EVP & Chief Customer Officer

The growth is really in what we'd classify in the industrial side of equation, more in the instrumentation side, and it is related to, as Todd talked about, a customer that we talked about probably a year ago. It is a customer that we've won and we have experienced good growth with them; they're bringing out new products and we are winning those. I think one of the reasons also for the little bit of a jump, Todd talked about the fact that industrial commercial was softer this quarter; that customer asked us to shift some components from one product line to another which impacted our revenue but allowed them to get the part that they needed out the door.

So, we'll also experience that revenue in the quarter as well. It's deep in growth with basic customer and it's ramping some new products.

Todd Kelsey - Plexus Corp - EVP & COO

The other thing I would add to that too, Mitch, from a new customer-win standpoint is we're seeing some pretty significant wins within the semi-cap space. So while we're not necessarily capitalizing on it to the level that we would hope to in the future, it positions us pretty well for when that market rebounds.

Mitch Steves - RBC Capital Markets - Analyst

Got it. Thank you very much.



Todd Kelsey - Plexus Corp - EVP & COO

Thank you.

Operator

Sean Hannan, Needham & Company.

Sean Hannan - Needham & Company - Analyst

Good morning, thanks for taking my questions. Just was curious, what was the component constraint that had affected you on the industrial side? Sorry if I had missed it; I don't know if you got very specific on that.

Steve Frisch - Plexus Corp - EVP & Chief Customer Officer

This is Steve. The issue was that the customer came in and asked us, within lead time, to build additional product. And we were not able to secure the materials within lead time. So there really wasn't a component constraint in terms of anything in the industry; it was just the ability to get enough parked in-house.

And so, as a result, they asked us to shift some of that inventory to build a different product. So there is really no component constraints in the industry. It was just a matter of them dropping in extra demand and asking us to shift the mix. We do not see any issue of that going forward, because now we have got the visibility and basically the lead times are not an issue at this point.

Sean Hannan - Needham & Company - Analyst

Okay. And in terms of program ramps and what, typically you would experience for any new-program activity, there tends to be fair inefficiencies. It seems like there are a number of ramps occurring today which have been helping; it seems like there are a fair amount of ramps in the next few quarters and particularly as we look to the back end of the year and into 2017. Can you talk a little bit around if there is any concerns for inefficiencies?

And then, separately, any exposure that you have or concerns in terms of new or nascent relationships where the nature of that ordering pattern could create some volatility for you or even some inefficiencies in those ramps themselves? Thanks.

Steve Frisch - Plexus Corp - EVP & Chief Customer Officer

I think we are in pretty good shape, really, from a productivity standpoint in the new business ramps. There is always some inefficiencies until you get the full leverage on the revenue coming out. That is part of the financial model is to overcome that, with new productivity, product improvements on existing programs.

We're loathe to use that as an excuse not to hit our margin targets and, of course, we are forecasting that we are going to hit our margin targets in the coming quarters. I think we're in good shape with the ramps that we are seeing.

In terms about the ordering patterns of those programs not coming to fruition, we would expect-- the visibility that we have at this point is that I'm not overly concerned that they are not going to unfold the way we predict or the way we are forecasting. I think the demand is clearly there based on what is happening in the particular industries where the ramps are occurring. I feel quite confident in terms of how the full year here is going to unfold and, frankly, how the momentum is going to start to carry into the new fiscal year.

Sean Hannan - *Needham & Company - Analyst*

That is great color. Thank you so much.

Operator

Herve Francois, B. Riley

Herve Francois - *B. Riley & Company - Analyst*

Thank you very much. Let me add my congrats to Dean and Todd as well. Congrats, guys.

Just in regards to the wins in the APAC region that you show in your slide, can you talk about what end markets you are seeing, the wins that have been taking place out there?

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

This is Steve. The wins in the APAC region, actually across all three regions, are probably evenly split across the sectors. So as you look at the sector splits, and you apply those to the regions, the mix is probably pretty equal across them.

Herve Francois - *B. Riley & Company - Analyst*

Got it. Is that wins from existing customers that are out there or some of them here domestically that some of the programs are just going to be manufactured out there?

Pat Jermain - *Plexus Corp - SVP & CFO*

These will be new program wins from either existing customers or new targeted customers, but these would not be considered transfers within Plexus. They would be incremental revenue as they ramp.

Herve Francois - *B. Riley & Company - Analyst*

Okay. Great. Thanks very much.

Todd Kelsey - *Plexus Corp - EVP & COO*

I would also just say that, in any given quarter, the bulk of the revenue from the new business wins is with existing customers by design. We're trying to increase our share with those customers. The commentary probably falls back to some of the earlier discussions about our ability to effectively ramp these new programs and gain leverage as well. Because when you have a higher number of higher concentration wins with existing customers, you tend to get the leverage and manufacturing quicker; the transitions tend to go smoother.

Operator

Thank you. We are showing no further questions. Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.



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