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PLXS - Q4 2016 Plexus Corp Earnings Call

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OVERVIEW:

Co. reported 4Q16 revenue of \$653m and GAAP diluted EPS of \$0.56. Expects 1Q17 revenue to be \$620-650m and GAAP diluted EPS to be \$0.74-0.82.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, and welcome to the Plexus Corp conference call regarding its fiscal fourth-quarter 2016 earnings announcement. My name is Sylvia, and I will be your operator for today's call. At this time, all participants are in a listen-only mode. After a brief discussion by Management, we will open the conference call for questions. The conference call is scheduled to last approximately one hour. I will now 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*

Thanks, Sylvia. 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 peer-to-peer comparisons. For a full reconciliation of the non-GAAP supplemental information, please refer to yesterday's press release and our periodic SEC filings.



We encourage participants on the call this morning to access the live webcast and supporting materials at Plexus' website, www.plexus.com, by clicking on Investor Relations at the top of that page, and then Event Calendar.

Joining me today are Todd Kelsey, President and Chief Executive Officer; Steve Frisch, Executive Vice President and Chief Operating Officer; and Pat Jermain, Senior Vice President and Chief Financial Officer.

Consistent with prior earnings calls, Todd will provide summary comments before turning the call over to Steve and Pat for further details. Let me now turn the call over to Todd Kelsey.

Todd Kelsey - Plexus Corp - President & CEO

Thank you, Susan, and good morning, everyone. Beginning with our fiscal fourth-quarter results on slide 3.

Yesterday after the close of the market, we reported results for our fiscal fourth quarter of 2016. Despite late-quarter revenue headwinds, we achieved solid operating performance, resulting in GAAP diluted EPS of \$0.56 and non-GAAP diluted EPS of \$0.82, the latter firmly positioned within our guidance range.

Our revenue of \$653 million was slightly below the guidance range. Revenue was impacted by late-quarter softness within our Networking/Communications sector and the temporary impact to our Xiamen, China, operation from Typhoon Meranti that made landfall on September 15, 2016.

Beyond these two items, we encountered modest softening of demand in our Defense/Security/Aerospace market sector. This was offset by strength in our Industrial/Commercial market sector as a result of new program ramps and improving demand from several semiconductor capital equipment customers.

Please advance to slide 4 for further clarification of the impact of Typhoon Meranti to our Xiamen, China, operations.

On September 15, our Xiamen 1 facilities sustained significant damage to the roof of the building, resulting in a two-day loss of power and several inches of water in certain areas of the facility. Despite these conditions, the site was largely operational three days after the typhoon, as a result of the tremendous efforts of our Xiamen and APAC teams. Our Xiamen 2 facility was not impacted by the typhoon, beyond the initial power outage.

After the typhoon subsided, we engaged our crisis-management protocol. As a result, we enacted daily customer communications with impacted customers and enlisted support from corporate and regional teams to assist with remediation efforts.

The typhoon had an approximately \$5-million impact to our fiscal fourth-quarter revenue as a result of lost production time and a meaningful inventory loss. Our global supply chain team rapidly engaged and has been clearing associated parts shortages. As a result, we do not expect an impact to fiscal first-quarter revenue as a result of the typhoon.

In addition, our customer relationships at the site have strengthened as a result of the proactive communication and aggressive recovery plans. Given the challenges we faced this quarter, I'm pleased with our operating performance. Our teams displayed great passion in minimizing the impact of Typhoon Meranti.

As a demonstration of the resiliency in our operating model, we exceeded our target operating-margin range of 4.7% to 5% on an adjusted basis despite revenue challenges. In addition, we improved our return on invested capital to 13.8%, or 280 basis points above our weighted-average cost of capital.

Please advance to slide 5.

Despite disappointing topline results in fiscal 2016, with revenue reducing by approximately 4%, we delivered an economic return of 280 basis points, below our goal of 500 basis points, but solidly in value-creation territory.

Please advance to slide 6 for a high-level review of fiscal 2016.

We entered the year with significant revenue headwinds in Q1 and Q2 of fiscal 2016 as a result of rapidly deteriorating end markets and our decision to proactively disengage with two customer programs that did not align with our financial model or market-sector strategy. The latter had an impact of \$130 million for the fiscal year.

We responded by immediately implementing our cost-reduction and productivity-improvement initiatives. Our goal was to create a more resilient platform, where we could achieve strong margin performance, even in a soft revenue environment. The end result was a 140-basis-point improvement to quarterly adjusted operating margin throughout the course of the fiscal year.

We met or exceeded our target operating-margin range of 4.7% to 5% in the fiscal third and fourth quarters, as we benefitted from the full impact of the productivity initiatives and improved revenue resulting from new program ramps.

Please advance to slide 7 for results of our market-sector performance in fiscal 2016 and insight into our expectations for fiscal 2017.

Our three nontraditional sectors of Healthcare/Life Sciences, Industrial/Commercial, and Defense/Security/Aerospace all displayed growth in fiscal 2016. However, this was overshadowed by the nearly 30% revenue reduction in our Networking/Communications sector. Much of the reduction is reflective of our internal shift out of the volatile and increasingly more commoditized Networking space.

As we look to fiscal 2017, Networking represents less than 20% of the sector revenue and less than 4% of Plexus revenue overall. In order to accurately reflect this portfolio change, we are eliminating the networking nomenclature from our sector naming convention. Going forward in our fiscal first quarter of 2017, this market sector will be named Communications.

It is important to note the significance of our differentiated portfolio on revenue growth moving forward. Factoring out the traditional networking business, which is reflective of our current portfolio, our five-year CAGR is 8%.

The CAGR improves to 10% over a six-year period, which is the longest time frame which we had the data segregated, and coincides with the end of the Great Recession. Our differentiated portfolio positions Plexus for accelerated growth moving forward and gives us confidence that we can grow at a high-singlelevel or low-double-digit percent-point rate.

Please advance to slide 8 for a few thoughts regarding fiscal 2017.

While we expect continued low growth end markets, we have confidence in our outlook for fiscal 2017, based on our strengthening wins momentum and record \$2.8-billion funnel of qualified manufacturing opportunities. We currently anticipate that we will return to sequential growth after the fiscal first quarter of 2017 and grow revenue within each of our market sectors for the full fiscal year.

Consequently, while the demand environment could certainly change over the course of the next year, we are increasingly optimistic that our goal of a \$3-billion annual run rate as we exit the fiscal year is attainable. Furthermore, with the exception of our seasonally challenged fiscal second quarter, we anticipate delivering operating margins within our target range throughout fiscal 2017.

In addition, we are committed to achieving meaningful growth and profitability in Europe and expanding our aftermarket services portfolio in fiscal 2017. Our teams continue to differentiate Plexus by providing customer-service excellence and delivering exceptional quality products on time at a fair price. Further, we are driving efficiency and consistency across the global enterprise by leveraging our One Plexus mindset.

Finally, we have recently become a full member of the Electronic Industry Citizenship Coalition, reflecting our commitment to socially responsible business practices.

Advancing to our fiscal first-quarter guidance on slide 9.

In the fiscal first quarter of 2017, we anticipate strong operating performance despite near-term revenue softness, as a result of a delay in orders with a large Industrial/Commercial customer and further end-market weakness within our Communications market sector. As a result, we are guiding fiscal first-quarter 2017 revenue of \$620 million to \$650 million.

With previously disclosed restructuring activities behind us and continued strong operating performance as a result of the resiliency in our model, we are guiding diluted GAAP EPS in the range of \$0.74 to \$0.82. This includes \$0.11 of stock-based compensation expense.

Please advance to slide 10.

Before concluding, I want to take a moment to thank the more than 14,000 Plexus team members globally. It is through their dedication to customer-service excellence that Plexus is able to deliver strong operating performance and industry-leading net promoter scores.

I will now turn the call over to Steve for additional insight into the performance of our market sectors and operations.

Steve Frisch - Plexus Corp - EVP & COO

Thank you, Todd. Good morning. Please advance to slide 11 for insight into the performance of our market sectors during Q4 of fiscal 2016, as well as our expectations for the sectors in fiscal Q1 of 2017.

Our Healthcare/Life Sciences sector was down 7% sequentially in Q4, below our expectations of low-single-digit decrease. Demand was relatively robust within the quarter due to several new program ramps exceeding expectations. However, delayed shipments due to the typhoon in Xiamen and customer delays with two new programs offset the strength.

Looking ahead to fiscal Q1 we, currently anticipate revenue in our Healthcare/Life Sciences to be up in the high single digits as we complete our recovery in Xiamen and several new programs continue to ramp. Seven of our top-ten customers increased their Q1 forecast from the prior period. Overall, we expect a healthy growth year in fiscal 2017 within our Healthcare/Life Sciences market sector as a result of recent program wins.

Our Industrial/Commercial sector was up 14% sequentially in our fiscal Q4, above our expectations of high-single-digit growth. Twelve of our top-15 customers outperformed their Q4 forecast. We currently anticipate that our Industrial/Commercial sector will be down in the high-single-digit percentage range in fiscal Q1 due to the temporary delay in orders with one large customer.

On a positive note, we have seen some forecast improvements in the semiconductor market space. We are expecting reasonable growth in the Industrial/Commercial sector in fiscal 2017.

Our Networking/Communications sector was down 18% subsequently in Q4, which was below our expectations of low-double-digit decline. Late-quarter shipments to a top customer were below expectations. Eight of our top-ten communications customers have soft forecasts in Q1, mainly due to end-market weakness.

As a result, we expect fiscal Q1 Communications revenue to be down in the high single digits. However, we expect sequential growth beginning in Q2 of fiscal 2017 due to growth in the existing program as well as new program ramps. As a result, we expect modest growth for fiscal 2017.

Our Defense/Security/Aerospace sector was down 1% sequentially in Q4, a result that was below our expectations of mid-single-digit growth. The soft results were not due to a single systemic issue. New program ramp delays, end-market softness, and inventory adjustments all contributed to the weaker results.

We currently expect Q1 revenue to be down in the mid single digits, mainly as a result of end-market softness. However, expect new program ramps to offset sluggish end markets and enable good year-over-year growth within the sector in fiscal 2017.

Next to new business wins on slide 12.

During the fiscal fourth quarter, we won 37 new programs in our manufacturing solutions group that we anticipate will generate \$200 million in annualized revenue when fully ramped in production. The second consecutive quarter of strong business wins is an indication that our focus on operational and customer-service excellence is being recognized by our customers.

Wins within our Americas region was exceptionally strong, with several key wins from existing customers. In addition, our EMEA region returned to a wins level required to support healthy growth going forward.

Please advance to slide 13 for further insights into the wins performance of our market sectors.

In the fiscal fourth quarter, our manufacturing solution wins were balanced across all four sectors. The wins include significant business expansions with three of our top customers and the addition of two new customers.

In addition, we expanded our relationship with one of our top customers within Q4 and expect additional wins and revenue growth with them in fiscal 2017. Our wins momentum continues to support our diversified portfolio strategy.

Now advancing to manufacturing win momentum on slide 14.

Our trailing-four-quarter manufacturing wins, as shown by the dark-blue bars, is at \$747 million. This performance results in a wins momentum of 29%, above our target of 25%, and the second consecutive quarter of strong results. As expected, engineering solutions delivered record wins in fiscal Q4 of approximately \$30 million.

With these wins, the backlog for engineering solutions is very robust as we start fiscal 2017. These engineering programs will provide a good pipeline of manufacturing opportunities in fiscal 2018.

Please advance to slide 15.

Even with the strong wins, our manufacturing funnel of qualified opportunities increased to \$2.8 billion, a new record for the Company. The funnel strength is being fueled by larger opportunities, especially from our Healthcare/Life Sciences and Industrial/Commercial sectors, further supporting our differentiated business mix.

Next I would like to turn to operational performance on slide 16.

Our revenue in fiscal Q4 finished slightly below the low end of our guidance range, at \$653 million. As Todd highlighted, the APAC team did an outstanding job mitigating the impacts of the typhoon in Xiamen. They were able to limit the revenue impact to approximately \$5 million. The backlog is expected to be recovered within this fiscal quarter.

Further, we reported adjusted operating margin of 5.1% and record non-GAAP operating profit for the quarter. Although these results were from enterprise-wide improvement efforts in fiscal 2016, our operations team in APAC delivered improvements throughout the year, and our operations teams in the Americas grew significant improvements in the back half of fiscal 2016. We expect these improvements to be sustained, as represented by our operating-margin guidance of 4.9% to 5.2% for Q1 of fiscal 2017.

With the record funnel and the strong business-development wins, our [quoting] and transition teams are very busy in all three regions. We will be making investments to support the anticipated revenue growth in fiscal 2017. However, we continue to drive productivity improvements across the enterprise and remain committed to maintaining our target operating-margin range of 4.7% to 5.0%.

I will now turn the call over to Pat for a detailed review of our fiscal performance.

Pat Jermain - Plexus Corp - SVP & CFO

Thank you, Steve, and good morning, everyone. Our fiscal fourth-quarter results are summarized on slide 17.

As mentioned, revenue of \$653 million was slightly below guidance, due to late-quarter softness within our Networking/Communications sector and the impact to our Xiamen facility from the typhoon.

GAAP gross margin of 9.4% reflects a detriment of approximately 50 basis points, related to losses incurred from the typhoon. Our Xiamen facility experienced damages to inventory, equipment, and the facility itself; and as a result, we recorded charges up to our insurance deductible of approximately \$2.9 million. Any additional charges, which we don't expect to be significant, would be covered by insurance.

Before considering the losses from the typhoon, adjusted gross margin was 9.9%, which was above our non-GAAP guidance and 50 basis points above the fiscal third quarter. By continuing to manage costs and improve productivity, we experienced margin expansion across all three of our manufacturing regions.

Selling and administrative expense of approximately \$36 million included \$5.2 million of accelerated stock-based compensation expense, related to the previously announced retirement agreement with our former CEO.

As most of you are aware, we have historically reported results inclusive of stock-based compensation expense and will continue to do so. However, given the amount and infrequent nature of this acceleration, we have excluded the \$5.2 million as part of our non-GAAP results.

So before restructuring and the items just mentioned, our adjusted operating margin of 5.1% was at the top end of our guidance. Our ability to operate within this range at a lower revenue level demonstrates the success we have had in managing our cost structure.

As anticipated and mentioned last quarter, the devaluation of the British pound had a minor impact to the overall fourth-quarter results, at less than 3% of Plexus' revenue is generated in the UK.

Diluted EPS of \$0.56 includes a detriment of \$0.26 per share as a result of the after-tax charges of approximately \$9.2 million, which included losses incurred from the typhoon, the acceleration of stock-based compensation, and restructuring and other charges. Excluding these special items, non-GAAP EPS of \$0.82 was slightly above the midpoint of our guidance. During the quarter, we recorded a gain below operating profit of \$0.02 per share, related to foreign-exchange activity.

Turning now to the balance sheet on slide 18.

Return on invested capital was 13.8% for fiscal 2016, reflecting an economic return of 2.8%, based on our weighted-average cost of capital of 11%. In fiscal 2017, our weighted-average cost of capital will reduce slightly to 10.5%.

During the quarter, we purchased approximately 155,000 of our shares for \$7.1 million at a weighted-average price of \$45.81 per share. For fiscal 2016, we completed the stock-repurchase program by purchasing \$30 million of our shares at an average price of \$39.43 per share.

Starting in fiscal 2017, we have begun purchasing shares under the new \$150-million multiyear repurchase program. We expect to execute this program on a consistent basis, similar to the fiscal 2016 program, depending on market conditions.

Also during the quarter, we repatriated \$100 million of cash from our foreign operations. We were able to offset the resulting tax expense through the utilization of accumulated US net operating loss carry-forwards and foreign tax credits. We believe the additional cash will enable us to maximize shareholder value by returning excess cash to shareholders through our previously announced share-repurchase program.

During the quarter, we generated approximately \$5 million in cash from operations and spent \$7 million on capital expenditures, resulting in cash outflows of \$2 million.

For the fiscal year, we generated \$128 million in cash from operations and spent \$31 million on capital expenditures, resulting in free cash flows of \$97 million, more than doubling the free cash flow from the prior year. Cash cycle at the end of the fourth quarter was 71 days, a sequential increase of 8 days, and 3 days above our guidance.

Please turn to slide 19 for details on our cash cycle.

Days in inventory were sequentially flat, which demonstrated our ability to effectively manage material purchases despite the revenue shortfall. Sequentially days in receivables were up 7 days, due to the timing of customer shipments and the anticipated mix change to customers with less favorable payment terms.

In addition, the close alignment of the fiscal and calendar periods resulted in less quarter-end payments being received prior to the fiscal year-end. Sequentially payable days were down 1 day, due to the reduced purchasing activity.

As Todd has already provided the revenue and EPS guidance for the fiscal first quarter, I will now turn to some additional details, which are summarized on slide 20.

During the fiscal fourth quarter, we completed all restructuring activities related to our cost reduction and productivity-improvement initiatives. At this time, we do not anticipate any restructuring charges or other special items in fiscal 2017. Therefore, the guidance provided today is GAAP only.

Fiscal first-quarter gross margin is expected to be in the range of 9.6% to 9.8%. The midpoint of this guidance suggests a sequential decrease of 20 basis points, a result of lower fixed-cost absorption caused by the anticipated revenue decline.

As we continue to tightly manage our operating expenses, we expect SG&A dollars in the fiscal first quarter to be in the range of \$29 million to \$30 million. At the midpoint of our revenue guidance, anticipated SG&A would be approximately 4.6% of revenue.

Fiscal first-quarter operating margin is expected to be in the range of 4.9% to 5.2%, which includes approximately 60 basis points of stock-based compensation expense. At the midpoint of this guidance [suggests] a 130-basis-point improvement compared to the prior-year first quarter.

A few other notes. Depreciation expense for the fiscal first quarter is expected to be approximately \$12 million, consistent with the fiscal fourth quarter. We estimate an effective tax rate of 9% to 11% for the fiscal first quarter as well as for the full year.

Our expectation for the balance sheet is a sequential improvement in working capital dollars. Cash cycle days are expected to be in the range of 67 to 71 days for the fiscal first quarter, suggesting a sequential improvement of 2 days at the midpoint of this guidance. The decrease in working capital dollars and cash cycle days is primarily related to a reduction in accounts receivable to a more normalized level.

We expect free cash flow in the range of \$20 million to \$40 million for the fiscal first quarter and to be above \$100 million for fiscal 2017. Fiscal 2017 capital spending is anticipated to be in the range of \$50 million to \$60 million to support new program ramps, refresh of equipment, and productivity improvements.

With that, Sylvia, I will now open the call for questions. We ask that you please limit yourself to one question and one followup. Sylvia?

QUESTIONS AND ANSWERS

Operator

(Operator instructions) Shawn Harrison, Longbow Research.



Shawn Harrison - Longbow Research - Analyst

Morning, everybody. I wanted to delve into the weakness I guess [call it calm]. Your largest customer within that segment [cited] a product transition in terms of technology. They're including, I think, one of the products you deal with and a ramp. As the calendar 2017 year progresses, maybe if you could talk about how that affects your view of the comp business throughout 2017, and if that's the biggest factor is just underlying demand -- a bigger dynamic versus just the technology transition in their product.

Todd Kelsey - Plexus Corp - President & CEO

Shawn, this is Todd, I'll take that question. Just give me one moment, please.

So with respect to the Communications market sector, as we look into Q1, we are seeing some broad-based softening. One of the things we want to be cautious of is, we don't want to talk about specific customers and what we see with specific customers. But what I would say is, as we go forward -- and we talked a quarter ago that we expected to start to see some sequential growth and expected reasonable growth throughout the rest of fiscal 2017.

And that outlook really hasn't changed. I mean, what it's done, I would say, is pushed a quarter, or so, out from our perspective. But in general, what we see is some near-term softening, as we talked about, across the board.

But as we get into next quarter and beyond, we're in the process of ramping several programs with a number of different customers within the sector, including with our largest customer. And I would say that we're very confident in our outlook with our largest customer in the sector. And I think external research from everything we can see would support that.

So overall, we still have confidence we're going to have growth within the Networking/Communications -- or within the Communications sector -- I have to get my own branding right here -- within our Communications sector in fiscal 2017. We believe there's sequential growth in each of the quarters.

And one of the things I'd want to point out before moving on from this question is, we still have a headwind from the one program disengagement that we announced last year within fiscal 2017 versus fiscal 2016, and that's to the tune of about \$58 million.

So as we look at our own internal numbers, we view Communications -- the underlying growth in Communications has actually been double-digit in fiscal 2017.

Shawn Harrison - Longbow Research - Analyst

So organic would be double-digit in fiscal 2017?

Todd Kelsey - Plexus Corp - President & CEO

Correct.

Shawn Harrison - Longbow Research - Analyst

Okay. And then as a followup, if I may, Pat -- I know you're controlling SG&A here in the March quarter. What is the typical down-tick or I guess increase you would see in terms of experience for the -- I'm sorry, the December quarter you're holding it down, March quarter you'll see an uptick. What's the typical increase and maybe what's a normalized dollar figure as we go through the year in terms of SG&A?

Pat Jermain - Plexus Corp - SVP & CFO

The merit increases and the payroll reset we typically see at the first of the calendar year is typically around \$1.2 million, \$1.5 million that hits operating expenses.

And then what I would say, Shawn, going through the year, in that range of \$30 million to probably \$32 million is reasonable. A lot of our incentive compensation flows through SG&A. And with the improved revenue and return on invested capital, we'll see some increase in operating expenses this year compared to last year.

Shawn Harrison - Longbow Research - Analyst

Perfect. And congrats, everybody, on just the solid profitability.

Operator

Matthew Sheerin, Stifel.

Matthew Sheerin - Stifel Nicolaus - Analyst

Thanks, good morning. Just following up on Shawn's question regarding the Communication business. That Networking portion, which is down to 20% -- are you expecting to grow that part of the business? And in terms of the deselecting and walking away from programs, is that also behind you at this point?

Steve Frisch - Plexus Corp - EVP & COO

This is Steve. I'll answer your second question first.

The walking away from business is behind us. We do have a few customers left in that space that we think fit our value proposition, and we anticipate to grow with them. But in terms of the split of the sector, it will remain a small portion of the Communications sector. So from this point forward, I would say relatively stable in terms of the percentage mix that it is.

Matthew Sheerin - Stifel Nicolaus - Analyst

Okay. And then just for your guidance for fiscal 2017 and your implication to get to the \$3 billion revenue run rate. That implies very strong second-half double-digit growth year over year by the next September quarter. Are you expecting -- it sounds like Communications is -- the underlying growth rate is going to be double digits, but are you expecting that kind of growth across the sector, or will one be stronger than the other, and which one?

Todd Kelsey - Plexus Corp - President & CEO

I'll hit the fiscal 2017 question first, and maybe in a little bit more detail because I'm sure a lot of people have interest in that area.

The first thing I would say is, to be cautious, we're not guiding fiscal 2017 or any specific quarters in fiscal 2017 beyond Q1. So it's certainly too early to guide the year or to predict what's going to happen come August or September of next year, due to ramp rates of programs, end markets, the macro environment, geopolitical issues, what have you.

But what I want to do is take things back to our investor day in June. And at our investor day, I spoke about our goal of exiting the fiscal year at a \$3 billion run rate. And we've talked, I believe, in Q&A about how realistic that goal was and what needed to occur. And I said right now it's attainable, there's a path to it. There's a path to this goal but a number of things we need to accomplish to make that occur as we exit the fiscal year.

And what I would say is, those things that are within our control that we needed to accomplish are largely accomplished. So there's still many things that I would say would not be in our control that could impact that number. But we feel really optimistic with what we've been able to accomplish and that we'll continue to get those actions done that would put us in position to be able to reach this goal.

So we view it as realistic. We view it as attainable, certainly not in the bag because so many things can happen over the course of the next year. But we also have more opportunities that really even weren't reflected or weren't even known in that June time frame that have a potential to move the needle in 2017.

So we feel good that if we continue to execute the way we're executing and markets stay like they are that we can do this.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

So even in a stable market environment, without underlying growth, you still think you can get to those numbers, based on the program wins and the backlog that you have?

Todd Kelsey - *Plexus Corp - President & CEO*

Well, it can't get any worse than it is now (laughter). I mean, we certainly couldn't have a recession and believe that we could make it, but we're really looking at today's environment as being the environment.

And for the most part, we're seeing stability across our market sectors. We've had a couple of customer-specific or sector-specific issues that are impacting us in the near term that we talked about. But our markets are pretty stable, as of right now as a whole.

Matthew Sheerin - *Stifel Nicolaus - Analyst*

Fair enough. Okay, thanks a lot.

Operator

Sherri Scribner, Deutsche Bank.

Sherri Scribner - *Deutsche Bank - Analyst*

Hi, thanks. I'm just having a hard time mathematically getting to modest growth in the Communications segment in fiscal 2017. I was just wondering if you could provide some additional detail on how you expect that business to ramp through the year, because if you look at the year-over-year -- the guidance for the first quarter, it suggests a 25% year-over-year decline in revenue, roughly. And then it seems like it'll be hard to get that number -- to offset that number through growth. And so I'm trying to understand when do these new programs kick in. Is it the second quarter you see a pretty significant ramp? Is it the third quarter? Just trying to understand that.



Steve Frisch - Plexus Corp - EVP & COO

Sherri, this is Steve. The expectation is that with some of the current products that we have that we will start seeing an uptick as early as Q2. I think I put that in my commentary that we expect a rebound with one of our significant programs in Q2. We also expect new program ramps to start occurring in Q2, as well.

So there is a little bit of softness that we saw here in Q1, so it'll be interesting to see how that fully plays out. But we do see a pretty significant ramp with some of these programs as we look into the later half of 2017, and gives us the visibility that modest growth is possible.

Sherri Scribner - Deutsche Bank - Analyst

Okay. And then you guys have done a great job with the operating margins. You're now above your target range. Should we assume that the margins start to trend down as you ramp some of this new business? You have a little bit of extra costs, but still in the high end of the target range for the rest of the quarters of fiscal 2017?

Todd Kelsey - Plexus Corp - President & CEO

I think, Sherri, what we want to continue to do is be sure we hit this 4.7% to 5%. Now, we know we've got some potential challenges in Q2 from the seasonal issues that Pat talked about that we still need to overcome, but that's still our goal within there.

We would expect, though -- while we've bumped ahead in Q4 and our guidance suggests we could exceed the range in Q1, we wouldn't expect that to be a long-term situation, as we believe we need to put in some reasonable investments, particularly around transitions for the new business that we're bringing in towards the back half of the year.

Sherri Scribner - Deutsche Bank - Analyst

Thank you.

Operator

Herve Francois, B. Riley.

Herve Francois - B. Riley & Company - Analyst

Good morning, guys. On your Industrial business, I think you mentioned in your opening remarks how 12 out of your top 15 customers outperformed their forecasts in the quarter. Can you drill into the little bit, what kind of product lines did you see? That's certainly impressive. Was it just -- I guess, strength across the board within Industrial, or is it a specific type of product line that you saw a lot of your customers increasing their forecasts with you throughout the quarter?

Steve Frisch - Plexus Corp - EVP & COO

This is Steve. I'll take that one.

We definitely saw an uptick in the semiconductor market, which is the first time we've seen that in quite some time. And I think we expect to see that continue in 2017. How strong it gets remains to be seen, but we definitely see an uptick there. We have several customers in that space, so that was a fair amount of it.



We do have a few other customers that are associated with that industry that saw an uptick, as well. We have not seen an uptick in oil and gas yet. That market stays flat to down for us. So it's really the semicon space that was the one that drove the majority of it.

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

Got it. And then switching over to the Healthcare side. I know it was impacted due to the typhoon, as you mentioned, in the quarter. Do you see that coming back over the next several quarters, outside of what was impacted due to the typhoon?

Steve Frisch - *Plexus Corp - EVP & COO*

This is Steve again. From a typhoon standpoint, we expect to be fully recovered with everything in this fiscal quarter. So the facility, itself, is back 100% operational. The only thing we're working through is filling the pipeline of inventory that was damaged, but we expect to hit all customer shipments in the quarter and be basically operating as normal here as we exit the fiscal first quarter. So there should be no further impacts for that.

With that said, in terms of Healthcare and Life Sciences, if you take a look at the wins percentage that have come out Healthcare/Life Sciences, we have significant opportunities that are ramping with Healthcare/Life Sciences, and that's what's giving us the confidence for the growth in F 2017 with Healthcare/Life Sciences.

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

Got it. If I could just have one last question. When you take a look at all your end markets throughout 2017 -- I know you're not giving guidance for all of fiscal 2017, which would you say has the best upside for improving their margins throughout the year versus where it stands today?

Steve Frisch - *Plexus Corp - EVP & COO*

This is Steve. It's difficult to say, in terms of improving margins. I think in terms of the optimism for growth -- I think it's important to note that the majority of the stuff that we're doing in terms of F 2017 growth is really associated with new program ramps.

And so we've kind of switched the [mode] from depending upon end-market growth to really figuring out how we're going to grow the organization with the ramps that we need to do.

And so there's a lot of focus on ramping customers. As you ramp customers, there's a little bit more pressure on margins, and I think Todd talked about the fact that we'll need to invest a little bit as we ramp these programs in the back half of 2017. So from that standpoint, we remain committed to the 4.7% to 5%, but we do note we'll have to invest to support the growth that we expect to see.

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

And I guess that's included within your \$50-million to \$60-million CapEx guidance for the year?

Todd Kelsey - *Plexus Corp - President & CEO*

That's correct.

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

Got it. Thanks again.



Operator

Mitch Steves, RBC Capital Markets.

Mitch Steves - RBC Capital Markets - Analyst

Thanks for taking my question, guys. So on the Defense/Security/Aerospace segment -- I know the five-year CAGR [that's 15%], which seems like a pretty high number in 2017. (inaudible) guys can help us think through the Q-over-Q there because you'll be starting at \$97 million, or so, roughly, based on the guidance for December and how that ramps over the next three quarters.

Steve Frisch - Plexus Corp - EVP & COO

This is Steve. I think -- in terms of this quarter, it really was a collection of things that drove the softness. We did see some softness in the Security markets. We have a couple of products with different customers that -- they definitely had softer end-market demand.

On the Aerospace side, the commercial remains strong from our perspective, maybe a little bit of hesitation in some of the helicopter market or in the [bus] jets. But from an overall standpoint, it was kind of a collection of things that happened.

We do see in the Aerospace market a bit of softness in Q1. But as you look forward, that rebounds nicely in the back half of 2017. So we're not expecting any kind of systemic things going on into the future. It just seems to be a softness in the one-quarter time frame, here.

Mitch Steves - RBC Capital Markets - Analyst

Got it. And in the Networking/Communications transition there, can you help us think about what type of products you guys are walking away from? Because it seems like if the five-year CAGR is down 28% for Networking, you're probably going to be readjusting the portfolio a bit. I know you guys can't give customer comments, maybe just products would be helpful.

Steve Frisch - Plexus Corp - EVP & COO

This is Steve again. I think it's important to note that we haven't walked away from any products now for probably three or four quarters. There was -- the business that we did walk away at the beginning of F 2016 on -- fiscal 2016 -- was really more associated with mobile infrastructure and some of the things that basically started to get commoditized, and not really the back-office stuff. So from that standpoint, it's really -- there really isn't anything more facing our portfolio that we feel like we need to walk away from.

Todd Kelsey - Plexus Corp - President & CEO

So I'll maybe just add a little bit to that, as well. Part of what we saw -- it certainly was a major impact, maybe the major impact, the large program that we walked away from. There was also end-market softness in that market, as well, too. So that contributed to the 29% down that we were in the Networking/Communications sector last year.

Mitch Steves - RBC Capital Markets - Analyst

Got it. And I just wanted (inaudible) clarify. So for the fiscal 2017 for the Communications side -- so the numbers should still be down double digits because of the disengagement you guys had, right? Or do you believe that's really going to flatline?

Todd Kelsey - Plexus Corp - President & CEO

No, we believe that it'll be modestly up from -- F 2017 will be modestly up to F 2016, even including the \$58-million headwind of the program disengagement.

Mitch Steves - RBC Capital Markets - Analyst

Wow. Okay.

Todd Kelsey - Plexus Corp - President & CEO

So the underlying (multiple speakers) we expect to be double digit, in essence.

Mitch Steves - RBC Capital Markets - Analyst

Got it.

Operator

Jim Suva, Citi.

Jim Suva - Citigroup - Analyst

Thank you very much. Can you quantify exactly, or at least close to what it was, the financial revenue impact from the typhoon for the September quarter? And then it sounds like you said that you're making it all up in December, and so it seems like that sequentially if that accurate, based upon my memory, then the December quarter should be guided to above normal. And I was kind of scratching my head about why it's not. Maybe is that because of the Industrial slow-down, or how can we bridge those factors?

Todd Kelsey - Plexus Corp - President & CEO

So, Jim, first of all, the typhoon revenue impact was about \$5 million. It's probably important to point out to everybody on the call, too, that the expectations when the typhoon occurred was on the order of maybe double that amount. So the team did a great job of getting product out the door within the quarter to the extent possible, limited the [revenue] to \$5 million.

It is true that that demand just shift into Q1. So there is some pretty significant softening of demand, but it's very limited for us in Q1. It's really down to two specific areas. One is an order push-out from an industrial commercial customer. And I would say that is -- you could call that a hard order, so it basically is a true push-out. That will be somewhere between a quarter to two in duration.

And then the second is the Communications weakness that we're seeing right now. So those two areas had a very significant impact to our guide for Q1.

Jim Suva - Citigroup - Analyst

Okay, thanks. That makes a lot of sense. And then as a followup, you mentioned some softness in Industrial, and you mentioned an order push-out. But you also mentioned Industrial actually did quite well across most of your portfolio. So how does one kind of bridge the gap of strengthened Industrial yet push-out. Was it like qualification by the customer and not necessarily challenges within Plexus, or is it their current products are

doing very well, or maybe what they're coming to market with has just been pushed back? How should we think about, again, the strength in Industrial yet kind of some push-outs?

Todd Kelsey - Plexus Corp - President & CEO

It's related to the customer, the push-outs. It's not related to any issues within Plexus. So we could certainly fulfill the demand. But there's some situations within there where the order's been pushed out. I don't want to give any more specifics than that, but it is demand that will come back. It's not lost demand by stretch of the imagination.

And when we look at the rest of the sector, the rest of the sector is pretty reasonable. And for the first time in a long time, I'd say we're seeing some strengthening in semiconductor capital equipment, which is really encouraging.

Jim Suva - Citigroup - Analyst

Okay, thank you so much for the details, much appreciated.

Operator

Steven Fox, Cross Research.

Steven Fox - Cross Research - Analyst

Thanks, good morning. Just getting back to the operating margins. Like you pointed out, you could be above the range two quarters in a row despite some revenue headwinds. Can you talk about why that is the case a little bit more specifically? Was there -- did the mix turn out to be a lot better than you thought it would be, or did you take some additional actions in order to make sure you're at least in your targeted range this quarter and above it last quarter? And then I have a followup.

Todd Kelsey - Plexus Corp - President & CEO

Sure, sounds good, Steve.

So if you looked at -- I'll compare it, really, to Q4 and where our results ended up in Q4. And bottom line is, what it comes down to is solid cost management and productivity gains.

But to give you a little bit more specifics, really four factors, I would say, play into this. One is the -- based off of what we came off of this past year, the Company is pretty conservative in spending. So we managed cost better than we had anticipated coming into the quarter, and we see that continuing into Q1.

We also had some really nice labor productivity gains in the Asia-Pacific region, so some areas that they focused on as part of our productivity improvement initiatives yielded better than anticipated results.

A third factor is our supply chain organization had really strong performance on specific customer accounts where we're expecting to provide future cost reductions. So they really drove progress on that ahead of the curve, so to speak. And then finally, we benefitted from the [mix] in the quarter.



Steven Fox - *Cross Research - Analyst*

Great, that's helpful. And then as a followup, like you pointed out, your funnel had a sharp increase this quarter, and I guess you were highlighting Healthcare and Industrial. I was wondering how much of that is expanded capabilities within Plexus versus seeking out business or types of business within those markets. And I was wondering if there's any color you can add around what types of business in those markets is helping your funnel? Thanks very much.

Steve Frisch - *Plexus Corp - EVP & COO*

This is Steve. From a strategy standpoint, our strategy hasn't changed. What we are seeing, with the economy being flat to down for some of our end customers, we see them looking to consolidate business more into a fewer number of suppliers.

We've been benefitting from that. So from my perspective, we're taking market share from the competition. And so the opportunity that we're seeing is, our customers are basically taking pieces of business and putting them together and making bigger packages out of them. And that's what's coming into our funnel, for one. Specifically in the Healthcare/Life Sciences space, that's happening.

And in terms of the Industrial/Commercial, we are benefitting from engagements with customers that have larger spend and larger opportunities. So both those teams have been doing a good job at really seeking and finding opportunities that are -- quite frankly, fit our value stream and our value proposition, and they just happen to be a bit larger. So it's good for us.

Steven Fox - *Cross Research - Analyst*

Just a clarification on that last point. So when you say larger spend, is that with new customers or existing customers, or both?

Steve Frisch - *Plexus Corp - EVP & COO*

This quarter, our win funnel was about 70% with existing customers and 30% with targets. And that's a healthy mix for us. We like that. We like growing with existing customers. It's easier. But we also want to add new logos, and that 70/30 split -- I'd have to go back and look and see if that's a historical trend, but that's typically where -- the areas that we're in, and we like that mix, that ratio.

Steven Fox - *Cross Research - Analyst*

Great. Thank you very much.

Operator

Sean Hannan, Needham and Company.

Sean Hannan - *Needham & Company - Analyst*

Good morning. Just to follow up on the question in terms of wins, just trying to get a perspective, and particularly, actually, focused around the funnel. Steve, you had commented that you're very pleased in accomplishing share gains. Can you broaden your comments a little bit more around that? To what degree are we accomplishing share gains, particularly as it relates to either traditional or nontraditional markets, versus newly outsourced programs? Obviously, that's not something you'd expect much in the traditional markets, but it would be interesting to hear commentary around the nontraditional in that regard. Thanks.



Steve Frisch - Plexus Corp - EVP & COO

Okay. Without getting into specifics with customers, by name or anything like that, there are a few of our customers that have decided to take their outsourcing spend and consolidate from -- anywhere from 6 to 7 suppliers down to 3. We've had that happen in the last quarter or two here with a couple of customers, and in all cases we've come out on the victorious side of being one of the selected 2 or 3.

So that is driving some of the funnel. And some of the opportunities that are basically -- both the wins as well as the size of the funnel, which also gives us a bit more optimism in terms of our ability to grow in the short term, because these are existing programs and existing opportunities that we just have to work through the transitions into Plexus for.

Sean Hannan - Needham & Company - Analyst

Okay. And then can you comment a little bit on newly outsourced programs coming from industry?

Steve Frisch - Plexus Corp - EVP & COO

Yes. Similar to the same scenario that's happening and the challenges that our customers are having with managing their costs, they are looking to basically take internal manufacturing and outsource it and consolidate it. So they will take a look at three factories, consolidate it into two, and then look to give us basically a piece of the spend that they historically had not outsourced.

And that happened a year ago with the large industrial customer that we've been talking about. That was internal manufacturing in the past. They decided to go down an outsourcing strategy, and we benefitted significantly from it.

Sean Hannan - Needham & Company - Analyst

Okay. And then last question here -- from a geographic standpoint, you guys obviously accomplished some positive momentum globally. Can you talk a little bit about expectations from a geographic facility standpoint as you look into fiscal 2017? Obviously there are some that provide a little bit more leverage than others based on where their revenue flow [has been]. Thanks.

Todd Kelsey - Plexus Corp - President & CEO

So Sean, first of all with regards to facilities, I think our footprint we view as stable right now. We think we have quite a bit of room to be able to grow within our existing footprint.

The one potential exception is around Guadalajara, where we've had a lot of success in ramping new business into Guadalajara. The [funnel] continues to remain very strong as the wins momentum into the site. So that would be the one area as we look out over the next couple of years where we could have a facilities expansion.

Now as we look at how our facilities potentially drive the business, there's certainly a lot of opportunity in our EMEA region, or in Europe, to be able to drive better leverage, to be able to drive stronger profitability.

That's something we expect as we're working our way through fiscal 2017 that we're going to continue to see strong growth in that region. And as a result, we're going to gain leverage and drive stronger margins out of that region as a whole.

But overall, again -- I want to again highlight that we want to stay focused around this 4.7% to 5% operating margin, and we want to use what you could consider that additional margin or dollars to fuel growth. Our key goal is to accelerate growth while driving this target operating-margin range.



Sean Hannan - *Needham & Company - Analyst*

Sure. Understood. All comments very appreciated. Thanks so much.

Operator

We have no further questions. At this time, I would like to turn the call back over to your host, Todd Kelsey.

Todd Kelsey - *Plexus Corp - President & CEO*

Thank you very much, Sylvia.

So what I'd like to leave you with is that we remain optimistic with our outlook for 2017. We admittedly have had a near-term revenue setback, as we look into Q1, but we view that very much as a temporary situation.

And I think even more importantly, we feel really good about the areas that we control. First of all, our cost structure is well aligned right now. We've shown the resiliency in our model, that we can execute within our model at lower revenue amounts.

From an execution standpoint, our sites and our regions are performing very well. This is reflected in the customer-satisfaction scores that we receive on our net promoter survey scores.

Also, we feel really good about our portfolio. We went through the difficult transition of two large programs out of the Company last year. That's well behind us. We feel really good about our customer base and our portfolio moving forward.

And then finally the wins in the funnel. We're taking share with customers. It's showing up in strong wins, and our funnel continues to build. So we feel really good about the things that we can control and that we'll do the right things for you in fiscal 2017.

So in closing, what I'd like to do is thank the analysts for all your good questions, and thank you to everybody who joined the call today.

Operator

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

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