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# EDITED TRANSCRIPT

PLXS - Q4 2015 Plexus Corp Earnings Call

EVENT DATE/TIME: OCTOBER 29, 2015 / 12:30PM GMT



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## PRESENTATION

### Operator

Good morning and welcome to the Plexus Corp. Conference Call Regarding its Fiscal Fourth Quarter 2015 Earnings Announcement.

(Operator Instructions). I would now like to turn the call over to Mr. Angelo Ninivaggi, Plexus' Senior Vice President, Chief Administrative Officer and General Counsel. Angelo?

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

Thank you, Cynthia. Good morning, everyone, 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 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 September 27, 2014, and the Safe Harbor and Fair Disclosure Statement in yesterday's press release.

Plexus provides non-GAAP supplemental information, such as return on invested capital, Economic Return and free cash flow, because those measures are used for internal management goals 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 margins, to provide a better understanding of core performance for purposes of period-to-period comparisons.



For a full reconciliation of non-GAAP supplemental information, please refer to yesterday's press release and our periodic SEC filings. We encourage participants on the call this morning to access the live webcast and supporting materials at Plexus' website at [www.plexus.com](http://www.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 Steven Frisch, Executive Vice President and Chief Customer Officer. Let me now turn the call over to Dean Foate. Dean?

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

Thank you, Angelo, and good morning everyone. Please advance to slide three. Yesterday after the close of the market reported results for our fiscal fourth quarter 2015 revenue was \$669 million with a diluted EPS of \$0.70. Both results were consistent with our guidance. During the quarter our sectors largely performed in line with our expectations with a modest beat in our Defense and Aerospace sector.

Please advance to slide four. For the full fiscal year we achieved strong top line growth of approximately 12% to \$2.7 billion meeting our enduring growth goal and setting a new record revenue level for the Company. Our economic return was approximately 3% below our goal of 5% but solidly in value creation territory. While our initiative to improve operating margin performance delivered tangible results, revenues fell precipitously below earlier expectations denying the anticipated leverage as we exited the fiscal year.

Please advance to slide five. Our sector growth was fairly well balance with double-digit growth in three of our four sectors. Our Healthcare/Life Sciences sector grew just 8% following a very strong performance in fiscal 2014. We remain confident in our longer-term growth potential in our Healthcare/Life Sciences sector and we enjoy excellent market penetration with our engineering solutions business.

Please advance to slide six. Taking a look at a regional view. I am pleased that we delivered growth in all three regions. While our EMEA growth percentage was the highest of the three, the growth rate was on a relative small revenue base. The modest dollar level of revenue growth was enough to swing the region to profitability as we had planned. As fiscal 2016 unfolds we need to grow at an even more aggressive rate to drive appropriate returns on our investments in that market. I'll take this opportunity to highlight that our Engineering Solutions business which is included in the regional numbers grew 17% in fiscal 2015. This is an exceptionally strong result for our higher margin professional services business.

Please advance to slide seven. Before I turn to our guidance, I want to thank the approximately 14,000 Plexus folks around the world for their dedication to customer service excellence as evidence by our strong growth and solid net promoter scores.

Advancing now to our fiscal fourth quarter guidance on slide eight. While fiscal 2015 turned out to be a pretty solid year fiscal 2016 is unfolding with some meaningful challenges we're working to overcome. During the fiscal first quarter we are facing a significant sequential reduction in revenue. The forecast volatility became apparent in the later weeks of fiscal Q4 2015 when customers trimmed forecasts by 11% or about \$75 million versus our expectations for fiscal Q1 back in July. With the forecast reset in mind we are establishing fiscal first quarter 2016 revenue guidance as \$600 million to \$625 million. Achieving the mid point of this guidance range suggests an 8.5% sequential contraction in revenue. At this level of revenue we expected diluted EPS in the range of \$0.41 to \$0.48 including approximately \$0.10 of stock-based compensation expense but excluding any special items. The EPS guidance clearly highlights unacceptable margin performance with our cost structure misaligned to a lower level of revenue.

Advancing now to our actions on slide nine. We are intensely focused on leverage our strong position with our customers to grow revenue and drive operation leverage. Additionally we have line of sight to a few new out sourcing opportunities that could move the needle during the fiscal year. Along with these top line growth efforts we will continue our focus on existing initiatives to drive productivity and margin improvement on the current book of business. However in the near-term these efforts will not be sufficient to overcome the misaligned cost structure brought about by the rapid decline in revenue. We are already executing certain cost reduction and control activities and we are reviewing additional actions to mitigate the margin challenge.

During the course of 2015 we conducted a strategic review of our business mix and arrived at a decision to prune two challenged pieces that are dilutive to our return on capital goals. At the time the decision was made we were in a position to overcome the revenue loss associated with these programs on the strength of expected new program ramps and modest end market expansion. We were anticipating growth in fiscal 2016 in the high single digits to the low double digit percentage range. Given our current outlook making the decision today would be more difficult but it is still the right decision. Proactively exiting these programs is designed to improve our overall returns and adjust our market mix to reduce risk and volatility. The first program exit is in our Industrial/Commercial sector. This program had a run rate of about \$15 million per quarter. We anticipate a complete exit by the end of our fiscal Q2 ending the relationship with this customer. The second program exit is in our network communication sector. This program had a run rate of approximately \$30 million per quarter. We anticipate a complete exit by the end of our fiscal second quarter. In this case we will continue the relationship with our customer retaining programs that better fit our model.

As a consequence of these actions we currently expect revenue in our fiscal second quarter to be in line with our first quarter as anticipated new program ramps offset the program exits. While we are experiencing significant near-term forecast volatility and longer-term visibility is becoming opaque for the moment we anticipate a return to sequential growth in the second half of fiscal 2016. In connection with the program exists we are working on the related capacity and cost reductions. In addition we are reviewing our overall global capacity level against our anticipated revenue level and will make the appropriate adjustments in consideration of the long-term strategic value propositions within each region. We'll provide details on any actions that might be material to our anticipated results at the appropriate time.

I will now turn the call over to Todd.

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

Thank you, Dean, good morning everyone. Please advance to slide ten for insight in to the performance of our market sectors during Q4 2015 as well as our expectations for the sectors in fiscal Q1 2016.

Our Networking/Communications sector was down 19% sequentially in Q4 which was in line with our expectations. Shipments to two of our top three customers had significant declines from Q3 while performance in the remainder of the sector was mixed. We experienced a recent major softening of Q1 demand as 7 of our top 10 Networking/Communications customers reduced forecast from earlier expectations. As a result we now expect fiscal Q1 Networking/Communications revenue to be down in the high teens when just one quarter ago we expected growth in the sector.

Our Healthcare/Life Sciences sector was up 2% sequentially in Q4 in line with our expectations of a low single-digit increase. Demand was relatively stable in the quarter. Looking ahead to fiscal Q1 we currently anticipate revenue in our Healthcare/Life Sciences sector to be up in the low single digits as new program ramps offset sluggish end market. Seven of our top ten customers reduced their Q1 forecast from the prior period. Overall we expect a good growth year in fiscal 2016 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 slightly above our expectation of low double-digit growth. Seven of our top ten customers grew sequentially in the quarter as we benefited from multiple new program ramps. We currently anticipate that our Industrial/Commercial sector will be down in the low teens percentage range in our fiscal Q1 as we see significant softening in the semiconductor capital equipment space and continued weakness in oil and gas. Despite these market challenges and the exit of the program Dean mentioned earlier, we are still expecting modest growth in the Industrial/Commercial sector in fiscal 2016.

Our Defense/Security/Aerospace sector was up 15% sequentially in Q4 a result that was above our expectation of high single digit growth. We successfully removed the production process constraint discussed on our last call resulting in upside with two major customers. We currently expect Q1 to be down in the low single digits as a result of an inventory correction from one of our top aerospace customers. We are positioned for strong growth in the sector in fiscal 2016.

Next to new business wins on slide 11. During the quarter we won 34 new programs in our manufacturing solution group that we anticipate will generate approximately \$167 million in annualized revenue when fully ramped in production. Our wins were balanced across our three regions. When reviewing the trailing four quarter wins as a percentage of the trailing four quarter revenue our EMEA region has particular strong wins momentum enhancing confidence that we can meaningfully grow the region in future quarters.

Please advances to slide 12. This slide provides further insight in to tech wins performance of our market sectors. It is important to note that there is significant volatility in the quarterly results and longer term trends provide the most value in measuring sector performance. In fiscal Q4 our manufacturing solutions wins were particularly strong in the Healthcare/Life Sciences market sector. The team has performed well over the past three fiscal years positioning us for solid growth in fiscal 2016 and beyond. When reviewing the trailing four quarter wins as a percentage of the trailing fourth quarter revenue the Healthcare/Life Sciences Defense/Security/Aerospace and Industrial/Commercial sectors all display wins momentum well above our 25% goal.

Now advances to wins momentum on slide 14. Our trailing four quarter manufacturing wins as shown by the dark blue bars is at \$713 million. This performance results in a trailing four quarter win ratio of 27% relative to trailing four quarter revenue above our target of 25%. While not included in the win results on the recent slides, we had a record quarter in engineering solutions with new projects wins totaling approximately \$27 million. Our engineering wins remain strong in our Healthcare/Life Sciences sector and we had solid quarterly wins in the Industrial/Commercial sector. Our backlog in engineering solutions is healthy and its operational performance has been very good. The team just completed its third consecutive year of double digit percentage revenue growth and has a 14% compounded annual growth rate over this time period.

Next I would like to turn to operating performance on slide 14. Our revenue in fiscal Q4 finished just above our record revenue level achieved in Q3 of fiscal 2015. Our Q4 operating margin held steady with Q3 as we successfully addressed the process constraints in our [NINA] Defense/Security/Aerospace factory. These gains were offset by underutilized fixed costs given that we had anticipated exiting the year with higher revenue levels which ultimately reversed just prior to Q4.

Our Guadalajara ramp continues to progress well as the site is currently at \$150 million run rate with sustained profitable. Customer satisfaction at the site is excellent and we continue to win new business. In addition our funnel of new business opportunities at the Guadalajara is quite strong. As anticipated our EMEA region returned to profitability within fiscal Q4. We expect to improve on this performance throughout fiscal 2016.

Please advance to slide 15 for additional insight into our future operating margin expectations. As Dean previously discussed, our fiscal Q1 revenue forecast deteriorated materially in late Q4. As a result our cost structure is not in line with revenue and our Q1 operating margin forecast is at an unacceptable level. We creating plans and taking a series of near term actions which are designed to remove \$6 million to \$8 million of costs per quarter. At the currently anticipated revenue level these actions should result in moderate operating improvement in fiscal Q2 and meaningful 100 basis points improvement in our fiscal Q3. Our areas of immediate focus include evaluating our footprint strategy and capacity, driving productivity improvements in each of our regions and reducing discretionary spending and operating expenses. Beyond these initial actions we anticipate additional positive margin impact in fiscal 2016 from our Guadalajara ramp and sustained growth in the EMEA region.

Finally we expect further benefits as a result of improved customer mix due to the program exits Dean discussed previously. Our operating margin projection do not include the benefits of this improved mix. We will reevaluate our cost structure as we approach fiscal Q3 as we currently expect reasonable sequential revenue growth in the second half of the fiscal year. We remain committed to achieving our target operating margin range of 4.7% to 5% and our working diligently to achieve that goal within fiscal 2016.

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

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

Thank you, Todd, and good morning everyone. Our fiscal fourth quarter results are summarized on slide 16. Fourth quarter revenue of \$669 million was above midpoint of the our guidance and relatively consistent with both the fiscal third quarter and prior year fiscal fourth quarter. Gross margin of 8.9% was also above the midpoint of our guidance and above the fiscal third quarter gross margin of 8.8%. Consistent with our expectations we saw margin improvements from our EMEA operation, our aerospace factory in Wisconsin and the continued ramp of business within our Guadalajara site. Anticipated and highlighted last quarter these improvements were partially offset by an under absorption of fixed cost due to the reduction in fourth quarter revenue for our Networking/Communications sector.

Selling, and administrative expenses f \$30.7 million was consistent with our expectations and as a percentage of revenue was 4.6%. For fiscal 2015 SG&A as a percentage of revenue was also 4.6% the lowest level we have seen in several years which is the result of improved productivity and

prudent management of expenses. Operating margin of 4.3% was at the midpoint of our guidance and consistent with the fiscal third quarter. Included in operating margin is approximately 40 basis points of stock-based compensation expense. Diluted earnings per share of \$0.70 was slightly above the midpoint of our guidance. We continue to see minimal impact to revenue and earnings from currency fluctuations related to our EMEA operations.

Turning now to the balance sheet on slide 17. Return on invested capital was 14% for fiscal 2015 reflecting an economic return of 3% based on our weighted average cost of capital of 11%. Although delivering a nice spread above our cost of capital this year's return was below the 15.2% for fiscal 2014. While invested capital grew at a similar pace to revenue our operating profit before restructuring grew just 5% due to the lower margin performance.

During the quarter we repurchased approximately 196,000 shares for \$7.5 million at a weighted average price of \$38.25 per share. For fiscal 2015 we completed the stock repurchase program by purchasing \$30 million of our shares at an average price of \$40.26 per share. In August our Board of Directors authorized an additional \$30 million stock repurchase program for fiscal 2016 which the Company expects to complete on a relatively consistent basis during the year.

During the quarter we generated \$21 million in cash from operations and spent \$8 million on capital expenditures resulting in free cash flow of \$13 million. For the fiscal year we generated \$77 million in cash from operations and spent \$35 million on capital expenditures resulting in free cash flow of \$42 million. Our cash cycle at the end of the fourth quarter was 66 days which was in line with our expectations and four days higher than our results in the fiscal third quarter.

Please turn to slide 18 for details on our cash cycle. Sequentially days and receivables were up five days due to a higher level of shipments at the end of our fiscal year and a mix change to customers with less favorable payment terms. Day in inventory and account payable days were sequentially down three days and two days respectively due to a reduction in purchasing activity in response to the lower forecasted revenue for the fiscal first quarter.

As Dean has already provided the revenue and EPS guidance, I will now turn to some additional details on the fiscal first quarter of 2016 which are summarized on slide 19. Restructuring charges which may arise from the cost reductions and control activities discussed earlier have not been quantified and therefore are excluded from the guidance discussed today. Fiscal first quarter gross margin is expected to be in the range of 7.7% to 8% significantly below our target range and historical average due to the under absorption of fixed cost caused by the anticipated decline in revenue. We are determining the appropriate cost reduction and control actions to mitigate our near-term margin challenges and are assessing our global capacity levels in order to take prompt action to address the anticipated revenue decline.

The improvement in gross margin from these actions is expected to be minimal in the fiscal first quarter and therefore not factored into this quarter's guidance. At the currently projected revenue combined with the impact from the decisions made this quarter we expect gross margin to exceed 9% in the latter part of fiscal 2016. As a result of tightly managing discretionary spending and pursuing other opportunities for cost reductions we expect SG&A expense in the range of \$26.5 million to \$27.5 million sequentially down 6%. At the midpoint of our revenue guidance anticipated SG&A would be approximately 4.4% of revenue down from 4.6% in the fiscal fourth quarter. We are taking diligent steps to control cost and prioritize spending for revenue generating activities. Even with losing leverage on our SG&A expenses revenue declines we see a positive trend, downward trend in our SG&A spend as a percentage of revenue. We believe we can manage SG&A spending in the range of 4.4% to 4.6% of revenue over a longer period.

Fiscal first quarter operating margin is expected to be in the range of 3.3% to 3.6% which includes approximately 50 basis points of stock-based compensation expense. We expect the decisions made this quarter will return us to our targeted operating margin range by the end of fiscal 2016.

A few other notes depreciation expense is expected to be approximately \$12 million in the fiscal first quarter consistent with fiscal fourth quarter. We are estimating a tax rate of 13% to 15% for the fiscal first quarter and 11% to 13% for the full year. The slight increase in rates is based on our expected global distribution of earnings. Cash cycle days are expected to be in the range of 76 to 80 days due to the anticipated revenue reduction during the fiscal first quarter and continued softness expected during the fiscal second quarter we are forecasting a further reduction in purchasing



activity which will reduce our accounts payable days by approximately six days. With lower revenue and flat inventory dollars for the fiscal first quarter our days in inventory are expected to increase by six days.

To improve our net inventory position we are working with customers to secure offsetting customer deposits for excess inventory and negotiating shorter lead times with suppliers. With the combined impact of lower account payable days and high inventory days we are forecasting negative free cash flow in the range of \$20 million to \$40 million for the quarter but positive free cash flow in the range of \$80 million to \$100 million for fiscal 2016 as we address working capital requirements. We expect 2016 capital spending to approximate \$40 million which will be focused on maintenance capital and 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. Cynthia?

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## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions). And our first question comes from Mark Delaney with Goldman Sachs. You may begin.

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### Mark Delaney - Goldman Sachs - Analyst

Yes, good morning. And thanks very much for taking the questions. The first question is on the programs that the Company is planning to wind down. I understand they weren't meeting the return targets of Plexus at this point. But maybe you can just talk about why you ended up in a situation where they weren't hitting your return targets? Because some of those programs actually look like they are fairly sizable especially by my math the networking program at \$29 million of revenue next quarter that's 20% of that segment sales. So it seems like a sizable program, and I'm trying to understand why it's not at the return targets any more?

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### Steven Frisch - Plexus Corp. - EVP, CCO

This is Steve. The first one on Industrial/Commercial that program was in our transportation sub sector and it is more of an automotive type product. And from a strategy standpoint Plexus has not pursued the automotive market. As that part become more of an automotive type application the margin structure and the customer expectation in terms of what they need for a long-term supply solution didn't really line up with Plexus' strategy, so we actually started a conversation with them over a year ago and talked about realigning their supply base to a supplier that basically matched what their needs were. So that was a long terms discussion with them in terms of winding that down. In terms of the Networking/Communications one, we have talked quite a bit over time in terms of projects or programs in that space have a tenancy to get commoditized over time and that is what happened with this one. The customer was under some significant pressure for cost reduction opportunities, and Plexus decided not to pursue basically aggressively going after our price model. So working with a customer we're basically unwinding that project as well. So both cases looking at the margin profile and the customer expectation on the supply chain solution we didn't feel we were a great fit for them so we work with them to unwind both of them.

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

I would make the final point that on the network/communication program they have portfolio business this particular customer. The piece that we're exiting is focused in the networking space where Steve said it is highly commodities. We are retaining other pieces of the business that make more sense and where we can achieve the kinds of returns we expect to achieve.



**Mark Delaney** - *Goldman Sachs - Analyst*

Okay. And then for a follow-up question I was hoping to get a better sense on the outlook for the March quarter. I understand some of these programs are going to be winding down. I appreciate the clarity on that. For the existing business what sort of trends should we expect there and I understand there are some macro headwinds you have been seeing. And you think June starts to grow again. I'm just hoping you can help us better separate some of the program wind downs with macro and seasonally effects that we would normally see in the March quarter.

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

As I said, we expect to be in line or about flat quarter-to-quarter from our fiscal Q1 to Q2. So the implication of that with the program wind down is the rest of the business is seeing some growth. And, Todd, do you want to comment more on that sector wise?

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

From a sector standpoint obviously we are seeing some headwinds in Networking/Communications in the current quarter. We expect a minor recovery I would say within that sector as we go out to the following quarters. But where we expect to see more strength is in the other three quarters and that is primarily a result of new program wins. Then end markets in general are soft. If we looked at our forecast for the current quarter our fiscal Q1 revenue has come down from our previous expectations in all four sectors quarter-over-quarter. So we're seeing general softness but the strength we have had in program wins over the past several years is really driving the growth we expect to see in those other three sectors to offset the program exits.

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**Mark Delaney** - *Goldman Sachs - Analyst*

Thank you very much.

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**Operator**

And our next question comes from Shawn Harrison with Longbow Research. You may begin.

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**Shawn Harrison** - *Longbow Research - Analyst*

Good morning. I wanted to get into more detail on the cost reduction actions. How much of what's occurring either with the SG&A coming down this quarter, the cost reduction actions which look to be all cog based over the next two quarters being permanent so if we look at your model in the back half of the year if demand rises you're not going to see a degradation in margins?

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

Shawn, this is Todd. So with the cost reduction activities, first of all Pat had mentioned SG&A reductions in the current quarter and those are not factored into the cost reduction targets that I gave the \$6 million to \$8 million. So this is real cost that is coming out call it for the long-term and will only be adjusted up in the case of revenue coming in. So you can expect that \$6 million to \$8 million to be incremental to the SG&A that is coming out right now.

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**Shawn Harrison** - *Longbow Research - Analyst*

And the SG&A that is coming out right now is it temporary or are these permanent cuts?





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

Well, the SG&A coming out right now a heavy percentage of that is variable incentive compensation.

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**Shawn Harrison** - Longbow Research - Analyst

Okay. Second question I guess the stock is not going to open higher this morning definitely going to open lower. Why not front load the buy back understanding you are going to be free cash flow positive for the year. I understand you like to fund it with free cash flow, but if you are going to improve costs as such and the earnings power will step up in the back half of the year why not use an opportunity to get at the market right now?

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

Shawn, this is Pat. I'll answer that. We have stuck with this strategy of consistently repurchasing throughout the year. And I don't want to get into trying to predict the market. The dollar cost averaging has worked well for us in the past. From time to time we do discuss this strategy with the Board based on our intrinsic valuation and decide whether we want to -- a change warranted so we'll continue to do that, But we're not prepared to change our strategy at this point.

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**Shawn Harrison** - Longbow Research - Analyst

Pat, if I may clarify something real quick. The free cash flow number does that include cash restructuring cost or is that prior to any cash restructuring cost?

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

It is prior to restructuring cost.

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**Shawn Harrison** - Longbow Research - Analyst

Thank you.

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**Operator**

And our next question comes from Sherri Scribner with Deutsche Bank. You may begin.

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**Sherri Scribner** - Deutsche Bank - Analyst

Hi, thank you. I wanted to dig a little bit in to the Networking/Communications segment. I heard you comment that a number of customers cut their forecast. Are you seeing any of this tied to weakness in Asia maybe you could give us a little bit of geographic detail on what you think the cuts are related to. We have heard from other companies that networking is a little bit weak but trying to get a little more detail on what is driving that for you specifically.

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

This is Steve. General color back from customers about China is they are seeing softness compared to what their expectations were but they are still seeing growth. So there is obviously some impact playing into the softness, but there is still optimistic in terms of the fact that they are growing

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in that region. What percentage is specifically called out that is impacting us is difficult to look at customer by customer and say that their growth projections are attributed strictly to Asia. So for us it is an impact, but we don't know that it is meaningful across each of the different sectors. And I know that is not necessarily a very clear answer but that is the best we're getting from our customers.

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**Sherri Scribner** - *Deutsche Bank - Analyst*

That is helpful. I was hoping the 9% gross margins in the backhalf of the year. I just wanted some clarification, is that in the backhalf of your fiscal 2016 or is that in the back half of calendar 2016 since there is a slight difference? Thanks.

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

Sherri, this is Pat. Yes, it is fiscal 2016.

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**Sherri Scribner** - *Deutsche Bank - Analyst*

Thanks.

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

Thank you.

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**Operator**

And our next question comes from Matt Sheerin with Stifel. You may begin.

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**Matt Sheerin** - *Stifel, Nicolaus & Co., Inc. - Analyst*

Yes, thanks. I just wanted to get back to the issue with the communications customer where you are winding down programs. It sounds like this customer is not going away, right? So what percentage of revenue will you retain with that customer?

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

I don't have the break out. You are saying what percentage versus what we had versus what --

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**Matt Sheerin** - *Stifel, Nicolaus & Co., Inc. - Analyst*

Yes, I'm trying to figure out what discussion was going from X run rate to what kind of run rate in terms of profitability. I'm just trying to figure out whether or not you're going to eventually just phase this relationship out?

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

No I don't think it is about phasing the relationship out. I think we are keeping maybe 25% to 30% of the overall revenue.



**Matt Sheerin** - *Stifel, Nicolaus & Co., Inc. - Analyst*

Okay.

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

It is focused in a different space within that overall sector.

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**Matt Sheerin** - *Stifel, Nicolaus & Co., Inc. - Analyst*

Just within that sector how is your strategy then changing Dean, relative to the telecom infrastructure, networking where obviously more commoditization a lot of competition from much bigger global players versus niche communication cable those kind of markets?

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

I would just say that what we're generally looking at is what I would consider to be pure networking gear that has I would say average program sizes are enormous for each product line relative to the other kinds of business that we execute and the product life cycles are very short. And we are going to be seeing a lot of pressure with software applications to essentially replace hardware or is driving down the pricing on hardware and commoditizing it. So we're currently focused our shift is as you said to more niche opportunities but we also enjoy a pretty good position in the companies that play more in the cable space where our value proposition is stronger.

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**Matt Sheerin** - *Stifel, Nicolaus & Co., Inc. - Analyst*

Okay. And then relative to the guidance that includes those two programs with the two different customers winding down as well so that's part of that?

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

That's correct.

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**Matt Sheerin** - *Stifel, Nicolaus & Co., Inc. - Analyst*

Okay. And then okay that plays through the year. And then just within on the Industrial side that weakness you're seeing in semi-cap and other end markets do you see that continuing into March and June or is there any sign that those markets are beginning to stabilize?

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

No. We believe it is going to continue forward certainly in to our Q2 if not Q3 which would be our June quarter. I would say the end markets there is what I'm talking about being quite challenge although we are working with a number of those customers to try to improve our share position so that we can potentially grow a little bit in the sub sector there, but we will have see how that plays out. Clearly when there is that sort of pressure on these companies it is difficult for them to support multiple EMS partners, and we have a strong position with a number of them which is kind of to my commentary about growing the top line. We're trying to take advantage of our strong execution, strong net promoter scores that we have with these customer and really get aggressive about increasing our share of the business as we expect a number of our customers will look to reduce the number of partners they are working with.

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**Matt Sheerin** - *Stifel, Nicolaus & Co., Inc. - Analyst*

Okay. Okay, great. Thanks a lot.

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

Thank you.

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**Operator**

And our next question comes from Mitch Steves with RBC Capital Markets. You may begin.

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**Mitch Steves** - *RBC Capital Markets - Analyst*

Thanks for taking my question. I just wanted to return to the 9% gross margin target you guys have for the back half of the year. If I plug in the numbers roughly speaking it looks like that means that the net sales number would have to decline on a year-over-year basis in the backhalf just to get to the 5% margin. So just want to make sure the math I'm doing there is roughly accurate?

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

I guess I'm trying to understand what you are saying the sales number relative to. If you look at the full year fiscal 2016 versus the full year fiscal 2015 clearly it is going to be a challenge for us to show top line growth when you look at the first two quarters being relatively flat at the current revenue level. But we do expect to see sequential growth at least for the moment as I said in both Q3 and Q4. Yes, correct, if we're not unwinding those couple of programs we would have saw the sequential growth begin in our second quarter. That is part of the leverage that we are going to get to generate stronger margins but we are also taking out a fair amount of cost. Pat is looking at me maybe he can help clarify.

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

Yes, I'll just add, Mitch, my guidance on gross margin was 7.7% to 8% and when Todd talked about the cost reduction \$7 million to \$8 million that's going to add about 100 basis points to our margin our gross margin. So my commentary was that gross margins should get to 9% or above, 9% or higher.

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**Mitch Steves** - *RBC Capital Markets - Analyst*

Got it. That makes since and then just a quick one on the SG&A. When would we expect this to get back to a run rate of \$30 million a quarter so I can get an idea of the linearity or the revenue ramp after exiting this year?

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

It is probably the back half of fiscal 2016. But again with some of the actions we're taking, we are going to see SG&A probably below \$30 million probably for the next foreseeable future and being in that range as a percentage of revenue 4.4% to 4.6%.

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**Mitch Steves** - *RBC Capital Markets - Analyst*

Got it. Thank you. Thank you very much.



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

Thank you.

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**Operator**

And our next question comes from Andrew Huang with initial B. Riley. You may begin.

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**Andrew Huang** - B. Riley & Co. LLC - Analyst

Thank you. To get to your 9% gross margin target can you give us a sense of what kind of minimum revenue levels you need?

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

I think, Andrew, we can be at this lower level of revenue and get to 9% again with the cost reductions Todd talked about. So when we talk about 9% again I'm talking 9% and above. So with any addition revenue we should be able to get north of 9%. But at the current revenue rate and the cost reductions discussed we should achieve 9%.

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**Andrew Huang** - B. Riley & Co. LLC - Analyst

Okay. And then perhaps on a more positive note maybe you could give us an update on the progress with the large multi national OEM in the industrial segment? And I think you also mentioned some potential needle movers that could happen during fiscal 2016.

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

This is Steve. In regards to the Industrial/Commercial customer we referred to previously we did win our first small opportunity with them. So we are prototyping and doing some NIP some initial projects that is actually happening in our Oradea, Romania facility which is very nice. We do have about an additional \$25 million of opportunities identified in our funnel that we are pursuing and we talked about these guys getting to be \$100 million run rate at some point in the future and we still believe that and they are still talking to us about that. One of the reasons we didn't recognize it initially is we knew it was going to be a little bit of a slower ramp and we didn't have to win these projects. So it is progressing nicely and kind of inline with what we expected so that's going well. In terms of the opportunities that Dean talked about one of the things we are seeing with some of the customer base is they are really evaluating their sourcing strategy whether they do it in-house versus looking for a complete out source. We have a few opportunities identified that we're talking with customers about them exiting their facilities which if they decide to do that obviously there would be a meaningful impact right off the bat. There are a few of those that we're pursuing. And we are expecting our customers to make the decisions in the year. So we are aggressively going after those.

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**Andrew Huang** - B. Riley & Co. LLC - Analyst

Thank you.

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**Operator**

And our next question comes from Steven Fox with Cross Research. You may begin.



**Steven Fox** - *Cross Research - Analyst*

Thanks good morning. I was wondering if we could step back a little bit and look at the entirety of the business over the last few years. You have been in the 4% to 5% range from time to time but not consistently and usually it has taken some extraordinary actions to get there. Can you talk about the reasonableness of sustaining that type of level of operating margin especially given it seems like the footprint was well adjusted for current demand levels before you announced last night?

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

I would just I know we're getting challenged here to have credibility around getting to our range but we know internally that the math works if we just get the capacity aligned right and get the returns on the newer investments we have made over the last few years with new facilities. But if you look at what we had thought was going to unfold for us in fiscal 2015 we expected to be at a much higher run rate of revenue in our fourth quarter than we ended up at. We saw this end market start to weaken primarily in the Networking/Communications space as we pre announced our Q3. If we had gotten that additional revenue like we thought, we would have been solidly up in that range. And if you look at our fiscal Q1, our forecast probably back in June time frame was probably \$100 million to \$110 million higher for our Q1 than we are actually going to execute. And Q1 the reduction in revenue there is not related to the loss of any programs any share shift. It is all related to end markets coming down. Ever one of our market sectors came down and of course, we saw this very steep decline in Networking/Communications, so now we are just faced with a much lower revenue level and we are not at a point now where our cost structure is aligned to this revenue level. It was the expectation of a much higher revenue level.

Now on the optimistic side of this is we have sewing the EMEA region to profitability like we said we would. We have a good funnel there, and we should see revenue ramping up and we should be able to improve the margin performance overall in the region as the year unfolds. Guadalajara was a drag for us last year, but it was a new start up. We started that thing up almost flawlessly and it got to profitability quicker than any other new assets that we've ever put up and we should see nothing but improvement in margin performance in that site. Todd talked about the strength of the funnel. The issue now is we are over capacity in a couple of other places that we're going to have to make some adjustments and then we have good solid line of sight without what I would call Herculean efforts to get up in our margin range. The math does work when you get under the hood. It is not a question on pricing on everything. We are talking about executing a couple of programs that have been dragging on us and quite frankly those programs that are a drag on our invested capital base as well so we should see improvement in our overall inventory position once we're out of those programs as well.

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**Steven Fox** - *Cross Research - Analyst*

Dean, just to summarize those thoughts which I appreciate, so you're basically saying the management challenge is just sort of timing all the capacity to the business as opposed to individual programs meeting your margin targets; is that correct?

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

Yes, and I would say over the last two years we are probably a little bit overly assertive in terms of the number of projects we had going on. Bringing up Oradea, bringing up Guadalajara consolidating three facilities to one here in Nina. We just had a lot of things going on. And quite frankly as we started to come out of the back end of fiscal 2015 a lot of the hard work and improvements that we expected were starting to unfold, what we didn't anticipate was revenue cratering the way it is which means now we have a whole other list of things we need to go after. Now investors I would hope would take some comfort in that we have managed through downturns particularly the great recession I think quite well. If you look at our performance through that we I think outperformed a number of our competitors through that period and came out stronger and growing. And of course we had the clarity where our largest customer hung us out to dry and we laid out the plan to recover from that and I think that unfolded with near precision to what we said would happen. So I think we should get some credibility around a (Inaudible) ratio. Todd is talking about getting this cost out we'll get the cost out and we'll get ourselves back to where we need to be. And again it is not like we don't have revenue growth opportunities in front of us, we do. The pressure this creates in the marketplace has a tendency to create opportunities for growth. We just got to get on with the work that needs to be done.

**Steven Fox** - *Cross Research - Analyst*

Thanks very much. Appreciate the candor.

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

You're welcome. Sure.

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**Operator**

And our next question comes from Jim Suva from Citi. You may begin.

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**James Suva** - *Citigroup Global Markets, Inc. - Analyst*

Thank you so much especially for all the details thus far in the call. As you think back about these customer program transitions were they at one point meeting or exceeding your goals and the products get mature or were they hopeful that the expansion could increase with your relationship with them or was it now they are just asking for more aggressive pricing that causes such a change? Because it is kind of sad to see a customer or product transition away. Of course it could also just be the normal life of things once they mature and get older they feather out. Can you help us understand each of those two different product scenarios of how they played, the strategy of historically and the outlook?

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

Sure, Jim. I think the networking business in particular we've been an player in that marketplace for a long, long time. Everybody knows that we had a very large customer surprise e us one day and told us they weren't going to do business with us anymore and part of it was the pressure they were seeing in the marketplace. And I think their conclusion was we weren't going to be able to get the pricing on those products where they needed it to be. Rather than challenge us to get there, they decided to walk away from us. It wasn't an elegant departure but it happened. If you look at what's been happening in that marketplace an enormous amount of pressure on some of these companies as the natural commodization and frankly disruptive changes taking place in that market. Part of it is the software define networking and et cetera, et cetera. That's a tough marketplace for us currently to participate in. This is where we came to the conclusion collectively with the current customer that we're talking about that maybe some of that technology doesn't make since for us. Now they have other technology that we think does.

Now the Industrial/Commercial space I will give you optics on that we're exiting from Tesla. This was a new technology that came into the market place. I was pretty skeptical that we should really participate but I was persuaded that we should. Early on they had a difficult time finding partners, and we stepped up and manufactured a number of their -- help them MPI and did the early manufacturing for a number of technologies. And of course, as they began to scale up and get to volume with some of their product they brought in more and more people from what I'll call the automotive supplier chain and had their big supplier day and talked about what they expected from all their suppliers. Our conclusion was we've seen this movie before and this is not a market space we should be apart of and we should work with them to back away from this business because we're not going to over the long run be able to provide them with the kind of pricing they are going to expect. So we just decided to walk away from it. So essentially we were supporting that marketplace or them in particular during the earlier adopter phase, but now that it has become more volume product it is not going to make sense for us.

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**James Suva** - *Citigroup Global Markets, Inc. - Analyst*

Great. My follow-up on the networking one it sounds like you will continue to do additional programs and products with that customer.

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

Yes.

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**James Suva** - Citigroup Global Markets, Inc. - Analyst

Can you help us understand about has there been a past history of lots of past products you kind of feather out and turn off your portfolio because they don't meet your needs, or is this a newer phenomena? The question would be is that customer are they used to you being a great partner and then feathering something out or is this kind of new? And does it add risk to does this partner then start to say maybe if they are feather off my other products I may need to reassess?

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

It is hard to predict the future there. But I think our relationship is strong. It is essential another kind of division within this company that we have enjoyed a position with for a long time. We provide a certain level of after market services for products so we're wound pretty tight with them. But in any case we enjoy this business, we think there may be more share we can gain here. But I will also say at the level we're out now as a concentration it has de-risked materially.

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**James Suva** - Citigroup Global Markets, Inc. - Analyst

Great, thank you again for all the details.

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

Thank you, Jim.

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**Operator**

And our next question comes from Rob Crystal with Goldman Sachs. You may begin.

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**Robert Crystal** - Goldman Sachs - Analyst

I just wanted to ask a little bit further about the buyback in terms of thinking about it more from the standpoint of the economic return you guys have always been returns focus. Could you comment on that a little bit maybe? Thanks.

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

We think having a buyback program is a good method of returning capital to our shareholders. We have had a consistent program in place the last several years. Again what I stated earlier doing it consistently throughout the year I think brings rigor to focusing our cash flow generation especially in the U.S. And I would mention again the basis for our share repurchase program is cash flow generation in the U.S. along with the ability to lever up in the U.S. Having access to offshore cash is a significant tax impact for us if we are bringing that back, so we take that into consideration in our decision on what level to set the repurchase at. So we've been pleased with the levels we have been at and we will continue that this year and continue to evaluate the return it brings to our shareholders.





**Robert Crystal** - *Goldman Sachs - Analyst*

Pat, I guess you if you understand the flow of working capital I'm guessing commercial bankers would as well. So why not be more aggressive if the stock is weak over the next three to six months given I'll forget whether it was (Inaudible) Dean's comment et cetera. Given you do have a strong history of that why not potentially be more aggressive if the market dislocates?

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

Part of it is when I look at the quarterly free cash flow generation and I mentioned this in my commentary that we are looking at a negative \$20 million to \$40 million in free cash flow for the first quarter and a lot of that is driven by higher working capital requirements that we're working through and trying to get our arms around and reduce. But that is impacting our ability to provide more of a share repurchase in the near-term and our ability to lever up further to support that program -- a more accelerated program. Now it is not to say we wouldn't potentially look at leveraging up even further. But I think we need to get through some of the restructuring activities as well to see what the impact on our cash is going to be from those decisions. So I'm not at this point ready to accelerate it.

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**Robert Crystal** - *Goldman Sachs - Analyst*

I understand. But we should think that given you are economically focused if it made sense to pull it forward because the stock was even more attractive that that would be a strong consideration, that is a reasonable thought?

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

Yes, definitely.

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**Robert Crystal** - *Goldman Sachs - Analyst*

Thank you.

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**Operator**

And our next question comes from Shawn Harrison with Longbow Research. You may begin.

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**Shawn Harrison** - *Longbow Research - Analyst*

Hi I wanted to follow-up on three things. Last quarter I know there was talk about the margin expansion opportunities in aerospace. Did you hit those this quarter because you fixed the bottle-necks or is there still upside to come from just fixing the problems within the aerospace business?

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

We did fix the aerospace bottleneck Shawn, there is continued growth opportunities in the sector. We're expecting a bit of a softening this quarter just as a result of inventory reset or inventory correction from one of our customers, but beyond that we do see the opportunity for strong growth in fiscal 2016.

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**Shawn Harrison** - *Longbow Research - Analyst*

But to be clear the margin headwinds that were there no longer apparent?



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

The margin headwinds due to the capacity strength are no longer apparent.

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**Shawn Harrison** - Longbow Research - Analyst

Okay.

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

We're still working through the productivity improvements that I've talked about in previous call and that's reflected within the \$6 million to \$8 million in cost improvements that I have talked about.

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**Shawn Harrison** - Longbow Research - Analyst

Okay. That is helpful. And then just as a follow-up (Inaudible) earlier in the call a bit in the middle of the call but potential large out sourcing wins. What exactly does that mean? How much of that is tied to semi cap companies consolidating into one supplier? How much of that is tied to just going from internal to external, and what are the odds that they actually hit this year and actually begin to ramp?

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

It is hard to give you odds at this point. The couple that I had in my mind were related to the Healthcare/Life Sciences market place where customers have physical assets where they are manufacturing product today and they are reconsidering whether they should continue to do that. In that situation our preferred method would be to take -- first would be to just extract the business out of the site the old fashion way. If that doesn't play out, then our next preferred method would be to do what we call a manage in place where we come into the facility, take over ownership of it. We would recognize revenues on day one. We would have a service agreement for the employees and the staff, and we would then work to exit the business out of that facility in to our facilities. And those things tend to be a little bit undeterministic in terms of timing, but there is certainly a handful of those now that are in play and of course, the decisions would get made then we would have recognition of the revenues as we took over control of the facility.

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**Shawn Harrison** - Longbow Research - Analyst

But nothing tied to consolidating down suppliers to one or anything of that nature?

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

There is plenty of opportunities like that, but those are more in a normal funnel. Those are just typical go get additional market share kinds of play and those unfold every year. Like I say you tend to see an acceleration when there is more pressure on the suppliers and we are winning some additional share in some semi-conductor capital equipment because of the reduction of supply chain partners.

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**Shawn Harrison** - Longbow Research - Analyst

Okay. And then last considering you had two customer that didn't meet the return targets, were there any other customers at the precipices of well, maybe we should keep them, maybe we shouldn't, so there is risk moving through 2016 that we get into 2017 and you face a similar hurdle?

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

There are always customers that we prune if they don't unfold the way we thought, but none as material as these two customers. And as I had said earlier, we had expected a strong enough growth to unfold in 2016 that we would still achieve single high to low double-digit growth even with the unwinding of these relationship. Given the revenue coming down the way it did and trying to explain flat quarter-to-quarter from Q1 to Q2 I felt we needed to give quite a bit of insight. One was is because of the size of the programs but also because of the impact on our Q2. So there isn't anything that we're contemplating today that is of this size that we would unwind. And like I said you wouldn't even have noticed the Industrial/Commercial one had our year been on track with what we had expected just a quarter or so ago.

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**Shawn Harrison** - Longbow Research - Analyst

Okay, thanks.

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

I just want to make a comment too on the full fiscal year because we're getting to the end year. We talked about it is going to be tough to grow this year, but I would say when you think about how we are going to come out of the year in the terms of the mix of business in our pie chart we are expecting pretty strong growth in Healthcare/Life Sciences for the moment up double-digits and then Defense/Security/Aerospace also for the moment up double-digit percentages. Industrial/Commercial because we're unwinding a pretty substantial piece of business right now looks to be just marginally up although we have a number of opportunities where we think we can improve upon that. It is the Networking/Communications sector that is going to be the most challenged, but we are like I say rotating ourselves to what we think is a more defendable position and de-risking the overall business by getting out of some of the most volatile and commodity like product technologies in that space and of course the most margin challenged as well. So I wanted to give you that sort of since of how this is going to unfold for the full fiscal year.

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**Operator**

And we have no further questions at this time.

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

All right. I want to thank everyone for their questions. And obviously we have work to do. So thank you very much.

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**Operator**

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

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