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PLXS - Q1 2017 Plexus Corp Earnings Call

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OVERVIEW:

Co. reported 1Q17 revenues of \$635m and GAAP diluted EPS of \$0.82. Expects 2Q17 revenues to be \$620-650m and GAAP diluted EPS to be \$0.71-0.79.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning and welcome to the Plexus conference call regarding its fiscal first-quarter 2017 earnings announcement. My name is Paulette and I will be your operator for today's call. (Operator Instructions). I would now like to turn the call over to Ms. Susan Hanson, Plexus's Director of Communications and Brand Management. Susan.

Susan Hanson - *Plexus Corp. - Director, Communications & Brand Management*

Thank you, Paulette. Good morning and thank you for joining us today. Some of the statements made and information provided during our call today will be forward-looking statements as they will not be limited to historical facts. The words believe, expect, intend, plan, anticipate and similar terms often identify forward-looking statements. Forward-looking 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 1, 2016 and the Safe Harbor and Fair Disclosure statement in yesterday's press release.

Plexus provides non-GAAP supplemental information such as ROIC, economic return and free cash flow because those measures are used for internal management goals and decision-making and because they provide additional insight into financial performance. In addition, management uses these and other non-GAAP measures such as adjusted net income and adjusted operating margin to provide a better understanding of core performance for purposes of period-to-period 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, www.plexus.com, 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 his summary comments before turning the call over to Steve and Pat for further detail. Let me now turn the call over to Todd Kelsey. Todd.



Todd Kelsey - Plexus Corp. - President & CEO

Thank you, Susan. Good morning, everyone. Please begin with our fiscal first-quarter results on slide 3. After the close of the market yesterday, we reported results for our fiscal first quarter of 2017. Revenue was \$635 million with GAAP diluted EPS of \$0.82. The EPS results included \$0.10 of stock-based compensation expense.

Our revenue was at the midpoint of our guidance range. Late in the fiscal first quarter, we fulfilled a broad-based pull-in of demand from customers within our Communications market sector that offset weaker-than-anticipated revenue from the Defense/Security/Aerospace market sector. A portion of the Communications pull-in will impact fiscal second-quarter revenue. Our GAAP EPS result was at the top end of our guidance range as we continued our solid operating performance throughout our regions.

Please advance to slide 4. In addition to the revenue and EPS results, our underlying performance in our fiscal first quarter leaves us optimistic for the balance of fiscal 2017. I will follow with a brief description of first-quarter highlights while Steve and Pat will provide further detail later in the call.

We achieved record operating profit of \$33.9 million based on operating margin of 5.3%, above our target range of 4.7% to 5%. The operating margin performance represents our best result since the second fiscal quarter of 2008. We finished with a cash cycle of 66 days, one day favorable to our guidance range. This was driven by strong accounts receivable performance.

The solid working capital performance in addition to the timing of near-term capital expenditures led to free cash flow of \$73 million, well above our guidance range. We delivered a return on invested capital of 17.3% resulting in an economic return of 680 basis points above our weighted average cost of capital. The latter is our best result since fiscal 2006 and exceeds our 500 basis point goal.

Our Xiamen, China facility fully recovered from Typhoon Meranti with all demand shift within the quarter and no customer disruptions. Our customer relationships at the site strengthened due to our proactive communications and aggressive recovery plans.

Our manufacturing wins momentum continues to accelerate as we achieved \$217 million of wins within the quarter. Our trailing four-quarter manufacturing wins now stand at \$785 million with a trailing four-quarter win ratio of 30%, well above our 25% goal. Our quarterly wins included significant business expansion with two of our top customers.

In addition to the strong wins performance, we slightly increased our funnel of qualified Manufacturing Solutions opportunities, which now stands above \$2.8 billion, a new record for us. We delivered solid Engineering Solutions wins positioning this high-margin group with a robust backlog as we progress through fiscal 2017.

Finally, in our recent customer Net Promoter survey, we achieved an 82% score, well above a manufacturing industry benchmark. This acknowledgment from our customers is evidence of our commitment to operational excellence and customer service excellence. As an example, we recently received Bombardier's Innovation Supplier award for efforts at our Oradea manufacturing facility. This accolade is in recognition of our superior execution and innovation.

Advancing to our fiscal second-quarter guidance on slide 5. In the fiscal second quarter of 2017, we anticipate strong operating performance with operating margin at the high end of our target range of 4.7% to 5%. This is despite the typical 40 basis point seasonal impact due to compensation cost increases and the reset of US payroll taxes.

We anticipate flat revenue in the quarter. Underlying revenue growth is expected to be offset by end-market weakness within the Communications market sector and an additional delay to the previously disclosed orders from a large Industrial/Commercial customer. As a result, we are guiding fiscal second-quarter 2017 revenue of \$620 million to \$650 million. We are guiding GAAP diluted EPS in the range of \$0.71 to \$0.79. This includes \$0.11 of stock-based compensation expense.



Please advance to slide 6 for a discussion of key initiatives for fiscal 2017. We have confidence in our outlook for the back half of fiscal 2017 based on our strengthening wins momentum, record funnel of qualified manufacturing opportunities and the progress of transitions of new business into our sites. We currently anticipate that we will achieve meaningful sequential revenue growth in the fiscal third and fourth quarters. Consequently, while the demand environment could certainly change over the course of the year, we remain optimistic that our goal of a \$3 billion annual run rate as we exit the fiscal year is attainable. Furthermore, we anticipate sustaining operating margins within or above our target range throughout fiscal 2017.

Our key initiatives for fiscal 2017 are focused on areas that align to sustained revenue growth. These include efficiently transitioning and ramping new programs, leveraging our strong Net Promoter scores to generate additional business, further accelerating our wins momentum, increasing the size of the funnel of qualified Manufacturing Solutions opportunities, delivering operational excellence by producing exceptional quality products on time at a fair price consistently across the globe, leveraging our One Plexus mindset and finally, providing customer service excellence to truly differentiate.

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

Steve Frisch - Plexus Corp. - EVP & COO

Thank you, Todd. Good morning. Please advance to slide 7 for insight into the performance of our market sectors during the fiscal first quarter, as well as our expectations for the sectors in the fiscal second quarter of 2017. Our Healthcare/Life Sciences sector was up 9% sequentially in the fiscal first quarter, which met our expectations of a high single digit increase. In addition to the full recovery of shipments that were delayed due to the typhoon in Xiamen, modest end-market strength and new program ramps fueled the growth.

Looking ahead to fiscal second quarter, we currently anticipate revenue in our Healthcare/Life Sciences sectors to be relatively flat as sequential growth is similar to the revenue that was generated in the first fiscal quarter as we recover from the typhoon in Xiamen. We expect to see meaningful sequential growth in the back half of 2017 due to several new program ramps that are in progress.

Our Industrial/Commercial sector was down 11% sequentially in the fiscal first quarter, below our expectations of a high single digit decline. A delay in orders from a large customer is impacting the sector. We currently anticipate that our Industrial/Commercial sector will be down in the mid-single digit percentage range in our fiscal second quarter due to a continued delay in orders with a large customer. We currently expect production to ramp in the fiscal third quarter with this customer.

Our Communications sector was up 3% sequentially in the fiscal first quarter, which was significantly above our expectations of a high single digit decline. Late quarter shipments to several customers drove the revenue above expectations. These end-of-calendar-year pull-ins and some end-market softness is impacting the fiscal second-quarter revenue. As a result, we now expect the fiscal second quarter to be down in the mid-single digits. However, we expect growth with an existing program, as well as new program ramps to support sequential growth in the back half of fiscal 2017.

Our Defense/Security/Aerospace sector was down 15% sequentially in the fiscal first quarter, a result that was below our expectations of a mid-single digit decline. Ten of our top 15 customers performed below expectations. The weaker results were a result of end-market softness in the security and defense subsectors and new program ramp delays in the aerospace subsector. We currently expect the fiscal second quarter to be up in the mid-teens mainly as a result of new program ramps.

Next to new business on slide 8. During the fiscal first quarter, we won 51 new programs in our Manufacturing Solutions group that we anticipate will generate \$217 million in annualized revenue when fully ramped in production. These wins represent the third consecutive quarter of a strong business wins result.

Wins with existing customers in our Americas regions were very good. Included in the Americas wins is a strategic Defense/Security/Aerospace microelectronics program that will be produced in our Boise, Idaho facility. Wins in our APAC region continued at a healthy level. Our EMEA team



generated a strong wins result in the fiscal first quarter. Included in the EMEA results is a key win with a new EMEA-based Industrial/Commercial customer.

Please advance to slide 9 for further insight into the wins performance of our market sectors. In the fiscal first quarter, our Manufacturing Solutions wins were balanced across all four sectors. Although the wins were mostly expansion with existing customers, Healthcare/Life Sciences, Industrial/Commercial and Defense/Security/Aerospace sectors each added a significant new customer. This wins performance continues to support our diversified portfolio strategy.

Now advancing to manufacturing wins momentum on slide 10. Our trailing four-quarter manufacturing wins as shown by the dark blue bars is at \$785 million. This performance results in a wins momentum of 30%, well above our target of 25%. Engineering Solutions also had a strong wins result. Wins of \$27 million in the fiscal first quarter continues to keep the backlog for Engineering Solutions healthy for fiscal 2017. In addition, Engineering Solutions wins impact the organization beyond just engineering revenue. Some of the program ramps that were mentioned are products that are being designed by our Engineering Solutions team.

Please advance to slide 11. Our customer teams have continued to develop new opportunities. Even with the strong wins performance, our manufacturing funnel of qualified opportunities reached a record \$2.8 billion. We are pleased that our focus on a differentiated business mix is supported by the continued funnel strength in our nontraditional market sectors.

Next, I would like to turn to operating performance on slide 12. Our revenue in the fiscal first quarter finished at the midpoint of our guidance range at \$635 million. As Todd highlighted, late quarter pull-ins from our customers in the Communications sector offset weakness in the Defense/Security/Aerospace sector. Even with the volatility, operational performance was outstanding. The Americas team was able to expedite product to meet our customers' requirements in the Communications sector while mitigating the impacts of lower demand in the Defense/Security/Aerospace sector. Our operations teams in the APAC sustained improvements they made in fiscal 2016. As a result, the 5.3% margin we reported yesterday exceeded our expectations for the fiscal first quarter. Looking at the fiscal second quarter of 2017, we expect this strong performance to continue resulting in operating margins in the range of 4.9% to 5.2%.

As Todd mentioned, we completed our Net Promoter survey score within the fiscal first quarter. Our score of 82% confirms that our focus on operational excellence and customer service excellence is being recognized by our customers. This high customer satisfaction rating, combined with the record funnel, the strong wins and the operational performance supports our goal of achieving a \$750 million quarterly revenue run rate at our operating margin range of 4.7% to 5% as we exit fiscal 2017.

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

Pat Jermain - Plexus Corp. - SVP & CFO

Thank you, Steve and good morning, everyone. Our fiscal first-quarter results are summarized on slide 13. As mentioned, revenue of \$635 million was at the midpoint of our guidance. Gross margin at 10.1% was above our guidance and 20 basis points above the fiscal fourth quarter. By continuing to deliver strong operational efficiencies and executing on supply chain productivity initiatives, we are able to overcome lower fixed cost absorption caused by the sequential revenue decline.

Selling and administrative expense of \$30.5 million was slightly above our expectations, primarily due to higher variable incentive compensation expense. For the first quarter, SG&A as a percentage of revenue was approximately 4.8%, up 10 basis points sequentially. Improved gross margin partially offset by a higher SG&A percentage resulted in an operating margin of 5.3%, exceeding our guidance range of 4.9% to 5.2%. Included in operating margin is approximately 60 basis points of stock-based compensation expense. GAAP diluted EPS of \$0.82 was at the top end of our guidance, no restructuring activities occurred during the quarter and we are not calling out any special items as non-GAAP.

Turning now to the balance sheet on slide 14. Return on invested capital was 17.3% for the fiscal first quarter, significantly above our fiscal 2017 weighted average cost of capital of 10.5% and the return we delivered in fiscal 2016 of 13.8%. Contributing to the higher return was a combination of the improved earnings and a reduction to our average invested capital.

During the quarter, we purchased approximately 145,000 of our shares for \$7.1 million at a weighted average price of \$48.79 per share. During the quarter, we also generated approximately \$80 million in cash from operations and spent \$7 million on capital expenditures delivering free cash flow of approximately \$73 million, a result well above our projection.

Our working capital initiatives drove our cash cycle down to 66 days, favorable to our expectations. The most significant contributor was a reduction in accounts receivables due to the sale of receivables under the recently-executed factoring program.

Please turn to slide 15 for details on our cash cycle. Overall, we delivered a sequential improvement of five days to our cash cycle, one day better than our guidance. Days in inventory were sequentially up three days. Inventory dollars were flat compared to the 3% reduction in revenue. Delayed orders already within purchasing leadtimes prevented an inventory reduction commensurate with the sequential revenue decline. Sequentially days in receivables were down nine days primarily due to the benefits from our receivables factoring program. Other contributing factors were the timing of customer shipments at quarter-end and the customer composition. Sequentially payable days were down one day while customer deposits were flat.

As Todd has already provided the revenue and EPS guidance for the fiscal second quarter, I will now turn to some additional details, which are summarized on slide 16. Fiscal second-quarter gross margin is expected to be in the range of 9.8% to 10.1%. The midpoint of this guidance suggests a sequential decline of 15 basis points primarily the result of seasonal compensation cost increases and the reset of payroll taxes for US employees.

For the fiscal second quarter, we expect SG&A expense in the range of \$30.5 million to \$31.5 million, slightly up sequentially due to the seasonal compensation headwinds, which are about \$1 million. At the midpoint of our revenue guidance, anticipated SG&A would be close to 4.9% of revenue. Fiscal second-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. The midpoint of this guidance suggests almost a 100 basis point improvement compared to the prior-year fiscal second quarter.

A few other notes. Depreciation expense for the fiscal second quarter is expected to be approximately \$12 million consistent with the fiscal first quarter. We estimate an effective tax rate of 9% to 11% for the fiscal second quarter and 8% to 10% for the full year. Even though we are guiding similar revenue and margin ranges as we did for the fiscal first quarter, our EPS guidance is slightly below the prior quarter. Contributing factors include the cost of the receivables factoring program, which is captured in miscellaneous expense and a higher outstanding share count from greater option dilution.

Our expectation for the balance sheet is flat working capital dollars while cash cycle days are expected to be in the range of 65 to 69 days for the fiscal second quarter. We expect free cash flow in the range of \$0 to \$20 million for the fiscal second quarter and to be above \$100 million for fiscal 2017. Some of the cash flow improvement we saw in the fiscal first quarter related to the timing of payments and represented a shift from Q2 cash flows to Q1, therefore not impacting our annual expectations. 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, Paulette, I will now open the call for questions. We ask that you please limit yourself to one question and one follow-up. Paulette.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Matt Sheerin, Stifel.

Matt Sheerin - Stifel Nicolaus - Analyst

Thanks and good morning, everyone. First question regarding your revenue guidance for the fiscal year ending at a run rate of \$3 billion. It sounds like you are looking at a linear step-up in each of the last two quarters, Q3 and Q4. So are you looking for a similar double-digit ramp in each quarter,



or will it be more back-end-loaded? Just within that, are you expecting to see growth across your sectors? It sounds like, from your backlog chart, that it's coming from across the business.

Todd Kelsey - Plexus Corp. - President & CEO

Thanks, Matt. I will take this question. With respect to -- first of all, the fourth quarter -- again, I need to be careful; we didn't guide the fourth quarter. We are talking about a goal here because there's certainly -- it's a long ways out yet and there's certainly many external factors that can come into play. But if we look at how the trend would look across the quarters, one of the things to keep in mind, I talked about two situations that are impacting Q2 revenue in a negative way and the magnitude of those two issues is pretty significant, on the order of \$30 million plus.

So if you -- factoring that in, which, of course, you can't do, but if you did factor it in, we'd be showing some pretty substantial sequential growth within Q2 and I think you can think of it as being similar type jumps in Q3 and Q4 and that's the way we are looking at it.

But if we look at the course of the fiscal year and how we progress in the goal of \$3 billion, we first started to talk about that in the June timeframe and basically everything that has occurred between now and June has stayed consistent with that goal. So we are seeing wins that needed to come in, came in; programs that need to ramp are transitioning; forecasts that needed to stay stable are staying stable. So the attainability of that goal, our confidence continues to increase in it. So while we are certainly not guiding it, all indications and everything we see internally are that it's a very achievable goal and we are very focused on making that occur during the course of the fiscal year.

With respect to the sectors, I think I will turn it over to Steve and he can provide some color around the sectors for the year.

Steve Frisch - Plexus Corp. - EVP & COO

Yes. Three of the sectors for sure are contributing to the growth in 2017 in a very healthy way. Healthcare/Life Sciences, as you look back over time, have had some significant wins. Those wins are generating those program ramps that Todd talked about that is driving growth. We were a little bit more bullish on the Communications sector in the beginning of the year. This end-market softness, a little bit here we have seen in Q2, a little bit of broadband will make the numbers a little bit more challenging in terms of the growth for the year. However, the programs that are basically going through their transitions now, as Todd mentioned, we expect those to continue. There is no really slowdown in those. So it is across the three sectors with Communications being a little bit lighter than what we anticipated when we started the year.

Matt Sheerin - Stifel Nicolaus - Analyst

Okay. Thank you very much. Just quickly a follow-up regarding the margins and you also said that you expect to be within that margin range for the rest of the year, your target of 4.7% to 5%. You've been trending at the high end and given the ramps and cost of ramping new programs, etc., are you expecting to go in the mid to low end before you start to go back up again?

Todd Kelsey - Plexus Corp. - President & CEO

Matt, I'm going to start with this and then pass it over to Pat for more color on this, but, as we look at the margins and we think about margins going forward, we've talked for a long time about the 4.7% to 5%. We've exceeded it a couple of quarters in a row and expect to again be right around that range as we look at Q2. So I think it's reasonable to think that there are going to be quarters that we are going to get above the margin range, but our bias is really towards investing to accelerate growth. So I think as you see the growth start to accelerate and more programs transition in, you could see that transition down a bit.



Pat Jermain - *Plexus Corp. - SVP & CFO*

Yes, and I would add to that, Matt, that if more of the growth, which we expect to come from new business wins versus end-market growth, that's going to require more transition costs and ramping time to get that revenue in here as opposed to just simply end-market growth. We've been really pleased with the margin performance when you look back the last couple quarters and our guide for this second quarter where we are absorbing the seasonal compensation costs. We are pleased; we've seen really good labor productivity out of APAC. We have seen some benefit from the strengthening US dollar that's benefited some of our sites. Our supply chain productivity has been strong. We are getting ahead of price reductions, but we do have downward pressure from inflation, customers' expectations around price reductions and if there would be a weakening dollar, that could impact some of our sites as well.

Matt Sheerin - *Stifel Nicolaus - Analyst*

Got it. Thanks very much.

Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - *Longbow Research - Analyst*

Have you had any discussions with customers or have they brought it up in terms of just thinking about their manufacturing footprint because we are entering into a world of unknown here very soon? And so just rethinking maybe, for lack of a better phrase, onshoring back into the US knowing that you've invested a lot in Mexico recently or just around the world? Just any conversations customers have had with you on that topic.

Todd Kelsey - *Plexus Corp. - President & CEO*

Sure. So with respect to really changes and I think everybody is looking at are there going to be changes in trade or trade policy and we are certainly keeping a close eye on those developments. But, at this point, anything is really speculative and I think our customers are largely taking a similar approach. So a lot of it is a bit of a pause and a wait and see and I would say that we are not seeing a big push to move business that's already at our facilities elsewhere in the world to the US and to be honest that doesn't surprise me. I think the economics of making a move like that are likely to not make sense because the business is already there and functioning.

One of the things that we are starting to see though, or a couple of trends that we are starting to see is I would say a pause of any business that may be maturing that would potentially go to other regions. Our customers are pausing on that from more of a wait-and-see approach and we are starting to see some anecdotal evidence of more new program ramps in the US. So I think it's too early to call it a trend yet, but there is some evidence that there could be more new program ramps and more manufacturing in the US.

Now, as we look at our footprint, I think we are in a good position to capitalize regardless because our US footprint is very strong. We've got great capabilities and a lot of available capacity, so we are executing around \$1 billion in US right now. We have capacity to easily get another 70% or so on top of that. We also have good capacity in the other regions. The one area where we don't have great capacity that we've talked about in the past is Mexico and part of it is because our square footage is significantly smaller than other regions, so it's filling up faster. But, at this point, we are just taking a wait-and-see approach on what we do within that region. But overall our footprint can support us to about the \$3.5 billion range is what we believe, so we think we are positioned well regardless of how the dynamics of trade progress over the course of the next couple of years.



Shawn Harrison - *Longbow Research - Analyst*

That's very helpful. And then if I may follow up just on the industrial program that's lagging the ramp schedule. Without giving I guess -- or whatever you can give away on that program, is it something about market acceptance? Is it the design of the program? Is there something else that gives you confidence that it will ramp in the back half of the year versus seeing another push-out?

Steve Frisch - *Plexus Corp. - EVP & COO*

I will take out one. The program is a little unique in that the opportunity is really for internal consumption and so our insight into the need and the forecast is pretty solid in terms of what the need is. It's really just more of the timing of when it's actually going to get executed. And so I'm not really going to get into what's causing the delay, but the visibility into the need is pretty clear. We are just working with the customer through what their ramp schedule looks like.

Shawn Harrison - *Longbow Research - Analyst*

Okay. That's helpful, Steve. Thank you.

Operator

Sherri Scribner, Deutsche Bank.

Sherri Scribner - *Deutsche Bank - Analyst*

Thanks. I just wanted to follow up a little bit on what gives you the confidence that you guys can see the growth of -- or get to a run rate of \$3 billion by the end of the year. Is it primarily driven by the new wins and the funnel of business that you have, or is there some underlying market growth that you think will help you?

Todd Kelsey - *Plexus Corp. - President & CEO*

Yes, with respect to the \$3 billion, again, it's primarily new wins. So we have a number of programs that we won over the course of fiscal 2016 and into fiscal 2017 that are ramping as we speak, so these are programs that are underway; they are ramping; we have transitioned them in and they just need to continue the ramp.

Now from an end-market standpoint, we are seeing some modest strengthening in a few different places, but I would say it's not really exceptional. In Healthcare, we are seeing some modest strengthening. In Industrial/Commercial, we are certainly seeing some solid strengthening in semi-conductor capital equipment, but the rest of the sector is not really doing much right now.

Steve Frisch - *Plexus Corp. - EVP & COO*

I will just add on to what Todd said. I think it's important to understand in these nontraditional sectors like Healthcare/Life Sciences or Defense/Security/Aerospace, the amount of qualifications that you have to go through, whether with first-article inspections or getting lines validated for FDA builds, they take a fair amount of time. So those things are occurring now, so we've got pretty good visibility where these ramps are at. So it is not something that is just going to come and go, it's something that has been building over the course of the year here and it has been driven by the wins from the historical past year that have been pretty strong.



Sherri Scribner - Deutsche Bank - Analyst

Okay. Great. And then, Pat, if I look at the CapEx guidance for the year, \$50 million to \$60 million, you guys just did \$7 million in the first quarter, how should we think about that ramping because it suggests a pretty big acceleration in CapEx spending and what is that CapEx spending for in the second half? Thanks.

Pat Jermain - Plexus Corp. - SVP & CFO

Yes. What I would say, Sherri, is that we did see some delay in spending in Q1 that's going to push into Q2. So right now, our fiscal Q2 is looking like a pretty strong CapEx quarter for us and the way I would model it is pretty much the remaining spend to get to \$50 million to \$60 million. I would spread that evenly over the next three quarters to support that back-end revenue growth.

Sherri Scribner - Deutsche Bank - Analyst

And what is that supporting?

Pat Jermain - Plexus Corp. - SVP & CFO

Well, all the new business wins. We've got new lines going in. There is no footprint expansion, but it's primarily lines to support the new growth and some refresh of older equipment in our sites.

Sherri Scribner - Deutsche Bank - Analyst

Thank you.

Pat Jermain - Plexus Corp. - SVP & CFO

Yes, it's spread pretty evenly among the regions as well.

Sherri Scribner - Deutsche Bank - Analyst

Perfect. Thank you.

Operator

Herve Francois, B. Riley.

Herve Francois - B. Riley - Analyst

Yes, that's a mouthful. Thanks very much. Good morning, guys. I'm used to it. So just a little clarification on the networking business. Can you give any clarification if that was one customer or several customers that asked for business to be pulled into your fiscal first quarter that allowed that segment revenues to be a little better than expected? And then if you can give explanation with that, coupled with the fact that you are talking about some softness that you guys are seeing in the networking business, which has been highlighted out there, but I don't know if the customers were seeing some softness and so the customer specifically asked for that business to be pulled in in your fiscal first quarter?



Todd Kelsey - Plexus Corp. - President & CEO

Yes, so with respect to pull-ins in the fiscal first quarter, we saw it from several customers, a number of customers and in large part, with maybe an exception of a major customer of ours, it appeared to be situations where they were call them year-end budget flushes maybe going on with their customers where they were seeing upsized demand as a result of it being year-end, so product that they may have sold in future quarters, or I should say in what would be our Q2 or calendar Q1, was going out in Q4. So that had an impact obviously on our Q1 as well as on our Q2. So that was really the major issue that occurred, but I would say it happened with several of our customers, so it was more than a limited situation here.

Steve Frisch - Plexus Corp. - EVP & COO

And in terms of the end-market softness, really the comment comes from the fact that we don't really see the forecast filling back in in Q2; hence a bit of a decline. So that pull-in seems to be an end-of-the-year thing, but doesn't seem to be any strength supporting the buildup for the forecast in Q2 for those customers. Now with that said, our optimism still lies in the fact that some of the programs we've talked about in the past and the programs that are ramping and transitioning, those remain on schedule here as we go into the back half of 2017.

Herve Francois - B. Riley - Analyst

Got it. I think as you said in your opening remarks, or even in your slide presentation, that you are seeing, I guess, increased demand from a couple of your strong customers within that specific end market. Is that correct?

Steve Frisch - Plexus Corp. - EVP & COO

I don't know that I would say -- our customers have given us a forecast for 2017 that they have anticipations of new program ramps and new products coming in and that forecast is still holding to what we felt we had here at the beginning of the year. So overall in terms of some of these program ramps and these new programs that are coming in, they are relatively in line with what we've thought. The short-term weakness here that we talk about is really just the fact that we didn't really see a fill-in on some of these Q2 things -- the pull-ins from Q2 into Q1, we didn't really see those fill back in here in Q2 saying there was any kind of broad strength that was really going to help the market. Again, it appeared to be just pull-ins from Q2 into Q1, but it's not impacting our forecast for our ramps as we go through the year here.

Herve Francois - B. Riley - Analyst

Got it, got it. Just lastly in regards within your Industrial/Commercial, the weakness there, you did talk about strength that I think a lot of folks are seeing in regards from the semicon equipment customers. Can you pinpoint a little bit more where is the weakness -- a little bit more specific where is the weakness within the Industrial/Commercial? What kind of segments within there are seeing the weakness and the softness?

Steve Frisch - Plexus Corp. - EVP & COO

We are seeing strengthening in the forecasts quarter to quarter and through the year here with the semiconductor across several of our customers, so we see that as well. We do not see any recovery in oil and gas markets yet. Retail is relatively flat for us as well. This delay is, as Todd talked about, a pretty substantial number. That delay is masking some of the growth that were underlying -- seeing in some of the semiconductor business, so that's really what's causing you to not really see that growth from us in the semiconductor space.

Herve Francois - B. Riley - Analyst

Got it. Is it fair to say that, with the CapEx spend that you are doing over the next couple of quarters, that that is I guess a lot will not be targeted towards those particular areas until you see some light, so to speak, at the end of the tunnel from your oil and gas customers?



Steve Frisch - Plexus Corp. - EVP & COO

Yes, the CapEx investments that Pat talked about are new equipment, new manufacturing lines associated with some of these ramps that we've talked about. The thing to keep in mind, the time from order until the time that they get put in service and hit our capital expenditures are also a little bit delayed. So some of this money is being spent today, or some of the orders are being placed today by us to support these ramps that will hit our CapEx forecast in future quarters. So we are investing today for the ramps that we are talking about.

Herve Francois - B. Riley - Analyst

All right. Thanks very much. Appreciate it, guys.

Operator

Steven Fox, Cross Research.

Steven Fox - Cross Research - Analyst

Good morning. A couple questions. First of all, you laid out a lot of the puts and takes on the operating margin change quarter over quarter. I was wondering if you could just be a little more specific though in terms of the 20 basis point improvement this quarter and then it looks like let's call it a 20 to 30 basis point decline next quarter. What are the specific drivers to get you to each of those numbers? Thanks.

Pat Jermain - Plexus Corp. - SVP & CFO

So, are you saying, Steve, the 20 basis points from Q4 to Q1?

Steven Fox - Cross Research - Analyst

Yes, Q4 to Q1 and then the Q1 to Q2 guidance.

Pat Jermain - Plexus Corp. - SVP & CFO

Yes. So, specifically, I will give you one example. Management of our fixed manufacturing expenses, revenue was down, as you know, 3% from Q4 to Q1. Fixed manufacturing expense was down 5% and that's just really good productivity in our sites getting after labor improvements, lean activities. So that was a major improvement for us. Supply chain performance also continued to improve compared to the fourth quarter. And as I mentioned, labor productivity in APAC was a contributing factor to that 20 basis point improvement.

Also, I would say we've had this mentality of very focused controlling discretionary spending and we've continued to do that especially in noncustomer-facing areas. So we saw that again in the fiscal first quarter. As we move into the fiscal second quarter, the biggest driver behind coming down in our margin guidance is the seasonal costs. I would say we are continuing with all of the improvements we saw from Q4 to Q1 maybe with the exception of some of the discretionary spending. We want to make sure we are investing for the future ramps that are coming in Q3 and Q4. So we are really sensitive about making sure we've got the right team in place. So we are seeing a bit more spending in that area along with the seasonal compensation costs is the real delta between Q1 and Q2.



Todd Kelsey - Plexus Corp. - President & CEO

Yes, I'd like to just add a little bit there too with respect to Q2, Pat, because I think one of the things if you think back to previous calls, we had talked about challenges potentially even making it into our range in Q2 because of the seasonal costs that are there. So we thought there was potential we could be under this 4.7% range and we are now guiding the high end of our range to above our range with the 40 basis point hit from the seasonal costs. So I view that as really strong performance and I am proud of our team for the efforts they put forth to get there.

Steven Fox - Cross Research - Analyst

So if I understand all that, just to make sure I'm clear, if you look at your core margin, it sounds like it's holding in pretty flattish and then the difference between where you are now and maybe in the second half is more discretionary spending around new program ramps?

Pat Jermain - Plexus Corp. - SVP & CFO

Yes. And I wouldn't necessarily even call that discretionary. It's required to support the investments for the revenue ramp. But like I said, in the past couple quarters, discretionary spending has been pulled back. We will see a little of that lift just because we have been really tight on travel costs and some headcount adds and so we are going to have to add some costs there, but I think the larger cost is around supporting the program ramps.

Steven Fox - Cross Research - Analyst

Got it. And then just lastly on the receivables program. So when you talk about a \$100 million free cash flow, is that excluding the receivables you just sold or is that including?

Pat Jermain - Plexus Corp. - SVP & CFO

That's including the benefit of selling those receivables.

Steven Fox - Cross Research - Analyst

Okay. And did you give the exact amount of the receivables sold in the quarter?

Pat Jermain - Plexus Corp. - SVP & CFO

No, I didn't. It was \$70 million in Q1 that we sold.

Steven Fox - Cross Research - Analyst

Got it. All right. Thank you very much.

Operator

Sean Hannan, Needham & Co.

Sean Hannan - *Needham & Co. - Analyst*

Thanks for taking my questions, folks. Just going back to Communications. Now, if I remember correctly, in terms of submarkets, most of your exposure is related to video content. Is that really the specific area where we saw these pull-ins?

Steve Frisch - *Plexus Corp. - EVP & COO*

No. It was really kind of broad-based across -- so Communications -- well, back up a second. So within the sector of Communications, we've talked about the fact, and that's why we rebranded Communications to be just Communications -- the customers within the Communications space are anything from video content to basic data creation in those areas, so it is quite broad. The pull-ins that we saw were across five to six customers and video was one of those areas, but it was in other areas as well. So it wasn't just specific to that.

Sean Hannan - *Needham & Co. - Analyst*

Okay. So that would include your largest customer within that segment, I would suspect, but some of the reason for these other guys would be year-end budget flushes, not necessarily as much the case with that large customer though, it's just some general softness.

Todd Kelsey - *Plexus Corp. - President & CEO*

No, I think what we are saying -- if we looked at the customers that are impacting Q2, even though networking is a really small chunk of that sector, it's predominantly that that's impacting Q2, predominantly.

Sean Hannan - *Needham & Co. - Analyst*

Okay, all right. That's helpful. So then if I were to back up and think about the aggregate for fiscal 2017, Communications would be [robbed] from Q2. We have some positive in Q1 due to the pull-ins. The expectation for the year now at this point, one didn't necessarily equate in neutralizing the other because that softness is still there a little bit, so the expectations for the year are perhaps a little bit more muted than what you previously had. But if I were to again think about the aggregate, it feels like the bigger impact right now would be more in terms of the continued push on the industrial side because that is a big number; that is a push and that is not necessarily a displacement or pull-in. So can you help me to frame the context of those scenarios and how it wraps up to the aggregate 2017 outlook?

Todd Kelsey - *Plexus Corp. - President & CEO*

That I/C event that we've talked about is by far the most significant event, much more so than the Q1 pull-ins.

Sean Hannan - *Needham & Co. - Analyst*

Okay. Okay, all right. That's actually very helpful. But it is still -- in terms of the size of the program, we don't have any tempered expectations in terms of what ultimately should materialize, etc.?

Todd Kelsey - *Plexus Corp. - President & CEO*

No, they are basically firm orders. It's just a timing issue.



Sean Hannan - *Needham & Co. - Analyst*

Okay. Great. All right, all right. Great. Thanks so much for taking my questions.

Operator

Jim Suva, Citi.

Jim Suva - *Citi - Analyst*

Thank you very much. You mentioned some softness in Security and Defense. Typically, one thinks of those as very long leadtime. Can you help us understand about why there would be softness or why the visibility wasn't there? Was it like year-end fiscal or political headwinds, or how should we think about the uncertainty in those markets? Thank you.

Steve Frisch - *Plexus Corp. - EVP & COO*

I will touch on those. On the Security one, it's a little bit of a unique situation that we have. We have a larger customer in that market space that I would say changed their marketing strategy a little bit and their forecast declined unexpectedly. Quite frankly, I think they made a bit of a mistake with what they are doing, so that was a surprise to us -- a surprise to them and a surprise to us as well. So I wouldn't say that that is a broad-based issue. It's probably more of just a customer-specific issue.

On the Defense side, Defense is a smaller component of the Defense/Security/Aerospace sector for us. It's in the 15% to 16% range. I think there is optimism that Defense spending is going to increase. We haven't necessarily seen that, and the impact for us was really more associated with some new program ramps and basically engineering changes that happened as well that delayed some of the products. So I wouldn't necessarily say it's end market yet in terms of either one of those; it's really more customer and situational-specific for us in the customers that we have in that space.

Jim Suva - *Citi - Analyst*

Okay. And then my last question is, on the \$3 billion run rate, is that a pretty solid number or is there something that drains out of the bottom like some customers or programs that are winding down or transitioning away that you are considering that we should be aware of, or is that \$3 billion the net number and a pretty good run rate?

Pat Jermain - *Plexus Corp. - SVP & CFO*

Again, it's a long ways out, so I want to be really cautious about calling anything that's two quarters out solid because it's a long ways and a lot of things can happen between now and then from a macro standpoint, but basically our confidence around that has all the positive things that we are doing baked in it. It also has anything that is detrimental is all baked in as well too. So we are looking at it from a holistic perspective of which customers are maybe potentially struggling and going down in revenue and which ones are we accelerating and which new programs are ramping. So we are looking at it from a very holistic perspective. We feel about as confident as you can in it given it's two quarters from now yet, but we know a lot of things could change within the macro environment between then and now that could impact revenue. So we want to be cautious to not make it a guide, but also yet communicate that we see some really, really solid growth coming ahead.



Todd Kelsey - Plexus Corp. - President & CEO

And, Jim, I would add we don't see any programs that are coming end of life that are going to impact us. But, as you may recall, last year, we had disengaged with some programs that we did see a headwind in Q1 and Q2 of this year, but that tails off and that impact is not necessarily very significant in our Q3 or Q4 numbers.

Jim Suva - Citi - Analyst

Thank you so much for the details.

Operator

Mitch Steves, RBC Capital Markets.

Mitch Steves - RBC Capital Markets - Analyst

Thanks, guys. Just one question on the pull-in and the push-out. So you guys mentioned \$30 million was the total number roughly. Do you mind just giving us maybe the rough breakdown of what that was between Communications and the Industrial side because, based on the commentary, you're saying it's probably more on the Industrial side. Does that mean like two-thirds of it roughly was the \$30 million, or how do I think about that?

Pat Jermain - Plexus Corp. - SVP & CFO

Yes, we don't want to give any exact numbers on that, but I think it's reasonable to (inaudible).

Mitch Steves - RBC Capital Markets - Analyst

Okay. And then, secondly, I noticed that in the recent filings you guys had that Micron is a 10% customer. Maybe you guys can't give us exactly what they are doing, but maybe you can at least shine some light on what you guys are creating for Micron at this point.

Steve Frisch - Plexus Corp. - EVP & COO

Yes, I think you hit on it. We really don't get into specifics in terms of details of what we are creating for a specific customer. In the case of Micron, we are more focused on their internal consumption than their external products is probably as far as I will go with that.

Mitch Steves - RBC Capital Markets - Analyst

Okay. Got it. Thank you very much.

Operator

Sean Hannan, Needham & Co.



Sean Hannan - *Needham & Co. - Analyst*

Yes, thanks very much for taking a follow-up here. Just in terms of your wins, so it seems like this is an accelerating scenario. We are seeing the numbers ticking up. You called this out during your comments. Is there something -- other than the very strong Plexus value proposition, is there something thematically that you can call out within -- whether it's from a macro standpoint or the markets that you are serving that is providing perhaps fertile ground for the ability to accomplish this, or do you feel that you are very uniquely out hustling other EMS providers?

Todd Kelsey - *Plexus Corp. - President & CEO*

Sean, I think there's a lot of factors that are going into this, but one of them that I don't think should be overlooked is the performance we are having for our customers. I talked about our Net Promoter survey scores and I highlighted that our sites are performing really well for our customers. And when you do that, it makes it a lot easier to win business and that's one of the big things that's going on, but then I'm going to let Steve maybe expound a little bit on what's happening within our go-to-market teams as well.

Steve Frisch - *Plexus Corp. - EVP & COO*

I think Todd hit a really key point there and I mentioned this in my comments about the fact that a majority of the wins were with existing customers. In fact, 42 out of those 51 wins that we highlighted were with existing customers. We've added some new key customers. The reality is our execution with current customers is driving some of that growth and so that's helping us in a couple of areas. One is with the relatively flat economy and some of the growth challenges some of the customers have had, they are also looking for, like Plexus, for ways to optimize and be more cost-efficient and they have been consolidating their supply base. We've been very beneficial in growing our marketshare with the customers that we have, especially like in the Healthcare/Life Sciences, Defense/Security/Aerospace sectors.

In these areas, we are benefiting significantly from customers that are looking to basically consolidate a bit and so that's driving some of the growth, but I think it is the value proposition and our focus in these areas. It's a pretty compelling story for customers and it's fueling growth with existing as well as being able -- us to add a few new logos.

Sean Hannan - *Needham & Co. - Analyst*

Great. Thanks so much for the feedback.

Operator

Mitch Steves, RBC Capital Markets.

Mitch Steves - *RBC Capital Markets - Analyst*

Thanks for letting me jump in again real quick. I just had one on the border adjusted tax potential. Can you maybe provide any context what type of capacity you guys have in the US versus abroad just so we have an idea if there is a border adjusted tax what type of capacity you guys could take on domestically?

Pat Jermain - *Plexus Corp. - SVP & CFO*

Yes, we have a lot of available capacity in the US and it's really high-quality facilities as well too, so if we needed to ramp up business in the US, we feel good. Probably could take on easily without even being crowded another \$600 million of business in the US in the existing square footage that we have. But we also have pretty good available square footage across our other regions as well, so we feel pretty good about our ability regardless of the way the environment proceeds -- that we feel pretty good about our capacity and our ability to be able to service our customers.

Mitch Steves - RBC Capital Markets - Analyst

Got it. So essentially if there is a tax raise, do you guys think that you will be more aggressive in terms of trying to win business domestically, or do you think that it will be more of you being forced to shift production of a lot of these products that are being done abroad into that \$600 million capacity?

Pat Jermain - Plexus Corp. - SVP & CFO

I don't think it will change our approach. We are always aggressive and trying to win business into the US, as well as elsewhere.

Mitch Steves - RBC Capital Markets - Analyst

Got it. Okay, thank you.

Operator

And I'm showing no further questions. I will now turn the call back over to Todd Kelsey for closing comments.

Todd Kelsey - Plexus Corp. - President & CEO

All right, thank you, Paulette. First of all, what I would like to do is just thank all the people that are listening in and attended our call today. We appreciate you taking the time. Also to our employees that are listening in, want to thank you for your strong performance. I think you are positioning us really well as we go forward. And then finally to all the analysts, we appreciate your questions and we appreciate that you are out there covering us. So thank you very much. We look forward to talking to you again.

Operator

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

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