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PLXS - Q1 2015 Plexus Corp Earnings Call

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OVERVIEW:

Co. reported 1Q15 revenues of \$665m and diluted EPS of \$0.67. Expects 2Q15 revenues to be \$630-660m and diluted EPS to be \$0.64-0.72.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Plexus Corp. conference call regarding its fiscal first-quarter 2015 earnings announcement. My name is Vivian and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. After a brief discussion by management we will open the conference call for questions. The conference call is scheduled to last approximately one hour. I would now like to turn the call over to Mr. Angelo Ninivaggi, Plexus' Senior Vice President, Chief Administrative Officer and General Counsel. Angelo?

Angelo Ninivaggi - *Plexus Corp. - SVP, CAO, General Counsel & Secretary*

Thank you, Vivian. Good morning and thank all of you for joining us today. Before we begin I should remind everyone that statements made during our call today and information included in the supporting material that is not historical in nature, such as statements in the future tense and statements that include believe, expect, can, plan, anticipate and similar terms are 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 earnings or margin excluding special items, as well as return on invested capital, economic return and free cash flow. We present information excluding special items because it provides a better indication of core performance for purposes of period-to-period comparisons.

Economic return, return on invested capital and free cash flow are used for internal management assessments because they provide additional insight into financial performance. In addition, we provide non-GAAP measures because we believe they offer insight into the metrics that are driving management's decisions as well as management's performance under the test that it sets for itself. 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 by clicking 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; and Pat Jermain, Vice President and Chief Financial Officer. Let me now turn the call over to Dean Foate. Dean?

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

Thank you, Angelo, and good morning, everyone. If we could please advance to slide 3. Yesterday after the close of the market we reported results for our fiscal first quarter of 2015. Revenues were \$665 million, relatively flat with the prior quarter, and up about 25% from the comparable quarter last year. First-quarter non-GAAP diluted EPS of \$0.72 was above the midpoint of our guidance range.

Please advance to slide 4 for a few comments regarding the fiscal first quarter. Our fiscal first-quarter revenue was above our guidance range due to better than anticipated end market demand in our network communications sector. Much of the upside was in emerging markets. Our go-to-market teams delivered \$190 million of manufacturing solutions wins above our target of \$160 million. The results were nicely balanced across our sectors. Our engineering solutions group experienced another solid quarter of project wins with the result at \$26 million.

As Pat will discuss in a few minutes, our margin performance was in line with expectations this quarter, but we had disappointing working capital results. Operating margin was 4.6%, consistent with our guidance as we invested in program transitions and the accelerated ramp at our new facility in Guadalajara, Mexico.

Our cash cycle degraded to 72 days. While inventory was consistent with guidance we had disappointing forecasting and management of receivables and payables resulting in significant cash use during the quarter. Return on invested capital was 14.4% resulting in an economic return of 340 basis points that was below our expectations.

Concluding with a few positive notes, we completed the exit of our facility in Juarez, Mexico successfully transitioning to customer programs to our new facility in Guadalajara, Mexico. Our strategy to position our new facility in Neenah, Wisconsin as an aerospace center of excellence is successfully unfolding. We continue to develop capabilities and competencies unique to this industry segment while improving our overall productivity and execution.

After the disappointing loss of the largest customer a couple of years ago it is rewarding to see our employment levels rise over the past two years here in our home state of Wisconsin. And finally, during the quarter we announced that Joann Eisenhart was nominated to join the Plexus Board of Directors. We look forward to Jo's deep insight and leadership as we further develop and execute our vitally important human capital strategies.

Advancing out to our guidance on slide 5. We are establishing fiscal second-quarter 2015 revenue guidance of \$630 million to \$660 million suggesting a 3% sequential decline at the midpoint of the range. At that level of revenue we anticipate diluted EPS of \$0.64 to \$0.72 including approximately \$0.10 per share of stock-based compensation expense, but excluding any unanticipated special items.

The anticipated revenue decline reflects the expectation that our network and communication sector will return to more normalized levels after a seasonally strong first quarter that exceeded our expectations. Our EPS guidance reflects near-term flat margin performance as our ongoing

operational improvements are masked by seasonal compensation cost increases and the one-quarter delay of additional programs transitioning into our facility in Guadalajara, Mexico.

With that I will now turn the call over to Todd for some further comments about our market sectors and operating performance. Todd?

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

Thank you, Dean. Good morning. Please advance to slide 6 for insight into the performance of our market sectors during our fiscal Q1 of 2015 as well as our current expectations for the second quarter of fiscal 2015. Our networking/communication sector was flat sequentially in fiscal Q1, which considerably exceeded our expectations of a decline in the high-single-digit percentage point range.

One of our top customers significantly exceeded expectations while several other customers also strengthened in order to fulfill calendar year-end demand. We expect our networking/communication sector to contract in the mid-teens percentage point range in fiscal Q2 as 9 of our top 10 customers are anticipated to be down quarter over quarter. This softening is consistent with our earlier expectations for the sector and represents a more normalized revenue level. Despite the near-term contraction we expect year-over-year growth within our networking/communication sector in fiscal 2015.

Our healthcare/life sciences sector was up 4% sequentially in Q1, in line with our expectations. We benefited from the traditional seasonal strength of one of our top customers and the ramp of new programs with another major customer.

Looking ahead to fiscal Q2, we currently anticipate revenue in our healthcare/life sciences sector to be down in the mid-single-digits as we experience the typical seasonal softness of our second fiscal quarter.

Interestingly, 11 of our top 15 customers in the sector improved their forecast for Q2 from previous expectations, continuing a near-term upward trend that we have observed for the past several quarters. We expect to return to growth in the sector as we move through fiscal 2015.

Our industrial/commercial sector was down 1% sequentially in our fiscal Q1, in line with our expectations. One of our top customers softened considerably in the quarter which was offset by the strengthening from two key customers.

We currently anticipate that our industrial/commercial sector will be up in the mid-single-digits in our fiscal Q2 primarily as a result of new program ramps. We expect strong sequential growth within our industrial/commercial sector each quarter throughout the remainder of FY15.

Our defense, security and aerospace sector was down 6% sequentially in Q1, a result that was in line with our expectations. We currently expect Q2 to be up in the mid-teens percentage point range as 6 of our top 10 customers show strong quarter-over-quarter growth. And we continue to benefit from new program ramps. We expect a strong growth year within the sector and longer-term forecasts remain relatively stable.

Next to new business wins on slide 7. During the quarter we won 32 programs in our Manufacturing Solutions group that we anticipate will generate approximately \$190 million in annualized revenue when fully ramped in production. From an absolute standpoint our wins were dominated by our APAC region, although we had a very good wins quarter in the EMEA region relative to current quarterly regional revenue.

The wins total for Q1 does not include a major industrial/commercial when impacting the America's region that was awarded in early January. This program will begin to ramp in late fiscal Q2. On a sector basis our Manufacturing Solutions wins showed good balance, but were particularly strong in industrial/commercial and healthcare/life sciences sectors. Our industrial/commercial wins were highlighted by the addition of two meaningful new customers with strong growth potential.

In addition, we had an excellent quarter in Engineering Solutions with new project wins totaling approximately \$26 million, nearing a record level. Our engineering wins continued to be strong in our healthcare/life sciences sector where we clearly differentiated in the marketplace and increased markedly in our industrial/commercial and defense/security/aerospace sectors.



Now advancing to wins momentum on slide 8. Our manufacturing wins trend remains strong and our trailing four-quarter performance, as shown by the blue bars, is at \$801 million resulting in a trailing four quarter win ratio of 32% relative to trailing four-quarter revenue. This is well above our target of 25%. Our funnel of new business opportunities remain steady at \$2.2 billion. The funnel remains at a four-quarter high and we view it as quite healthy.

Next I would like to turn to operating performance on slide 9. In fiscal Q1 of 2015 our revenue exceeded earlier expectations and was near the record level achieved in Q4 of fiscal 2014, providing further evidence of the success of our go-to-market strategy and our focus on customer service excellence.

Operating margin finished in line with expectations at 4.6% as we invested in the startup of our new Guadalajara site and our aerospace and defense Center of Excellence in Neenah, which offset some of the progress made through our ongoing operational improvement initiatives.

Please advance to slide 10 for additional insight into our recent operating margin performance and our future expectations. This is the same slide shown last quarter to clarify operating margin performance anticipated in Q1. It continues to remain relevant for Q2 and the rest of fiscal 2015.

As shown in the chart, our operating margin goal remains 5%, although we consider performance from 4.7% to 5% to be a healthy range. Our 4.8% operating margin performance in Q4 of fiscal 2014 included a roughly 25 basis point drag as a result of the Juarez closure coupled with the Guadalajara ramp of the Juarez business.

Our 4.6% operating margin performance in Q1 included an additional 15 basis point drag as a result of our accelerated Guadalajara ramp and another 10 basis point drag due to the aerospace and defense Center of Excellence ramp resulted in Q1 operating margin performance in line with expectations. As these sites ramp revenue or new customers at a much faster rate than anticipated, we are committed to maintaining operational excellence and properly investing ahead of the revenue.

As we move into Q2 we will face the typical seasonal headwinds due to US payroll tax reset and compensation adjustments. We will begin to recover the ramp cost of the aerospace and defense Center of Excellence and we'll see improved leverage from revenue growth in EMEA in fiscal Q2. We expect to offset much of the seasonal costs through these improvements as well as progress from our ongoing operational improvement initiatives.

While we have invested in the resources in Guadalajara, our revenue ramp is pushed one quarter due to a delay in our customer's plan. Our expectations for the site remain unchanged but are slightly delayed.

We continue to anticipate approximately 40 basis points of operating margin drag in Q2 of fiscal 2015 as a result of the accelerated ramp of additional customers in Guadalajara. We expect our Guadalajara site drag to reduce substantially in Q3 due to the projected rapid revenue ramp.

We expect to approach profitability in Q3 and achieve corporate margin expectations by Q1 of fiscal 2016 as our annualized run rate exceeds \$200 million. Moreover, our funnel of new business opportunities at the Guadalajara site, which is not included in these revenue projections, is very strong and continues to strengthen.

Overall, we believe we will approach our corporate operating margin goal as we exit fiscal 2015. I will now turn the call to Pat for a more detailed review of our financial performance. Pat?

Pat Jermain - Plexus Corp. - VP & CFO

Thank you, Todd, and good morning, everyone. Our fiscal first-quarter results are summarized on slide 11. First-quarter revenue was \$665 million, which was above the top end of our guidance range for the quarter and about 25% above the prior-year first quarter. Gross margin was 9.2% for the first quarter. This was in line with our expectations and below the fiscal fourth-quarter result of 9.4%. As anticipated and mentioned last quarter, gross margin for the first quarter was impacted approximately 15 basis points by the continued ramp up of our Guadalajara, Mexico facility.

Selling and administrative expenses were \$30.9 million, slightly above the high end of our expectations for the quarter. This was primarily the result of higher calendar year end healthcare claims and higher variable incentive compensation expense due to the improved revenue for the quarter. While SG&A dollars increased compared to the prior quarter, SG&A as a percentage of revenue was approximately 4.6% for the first quarter, consistent with the fiscal fourth quarter. Operating margin of 4.6% before special charges was in line with our guidance range.

Diluted earnings per share of \$0.67 includes \$0.05 per share detriment due to restructuring charges. Consistent with our guidance we incurred \$1.7 million in restructuring charges related to the Juarez closure and transition to Guadalajara. This now concludes our restructuring activities for these sites.

Excluding the \$0.05 of restructuring charges non-GAAP earnings per share of \$0.72 was slightly above the midpoint of our guidance. Not contemplated in our original guidance was \$0.01 per share of additional tax expense related to the geographic distribution of earnings.

Turning now to the balance sheet on slide 12. Return on invested capital was 14.4% for the fiscal first quarter. We created an economic return of 3.4% based on our fiscal 2015 weighted average cost of capital of 11%. Return on invested capital was lower than the 15.2% we delivered in fiscal 2014 and was negatively impacted by the higher invested capital.

During the quarter we repurchased 188,000 of our shares for approximately \$7.3 million at a weighted average price of \$38.81 per share. The shares were purchased under the \$30 million stock repurchase program authorized by the Board of Directors on August 13, 2014. The Company expects to complete the authorized repurchases on a relatively consistent basis over the remainder of fiscal 2015.

During the quarter we used \$90 million in cash for operations and spent \$10 million in capital expenditures. Resulting free cash flow during the quarter was a negative \$100 million. With the majority of this outflow related to working capital changes, I want to focus on our cash cycle performance on slide 13.

Similar to the last couple of years we saw an increase in working capital requirements during the fiscal first quarter. However, this quarter's cash cycle of 72 days was significantly higher than our expectations and 16 days higher than our results in the fiscal fourth quarter. Relative to the prior quarter, days and receivables increased 8 days to 52 days. This increase was largely the result of delays in customer payments at the end of the quarter.

Also impacting our receivable days was a higher level of shipments at the end of the quarter to meet customer requirements. As I mentioned last quarter, we also experienced a mix change to customers with less favorable receivable terms. Days in inventory were 82 days, up 2 days from our results in the prior fiscal quarter. This increase was partially offset by a 1-day increase in customer deposits.

Accounts payable days were 53 days, down 7 days from the prior fiscal quarter due to the timing of inventory purchases and supplier payments during the quarter. With our fiscal quarter ending after the calendar year end we experienced a higher level of payments the last week of the quarter compared to the prior fiscal quarter.

To provide further insight into the change in our cash balance from the prior quarter, please turn to the cash flow analysis on slide 14. Whereas slide 13 compares cash cycle days to the fiscal fourth quarter, this slide provides a comparison to our forecasted cash flow for the first quarter.

We forecasted finishing the quarter with over \$300 million in cash while we actually ended at \$240 million. Similar to the variance with cash cycle days, the two primary variances from forecasts related to higher accounts receivable and lower accounts payable primarily linked to the timing of receipts and payments.

Although the overall working capital performance for the first quarter was disappointing, we expect improvement in the second quarter with a return to more normal levels. While customer mix will be a consideration, I believe there is an opportunity for improvement in all areas of our cash cycle as we continue to implement working capital initiatives.



On a positive note, this quarter we completed the tax efficient repatriation of \$27 million from our foreign subsidiaries to the US. This completes the program we began last spring and resulted in a total of \$67 million remitted to the US.

As Dean has already provided revenue and EPS guidance I will now turn to some additional details on the fiscal second quarter of 2015 which are summarized on slide 15. Gross margin is expected to be in the range of 9.0% to 9.3% comparable to the fiscal first quarter of 2015. Our gross margin guidance includes the impact of merit increases implemented at the beginning of the calendar year and the reset of payroll taxes for US employees.

We expect SG&A cost to be slightly lower than the fiscal first quarter in the range of \$29.5 million to \$30.5 million. At the midpoint of our revenue guidance range SG&A will be approximately 4.6% of revenue and consistent with the fiscal first quarter. This results in expected operating margin of approximately 4.4% to 4.7% for the fiscal second quarter.

A few other notes, depreciation and amortization expense is expected to be approximately \$12.6 million in the fiscal second quarter, down slightly from the \$12.7 million in the fiscal first quarter. We are estimating a tax rate for the fiscal second quarter of 10% to 12% and a tax rate for the full fiscal year of 9% to 11%. This is above our fiscal 2014 tax rate of 7% which had included approximately \$4 million of discrete tax benefits.

Our expectation for the balance sheet is for working capital dollars to be down significantly from the fiscal first quarter. Based on the forecasted levels of revenue we expect these changes will result in cash cycle days net of deposits of 60 to 64 days for the fiscal second quarter. This decrease in days reflects an improvement in all categories of working capital.

We are currently forecasting between \$80 million to \$100 million in free cash flow for fiscal 2015. We continue to forecast capital spending at approximately \$50 million for fiscal 2015. The majority of this capital is for equipment to support new capabilities, new program ramps and the refresh of older equipment. I will now turn the call back to Dean for some wrap up comments. Dean?

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

Thank you, Pat. If listeners would please advance to slide 16 for some comments regarding near-term focus items. First let me begin with a review of our goals for fiscal 2015. On the growth front our business wins performance has been strong over the past several quarters setting the stage for double-digit growth this fiscal year.

We continue to believe our business model is healthy with operating margins in the range of 4.7% to 5%. With operating margin performance in our target range, the conservative level of capital expenditures and proper management of working capital we should generate meaningful free cash flow.

Our key measure for shareholder value creation is our economic spread. We expect to deliver in the range of 400 to 500 basis points.

Reviewing a few key supporting initiatives -- our team has executed extremely well on the startup of our new facility in Guadalajara, Mexico. All customer program transitions from our former site in Juarez, Mexico to Guadalajara have been completed.

As part of the Guadalajara first-year operating plan we will also transition certain customer programs from one of our sites in the US where we are capacity bound. This transition has been delayed one quarter due to customer constraints. We need to execute this transition to the revised plan over the next couple of quarters to ensure we swing our Guadalajara site to profitability.

Our EMEA region has been in a significant investment phase over the past few years. We are getting good traction in the region with our expanded capabilities and footprint. Part of our operating plan improvement depends on swinging the region to profitability in the second half of this year. We are on track to deliver this result with a significant ramp in revenues at our facility in Oradea, Romania*.

Pat spent a fair amount of time reviewing our working capital missteps in Q1. We will get it fixed. Todd's teams are driving meaningful improvement with our operational excellence initiatives. We need to continue our progress not only to improve our operating metrics but to delight our customers.



Finally, we need to remain vigilant on our understanding of our end market dynamics as our customers continue to provide poor visibility to our quarter forecasts. With that, operator, we will take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Brian Alexander, Raymond James.

Brian Alexander - Raymond James - Analyst

Just on the communications segment, are you actually seeing the order rates decline to the magnitude of your guidance of down mid-teens sequentially? Or is that caution just based on the strong momentum that you have seen over the last couple quarters? And then I just have a follow-up.

Pat Jermain - Plexus Corp. - VP & CFO

With the networking/communication sector we are seeing a decline that is consistent with our forecast here. And maybe just to add a little bit more color around the networking/communication sector, we of course had a large spike in Q4 as a result of a new program ramp. That program did reset to more normalized levels in Q1 and it maintains that way as we move forward through fiscal 2015.

But what we were able to accomplish in Q1 is another one of our significant customers saw a strong upside in emerging markets as a result of the new program ramp. So they were able to capitalize on that. We also saw some end of year pull in from a number of our other customers and that subsides as we enter Q2 and beyond. So we really believe the level that we are forecasting now is I would call it the new normal or the baseline from which we will work on.

Brian Alexander - Raymond James - Analyst

That's what I was getting at. I wanted to make sure that this \$200 million a quarter is the new base after a couple quarters of \$230 million-plus. And Pat, just on the margins, I guess as we look at all the puts and takes to margins, is there any change in the trajectory of the operating margin improvement that you are expecting now versus 90 days ago?

I know you talked about maybe a one-quarter delay with the ramp in Guadalajara. But as you look to that 5% goal exiting the year, has the timing changed at all or the magnitude of that improvement? Thanks.

Pat Jermain - Plexus Corp. - VP & CFO

No, it hasn't Brian. And when Todd put up the slide showing that waterfall, that was the same slide that we put up last quarter. It is still very consistent.

Brian Alexander - Raymond James - Analyst

Okay. Thank you.



Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - Longbow Research - Analyst

I wanted I guess to get a little bit more detail on the large industrial win that Todd mentioned in his prepared remarks. Maybe if you could size it, any other details? I think you said it would ramp later in the second quarter as the year progressed, but just additional details would be helpful.

Todd Kelsey - Plexus Corp. - EVP & COO

Sure. So it impacts our America's region. It will be on the order of about \$100 million when fully ramped up and it could approach that at least. And what we would expect is pretty minimal impact in Q2 as it starts to ramp as we start to build some pilot production, but a more meaningful impact in Q3. It will really be 2016 before it is fully ramped. But it is relatively aggressive from a ramp standpoint as compared to the typical program.

Shawn Harrison - Longbow Research - Analyst

And this is a brand-new customer to Plexus?

Todd Kelsey - Plexus Corp. - EVP & COO

Relative -- a returning customer would be the best way to put it. We have done business with them in the past.

Shawn Harrison - Longbow Research - Analyst

Got you. And then just second, just broadly on the organic environment. Previous times you had talked about I guess limited visibility within customer forecast, push-ins and pull-outs. Has that quieted down or are you seeing any more volatility -- I guess increased volatility in customer forecast?

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

I think it's an interesting dynamic that we've seen over the past I guess four or five quarters where customers are really I would say under forecasting out quarters. And we see the out quarter forecast kind of come up reasonably consistently as we move to the current quarter that we are in.

So this is I think a bit of a change in the mindset from customers. Again, this isn't across-the-board, but generally speaking that we used to see customers tend to over forecast demand in an effort to overdrive your availability of inventory and capacity to ensure that you can meet their needs. And we're seeing customers manage that dynamic around inventory, around the channel much tighter. They are really more focused on the current quarter and maybe the next quarter but really the current quarter. And as I said, the dynamic has been more to bring the forecast up as you kind of move through the quarter.

So I guess part of this is just that in general I think the whole supply chain has become more responsive to customer end market demand dynamics. Certainly our platform has gotten much more agile and flexible to meet those needs of customers and they don't see any need to overdrive. And I think they are more concerned about being conservative on their side just from an inventory channel management.

Shawn Harrison - Longbow Research - Analyst

Got you. Congratulations on the results again. Thanks.

Operator

Sherri Scribner, Deutsche Bank.

Sherri Scribner - *Deutsche Bank - Analyst*

I just wanted to get a little more detail on what you are seeing in the healthcare/life sciences segment. I think that you mentioned that a number of customers continue to improve their forecast there. I was hoping to get a little more detail.

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

Yes, I would say I think that healthcare/life sciences is really indicative of what I was talking about where we see healthcare/life sciences' out quarter forecast is quite soft. And we have seen this pattern where they bring that forecast up maybe 4% or 5% kind of as you move through the current forecasts and that keeps happening quarter over quarter.

So generally we expect to have a good outcome in healthcare/life sciences, but it's hard to get a read on where we are going to actually end up for the full year because we have to second-guess their out quarter forecast as the pattern has been to under forecast.

Sherri Scribner - *Deutsche Bank - Analyst*

And is there any specific area that is stronger or anything that you would call out?

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

I don't have anything in particular. I think -- well, Todd, do you have any comments relative to --?

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

Well, I guess the one thing I would talk about would be the markets. And I think in general the healthcare/life sciences markets are soft and developed markets have been soft for several years now, the US and Europe in particular, and that continues.

Now what has really changed is that emerging markets have also softened a bit from where they had been and we had been seeing about 10% plus growth in emerging markets. And right now the data that we have suggests about 4% to 8% growth in emerging markets. So in general it is soft end markets that we are benefiting from new program ramps more than anything.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay. And then just a question for Pat. Is there any FX impact that you guys are seeing from the changes in the currency? Thanks.

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

Yes. Not significant, Sherri. We ship over 90% and invoice in US dollars. So it is pretty minimal. And for Europe that is less than 5% of our shipments are in either euro or pound sterling. So from a top-line perspective it is less than \$1 million. And then when you look at the natural hedges we've got with pain expenses in local currency the bottom-line impact is de minimis.



Sherri Scribner - *Deutsche Bank - Analyst*

Thank you.

Operator

Steven Fox, Cross Research.

Steven Fox - *Cross Research - Analyst*

Just a couple questions on the footprint. Given the new win you just highlighted, and looking at the mix of the wins in the last few quarters, it seems like the North America manufacturing base is somewhat oversubscribed and you are still having to fill up some whitespace overseas. I guess I'm wondering how those dynamics maybe play out over the next couple of quarters.

And just as a follow-on to that, with the new program you just highlighted, the \$100 million piece of business, can you just give us a little color on your comfort level of the ramp? Is it something new in terms of complexity or end market? And is it something new to the customer, new product, or are you taking some business from someone else? Thanks.

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

With respect to the footprint and capacity in North America, I think we are really in good shape. I would just remind the listeners that we did a consolidation here in Neenah, we consolidated a couple older plants and a smaller plant I'm Appleton nearby into our new facility which we keep referring to as our aerospace Center of Excellence because it houses that capability. That building in terms of raw square footage is bigger than the three buildings that we combined into it. So we picked up some square footage here in Wisconsin to support customers.

Secondly, we of course closed Juarez and opened the facility in Guadalajara and we have a significant amount of capacity now available to us in Guadalajara having rotated a relatively small amount of revenue, I would say, from Juarez into Guadalajara. And of course we are in the process, as I stated, of freeing up some capacity at one of our facilities in the Americas with some additional program rotation out of that facility into Guad, which will give us additional whitespace, or kind of flexibility here in the Americas.

So overall we are in real good shape square footage wise in the Americas and, for that matter, in the other two meaningful regions for Plexus as well. So we've got a lot of available raw square footage that we can grow into and shouldn't anticipate having to do anything from a brick-and-mortar standpoint for quite some time. With respect to the new program I will let Todd take that one.

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

I would say, Steve, that the comfort level is at a reasonable level. What we're doing is we're transitioning business from our customer site, so it is existing business that they have at their site and have an interest in moving out and of course we have an interest in pulling it in. Now there is also a risk there could be a quarter or so delay and there's always a risk that it will amount to what we speculate it will at this point. But right now we feel good about the transition.

Steven Fox - *Cross Research - Analyst*

Thanks for that. And then Dean, just a clarification. I guess what I was getting at is, the amount of business that you are winning that is going overseas, is that up to what you would've been thinking in terms of capitalizing on some of the leverage in Europe? I know you're getting Europe

towards breakeven, but is it tracking to how you would have anticipated say a year ago so that you continue to improve profitability in those parts of the world?

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

Certainly Europe is. It was slower going than we thought. I think we were a couple of quarters behind I would say where we thought we would be at this point in time. But generally we are getting very good traction and I would say an improvement in momentum into new business wins there.

And of course we want to manage that carefully because you have a very -- a new site in Oradea, Romania, a relatively new site, an experienced management team, but the scale of that business now is starting to rise pretty rapidly. So we're really trying to make sure we protect our customers and manage to flawless performance for them to make sure that we build a strong brand in that marketplace. But generally I am really pleased with now how that is unfolding having admitted that we are probably a couple quarters behind where we ideally would've liked to have been.

With respect to APAC again, we had a little bit of I would say a drought in terms of revenue momentum into the APAC region. We did a reasonable job recovering from the loss of Juniper there, but we hadn't been winning quite at the rate that we would like. Now this has been a good quarter for us here which will get us back on growth track into the APAC region.

Steven Fox - Cross Research - Analyst

Great. That's very helpful. And good luck going forward.

Operator

Jim Suva, Citi.

Jim Suva - Citigroup - Analyst

Congratulations to you and your team there at Plexus. Dean, as we look ahead, I am just thinking about what consensus was modeling for sales. Given your win rate, which has been very impressive, as well as this additional industrial win coming on, I kind of scratch my head to see that consensus is looking at kind of single digit year-over-year growth rates for your outward quarters kind of the June/September quarter and kind of bringing the full year closer to like 11% to 12%.

But it seems like your win rate would support closer to 15% or more, or can you help me bridge the gap about why maybe those expectations are somewhat realistic? Or is there some type of hesitation or something that we should be mindful of so we just don't get too ahead of ourselves on your longer-term outlook, given the win rate?

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

Jim, your arithmetic is absolutely right on, in that we should be able to put up numbers that are meaningfully in the midteens growth rate. But I would caution against doing that because, again, right now as we say, we've got fairly tepid forecasts in our quarters from customers.

My personal feeling is some of those tepid forecasts are not quite supported by the macro, but that would suggest I am able to outguess the customers in terms of what they're going to do in their end markets. Now, as I said earlier, their behavior has been to improve those out quarter forecasts kind of every quarter as we move through the current quarter that we are in.

But right now, I think there is just a fair amount of conservatism and concern about what is going on around the world and how that dynamic could impact customers' ability to continue to achieve reasonable growth rates in those out quarters. So I am comfortable really right now which were



The Street is for the full year. That certainly is a reasonable spot to be in. Theoretically, we should be able to outperform that, but I would caution about trying to get ahead of it at this point until we get a little bit further into the fiscal year.

Jim Suva - Citigroup - Analyst

Great. Then a quick follow-up. Is the best way to think about the wins rate is kind of optimally, this is where they should go, but like you said the visibility isn't quite there to give you 100% certainty to then mathematically build that into say the forward-looking four quarters? Is that the way to think about it?

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

Well, I think with the wins rate, relative to the wins rate, there is a lot of variability to the ramp-up, right, of these programs when we announce them. I think over time, the math holds up. But in the short run, it is pretty hard to really extrapolate precisely from the current quarter wins to over the next four quarters it is going to be at full run rate.

Like I said, there is a lot of variability in that. But right now, I think the math historically has held up that if we achieve this sort of 25% of trailing four-quarter revenues, it should drive our growth rate. It should facilitate a growth rate that is in the kind of low teens or targeted 12%.

Jim Suva - Citigroup - Analyst

Thank you. And again, congratulations to you and your team there at Plexus.

Operator

Amit Daryanani, RBC.

Amit Daryanani - RBC Capital Markets - Analyst

Two questions. One maybe a question on the cash flow side. Pat, I think you mentioned you could do \$80 million to \$100 million of cash flow this year. I want to make sure I heard that right. And if that is correct, that would imply a pretty impressive \$200 million cash generation in the next three quarters.

Just maybe walk me through how do you get there, because my math says cash cycle probably your cash is only going to get into the mid-\$50 millions in the back half for you to get to those numbers.

Pat Jermain - Plexus Corp. - VP & CFO

Yes, I can help you out with that and just to confirm it is \$80 million to \$100 million. So Amit, we see a pretty significant improvement in the fiscal second quarter. We are looking at cash cycle days improving, if you take the midpoint of the range I provided, that's a 10-day improvement.

So just alone in the second quarter if you look at each day representing about \$5 million of cash, that's a \$50 million improvement. And then you layer on top of that our cash earnings less our capital expenditures. We are at a range in the fiscal second quarter of about \$70 million to \$100 million in that quarter alone.

So we should recover a lot of what we went down in the fiscal first quarter and then see that improvement in positive cash flow in the back half of this year to get us to that range of \$80 million to \$100 million.



Amit Daryanani - RBC Capital Markets - Analyst

Got it. That's really helpful. And just curious on the industrial in commercial sector, it performed a bit lower than I think what you guys were expecting in the December quarter. What were the levers that led to that headwind. Maybe I missed it? And then could you just touch on if you have any oil and natural gas exposure there that could create some headaches as you go through the year?

Todd Kelsey - Plexus Corp. - EVP & COO

First of all with respect to the December quarter, it finished just about on top of where we had expected. I think if we looked at our numbers it was about a percent below expectations. So we would consider that finishing on expectations.

But what we had is one key customer that softened and that was really offset by two other customers strengthening, which ended up relatively flat.

Now with respect to the rest of the year and with oil and gas in particular, so oil and gas, the first thing that is important to note is that it is less than 2% of our revenue. So we really don't have very big exposure to oil and gas from an overall Plexus standpoint.

Then if you look at oil and gas, there's two different areas of product, there's exploratory product and then there's in-service well product. Now exploratory is the area that is really suffering in the marketplace right now as the oil companies aren't doing much exploration given the current price of oil. In-service is relatively stable, slightly soft.

The bulk of our business is in this in-service area. So we are seeing a bit of softening in oil and gas in our exposure to it, not significant though because it is primarily in-service wells. The other significant positive for us is that we are performing very well with our customers in this space, so we're growing our market share. So we do not expect to have a very negative impact from the oil situation to Plexus and Plexus revenue.

And then getting back to the industrial/commercial sector, I think it is important to note that we are launching a number of new programs that are major new programs and seeing a bit of strengthening in the marketplace in the rest of industrial/commercial. So we are expecting very strong growth throughout fiscal 2015 and should see strong quarter-over-quarter growth each quarter.

Amit Daryanani - RBC Capital Markets - Analyst

Perfect. Thank you.

Operator

Mark Delaney, Goldman Sachs.

Mark Delaney - Goldman Sachs - Analyst

I was hoping first to talk on the SG&A outlook. I know SG&A is actually coming down sequentially this quarter and normally there are some seasonal pressures. And so beyond the March quarter should we expect the SG&A to step up, or are you going to be able to capture some of the savings and flow those through for the rest of the fiscal year?



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

I think we will be able to keep it pretty steady with our forecast for the fiscal second quarter. I don't see that going up significantly. So we should be in that similar range that we are forecasting for the second quarter.

Mark Delaney - *Goldman Sachs - Analyst*

Okay. That is helpful, Pat. And then the second question I wanted to discuss a little bit more on the networking business. I think by my math from the 10-K with aeros moving up to I think 12.5% of total sales, I think that implies it was almost a little under 40% of the networking business revenue in fiscal 2014.

So it was somewhat meaningful customer concentration there within the networking business and I know they had some wins, some program ramps that drove that. Maybe you can just help me think through your degree of confidence that that is going to reset at a normalized rate at this \$200 million level for the networking business overall, or if there is any risk from just having that large customer concentration that it steps down further. And then also related to that, if you can just help us think through your ability to diversify and broaden the networking customer base as you move through the year.

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

First of all, the risk to the \$200 million reset level, we think it's relatively small although the markets in networking/communications are certainly softening as we saw and as some of our competitors have seen recently. But the aeros revenue in particular we believe is at a level that is supportable in there end markets, so that in particular looks reasonably good to us.

As we look at the rest of the networking/communications business the team is doing a nice job of bringing on new customers and new programs as well and much of what we are seeing in the back half of the year is a result of new programs coupled with soft end markets, is the way I would explain our networking/communications sector. So we believe we are in position, once that sector begins to stabilize again, to show growth in the sector.

Mark Delaney - *Goldman Sachs - Analyst*

Thanks very much.

Operator

Sean Hannan, Needham & Company.

Sean Hannan - *Needham & Company - Analyst*

Just a quick question on that delayed transition that you had with Guadalajara. Was there any revenue disruption that came as a result of that, or was that purely a margin impact?

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

No, there was no revenue disruption. Again, this is business that we execute at another US site and part of the strategy was to rotate some of that product into Guadalajara and to, as I said, free up some space there at our facility and give the customer a more competitive cost point.

So it's just a question of a customer resource challenge and them not wanting to execute on the transition in the quarter as planned. So it will -- we believe it should be fairly deterministic from this point forward relative to our plan of transition.

Sean Hannan - *Needham & Company - Analyst*

Okay, that's helpful. And then, Dean, and Todd as well, as you think about the medical -- your medical customers, the forecast that you're getting from them it sounds like out quarters aren't incredibly encouraging. However, you've also made some comments during the course of the call that we have seen a pattern in a very general sense across your business that out quarters have been understated and we have gone through a period of as we move closer to those quarters consistently seeing those revisions upward.

Would you also apply that to having seen that or been experiencing that within medical or has that been less of an impact? Any color around that would be great. Thanks.

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

No, I would say the healthcare/life sciences sector for us has been a poster child for that behavior. Very, I would, say conservative in our quarter forecasts.

Sean Hannan - *Needham & Company - Analyst*

Okay. So perhaps nothing to read too much into in terms of those out quarters?

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

No, I don't think so. And relative to healthcare/life sciences even with the pessimistic out quarter forecast we expect to have very healthy growth this year. Not quite to the enormous kind of performance that we had last year but still healthy growth.

And in my opinion I think given the pattern of forecast revisions we are going to see it come up from what we currently have in our current operating plan. And as Todd said it is important to also understand despite the weaker out quarter forecasts we continue to win new business in healthcare and ramp those programs up so we are driving much of the forecasted growth with new program ramps and the end market growth is just not apparent in those out quarters.

Sean Hannan - *Needham & Company - Analyst*

Okay. That's very helpful clarification. Thanks so much.

Operator

Todd Schwartzman, Sidoti & Company.

Todd Schwartzman - *Sidoti & Co. - Analyst*

With regard to the delays and customer payments can you speak to how isolated that was, maybe how many total customers were involved and where there's any concentration in either by sector or geography?



Pat Jermain - Plexus Corp. - VP & CFO

I would be happy to take that. Let me first say that a lot of these issues were cleared up the second and third weeks of January. So it really was a timing issue, one where we just had some delays with our customers paying us during those holiday weeks.

I would say it was spread evenly between the America region and the APAC region. It was concentrated among probably three or four of our larger accounts customers.

But we did see a general increase in past-due balances from 1 to 10 days past due in the increase this quarter compared to last quarter. And that is where I see improvement going forward where we can be more diligent on staying after our customers on paying us under the contractual terms. And we will see that improvement going forward.

Todd Schwartzman - Sidoti & Co. - Analyst

Historically at holiday time you would normally expect to see a one-off or two-off kind of similar delay?

Pat Jermain - Plexus Corp. - VP & CFO

We would. But not to the magnitude we saw this quarter.

Todd Schwartzman - Sidoti & Co. - Analyst

Got it. And also I wonder if you could speak to the aerospace Center of Excellence initiative, what your objectives are there, how should we look at that?

Todd Kelsey - Plexus Corp. - EVP & COO

Sure. So with respect to the aerospace Center of Excellence we actually have two sites that we're designating as aerospace Center of Excellence, one in Penang, Malaysia and one in Neenah, Wisconsin. And our goal is to put in place process and tools and technology and supply chain solutions that are specialized or tailored to the aerospace industry.

So we're in the process of doing that. And the plan would be to use that to provide better service to our customers, which would ultimately grow our business within that space.

And I think we are seeing good results on it so far. If you look at the quarter-over-quarter growth that we are projecting within defense/security/aerospace, it is quite strong. And we have run a pretty good track record over the last few years of growing that sector in a meaningful way.

Todd Schwartzman - Sidoti & Co. - Analyst

Terrific. Thank you very much.

Operator

I am not showing any further questions at this time.



Todd Kelsey - Plexus Corp. - EVP & COO

Okay. Well, I want to thank everyone for the good questions and your support of Plexus Corp. Thank you.

Operator

Thank you, ladies and gentlemen. This concludes today's conference.

Thank you for participating. You may now disconnect.

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