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PLXS - Q2 2013 Plexus Earnings Conference Call

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OVERVIEW:

PLXS reported 2Q13 revenues of $558m and EPS of $0.52. Expects 3Q13 revenue to be $550-580m and EPS (excluding any unanticipated restructuring charges and including approx. $0.08 per share of stock-based compensation expense) to be $0.55-0.62.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Plexus Corp. conference call regarding its fiscal second-quarter 2013 earnings announcement. My name is Richard and I will be your operator for today's call. At this time all participants are in a listen-only mode. After a brief discussion by management we will open the conference call for questions. The conference call is scheduled to last approximately one hour. Please note that this conference is being recorded. I will now turn the call over to our Angelo Ninivaggi, Plexus Senior Vice President, General Counsel and Secretary. Angelo, you may begin.

Angelo Ninivaggi - *Plexus Corp. - SVP, General Counsel, Corporate Compliance Officer & Secretary*

Thank you, Richard. Good morning, everyone, and thank you for joining us today. Before we begin I should remind everyone that statements made during this call today that are not historical in nature, such as statements in the future tense and statements that include belief, expect, intend, plan, anticipate, and similar terms and concepts 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 major factors that could cause actual results to differ materially from those projected 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 29, 2012 and the Safe Harbor and fair disclosure statement in yesterday's press release.

The Company provides non-GAAP supplemental information. For example, our call today will reference return on invested capital and free cash flow. These non-GAAP measures are used for internal management assessment because they provide additional insight into ongoing financial performance and metrics that are driving management decisions. Other measures such as earnings excluding special charges help assess trends in performance over time by limiting the effects of unusual events.

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 on the Plexus website at www.Plexus.com by clicking on Investor Relations at the top of the page and then Events Calendar.

Joining me this morning are Dean Foate, Chairman, President and Chief Executive Officer; Ginger Jones, Senior Vice President and Chief Financial Officer; and Todd Kelsey, Executive Vice President of Global Customer Services. 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. For those following along on the reference material, please advance to slide 3. Last night we reported results for our fiscal second quarter of 2013. Revenues are up 5% sequentially to $558 million with EPS of $0.52.

Our revenue performance was below the midpoint of our guidance as certain customers in our Network and Communications sector continue to struggle with end market demand. Forecast volatility was prevalent in other sectors as well during fiscal Q2, but on balance results were reasonably consistent with guidance.

While revenue performance was a little light -- lighter than we had hoped, our margin performance was consistent with our expectations. Ginger will provide more detail on the dynamics of improving operating margins during her comments.

Advancing now to slide 4 for some insight into the performance of our market sectors during our fiscal second quarter of 2013 and our current expectations for fiscal Q3. Our Networking/Communications sector was up about 7% sequentially in fiscal Q2. The result was significantly weaker than our expectations for high teens percentage growth as four of our top five customers in this sector performed below earlier forecasts.

We are cautiously guiding our Networking/Communications sector revenues to a mid-single-digit percentage decline in fiscal Q3. We will experience a meaningful reduction of revenues from Juniper in Q3 as we continue to execute the disengagement plan. While some of the Juniper reduction will be offset by other customers that are either ramping new programs or are forecasting better end market demand, the recent end market volatility gives us pause.

Our Healthcare/Life Sciences sector performed closest to our original expectations for the quarter with revenue results down about 3% sequentially as our largest customer in this sector exhibited typical seasonality. Looking ahead to fiscal Q3 we currently anticipate revenues in our Healthcare/Life Sciences sector to grow in the mid- to high-single-digit percentage range largely due to recent new program wins.

Our Industrial/Commercial sector was up sequentially about 7% in fiscal Q2. The growth was slightly better than our expectations as a few of our test and measurement instrumentation and semi cap equipment customers improved upon earlier forecasts. We currently anticipate that our Industrial/Commercial sector will be up in the low-single-digit percentage range in our fiscal Q3.

Our Defense/Security/Aerospace sector was up about 12% in Q2, a result that was a little software than our expectations for even stronger growth in our aerospace component of this sector. We currently expect Q3 to be up in the low-single-digit percentage range.

Turning now to new business wins on slide 5. During the quarter we won 33 new programs in our Manufacturing Solutions group that we anticipate will generate approximately $143 million in annualized revenue when fully ramped into production. The new program wins performance this quarter was particularly strong in our Americas region representing [61]% of the revenue. On a sector basis our Industrial/Commercial sector was the strongest performer this quarter with 60% of the total.

Going to slide 6 our new wins performance in fiscal Q2, as shown by the overlay green bars, was admittedly softer than our strong performance over the last several quarters. While our trailing four quarter wins, as shown by the blue bars at $773 million is sufficient to keep our wins momentum above our 30% goal, we need to do a better job in the coming quarters to sustain our goal of returning to growth in fiscal 2014.

Slide 7 -- the good news is that we did a good nice job building the funnel of opportunities to a record level of $2.4 billion. Our objective is to harvest a greater number of these opportunities in the coming quarter by continuing to back fill the funnels. And with that I will turn it to Ginger.

Ginger Jones - *Plexus Corp. - SVP & CFO*

Thank you, Dean. Our fiscal second-quarter results are summarized on slide 8. Second-quarter revenue was $558 million, in line with the guidance for the quarter. Gross margin was 9.3% for the fiscal second quarter, at the high-end of our expectations and below our fiscal first-quarter results of 9.6%.

As a reminder, our fiscal first-quarter earnings were positively impacted by the sale of certain inventory that had previously been written down. Without this positive impact gross margin in the fiscal first quarter would have been 9.3% and consistent with our results in the fiscal second quarter. Our gross margin was also positively impacted by customer mix issues.

Selling and administrative expenses were $28.8 million, below our expectations for the quarter. We have continued to manage our SG&A costs closely and are making reductions in spending where possible. SG&A as a percentage of revenue was 5.2% in the fiscal second quarter, lower than the fiscal first quarter based on the lower level of spending and the higher level of revenues during the quarter.

Operating margin was slightly above our expectations at 4.2%. We recorded a tax rate of 10% during the fiscal second quarter. This higher rate was a result of payment during the quarter of approximately $500,000 to settle a routine federal audit. We are estimating a tax rate for fiscal 2013 of 6% to 8%, in-line with our fiscal 2012 tax rate of 7%. Diluted earnings per share was approximately $0.01 lower than expected for the quarter from this tax adjustment.

Turning to now to the balance sheet on slide 9, return on invested capital was 12.7% for the fiscal second quarter of 2013, above our weighted average cost of capital for F13 of 12%. ROIC has improved since the fiscal first quarter, although still below the 15.5% we delivered in fiscal 2012 and our long-term target of 500 basis points better than our weighted average cost of capital.

During the quarter we repurchased 615,000 of our shares for approximately $15.5 million at a weighted average price of $25.17 per share. Fiscal year to date we have repurchased 877,000 shares for approximately $21.5 million at a weighted average price of $24.56 per share.

As previously announced, in October 2012 the Plexus Board of Directors approved a stock repurchase program under which the Company is authorized to repurchase up to $50 million of its common stock which will be funded with existing cash. We expect to complete this repurchase program relatively consistently over the balance of fiscal 2013. We believe this creates a disciplined process to evaluate our cash requirements, cash balances and return excess cash to shareholders.

Our cash cycle at the end of the fiscal second quarter was 64 days, lower than our expectations and 10 days lower than our results in the fiscal first quarter. This is a return to more normal results for us below the unusually high levels in the first fiscal quarter of the year. In total working capital decreased by approximately $29 million during the quarter.

Days and receivables increased by five days to 55 days; the increase was driven by two factors. First, we saw a more normal pattern of orders late in the fiscal quarter which increased our days of receivables. Second, Juniper Network's payment terms increased during the quarter in accordance with our disengagement agreement. The longer payment terms were agreed to in exchange for better pricing on current production.

The impact of longer terms will be limited to the remaining two quarters in which we are operating under this agreement and days and receivables should be lower in our fiscal fourth quarter when Juniper is no longer a customer.

Days in inventory were 87 days, down five days from our results in the prior fiscal quarter. Approximately three days of this reduction in inventory during the quarter related to Juniper as we began executing inventory sales under the disengagement agreement. The dollar value of inventory was up $4 million from the prior quarter. This modest increase and the higher level of revenue resulted in the decrease of five days.

Accounts payable days were 61 days, flat from the prior fiscal quarter. Days of cash deposits increased significantly from the prior fiscal quarter by 10 days to 17 days. The dollar value of cash deposits increased by approximately $60 million to $97 million as we received deposits from Juniper Networks related to the disengagement.

Effectively these deposits allow us to capture much of the benefit to working capital that we expect from the disengagement this quarter. These deposits will be offset by reductions to inventory from sales of inventory to Juniper or their new suppliers over the remainder of the fiscal year.

Free cash flow during the quarter was $27 million. We generated $54 million in cash from operations and spent $27 million in capital expenditures with approximately $16 million of that capital for footprint expansion in Romania and Wisconsin.

I will now turn to some comments on the fiscal third quarter of 2013 which are summarized on slide 10. We are establishing fiscal third-quarter revenue guidance of $550 million to $580 million. At that level of revenue we anticipate EPS in the range of $0.55 to $0.62 excluding any unanticipated restructuring charges and including approximately $0.08 per share of stock-based compensation expense.

The midpoint of this guidance range suggests that our fiscal third-quarter revenue will be up slightly when compared to our second quarter. Gross margin is expected to be in the range of 9.4% to 9.6%, up from our gross margin of 9.3% in the fiscal second quarter. This improved gross margin is a result of our concerted efforts to improve margins that began in fiscal first quarter.

These initiatives include -- higher utilization of our existing facilities and equipment resulting in slower growth in depreciation and capital expenditures; higher operational productivity from lower fixed labor and overtime; improved results from our engineering solutions group through improvements in utilization of staff; supply chain efficiencies from sourcing strategies; reductions in material labor; freight savings and leveraging our recent investments in supply chain tools.

In addition, gross margin in the fiscal third quarter will benefit from a lower level of expected revenue with Juniper Networks. This customer is dilutive to gross margin and we will begin seeing the impact of the disengagement on our gross margins in the fiscal third quarter.

We expect SG&A costs to be up slightly from our spending in the fiscal second quarter in the range of $29 million to $30 million. At the midpoint of our guidance range for revenue this will result in approximately 5.1% to 5.3% SG&A as a percentage of revenue. This would be in -- consistent with the 5.2% in the fiscal second quarter.

This estimate in the fiscal third quarter includes additional SG&A of approximately $300,000 from our annual salary increases. This will result in expected operating margin of 4.2% to 4.4%, which is a solid increase from our performance in the fiscal second quarter.

A few other notes -- we currently anticipate $1 million to $1.5 million of restructuring charges in our fiscal third quarter primarily for severance related to the disengagement of Juniper Networks. Depreciation and amortization expense is expected to be approximately $12.5 million in the fiscal third quarter, up slightly from the $12.4 million in the fiscal second quarter.

Interest expense will be reduced by approximately $1 million in the fiscal third quarter as fixed interest rate swaps on some of our long-term debt expire. We are estimating the effective tax rate for fiscal 2013 will be 6% to 8% which is consistent with the 7% for fiscal 2012.

Our expectations for the balance sheet are for working capital dollars, which is inventory, Accounts Receivable, Accounts Payable and cash deposits, to be down from the fiscal second quarter. Based on the forecasted levels of revenue we expect these changes will result in cash cycle days, net of cash deposits, of 60 to 64 days for the fiscal third quarter of 2013. (Technical difficulty) engagement in our fiscal third-quarter guidance.

Turning now to slide 12, I would like to give some visibility to other actions we have underway. As I mentioned earlier in my discussion of gross margin improvement, we have focused on a number of initiatives to improve our operating profit and we are seeing those improvements reflected in our fiscal third-quarter expectations.

Along with these initiatives we have also reduced headcount, delayed our annual salary increases from January to April 2013 and eliminated some employees from participation in our variable incentive plan. All of these actions are having a positive impact on our fiscal 2013 results.

As we look ahead to the second half of fiscal 2013 and fiscal 2014, we have a number of longer-term projects underway. These projects include the completion of our manufacturing facility in Romania which is on track for this fiscal quarter. We've believe this investment in low cost manufacturing capacity in the EMEA region is critical to our long-term success in EMEA and we are seeing strong interest from customers as we near completion of the facility.

This is a replacement for an existing leased facility and we have a team in place, so the only potential drag from this facility would be related to the operational costs and depreciation of the new building. With the strengthening forecast for our sites in Scotland and the ramping of customers in the new facility in Romania we expect to see improved operating margins in the EMEA region in fiscal 2014 inclusive of the operating costs for the new facility.

As we announced in May 2012, we are pursuing a consolidation strategy of facilities in Wisconsin. We are constructing a new manufacturing facility that will be complete in late fiscal 2013. This will enable us to exit two leased facilities in Neenah, Wisconsin and one smaller owned facility in Appleton, Wisconsin.

The efficiencies from consolidating manufacturing into one facility, exiting higher cost leased space and the benefit of incentives from the state of Wisconsin enable us to deliver improvements to gross margin when this is completed. The transition will happen over the first half of fiscal 2014 and will likely require unusual charges of approximately $4 million to $5 million in severance facility exit costs and costs to move equipment. We have not finalized these estimates or incurred these costs, but wanted to give investors visibility into our plans for this consolidation.

Finally, we believe we are currently disadvantaged in the Americas region with our low cost solution in Juarez, Mexico. Although this site is performing well, we believe the brand at that site is tarnished by violence in Juarez. We are exploring solutions in Mexico and hope to make a decision and announce our plans in the fiscal third quarter.

We expect that these actions will result in operating profit of 4.5% or better in the fiscal fourth quarter. We think this is a reasonable level of operating profit in the current environment and this remains industry-leading operating margin.

The actions above are designed to return us to our targeted operating margin goal of 5% in fiscal 2014. We are confident that we understand the risks and the work underway and from our major customer disengagement and are taking the actions necessary to improve operating performance.

With that I will turn the call back to Dean for a few closing comments. After Dean's comments we will open the call for questions. We ask that you please limit yourself to one question and one follow-up.

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

Slide 13, please. All right, I will just make a few wrap-up comments here, a few bullet points of the things that we are focused on in the near term; of course one of which is to accelerate the velocity to the funnel. While the funnel has grown well, we need to close on a number of those opportunities here in the coming quarters to ensure that we can keep our growth momentum going.

We are working hard on improving productivity and we see some opportunities for some step function improvements in the overall capacity utilization and productivity across our manufacturing platform and we have some initiatives meaningfully underway there.

The Juniper disengagement, of course, is a lot of hard work, but I would emphasize that it is going according to the plan. And the work with Juniper as well as the receiving (inaudible) companies is constructive.

The new Oradea facility is important to us; we will close a couple of smaller leased facilities there and move into that facility and of course that creates a real opportunity for us to continue our growth momentum in EMEA which has been quite good and is returning good on our investments there in people and the facilities.

Fox Cities' work will of course primarily be underway here in fiscal 2014, but this is going to be another important project for us that we need to execute on flawlessly so that we can continue to deliver product to customers in a flawless way during the transformation. So we have got a lot of product movement going on in the first couple of quarters here of fiscal 2014.

And then finally, we would expect a decision on our longer-term strategy for low cost North America Manufacturing in Mexico. And with that we will turn it back for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Amit Daryanani, RBC Capital Markets.

Amit Daryanani - *RBC Capital Markets - Analyst*

Thanks a lot. Good morning, guys. Two questions for me. One, on the networking side, maybe I missed this, but could you talk about how much was Juniper for you guys in the March quarter? And if you exclude that out I am curious, the softness that you saw in networking, was that more driven by some of the ramps you anticipated that didn't come through or was it more from organic softness?

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

It is all of those things. We came up a little light overall on the Juniper business and we had at least three other of the top five customers in addition to Juniper that came up light for the quarter. Some of that was a consequence of just end market softness and also a consequence of some of me newer program wins with the other customers that are not ramping up quite at the pace that we would have expected.

Part of that is due to lower end market demand I suppose slowing down as ramp rates. And the other, with one customer in particular there was a bit of a technical challenge with one of the new product launches. So, we just had a number of things that converged there to have us come up short of expectations.

Amit Daryanani - *RBC Capital Markets - Analyst*

Did you guys disclose, or could you, how much was Juniper for you guys in the March quarter?

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

We did not disclose the overall revenue number and I think we would be reluctant to do that. We still want to honor expectations with Juniper that we won't make specific dollar disclosures around their revenues.

Amit Daryanani - *RBC Capital Markets - Analyst*

Fair enough. And then maybe the one area I think everyone has struggled to understand is as you get past fiscal Q3 -- I'm not saying fiscal Q4 -- do we expect that revenue number to kind of drop down to $500 million, potentially slightly below that, given the Juniper disengagement will be all visible then?

And what do you think operating margins will look like in that fiscal Q4 when Juniper is completely gone? And then beyond that maybe just touch on do you expect some new ramps to offset all the Juniper losses in the September quarter?

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

I guess I'm struggling with the first -- the first part of the question was around $500 million?

Amit Daryanani - *RBC Capital Markets - Analyst*

I am roughly assuming Juniper was around -- I'm using last quarter numbers. And so that completely goes away in fiscal Q4, would you end up seeing September revenues at around $500 million essentially? Or are there ramps that you think will completely -- that should help negate that headwind in a decent fashion? And then how do you think the operating margin would look like in the quarter when Juniper is at zero?

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

I guess you are asking us to guide Q4. I will say this though, that we would expect potentially some material sales to Juniper in Q4 that will probably be somewhere between $35 million and $40 million, $45 million. That is uncertain yet, it kind of depends upon whether some of that pulls us into Q3 or whether it all ends up in Q4, which is part of why we are struggling a little bit to give a good guide on Networking/Communications in Q3 because there are a few moving pieces related to the material sales. But -- and I will let Ginger talk to the margin performance in the quarter.

Ginger Jones - *Plexus Corp. - SVP & CFO*

We believe the margin performance will be at 4.5% or better in the fiscal fourth quarter. So when you think about where we are guiding for Q3, which has improved, and the work we have underway around efficiency, and then finally the benefit of not having a significant amount of Juniper revenue in that quarter, we think that an operating margin of 4.5% or better is realistic.

Amit Daryanani - *RBC Capital Markets - Analyst*

Got it. That is it for me and thanks a lot for the slide deck, by the way; it is really helpful.

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

Okay, thank you.

Operator

Jim Suba, Citi.

Nicholas Jones - *Citi - Analyst*

This is Nicholas Jones on behalf of Jim Suba. I just wonder if you guys could bridge the gap between the funnel and your win. It looks like over the past quarter the funnel has increased while your dollar value of wins has decreased.

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

Well, I think that the wins certainly stepped down in the current quarter. I think that generally we measure these wins on a trailing four quarter basis and we expect some volatility quarter to quarter. But part of the issue here is just the rate of harvesting and the decision-making.

I think another point perhaps is that you can see that the wins in the current quarter, the average size was somewhat smaller. And I think this is indicative of essentially share gain wins with existing customers. New customer wins many times will come with a little bit bigger chunks and new customer wins and particularly significant new program wins tend to move a little bit slower through the process.

So I don't know that -- at this point I don't think you would look at kind of a one quarter issue here as a problem, because the other quarters, while you saw it kind of come down a little bit incrementally quarter to quarter, it still is dramatically above our overall win rate goal. So we need to obviously correct this here in the coming couple of quarters, but I wouldn't read too much into a single quarter.

Nicholas Jones - *Citi - Analyst*

It looks like there was -- last quarter it came down sequentially and annually and then this quarter it came down sequentially and annually, while the trailing four quarters has also come down.

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

That is true, but you are measuring it from performance levels that were significantly above our target. Again, we try to drive consistently above the target on each individual quarter and then on a trailing four quarter basis. So there will be some volatility in that, but clearly we need to -- when you see the funnel increasing that is obviously a good sign.

There is a lot of opportunity there, it's just a matter of getting them harvested and across the finish line. And there is a lot of I would say -- volatility probably isn't the right word, but certainly there is some unpredictability quarter to quarter in terms of ability to close down particularly bigger programs.

Nicholas Jones - *Citi - Analyst*

And the Networking segment, is it -- did you see the softness more in wireline or wireless?

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

I would say it is more along the wireline, but it is hard to really draw any trends there. And we are seeing a number of different factors going on in Networking/Communications right now. Some of it is end market demand. Some of it is new program ramp delays -- and the delays are happening for a number of reasons. A little bit of it is market demand.

As Dean mentioned, some of it is technical challenges with certain products and the other is just slower moves out of competitors, not that they are not going to happen but just muted in time. So that is the way I would kind of characterize the Networking sector right now.

Nicholas Jones - *Citi - Analyst*

Okay, great. Thanks, guys.

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

Thank you.

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

One of the things -- again, this is Todd -- one of the things I'd add in the Networking sector is there are a few -- a number of significant new wins that we have had in there over the last several quarters. So they do have the ability to be material, so those are ramps that are underway right now.

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

Next question.

Operator

Brian Alexander, Raymond James.

Brian Alexander - *Raymond James - Analyst*

Thanks. Good morning, everyone. Just following on on the Communications segment. If I look over the last few years it has been consistently down if I back out Juniper and even if I go back to fiscal 2011 and 2012 and back out [AVUS] and Starent, I think your segment was down about 6% to 7% in those two-year and it looks like it might be down that much again this year.

And it looks like your June quarter, if I back out Juniper, might be down over 15% year-over-year. So I just want to revisit this and how much of this is weaker demand and slower ramps from your customers versus maybe something more Company specific, competitive, marketshare related. Just wondering if there is a bigger picture issue here. Thanks.

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

Boy, I am having a hard time keeping up with all of your arithmetic here, but I am going to (inaudible). I think that that sector clearly is a little more challenging sector certainly from a pricing standpoint, and it also tends to be a sector that is a little bit more volatile in terms of the longevity of companies.

And a number of customers, some of them you just spoke about, were acquired by other customers, that creates certainly some opportunity for disruption. In other cases we have had a number of customers that just no longer cease to exist as enterprises because of the rate of change in technology and they just didn't have product technologies that were going to last over a long period of time.

So I don't know that there is -- certainly when we think about the overall sort of competitive landscape and where many of those product technologies are, certainly they tend to be shorter in life and they tend to be closer to commodity in pricing. And I think that's a more challenging market space to be competitive in over a long period of time for certain kinds of products.

But it doesn't mean there isn't a segment of that overall sector that we can compete in. And we are doing quite well accumulating shares with certain customers where we think we can -- their technologies are more challenging to manufacture and where we think we can sustain longer-term competitive advantage.

So I don't know that I see anything sort of underlying that that gives me any great concern. It certainly, I think, leads to the opportunity for us to have a more balanced portfolio overall however.

Brian Alexander - *Raymond James - Analyst*

Okay. And then just going back to the new wins and, to your point, they have been stellar for several quarters. But when we look at them coming down this quarter and the average program size coming down, which you explained a little bit, and the funnel going up, is there anything else to read into that?

Is this maybe a function of some larger programs that you have in the funnel that you thought you were going to win in the March quarter but they might have slipped into the June quarter? Or is there more price competition on larger deals than what you had seen in the past? Just curious how confident you are that you can maybe get back closer to that $200 million rate that you were at and what you need to do specifically to make that happen? Thanks.

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

I will let Todd take a swing at that.

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

This is Todd. With respect to what had happened in the quarter, I mean I think we saw a few different things. We saw a couple of programs that were significant that we expected to close that pushed into the following quarter.

We saw a couple that were significant that turned out to not materialize, that there really was no movement on from what the existing solution was. And there were a couple of significant wins that were included in that $143 million. So we are still bringing home some big programs and with the funnel the way it is that would imply that there are some significant programs in there.

With respect to the pricing environment I would really say no change. It is competitive but it has always been competitive. And as far as trends, I mean it is really difficult to predict what the wins will be next quarter, a quarter out. We try to do it, we have a number internally, but it is difficult to predict when those will close. We don't believe this is a long-term trend. We think this will be turned around and we will be back to strong wins as we move forward.

Brian Alexander - *Raymond James - Analyst*

Just a last follow up. What would be kind of your targeted harvest rate of your funnel in any given quarter? Are you looking to win over 25%, 30%?

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

About 30%, we are looking for about $180 million in wins is what we would consider a strong quarter. So you go back and prior to this quarter the last six have exceeded that number, so we felt really good about that trend. We are a little light this quarter. We expect we can get back above that though as we move forward.

Brian Alexander - *Raymond James - Analyst*

Okay. Thanks, guys.

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

Thank you.

Operator

Sherry Scribner, Deutsche Bank.

Sherri Scribner - *Deutsche Bank - Analyst*

I just wanted to dig again into the Networking segment. Dean, I think you said on the guidance that you expect Juniper to be down, but that your customers are generally expecting better demand and that you are also seeing some new program ramps. Can you give us some sense of how much is better demand versus new program ramps? And what type of visibility are your customers giving you for the second half in terms of their demand?

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

Well, Todd, do you want to try to split that up into pieces?

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

Sure. I would say end market demand, I would call it flattish from end markets. I would say growth that we are getting is new program wins as they are ramping. And if you look at why would we have come up a little bit short in Q2 from our earlier expectations, it would be delayed ramps, is the way I would characterize it. I would say visibility is still pretty poor in this sector, though, and it is quite choppy.

Sherri Scribner - *Deutsche Bank - Analyst*

Okay, that is helpful. Then turning to the Industrial segment, I think you commented that some of the strength you are seeing is on the [semi cap to test] and Instrumentation segments. You guys are now really doing a decent amount of business in that segment, and wanted to get a little more sense of expectations as we move forward.

Has this sort of become the more important segment for you as we move away from Juniper, and what are your expectations there? Thanks.

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

It is certainly an important segment for us, and we see it as a marketplace obviously that has very low levels of penetration. I think that I wouldn't characterize it necessarily as specifically [semi cap] and instrumentation and some of these as being the solely important component of that segment overall. We think there is a lot of opportunity across that sector overall, including in some of the more what I will call energy components of that marketplace, not necessarily the wind in some of these subsidized energy but other places like down hole technologies and some of those that we think longer-term are going to be really good places for us to play in this marketplace and we are building a good position.

So I think -- overall I think it looks like it is good to be a good sector for us. It is going to be I think similar in our ability to defend it like Healthcare/Life Sciences sector where we have enjoyed a good position with customers as well and where we think there is a lot of long-term opportunity for growth. So I think that's just an enormously big opportunity across that entire space.

Sherri Scribner - *Deutsche Bank - Analyst*

And just following up on that quickly, what type of visibility are you getting from those customers for the back half of the year? I think you have guided to slightly up; are you seeing an improvement in demand from those customers or is that also sort of flattish like Networking? Thanks.

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

I think it depends on which component of that overall sector. We are seeing some trends I think that are good and improving some of that based on investment that you can tie out. In other cases I think those markets are essentially moving sideways or flattish as well and the growth for us is really coming around new program ramps.

Sherri Scribner - *Deutsche Bank - Analyst*

Thank you.

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

Thank you.

Operator

Steven Fox, Cross Research.

Steven Fox - *Cross Research - Analyst*

Good morning. Just one question from me. There was a couple comments about 2014 I was wondering if we could sort of clarify. I think, Dean, you said you need to do a better job on wins in order to return to growth in fiscal 2014. And then, Ginger, you also mentioned that there's -- it's I guess 5% targets for operating margins next fiscal year are I guess achievable.

I'm just trying to figure out what type of sales growth you need to get, whether the 5% is at risk given what you are seeing right now, new wins -- any more clarity around that would be really helpful? Thanks.

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

Yes, let me just speak to be wins. The wins momentum that we have actually seen through fiscal 2013 should be sufficient to drive growth in fiscal 2014 and as we look at a longer-range forecast we would expect growth in 2014. We haven't guided 2014, but certainly we feel that we have enough ramping and enough kind of in the business now that we should be able to overcome the Juniper headwind for us.

Now to get that to create a better level of comfort and to keep that growth momentum throughout the coming fiscal year then we -- obviously if we see wins coming down now then that is going to start to hurt the back half of that year and the momentum through the year.

So I don't want to suggest that the downtick here has suddenly torpedoed fiscal 2014, but I think we are also a little bit cautious about making a commitment to what the growth rate is going to be yet until we get a little bit further here into this fiscal year and get the Juniper situation behind us. So now having said that let me turn it to Ginger for some discussion here on where we think margin performance is going to be.

Ginger Jones - *Plexus Corp. - SVP & CFO*

Steve, our intent today about F14 was not to try to guide you to revenue or margins because this is so volatile right now, but to let you know the work we are doing internally. And our goal internally is to make the business more efficient so that we can get back to our 5% operating target in F14, likely on lower revenue than we would like to see, so in a lower growth environment.

So we are doing a lot of work internally. We are not going to commit yet on when that might happen or what level of revenue we would need, but that we feel like we need to deliver that in a lower growth environment.

Steven Fox - *Cross Research - Analyst*

Just one quick follow-up on that, Ginger. Just given the timeline you laid out for a lot of the actions you are considering or planning going out into next fiscal year, if sales were sort of flattish is there an amount of improvement in margins you could just get from those actions versus say the 4.5% plus you exit this fiscal year at if that was to happen?

Ginger Jones - *Plexus Corp. - SVP & CFO*

Yes, I think there is absolutely the ability to be better in fiscal 2014 than the 4.5% we hope to exit at this year at a low level of revenue growth or flat revenue.

Steven Fox - *Cross Research - Analyst*

Okay, that is helpful. Thank you.

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

Thank you.

Operator

Sean Hannan, Needham & Co.

Sean Hannan - *Needham & Company - Analyst*

Good morning. I just wanted to get back to the program wins topic. One thing I wanted to call out, I am not sure if the wins coming down was necessarily a Plexus dynamic. So I wanted to probe a little bit deeper with you to get a sense of whether you think perhaps as the environment changed versus the speed/pace we saw for harvesting new wins during kind of late 2011 and 2012.

And I look at that period as not just a strong period for you folks, but also for the industry in what might have been a little bit of a cyclical surge in outsourcing activity by OEMs. And just want to get your perspective there if perhaps that is calming in some type of a relative sense there?

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

Yes, there is certainly some truth to that in that you can see periods of time where you see decent pieces of business that come out of OEM factories that have been typically internal. You can also see periods where there is a shuffling of the supplier deck so to speak where pieces of business move from one EMS partner to another as OEMs when they are under pressure consolidate the numbers of partners that they are doing business with.

And in some cases obviously with Juniper was a big loss situation for us. But there are a number of other situations where we gained in that respect. So there has been quite a bit of business shuffling going on. But I also would make the point that the funnel, our funnel has grown and so one take away from that perhaps is that no one else won that business either. That the business is still yet to be awarded and a number of BMS companies are still competing for some of that business.

Now business in our funnel may not necessarily be in every other EMS company's funnel, but certainly we have competitors that are going after some of the same pieces of business.

So I think it is just a question of we were not able to harvest our typical one or two bigger programs during the quarter that we would normally see and those are the decision-making processes a little more thoughtful or more lethargic then we would hope to close down on a couple of those in the coming quarter, in addition to the normal kind of number of smaller kind of incremental wins that we get in any given quarter.

Sean Hannan - *Needham & Company - Analyst*

That is great, Dean. That is actually very well put. I appreciate that. Then kind of as part two, that when we consider the wins that you have had over the course of the last 12 months, and then also as we fold in thoughts around the volatility and the direction of communications, where should we expect the percentage for the communications business to play out say 12 to 18 months from now?

Can you share any views around what you think your mix might look like versus what you would like it to be ultimately longer-term? I know Dean, I think you had commented a little earlier on potentially seeing a more balanced portfolio, so just trying to understand should we interpret that as not really seeing a meaningful scenario where that communications segment builds up much again as a percentage of mix post Juniper? Thanks.

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

I want to be a little cautious with this, but in my own mind as we kind of come through fiscal 2014 we are really trying hard obviously to continue to keep the pedal down on the other sectors. Because for a long time we thought that it would be better for the Company to have a more balanced portfolio.

And so in my mind the way I think about this is about 35% Network/Communications and then 25%-25% in each of Industrial-Healthcare and then the balance in Defense/Security/Aerospace which would suggest some meaningful growth there.

Now what might look a little frightening is that that would suggest that the Networking/Communications would come down even a little bit more, but I am suggesting that that would happen because we are actually seeing stronger growth in some of those other sectors. But that would be I think a reasonable sort of view.

And what I will say is maybe the near-term -- even longer-term I think that we would like to continue to see stronger growth in some of those other sectors and continue to move in that direction.

Sean Hannan - *Needham & Company - Analyst*

That is valuable perspective. And then last question, in terms of the Industrial space, you obtained a few customers within oil and gas that I think you have already talked about as ramping, there have been some more recent wins you've had for new customers there.

Can you elaborate for us as these relationships evolve the nature of the technology that is being used, how it is being used at say well sites, just primarily technology in the drilling process? Or is some of your involvement getting into the technology also in the production of the well? Any perspective around how you are involved really in that evolving gas -- I'm sorry, oil and gas space would be helpful? Thanks.

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

Sure. I will speak just kind of generally and not specifically point to customers here. But generally speaking this is, as I have learned here over the last few years, is an enormously complex field and there is just an enormous amount of technology that goes into deep down hole drilling and horizontal drilling and the fracking process that is used, the ability of the drill heads and the intelligence in the drill heads, the telemetry and guidance of those drill heads, it requires an enormous amount of technology and technology that has to be -- that involves manufacturing processes and that are very challenging and unique.

So we have made it a point to understand that marketplace and to go after customers and partner with customers to be the manufacturer of choice for some of these really complicated manufacturing processes and we have gotten good traction there. It is not to say some of the other alternative energy fields aren't long-term going to be of course good places to be, but we tend to focus on some of these more traditional areas that in particular are seeing some really strong performance in North America through the US' efforts to be more independent.

Sean Hannan - *Needham & Company - Analyst*

That is great. Thanks so much for all the color, Dean.

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

Thank you.

Operator

Shawn Harrison, Longbow Research.

Shawn Harrison - *Longbow Research - Analyst*

Good morning, everyone. Just one question. Free cash flow, I guess with CapEx coming down for the year and some of the volatility in the second half, I guess what should we expect for free cash flow in the third and fourth quarters, Ginger?

Ginger Jones - *Plexus Corp. - SVP & CFO*

We expect positive free cash flow in the third and fourth quarter. And my guess is -- and we are about $10 million positive to date between the first and the second quarter. I think we will see free cash flow somewhere between $55 million and $65 million probably for the full year.

Shawn Harrison - *Longbow Research - Analyst*

Okay. And then just -- (inaudible) that came to mind. SG&A at this run rate, I guess you would expect it to continue that way for the next couple quarters?

Ginger Jones - *Plexus Corp. - SVP & CFO*

We do, Shawn. What we're looking at is trying to keep SG&A at this run rate frankly for the next -- through the end of F13 and early into F14. In the current low growth environment our idea is to try to keep SG&A as flat as we can and that is really a balance of cuts we're making and investments we are making in other areas for growth.

So we certainly are making investments in SG&A, some in our team in the EMEA region to help them be successful, some in new tools that we are using globally. So what we're trying to do is make cuts where we can to make really critical investments but overall keep SG&A flat. And I would say that would be our expectation probably into the first half of F14 as well.

Shawn Harrison - *Longbow Research - Analyst*

Okay. And then just one last thing because I thought of it. Dean, I'm going to beat a dead horse, but you don't see the decline in the win scenario this quarter as any way representative of what happened in late 2010 or early 2011 when wins dropped?

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

No, I think if we go back and we look at that decrease, part of that issue was that we spent so much energy focused on harvesting the funnel we didn't do a good job back filling. And so, we essentially I will say somewhat ran the well dry. And of course we are doing a much better job now -- kind of what we'll say is the farming piece as well as the hunting piece is better balanced now. So I wouldn't anticipate that sort of situation.

Shawn Harrison - *Longbow Research - Analyst*

Okay, very helpful. Thanks so much.

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

Thank you.

Operator

Brian White, Topeka.

Brian White - *Topeka Capital - Analyst*

Good morning. Dean, maybe you could talk a little bit about the competitive environment and the pricing environment you are seeing out there right now?

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

Sure. I would say that generally speaking EMS competitors are thoughtful in their pricing models, they are focused more on getting return on invested capital performance up. So I haven't seen any meaningful movement here or trends that would suggest that we are back to a period of irrational pricing. I would say that that -- not that it doesn't occur on occasion, but generally speaking I think that the pricing environment has been stable and reasonably healthy.

Brian White - *Topeka Capital - Analyst*

Okay, great. And how many customers were over 10% in the quarter?

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

We just had the one and that would be Juniper.

Brian White - *Topeka Capital - Analyst*

Okay, thank you.

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

Thank you.

Operator

David Fondrie, Heartland Funds.

David Fondrie - *Heartland Funds - Analyst*

Good morning. I am sorry to go back to Juniper, but I think you mentioned that $30 million to $40 million of materials might be included in the -- I believe it was in the fourth quarter. Is that $30 million or $40 million then -- A, is it part and parcel of the [250] to [270] guidance that you gave? And secondly, with the pass-through or the sale of materials, would that be at much lower margins?

Ginger Jones - *Plexus Corp. - SVP & CFO*

Hi, Dave. This is Ginger. Yes, that is included in our guidance. That will be revenue for us in the fourth quarter even after we have completed production. And it generally is at lower margins. So we have factored that in and we believe we have other improvements in operating margin that will allow us to deliver the 4.5% or better operating margin that we have talked about for the fiscal fourth quarter.

David Fondrie - *Heartland Funds - Analyst*

So that is a little bit of change, because I think -- so all the programs, the builds, are done at the end of the third quarter and it is just this excess inventory that they have committed to take that will flop over into the fourth quarter, is that a way to look at it?

Ginger Jones - *Plexus Corp. - SVP & CFO*

Yes, absolutely. And we are still working with them. Some of that may -- a little more of that may end up in the third quarter in the June quarter and some may end up in September. But we are working through that with Juniper now and, as you said, the production will be complete at the end of June.

David Fondrie - *Heartland Funds - Analyst*

Great, great. Appreciate that clarification. And then, you didn't mention Coke at all. I think in prior quarters you suggested that there was a little bit of an inventory correction going on with Coke. Could you update us on that to the extent that you're able to?

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

Yes, I think we were talking about the Coke production somewhere being around $20 million per quarter, that is somewhere in that neighborhood. I would just say that generally the demand, at least to us, hasn't changed dramatically. They are still working through the inventory positions that they have with the technology. And so, we are not baking in any sort of growth expectations into fiscal 2014. Now, not that that could change, but we are just assuming right now that we continue to produce at a relatively lower level.

David Fondrie - *Heartland Funds - Analyst*

Thank you very much.

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

Thank you.

Operator

Sean Hannan, Needham & Co.

Sean Hannan - *Needham & Company - Analyst*

Thanks for taking the follow-up. So I just wanted to ask kind of a high-level question here. I wanted to see if we can get a perspective from you folks around the competitive landscape whether you are seeing some of the Asian-based EMS or other types of players perhaps becoming a little bit more visible these days in the traditional technology markets that you will cater to such as datacom, telecom, Networking, etc. Just kind of a quick sanity check around the thoughts of what you're seeing there.

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

Sure. Sean, this is Todd. Overall I would say we are not seeing a significant change in the Asia-based competitors. I mean there is a little bit of focus there around the Networking products. I mean [Hanhai] for instance has a number of the large Networking companies as customers, but we don't share any customers with them. And in general we tend to not see it in our other sectors.

Sean Hannan - *Needham & Company - Analyst*

Okay. Thanks, Todd. And then one thing to follow up on on Coca-Cola -- is there a little bit of color we could get around any additional perspective that has been shared with you from Coca-Cola in terms of their international goals, plans and how that or when that could potentially materialize? Thanks.

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

Yes, they do from time to time. We have dialogue about what their longer-term -- their plans are for the technology. But in my view I think they also have to think about whether or not the platform they have is the right one for these other marketplaces. And of course with the lower production rates or lower acceptance rates of the platform as it is today I think they are thoughtfully going through that longer-term strategic thinking.

I remain a big fan of technology. I mean, it isn't deploying quite at the rate that they thought, but they are to me still making progress penetrating the market with the technology. And where the technology exists it's delivering real value to their customers. So we are not at liberty really to talk about any more detail than that unfortunately.

Sean Hannan - *Needham & Company - Analyst*

Okay. Thanks for the perspective.

Todd Kelsey - *Plexus Corp. - EVP, Global Customer Services*

You are welcome.

Operator

(Operator Instructions). We have no further questions at this time.

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

All right, I would just like to thank everyone for their participation and I would like to just reiterate a few points in that, one, I am actually quite enthusiastic about the prospects for getting ourselves back to some reasonable growth in fiscal 2014. Certainly the opportunities in the funnel and our performance closing on business has been pretty good and has set the stage for returning to growth.

I am also enthusiastic about the work that our teams have done to reconsider productivity -- variable cost productivity, materials, a number of things in the Company. It is one thing that a little bit of pause in growth and some economic stress can do for you and that is to make you think differently. And we certainly are making some good progress on driving productivity through the Company to make sure that we can back get back to our margin performance even if growth remains at a slower pace.

So I think we are in a reasonable position. We certainly have got our work cut out for us here over the next few quarters, but I think we are in a reasonable position now to get ourselves back to value creation. So, thank you very much.

Operator

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