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PLXS - Q3 2012 Plexus Earnings Conference Call

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## OVERVIEW:

PLXS reported 3Q12 revenues of \$609m and EPS of \$0.66. Expects 4Q12 revenue to be \$590-620m and EPS to be \$0.60-0.66.



## CORPORATE PARTICIPANTS

**Angelo Ninivaggi** *Plexus Corp - VP, General Counsel and Secretary*

**Dean Foate** *Plexus Corp - President and CEO*

**Ginger Jones** *Plexus Corp - VP and CFO*

**Todd Kelsey** *Plexus Corp - EVP of Global Customer Services*

## CONFERENCE CALL PARTICIPANTS

**Wamsi Mohan** *BofA Merrill Lynch - Analyst*

**Jim Suva** *Citigroup - Analyst*

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

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

**Craig Hettenbach** *Goldman Sachs - Analyst*

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

**Sean Hannan** *Needham & Company - Analyst*

**Brian Alexander** *Raymond James & Associates - Analyst*

**Amit Daryanani** *RBC Capital Markets - Analyst*

**Brian White** *Ticonderoga Securities - Analyst*

## PRESENTATION

### Operator

Good morning, ladies and gentlemen, and welcome to the Plexus Corp. conference call regarding its fiscal third quarter 2012 earnings announcement. At this time, all participants are in a listen-only mode. After a brief discussion by management, we will open the conference call for questions. The conference call is scheduled to last approximately one hour. I would now like to turn the call over to your host, Mr. Angelo Ninivaggi, Plexus' Senior Vice President, General Counsel and Secretary. Angelo?

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### Angelo Ninivaggi - Plexus Corp - VP, General Counsel and Secretary

Good morning, and thank you all for joining us today. Before we begin, I would like to establish that statements made during this conference call that are not historical in nature, such as statements in the future tense and statements including believe, expect, intend, plan, anticipate and similar terms and concepts are forward-looking statements. Forward-looking statements are not guarantees, concern 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 October 1, 2011 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. Non-GAAP financial measures, including return on invested capital, are used for internal management assessments because such measures provide additional insight into ongoing financial performance. For a full reconciliation of non-GAAP supplemental information, please refer to yesterday's press release and our periodic SEC filings.



Joining me this morning are Dean Foate, President and Chief Executive Officer; Ginger Jones, Senior Vice President and Chief Financial Officer; Todd Kelsey, Executive Vice President of Global Customer Services; and Mike Buseman, Executive Vice President of Global Manufacturing Operations. Let me now turn the call over to Dean Foate. Dean?

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**Dean Foate - Plexus Corp - President and CEO**

Thank you Angelo, and good morning, everyone. Last night we reported results for our fiscal third quarter of 2012. Revenues were up 6% sequentially to \$609 million with EPS of \$0.66. The revenue result was above the mid-point of our guidance and set a new record for the Company. Our EPS result was at the high end of our guidance, benefiting from foreign currency gains and a lower than expected tax rate.

Overall, considering the environment, I was pleased with the quarter. We delivered strong revenue growth with acceptable margins while making a meaningful improvement to working capital. Our return on invested capital performance was solidly above our weighted average cost of capital, and we generated decent free cash flow.

The actual to demand forecast performance within our fiscal third quarter was relatively stable with our sectors performing largely as expected. However, our longer range forecasts across our sectors continue to be volatile as customers struggle to project end-market demand in the challenging macro-environment.

Turning now to some insight into the performance of our market sectors during our fiscal third quarter of 2012 and our current expectations for Q4. Our Networking/Communication sector was up about 13% sequentially in fiscal Q3. On balance the result was a bit stronger than our expectations when we set guidance in April.

We currently anticipate fiscal Q4 revenue will be sequentially flat to slightly up for our Networking/Communications sector, reflecting a softening of the expectations that we had a quarter ago. In our view, end-market challenges are affecting the majority of our customers in this sector. In Q4, we are beginning to ramp a new customer program that is offsetting, in part, some of the broader weakness in this sector.

Our Medical sector revenues were up about 11% sequentially in fiscal Q3, slightly softer performance than our earlier expectations. Our Medical sector forecast has softened modestly for Q4 when compared to our view in April. We currently expect revenue to be up sequentially in the low single digit percentage range. Our Industrial/Commercial sector was down sequentially about 1% in Q3, a result that was marginally weaker than our expectations for a flat to slightly up quarter when we set guidance.

Now, when we set guidance last quarter, we noticed that a few of our top customers in our Industrial/Commercial sector were managing inventory positions in anticipation of end-market weakness in our fourth quarter. We currently anticipate that the combination of a continuing inventory correction and further end-market weakness will result in revenues declining in the mid-teens percentage range for this sector in our Q4. The weakness is broad based with 13 of our top 20 customers in this sector indicating sequential declines in revenue.

Our Defense/Security/Aerospace sector was down about 4% in Q3, in line with our flat to down expectations. Consistent with our earlier view, we currently anticipate strong growth in Q4 for our Defense/Security and Aerospace sector with revenues up 20% or better, driven primarily by new program wins.

Turning now to new business wins, during the quarter we won 36 new programs in our Manufacturing Solutions group that we anticipate will generate approximately \$203 million in annualized revenue when fully ramped in production, representing four quarters of new wins performance above our target. Our new -- our business development funnel strengthened this quarter to \$2.2 billion, a good result considering the number of new wins harvested from the funnel over past several quarters.

Turning now to our guidance, we are establishing fiscal fourth quarter 2012 revenue guidance of \$590 million to \$620 million. At that level of revenue, we anticipate EPS of \$0.60 to \$0.66, 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 fourth quarter revenue will be essentially flat when compared to our fiscal third quarter.



Now I'd like to make a few comments on our operating environment. As I highlighted in the press release, and consistent with last quarter, our growth is largely being driven by our strong performance winning new customers and programs versus end-market growth of mature programs. This growth profile, when our growth mix is heavily biased toward new programs, pressures our financial model.

To optimize our financial model, we need a better balance of growth of our mature programs, which typically yield better operating returns, essentially fund the startup costs associated with new programs in their early production phases. While we believe our current level of operating margin performance is industry leading, it is below our target and may be difficult and challenging to achieve with our current growth mix and our capacity investments that are required to support our new customers and programs.

Looking ahead to fiscal 2013, we are anticipating a macro-environment that continues to be challenging, making longer-range growth projections exceptionally difficult as end-markets for many of our customers remain volatile or muted. Despite the macro backdrop, we remain optimistic that we will experience stronger year-over-year growth in fiscal 2013 as we work to continue the strong new program wins performance that we achieved over the past several quarters. To ensure that this growth delivers economic profit to our shareholders, we will continue to drive initiatives that are intended to improve our operating performance and our invested capital efficiency. Ginger?

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**Ginger Jones** - Plexus Corp - VP and CFO

Thank you, Dean. As Dean mentioned earlier, our third quarter revenue was slightly above the midpoint of our guidance range. Gross profit was 9.4% for the fiscal third quarter. This was in line with our expectations and slightly lower than our fiscal second quarter results of 9.5%.

Selling and administrative costs were \$30.1 million, at the high end of our expectations as a result of higher variable incentive compensation expense. SG&A costs as a percentage of revenue were 5% in the fiscal third quarter, consistent with the 5% in the fiscal second quarter.

Operating margin was in line with our expectations at 4.5% and consistent with our operating margin in the fiscal second quarter. Return on invested capital was 15% for the fiscal third quarter, 250 basis points above our weighted average cost of capital for F '12 of 12.5% and improved from the fiscal second quarter. Our efforts to reduce working capital continue to show excellent progress as cash cycle days came down three days to 63 days. This is a very good result, well below our expected range of 66 to 68 days and a decrease of seven days from the end of fiscal 2011.

I'll now get into the details by balance sheet line item. Days and receivables remained at 47 days. Days and receivables have very consistently been in this range of 46 to 47 days during fiscal 2012.

Days in inventory were 81 days, down six days from our results in the prior fiscal quarter. The dollar value of inventory was down about \$5 million from the prior quarter. This is a very good result and the result of a lot of hard work and great teamwork from our supply chain and customer management team, as well as our three regional teams.

Accounts payable days were 59 days, down three days from the prior fiscal quarter and at a more normal level for Plexus. Days of cash deposits were consistent with the prior fiscal quarter at six days. The dollar value of cash deposits increased by about \$2 million to \$35 million. As a reminder, these are deposits received from customers to offset the risk of inventory that we hold on their behalf.

Free cash flow generated during the quarter was again very strong at \$23 million. This cash was generated largely from earnings during the quarter as total working capital dollars increased slightly in the fiscal third quarter on the higher revenue level.

During the quarter, we spent \$12 million in capital expenditures with approximately \$4 million of that for footprint expansion in Xiamen, China and Oradea, Romania. Our fourth facility in Penang, Malaysia is complete and began operations in our first fiscal quarter of 2012.

We have not yet begun significant spending on the new production facility in Neenah, Wisconsin that we announced in May 2012, although work is underway and we expect to complete the facility in the fall 2013. As a reminder, this, 410,000 square foot manufacturing facility will replace two existing leased facilities in Neenah and will consolidate approximately 1,000 employees into the new building. The facility is expected to cost approximately \$50 million, and Plexus is eligible for \$15 million in enterprise zone tax credits from the state of Wisconsin through the Wisconsin

Economic Development Corporation and additional incentives from the city of Neenah. After completion of the facility and consolidation into this location, we expect this to reduce our operating costs and improve the manufacturing capabilities for our customers in the Americas region.

As discussed in the press release, during the fiscal third quarter we entered into a five-year \$250 million senior unsecured credit facility. This new credit facility includes a \$160 million revolving credit facility and a \$90 million term loan which refinanced our previous \$100 million senior unsecured revolving credit facility and the balance of \$90 million under our senior unsecured term loan, both of which were scheduled to mature in April 2013. The additional borrowing capability under the new facility is available to satisfy future growth and general corporate purposes. We believe this level of debt appropriately leverages our balance sheet to improve weighted average cost of capital and create shareholder value.

I will now turn to some comments on the fiscal fourth quarter of 2012. Gross margin is expected to be the range of 9.5% to 9.7%, up slightly from our gross margin in the fiscal third quarter. This is a good result considering the current challenges which include modest drag from new capacity in Penang, the transition costs for the new Kontron business and the challenges of achieving our target model when a significant portion of our revenue growth is coming from new program wins.

We are continuing our focus to offset near-term gross market pressure with aggressive cost net containment of SG&A in an effort to protect operating profits. We are seeing leverage in SG&A with a decrease of 5.3% in the fiscal first quarter to 5% in the fiscal third quarter. SG&A for the fiscal fourth quarter of 2012 is expected to be in the range of \$29 million to \$30 million, consistent with our spending in the fiscal third quarter.

Depreciation expense is expected to be approximately \$12.2 million in the fiscal fourth quarter, up slightly from the \$12.1 million in the fiscal third quarter. This results in expected operating margin of 4.6% to 4.8%, modestly improving from our results in the fiscal third quarter.

Although the EPS range for the fiscal fourth quarter is the same as for the fiscal third quarter, the results are operationally stronger as we're not expecting the benefits we saw in the current quarter from currency exchange gains and the reduced tax rate.

We are estimating the effective tax rate for fiscal '12 will be 9%, a slight decrease from the 10% discussed last quarter. This is consistent with the 8% to 10% range that we established at the beginning of fiscal 2012. And just as a reminder, this is an increase from fiscal '11 based on improved outlook for US operations and for changes in the mix of forecasting earnings between taxing jurisdictions.

Our expectations for the balance sheet are for working capital dollars, inventory, accounts receivable and accounts payable to be relatively flat for the fiscal third quarter. Based on the forecasted levels of revenue, we expect these changes will result in cash cycle days net of cash deposits of 62 to 64 days for the fiscal fourth quarter.

Our capital spending forecast for fiscal 2012 will be approximately \$70 million to \$75 million, a slight decrease from our estimate last quarter. This estimate includes our announced investments for future growth, specifically our new footprint in China and Romania and the Neenah, Wisconsin consolidation footprint in the United States. We remain optimistic about our continued organic growth, and we will continue our plan to expand our footprint in close proximity to our existing locations.

In addition, over the past several quarters we have improved utilization of our existing facilities and equipment to serve new customers. With these improvements and the new capacity of Penang, Malaysia that was completed early fiscal in 2012, we are at 80% global actual capacity in the fiscal third quarter.

As Dean mentioned, our current customer forecast supported improving revenue growth through fiscal 2013. Although gross margin and operating margins may be slightly below our long-term targets currently, we believe that we are delivering significant value to shareholders through the combination of significant revenue growth, industry leading operating margins and the shareholder value created by our ROIC of 250 basis points above our weighted average cost of capital.

With that, I will open the call for questions. We ask that you please limit yourself to one question and one follow-up. And operator, please leave the line open for follow-up questions.

## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions) Our first question comes from Wamsi Mohan from Bank of America Merrill Lynch. Your line is open.

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### Wamsi Mohan - BofA Merrill Lynch - Analyst

Thank you, good morning. You had over \$200 million in new wins in the past four quarters. You clearly alluded to the fact that these new wins are contributing more to growth and pressuring margins. I was wondering if you can share what the split is of revenue from new wins over the past four quarters on average, compared to those of existing programs. What I'm getting to is, is there a certain mix of new programs versus mature programs that you view as best suited both for growth and maintaining margins? Thanks.

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### Dean Foate - Plexus Corp - President and CEO

I don't know that we have a very precise number that we can give you. I can tell you, though, that if you look at programs that were executing a year ago in the market, and this is a broad statement because certainly, there are individual customers and individual product lines that are doing quite well, it's clear there's just not a lot of end market growth out there, and I don't think that should be a surprise to anyone.

Right now, I'd say you look at our top line growth, and it's -- I would say the growth you could attribute to, 75% or 80% of that is associated with programs that we have won during this uptick in accelerated new wins that began in Q4 of fiscal '11. Todd, you're welcome to opine here if you think you've got a more accurate number here, but I know that we look at this in terms of how we try to break it out.

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### Todd Kelsey - Plexus Corp - EVP of Global Customer Services

I'm good, Dean.

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### Wamsi Mohan - BofA Merrill Lynch - Analyst

Okay, thanks, Dean. And as a follow-up, you noted the funnel of qualified business opportunities has actually increased to \$2.2 billion. Any color you can share there would be helpful. Thanks.

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### Dean Foate - Plexus Corp - President and CEO

Yes, I think that is attributable to our team. I think that we continue to work on building the team and the tools and the processes that we use to drive new business development, and I think that we have got the best team that we have ever had in the Company driving revenue growth sector by sector, the best accountability, the best tool set. And so we're just getting, I think, in front of more opportunities, and I think the other piece of it that is important is that the economic pressure that continues to be put on the OEMs is having them consider who they want to be as their long-term partner.

So, there's a consolidation process going on in terms of selecting EMS partners, and there are also opportunities that are new outsourcing opportunities, so this will be revenue that's currently manufactured inside at OEMs. And we continue to see, I won't say a fast pace, but certainly a very consistent pace of those newer, bigger opportunities coming into the funnel where OEMs are looking to shut down manufacturing.

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**Wamsi Mohan** - BofA Merrill Lynch - Analyst

Thanks for the color, Dean.

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**Dean Foate** - Plexus Corp - President and CEO

You're welcome.

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**Operator**

Our next question is from Jim Suva from Citi. Your line is open.

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**Jim Suva** - Citigroup - Analyst

Thank you to Plexus and congratulations to and your team. I have one question for Dean and then one question for Ginger post your prepared comments.

Dean, you had mentioned something about, I think you heard say aerospace should be pretty strong going forward, or maybe that was aerospace and defense, or -- can you exactly clarify which of those subsets it was? Can you help us understand that? As you know, I think people many people think that defense and aerospace and those are under a little bit of pressure, or is the aerospace more driven to the commercial side? And help us understand why it would be so lumpy as most people think about airplane production ramping, but pretty steady, not a lot of puts and pulls each quarter.

And then Ginger, you made some comments about operating margins under a little bit of pressure due to program ramps. On that comment, was there anything specific that you could point to? Because I would think that Plexus, given your pipeline of new business wins, is always ramping new programs. So I was curious about your commentary around the operating margin pressures. Or is it just more top line is not quite as healthy as what you are used to for the 15% growth that may prevent a little bit of getting operating margins to your goals? Thank you.

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**Dean Foate** - Plexus Corp - President and CEO

Jim, I know that you specifically pointed that first part of that question at me, but I'm going to ask Todd to take it because he is much closer to the customer sets in our DSA sector and could give you some good color, I think, around it. Todd?

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**Todd Kelsey** - Plexus Corp - EVP of Global Customer Services

Sure, so first of all, Jim, when Dean referred to the Defense/Security/Aerospace numbers, those were across those three sectors that we really lump in together under one go-to-market team. So there's, I'd call it three distinct components there, and I think you are correct when you say that aerospace tends to not to be very lumpy and tends to be very stable, and that's a pretty good chunk of our business within that sector. Probably on the order of when you lump Defense/Aerospace with Aerospace, probably close to half of the sector.

But there's also another major component in there, which is Security, which tends to be around Homeland Security and government or agency-based security, and that can be a little bit lumpier based on buying patterns of typically what would be government agencies and things such as that. So we perhaps saw a little bit of weakness in that area in our fiscal Q3 where we are seeing strength in that area in Q4, but then the continued growth of the sector through the new business wins, and the business wins have been strong in that sector, as well as our other four market sectors.

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**Ginger Jones** - Plexus Corp - VP and CFO

Jim, (multiple speakers) and I will address your second question about the operating margin. We have been trying to make clear over the last couple quarters the challenges we have to hitting our full targeted 5% operating margin in the current environment. And in this environment, what we are seeing is existing programs, so mature programs that would traditionally be more profitable are not growing or are shrinking in this challenged macro-economic environment we have got.

We've been able to show top line growth, largely because of the strong new program wins, and those businesses, as I'm sure you know, are a little more challenged in the early quarters of the ramp because we are still working out the manufacturing solution, we're still getting to full volume and we're still optimizing the supply chain. So you're right, on an ongoing basis, Plexus is a growth company, so we're always going to have some mix of new and mature programs. But what we're finding is in this environment where new revenue is primarily coming from new programs, it's very difficult to get to our full 5% operating margin.

Although with that said, the margins we are delivering of 4.5% I think are very strong, industry leading and certainly generate significant shareholder value. So, we want to get this balance right, we want to let shareholders know we haven't let go of the 5% operating margin target. That is still our target, but we are also pleased with the results we were able to deliver in this current environment of 4.5%, and we think that is a strong result.

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**Jim Suva** - Citigroup - Analyst

Great, thank you so much for your clarity and again, congratulations to you and your team at Plexus.

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**Dean Foate** - Plexus Corp - President and CEO

Thank you, Jim.

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**Operator**

Our next question is from Steven Fox from Cross Research. Your line is open.

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**Steven Fox** - Cross Research - Analyst

Thanks, good morning. Two questions, first on your operating margin guidance for the quarter, it's -- you are calling for it to uptick a little bit, but you raised a number of drags during the -- your prepared remarks, and I am just curious, relative to having flat revenues this quarter versus last quarter, what is benefiting in the margins to get them a little bit stronger this quarter? And then secondly, Dean, given some of the, what seemed like more subdued comments about next fiscal year, how is that going to affect some of the capacity or expansion plans underway or recently completed, and what could that mean for your CapEx number for next year? Thanks.

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**Ginger Jones** - Plexus Corp - VP and CFO

Yes Steve, I'll start. We do expect margin to be slightly better in our fiscal fourth quarter, and part of that is just the continuing mix of business that is often a large driver of what programs we expect to be strong during the quarter, although I would say there is a modest improvement from our process of integrating the Kontron business. This is business that we took on in January. We've been able to make good progress in getting all of that business moved to one of our -- a Plexus facility and out of the Kontron existing facility. So, we have not completed all that work, and there is more work to do as we look into F '13, but we are seeing some modest benefit from that in the fiscal four quarter.





**Dean Foate** - Plexus Corp - President and CEO

Yes, now I'll talk about the comments on next year. I think what we're trying to do is signal that, obviously, there is a lot of uncertainty in the macro environment next year. I would say that at this point we still have line of sight to double-digit top line growth, and we think that the acceleration of the new business wins here over the course of the last year certainly supports that kind of growth, but it is just early yet at this point to really get any confidence around it because of all the uncertainty.

So, at this point, I would say that we are continuing with our capacity expansions carefully, because we do have other expansions contemplated beyond the ones that we currently have underway, and of course we would not begin any of those kinds of things until we get a lot more certainty in F '13. And I'm not suggesting that those are going to be F '13 projects at all, but they are things that we start to get ready to do, and I think it just depends upon the trajectory here of revenue growth.

But at this point, we are still -- we're quite optimistic just because we continue to win a lot of new business, and the expansion of those customers in the regions at which those customers need us to service them compels us to continue on with the facility in Oradea. We talked, Ginger talked, I think, at length about the facility here in the Fox Cities. I think it's important again to emphasize that that is a consolidation play which, when done, will actually be beneficial to operating performance and also then will give us some additional capacity expansion while actually giving us a more efficient operating performance.

We've got a couple things that are actually in play right now that will make life better for us here as we move through fiscal '13 into '14. But really, right now we feel pretty good about our top line growth. You just can't tell whether all of a sudden we're going to tip over into a recession here. We've got an economy that some people are estimating is almost a no-growth economy, so we'll have to see how this plays out.

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**Steven Fox** - Cross Research - Analyst

Thank you, that is very helpful.

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**Operator**

Our next question comes from Sherri Scribner of Deutsche Bank. Your line is open.

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**Sherri Scribner** - Deutsche Bank - Analyst

Hi, thank you. I wanted to dig a little bit into some of the segments. In terms of the telecom segment, you guys seemed to perform a bit better than we would have expected, and I think the commentary was that that segment was better than expected. Even though in this environment it sounds like most of the telecom companies have been relatively negative. So, I wanted to understand why you outperformed there, what you think is different about what you guys are doing?

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**Dean Foate** - Plexus Corp - President and CEO

I think everyone knows we had a bit of a tough Q2 in that segment, so we did get some recovery. I would say also that part of our performance here is related to new business wins and the ramping of new programs, some of which has been a consolidation of business into Plexus away from competitors. So I'm not -- I wouldn't want to say this is all because the end markets have suddenly recovered and gotten strong by any stretch. A lot of this is just, like I said, around the volatility overall that we are seeing near-term in that sector.

On a forward basis, we want to really be cautious about what we say here because obviously, we are out in front here of our biggest customer who reports next week, so we don't want to get specific at all on anything related to Juniper. But as my commentary in the script said, we are seeing some weakness across almost all of our customers in that sector in Q4.



We don't know whether that is just cautiousness on their part with their forecasting or whether they are really concerned about end market demand. And really, what is holding us at a relatively flat to slightly up performance in Q4 is more because we are ramping some business from a new customer that we won just a quarter or so ago, so we are getting a little bit of support there in the Q4 -- in our Q4.

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

Okay, that's helpful, thank you. And then Ginger or Dean, I don't think anyone has asked about it, but how is your Coca-Cola business ramping? I know you had a really good quarter with them last quarter, they were a more than 10% customer, and then now we knew that they were going to fall off a bit, but if you could give us an update on that business. Thanks.

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**Dean Foate** - *Plexus Corp - President and CEO*

Yes, I think with Coke, the full year turned out -- it looks like it's going to turn out pretty well close to what we thought, approaching \$200 million or so, which is what our expectation was. It will be a little bit softer here in this -- certainly it will be down some in this Q4. I think the notable with Coke is like many of our customers in that sector, they're going through an inventory reconsideration here and a correction, and we think with Coca-Cola specifically, this was a new product coming into the marketplace.

Initially, this technology had some component yield issues and manufacturing yield issues as we worked through all of those kind of things. Coke was really concerned about making sure they had enough of these units on the shelf, so they built a pretty strong inventory position of the units. And what has happened over the last couple of quarters of course is they have realigned this business into a different team.

The technology is more stable now, and we've proven that we can burst quite strongly here in terms of the manufacturing rate with really high yields. And so, Coca-Cola, at least as we understand it, right now is reconsidering their inventory position of these units, because they feel that we can burst to keep up with demand if they need us to. So, we believe we are going to see a pullback here in the next quarter or two in terms of production rate, which we have baked into our numbers as they start to work down the inventory position a little bit to what seems to be a little bit more what we would think would be reasonable.

So -- but a lot of that is all -- there is some uncertainty yet around what the actual full production rate will be for the coming fiscal year. They are still working through their whole reconsideration of their plan considering the inventory realignment, but we feel really good about the technology and where it is going. And of course, they were pleased that we could bill at such a high rate with such a high yield level. So, in some respects, it creates a near-term problem for us, but I think overall, having the supply chain leaner on the units is a good thing.

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

Okay, great. Thank you for all the detail.

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**Operator**

Our next question comes from Craig Hettenbach from Goldman Sachs. Your line is open.

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**Craig Hettenbach** - *Goldman Sachs - Analyst*

Yes, thank you. Dean, can you give some context, you mentioned the Networking segment, a new customer ramp there, just ex- that the core business, how it looked versus the flat guidance you provided?



**Dean Foate** - Plexus Corp - President and CEO

Oh, let's see here, what would we take out? Todd, do you get the number in your head roughly what it would be? I think you got to take out another \$25 million or \$30 million out of the projected number for Q4. I mean, think --

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**Todd Kelsey** - Plexus Corp - EVP of Global Customer Services

I would say if you look at the customers that we came into the fiscal year with and you subtracted out the new one, you'd say the existing are down. It is a soft end market, and that team's doing a great job of winning new business which has been showing up in our new program wins, so that would be the best way to put it.

And when we say new program wins, I think that one thing that everybody should keep in mind too is we consider new programs with existing customers to be a new program win. And so a good share of those wins have been existing customer wins, and I would say even the majority because we have a relatively small customer base.

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**Dean Foate** - Plexus Corp - President and CEO

Yes, and I want to make sure I get this number right, because I was talking a full year number with that ramp in customers, so it would probably be down a couple of percent if you pulled out the ramp.

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**Craig Hettenbach** - Goldman Sachs - Analyst

Okay, so that \$25 million to \$30 million is a full year number?

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**Dean Foate** - Plexus Corp - President and CEO

Yes.

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**Craig Hettenbach** - Goldman Sachs - Analyst

Got you. Okay, so just as a follow-up, nice growth in Medical in the quarter and some outlook for some continued growth there. Can you talk about some of the growth drivers you are seeing in that end market?

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**Dean Foate** - Plexus Corp - President and CEO

Again, this is all about new business wins. Medical is -- our Medical and healthcare team here has been just doing a phenomenal job consolidating business with some of our existing customers who've got business spread out all over the place, and so we have been a net beneficiary of that.

We've also engaged in a couple new customers that have some pretty interesting technologies that they are bringing into the marketplace. And so our portfolio of customers is becoming, I think, more robust across life-sciences as well as some of the traditional healthcare space, where we have been heavy in imaging and cardiac rhythm management and some of these other places that we like, but also we like getting ourselves a little bit more diversified.

These life science pieces are starting to become meaningful to our overall medical sector, and in fact, just to telegraph a little bit, we are probably going to rebrand the name of that sector here as we come into the new fiscal year to more accurately define the breadth of the business that we have there.



**Craig Hettenbach** - *Goldman Sachs - Analyst*

Any changes to profitability in that segment?

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**Dean Foate** - *Plexus Corp - President and CEO*

No, I think the profitability has been consistent. I think over the years I think it tends to be -- the business tends to be a little bit more stable, at least near-term. The question is what the profitability is going to look like on the go forward, because of the healthcare law and the excise tax that's going to be put on medical equipment companies and how successful they're going to be at pushing that back to the supply chain or passing it along to customers, or whether or not they're just going to get leaner and meaner themselves and try to take the cost out of their business models.

So, we haven't seen anything real meaningful around that, but there is that uncertainty. I think the flip side of that is the healthcare law is going to enable a whole bunch more people to have health care and so therefore, the medical equipment folks see this as an opportunity to expand, essentially, their customer base and their revenue base over time.

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**Craig Hettenbach** - *Goldman Sachs - Analyst*

Got it. Thanks for that.

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**Operator**

Our next question comes from Shawn Harrison from Longbow Research. Your line is open.

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

Good morning, everyone. Just wanted to -- the \$200 million of program wins this quarter, if you could just discuss the end market mix of that and maybe if that has been any different than what you have seen over the past three quarters of robust wins?

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**Dean Foate** - *Plexus Corp - President and CEO*

Yes, I can give you the -- I'll give you the breakdown in percentages here, and you will have to excuse us if this doesn't add up exactly to 100%. Sometimes we have some rounding there. But when you look at the \$200 million plus here, about 26% of that number was in Networking/Communications, 29% Medical, 32% Industrial/Commercial and 14% in Defense/Security/Aerospace.

I think also encouraging is when you look at it on a regional basis, so this would be where the revenue is going to be executed. We had a really strong quarter here for revenue that will be executed in Americas, so about 58% of it is new wins into the Americas region, 16% in EMEA and 26% into APAC. We wanted to drive some diversification of the platform here in the Americas, and so that certainly is a good outcome for the quarter. But these things have been slow quite a bit obviously quarter-to-quarter, but certainly in the current quarter, that is a good outcome.

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

As we look at the pipeline growing to \$2.2 billion, how does that mix shake out? And more importantly, what does that say about your ability to continue to drive next quarter or the quarter beyond, another few quarters of \$200 million program wins? You've been running at such a high rate for a while, just wanted to see, does the larger pipeline mean that you can keep it up through the end of the calendar year?

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**Dean Foate** - Plexus Corp - President and CEO

Well Todd, what say you? (laughter) Your partner might (inaudible), as well. I guess I'm on the spot here. I guess what I would say, Shawn, is we are seeing growth in the funnel of broad-based across all our market sectors. So, I think it's a good testament to the go-to-market teams as well as the operational folks that support those teams and execute at such a high level within Plexus.

So I think what we're seeing is more traction with the brand in the marketplace and more ability to be able to grow that business across all four of our market sectors. As we look at wins, I hate to be a prognosticator to the end of the year, but I would say certainly we feel good about next quarter, and I think that is where you look at the visibility being -- things change so quickly within the funnel. Opportunities come in, they move out, but we feel really good about our ability to be able to continue the strong wins performance looking into next quarter.

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**Shawn Harrison** - Longbow Research - Analyst

Thanks so much.

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**Operator**

Our next question comes from Sean Hannan from Needham & Company. Your line is open.

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**Sean Hannan** - Needham & Company - Analyst

Yes. Good morning. When you look at the new business, Dean, that you have won over the course of last 9 to 12 months and think about how this was originally supposed to ramp, now as you look to September or early fiscal '13, can you share your perspective around what may have shifted out? Have there been any shift outs? Are there any large programs or segments where that dynamic might be pronounced or more at risk? That is kind of part one.

And then part two, also in terms of new program ramps, I believe that there were a number of not just new programs, but specifically new customers coming in within your Communications segment. Can you provide us with any thoughts around that, how that will help that piece of your business?

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**Dean Foate** - Plexus Corp - President and CEO

Yes, I think -- there's a lot going on in your questions. I guess what I would say is that from a -- there is always variability, in terms of the way new programs ramp. I would say that generally programs with existing customers are a little bit more predictable than programs with new customers, just because the transitions are a little bit more uncertain, particularly when you're pulling business away from a competitor, or whether it is a brand-new to the market technology where if you're building follow-on technologies for existing customers and it's a little less variability.

But overall, I would say that the ramps have been reasonably consistent with expectations. I think that it's important when people are looking at our overall revenue, there's been a little bit of skepticism a little bit, whether or not the revenue -- the new wins are creating revenue. And I remind everyone that our acceleration of new wins began in Q4 of F '11. As so, as you know, it takes a bit of time for these things, a couple of quarters usually before you start to see the ramps.

Now, if you look at the year over number on Q3, we are up nearly 9% on the full year -- on the Q3 year over, and you have to contemplate that there was still \$15 million of the Avocent business in our prior year Q3. You look at the Q4 number that we're guiding here, because we had a soft Q4 last year, we're up, I think, if we assume we're going to hit the midpoint, we are up about 12.5% on the year over in Q4. You look at our projected full-year now in fiscal 2012 and compare that to the full-year fiscal '11, it only shows that we're going to be up 3.8% to 4%.

But also, when you look at the full-year, last year in fiscal '11 we had between Avocent and Starent, the two programs that we disengaged from, there was \$80 million in revenue in fiscal '11. So, when you normalize those numbers, I think it becomes evident that we are, in fact, seeing growth



from these new program wins and that we would expect that growth to continue to accelerate, assuming that the economy doesn't crash and burn. So I think overall, things are playing out pretty well considering the variability, in terms of production ramps and new programs.

Now, coming to the new customers in the Network Communications sector, I'm not exactly sure how to answer that other than to say that this has been a sector, obviously, that -- where we have our biggest customers. So, of course, revenues in that sector are dominated by our biggest customer, and we like the relationship we have with Juniper, and we continue to win new business opportunities with Juniper and expect that we will continue to be a strong partner to them.

But we also know that it's important for us to diversify that business, and so we have added other customers into that sector, some of which are fairly significant customers where we are beginning to gain share. Others are smaller, I would say more emerging technology kind of companies that we think can have some explosive growth as their technologies come out into the marketplace. But of course, there's always more in uncertainty with those explosive growth companies on whether or not they can launch follow-on products and follow-on technologies or perhaps what even the exit strategy is for those companies as they compete in a marketplace that's got some very big competitors.

So I think generally I think it's -- we are diversifying and trying to engage with the right kinds of customers so we can reduce the risk that we might have when some of the smaller companies would -- were perhaps getting taken out in the marketplace and try to get more stable revenues in that marketplace.

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**Sean Hannan** - *Needham & Company - Analyst*

That's helpful. And then one more here, the \$200 million plus of wins you've reported in the quarter, can you remind us of the level of wins that you require for the double-digit growth targets that you folks have? And then when you say that you have the line of sight to double-digit growth for fiscal '13, what are you assuming from your mature programs? Would the growth that you saw this year, 80%-ish, coming from new wins, is that something that we would expect to be continued? Or what is assumed behind that other piece of the comment?

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**Dean Foate** - *Plexus Corp - President and CEO*

I think our assumption right now is that end markets continue to be challenged and that we're not going to see a lot of growth acceleration of what I'll call legacy or more mature programs. And so our assumptions are around fairly anemic end market growth, and what's going to drive top line growth is going to be the acceleration of the continuing ramp of the programs that we've been adding into the business here over the course of the last year. Now, there's another piece -- a piece of your question around the \$200 million, so let me -- I'm going to let Todd walk through the math on that real quick.

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**Todd Kelsey** - *Plexus Corp - EVP of Global Customer Services*

Sure, so thanks, Dean. The one -- I guess the biggest thing to keep -- to take into consideration when you look at the new wins and the impact on revenue is the broader economy. One of the things as we have really evaluated our needed wins to maintain the 15% growth rate as we look at the biggest factor in how much growth do we get is the broader economy.

Take that into consideration first, but what we look at, and we look at how much business do we need to win in a, call it a stable or normal economic environment. And if we factor in that number, it is about \$150 million to \$180 million, given where we're at right now. We view it at the high 20s percentage of trailing four quarter wins that we need to win to be able to maintain the 15% growth projections.

I think one could say that, and I think it's pretty obvious that we are not in a normal economic environment, so if we're going to achieve the 15% growth, we need to far outsize that upper 20s percentage range. But right now we're at 39% if you do the trailing four quarter math. So I think we feel reasonably good, but again, we don't know that is enough to overcome the broader economic malaise that's going on right now.



**Sean Hannan** - *Needham & Company - Analyst*

That is a very helpful thought process and data, thank you.

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**Operator**

Our next question comes from Brian Alexander from Raymond James.

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**Brian Alexander** - *Raymond James & Associates - Analyst*

Just to follow on that train of thought, even if the base business doesn't growth in fiscal '13 or even shrinks a little, Dean or Todd, it would seem like new wins alone should support meaningful growth acceleration in the neighborhood of 20% or even better should be doable, even if we haircut the new wins by 30% or 40%. Is that too optimistic, or are you expecting the base business to shrink more than 5%?

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**Dean Foate** - *Plexus Corp - President and CEO*

That feels a little optimistic to me, just because if the economy would be such that we would get zero growth from the mature programs, that would also suggest likely that those same economic pressures would apply to the new business wins. And so I wouldn't want anybody out there suggesting 20% growth at this point, just because I think there's just far too much uncertainty.

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**Todd Kelsey** - *Plexus Corp - EVP of Global Customer Services*

One other piece, too, Brian, that I didn't talk about in the response to Shawn, or a couple other factors that are significant is really what happens with that legacy business. I think pieces that need to be factored in is there are certain programs that are going to go to end of life, so their revenue will essentially be zero year-over-year.

And there is a certain amount of cost reductions or price reductions that our customers expect from us, so it really makes the hurdle larger. And that is where the broader economy has such a significant impact because it can overcome those end-of-life programs and the cost reductions that our customers expect us to pass on. And right now, we are not getting that end market growth.

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**Brian Alexander** - *Raymond James & Associates - Analyst*

That was actually my next question, Todd. Are you seeing a greater than normal level of end-of-life programs than you have historically?

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**Todd Kelsey** - *Plexus Corp - EVP of Global Customer Services*

No, not greater than normal, typical.

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**Brian Alexander** - *Raymond James & Associates - Analyst*

Okay, and then just on the margins, Ginger, how much of this is just a function of larger programs having inherently lower margins during their entire lifecycle, and those are becoming a bigger part of the mix versus more timing of program ramps? I'm trying to get a sense for whether you think you can improve from 9.5% to 9.7% gross margin as the programs mature, or if the business mix suggests that we're going to be at these levels for a longer period. Thanks.

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**Ginger Jones** - Plexus Corp - VP and CFO

Yes, Brian, we think the biggest driver is the maturity of the program, where they are in the ramp, and not the size of the program. We still believe with our target sectors and the customers we have that we can get back to a 5% operating margin when that mix of new revenue growth is better, right when it's balanced between end programs growing and mature programs growing a little bit and new programs that will ramp. I think far and away the biggest factor in this is the issue we have been talking about, which is that mix of business and the challenges when so much of the revenue is weighted towards new programs.

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**Brian Alexander** - Raymond James & Associates - Analyst

And just finally, I know you commented on CapEx for this year, did you also provide a range for next year?

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**Ginger Jones** - Plexus Corp - VP and CFO

We have not, and I think that's a little bit, really I would say that it will probably be above what we would expect to see for this year, the \$70 million to \$75 million, but I don't think significantly above that. We have a number of programs that are -- projects that are underway, so we have good visibility to Romania, completing Xiamen, China, which will frankly be done this fiscal year and the new Neenah operations. So, I would say slightly above where we are expecting for this year.

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**Operator**

Our next question comes from Amit Daryanani from RBC Capital Markets. Your line is open.

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**Amit Daryanani** - RBC Capital Markets - Analyst

Thanks, good morning, guys. Just have a question. When I look at the September guide that you guys are providing, it sounds like demand is going to be down sequentially on an organic basis, but you have ramps in Networking and Defense. Given everything you've talked about, the macro being weak and seeing the end demand down, how much comfort do you really have that these ramps won't get delayed or shrink in size, especially in the current macro environment? And have you seen that happen in the last quarter or two?

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**Dean Foate** - Plexus Corp - President and CEO

I don't think that we have seen anything incredibly material to the ramps and the ramp rates associated with newer customers. We are always pretty conservative, I think, when we try to give our revenue guidance and of course, we've got a good track record for being in the guidance window. So I think that I feel pretty good about the integrity of our forecasting process and that it will hold up in the quarter.

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**Amit Daryanani** - RBC Capital Markets - Analyst

Fair enough. And then it sounds like the 10% gross, 5% op margin targets, you don't anticipate hitting that in the next few quarters unless obviously demand improves. But is there a revenue run rate that you have in mind that could enable you to achieve those numbers?

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**Ginger Jones** - Plexus Corp - VP and CFO

Yes, Amit, I don't think that is the right way to think about it for F '13, and we have thought about this a lot and how to get back to those numbers. So I think the best thing for us to say is in the current environment, we certainly don't believe we're going to get our 5% operating margin target until later in fiscal '13.





And so I think the real way to think about this is -- what materially could move that is if we do begin to see a strengthening of the economy and we see some end market growth. At this point, that is our biggest driver, and so I wouldn't want to set a revenue level at which I'd say that gets us back to 5% operating margin.

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**Amit Daryanani** - RBC Capital Markets - Analyst

Fair enough. And just finally, I know you guys said you don't want to touch a whole lot on your largest customer, but the customer did perform exceptionally well in the September quarter. Do you expect that kind of trend to sustain, or was that some specific program driven benefit that you just had in the June quarter?

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**Dean Foate** - Plexus Corp - President and CEO

I think we're just going to have to stay away from any specific comments around Juniper. Otherwise we could end up having people misinterpret the information, so I think we will just leave the Juniper questions to Juniper when they do their earnings next week.

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**Amit Daryanani** - RBC Capital Markets - Analyst

Thank you.

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**Operator**

(Operator Instructions) Our next question comes from Brian White from Topeka Capital. Your line is open.

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**Brian White** - Ticonderoga Securities - Analyst

Good morning. Dean, on the industrial side, is this more semi-cap or the Coca-Cola program, or is it really just a combination on the outlook?

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**Dean Foate** - Plexus Corp - President and CEO

Brian, it's just about everybody. It is really coming down broadly. Certainly, the inventory adjustment of Coke is meaningful in the quarter, but you look at the forecast numbers across the thing, certainly semi-cap. I think there was a lot of hope there's going to be stronger performance forward but certainly, we are seeing everybody come down broadly across that sector.

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**Brian White** - Ticonderoga Securities - Analyst

Okay, and Networking, when did you start to see Networking weaken? It has been weak just in general. You had a very good quarter in Networking. But thinking about the September quarter, when did it tilt to the negative?

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**Dean Foate** - Plexus Corp - President and CEO

I think actually while we're moving through the quarter, I think that as we start -- we roll the forecast in a very meaningful way, obviously, every month and as we come to the back end of the quarter, we're looking at it on a weekly basis, and we started to see that it was going to get softer as we moved through the quarter. But again, it is hard to read too much into it because it has been so volatile.



You can have a customer down one week and then you come back and touch the forecast again and they are back up, so there is a tremendous amount of volatility among customers in that sector. It is really hard to get any sort of confidence more than -- even in the coming quarter in a meaningful way, let alone a quarter or more into the future. So, I think it's just going to be very volatile here for some period of time.

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**Brian White** - *Ticonderoga Securities - Analyst*

Dean, without the new programs in the September quarter, Networking would be down; is that a fair statement?

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**Dean Foate** - *Plexus Corp - President and CEO*

Without specifically a new customer ramping, yes, it would be down maybe a percent or two.

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**Brian White** - *Ticonderoga Securities - Analyst*

Okay, great, thank you.

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**Dean Foate** - *Plexus Corp - President and CEO*

You are welcome.

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**Operator**

We have a follow-up question or comment from Sean Hannan from Needham & Company. Your line is open.

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**Sean Hannan** - *Needham & Company - Analyst*

Yes, thank you, so just to clarify on the comments you just made on the Industrial segment, it sounds like this is really a ratcheting down of what had previously been more optimistic outlook, so more on a relative basis versus deterioration in the customer environment, is that the right way to interpret that?

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**Dean Foate** - *Plexus Corp - President and CEO*

Yes, I think so. I think the customers generally are just -- they were hoping to see this better magical back half, and it's becoming clear that they're not going to see this strength in the back half of the calendar year. And so that's probably affected that customer set.

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**Sean Hannan** - *Needham & Company - Analyst*

Okay, that's helpful, thank you, Dean.

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**Dean Foate** - *Plexus Corp - President and CEO*

You're welcome. I also want to say -- let me just make this comment because we were talking a lot about Industrial/Commercial and we're talking about -- and those discussions followed a little discussion around Network Communications. I also want to make clear that Network Communications we are seeing -- like Industrial/Commercial, we are seeing and fairly broad reduction from customers in that sector.



This is not a customer issue. This is multiple customers that are going to be down in Q4. Our overall revenues, we're saying they're going to be flat to up a little bit, but again, that flat to up a little bit is because of the newer customer and new program ramp that we have going on. So, it is a fairly broad-based reduction in our Q4 as well as in that sector similar to what we're seeing Industrial/Commercial. Okay, go ahead.

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**Operator**

I'm showing no further questions at this time. I will now turn the call back over to Dean Foate for closing remarks.

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**Dean Foate - Plexus Corp - President and CEO**

All right, just to quickly close, again, I thought it was a -- all things considered, I think it was a pretty good quarter. Certainly rightfully so drilling on our financial model and when we're going to get back to our operating target of 5%. We certainly see 4.5% as where we are at the moment and of course, we are trading right now about 500 basis points of operating margin performance, in some respects, because of the headwind we are having here with the lack of end market growth of existing customers, but also because of the cost associated with some of the new facility expansions that we have going on.

And we think right now it is an intelligent trade-off, I think, to make sure that we take advantage of the new programs and new customers and make sure that we get the capacity in the right places to support these customers going forward. We could stop all that and drive our performance back up to 5%, I think, pretty quickly, but I don't think that is the right thing to do, and I'm not sure that we would get all that rewarded for it in the broader backdrop of what's going on in the marketplace right now. So, I think it's a -- to invest that 500 basis points, take advantage of the acceleration of growth that we are seeing.

And of course, if this becomes the new normal and we're not going to see end market growth on a long-term basis, well, then we're going to have to reconsider a more aggressive posture and slow things down in terms of investment. But right now, we think it is the right and to be doing to take advantage of expansion of share and growth in our market.

With that, I want to thank everybody for the great questions on the call. And thanks also to our folks worldwide, now approaching nearly 10,000 people that make this happen for us every day, so thanks.

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**Operator**

Ladies and gentlemen, that does conclude today's conference. You may all disconnect, and have a wonderful day.

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