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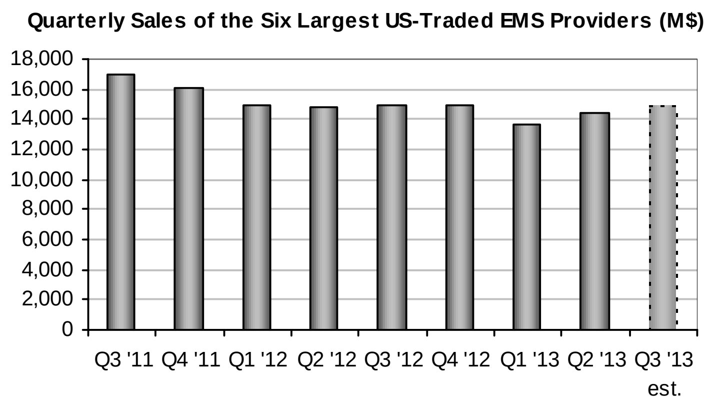
Another Down Year for US-Traded Group?

Sales may have hit bottom in Q1

Based on *MMI's* estimates for the first nine months, the six largest US-traded EMS providers, as a group, will need a double-digit gain in the fourth quarter in order to turn 2013 into a growth year. Any combined revenue increase of less than 10.4% sequentially (or 10.6% year over year) in Q4 will result in the second down year in a row for this group, according to *MMI's* projections. In the current demand environment, such growth may be a tall order for the final quarter, although providers have been working diligently to boost sales with new program ramps. If, for example, **Flextronics** hits its $6.9-billion target in Q4, that result would yield about 4.4% sequential growth in the group's Q4 revenue, still less than half of what would be needed in Q4 to bring 2013 even with 2012.

While it remains to be seen whether these providers can collectively eke out a growth year, there is evidence that they already reached a combined revenue bottom in 2013. *MMI* is projecting third-quarter sales for the group will total $14.94 billion by setting the sales estimate for each provider equal to the midpoint of its Q3 guidance. At that level, Q3 sales will have risen 3.6% sequentially, marking the second straight quarter-on-quarter increase. Since the sequential increases will have started two quarters back, Q1 2013 looks in the rear view mirror like a revenue bottom (see chart).



MMI estimates that group sales for the first nine months will reach $42.98 billion, down 3.6% year over year. Five out of six providers are expected to experience revenue declines for the period, and all of the declines will be of the single-digit variety except for **Celestica's** double-digit drop (Table 1, p. 2). **Jabil** will be the only provider to achieve revenue growth for the first nine months, *MMI* predicts.

In contrast with the projected nine-month decrease in group revenue, revenue for Q3 is forecasted to increase slightly by 0.5% year over year. According to *MMI's* estimates, Q3 sales for both Flextronics and Jabil will grow versus the year-earlier period, while the others will see offsetting revenue declines ranging from 0.9% to 6.4%. On a sequential basis, Q3 sales growth at Flextronics, Jabil and **Sanmina** should outweigh minor declines at the other three providers (Table 1).

Guidance suggests that adjusted EPS for Q3 will increase sequentially at Flextronics, and at the midpoint of its guidance the growth would be 14%. One can also infer from guidance that **Plexus** expects a sequential decline in

Some articles in this issue

Table 1: Q3 2013 Guidance and Estimates for the Six Largest US-Traded Providers (sales in B$ except as noted)															
Company	Q3 '13 guidance	Q3 mid-point	Q2 '13 sales	Qtr.-qtr. estim. chg.	Q3 '12 sales	Yr.-yr. estim. chg.	Q1-3 '13 estimat-ed sales	Q1-3 '12 sales	Esti-mated change	Q3 guidance adjusted EPS* $	Q3 EPS midpoint $	Q2 '13 adjusted EPS* $	EPS Q-Q chg. at midpoint	Q3 '12 adjusted EPS* $	EPS Y-Y chg. at midpoint
Flextronics	6.1 - 6.4	6.25	5.79	7.9%	6.17	1.2%	17.34	18.52	-6.4%	0.19 - 0.22	0.21	0.18	14%	0.26	-21%
Jabil**	4.45 - 4.65	4.55	4.47	1.8%	4.34	4.9%	13.44	12.83	4.8%	0.50 - 0.58	0.54	0.56	-4%	0.54	0%
Sanmina	1.475 - 1.525	1.50	1.49	0.7%	1.58	-5.0%	4.42	4.59	-3.8%	0.37 - 0.43	0.40	0.40	0%	0.46	-13%
Celestica	1.425 - 1.525	1.475	1.50	-1.3%	1.58	-6.4%	4.34	5.01	-13.3%	0.17 - 0.23	0.20	0.21	-5%	0.26	-19%
Benchmark	590 - 620 M	0.605	0.61	-0.4%	0.61	-0.9%	1.75	1.83	-4.3%	0.28 - 0.32	0.30	0.31	-3%	0.31	-3%
Plexus	545 - 575 M	0.560	0.57	-2.1%	0.59	-5.9%	1.69	1.78	-4.9%	0.60 - 0.66	0.63	0.68	-7%	0.66	-5%
Total/avg.		**14.94**	**14.42**	**3.6%**	**14.87**	**0.5%**	**42.98**	**44.56**	**-3.6%**						

Q3 estimates equal midpoint of Q3 guidance. Nine-month 2013 estimates equal first-half sales plus midpoint of Q3 guidance.
*Adjusted EPS may not be comparable from company to company. **Q3 2013 data correspond to the quarter ending August 2013.

its Q3 EPS, with a 7% drop at its guidance midpoint. No such conclusions can be drawn from the guidance issued by the other four providers. At the midpoint of their guidance, adjusted EPS would fall by 4%, 5% and 3% at Jabil, Celestica and **Benchmark** respectively and remain unchanged at Sanmina.

When compared with the year-earlier quarter, Q3 guidance implies a decrease in adjusted EPS at Flextronics, Sanmina and Celestica. At the midpoint of their guidance, all three would face double-digit declines in adjusted EPS. Based on guidance from Plexus, it expects adjusted EPS in Q3 to be equal to or less than the year-earlier value, and at its guidance midpoint, EPS would be down 5%. No inferences can be made from the guidance of the other two providers. At the midpoint of their guidance, Jabil's adjusted EPS would be the same as the year-earlier result, and Benchmark's would decline by 3% year over year (Table 1).

US-Traded Group Beats Estimates

The second quarter did not bring a macroeconomic lift to the EMS industry. Still, there were some shafts of light poking through the dark clouds. While as a group the six largest US-traded EMS providers did not return to year-over-year growth in Q2, they came much closer than *MMI* had estimated. Not only that, the group's sequential growth was significantly higher than what *MMI* had predicted.

MMI had expected a sequential increase of 2.0% (see May p. 6); actual growth was 5.9%. In addition, the newsletter forecasted a year-over-year drop of 5.9% for the group's Q2 sales; instead, group revenue declined by a modest 2.3% (Table 1A, p. 3).

This better-than-expected performance reflects the fact that all of the providers in the US-traded group achieved sales greater than *MMI's* estimates. *MMI* based its estimates on the midpoint of each company's sales guidance, and every company in the group posted sales above the midpoint of its guidance. Furthermore, three companies in the group – **Benchmark Electronics**, **Celestica** and **Flextronics** – generated revenue that exceeded guidance.

With each provider surpassing its midpoint and three companies beating guidance altogether, Q2 sales for the group of six were $533 million higher than estimated. Combined Q2 revenue amounted to $14.42 billion, 4% above what *MMI* had projected.

All six companies grew their Q2 sales from the prior quarter, led by Benchmark's 12.0% gain. Close behind were Flextronics and Celestica with increases of 9.4% and 8.9% respectively.

When Q2 results were compared year over year, a different, less sanguine picture emerged. At five out of six providers, sales were down versus the year-ago period, with Celestica reporting a double-digit drop (Table 1A). Only **Jabil** succeeded in boosting its revenue from a year earlier (Jabil's results were based on the quarter ended May 31.) The declines outweighed Jabil's advance, dragging the combined result into negative growth territory.

Q2's 2.3% decrease versus a year earlier followed an 8.8% decline in Q1. The two quarters combined to yield a first-half sales drop of 5.6%. Although nowhere near growth, this result was still 180 basis points better than what *MMI* had projected. First-half sales for the group totaled $28.04 billion, down from $29.69 billion in the year-earlier period. Again, Jabil alone was able to grow its first-half sales year over year. Posting the greatest first-half declines from a year earlier were Flextronics and Celestica, both of which endured double-digit drops (Table 1A).

Five out of six providers follow GAAP accounting rules, while the sixth, Celestica, adheres to IFRS reporting standards. For the five GAAP companies, GAAP gross margin in Q2 was a combined 6.6%, up 80 basis points sequentially but down 30 basis points year over year. All five companies raised their gross margins sequentially, while only two managed to accomplish this feat on a year-over-year basis (Table 1A).

Together, the five companies produced a GAAP operating margin of 2.0%, up 40 basis points sequentially but down 100 basis points year over year. **Plexus**, which attained the highest gross margin in the quarter, as usual turned in the highest operating margin at 4.4%. Two GAAP providers – Flextronics and Plexus – improved their operating margins from the prior quarter, while only Sanmina achieved a margin increase versus a year earlier. As for the lone IFRS reporting company, Celestica, its IFRS operating margin was up sequentially and year over year.

GAAP net income for the five companies in Q2 rose much faster than sales did in the sequential comparison, mostly because of an earnings increase at Flextronics, which started with a net loss in the prior quarter. Plexus also improved its GAAP net income from the prior quarter. Combined net income of $159.8 million grew 77.8% quarter on quarter, while sales rose 5.6%. On a year-over-year basis, however, net income fell 43.8%, as revenue declined just 0.7%. Sanmina was the only provider to attain year-over-year growth in net income. Q2 net margin for the GAAP reporting companies was 1.2%, up 50 basis points sequentially but down 100 basis points from a year earlier in line with the year-over-year decline in operating margin.

For the first half of 2013, combined GAAP net income for the five companies dropped 54.5% to $249.7 million from $549.3 million in the year-earlier period. The drop in net income was far worse that the 4.1% drop in sales. To be fair, though, restructuring charges, especially those taken by Flextronics, took a toll on net income in the first half.

Q2 summaries for two providers

Last month's issue covered quarterly results for four out of the six largest US-traded EMS providers. Results for the remaining two companies are briefly summarized below.

Benchmark Electronics. Q2 sales totaled $608 million, up 12% sequentially but down 4% year over year. Revenue exceeded guidance of $560 million to $590 million. Sequential growth was driven by new programs ramping to production as well as seasonal strength in computing. Sales included some $7 million from the company's **Suntron** acquisition completed during the quarter (July, p. 6-7). Non-GAAP EPS amounted to $0.31, up 41% from the prior quarter but down 3% from a year earlier. The EPS result was one cent above the company's guidance of $0.25 to $0.30, primarily as a result of top-line growth.

For Q2, Benchmark earned net income of $8.5 million, or $0.16 a share, compared with $11.5 million, or $0.21 a share, in the previous quarter and $13.6 million, or $0.24 a share, in the year-ago period. Q2 results include $5.7 million in restructuring and integration costs and $2.6 million for an asset impairment charge and other items. In an effort to realign its footprint, the company is closing its Brazil and Singapore factories (July, p. 7). Note that year-earlier quarter included Thailand flood-related charges of $4.7 million. There were no flood insurance recoveries during Q2.

Non-GAAP operating margin came in at 3.5%, up 80 basis points sequentially but down 20 basis points year over year. This margin result exceeded expectations, and the company said it was pleased with the progress made in returning its non-GAAP operating margin to this level. The sequential improvement mainly resulted from efficiencies gained as well as the quarter's higher revenue level. Still, there were margin headwinds associated with the level and number of new programs underway. Benchmark remains committed to achieving a 4% non-GAAP operating margin.

On a sequential basis, Q2 revenue was up in four of the company's five sectors. Sales from the computing sector rose 29% from the prior quarter as the sector gained strength from several new programs ramping to production

Table 1A: Q2 and Six-Month 2013 Results for the Six Largest US-Traded EMS Providers (M US$ or %)

Company	Q2 '13 sales	Q1 '13 sales	Qtr.-qtr. chg.	Q2 '12 sales	Yr.-yr. chg.	Q2 '13 gross marg.	Q1 '13 gross marg.	Q2 '12 gross marg.	Q2 '13 oper. marg.	Q1 '13 oper. marg.	Q2 '12 oper. marg.	Q2 '13 net inc.	Q1 '13 net inc.	Q2 '12 net inc.	Q1-2 '13 sales	Q1-2 '12 sales	Yr.-yr. chg.	Q1-2 '13 net inc.	Q1-2 '12 net inc.
Flextronics	5,791.1	5,295.3	9.4	5,976.0	-3.1	5.4	3.7	6.0	1.4 [1]	-0.7 [1]	2.7 [1]	59.3	(49.3)	136.8 [2]	11,086.4	12,346.0	-10.2	10.0	280.1
Jabil [3]	4,467.8	4,417.3	1.1	4,250.9	5.1	7.4	7.3	7.7	2.3	3.4	3.7	50.1	88.5	101.3	8,885.1	8,487.1	4.7	138.6	199.0
Sanmina	1,489.2	1,427.6	4.3	1,549.3	-3.9	7.7	7.0	6.8	2.4	3.2	2.3	18.7	21.2	8.9	2,916.8	3,012.4	-3.2	39.9	7.5
Benchmark	607.5	542.4	12.0	630.0	-3.6	7.3	6.8	7.3	2.1	2.6	2.9	8.5	11.5	13.6	1,149.9	1,223.4	-6.0	20.0	19.2
Plexus	571.9	557.8	2.5	608.8	-6.1	9.7	9.3	9.4	4.4	4.2	4.5	23.2	18.0	23.5	1,129.7	1,182.3	-4.4	41.2	43.5
Subtotal/avg.	**12,927.5**	**12,240.4**	**5.6**	**13,015.0**	**-0.7**	**6.6**	**5.8**	**6.9**	**2.0**	**1.6**	**3.0**	**159.8**	**89.9**	**284.1**	**25,167.9**	**26,251.2**	**-4.1**	**249.7**	**549.3**
Celestica	1,495.1	1,372.4	8.9	1,744.7	-14.3	6.4	6.3	6.7	2.1	1.2	1.9	28.0	10.5	23.6	2,867.5	3,435.6	-16.5	38.5	66.8
Total/avg.	**14,422.6**	**13,612.8**	**5.9**	**14,759.7**	**-2.3**										**28,035.4**	**29,686.8**	**-5.6**		

All results are based on GAAP except those of Celestica, which has converted to IFRS reporting. With the exception of sales, GAAP and IFRS results are not necessarily comparable. [1] Intangible amortization was subtracted from reported operating income. [2] Net income from continuing operations. [3] For Jabil, Q2 '13 corresponds to the quarter ended May 31.

as well as from seasonality. Business increased 13% in the industrial controls sector, where the Benchmark saw good overall demand levels in addition to new program ramps. Test and instrumentation sales grew 11%, with continued improvement in the semiconductor capital equipment space, and medical revenue went up 4%. Telecom revenue weakened slightly primarily due to the timing and qualification of new programs and revisions in existing programs.

During the quarter, Benchmark booked 28 new programs, of which nine are engineering projects, with an estimated annual run rate of between $135 million and $155 million.

At the midpoint of the company's sales guidance for Q3, revenue would be essentially flat. Benchmark foresees the positive impact of new programs in Q3 being offset by summer softness in Europe, seasonal weakness in IT spending, and caution among customers. For the company's Q3 guidance, see the table on page 2.

Celestica. The company reported Q2 sales of $1.50 billion, up 9% sequentially but down 14% year over year, with the latter decline mainly due to the wind-down of manufacturing services for **BlackBerry** in the second half of 2012. Excluding Q2 2012 revenue from BlackBerry, revenue would have been up 3% versus the year-earlier period. Q2 revenue surpassed guidance of $1.375 billion to $1.475 billion. Non-IFRS EPS of $0.21 also beat guidance, which called for $0.13 to $0.19 a share, as non-IFRS EPS rose 31% sequentially but declined 5% year over year.

IFRS earnings amounted to $28.0 million, or $0.15 a share, up from $23.6 million, or $0.11 a share, in the same period a year ago. While revenue was down year over year, IFRS earnings increased mainly due to lower restructuring charges and income tax expense. Restructuring charges in Q2 totaled $3.4 million. Non-IFRS earnings came to $38.6 million, compared with $47.1 million a year earlier.

Non-IFRS gross margin was 6.6%, unchanged from Q1 but down 30 basis points from the year-ago period. Celestica said gross margin continues to be impacted by excess capacity in its semiconductor business. Non-IFRS operating margin came in at 2.9%, up 40 basis points sequentially but down 40 basis points year over year.

In line with expectations, Celestica saw sequential growth across all of its end markets except servers. Representing 25% of total sales, revenue from diversified end markets increased 11% sequentially, with growth from industrial and aerospace and defense partially offset by a decline in healthcare. However, the 11% growth rate was lower than expected, mainly due to continued weak demand in the company's semiconductor business and from several industrial customers. Compared with Q2 2012, diversified revenue grew 14%, with growth across all areas except healthcare.

At 42% of company sales, communications business rose 14% sequentially and 11% year over year as Celestica experienced better than expected demand across a number of customers.

Comprising 14% of sales, the company's server segment declined 7% sequentially as improved demand from some customers was more than offset from the transition of a program to a customer facility. Compared with the year-earlier quarter, server revenue fell 23%, primarily because of lower demand and that program transition.

Accounting for 12% of sales, the storage end market was up 8% sequentially on higher demand. But the segment was down 10% year over year due to weak demand from one program.

Contributing 7% of sales, the consumer end market increased 12% sequentially as a result of greater demand overall. But this end market dropped 72% year over year mainly because of the BlackBerry disengagement.

During Q2, the company generated free cash flow (non-IFRS) of $50.5 million.

On a sequential basis, Celestica expects relatively flat Q3 revenue from communications, mid single-digit growth in the diversified and storage end markets for Q3, and double-digit declines in the server and consumer segments. Compared with a year earlier, the Q3 outlook calls for mid to high single-digit growth in communications and double-digit growth in the diversified segment. For Q3, the company is projecting a non-IFRS operating margin of 3% at the mid point of guidance, which appears on page 2.

Modest Sequential Growth for North American Group

Combined Q2 sales for seven mid-tier and smaller EMS providers based in North America improved from the prior quarter by 2.4%. Five companies out of seven increased their Q2 revenue sequentially, and their gains outweighed declines at the other two providers. **Nortech Systems** posted the highest sequential increase at 9.7%. But this North American group's sequential growth did not keep up with that of the largest providers in the US-traded sector as their combined sales went up by 5.9% (see table on p. 3).

In the aggregate, the seven mid-tier and smaller providers also fell short of their large US-traded competitors when Q2 revenue was measured against the year-earlier level. Q2 sales for the mid-tier and smaller group totaled $559 million, down 4.5% year over year. By comparison, the revenue of the large US-traded group declined 2.3%.

Of the seven mid-tier and smaller

Table 1B: Q2 and Six-Month 2013 GAAP Results for Seven Mid-tier and Smaller EMS Providers Based in North America (M$ or %)

Organization	Q2 '13 sales	Q1 '13 sales	Qtr.-qtr. chg.	Q2 '12 sales	Yr.-yr. chg.	Q2 '13 gross marg.	Q1 '13 gross marg.	Q2 '12 gross marg.	Q2 '13 oper. marg.	Q1 '13 oper. marg.	Q2 '12 oper. marg.	Q2 '13 net income	Q1 '13 net income	Q2 '12 net income	Q1-2 '13 sales	Q1-2 '12 sales	Yr.-yr. chg.	Q1-2 '13 net inc.	Q1-2 '12 net inc.
Stand-Alone EMS Providers																			
Key Tronic	84.6	84.3	0.3	96.7	-12.5	9.1	9.3	9.6	4.1	4.3	5.4	2.4	2.9	3.8	169.0	192.3	-12.1	5.3	7.2
SMTC	64.9	65.4	-0.8	75.1	-13.6	1.9	10.6	9.7	-7.9	3.0	4.7	(6.0)	1.2	2.8	130.3	147.6	-11.7	(4.8)	5.2
IEC Electronics	35.2	33.7	4.4	36.0	-2.4	14.7	8.6	19.0	1.7	-4.2	8.3	0.4	(1.1)	1.8	68.8	74.0	-7.0	(0.8)	4.3
Nortech Systems	28.5	25.9	9.7	28.0	1.5	11.8	12.5	11.0	1.3	0.9	1.1	0.2	0.1	0.1	54.4	56.4	-3.6	0.3	0.2
Subtotal/avg.	**213.1**	**209.4**	**1.8**	**235.9**	**-9.7**	**8.2**	**10.0**	**11.2**	**-0.3**	**2.1**	**5.1**	**(3.0)**	**3.0**	**8.6**	**422.5**	**470.3**	**-10.2**	**(0.0)**	**17.0**
EMS Units of Larger Public Companies																			
Kimball Electronics Group [1]	192.7	182.1	5.8	164.9	16.9				4.5	4.9	3.6	7.4	6.5	4.1	374.8	325.8	15.0	13.9	7.4
Ducommun LaBarge Technologies	107.5	103.2	4.1	107.8	-0.3				10.5 [2]	7.7 [2]	9.7 [2]				210.7	217.9	-3.3		
CTS Electronics Manufacturing Solutions	46.2	51.5	-10.2	77.5	-40.4				-0.2 [3,4]	2.1 [3,5]	7.9 [3,6]				97.6	148.0	-34.0		
Total/avg.	**559.5**	**546.1**	**2.4**	**586.0**	**-4.5**										**1,105.6**	**1,162.0**	**-4.9**		

[1] Operating and net income are not necessarily equivalent to GAAP results on a stand-alone basis. [2] Segment operating income did not include corporate general and administrative expenses. [3] Segment operating income did not include corporate and shared services charges. [4] Excluded restructuring and related charges of $8.1 million not allocated to business segments. [5] Excluded restructuring and related charges of $0.8 million not allocated to business segments. [6] Excluded restructuring and related charges of $3.8 million not allocated to business segments.

players, just two – **Kimball Electronics Group** and Nortech Systems – achieved year-over-year growth in Q2 revenue. Kimball Electronics stood out as the only provider to record a double-digit increase in Q2 revenue versus a year earlier. Four providers saw their sales drop appreciably from a year earlier, and three of them reported double-digit declines, which reached -40% in the case of **CTS Electronics Manufacturing Solutions**. (Sales were essentially flat for the final provider, **Ducommun LaBarge Technologies**.) [See Table 1B above.]

Interestingly, when first-half results of the two groups are compared, their sales declines are less than one percentage point apart. For the first six months, the mid-tier and smaller group generated sales of $1.11 billion, down 4.9% year over year. The comparable decline for the large US-traded group was a slightly worse 5.6%. It appears, then, that the mid-tier and smaller group held its own over the first half of the year.

Still, the group's first-half decline would have been worse had it not been for Kimball Electronics, which was the sole provider to register a revenue increase (year over year) for the period. Kimball's 15% sales growth mitigated to some extent the declines at the other five providers. Three providers – **Key Tronic**, **SMTC** and CTS Electronics Manufacturing Solutions – recorded double-digit drops, and these players were the same three that posted two-digit decreases for Q2 sales.

The group of seven mid-tier and smaller providers consists of four companies in the EMS space, all publicly traded, and three EMS units within larger publicly held corporations. Together, the four stand-alone providers produced a Q2 gross margin of 8.2%, down 180 basis points sequentially and 300 basis points year over year. **IEC Electronics** turned in a high of 14.7%.

Collective operating margin for the four stand-alone providers came in at -0.3%, dragged into a loss position by SMTC's -7.9% margin. The collective result for Q2 was down 240 basis points from the prior quarter and 540 basis points from a year earlier (Table 1B).

Among the EMS units, Ducommun LaBarge Technologies raised its operating margin from the previous quarter, while DLT and Kimball Electronics increased their margins year over year (Table 1B).

On a combined basis, the four stand-alone providers earned a net loss of $3.0 million in Q2 as a result of SMTC's net loss. First-half net income for the four providers was at break-even as net losses of SMTC and IEC offset net income of Key Tronic and Nortech.

A brief look at each provider

CTS Electronics Manufacturing Solutions. CTS's EMS unit generated Q2 sales of $46.2 million, which fell 10% from the prior quarter mainly because of lower demand in the defense and aerospace and communications markets. Compared with Q2 2012, sales were down 40% primarily from CTS's decision to disengage with certain customers last year and declines in the defense and aerospace and communications markets. The unit had a

Q2 operating loss of $102,000 before corporate and shared services charges and an operating loss of $1.5 million including those charges but excluding restructuring and related charges of $8.1 million.

Ducommun LaBarge Technologies. Ducommun's DLT segment reported Q2 sales of $107.5 million, almost equal to $107.8 million in the same period a year ago. Defense electronics and commercial aerospace revenue increased 16.5%, offset by a 25.8% decline in the segment's revenue outside of aerospace and defense.

DLT's operating income for Q2, which did not include corporate general and administrative expenses, amounted to $11.2 million, or 10.5% of revenue, up from $10.5 million, or 9.7% of revenue, a year earlier. The increase primarily resulted from a richer product mix and the realization of cost synergies achieved following the integration of LaBarge.

IEC Electronics. For its fiscal Q3 ended June 28, revenue of $35.2 million declined 2.4% year over year. The company noted that last year it initially acted as sole source of assemblies for a new product introduced by one of its large industrial customers. But once this high-margin program was underway, the customer added a second supplier, and volume returned to more normal levels. In addition, a medical customer had been in the last stages of an FDA recall, and once that spike in production volume was over, their volume and margins also dropped to more normal levels. Both of these volume reductions were largely offset by a new telecom customer. However, the customer's product was unstable for a long time, causing IEC to absorb a lot of costs.

The company improved its net income to $382,000 in fiscal Q3 from a net loss of $1.1 million in the prior quarter despite $1.1 million of legal and accounting costs associated with restating IEC's financial information (June, p. 4).

IEC expects fiscal Q4 to show stronger sales and earnings than fiscal Q3.

Key Tronic. Revenue for its fiscal Q4 ended June 29 totaled $84.6 million, down 13% year over year. Net income was $2.4 million, or $0.22 a share, compared with $3.8 million, or $0.35 a share, for the year-earlier quarter.

Revenue in the second half of fiscal 2013 was primarily impacted by the anticipated slowdown from a large customer.

At the end of the quarter, the company counted 56 customers and 183 revenue-generating programs, up from 48 customers and 165 programs a year ago.

As Key Tronic moves into the September quarter, it is seeing a reduction in orders from another large customer, and a few of its new programs are not ramping up as rapidly as expected. For the September quarter, the company expects revenue of $73 million to $78 million and EPS of $0.15 to $0.20. The company anticipates a return to sequential growth in the December quarter.

Kimball Electronics Group. For fiscal Q4 ended June 30, sales from Kimball's EMS unit increased by 17% year over year on double-digit sales growth from customers in all four of the unit's vertical markets: automotive, medical, industrial and public safety.

Gross margin of the EMS business in the quarter improved by 150 basis points year over year mainly due to leverage gained on the higher revenue as well as benefits realized from global purchasing efforts and operating efficiencies.

Selling and administrative expenses for the unit rose 29% from the same quarter a year ago primarily as a result of higher incentive compensation costs and an allowance recorded for notes receivable.

Nortech Systems. Q2 sales of $28.5 million grew 10% sequentially and 1% year over year. Q2 operating income rose 67% sequentially and 17% year over year. For the quarter, the company earned net income of $187,000, up from $126,000 a year earlier.

Nortech said sales to defense customers were particularly strong in the quarter as it launched several new programs and a number of new customized cable assemblies.

The company's improved profitability for Q2 was aided by continuous improvement from lean workouts, the implementation of automation technology and increased plant utilization.

Nortech's 90-day backlog increased 11% year over year.

SMTC. The provider posted Q2 revenue of $64.9 million, down 1% sequentially and 14% year over year. The latter decline mainly resulted from a reduction in revenue from one longstanding customer as well as the closure of SMTC's Markham (Ontario) plant, which resulted in the loss of certain customers. SMTC recorded a Q2 net loss of $6.0 million, compared with net income of $2.8 million in the year-earlier period.

Gross margin for Q2 came in at 1.9% versus 10.6% in the prior quarter and 9.7% a year earlier. Gross profit was adversely affected by $2.1 million in an unrealized foreign exchange loss on derivatives, a $1.3-million negative contribution from the now-closed Markham facility, and $1.2 million in non-recurring costs associated with inventory. Excluding these drags on gross profit, Q2 gross margin was 9.1% compared with 8.4% in Q1 and 10.2% in the year-ago quarter.

When the gross profit impact of the Markham facility and non-recurring SG&A expenses were removed, adjusted EBITDA for Q2 was $2.3 million versus $1.9 million in the prior quarter and $4.7 million a year earlier.

First-Half Sales Declined Decidedly

For 10 of the world's largest EMS providers, combined first-half sales fell 8.5% year over year in US dollars, ensuring that EMS industry revenue overall was also down decidedly in the first half of 2013. Accounting for 80% to 90% of industry revenue, the 10 providers racked up a total of $89.4 billion in sales for the first six months. Admittedly, not all of this revenue was purely EMS, but the vast majority of it was, enough so that their sales decline serves as a rough gauge of how well the industry did in the first half.

Of the 10 EMS providers, only **Jabil** and **Universal Scientific Industrial** managed to increase their first-half sales from a year earlier, as USI became the sole provider to record double-digit growth. Revenue fell by double-digit percentages at four companies including **Hon Hai Precision Industry**, the EMS giant. Without Hon Hai, the aggregate sales decline would have improved by 2.9 percentage points (Table 1C below).

For the first six months, the 10 providers together earned net income of approximately $1.5 billion for a net margin of about 1.7%. (The net income total is approximate because not all companies follow the same accounting standard.) **Plexus**, USI and **Venture** were the only providers to produce net margins above 3%. Hon Hai contributed about 74% of net income while generating 64% of the group's sales for the period.

Q2 sales for the group of 10 amounted to $46.4 billion, up 7.8% sequentially but down 1.4% year over year. All but one player raised their Q2 sales from the prior quarter. Compared with the year-earlier period, eight providers out of 10 saw their Q2 sales decline, with sales at **Cal-Comp Electronics** and **Celestica** down by double digits. The declines more than offset the gains achieved by Jabil and USI.

Despite the slight drop in Q2 sales year over year, Q2 net income of $804 million grew about 4% from a year earlier.

Table 1C: Q2 and Six-Month 2013 Results for 10 of the Largest EMS Providers (M US$ or %)

Company (in order of 6-mo. sales)	Head-quarters	Reports in US$	Q2 '13 sales	Q1 '13 sales	Qtr.-qtr. chg.	Q2 '12 sales	Yr.-yr. chg.	Q2 '13 net profit	Q1 '13 net profit	Q2 '12 net profit	Q1-2 '13 sales	Q1-2 '12 sales	Yr.-yr. chg.	Q1-2 '13 net profit	Q1-2 '12 net profit
Hon Hai (Foxconn)	Taiwan	No	30,010	27,431	9.4	30,127	-0.4	569	554	407	57,442	63,863	-10.1	1,123	943
Flextronics	Singapore	Yes	5,791	5,295	9.4	5,976	-3.1	59	(49)	137	11,086	12,346	-10.2	10	280
Jabil	Florida	Yes	4,468*	4,417	1.1	4,251	5.1	50	89	101	8,885	8,487	4.7	139	199
Sanmina	California	Yes	1,489	1,428	4.3	1,549	-3.9	19	21	9	2,917	3,012	-3.2	40	8
Celestica	Canada	Yes	1,495	1,372	8.9	1,745	-14.3	28	11	24	2,868	3,436	-16.5	39	67
Cal-Comp Electronics	Thailand	No	1,015	994	2.2	1,220	-16.8	8	9	13	2,009	2,321	-13.4	17	20
Benchmark Electronics	Texas	Yes	608	542	12.0	630	-3.6	9	12	14	1,150	1,223	-6.0	20	19
Plexus	Wisconsin	Yes	572	558	2.5	609	-6.1	23	18	24	1,130	1,182	-4.4	41	44
Universal Scientific Industrial	China	No	475	556	-14.4	453	5.0	15	21	15	1,031	918	12.2	36	31
Venture	Singapore	No	471	429	9.8	484	-2.8	24	23	27	899	939	-4.2	47	55
Total/avg.			**46,394**	**43,022**	**7.8**	**47,044**	**-1.4**	**~804**	**~707**	**~769**	**89,417**	**97,728**	**-8.5**	**~1,511**	**~1,665**
Total/avg. without Hon Hai			**16,384**	**15,591**	**5.1**	**16,916**	**-3.1**	**~235**	**~153**	**~362**	**31,975**	**33,865**	**-5.6**	**~388**	**~722**

Results in non-US currencies were converted to US dollars by applying a three-month average exchange rate for the corresponding quarter. Average exchange rates were based on monthly 2012 and 2013 data from the US Federal Reserve. Company net profits shown here are attributable to shareholders. Net profit totals are approximate because not all companies follow the same accounting standard. *For the quarter ended May 31, 2013.

News

Jabil Is Taking Over Some IBM Operations

IBM has confirmed a local newspaper report saying that IBM has tapped **Jabil** (St. Petersburg, FL) to take over some of IBM's manufacturing in Poughkeepsie, NY. According to an IBM spokesperson, IBM has expanded its relationship with Jabil "to include portions of the assembly operations performed on customer-configured high-end systems, and the procurement operations and assembly of large panel and mechanical subassemblies (or LPAT) for IBM." [LPAT stands for large panel assembly and test.]

The outsourced operations will continue to be located at the IBM Poughkeepsie site, and a number of IBM employees working in these operations were offered employment by

Jabil. However, the majority of Poughkeepsie manufacturing operations will continue to be performed by IBM employees, the spokesperson pointed out.

Citing the competitive nature of IBM's business, the spokesperson would not provide *MMI* with additional information.

Flextronics to Acquire Plastics Processor

Flextronics (Singapore) has entered into a definitive agreement to acquire **RIWISA** (Hagglingen, Switzerland), a family-owned provider of high-volume injection molding and automation solutions. With 300 employees, RIWISA divides its activities into three business units: Medical, Consumer Packaging and Industrial.

Flextronics said the deal will broaden its precision injection molding and high-speed automation offerings and expand its medical capabilities. "The addition of RIWISA's precision plastics and automation capabilities to Flextronics Medical is a tremendous complement to the broad range of healthcare solutions we can offer our customers globally and underscores the strategic commitment we have made to expand our services in this market," stated Mark Kemp, president of Flextronics Medical.

The transaction is expected to close by the end of October.

More deals announced…**Sparton** (Schaumburg, IL), a provider of complex and sophisticated electromechanical devices, has entered into a definitive agreement to acquire certain assets and liabilities of **Aydin Displays**, a developer of flat panel display and touch-screen solutions. An $18 million-a-year business, Aydin is a subsidiary of **Video Display Corp.** (Birdsboro, PA)….Privately held EMS provider **Nistec**, whose facilities are in Israel, intends to acquire a controlling 50.5% interest in **Eltek**, a PCB manufacturer also located in Israel, through two transactions worth a total of $6.5 million.

Deals done…On July 1, **Key Tronic** (Spokane Valley, WA) completed its acquisition of **Sabre Manufacturing**, a sheet metal fabricator, for about $6.0 million in cash (June, p. 7). …**OSI Electronics**, the primary EMS activity of publicly held OSI Systems (Hawthorne, CA), has acquired **Briton EMS**, a privately owned EMS company in Bedford, UK, with a facility listed at 22,000 ft^2. OSI Electronics has manufacturing plants in California, Indonesia and Malaysia.

Some new business…According to *The Wall Street Journal*, **Hon Hai Precision Industry** (New Taipei, Taiwan) is producing large-screen TVs for sale by **7-Eleven** stores in Taiwan. What's more, in Pardubice, the Czech Republic, Hon Hai will manufacture a tablet for **teXet**, a mobile-phone OEM based in Russia, *The Prague Post* reported….**Quantum** (San Jose, CA), a global storage company, announced in July that it will transition the rest of its tape automation manufacturing to a **Benchmark Electronics** facility in Alabama over a period of six months. Benchmark has supported Quantum for more than a decade.

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