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Three Quarters of Growth Despite Head Winds

Despite a persistently sluggish US economy and lingering debt problems in Europe, it is now quite possible that 2012 could be a growth year overall for 20 of the largest contract manufacturers. Through the first nine months of 2012, combined sales of the 20 CMs grew 4.7% year over year, setting the stage for low or modest annual growth as long as there is no double-digit decline in Q4 that would wipe out the sales gains of the first three quarters. Nine-month sales of the 11 EMS providers and 9 ODMs in the group totaled \$246.3 billion, up from \$235.2 billion in the same period a year ago.

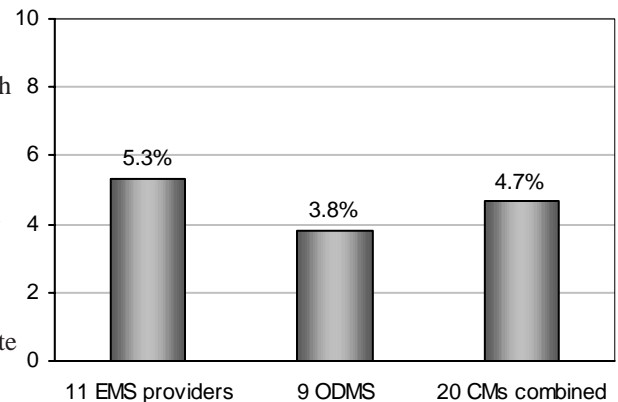
These 20 large CMs account for the vast majority of business in the outsourcing space for manufacturing on the board and system level. Hence, this group can be used as a proxy for the outsourcing space, and *MMI* believes that the group's nine-month growth rate serves as the best available indication of year-to-date growth in the space. Assuming then that the global outsourcing business in contract manufacturing grew at or near 4.7% for the first nine months, one can conclude that the contract manufacturing market outperformed the global economy, which the *IMF* estimates is growing at an annual rate of 3.3% this year. The contract manufacturing business still has the wherewithal to outgrow a macroeconomic base line, but so far this year that ability isn't worth more than about 1.4 percentage points in addi-

tional growth above the global norm.

For the first nine months, aggregate growth of the 11 EMS providers in the group was somewhat higher than that of the nine ODMs. Revenue on the EMS side increased by 5.3% year over year, compared with 3.8% for the ODMs (Chart 1). Note that the ODM business remains beholden to the PC market, whose shipments are projected by *IHS* to decline this year.

ODM **Pegatron**, which has a growing EMS business, achieved a best-in-group growth rate of 49.7% in US dollars for the first three quarters. Two other CMs in the group, ODM **Am-TRAN Technology** and **Hon Hai Precision Industry**, primarily an EMS provider, also increased their sales in US dollars by double digits. Half the group grew their nine-month sales (in

Chart 1: Nine-Month Sales Growth Year Over Year



US dollars) year over year, and the other half saw their sales decline (Table 1, p. 2).

The group of 20 CMs could not have attained its 4.7% growth rate without the contribution of Hon Hai, by far its largest member, which accounted for 34.7% of group sales for this first nine months. Excluding Hon Hai, combined nine-month sales of the other CMs declined by 0.3% (Chart 2, p. 2). In the absence of Hon Hai,

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growth evaporates for the rest of the group, leading to the disappointing realization that on a combined basis the rest did not keep up with the global economy.

Without the support of Hon Hai, collective nine-month sales of other 10 EMS providers would have fallen by 7.2% from the year-earlier period. Hon Hai, whose nine-month sales rose by 14.0% (in US dollars), added 12.5 percentage points to the growth rate of the EMS side. Excluding Hon Hai, aggre-

gate sales for the 10 EMS providers would have trailed those of the ODMs by 11 percentage points (Chart 2). This is a reversal from last year, when the 10 EMS providers lead the nine ODMs by 9.7 percentage points for the first nine months (Dec. 2011, p. 2).

Nine-month net income for the 20 CMs amounted to about \$4.4 billion. (The total is approximate because not all

Chart 2: Nine-Month Sales Growth Year Over Year Excluding Hon Hai

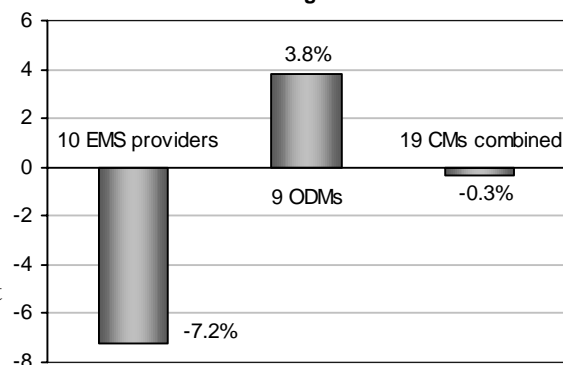


Table 1: Q3 and Nine-Month 2012 Results for Twenty of the Largest Contract Manufacturers (M US\$ or %)

Company (in order of 9-mo. sales)	Primary busi- -ness	Head- quarters	Reports in US\$	Q3 '12 sales	Q2 '12 sales	Qtr.- qtr. chg.	Q3 '11 sales	Yr.-yr. chg.	Q3 '12 net profit	Q2 '12 net profit	Q3 '11 net profit	Q1-3 '12 sales	Q1-3 '11 sales	Yr.-yr. '12 net chg.	Q1-3 '12 net profit	Q1-3 '11 net profit
Hon Hai (Foxconn)	EMS	Taiwan	No	29,346	30,127	-2.6	29,584	-0.8	1,015	426 ¹	657	93,210	81,731	14.0	1,944 ¹	1,599
Quanta Computer	ODM	Taiwan	No	9,157	8,023	14.1	9,709	-5.7	217	202	187	25,139	27,813	-9.6	591	568
Flextronics	EMS	Singapore	Yes	6,175	5,976	3.3	8,008	-22.9	151 ²	129 ²	130 ²	18,547	22,303	-16.8	404 ²	397 ²
Pegatron ³	ODM	Taiwan	No	6,459	6,337	1.9	5,350	20.7	45	28	13	17,824	11,906	49.7	116	(30)
Compal Electronics	ODM	Taiwan	No	5,807	5,569	4.3	5,922	-1.9	55	53	72	16,811	17,877	-6.0	171	306
Wistron	ODM	Taiwan	No	5,144	5,366	-4.1	5,701	-9.8	52	49	75	16,473	15,917	3.5	164	231
Jabil ⁴	EMS	Florida	Yes	4,338	4,251	2.1	4,280	1.4	83	101	114	12,825	12,437	3.1	282	274
Inventec	ODM	Taiwan	No	3,174	3,393	-6.5	3,441	-7.8	28	46	28	10,023	9,310	7.7	88	52
TPV Technology	ODM	Taiwan	Yes	3,224	2,790	15.6	2,855	12.9	31	24	10	8,353	8,152	2.5	75	80
Celestica	EMS	Canada	Yes	1,575	1,745	-9.7	1,830	-13.9	44	24	50	5,011	5,460	-8.2	111	126
Sanmina	EMS	California	Yes	1,579	1,549	1.9	1,697	-7.0	164	9	18	4,591	4,940	-7.1	172	41
Cal-Comp Electronics	EMS	Thailand	No	1,173	1,220	-3.8	1,232	-4.7	13	13	4	3,486	3,337	4.5	34	36
Qisda	ODM	Taiwan	No	1,025	941	8.9	977	4.9	(37)	(31)	(12) ²	2,950	3,136	-6.0	(52)	(48) ²
Shenzhen Kaifa Technology	EMS	China	No	623	693	-10.0	747	-16.6	1	3	12	1,956	2,194	-10.9	11	28
Benchmark Electronics	EMS	Texas	Yes	611	630	-3.0	570	7.1	19	14	20	1,834	1,694	8.3	39	49
Plexus	EMS	Wisconsin	Yes	595	609	-2.3	538	10.5	1	24	18	1,777	1,665	6.7	44	64
AmTRAN Technology	ODM	Taiwan	No	538	512	5.1	379	41.9	13	14	8	1,524	1,264	20.6	41	23
Venture	EMS	Singapore	No	489	484	0.9	476	2.7	26	27	29	1,427	1,443	-1.1	81	95
Universal Scien- tific Industrial	EMS	Taiwan	No	507	453	12.1	484	4.9	28	17	17	1,426	1,484	-3.9	63	40
Ability Enterprise	ODM	Taiwan	No	381	398	-4.2	448	-15.0	13	13	14	1,117	1,181	-5.4	37	28
Total/avg.				81,919	81,065	1.1	84,230	-2.7	-1,962	-1,184	-1,465	246,303	235,243	4.7	-4,416	-3,958
Total/avg. with- out Hon Hai				52,573	50,938	3.2	54,645	-3.8	-946	-758	-808	153,094	153,512	-0.3	-2,472	-2,359

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 2011 and 2012 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. ¹ Includes a pretax loss of about \$153 million in connection with the Hon Hai's planned investment in Sharp. The loss was subsequently reversed. ² Net profit includes discontinued operations. ³ Results correspond to Pegatron's core DMS business. ⁴ For Jabil, Q3 '12 corresponds to the quarter ended August 31.

Table 2: Comparing Results Where Companies are Grouped by Primary Business (M US\$ or %)

No. of companies	Primary business	Q3 '12 sales	Q2 '12 sales	Qtr.-qtr. chg.	Q3 '11 sales	Yr.-yr. chg.	Q3 '12 net profit	Q2 '12 net profit	Q3 '11 net profit	Q1-3 '12 sales	Q1-3 '11 sales	Yr.-yr. chg.	Q1-3 '12 net profit	Q1-3 '11 net profit
11	EMS	47,011	47,736	-1.5	49,447	-4.9	~1,545	~785	~1,070	146,090	138,688	5.3	~3,184	~2,750
9	ODM	34,908	33,329	4.7	34,783	0.4	~417	~399	~395	100,214	96,555	3.8	~1,233	~1,208
20		81,919	81,065	1.1	84,230	-2.7	~1,962	~1,184	1,465	246,303	235,243	4.7	~4,416	~3,958

Net profit totals are approximate because not all companies follow the same accounting standard.

companies follow the same accounting rules.) Net income, which went up around 11.6% from the year-ago period, increased faster than the 4.7% rate of sales growth. Of the 20 CMs, 11 succeeded in improving their nine-month net income (Table 1, p. 2).

Q3 sales for the 20 CMs totaled \$81.9 billion, up 1.1% sequentially but down 2.7% year over year. Hon Hai actually lowered the sequential gain by 2.1 percentage points (Hon Hai's contribution is not always positive), while raising the year-over-year increase by less than one percentage point (Table 1).

Compared with the prior quarter, 11 companies raised their sales, while nine experienced revenue declines. Turning in double-digit gains (in US dollars) were ODMs **Quanta Computer** and **TPV Technology** and EMS provider **Universal Scientific Industrial** (Table 1).

In Q3, the EMS providers together generated sales of \$47.0 billion, down 1.5% sequentially, while the ODMs piled up sales of \$34.9 billion, up 4.7% sequentially (Table 2). By this comparison, the ODMs bested their EMS counterparts by 6.2 percentage points.

The ODMs also collectively outgrew the EMS providers versus the year-earlier quarter. Sales of the ODMs rose slightly by 0.4% year over year, while revenue on the EMS side dropped 4.9%, giving the ODMs a 5.3-percentage point lead. When Hon Hai is excluded, the ODM lead swells to 11.5 percentage points, as the sales decline on the EMS side expands to -11.1%.

Eleven companies reported Q3

sales that were down year over year in US dollars. Double-digit declines occurred at three EMS providers – **Celestica**, **Flextronics** and **Shenzhen Kaifa Technology** – as well as at one ODM, **Ability Enterprise**. Still, four CMs achieved double-digit growth in Q3 versus a year earlier, and three of them were ODMs: AmTRAN Technology, Pegatron and TPV Technology. EMS provider **Plexus** also accomplished a two-digit percentage increase (Table 1).

Together, the 20 CMs earned net income of approximately \$2.0 billion in Q3 for a net margin of about 2.4%. Net income climbed by about 33.9% year over year, despite a 2.7% decline in sales. Without Hon Hai, Q3 net income would have increased by about 17.1%. Half of the group raised their net income in US dollars from the year-ago quarter. On a sequential basis, net income soared by about 65.7%, but Q2 net income included a pretax charge of about \$153 million taken by Hon Hai and subsequently reversed.

MMI compiled quarterly operating margins for eight out of nine ODMs. (One ODM, Hong Kong-listed TPV, does not report results consistent with those of the other ODMs.) For Q3, combined operating margin for the eight ODMs was just 1.12%, compared with 1.06% in the prior quarter and 0.88% in the year-ago period. By contrast, five large US-traded providers produced an aggregate operating margin of 3.0% for Q3 (Nov., p. 3). Ability Enterprise was the only ODM with a margin above 2.0%. This year, combined quarterly margins for these ODMs have not gone above 1.2%, reinforcing the notion that the ODM sec-

tor has been largely relegated to commodity status.

Of course, the ultimate measure of profitability is net income. For Q3, net margin for the 11 EMS providers was approximately 3.3% (3.0% without Hon Hai), compared with the ODMs' result of about 1.2%. Here is yet another example of the ODM sector's diminished earnings power.

Editor's note: This analysis presents a rough approximation of EMS versus ODM sales since a number of the contract manufacturers listed here do both EMS and ODM work. Companies were classified as EMS or ODM based on which model represents their primary business. In addition, sales of some EMS providers include non-EMS revenue from such activities as component-level manufacturing.

Double-Digit Growth for N. American Group

A group of North America-based EMS providers bucked economic headwinds in Q3 by achieving combined double-digit sales growth versus the year-ago quarter. The eight mid-tier and smaller providers collectively increased their Q3 sales by 10.6%, an indication that the EMS market is not without pockets of growth. Revenue for the quarter totaled \$618.1 million, up from \$558.7 million in the year-earlier period. This marks the second quarter of healthy year-over-year growth for the group; in Q2 combined sales rose by an adjusted 9.4% year over year (more about adjusted growth later).

The group's Q3 growth rate stands

in stark contrast with the comparable sales performance of the six largest US-traded providers, whose combined sales fell by 12.1% year over year (Nov., p. 3).

Year-over-year sales growth at four providers in the North America-based group easily outweighed sales declines at the other four competitors. Three providers turned in double-digit gains led by **SMTC** at 71.4% and followed by **Key Tronic** at 39.8%. With a high of 71.4% and a low of -19.7% (**CTS Electronics Manufacturing Solutions**), the variation in year-over-year growth rates for Q3 was great (Table 1A).

A sequential comparison yields news that's not so good overall. The group's Q3 sales were down 4.5% from the prior quarter. This unappealing result mainly stemmed from sequential declines in the vicinity of 20% at two providers – **CTS Electronics Manufacturing Solutions** and **Sparton**. Only one provider, **IEC Electronics**, reported sequential growth above 1%, and its best-of-group increase was 2.9% (Table 1A).

For the first nine months of 2012,

group sales rose by an adjusted rate of 7.1% year over year. By contrast, combined sales of the six largest US-traded providers dropped by 8.1% (Nov., p. 3). While 2012 revenue is expected to be down significantly for these six large providers as a whole – *MMI* is projecting an 8.5% annual drop – the North American group of smaller competitors should have a growth year unless its Q4 revenue goes into a free fall.

Note that the nine-month growth rate for the North American group was adjusted to fully account for **Ducommun's** June 2011 acquisition of **LaBarge**, which resulted in **Ducommun LaBarge Technologies**. DLT's sales for the first half of 2011 do not include LaBarge's \$163.5 million in revenue prior to the acquisition. Without counting the LaBarge revenue, the group's nominal nine-month growth rate is an unrepresentative 17.8% (Table 1A). When the LaBarge revenue is added in, the growth rate becomes the adjusted 7.1%, a more realistic measure of the group's performance (Table 2A, p. 5).

The group of eight mid-tier and

smaller providers consists of five companies in the EMS industry, all publicly traded, and three EMS units within larger publicly held corporations. Together, the five stand-alone providers produced a Q3 gross margin of 11.3%, down 190 basis points sequentially and 70 basis points year over year. Three of these providers turned in double-digit margins, and the high was **IEC's** 18.3%. One provider, **Key Tronic**, improved its gross margin both sequentially and year over year. The other four saw their Q3 margins decline in both comparisons (Table 1A).

In the aggregate, Q3 operating margin for the five stand-alone providers stood at 4.3%, down 200 basis points from the prior quarter but up 170 basis points from the year-earlier period. This Q3 margin was 130 basis points above the collective result of five large US-traded providers (Nov., p. 3). **Key Tronic** and **Nortech Systems** raised their operating margins from the prior quarter, while **IEC**, **Key Tronic** and **SMTC** increased their margins year over year.

On a sequential basis, none of the

Table 1A: Q3 and Nine-Month 2012 GAAP Results for Eight Mid-tier and Smaller EMS Providers Based in North America (M\$ or %)

Organization	Q3 '12 sales	Q2 '12 sales	Qtr.-qtr. chg.	Q3 '11 sales	Yr.-yr. chg.	Q3 '12 gross marg.	Q2 '12 gross marg.	Q3 '11 gross marg.	Q3 '12 oper. marg.	Q2 '12 oper. marg.	Q3 '11 oper. marg.	Q3 '12 net in-come	Q2 '12 net in-come	Q3 '11 net in-come	Q1-3 '12 sales	Q1-3 '11 sales	Yr.-yr. chg.	Q1-3 '12 net inc.	Q1-3 '11 net inc.
Stand-Alone EMS Providers																			
Key Tronic	97.5	96.7	0.8	69.8	39.8	9.7	9.6	7.2	5.8	5.4	2.3	3.7	3.8	1.2	289.8	199.2	45.4	10.9	3.5
SMTC	75.6	75.1	0.6	44.1	71.4	7.9	9.7	8.4	2.3	4.7	-2.2	1.3	2.8	(1.5)	223.1	149.2	49.5	6.6	(1.7)
Sparton	49.0	61.3	-20.1	51.8	-5.4	14.7	20.0	16.1	2.7	9.9	4.6	1.0	4.1	1.5	165.4	163.1	1.4	7.0	3.3
IEC Electronics	37.1	36.0	2.9	34.9	6.1	18.3	20.6	20.1	8.7	9.8	7.1	2.0	2.2	2.6	145.0	133.3	8.8	7.8	6.8
Nortech Systems	25.5	28.0	-9.0	28.3	-9.9	10.9	11.0	11.6	1.3	1.1	1.5	0.1	0.1	0.2	81.9	85.1	-3.8	0.4	1.0
Subtotal/avg.	284.7	297.2	-4.2	228.9	24.4	11.3	13.2	12.0	4.3	6.3	2.6	8.1	13.0	4.1	905.2	730.0	24.0	32.6	12.8
EMS Units of Larger Public Companies																			
Kimball Electronics Group ¹	164.2	164.9	-0.4	142.8	14.9				3.1	3.6	-1.6	3.3	4.1	(1.1)	490.0	504.9	-3.0	10.6	3.3
Ducommun LaBarge Technologies	107.4	107.8	-0.3	110.0	-2.3				9.7 ²	9.7 ²	6.6 ²				325.3	168.8	92.7		
CTS Electronics Manufacturing Solutions	61.8	77.5	-20.2	77.0	-19.7				3.8 ^{3,4}	5.4 ^{3,5}	4.6 ³				209.8	235.4	-10.9		
Total/avg.	618.1	647.4	-4.5	558.7	10.6										1,930.3	1,639.0	17.8		

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 included corporate and shared services charges. ⁴ Excluded restructuring and related charges of \$0.9 million not allocated to business segments. ⁵ Excluded restructuring and related charges of \$3.8 million not allocated to business segments.

Table 2A: Adjusted Nine-Month 2012 Sales Growth for Eight Mid-tier and Smaller EMS Providers Based in North America (M\$ or %)			
Organization	Q1-3 '12 sales	Q1-3 '11 sales	Yr.-yr. chg.
Stand-Alone EMS Providers			
Subtotal/avg.	905.2	730.0	24.0
EMS Units of Larger Public Companies			
Kimball Electronics Group	490.0	504.9	-3.0
Ducommun LaBarge Technologies with adjusted 2011 sales	325.3	332.3*	-2.1
CTS Electronics Manufacturing Solutions	209.8	235.4	-10.9
Total/avg.	1,930.3	1,802.5*	7.1

*Sales were increased by \$163.5 million to reflect the 2011 sales of LaBarge before it was acquired by Ducommun in June 2011.

three EMS units could boost its Q3 operating margin, but compared with the year-ago quarter, DLT and **Kimball Electronics Group** succeeded in improving their margins (Table 1A).

Q3 net income for the five stand-alone providers totaled \$8.1 million, or 2.9% of sales, compared with \$13.0 million for Q2 and \$4.1 million for Q3 2011. For the first nine months, the five providers earned a combined net profit of \$32.6 million, or 3.6% of sales, up from \$12.8 million a year earlier. Nine-month profit climbed 154% year over year, while sales for the period rose 24%. Four out of five stand-alone providers increased their nine-month net income year over year (Table 1A).

A brief look at each provider

CTS Electronics Manufacturing Solutions. CTS's EMS unit generated Q3 sales of \$61.8 million, which fell 19.7% year over year partly because of the weak global economy as certain customers delayed orders, particularly in the defense and aerospace and communications markets. Also playing a role were the lingering impact of the Thailand flood and the company's strategy to exit certain unprofitable accounts. Segment operating earnings of \$4.2 million before corporate and

shared services charges decreased by \$1.7 million from the year-earlier period, primarily as a result of lower sales.

On a sequential basis, Q3 sales dropped 20.2%. Reflecting the weak global economy, demand fell across all markets served. Segment operating earnings before corporate and shared services declined by \$1.9 million from Q2, again mainly due to lower sales.

In response to the weak economic environment, CTS is taking actions to further reduce its cost structure. The company has announced plans to close its EMS operation in Tianjin, China.

CTS's latest guidance calls for its EMS business to decline 9% to 12% in 2012.

Ducommun LaBarge Technologies. Ducommun's DLT segment reported Q3 sales of \$107.4 million, down 2.3% year over year. This decline reflected lower sales in the natural resources and industrial end-use markets, partly offset by higher shipments of military and commercial aerospace electronics. On a sequential basis, revenue was essentially flat.

DLT's operating income for Q3, which did not include corporate general and administrative expenses, amounted to \$10.5 million, or 9.7% of revenue, up from \$7.3 million, or 6.6% of revenue, in the year-earlier period, thanks to a favorable mix of higher margin products and benefits from Ducommun's integration efforts. EBITDA was \$15.2 million, or 14.1% of revenue, compared with \$12.0 million, or 10.9% of revenue, in Q3 2011.

IEC Electronics. For its fiscal Q4 ended Sept. 30, revenue of \$37.1 million grew 6.1% year over year, but net income of \$2.0 million fell 23.9% over the same interval. EPS for the September quarter came in at \$0.20, down

from \$0.26 in the same period a year ago. The year-earlier result included a positive adjustment of \$0.08 per share related to **Southern California Braiding**, a company acquired by IEC. Excluding this adjustment, EPS for the September 2011 quarter was \$0.18, and on that basis EPS would have increased 11% year over year.

Operating margin came in at 8.7% versus 9.8% for the prior quarter and 7.1% for the year-ago period. Considering the year-over-year increase in operating margin, the company said its fiscal Q4 was a good quarter.

IEC expects revenue growth from its existing businesses to be between 9% and 14% for fiscal 2013. For the new fiscal year, none of its customers in the military/aerospace sector have told IEC that they expect delays in their programs, and none of them expect sequestration to affect platforms which IEC supports. The military/aerospace sector, which had experienced delays through most of fiscal 2012, accounted for 43% of fiscal 2012 sales.

Key Tronic. For its fiscal Q1 ended Sept. 29, revenue totaled \$97.5 million, up 39.8% year over year, while net income amounted to \$3.7 million, up 200% year over year. EPS came to \$0.35. The company was pleased with its strong year-over-year growth in revenue and earnings for the quarter. Sales rose 0.8% sequentially, while net income declined 1.8%.

Gross margin for the quarter stood at 9.7%, up 10 basis points sequentially and 250 basis points year over year, while operating margin was 5.8%, up 40 basis points sequentially and 350 basis points year over year.

At the end of fiscal Q1, Key Tronic was generating revenue from 168 programs and had 51 customers, up from 135 programs and 36 customers a year earlier. The company also continued to diversify its future revenue base during fiscal Q1 by winning new programs involving solar energy and power man-

agement products.

For the December quarter, the company expects revenue of \$93 million to \$99 million and EPS of \$0.32 to \$0.38.

Kimball Electronics Group. For fiscal Q1 ended Sept. 30, sales from Kimball's EMS segment amounted to \$164.2 million. Compared with the year-ago quarter, sales rose 14.9% primarily from double-digit growth in sales to customers in the automotive and industrial markets. On a sequential basis, sales were almost flat.

The EMS unit's gross margin for the September quarter improved by 360 basis points year over year mainly because of higher absorption of fixed costs, benefits from restructuring activities completed in the prior fiscal year, and increased operational efficiencies.

As a percentage of sales, SG&A costs for the unit declined 100 basis points from the year-ago quarter, although SG&A dollars increased slightly by 2%. The unit's operating income was \$5.0 million, up from an operating loss of \$2.3 million a year ago, and its net income came to \$3.3 million, up from a net loss of \$1.1 million a year earlier. (Note that unit operating and net income are not necessarily equivalent to GAAP results on a stand-alone basis.)

Nortech Systems. Q3 sales of \$25.5 million dropped 9.9% year over year. Operating income for the quarter was \$329,000, down 21.7% year over year, and the company earned net income of \$105,000, down 42.6% year over year.

Lower sales volume in Q3 hurt plant utilization and profitability, Nortech reported. The company implemented cost reduction and cost avoidance initiatives to better match demand.

Q3 gross margin came in at 10.9%, down 70 basis points from the year-earlier period. Operating margin was 1.3%, 20 basis points below the year-

earlier level.

A hoped-for second-half recovery is not materializing, which is particularly true for many industrial customers in Nortech's largest segment.

The company said some customers appear to be gaining momentum, while others are still making inventory adjustments or delaying orders.

SMTC. Q3 revenue of \$75.6 million grew 0.6% sequentially and 71.4% year over year. The company earned Q3 net income of \$1.3 million, or \$0.08 a share, compared with net income of \$2.8 million, or \$0.17 a share, in the prior quarter and a net loss of \$1.5 million, or a loss of \$0.09 a share, in Q3 2011. The \$0.08 EPS result for Q3 benefited from a nonrecurring tax recovery equivalent to \$0.02 a share.

Gross margin in Q3 stood at 7.9% including unrealized gains from foreign currency forward contracts of \$1.1 million. This margin result was down 180 basis points sequentially and 50 basis points year over year. Adjusted EBITDA for the quarter was \$2.6 million, down from \$4.3 million in Q2 but up from \$0.7 million a year earlier.

The company said that overall, the quarter was weaker than expected. SMTC has started lean manufacturing initiatives in its Mexican plant and is reviewing its Canadian operations in order to improve profitability. SMTC's Canadian location (Markham, Ontario) serves as its headquarters and provides manufacturing support.

Q4 guidance calls for revenue of \$70 million to \$77 million, adjusted EBITDA of \$3.0 million to \$3.5 million, and adjusted EPS of \$0.09 to \$0.12. This guidance does not include SMTC's purchase of **Seksun Array Electronics** assets, the completion of which was announced this month (see News, p. 7).

Sparton. For its fiscal Q1 ended Sept. 30, sales totaled \$49.0 million, down 5.4% year over year, while net

income amounted to \$1.0 million, down 36.8% year over year. The decrease in revenue and earnings resulted from the timing of US Navy lot deliveries from Sparton's Defense & Security Systems (DSS) business as well as a shift of demand within its Complex Systems (CS) business from fiscal Q1 into the remainder of the fiscal 2013.

The company won 14 new programs during the September quarter worth an estimated \$13.4 million in annualized revenue.

Medical sales for the quarter, which represented 57% of the company's total, grew \$0.6 million, or 2.2%, year over year. Gross margin for this business improved to 14.9% from 13.2% in the year-ago quarter. Excluding a \$1.1-million increase in intracompany sales, CS sales to external customers fell by \$1.3 million from the same quarter last year. The CS segment produced a gross margin of 8.9%, up 20 basis points year over year. DSS sales declined by about \$2.1 million from a year earlier, while the segment's gross margin dropped to 14.6% from 23.8% over the same interval.

Sparton expects year-over-year increases in both revenue and profitability for fiscal 2013 and forecasts that the second half will be stronger than the first half.

News

Flextronics in Two Deals

This month, **Flextronics** (Singapore) made one acquisition and signed an agreement that will lead to a second transaction. But the two deals have little in common as they are intended to benefit different businesses within Flextronics. First, the company acquired **Saturn Electronics & Engineering** (Rochester Hills, MI), a move that will expand Flextronics' automotive offering. Next, Flextronics and **Google-owned Motorola Mobility** agreed that Flextronics will buy Mo-

torola Mobility's China factory outright and acquire equipment and take over operations at Motorola Mobility's Brazil factory.

In the latter deal, Flextronics will acquire Motorola Mobility's manufacturing operations in Tianjin, China, and will also assume the management and operation of the OEM's facility in Jaguariuna, Brazil. Flextronics will pay about \$75 million for the China factory and related equipment as well as equipment in Brazil. (The price does not include a premium.) During a conference call, Flextronics CEO Mike McNamara said the company will also be hiring "a few thousand" Motorola Mobility workers in both Tianjin and Jaguariuna. The deal comes with a multiyear contract, potentially worth several billion dollars in annual revenue, for the manufacture of Android and other mobile devices. Subject to customary conditions, closing is expected to occur during the June 2013 quarter.

Flextronics said this partnership strengthens the company's business for many reasons, and the company gave three. First, the deal positions Flextronics as a key supply chain partner for Motorola Mobility and future hardware products within Google's ecosystem. Second, the Motorola Mobility operations will strengthen Flextronics' manufacturing footprint in China and Brazil with highly trained and skilled employees that are increasingly difficult to find in today's manufacturing labor markets. Third, the deal is synergistic to Flextronics' end-to-end solutions including metals, plastics, global services and components and further leverages the provider's operating expense structure. Although Flextronics hopes that Motorola Mobility will expand its use of Flextronics' components and other end-to-end offerings, the deal does not cover this aspect.

With this deal, Motorola Mobility will be 100% outsourced, and Flextronics will become its largest EMS

supplier, according to McNamara.

Flextronics expects the deal to be accretive to EPS and operating income for fiscal 2014, with ROIC above 20%. The company anticipates that the transaction will yield an operating margin within the target range of 2%-plus for Flextronics' High Velocity Solutions (HVS) business.

Why is Flextronics adding high-velocity business when its business mix has shifted toward less HVS business? McNamara pointed out that the company still has about \$7 billion in HVS business. "It is a business that tends to be transactional and tends to be shorter product lifecycle, so we like to keep it in balance," he said. "We still need to continue to book business in this particular category." But finding a customer with the right profile for the company's HVS business has been difficult. Flextronics believes that the Google-Motorola Mobility deal has the characteristics that the provider needs.

McNamara estimated that the China factory is just shy of 1 million ft², while the Brazil facility is "very significant in terms of size." Flextronics said the Motorola Mobility business will be right-sized when Flextronics takes it over.

In acquiring Saturn Electronics & Engineering, Flextronics gained a business that most recently reported more than \$300 million in annual revenue. As a supplier of EMS, wiring, and automotive solenoids, Saturn serves the automotive, appliance, consumer, energy and industrial markets. The company manufactures and assembles electronic products in its Monterrey, Mexico, plant, while wiring products are turned out in Saturn's Juarez, Mexico, facility. Solenoid production takes place at the company's Coopersville, MI, and Suzhou, China, sites. A services support center is located in Cebu, Philippines.

"Our combined capabilities will provide customers with an expanded

range of services in automotive energy management and vehicle electronics," stated Chris Obey, president of Flextronics Automotive.

*Reportedly, Sharp will divest plants to Foxconn... **Foxconn Technology Group** and Japan's **Sharp** have reached an agreement whereby Sharp will sell its TV factories in Mexico, China and Malaysia to Foxconn for a price of some \$667 million, according to a Chinese language website, *udn.com*, and the *Taipei Times*. The latter based its report on a Japanese newspaper, *Sankei*. Foxconn, through its anchor company **Hon Hai Precision Industry** (Tucheng City, Taiwan), would not comment on the website's report, according to a statement posted on the Taiwan Stock Exchange. Earlier, the two parties were said to be negotiating the sale of the three TV plants to Foxconn (Oct., p. 8).*

SMTC Acquires Operation in China

SMTC (Markham, Ontario, Canada) has purchased the manufacturing assets of **Seksun Array Electronics (Suzhou) Co. Ltd.**, an EMS provider in Suzhou, China, for a price of about \$2.0 million. This acquisition will further expand SMTC's operations and capabilities in China, strengthen its global footprint, and support the growth of new business in the region.

The Suzhou operation will specialize in manufacturing mid-to-low mix/mid-to-high volume electronics equipment for telecom, wireless, life science and automotive customers.

SMTC expects this transaction to be immediately accretive.

The operation was part of the **Seksun Group**, a metal components manufacturer with operations in Asia.

Meanwhile, under a new manufacturing agreement, **FICOSA International** (Barcelona, Spain), a supplier of automotive systems and parts, will

move the manufacturing of select programs to SMTC's Suzhou plant.

Through this partnership, SMTC will also offer its customers the expertise of **Idneo**, a product design subsidiary of FICOSA with 180 engineers.

Another deal done... EMS provider **Electronic Manufacturing Solutions** (Thatcham, UK) has acquired **Applied Assembly** (Southampton, UK), a supplier of cable and electromechanical assemblies.

Apple to Invest in US Production

Foxconn explores expansion in the US

As has been widely reported by now, **Apple** CEO Tim Cook told *Bloomberg Businessweek* that Apple intends to spend over \$100 million in 2013 on production of Mac computers in the US. In the magazine interview, he said the company will not undertake this project alone.

At the same time, Foxconn Technology Group has confirmed, through a statement provided to *MMI*, that it "is exploring the opportunity to expand its existing manufacturing operations in the US, which have always been a part of our global manufacturing operations, to meet the needs of

our customers and to leverage the high-value engineering talent that is available in that important market."

Whether these two developments are linked or are merely a coincidence is a question that neither company has answered. However, a *Digitimes* report based on supply chain sources asserts that Apple plans to transfer Mac mini manufacturing to a US activity set up by Foxconn.

It is said that Foxconn's expansion plans also include Indonesia (Sept., p. 6), but *The Jakarta Post* is now reporting that the group's investment in the country has been delayed as talks with the government continue.

Foxconn invests in US company... Foxconn Technology Group's anchor company, Hon Hai, has invested \$200 million in California-based **Woodman Labs**, maker of wearable and gear-mountable cameras. Foxconn seeks image-capture technology and believes it will be in a position to manufacture for Woodman, *Bloomberg News* reported.

Plant closure... According to reports out of Israel, **Sanmina** (San Jose, CA) plans to close its factory in Lod, Israel.

People on the move... **Celestica** (Toronto, Canada) has appointed Dar-

ren Myers executive VP and CFO succeeding Paul Nicoletti, who is leaving the company to pursue other interests. Myers most recently served the company as senior VP and corporate controller...Markus Walther has been promoted to CEO of the **ESCATTEC Group** (Penang, Malaysia) from COO. Company founder Christophe Albin remains executive chairman with responsibility for special projects. ...Sanmina has named Alan Reid executive VP, global HR to succeed David Pulatie, who has retired.

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