

# Manufacturing Market™ INSIDER

inside the contract manufacturing industry

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## 2013 Outlook: Growth, But No Banner Year

How will 2013 compare with 2012 in the contract manufacturing space? A number of forecasts including projections for the semiconductor industry and the IMF's outlook for the global economy suggest that 2013 will show some improvement over 2012. If these projections are pointing in the right direction, then 2013 should be a growth year in the outsourcing space, but one that probably won't create widespread excitement.

Let's start with the outlook for the global economy. The **International Monetary Fund** (IMF) is estimating that the world's economy will grow slightly faster this year than in 2012. In the IMF's forecast, global growth will come in at 3.6% this year, which is still sluggish by IMF standards. That compares with an IMF estimate of 3.3% for 2012. Advanced economies overall will remain in a minimal growth phase with a GDP increase of 1.5%, up 20 basis points from 2012. Emerging and developing economies will pick up 30 basis points of growth for a GDP gain of 5.6%, according to the IMF.

But, as one would expect, not all economists hold the same world view. Market information provider **IHS** foresees that world growth will stabilize in 2013 at 2.6%, with a modest acceleration of growth in the latter part of the year. IHS puts world growth for 2012 at around 2.5%.

The more optimistic forecast calls for an appreciable pickup in global growth, while in the less sanguine outlook the growth rate will hold steady. In either view, things will not get worse at the world level and might get somewhat better if the IMF's perspective proves out. Note that even a stable world economy leaves room for growth in the contract manufacturing space.

Acknowledging the IMF forecast, the **Japan Electronics and Information Technology Industries Association** has released a 2013 projection for production by the global electronics and IT industries. JEITA expects this global market mix to increase in value by 5% this year, reaching of 221.7 trillion yen (\$2.5 trillion). The mix consists of electronic equipment of various types, components, display devices and IT solution services. *MMI* stripped out the non-equipment categories and found that the aggregate increase for electronic equipment, pro-

jected to total 105.8 trillion yen (\$1.2 trillion) in 2013, will still amount to an estimated 5%.

The JEITA outlook can be used as one way to predict overall end market demand in 2013. Forecasts for the semiconductor industry are another. Three semiconductor sales forecasts for 2013 are in agreement or nearly so. Both **Gartner** and **WSTS** (World Semiconductor Trade Statistics) are predicting 4.5% growth for semiconductor revenue worldwide. A third forecast, from **IDC**, pegs semiconductor sales growth at 4.9% for 2013. But these are not the only projections made for the semiconductor industry. **IHS's** more upbeat forecast for the global semiconductor market has revenue growing 8.2% this year. Then there's **IC Insights**, which foresees market growth probably in the range of 3 to 7%, according to an article published by *Solid State Technology*.

With the JEITA outlook and three out of five semiconductor forecasts

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calling for growth rates ranging from 4.5% to 5%, one can make a case for a prediction of around 5% for the growth of end markets in 2013. Add about 1.5 percentage points for the effect of outsourcing, and the result is a growth projection for contract manufacturing (EMS + ODM) in the neighborhood of 6.5%. Naturally, if equipment production falls short of the JEITA forecast, then all bets are off.

Already, there is reason to question forecasts of 4.5% or 5% macro growth for end markets. Take the WSTS forecast of 4.5% growth for semiconductor revenue versus an estimated decline of 3.2% last year. During **Flextronics'** earnings call this month, CEO Mike McNamara referred to the semiconductor forecast and reported that his company has "no visibility of that rebound existing in our base business today." Furthermore, Flextronics is not the only US-traded provider to have reported end market softness as the year begins.

The 6.5% projection, albeit rough, is consistent with year-to-date results for 20 of the largest contract manufacturers in 2012. For the first nine months of last year, their combined sales grew 4.7% year over year (Dec. 2012, p. 1). JEITA's statistics show that the yen value of electronic equipment production increased by 3.3% last year. (This percentage did not change appreciably when data was converted to US dollars.) Thus, one can conclude that outsourcing was responsible for about 1.4 percentage points of growth for those 20 CMs, which represent the vast majority of the space for outsourced manufacturing. That's how *MMI* came up with the outsourcing contribution of 1.5% to the 2013 growth rate. Modestly higher equipment growth in 2013, if it comes to pass, should result in modestly higher contract manufacturing growth under the assumption that outsourcing will make roughly the same contribution to the growth rate in 2013 as in

2012.

IDC's 2013 forecast for contract manufacturing is slightly less optimistic than *MMI's* outlook as IDC is projecting growth of 5.9% for the outsourcing space. Still, the two estimates are not that far apart, and combining them, one can arrive at a melded projection of 5.9% to 6.5% for contract manufacturing growth in 2013.

Of course, a growth projection for contract manufacturing does not necessarily translate into a forecast for the EMS industry as the industry shares the contract manufacturing market with the ODM sector. History has shown that in a given year these two sides of the outsourcing space do not grow at equal rates. Sometimes the difference can be rather small, as in the first nine months of 2012 (Dec. 2012, p. 1). In other years such as 2011, the gap can be wide (April 2012, p. 1). It's a matter of end market dynamics, which are tough to forecast.

One thing is for sure: tablets are a hit among consumers. **NPD DisplaySearch** expects tablet shipments to surge 64% in 2013, easily overtaking notebook PCs, still the bread and butter of the ODM sector. *MMI* believes that the ODM outlook for 2013 depends on whether the PC market rebounds from a shipment decline in 2012 and how much market share ODMs will win in the tablet space. By contrast, the EMS industry spreads its risk across a basket of diverse end markets, something that the industry does not receive enough credit for. But EMS end markets are not equally penetrated, nor do they grow at the same rate. IDC is projecting EMS industry growth of 5.6% for 2013. If the EMS industry outgrows the ODM sector and the outsourcing space expands at a mid single-digit rate, then IDC's forecast could end up being conservative.

Now the big unknown in any EMS forecast is giant **Hon Hai Precision Industry**, which can easily skew collective sales results on the EMS side.

Hon Hai would boost the EMS industry's growth in 2013 if the company grows faster than the average, as Hon Hai has done in the past.

With potentially moderate growth as a backdrop, *MMI* has identified eight EMS industry trends worth watching in 2013. Here they are in no particular order.

**In 2013, there will be more discussion of high- versus low-cost manufacturing locations within a region.**

With greater acceptance of regional manufacturing (manufacturing in the region where a product sold), high-cost locations – principally the US, Canada, the UK, France, Germany and the Nordic countries – will get a second look from increasing numbers of OEMs. In North America, these OEMs and their providers will focus their discussions on the US or Canada versus Mexico. In Europe, much of the talk will revolve around an OEM's country of origin versus sites in Central or Eastern Europe. In Asia, the continually rising costs of manufacturing in China, will prod some OEMs and their EMS partners to start evaluating other Asian locations besides China.

High-cost countries may still lose out in cases where OEMs are most concerned with cost per unit. But places such as Mexico and Eastern Europe do not have China's supply base for lower cost materials. So in a regional scenario, lower-cost sites in North America and Europe are mainly competing based on their labor costs and any government incentives, *MMI* believes. For some OEMs, factors such as proximity, responsiveness, logistics, and several types of risk (i.e., worker turnover, crime, yields) may tip the scales toward a higher-cost location. Deciding where to manufacture is a complex undertaking, which depends on many factors including the type of product being outsourced. Thus, it is beyond the scope of this outlook to pick regional winners and losers. In-

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deed, both high- and low-cost countries will probably benefit from regional manufacturing.

Still, there is one area, new product introduction, where high-cost locations have a clear advantage. OEMs will continue to prefer having outsourced NPI located near their engineering centers in high-cost countries.

One factor that *MMI* believes will have little or no effect on OEM decision making is **Apple's** plan to invest in US manufacturing (Dec. 2012, p. 8). For one thing, the amount of work being moved to the US represents a small percentage of Apple's total production. Apple will continue to depend on China. More important, Apple has offered no rationale for the investment. In the absence of an explanation, OEMs and their providers cannot help but think that PR played a role in Apple's decision. Unless Apple cites sound business reasons for this investment, it will lack credibility in the outsourcing community.

**Barring an unexpected surge of high demand, supplier consolidation will gain momentum in 2013.**

A recent survey conducted by global information provider **IHS** found that 51% of OEMs polled plan to shrink their supply base of contract manufacturers during 2013 (Nov. 2012, p. 1). This is not a new idea. OEMs know full well that it costs them extra to manage multiple CMs. By reducing the number of CMs, OEMs can lower their internal costs associated with outsourcing. When sales growth is anemic, as is the case today for many OEMs, their focus becomes margin improvement through cost cutting.

But cost cutting is not the only reason to use fewer CMs. Over time, OEMs can accumulate more CMs than they need. Sometimes, they will inherit CMs from companies that they acquire. In other cases, a new manager will want to add a CM with whom the person had a prior relationship. Or an OEM might bring on CMs that manu-

facture in parts of the world that the OEM wants to reach. Or the OEM plans to introduce a new product line and wants to find a new CM for it. According to the **IHS** survey, OEMs average eight manufacturing partners, a number indicating that bloated CM supply bases are a common problem.

*MMI* suspects that there will be a tendency to eliminate smaller CMs in an OEM's supply base as long as their services can be provided by others.

Being on the losing end of an OEM's supplier consolidation plan can be a major blow to a provider when the OEM accounts for a significant part of that provider's business. Just ask **Celestica** and **Plexus**, both of which were recently cut from their largest customer's supply base (June 2012, p. 7; Nov. 2012, p. 1-2). Given such examples, EMS providers will grow even more cautious about customer concentration when supplier consolidation is on the rise.

It is ironic that the same focus on cost saving that compelled many OEMs to resort to the use of contract manufacturers in the first place is now causing them to cut back on the number of CMs that they work with.

**Foxconn Technology Group's plan to install large numbers of robots may be behind the group's original schedule, but don't count Foxconn out.**

It was widely reported that Foxconn planned to employ 300,000 robots last year and 1 million by 2014. *MMI* had identified the robots initiative as a trend to watch in 2012 (Jan. 2012, p. 5), but by many accounts Foxconn did not come close to reaching its goal of 300,000 in 2012. Though it may have been premature to call out this trend for 2012, this year should be a different story.

There is no evidence that Foxconn is backing away from its robotics effort. The group has invested in facilities to produce its own automation equipment. Indeed, *Digitimes* reported

Foxconn as saying that automation takes time, and that its effort remains on schedule. It is not clear what the company's targets are, but it is safe to assume that with a year under its belt the company is in a better position to begin installing robots in larger numbers in China.

*MMI* believes that 2013 will produce a verdict on Foxconn's automation concept. To prove this concept, the group must show that robots (plus software) are not only cost effective but can be adapted to many of the factory jobs now performed by humans. If the economics and utility of robots can be proven in China, then the door is opened for EMS applications in higher-cost countries where presumably the payback period would be shorter.

**At the top end of the industry, non-EMS businesses have become increasingly important for margin improvement.**

**Jabil** is perhaps the poster child for the pursuit of non-EMS business. Its Specialized Services sector, consisting of Jabil's Materials Technology Group and aftermarket services, accounted for 31% of the company's sales for the November 2012 quarter. All of that Specialized Services business would be considered non-EMS.

**Sanmina** recently introduced a new reporting structure that separates its non-EMS activities from its EMS business. The provider now lumps its components, products and non-EMS services into a single category separate from the EMS portion of its business (Nov. 2012, p. 4-5). This non-EMS segment, fittingly called Components, Products and Services, represents about 20% of Sanmina's revenue.

**Flextronics** also maintains components businesses, although the company sold its camera modules business last year. Other non-EMS activities include aftermarket and retail services and contract manufacturing of products that are not electronic in nature. The extent of these non-EMS activities

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is unknown as the company does not break them out.

Both **Benchmark Electronics** and **Celestica** have invested in mechanical capabilities. Benchmark provides precision mechanical manufacturing services through its Precision Technologies sites. Over the past two years, Celestica has made two acquisitions on the mechanical side including an operation that does mechanical contract manufacturing for the semiconductor capital equipment industry.

Non-EMS activities are attractive for several reasons, but perhaps the most important one is the potential such business has to generate higher margins than what EMS can deliver. In 2013, providers will look to maximize the margin performance of non-EMS businesses as one to way improve margins overall. At the same time, they will seek to grow the non-EMS side as a larger percentage of the business mix where possible. Achieving a greater mix of non-EMS business at higher margins is another way to raise corporate margins. In 2013, a number of providers in the margin-starved EMS industry will look upon their non-EMS activities as an important lever to pull for raising margins. This trend extends to some lower-tier providers that also maintain non-EMS businesses. These players as well have the opportunity to use their non-EMS activities to ratchet up margins.

Nevertheless, don't expect large numbers of providers to suddenly start venturing into non-EMS businesses. Such activities may divert capital and management resources from a provider's core EMS business and can be a drag on margins during periods of soft demand.

**Many EMS providers will have conflict minerals reporting on the front burner in 2013.**

During the year, providers will be preparing to inform their SEC reporting customers of the use of conflict minerals, which include tantalum, tin,

gold and tungsten from the Democratic Republic of the Congo or an adjoining country. According to a rule adopted last year by the US Securities and Exchange Commission, conflict minerals disclosures for SEC reporting OEMs are due on May 31, 2014 for calendar year 2013 (Sept. 2012, p. 5-6). Mandated by the Dodd-Frank Act of 2010, this rule applies to an SEC reporting company if conflict minerals are "necessary to the functionality or production" of a product manufactured by the company or contract manufactured on its behalf. For products whose manufacturing is wholly or partially outsourced, reporting OEMs will naturally seek information on conflict minerals usage from their contract manufacturers.

Conflict minerals reporting will affect a large portion the EMS industry, and not just US-based providers, because any EMS provider that does business with an SEC reporting company could, and most likely will, be asked to provide information on conflict minerals usage. That means EMS providers – whether they're publicly or privately held, based in the US or outside it, small or large – must be prepared to obtain the proper disclosure information on behalf of their reporting customers.

The requirements for conflict minerals disclosure are not simple, and any provider with reporting customers cannot afford to wait until next year before starting a conflict minerals program. As *MMI* sees it, EMS providers will need time to identify by every product of every reporting customer any parts or added materials that contain tantalum, tin, gold or tungsten. They will then turn to materials and components suppliers who generally will be in a better position to get the necessary information on the designated minerals in the items they sell. In some cases, even these suppliers may need to go to their suppliers to track down the necessary information. That

information will be sent back up the supply chain to the EMS providers who must organize it by customer product and ensure that every turnkey part or added material containing one or more of the minerals in question has been accounted for. The process becomes even more time consuming if, after a country-of-origin inquiry, a supply-chain company knows or has reason to believe that the minerals may have originated in the covered countries and may not be from scrap or recycled sources.

**This year may see a rise in M&A as some providers look to grow faster than what organic business would permit.**

*MMI* finds several factors that could push M&A upward after a soft 2011 and first-half 2012. (Statistics on the full year 2012 have not yet been compiled.)

- If growth projections pan out, the EMS industry probably won't come close to double-digit growth in 2012. Ambitious providers that want two-digit growth this year have two options: win more than their share of new business or make an acquisition. The second option is appealing because it adds revenue immediately rather than in six to nine months as with the first choice.

- Free cash flows and low interest rates have put providers in a solid financial position to make deals.

- As the year goes on, stability in end markets should result in more visibility and less uncertainty. Uncertainty is the enemy of M&A. This factor applies especially to Europe, an important source of M&A, as long as its debt problems grow no worse.

- The regional manufacturing trend will likely make operations in high-cost locations more desirable to potential buyers. Owners of these operations will see this as a selling opportunity.

- Acquisitions of new capabilities and niche operations will continue to appeal to the largest providers, who

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treat such deals as “tuck-in” acquisitions, as well as to other providers who want to differentiate themselves from the competition.

**Foxconn’s agreement to abide by a 49-hour work week in China will set the stage for a substantial increase in wages throughout China’s manufacturing centers.**

As a result of the **Fair Labor Association’s** 2012 investigation of three Foxconn operations that manufacture for **Apple** in China, Foxconn agreed to comply with Chinese law regarding overtime by July 1, 2013 (April 2012, p. 7). Chinese law limits overtime to 36 hours per month, so Foxconn will restrict its employees to a 49-hour work week on average. The provider also agreed to protect worker pay since overtime would be slashed. Foxconn had capped overtime at 80 hours a month (60-hour work week) as of August 2012. In order to keep worker pay from dropping when overtime hours are cut, Foxconn will have to raise wages substantially. A *New York Times* article published last month reported analysts as saying that many employees will receive a wage increase amounting to 50%.

If Foxconn can reduce overtime while convincing workers that they are not losing any pay, then other manufacturing operations in China will find it difficult not to follow suit. *MMI* pre-

dicts that other companies in **Apple’s** supply chain will follow Foxconn’s lead lest they be accused of condoning excessive overtime. Pressure to cut overtime while raising wages will build at other factories, especially those operated by image-sensitive multinationals. Some manufacturers, however, may try to avoid wage hikes by continuing to offer plenty of overtime. Still, *MMI* believes that if Foxconn’s compensation plan is successful, then it will set off a round of higher-than-normal wage increases that will eventually spread to much of China’s manufacturing industry.

Unless it’s a bust, Foxconn’s prospective increase in wages will give the regional manufacturing trend a push, increasing its momentum.

**EMS providers, especially the large ones, will put more effort into joint design manufacturing (JDM).**

JDM benefits both sides of an outsourcing relationship. An OEM gets to retain whatever design activities are important to it. Depending on the OEM, examples of such activities might be specification writing, system design and test engineering, and software engineering. By retaining such functions, the OEM keeps its ability to create a new product and the associated intellectual property. This ability is also quite useful for creating a product road map. By contrast, in an ODM

relationship it is well known that most if not all the IP lies with the ODM.

In a typical JDM relationship, the OEM will turn over to its EMS provider some design functions that the provider is better equipped to carry out. Again depending on the OEM, such functions might include, but would not necessarily be limited to, board layout and design. The provider benefits in a big way because it is in an ideal position to get the customer’s manufacturing program. In effect, JDM can be viewed as a rather stealthy business development strategy for an EMS provider.

Of course, JDM is not just a matter of dividing up responsibilities. The two sides also work together at various stages, maybe the biggest reason for adopting a JDM approach. In particular, when a product design is being translated into physical reality, the EMS provider is present to assure that physical designs are viable and efficient for manufacturing. The EMS provider’s experience can also help the customer avoid design pitfalls such as obsolescent components. Yet another benefit arises when the OEM opts for components for which the provider has obtained favorable pricing.

JDM, of course, is not a new concept. But in today’s cost-cutting environment, OEMs may be more easily sold on the merits of JDM.

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## Some Quarterly Results

**Celestica.** Q4 revenue totaled \$1.50 billion, down 5% sequentially and 15% year over year, predominantly as a result of the wind down of manufacturing services for **RIM**. Excluding RIM, revenue would have risen by 4% sequentially and 6% year over year. Revenue was within guidance of \$1.425 to \$1.525 billion and above the midpoint. Adjusted EPS of \$0.25, which included a \$0.06 per share tax recovery, came in above guidance of \$0.15 to \$0.21 per share.

This EPS result was down 4% from the prior quarter and 24% from the year-earlier period.

The company recorded IFRS net earnings of \$7.2 million, or \$0.04 a share, down from \$43.7 million, or \$0.21 a share, in Q3 and below \$69.2 million, or \$0.32 a share, a year earlier. Q4 net earnings were impacted by other charges totaling \$34.5 million, which included \$16.7 million from restructuring and \$17.7 million in asset impairment charges.

Sales from the company’s diversified end markets grew 3% sequentially

and 11% year over year. In Q4, the diversified segment represented 23% of total sales, up from 18% in the year-ago quarter. For the full year, the segment’s revenue increased 27% year over year, with about half of the gain driven by organic growth.

Comprising 37% of Q4 sales, communications revenue fell 3% sequentially with weakness from several customers and also declined 3% year over year. At 17% of sales, the server segment rose 10% sequentially and grew 5% year over year, driven by strong demand from one customer.

## Results

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Representing 14% of sales, storage business was up 4% from the prior quarter and increased 18% from the year-ago period, driven by strong demand across several customers. Accounting for 9% of Q4 revenue, consumer sales dropped 42% sequentially and 69% year over year, adversely affected by the wind down of RIM production, which was partly offset by growth from several customers.

Non-IFRS gross margin for the quarter stood at 6.9%, down 30 basis points from Q3 primarily due to lower revenue. Non-IFRS operating margin of 3.1% declined 20 basis points sequentially on lower revenue.

The company generated free cash flow (non-IFRS) of \$90.2 million.

Celestica has increased its restructuring estimate to between \$55 million and \$65 million from \$40 million to \$50 million originally set forth in July 2012. The company's restructuring effort has already resulted in charges of \$44.0 million taken in 2012.

As for Celestica's outlook for Q1 2013, overall demand continues to remain soft across a number of the company's end markets, and the company expects seasonal impacts. The provider is projecting Q1 revenue of \$1.325 to \$1.425 billion, at the midpoint of which revenue would be down about 8% sequentially. Excluding RIM, Celestica expects revenue to be relatively flat year over year. For Q1, Celestica expects non-IFRS EPS of \$0.11 to \$0.17. At the midpoint of Q1 guidance, non-IFRS operating margin would be about 2.3%.

A customer in Celestica's server segment recently informed the provider that the customer will be insourcing a lower-margin system assembly program, which is part of its business with Celestica. As a result, the provider expects a sequential decline of \$50 million in server revenue for Q2. Celestica believes that the customer's decision is not indicative of any broader trend in insourcing.

**Flextronics.** For its fiscal Q3 ended Dec. 31, 2012, revenue totaled \$6.12 billion, down 18% year over year, mainly reflecting the wind down of Flextronics' assembly business with **RIM** and the EMS provider's prior exit from the ODM PC business. On a sequential basis, revenue declined less than 1%, while exceeding the midpoint of guidance of \$5.8 to \$6.2 billion. Non-GAAP EPS of \$0.22 from continuing operations was at the high end of guidance of \$0.18 to \$0.22 and included a gain of \$0.04 a share from investments. Note that this gain was not baked into the EPS guidance. The non-GAAP EPS result was down 15% sequentially but up 22% year over year.

Non-GAAP operating income of \$146.1 million for the quarter declined 5% year over year, while GAAP operating income of \$34.9 million fell 75% from a year earlier, reflecting the impacts from restructuring charges of \$102.7 million. Flextronics recorded GAAP EPS from continuing operations of \$0.05, down 67% year over year.

Non-GAAP gross margin amounted to 5.7%, down 30 basis points from the prior quarter. The company's PCB fabrication business impacted gross margin by over 25 basis points, as lower demand resulted in underutilization. Non-GAAP operating margin came in at 2.4%, down 60 basis points sequentially but up 40 basis points year over year.

At 45% of company revenue, Integrated Network Solutions (INS) sales grew 1% sequentially and declined 2% year over year. The sequential increase, which beat expectations of a mid single-digit decline, was primarily driven by better than expected growth in the company's server and storage business group. The rest of the INS business was generally flat to slightly down from the prior quarter as Flextronics continues to see weakness in telecom and networking.

Comprising 15% of sales, Industrial

and Emerging Industries (IEI) business declined 6% sequentially, in line with expectations. Although the company had some new programs ramping in the appliances area, sequential performance of many IEI sub segments ranged from flat sales to a mid single-digit decline.

Representing 12% of sales, revenue from High Reliability Solutions (HRS) rose 9% sequentially and 21% year over year. The sequential growth, which was better than expectations of stable sales, was driven by continued strength in Flextronics' automotive business, which benefited from the December closing of the company's **Saturn Electronics** acquisition (Dec. 2012, p. 6-7). Year over year, the automotive business grew over 20% on the strength of new programs.

Contributing 28% of sales, High Velocity Solutions (HVS) business fell 4% sequentially, which was slightly lower than expectations for stable revenue as demand was lower than anticipated for certain consumer electronics programs being ramped. Within HVS, high single-digit sequential gains in the consumer and high-volume computing areas were offset by a substantial decrease in mobile business caused by the wind down of RIM assembly. Year over year, HVS dropped 44% due almost entirely to the RIM wind down coupled with Flextronics' prior exit from the ODM PC business.

For the December quarter, the company generated \$395 million in free cash flow.

Some underutilized facilities will not benefit from the company's projected growth in fiscal 2014, so Flextronics has resorted to the aforementioned restructuring, expected to result in charges of \$100 million to \$125 million in the March quarter.

For the March quarter, the company expects revenue of \$5.0 to \$5.3 billion (down 16% sequentially at the midpoint) and non-GAAP EPS of \$0.11 to \$0.15. At the midpoint of sales guid-

ance, Flextronics is forecasting sequential declines of high single digits for INS, mid to high single digits for IEL, and 30 to 35% for HVS, while HRS is expected to grow by mid single digits.

**Jabil.** For its fiscal Q1 ended Nov. 30, sales of \$4.64 billion rose 6.9% sequentially and 7.2% year over year. Sales surpassed the high end of guidance, set at \$4.3 billion to \$4.5 billion. Non-GAAP EPS amounted to \$0.61 versus guidance of \$0.51 to \$0.62, while GAAP EPS came in at \$0.51, which beat guidance of \$0.37 to \$0.50. Non-GAAP EPS increased 13% sequentially but fell 6% year over year, as GAAP EPS climbed 31% sequentially but dropped 6% year over year. The company earned GAAP net income of \$105.8 million, up from \$82.8 million in the prior quarter but down from \$112.9 million in the year-earlier period.

Non-GAAP operating margin for the November quarter was 4.2%, up 20 basis points sequentially but down 30 basis points year over year. Non-GAAP operating income of \$192.5 million grew 10% from the prior quarter but declined 1% from a year earlier. GAAP operating income of \$170.3 million was nearly unchanged from a year earlier, while GAAP operating margin equaled 3.7%, down 20 basis points year over year.

Revenue from Diversified Manufacturing Services grew 20% year over year, driven by continued strength in Specialized Services, which was partly offset by weakness in instrumentation and clean tech. Jabil had expected DMS growth of 12% (Oct. 2012, p. 5). DMS represented 47% of the company's sales in the quarter. The segment's non-GAAP operating margin stood at 5.8%, up 50 basis points sequentially but 100 basis points below the year-earlier result.

Accounting for 30% of total revenue, Enterprise and Infrastructure business increased 17% year over year,

slightly above the company's earlier expectation of 14%. Non-GAAP operating margin for the E&I segment was 2.4%, unchanged from the prior quarter but up 40 basis points year over year.

Sales from the company's High Velocity segment fell 20% year over year, primarily driven by declines in handset volumes. The segment performed better than Jabil's earlier guidance of a 24% decline as the company saw improvement in handset volumes during the quarter but also weakness in printing and set-top box revenues. As a result, non-GAAP operating margin for the segment came in at 3.2%. This metric was down 60 basis points both sequentially and year over year.

Jabil's free cash flow for the November quarter went negative after accounting for \$165 million in capital expenditures, the majority of which were directed toward the DMS segment. Still, the company continues to believe that it will generate \$1 billion in cash flow from operations during its current fiscal year.

For the February quarter, Jabil expects revenue to grow about 4% year over year and to fall in the range of \$4.3 billion to \$4.5 billion. The company's projections for the quarter also include non-GAAP operating margin of 3.8% to 4.1%, non-GAAP EPS of \$0.50 to \$0.58, and GAAP EPS of \$0.40 to \$0.48. On a year-over-year basis, the company estimates that DMS and E&I sales for the quarter will increase 7% and 15% respectively, and that High Velocity revenue will decline 13%.

**Plexus.** For its fiscal Q1 ended Dec. 29, 2012, sales totaled \$531 million, in line with revised guidance issued on Jan. 7 but 6% below the midpoint of original guidance, which called for revenue of \$550 to \$580 million. Sales for the quarter were down 11% sequentially. Revenue performance reflects weakness that unfolded in manufacturing demand

across all of the company's market sectors during the quarter. Plexus' Networking/Communications sector presented the greatest difficulty in the quarter as the product demand-pull that the company typically experiences in the final weeks of the quarter did not materialize, particularly from the company's direct order fulfillment customers.

EPS for the quarter amounted to \$0.47, which was within revised guidance of \$0.45 to \$0.47 but below original guidance of \$0.50 to \$0.55. Compared with the year-earlier quarter, EPS was down 8%, while sales remained flat.

In Plexus' December 2012 quarter, Networking/Communications sales fell 13% sequentially, a weaker result than earlier expectations of flat to down performance. For the March quarter, the company is forecasting sequential growth in the high teens percentage range, a significant portion of which will be driven by the provider's disengagement with **Juniper Networks** (Nov. 2012, p. 1-2). Healthcare/Life Sciences business in Plexus' December quarter was down 4% sequentially versus a projected decline in the mid single digits. Plexus anticipates that March quarter revenue from this business will be flat to down.

Industrial/Commercial revenue in the company's December quarter dropped 18% sequentially, a weaker performance than expected as a couple of customers fell short of already weak forecasts. The company expects sector revenue in March quarter to be modestly up, although forecasts are mixed. Sales from the company's Defense/Security/Aerospace sector declined 3% in the December quarter, compared with an outlook for modest growth. For the March quarter, Plexus is projecting sector growth in the mid to high teens percentage range, driven in part by better demand among aerospace customers.

Gross margin for the December

quarter was 9.6%, above expectations and up 10 basis points sequentially though down 20 basis points year over year. The company gained about 30 basis points of margin above expectations from written-down inventory that was sold. Gross margin also benefited from customer mix. Operating margin came in at 4.1%, in line with expectations but down 50 basis points sequentially and 40 basis points year over year.

Guidance for the March quarter calls for revenue of \$550 to \$580 million and EPS of \$0.50 to \$0.55, excluding any unanticipated restructuring charges. At the midpoint of this guidance, revenue would be up 6% sequentially, reflecting higher forecasted revenue from Juniper, for whom Plexus will be building buffer stock in addition to meeting demand during the disengagement process due to be substantially complete by June 30. The company expects an operating margin of 4.0 to 4.1% for the March quarter.

Given the Juniper exit and ramps of new business, Plexus' goal for fiscal 2013 is to work its way back to flat revenue versus fiscal 2012.

## News

### Bribery Probe

**Foxconn Technology Group**, anchored by **Hon Hai Precision Indus-**

**try** (Tucheng City, Taiwan), has confirmed to *MMI* that it is working with law enforcement officials to investigate allegations that a number of Foxconn employees received illegal payments from supply chain partners. Foxconn said it brought in the officials to work with its own internal audit team.

The group reported that it is also carrying out a full review of its policies and practices to identify steps it can take to strengthen measures for preventing such activity.

### Suntron Divests

EMS provider **Suntron** (Phoenix, AZ) has signed definitive agreements to sell its manufacturing facility and Embedded Computing Solutions (ECS) business in Methuen, MA, to separate buyers.

Another EMS provider, **Electronic Instrumentation and Technology** (Sterling, VA) is acquiring the Methuen plant, which will become EIT's Northeast Operations. EIT said the addition of this facility in New England will help EIT grow its presence in the US Northeast and offer its existing customers new services and options.

Suntron said the sale will position it to better serve its high reliability, mission critical, and safety critical cus-

tomers.

The ECS business is going to a subsidiary of Taiwan-based **Axiomtek**, a provider of industrial computers.

*Expanding operations...* **Plexus** (Neenah, WI) intends to relocate its design center in Livingston, Scotland, to a larger 15,500-ft<sup>2</sup> space in nearby Bathgate. The new design center will also incorporate a regional office. In addition, the provider plans to establish a 47,000-ft<sup>2</sup> manufacturing facility at the Bathgate location.

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