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JBL - Jabil Circuit, Inc. at JPMorgan TMT Conference

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Mark Strouse *JPMorgan - Analyst*

PRESENTATION

Mark Strouse - *JPMorgan - Analyst*

Good morning, everyone. Thanks for coming. My name is Mark Strouse. I cover Applied and Emerging Tech here at the firm and we are very happy to have Tim Main, CEO of Jabil. I actually don't cover Jabil at the moment, so this is actually going to be very interesting and informative for me. So maybe, Tim, if you can just spend a few minutes for me, and I'm going to assume a few other people in the audience aren't 100% familiar with the company, just give an overview of your company and maybe kind of walk through your different operating segments.

Tim Main - *Jabil Circuit - CEO*

Sure. We're a \$16.5 billion company in our fiscal '11. Our fiscal year ends in August. Analyst expectations generally are for the, to be in the mid \$17 billion range in fiscal '12. We provided a framework of understanding, how to look at fiscal '13 in the \$19 billion plus range. So we're actually a rapidly growing company. We report our business in three areas. High velocity, which you think about set top boxes, printing, more commoditized market, that makes up about anywhere from 28% to 30% of our business depending on the quarter. Enterprise infrastructure which is things like networking, high end enterprise storage products to the nation's wireless infrastructure, that makes up, again depending on the quarter, 28% to 30% of our business.

The big growth story for our company which is getting a lot of attention now is diversified manufacturing services which is a group of very high value add, high mix, high complexity businesses comprised of healthcare and instrumentation, industrial and clean tech, and an area that we called specialized services which is the most rapidly growing part of our business that's comprised of materials technology group and our aftermarket services business.

In the most recent quarter diversified manufacturing services made up 44% of our overall business. At our analyst day a couple of weeks ago we talked about a crossover point sometime during fiscal year '13 where diversified manufacturing services could grow to 50% or more of our business. At that point in time, really the company is a well diversified manufacturing business and with deep, broad participation in higher value add industries. So we're really excited about the growth trajectory there.

Operating margins have been solidly above 4% which leads our industry significantly. Return on invested capital in the mid to high 20s depending on the quarter. That's also a leading metric for the Company. We generate about \$1 billion in EBITDA a year with the goal of the Company being to have a free cash flow yield of about 20% to 30% on that EBITDA level.

So the Company is doing well, growing rapidly, focusing on high growth areas and diversified manufacturing services, and I think is a great long term story for investors today.



QUESTIONS AND ANSWERS

Mark Strouse - JPMorgan - Analyst

So maybe dig in a little bit deeper into if we group high velocity and enterprise and infrastructure into a traditional EMS and then versus the emerging DMS business, have you given any kind of guidance as far as growth rates for the upcoming year? And maybe talk about the margin differentials?

Tim Main - Jabil Circuit - CEO

Sure. In the traditional areas, our long term growth thought is 5% to 10% on a compounded annual growth rate over the three to five-year period. Operating margins in high velocity have been 4%, that's above our targeted range of 2% to 2.5%. Enterprise and infrastructure has been below our target range of 4% to 4.5% recently because of some short term issues that we'll work through and recover margins there.

So the differential in growth rate between the traditional area of 5% to 10% and diversified manufacturing services which is growing at 20% to 30% on a long term basis, really drives the business mix to become much more, much greater exposure to the DMS area and less so on the traditional areas over time. And again, we talked about a crossover point in fiscal year 2013 where DMS will become the majority of Jabil's business.

We also provided a framework for growth in FY'13. 0% in high velocity, roughly 10% in enterprise and infrastructure. Industrial and clean tech and healthcare and instrumentation at 15%. And then the materials technology group at 25%. That results in somewhere in a \$19.3 billion, \$19.4 billion fiscal year '13.

So we're actually very optimistic about our prospects, both in the near term and the long term.

Mark Strouse - JPMorgan - Analyst

Okay, and then with DMS, it seems one of the biggest drivers is what you guys call the materials technology group. [Jerry spoke at analyst] day the other week, he talked about targeting to double that revenue within the next three years. Can you just talk about what's driving that? Is that pure organic? Is there any acquisitions baked into that? What should we expect there?

Tim Main - Jabil Circuit - CEO

Growth has been entirely organic. Our materials technology group is a group of material scientists that have great knowhow, expertise, and some IP in dealing with everything from types of metals, glass, ceramics, plastics, and a lot of process knowhow with their primary exposure today being in the high end mobility area. So smart phones, tablets, these types of products.

But increasingly we're seeing a significant contribution in that materials technology group contributing to business growth in our healthcare area. One of the really hot themes in the healthcare area is converged products. Products that require electronics, the types of materials that we talked about in terms of steel, plastics, others, miniaturization, in driving lower costs. And so our expertise in the mobility market and optics, camera modules, a materials technology group along with a world class capability in manufacturing healthcare products at the quality levels that our customers expect, is a great opportunity.

So we see a lot of synergies among the business groups in diversified manufacturing services and ways in which the materials technology group contributes not only to our participation in the high-end mobility area, but also in healthcare, industrial, and the clean tech area.

Mark Strouse - JPMorgan - Analyst

And then sticking to DMS, just can you talk us through the sales process as far -- I mean because it seems that you're, on that side of the house, you're more integrated with the design phase. So Company X approaches you about a particular product it wants you to help design. How long does it take to, on average, to design and then to set up prototypes and manufacturing and then ultimately getting out to the end customer?

Tim Main - Jabil Circuit - CEO

That's a great question. I think generally speaking, I think this is an area that the investor community has some misperceptions about how the business operates, both in traditional as well as DMS. And I'll get to the DMS area in a minute. But I think the perception is that there's heavy, heavy, heavy price competition, that programs are put out for bid and they change hands every 90 days and it's very low barriers to entry, so a real cut throat business. And although parts of our business are very competitive, that's not the way the industry behaves at all.

Business rarely moves from vendor to vendor. Even big customers that dominate in high velocity and enterprise infrastructure areas rarely change their supply chain. And in fact, the trend has been to consolidate the supply chain to fewer and fewer players. And so that's why the leading companies like Jabil in the industry have been able to actually gain market share and continue to have successful businesses.

I think in terms of margin performance, there's been some commoditization and Jabil has been able to offset that competitive nature with lean manufacturing efficiencies, productivity gains, and actually delivered excellent margins relative to the industry in those areas that are highly competitive. But again, business rarely moves from supplier to supplier.

In DMS that sales cycle takes years. In healthcare for instance, we highlighted a significant pipeline of new product introductions that will roll out, I think 20 different programs that will roll out in fiscal year 2013, 2014, 2015. The development cycle is as long as two or three years and then you have to go through FDA certifications and approvals, and then into mass production. So it's a very long cycle, and I think that the benefit to that cycle is very consistent, sustained results over a longer period of time.

This is another investor misperception in terms of product life. The perception is that all product lives are very short. While that's true in some products areas in healthcare industrial companies, these products are in production typically for 10, 15 years and then there's a 10, 15-year service cycle. Even in areas of our business where there's a lot of short term product cycles, like in the mobility space for instance, we are still providing aftermarket services support to Motorola phones that were sold earlier in the decade.

So we have a continuum of services that we could participate in real revenue and earnings stream throughout a product lifecycle. And then in the aftermarket services area from short product cycles in industries in high velocity where the product cycle may only be 12 months to areas like industrial and healthcare where the product lifecycle is 7 to 10 years with a 10 year follow on in terms of post sales support.

Mark Strouse - JPMorgan - Analyst

Besides in-house manufacturing, who would you consider to be your biggest customers and what kind of market share --

Tim Main - Jabil Circuit - CEO

Biggest competitors?

Mark Strouse - JPMorgan - Analyst

Yeah, biggest competitors and then what kind of market share would you say you have among your biggest segments?



Tim Main - *Jabil Circuit - CEO*

I think in diversified manufacturing services we see different competitors in different spaces. And in diversified manufacturing services it's characterized by very, very high mix, high complexity production. And as you note, kind of the biggest competitor is the existing infrastructure that our customers have, but as it's become more imperative for them to penetrate emerging markets and then come out with these converged products, the level of the interest in partnerships with companies like Jabil is continuously increasing. And our competitors in that area range from companies like Plexus and Benchmark to we see Flextronics sometimes and that type of group. You don't -- rarely ever see companies like Foxcon or Asian ODMs in that business area.

Enterprise infrastructure is a big business with big customers with big requirements. So it takes companies of significant scale to accommodate the requirements of the customer base there and Jabil is one of the three largest companies in the world that participate in that segment. Along with Foxcon and Flextronics, and Jabil is number three. And in high velocity you have a high range of ODMs and traditional as well as new EMS companies in that business area.

So I feel like our ability to compete is unique in that we have a capability to compete in all three of the business areas that we do business in. And that's relatively rare in our industry.

Mark Strouse - *JPMorgan - Analyst*

Let's see, so I guess -- sure, go ahead.

Unidentified Audience Member

(inaudible - off mike)

Tim Main - *Jabil Circuit - CEO*

Yeah, I think we are in the final couple weeks of our quarter, so anything I say around short term demand will be misconstrued in one way or the other. I think our results, our expectations are consistent with what we've been saying for the last actually couple of years. And this is a very slow, choppy economic recovery from a deep recession and I think the really interesting thing for investors is Jabil has significantly outperformed most companies in the Fortune 500. As a matter of fact, we're one of 9 Fortune 500 companies that have grown at our rate in earnings and revenue since 2008. We're one of 5 Fortune 500 companies that have grown at our rate in terms of EBITDA and revenue since we went public in 1993.

So this is an extraordinary opportunity I think to participate in a long term growth story that is very fundamental, has to do with megatrends in the world, the complexity of managing complex global supply chains, and Jabil's ability to really differentiate on the basis of knowhow and capability. And that is really driving some great long term growth.

And I think that the short term variations in demand really just haven't had much of an impact on our company since the recession and it takes something like a huge economic contraction to really throw us off our game. The difference between a 1% GDP growth and 3% GDP growth is marginal. We'll still grow and we'll still outgrow the market and we have significantly outgrown GDP growth for our really entire corporate history.

Mark Strouse - *JPMorgan - Analyst*

So you're investing pretty heavily in the DMS business right now. I think for this fiscal year you talked about generating \$500 million in cash from operations but plowing all that back into CapEx. Next year you're talking about \$1 billion in cash from operations but then another \$500 million of CapEx. I guess at what point can we, do you start to see some of that Cap Ex investment scale back and really start leveraging some of that investment?

Tim Main - *Jabil Circuit - CEO*

Well if \$1 billion in cash flow from operations, \$500 million in CapEx and the type of growth that we're going to see in FY'13, I kind of take that, I'll take that any day. So the appetite for CapEx right now has a really, really good purpose in growing the business and growing the business profitably. I think our maintenance CapEx, if there were very little growth or no growth, our maintenance CapEx would be in the \$250 million range. I think kind of our natural appetite in a more moderate growth environment where the company is hitting targeted levels but not exceeding it in the \$350 million to \$400 million a year range, as EBITDA continues to move up to \$1 billion, \$1.1 billion, \$1.2 billion, \$1.3 billion, we'll continue to -- at a CapEx level of \$350 million to \$400 million, we'll produce significant free cash flow.

Mark Strouse - *JPMorgan - Analyst*

So I think the media might be paying more attention to this than investors, but can you just talk about some of the recent reports in the media as far as work/life balance from workers in Chinese factories and rising labor costs, how that could potentially impact your business?

Tim Main - *Jabil Circuit - CEO*

Sure, it's a great question. We're actually really proud of our track record in that area. I think our -- we self audit, we're a founding member of the EICC. We do self audits, we have numerous customer audits and kind of uniformly we exceed industry standards and have had a lot of great feedback. Not to say we don't have issues from factory to factory, we do. And there will continue to be issues. We're a big manufacturing company. But we think our track record in this area is very good and we'll continue to focus on that as a differentiator for customers.

We're in the position to protect not only Jabil's brand and Jabil's reputation, but our customers' reputation and our customers' brand. And we take that very seriously and take that to heart and I think we've done a decent job of that and we'll continue to focus on that as a key, key part of our business.

Wages are increasing in China, they'll continue to increase. I think again we'll focus on offsetting cost increases first through productivity gains, lean manufacturing, being more efficient with the assets that we have, and in cases where wage escalation is exceeding our ability to do that, then we'll typically adjust the economics with our customer base because that's just part of what happens in the business.

We have a broad range of facilities around the world. So in addition to China, in terms of low cost locations, we're also in Vietnam, Malaysia, we're in Singapore, Mexico, other locations in Latin America like Brazil, Eastern Europe, Central Europe. So we have a lot of choices to offer customers and I think we'll probably have a western central China location sometime in the next year. That will be more for the availability of capacity and people than it will be to mitigate wage increases in China.

But I think this is -- the China-only card that drove the industry from 1999, 2000 through 2008, 2009, that card's kind of played and played out. Everybody, every leading company in our industry is in every location they need to be. So the differentiator is not about being in the next lowest labor cost location. It's about capability and managing complexity around the world. And that's what we do very well.

Unidentified Audience Member

(inaudible - off mike)

Tim Main - *Jabil Circuit - CEO*

Yeah, so great question. It's one on enterprise and infrastructure and the other on high velocity, rebuilding the margin structure, getting it closer to the target in enterprise and infrastructure. We actually did a fairly detailed map on how we rebuild margins in our last conference call. That's a

slide in the slide deck that you can find on our website. We expect about 70 basis points of improvement this quarter followed by sequential improvements of 50 basis points a quarter to get us back to the 4% range in the next 3, 4, 5 quarters kind of thing.

The issues there have been the western European sites along with actual revenue levels being lower, particularly associated with programs that are incoming, market share gains. So somewhat driven by lack of capacity absorption as well as the western European sites. So we feel like we're on a great path to rebuild margins in that area and expect to be able to do that. We operated in a price infrastructure in the targeted range, above the targeted range, for virtually all of 2010 and 2011. So we've got a good track record of rebuilding margins.

In high velocity, we will address our long term targets by business area on our September call. I think you can probably expect us to raise the target range of 2 to 2.5 and we definitely can be more selective in the business that we take on in high velocity. I mean it's an area where we are agnostic about growth. We want to do a great job serving the customers that we have and driving profitability and cash flow, but we're relatively agnostic to whether or not that business area grows. So we can be selective in the business relationships that we engage in there.

Unidentified Audience Member

(inaudible - off mike)

Tim Main - Jabil Circuit - CEO

I know this is counterintuitive, but in our business contracts just don't matter. Contracts are typically evergreen documents that specify what happens if the world comes to an end, and then day to day business is conducted through a collaborative way and pricing and the rest of it, so we rarely refer to contracts.

Mark Strouse - JPMorgan - Analyst

Let's talk about your use of cash, dividend policy, share buybacks and then M&A, if there's any large opportunities or if it's kind of tuck-ins here and there.

Tim Main - Jabil Circuit - CEO

I think tuck-ins is more of the Jabil style. We've done a couple of big deals in our history, but we're definitely more, look more favorably on tuck-ins. I think we made a fabulous acquisition in Telmar recently which opens up the telecommunications vertical for our aftermarket services group. We're very excited about the prospects there. I think you can anticipate Jabil making an acquisition to bolster our healthcare business in building capabilities in healthcare and kind of widen our lead over the rest of the market. As well as additional acquisitions in aftermarket services as they come up. But generally speaking, an acquisition or two every couple of years is kind of the limit for Jabil.

Unidentified Audience Member

(inaudible - off mike)

Tim Main - Jabil Circuit - CEO

France and Italy. Yeah, we reacquired three sites and we're now down to two sites, one in Italy and one in France. And the go-forward strategy there is to build middle market relationships and use them as MPI sites and give them an opportunity to develop a business plan that can sustain breakeven to profitable performance in those areas and I think we're on that path. So that's kind of the plan for the France and Italy sites.

I think it will become less and less material over the next year. When we sold the sites they were losing about \$40 million a year. When we reacquired the sites, they were still losing about \$40 million a year and I think we'll get that down to the \$5 million a quarter range and then from there I think it will be noise level. And hopefully we'll be able to continue to land new business for the sites and give them an opportunity to have a continuing sustained business.

Unidentified Audience Member

(inaudible - off mike)

Tim Main - Jabil Circuit - CEO

We don't -- it's company policy not to talk about individual customer relationships, but I think the last 12 to 18 months has been really instructive in terms of the impact that major customers have on Jabil's results. We've had some enterprise infrastructure customers struggle in fiscal '11 and '12. We've had a mobility customer that's had some struggles, and yet the company has put up, been very predictable in hitting numbers, and has put up very significant growth over that time period. So we think that the notion of our company, and this is probably true of some other EMS providers in our industry, the notion that we're a derivative, our performance is a derivative function of major customers, has become obsolete, and a misnomer for our company. We love our customers, some of them are big in terms of revenue, but they have a lower and lower impact on the earnings power of the Company.

In diversified manufacturing services, that makes up 44% of our revenue, makes up 60% of our income. And so that's a very, very well diversified business area for us. So the Company has become more resilient and sustainable over the last 3, 4 years. Remarkably different than the Jabil of 2005, 2006. Back then, most of the Company's income and revenue was derived out of high velocity. Today that's completely reversed. And that does make the company more resilient in a much more sustainable business model.

Mark Strouse - JPMorgan - Analyst

We probably have time for one more. Go ahead.

Unidentified Audience Member

(inaudible - off mike)

Tim Main - Jabil Circuit - CEO

So we actually included quite a bit of detail in the stuff for our analyst meeting, so if anybody wants to, we might be able to share some of the documentation. You can certainly go to our website and get some of the slide ware, but we believe the DMS area is a \$500 billion addressable market. And when you look at healthcare, industrial, some instrumentation, these are industries that in terms of outsourcing penetration in the 10% to 15% range. And then the dynamics of look, all the growth is occurring in emerging markets, they tend to have all of their capacity in high cost locations, I talked about converged products, high mix electronics, global supply chain networks becoming more and more complex, Jabil's ability to help customers in diversified manufacturing services sort through the challenges they have in managing those is very complex global supply chains is encouraging them to outsource more and more of their production to Jabil and really partner with Jabil on long term, on strategic long term, strategic basis. So we think that these growth rates are sustainable for the next five years.

Mark Strouse - JPMorgan - Analyst

Okay, with that I think we should probably wrap it up. Thank you very much for coming. Thank you, Tim.



Tim Main - Jabil Circuit - CEO

Thank you.

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