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JBL - Q2 2012 Jabil Circuit, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good afternoon. My name is Susan and I will be your conference operator today. At this time, I would like to welcome everyone to the Jabil second quarter of fiscal year 2012 earnings call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

(Operator Instructions)

Thank you. I would now like to turn today's call over to Beth Walters, Senior Vice President of Communications and Investor Relations. Ms. Walters, you may begin your conference.

Beth Walters - *Jabil Circuit Inc - SVP, Communications and IR*

Thank you, and welcome, everyone, to our second quarter of 2012 earnings call. Joining me today are President and CEO, Timothy Main; and Chief Financial Officer, Forbes Alexander. This call is being recorded, and will be posted for audio playback on Jabil website, Jabil.com in the investor section. Our second quarter press release and corresponding webcast with slides are also available on our website. In these slides, you will find the financial information that we cover during this call.

We ask that you follow the our presentation with the slides on the website, and beginning with slide 2, our forward-looking statement. During this call, we will be making forward-looking statements, including those regarding the anticipated outlook for our business, our currently expected third quarter of fiscal 2012 net revenue and earnings results, our long-term outlook for our Company, and improvements in our operational efficiencies and financial performance.



These statements are based on current expectations, forecasts, and assumptions involving risks and uncertainties that could cause actual outcomes and results to differ materially. An extensive list of these risks and uncertainties are identified in our annual report on form 10-K for the fiscal year ended August 31, 2012, on subsequent reports on Form 10-Q and form 8-K, and our other Securities filings.

Jabil disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. And I just realized that I misspoke. It's August 31, 2011; not 2012. As we indicated last quarter, we have begun to highlight GAAP operating results. While we currently are still reporting and publishing core results, it is also our intention to move fully to GAAP beginning in fiscal 2013.

In addition, we will also be providing guidance on long-term year-over-year outlook. This change to our guidance aligns more closely with how we run the Business, making strategic long-term decisions. We believe providing guidance in this fashion gives investors the most appropriate view into our business.

Today's call will begin with our second quarter results, highlights and comments from Forbes Alexander, as well as guidance on our third fiscal quarter of 2012. Tim Main will follow with macro environment and Jabil-specific comments about our performance, our model, and our current outlook. We will then open it up to questions from call attendees.

I'll now turn the call over to Forbes.

Forbes Alexander - Jabil Circuit Inc - CFO

Thank you, Beth. Good evening, everyone.

If you're following along, I'd like you to, if you would, turn to slide 3 of our presentation. Our net revenue for the second quarter was \$4.2 billion, an increase of 7.8% on a year-over-year basis. GAAP operating income was \$150 million, or 3.5% of revenue, which compares to \$105 million GAAP operating income on revenues of \$3.9 billion, or 2.7%, in the same period in the prior year. Core operating income, excluding the amortization of intangibles and stock-based compensation increased 4.6% to \$176.2 million, and represents 4.2% of revenue.

This compares to \$168.4 million, or 4.3% for the same period in the prior year. GAAP diluted earnings per share for the fiscal quarter was \$0.46, an increase of 84% over the prior year. Core diluted earnings per share was \$0.58, an increase of 7.4% over the prior year. If you'd now turn to slide 4 for some discussion on our segments.

In the second quarter, our diversified manufacturing services segment grew 33% on a year-over-year basis. Revenue was approximately \$1.9 billion, representing 44% of total Company revenue. Core operating income was 5.9% of revenue. While our specialized services group exceeded our expectations from a revenue standpoint, most of the out-performance was driven by materials technology group.

Gains in this group were offset by continued design investments in our Healthcare business, and weakness in our Aftermarket Services group, where an internal site transition negatively impacted both revenue and segment profitability for the quarter by some 40 to 50 basis points. We expect this transition to be resolved, and operating performance within our Aftermarket Services group to return to previous historical levels in the upcoming quarter. The enterprise and infrastructure segment decreased 2% on a year-over-year basis. Revenue was approximately \$1.2 billion, representing 29% of total Company revenue, and core operating income for this segment was 1.7% of revenue.

Our enterprise and infrastructure performance remain below our previous expectations. As a result, continued end market weakness across our telecoms and networking customer base. I shall provide more color towards the end of my prepared remarks on our plans to return this segment to within our long-term operating range targets. The High Velocity segment, once again, operated very efficiently during the quarter. Revenue was approximately \$1.2 billion, down 10% on a year-over-year basis, and representing approximately 27% of total Company revenue in the quarter.

Core operating income for the segment was 4% of revenue. The sequential and year-over-year margin out-performance in the segment was primarily associated with a more favorable mix of products. For the second straight quarter, we have one 10% customer in each of our three segments, while our top 10 customers comprised 61.8% of revenue in the fiscal quarter.

If you'll now turn to slide 5, I'll review some of our balance sheet metrics. We ended the quarter with cash balances of \$707 million. As previously announced, we concluded the acquisition of Telmar for \$128 million in cash on the first of December, and during the course of the quarter, we repurchased approximately 1.7 million shares at an average price of \$22.73 per share, or approximately \$40 million, with little impact to EPS for the quarter, as a result of these repurchases.

On a year-over-year basis, GAAP-based return on investment capital expanded by 2% to 22% in the first half of fiscal 2012. EBITDA for the same period expanded by \$45 million to \$535 million, or 6.2%, while cash flows from operations was \$5 million. Our capital expenditures during the quarter were approximately \$77 million, or \$180 million in the first half of the year. In the quarter, inventory decreased by 1% to \$2.35 billion, and inventory returns remained at seven.

Cash used in operations for the quarter was \$109 million, as a result of a more non-linear quarter than we previously anticipated, causing average and period-end working capital levels to be elevated. We expect working capital levels to return to within recent historical ranges in the coming quarter, and as a result, a return to positive operating cash flows in both our third and fourth fiscal quarters.

I'm also pleased to announce that we have recently amended our bank revolver, adding capacity of \$300 million to a total of \$1.3 billion, and extending this facility into 2017. This continues to provide us flexibility in our capital structure, as we continue to position the Company for growth in 2013 and beyond. If you'd now turn to slide 6. We are pleased with our second quarter's results. Core operating margin performance was 4.2%, the midpoint of our guidance. Revenues were at the high end of our range. Both Core and GAAP EPS, also at the midpoint of our guidance.

If you'd now turn to slides 8, 9, and 10, I would like to discuss the upcoming third quarter's guidance. We expect revenue in the third quarter on a year-over-year basis to increase approximately 2%, in the range of \$4.2 billion to \$4.4 billion. Core operating income is estimated to increase approximately 10% on a year-over-year basis, and to be in the range of \$185 million to \$205 million, core operating margin in the range of 4.4% to 4.6%.

Our core earnings per share will be in the range of \$0.60 to \$0.70 per diluted share, and GAAP earnings per share expected to be in the range of \$0.49 to \$0.59 per diluted share. This is based upon a diluted share count of 213 million shares, and based upon the current estimates of production, our tax rate on core operating income is expected to be 18%. Turning to our segments in year-on-year performance, the diversified manufacturing services segment is expected to increase 25%, as a result of growth across all areas within the segment.

On a sequential basis, the Diversified Manufacturing Services segment is expected to grow modestly at 2%, as we commence product transitions and additional capital investments in our manufacturing technologies group. The Enterprise and Infrastructure segment is expected to decline 8% on a year-over-year basis, citing declines in networking and telecommunication products set, offset by growth in storage. On a sequential basis, the segment is expected to grow 5%, with growth across networking, storage, and telecommunications.

And finally, our High Velocity segment is expected to decline 14% on a year-over-year basis, as a result of continued declines in handset volumes, offset by growth in automotive, point-of-sale printing, and our Set Top Box business. Capital expenditures in the second half of the fiscal year are expected to be approximately \$320 million. The majority of this investment is associated with continued investments in our materials technology group, the group's capacity, and capabilities.

Total capital expenditures for the full fiscal year are now expected to be approximately \$500 million, with an excess of 75% of these expenditures being invested in our Diversified Manufacturing Services segment, positioning this segment for continued growth in 2013 and beyond.

I'd now like to ask you to turn to slide 11 for discussion on our Enterprise and Infrastructure segment operating margin performance. This slide shows two charts, the top being expected operating margin progression in the upcoming quarter, and the bottom, progression of a return to 4% operating margins in this segment during the first fiscal quarter of 2013, or 9 months from now. We expect the operating margin performance in



our third fiscal quarter to improve by some 70 basis points, 25 basis points coming from both the growth in revenues and networking, program wins, and product ramps in storage, and the recovery to growth in the Telecommunications sector.

The sites we acquired in France and Italy during fiscal 11, and targeted overhead reductions show contribute 10 basis points each, or 0.1% each. Turning to the chart at the bottom of the slide, we have line of sight to return to growth through the balance of calendar 2012, with revenue growth in storage and networking contributing 1%, and 0.35% in Telecom's revenue growth. The sites in France and Italy are expected to contribute 0.3% through the addition of revenues and cost reduction programs, while targeted overhead reductions across the Segment shall yield an additional 0.65%, returning this Segment to 4% operating margin performance.

With that, I'd now like to hand the call over to Tim Main.

Tim Main - Jabil Circuit Inc - President and CEO

Thank you, Forbes.

I'd like to spend a few minutes discussing our diversified manufacturing services segment and growth by business group, and also, for the first time, provide you some perspective on how we're thinking about fiscal year '13. If you'd please turn to slide 13.

The Materials and Technology group is really about ingenuity and innovation, and we have invested for growth, both in 2010, 2011, 2012, and we expect further growth in 2013. Typically, from the investment of CapEx there is a lag time of approximately 3 to 6 months as we install the equipment, begin production, and manage to higher levels of expected yields in that 4 to 6 month period.

Currently managing through significant expansion of our capacity, and introducing new product families across a broad range of customers. We are very bullish on another great year of growth, and we expect over roughly \$3 billion in fiscal year '12, and hope to grow to approximately \$4 billion in FY '13.

Please turn to slide 14. In our Healthcare and Life Sciences business, Jabil is really a safe pair of hands. We pursue business in essentially six modalities; patient bedside, portable on and in-body, surgical and procedural devices, analytical lab equipment, imaging, and single-use devices. We are very proud of the customer base that we have, and we've spent a lot of time developing new relationships over the last few years. Although there was roughly a flat year growth in fiscal year '12, we do expect that rate of growth to accelerate as we enter FY '13.

Please turn to slide 15. This rate of growth is expected to accelerate through the pipeline of growth, particularly through the large portfolio of products that are in our design labs today, which will be introduced to production over the course of fiscal '12 and fiscal '13.

We have well over 20 design wins in this Healthcare business area, and we are very happy that when those products go into manufacturing, they tend to typically have a 10-year average product life cycle. This leads to very sustained growth, and gives us a great deal of confidence that our fiscal year '13 and '14 revenue growth should be at the top end of our 20% to 30% revenue guidance for the diversified manufacturing services area.

Turn to slide 16, please. In Industrial and Clean Tech market, we're really about solving global complexity, and enabling innovation. We have business in energy generation, infrastructure, heavy machinery, white goods, and a broad range of industrial products. We have some of the leading companies in the world as our customers, spanning activity from smart metering to agriculture, white goods, and other types of clean tech areas.

Turning to slide 17, please. We really are developing a global expertise that simplifies complexity. This is really a very high mix business, and nearly 50% of Jabil's Industrial Energy manufacturing is in lot sizes of 50 or less. Remember that Jabil's business, overall, Jabil builds about 70% of its output in lot quantities of 100 or less.



We need to have very advanced planning tools and techniques to optimize production for these customers, and we have a very high performance standardized inter-plant product transfer process for business continuity and low transfer costs. We are very excited about continued growth in the industrial and clean tech area.

Please turn to slide 18. We are enjoying continued success of our core depot repair activity in the Aftermarket Services area, and we are seeing additional growth in worldwide parts fulfillment, developing new capabilities that are really taking off now, including diagnostics, distributed screening, and customer-facing activities. We expect our growth in Aftermarket Services to continue to be 15% to 20% on an organic basis.

Taking our diversified manufacturing services group in full, as we look at fiscal year '13, we see growth in our High Velocity area of approximately 0%, and Enterprise and Infrastructure, 10%, and then you can see in Industrial Clean Tech, Healthcare and Instrumentation, and Aftermarket Services, we think these businesses can grow year-over-year on a 15% basis. Materials Technology group, as I'd mentioned previously, we expect to have another very robust year of growth. This will easily support 10% to 15% growth in our fiscal year '13 and we are very excited about our prospects on a longer-term basis.

I think we've spent a lot of time focusing on the short-term, and we are very pleased with how our Business is coming together from a long-term basis, and looking forward in FY '13, '14, and '15, and seeing continued growth of 10% to 15%.

Beth Walters - *Jabil Circuit Inc - SVP, Communications and IR*

Okay, that concludes our prepared remarks. Operator, we're ready for the question-and-answer session, now.

QUESTIONS AND ANSWERS

Operator

Certainly.

(Operator Instructions)

Your first question comes from the line of Steven Fox with Cross Research.

Steven Fox - *Cross Research - Analyst*

Hi. Good afternoon. Tim, two questions. First on the capital spending plans around materials technology. How much of that comes on line as the customer program ramps, and how much overhead do you think you have to carry until you actually get into the full ramps versus the planned capacity? And then secondly, if you could just go back over the E&I margins for the quarter. You explained very well what to get to from where they are to where you want them by the end of the year, but what went wrong during the quarter to keep them at the low levels they were at?

Tim Main - *Jabil Circuit Inc - President and CEO*

Okay, in terms of materials technology group investments, the slide that we developed and included in our presentation, slide 13, is intended to give investors an idea of the lag time between capital investment and the advent of revenue. Revenue would typically commence approximately three, four, five months after the investment, and would inspect to ramp into production through months four, five and six and get to more mature yield levels and profitability levels by approximately the sixth month. We are going through our product transition now, with new product families that are ramping. We'll be doing that over the course of the spring and summer, and making some significant investments.

So I would expect the margins in the materials technology group to continue to be in the expected ranges. They will certainly be better when you reach mature levels of production, a little bit on the lower side during periods of product transitions, but still within the targeted range. It's getting to be a very big business, obviously. In half-year increments, we are looking at a \$1.5 billion per six month period pace in fiscal '12, moving to a \$2 billion or more half-year pace in fiscal year '13. So we are very pleased with how that business is coming together, and we are adding capacity as we speak.

In terms of the enterprise and infrastructure area, there is not a whole heck of a lot to report, Steve, except that revenue was a little bit lower than expected, and we think it is important to really focus on how we get back to 4% from where we are today. And we think we have a good line of sight. My own -- when I look at this business, there has been a very significant slowdown in overall enterprise and infrastructure spending from the spring of 2011, when the European debt crisis first emerged; a lot of caution throughout the summer. As the US had its debt crisis, government spending has been on the decline. That has impacted some of our higher-end government related types of products. 2.5 G spending collapsed in certain areas of Asia. All of those provided significant headwinds over the last few quarters.

In my experience, having been in the business as long as I have, is that you have these periods of under-investment, a little bit of excess inventory, people work through those, and then spending starts to pick up. So provided that the US, particularly the US market, continues to be stable and grow, even at a lower rate, I would expect IT enterprise-related spending to start to pick up mid-year, and show some more normal levels of at least secular growth rate of 5% to 10% as we exit fiscal '12, and begin our fiscal year '13.

Steven Fox - *Cross Research - Analyst*

Great. That's very helpful. Thank you.

Tim Main - *Jabil Circuit Inc - President and CEO*

Okay.

Operator

Your next question comes from the line of Brian Alexander with Raymond James.

Brian Alexander - *Raymond James & Associates - Analyst*

To follow up, Tim. Of the 135 basis point improvement that you're expecting in E&I, I think it's about \$16 million a quarter of incremental profit from where we are today. How much revenue increase is required to hit that, and again, how much visibility do you have into programs ramping by the end of the year to get you there?

Tim Main - *Jabil Circuit Inc - President and CEO*

We are actually not counting on a lot of revenue growth. Forbes, do you characterize the level of revenue growth?

Forbes Alexander - *Jabil Circuit Inc - CFO*

In terms of overall revenue, line of sight, Brian, we have line of sight for that. There's some great progress in our storage area with some new wins there that are ramping in this coming quarter, giving me a great deal of comfort in terms of our rebound, in terms of the storage and networking in the short term, here. Then, as we move forward to the balance of the next three quarters, continued growth in that area, and some rebound with our networking customers, there. In terms of overall revenue, without getting into the guidance for the full second half of the year, it is somewhere



in the region of \$200 million, \$250 million, something of that nature. We are seeing a sequential uptick of 5 points this coming 90-day period, and if we see any little bit of tailwind, then clearly it will be better than this. But, we feel pretty comfortable about that. The telecommunications business, we are starting to see some pick up there. I think, as we've articulated before, we had some wins in the wireless area there over the last two quarters, and we're starting to see that pick up again, which is good news as we move through the balance of calendar '12.

Brian Alexander - *Raymond James & Associates - Analyst*

So the \$200 million to \$250 million, Forbes, that you called out, over what time period is that? Is that basically --

Forbes Alexander - *Jabil Circuit Inc - CFO*

It is the back half of the calendar year. Fiscal year, excuse me, Brian.

Brian Alexander - *Raymond James & Associates - Analyst*

Then, on cash flow negative in the quarter, I think most of that was due to payables coming down by almost \$400 million. I think you said you would get back to being operating cash flow positive in the second half. When do you think you'll get back to being free cash flow positive, given the increased CapEx investments that you highlighted?

Forbes Alexander - *Jabil Circuit Inc - CFO*

Yes, based upon the CapEx that we are highlighting for the back half of the year, these investments in our MTG area, I think it will be moving into fiscal '13. I would expect our overall cash from operations, minus our CapEx and our acquisition of Telmar this year, to be cash neutral. So, some work to do in the back half of the year, but I think that is very attainable. As we look forward into '13, clearly, we have some additional capital investments during fiscal '13, but we are very comfortable that we will see significant free cash flows during fiscal '13.

Brian Alexander - *Raymond James & Associates - Analyst*

Do you think you'll be back at that 30% EBITDA-to-cash flow, or cash flow-to-EBITDA ratio that you've targeted long-term?

Forbes Alexander - *Jabil Circuit Inc - CFO*

Yes, absolutely. Certainly, Tim talked to what's looking -- we're shaping up to be a great year in '13, with revenue growth at about 10% to 15%. EBITDA margins should be at those type of levels, tracking 6 points to 6.5 points. So certainly we should see that type of contribution from overall cash flows. Yes.

Brian Alexander - *Raymond James & Associates - Analyst*

Thank you.

Forbes Alexander - *Jabil Circuit Inc - CFO*

You're welcome.



Operator

Your next question comes from the line of Wamsi Mohan with Bank of America Merrill Lynch.

Ruplu Bhattacharya - BofA Merrill Lynch - Analyst

Good afternoon. This is Ruplu filling in for Wamsi. Just wanted to touch on the operating margins for the DMS segment for this quarter. The side in AMS that you had an internal transition, could you elaborate on that? Why was that needed? Did you move to a low-cost location, and is this part of the Telmar acquisition?

Tim Main - Jabil Circuit Inc - President and CEO

It is not related to the Telmar acquisition. It is related to the movement of production among sites in Mexico, which has been planned for some time. That transition did not go well. So we think we have that under control now. And I would point out that AMS has been -- our Aftermarket Services business has been historically very predictable and very efficient, and has delivered very consistent margins over time. So it is well under control, and we are very confident that they will bounce back to, as Forbes said, historical levels in fiscal Q3. I'd also point out that in terms of the cycle of diversified manufacturing services operating margins, F Q2 for the last three years has been a low point. In '10, it was significantly below the targeted range. In '11, it was near the bottom of the range, and in both cases recovered to the 6.5% to 7% area.

So we see no structural issues with that business at all, and as we bring some of these great healthcare products into the production cycle, we continue to ramp our MTG business, our industrial and clean tech business continues to grow in a predictable way at good margins, and then Aftermarket Services recovers from their product transitions among sites in Mexico, then we have very -- every confidence that Diversified Manufacturing Services will get back to our expectations.

Ruplu Bhattacharya - BofA Merrill Lynch - Analyst

Okay, thanks, Tim. And, Forbes, if you could just help us bridge the 300 basis points improvement between this quarter and the next quarter. I know you said 70 basis points in the E&I section, and then you were affected by about 50 basis points in the DMS segment. So the remaining 180 basis points sequential improvement in op margin, can you help us bridge that between the different segments?

Tim Main - Jabil Circuit Inc - President and CEO

We are a little bit puzzled at your math, there, because we are at 4.2% in Q2 overall, we are looking for 4.5% in Q3, and that is a 30 basis point improvement, to 70 basis point improvement in Enterprise and Infrastructure quarter-on-quarter, and roughly 130 basis points over the next three quarters, to Q1 of 2013. Forbes walked through the four major elements of that margin improvement expected, just in the Enterprise and Infrastructure group. I would point out to you that, even with the under-performance in Enterprise and Infrastructure, the Company is doing extremely well from a margin standpoint, fully a couple hundred basis points against most of our competition, and our EBITDA margins at 6.2% lead our industry by a fairly significant margin.

Ruplu Bhattacharya - BofA Merrill Lynch - Analyst

Okay, thanks for the clarification. And just looking at CapEx for fiscal '13, do you have an estimate for what that could be?

Tim Main - Jabil Circuit Inc - President and CEO

We don't have an estimate. I would expect it to abate a little bit, but we'll see if our expected growth rate is too conservative or not. At this point we would expect it to probably rotate back to normalized levels.

Ruplu Bhattacharya - *BofA Merrill Lynch - Analyst*

Okay. Thank you so much.

Operator

Your next question comes from the line of Craig Hettenbach with Goldman Sachs.

Craig Hettenbach - *Goldman Sachs - Analyst*

Tim, a number of the EMS companies are talking up the growth opportunities in the medical and industrial market. I know you laid out some of the wins that you have there, but I was hoping to get your view on the competitive landscape, what you're doing to differentiate in that space, and your view of the margin profile on the intermediate to longer-term basis?

Tim Main - *Jabil Circuit Inc - President and CEO*

Sure, we think that the margin profile that we have articulated at 6% to 8% is sustainable into the foreseeable future, and that's a three to five year time horizon for Jabil. We've been operating at that level for the past few years, as well, so there is some historical basis for that. I think when we look at healthcare and life sciences, one of the things that we've tried to highlight is the many, many design wins, the integration of design, our materials technology group and single use devices, our optics capability, and integrating all of those capabilities into a very broad portfolio of new products that will come out of our product development labs over the next 12 to 18 months, and contribute significantly to an acceleration of growth in our healthcare and instrumentation area. When I look at industrial and clean tech, although a lot of people talk about it, I don't think that our competitors have the diversity and capability that we do.

I think we build high mix electronics at more low-cost locations than anybody else in the world. When you consider Jabil's hope will be in that mid-\$17 billion range this year, or at least above \$17 billion in revenue this year, and 70% of that output is built in lot quantities of 100 or less, we are the largest high mix manufacturing business on the planet. We think that is a very highly differentiated capability to bring to a market, in a world where virtually all customers are efforting to get to new places, new locations, tap growth in emerging markets, bring new technologies to the products that they have in their portfolio, leverage our product development skills. So, helping our customer base manage through that global complexity, and architecting, helping them architect global supply chain networks is a significant differentiator for us.

Craig Hettenbach - *Goldman Sachs - Analyst*

Okay, and just as a follow-up, as you talk to customers, what is your sense in terms of in demand today versus three to six months ago, and then just inventory adjustments, do you think we are through most of those?

Tim Main - *Jabil Circuit Inc - President and CEO*

I think it varies, Craig, by business area. In Enterprise and Infrastructure, my sense is that the mood is turning more towards optimism. So there is more bias to the upside. I think the overhang of the T-Mobile AT&T acquisition put a cap on some needed infrastructure spend in North America. The collapse of 2.5 G in China, and some of the economic slowdown, a worry about economic slowdown in Asia, put a cap on spend there. And of course we have Europe, which is in the midst of a recession. My sense is that most of the inventory issues have been worked through, and that we will see an expansion of spend as some of the uncertainties have cleared down over the last three or four months, and as people get progressively -- you know it depends on how them macroeconomic environment does, but as long as it stays in a state of even lackluster growth, I think that the bias is more towards the upside.



Diversified Manufacturing Services is just going crazy. We've got great growth there. We've had great growth there. And we expect to continue to have great growth there. Customers are happy with our performance. We're happy with our customers, and we feel like we can continue to grow that at a world-class pace. And in High Velocity, that is not an area where we look for a lot of great growth, but we have significant customer relationships there, and you know, Craig, we're getting pretty good at it. And in High Velocity, too, I don't think we'll continue to earn 4% operating margins in High Velocity.

I would expect as Enterprise and Infrastructure margins improve, we might see High Velocity move into the mid-3s, because we do need to support customers, it is a very competitive business. But, that said, we've really been able to use lean manufacturing, and consolidate our operations around the world, and get our customers into fewer sites, and drive a lot of efficiency that way. So we're very happy with our performance in that area. I don't think the consumer spend has been great across the board, but it has been okay, and our customers there are doing pretty well. So I would say we're getting progressively more optimistic than the way things looked three or four months ago.

Craig Hettenbach - *Goldman Sachs - Analyst*

Okay. Thanks for the details around that. I appreciate it.

Tim Main - *Jabil Circuit Inc - President and CEO*

Okay.

Operator

Your next question comes from the line of Amitabh Passi with UBS.

Amitabh Passi - *UBS - Analyst*

Thank you. I just wanted to clarify first on margins. Forbes, when we look at DMS, should we expect a similar trajectory to fiscal '11, where we would see some modest improvement in the May quarter, and then maybe another step up into the August quarter? I'm just trying to understand how we go from 5.9% to the high 6% over the next two to three quarters?

Forbes Alexander - *Jabil Circuit Inc - CFO*

Yes, I think that is a fair representation. We would expect, obviously, as I have articulated, the Aftermarket Services going in to bounce back to historical levels, so that gets us into about 6%, 6.4%, 6.5%, and we have got some product transitions going on in Q3, that are investments in MTG, but I think a similar ramp through the back half of the year to what you saw last year is appropriate. So, yes, we feel very comfortable that we can certainly deliver that type of recovery back into the targeted ranges.

Tim Main - *Jabil Circuit Inc - President and CEO*

It has certainly been the cycle of operating margins in that area to rebound from the Q2 period. As Forbes said, there is a very straightforward reason in Aftermarket Services why we have confidence that will recover. I think that the brighter, more interesting part of the story is, looking at FY '13, and the growth of the Diversified Manufacturing Services segment. If you take what we've shown you in slide 19 overall, Diversified Manufacturing Services is expected to grow at 22% in FY '13. Overall, that drives about a 12% to 13% growth for the Company, when you consider Enterprise and Infrastructure. And if you just look at our margin mix generally speaking, with Diversified Manufacturing Services conservatively in the 6.5% range, and then more normalized margins in High Velocity and Enterprise and Infrastructure, should be a great year for us.



So I really think that's the more interesting part of the story. As you go quarter to quarter, these 90 day periods are relatively arbitrary. We will have margins, a little bit of margin variation, as individual aspects of the business do better or worse. We are really happy that revenue was as strong as it was in the quarter, \$4.2 billion, at the high end of the range, and operating margins are at the midpoint, and EPS and earnings being where they should be in that environment. So it is a bullish set of circumstances for us to be in today, particularly when you consider how are doing relative to some of the other comparisons in the industry that showed contraction in the December period, and we'll see how people do in the March period, but I think we are essentially doing a good job of growing the Company and showing good earnings in this environment.

Amitabh Passi - UBS - Analyst

Thanks for the color, Tim. And I was also wondering, on slide 15 you showed, basically, a list of design wins in your healthcare and life sciences area. Is there any way you can give us a sense of the size of this pipeline? Just trying to get a sense of how robust --

Tim Main - Jabil Circuit Inc - President and CEO

The size of this pipeline alone would support about a 30% growth rate in healthcare and life sciences.

Amitabh Passi - UBS - Analyst

For fiscal '13?

Tim Main - Jabil Circuit Inc - President and CEO

For fiscal '13, '14. It's kind of graded in that area. But, yes, we'll start with fiscal '13, sure.

Amitabh Passi - UBS - Analyst

And then just a final question from me, on your Enterprise and Infrastructure for fiscal '13, I think you put a 10% growth rate expectation. Just wondering, is that all just sort of organic? Are you expecting some incremental program ramps or market share wins? Just curious your thought process around a 10% growth for fiscal '13?

Tim Main - Jabil Circuit Inc - President and CEO

Okay, well there are some new business opportunities. There always are from time to time in that business. But it is a return to a secular growth rate, as some of the headwinds that we've discussed, from Europe to mergers between carriers, and Asia, along with inventory corrections, all those things kind of abating, combined with some of the market share wins that we've obtained over the last 12 months, and then there are some new business opportunities for us with existing customers. So were in great shape with our storage customers. We think that telecommunications will start to recover, as well as networking. So I look at that business over a long-term period of time, and say that we would expect that business to grow at a secular growth rate of 6% to 8%, which you can look at a number of electronic publications that track growth and enterprise, facing and infrastructure industries, and that's a normalized growth rate. We think we can do just a little bit better than that in FY '13.

Amitabh Passi - UBS - Analyst

Okay, thank you.



Tim Main - *Jabil Circuit Inc - President and CEO*

Okay.

Operator

Your next question comes from the line of Sean Hannan with Needham.

Sean Hannan - *Needham & Company - Analyst*

You've provided a lot of great color today. I think everybody appreciates that, certainly ahead of your event coming up in May. One area I want to see if I can focus around was materials technology group. There's been a lot of speculation and news out there around competitors large and small. I think that you've spoken to this at different points in time. I was looking to see if you could update us on the competition you are seeing within that space, the degree you are seeing, even in some cases, perhaps, new entrants or changes in scale, or perhaps even pricing at some of the other players?

Tim Main - *Jabil Circuit Inc - President and CEO*

In terms of competition, it is the usual suspects. I think Catcher is a compare. Foxconn certainly has an activity in this area, Hi-P, Nipro, BYD; these are companies that engage in this type of activity, so the competitors are the same, which is typical for, particularly, what comes out of Taiwan sometimes, is an over-reaction, or a dramatization of random news bites that come out. This is a big, exploding marketplace and I think the thing that people really don't grasp entirely is that this is not a mature market yet, when we talk about smartphones, and higher and higher end products in the mobility marketplace. Our people believe that we are really in the beginning years of this expansion, and this will be a very big market that will require more than just our MTG group to support.

So we would caution people not to over-react to news bites that come out. Our relationships are very strong. We are expanding capacity with some very strategic customers. We have good line of sight through new product transitions and new product families. So we feel very good about our position. It can be a brutally competitive market, but our engineering and innovation and ingenuity carries the day for us, and that is what we rely on to be competitive. So, we'll continue to effort to keep our technology updated, keep bringing new ingenuity to the marketplace, and stay at the forward part of the market developments, and not be a fast follower beyond the more commoditized part of the marketplace.

Sean Hannan - *Needham & Company - Analyst*

That's very helpful. And then a follow-up some of your thoughts around that space. Obviously, it has grown very well. Part of that has been on the back of a very large smartphone and tablet OEM. Can you talk about how you would rank the contributors to that '13 growth that you are targeting in terms of either further penetration with that largest customer in the space, others perhaps that may be within the consumer markets. I think that there is an element of some medical customers, a number of programs that will be coming in as revenues next year, and if there is a little bit of insight around how much they could contribute to that 25% growth, that would be helpful.

Tim Main - *Jabil Circuit Inc - President and CEO*

Yes, that is a great point. We are very excited about the single-use device market, and how we can leverage our skills in MTG into a broader participation in the healthcare and life sciences area. I think you will see increasing contribution from that aspect of our business in FY '13 and FY '14. That said, I think the bigger part of the story will continue to be mobility with the existing customer base for the foreseeable future, just because the numbers are so big, it tends to dwarf the great progress that we are making in areas like healthcare. But we are very excited about it.



It is very meaningful when we look at these plus 20 design wins, when we can show them the capabilities that we have to integrate these complex products from optics capability to our MTG capability, along with world-class healthcare design capability, and manufacturing and quality to be a safe pair of hands to bring all of that capability together, and really help customers create great new products that they couldn't manifest on their own, or would struggle to manifest on their own, would be a more accurate way to put it. And that is going to be, over the next three to five years, that's going to be an increasingly important part of the business. But, Sean, I would say, when we look at FY '13, the bulk of the \$1 billion or so of growth that we should see in MTG will be driven primarily through the existing customer base and continued expansion across a broad range of mobility products and accessories.

Sean Hannan - *Needham & Company - Analyst*

Great. Thanks so much for the color, Tim.

Tim Main - *Jabil Circuit Inc - President and CEO*

Okay.

Operator

Your next question comes from the line of Amit Daryanani with RBC Capital.

Amit Daryanani - *RBC Capital Markets - Analyst*

Good afternoon, guys. I just have a question on the MTG group. It looks like more than half of the revenues in that segment really come from one customer. I'm curious, are you guys really comfortable with that kind of concentration, and are the CapEx plans in place to support that one customer, or is it to really broaden the customer base?

Tim Main - *Jabil Circuit Inc - President and CEO*

We would like to have more diversity, overall, Amit, and we are adding customers to that portfolio, but you also need to make sure that you are doing business with market leaders, and so we are comfortable that the investments that we are making have very sound business prospects ahead of it. I'd also like to remind everybody that our larger customers in that business co-invest with Jabil. So many of the dollars that you see flowing into MTG, a very high percentage of that is matched with co-investment from customers. So there's a very high level of commitment to the go-forward plan on a long-term basis. So that really helps us get comfortable with the fidelity of the relationship and the solidity of the go-forward plan.

Amit Daryanani - *RBC Capital Markets - Analyst*

Got it. And just looking at that segment again, can you maybe help us understand what are the current utilization were rates in that segment, and how much incremental capacity are you really adding, given the CapEx plans right now and for fiscal '13.

Tim Main - *Jabil Circuit Inc - President and CEO*

I can't really give you a percentage. I guess an easy math I would say we are adding approximately 25% to our capacity over the course of between now and approximately the midpoint of FY '13. We are at extremely high levels of utilization right now in most areas of the business.



Amit Daryanani - RBC Capital Markets - Analyst

Got it. And just, finally, on the High Velocity side, given the fact that, I think you guys made a comment that handsets within that segment should decline in Q3. Should we expect the margins to continue to remain in the high 3% to 4% for, potentially, May and August quarter as well?

Tim Main - Jabil Circuit Inc - President and CEO

I wouldn't expect the 4% range. We are not providing specific segment margin guidance. It gets a little bit tricky. I have indicated that I think that we can operate High Velocity for the full fiscal year at 3% or above, and I think we will address our long-term targets for that business area later this year on an annual cycle; revisit all of our long-term targets, probably, on the December call.

Amit Daryanani - RBC Capital Markets - Analyst

Thank you.

Tim Main - Jabil Circuit Inc - President and CEO

Okay.

Operator

Your next question comes from the line of Shawn Harrison with Longbow Research.

Shawn Harrison - Longbow Research - Analyst

Hi. Good evening, hopefully you can hear me. Just a few clarifications I was looking to get. The repurchase, I think, there's about \$150 million remaining. Is that the expectation that you would finish up before the end of the fiscal year? And then with just the overhead reductions cited in the presentation, is that solely headcount reductions, or is that facility closures?

Forbes Alexander - Jabil Circuit Inc - CFO

Okay. Hi, it's Forbes. Actually, our authorization was for \$100 million for stock repurchase, and that runs through to the October timeframe of 2012. So \$60 million outstanding, \$40 million repurchased in the last quarter. The intent of that repurchase program was to ensure we attenuated the dilution of our stock. We will see how that progresses. But, certainly, at this point in time, our intent would be to complete that repurchase program over the balance of the term, if you will, through October 2012.

Shawn Harrison - Longbow Research - Analyst

Okay. And then just in terms of the overhead reduction action, is that headcount based or facility based or a combination?

Forbes Alexander - Jabil Circuit Inc - CFO

We're really characterizing that as, we don't foresee any specific facility closures or anything of that nature. But really, if you look at the performance that we've put up in terms of our High Velocity business, and some of the lean practices, leaning out our processes and efficiencies there; we will look to take some of the lessons learned there, apply those across that Enterprise and Infrastructure segment. So at this point in time, we certainly,



I would not expect any site capacity reductions. But certainly, really attribute that to much more of leaning out our processes and efficiencies of running our manufacturing operations.

Shawn Harrison - Longbow Research - Analyst

Okay, and one final question if I could. As you move toward the GAAP reporting in fiscal '13, the variance between the margins right now and the GAAP margins, how would that be split between the business units? Should we just assume it is equitably split, or just an idea of how to think about that?

Forbes Alexander - Jabil Circuit Inc - CFO

Yes, the intangible elements will certainly be attributed directly to the various business units, and that is, what, about \$16 million, \$20 million a year. The stock-based compensation, we are still working through that. That is a little bit trickier in terms of how one allocates that, given that that is based on headcount. So we'll continue to work through that, and we will certainly give you more color on that as we move towards the end of the fiscal year here.

Shawn Harrison - Longbow Research - Analyst

Okay, thank you so much.

Forbes Alexander - Jabil Circuit Inc - CFO

You're welcome.

Operator

Your next question comes from the line of Jim Suva with Citi.

Jim Suva - Citigroup - Analyst

Thank you, and congratulations to you and your team there. A little bit focusing on the DMS margins, and understanding you had the issues compacting the margins this year. But when we look at, year over year, the very, very strong growth in that segment of 44%, but operating margins was up only about 4%. If you strip out that one-time item, can you let us know about what that would have been? And going forward, of course, seasonally, we would expect the margins in that business to grow, or segment to grow, as it has been in the past, but can you get some leverage of that to actually grow operating margin percents higher year over year in that segment, or is it more about the throughput in velocity?

Forbes Alexander - Jabil Circuit Inc - CFO

Yes, Jim, the impact this past quarter, I think that's what you referred to, was about 40 or 50 basis points in the quarter, which is -- that is about, for the year --

Tim Main - Jabil Circuit Inc - President and CEO

It is \$8 million in the quarter, right, so it is not that much.

Forbes Alexander - *Jabil Circuit Inc - CFO*

It is going to be 10, 20 basis points for the year. So as we move forward here, we'd certainly expect to see year-over-year expansion in terms of our DMS segmentation margins. As we have articulated, we are making some significant investments in the back half of this fiscal year, and revenues and income streams contributing to that investment will then start to appear towards the end of Q4, and certainly into the first half of fiscal '13. So as we run volumes through there, and we start to see some of these design activities come to fruition in terms of revenue flow, the full year's contribution in Telmar for our Aftermarket Services business there, and the organic expansion of some opportunities there, we'd certainly expect to see some nice overall margin expansion on both a year-over-year basis, and a full fiscal year, '13 versus '12 as we move through fiscal '13.

Tim Main - *Jabil Circuit Inc - President and CEO*

Yes, Jim, I think when we look at FY '13, and we look at the growth in Diversified Manufacturing Services relative to the other business areas, DMS should rise to 47%, 48% of the overall business from where it is today, and the basic margin portfolio, or margin mix, should provide some year-over-year margin expansion for the Company overall that would be very attractive.

Jim Suva - *Citigroup - Analyst*

Yes, that is very, very good news. Thanks, gentlemen, for clarifying that. A quick follow-up. With a CapEx number that is higher, the \$0.5 billion CapEx, should we look at that as kind of the new run rate for the Company, or is this kind of a big, big investment year for the Company, or should we -- I'm trying to get a grasp on what the CapEx is required, given your new business model of DMS and higher profitability? Thank you.

Tim Main - *Jabil Circuit Inc - President and CEO*

It's a great question. We don't know what we are going to spend in FY '13. We are going to have to start expressing this in terms of percent of incremental revenue and things like that, because the Company is getting a heck of a lot bigger, and our EBITDA margins are increasing. So it's not really, fundamentally quarter-to-quarter, it might look a little odd, but fundamentally over the longer-term period, it certainly is not impairing the Company's ability to generate cash flow from operations and free cash flow. In fact, we think, in terms of EBITDA yields, we will still have significant free cash flow over time. With an EBITDA margin of 6.2%, and we're looking at additional margin expansion in FY '13, CapEx could be another \$500 million. I don't think it'll be that high, but we just don't know at this point, and if EBITDA margins climb another 30, 40, 50 basis points, we're going to be generating a lot of cash flow, and even at that level, with a \$19 billion-plus Company, we're going to see pretty good free cash flow, which is still paramount in the Company's business plan.

Jim Suva - *Citigroup - Analyst*

Thanks, and congratulations to you and your Team, and especially for the details on the DMS margins, that was very helpful. Thank you, guys.

Tim Main - *Jabil Circuit Inc - President and CEO*

Okay, Jim. Thanks.

Beth Walters - *Jabil Circuit Inc - SVP, Communications and IR*

Thanks, Jim. Operator, I understand we have one last question on the line?



Operator

Your last question comes from the line of Sherri Scribner with Deutsche Bank.

Sherri Scribner - Deutsche Bank - Analyst

Hi, thanks. Most of my questions have been answered. I just wanted to follow-up with, I think last quarter you talked about a full-year revenue guidance of \$17.4 billion for fiscal '12. Are you still comfortable with that, and do you think you could beat that number?

Tim Main - Jabil Circuit Inc - President and CEO

I think it is certainly possible. The midpoint of our guidance of 4.3%, that would imply a much bigger Q4 than I would ask people to model. I think we are very comfortable with the earnings and the operating income, so we might have a little bit more revenue variation, Sherri, than what we thought last quarter, but we are still very comfortable with the earnings profile and driving the margins up. So the business mix is actually improving, and so we're less concerned about where exactly we are in terms of revenue. Revenue could be plus or minus \$200 million, and I think we would be okay with that, as long as the earnings are there, and we feel very good about the earnings.

Sherri Scribner - Deutsche Bank - Analyst

Okay, great. Thank you.

Tim Main - Jabil Circuit Inc - President and CEO

Okay, thank you.

Beth Walters - Jabil Circuit Inc - SVP, Communications and IR

Okay. Thank you, everyone for joining us on the call today. Obviously, we are pleased with our performance in the second quarter, and our outlook moving forward, and our traction to our stated long term goals of growing our Diversified Manufacturing Services, too. So I would also note that Tim Main will be a guest on Mad Money tomorrow evening, so you might want to tune in and check out that. Thanks very much for joining us.

Operator

Thank you for participating in today's conference call. You may now disconnect.

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