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PLXS - Q2 2018 Plexus Corp Earnings Call

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OVERVIEW:

Co. reported 2Q18 revenue of $699m, GAAP diluted EPS of $0.36. Expects 3Q18 revenue to be $700-740m and GAAP diluted EPS to be $0.76-0.86.

CORPORATE PARTICIPANTS

Patrick John Jermain *Plexus Corp. - Senior VP & CFO*

Steven J. Frisch *Plexus Corp. - Executive VP & COO*

Susan Hanson *Plexus Corp. - Director of Communications & Brand Management*

Todd P. Kelsey *Plexus Corp. - President, CEO & Director*

CONFERENCE CALL PARTICIPANTS

Jim Suva *Citigroup Inc, Research Division - Director*

Matthew John Sheerin *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

Mitchell Toshiro Steves *RBC Capital Markets, LLC, Research Division - Analyst*

Paul Coster *JP Morgan Chase & Co, Research Division - Senior Analyst, Alternative Energy, and Applied and Emerging Technologies*

Sean Kilian Flanagan Hannan *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

Shawn Matthew Harrison *Longbow Research LLC - Senior Research Analyst*

Sherri Ann Scribner *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

PRESENTATION

Operator

Hello and good morning. Welcome to the Plexus Corp. Conference Call regarding its Fiscal Second Quarter 2018 Earnings Announcement. My name is Michelle, and I will be your operator for today's call. (Operator Instructions)

I would now like to turn the call over to Ms. Susan Hanson, Plexus's Senior Director of Communications and Investor Relations. Ma'am you may begin.

Susan Hanson - *Plexus Corp. - Director of Communications & Brand Management*

Thanks, Michelle. Good morning, and thank you for joining us today. Some of the statements made and information provided during our call today will be forward-looking statements, as they will not be limited to historical facts. The words believe, expect, intend, plan, anticipate and similar terms often identify forward-looking statements.

Forward-looking statements are not guarantees since there are inherent difficulties in predicting future results, and actual results could differ materially from those expressed or implied in the forward-looking statements. For a list of factors that could cause actual results to differ materially from those discussed, please refer to the company's periodic SEC filings, particularly the risk factors in our Form 10-K filing for the fiscal year ended September 30, 2017, and the safe harbor and fair disclosure statement in yesterday's press release.

Plexus provides non-GAAP supplemental information, such as ROIC, economic return and free cash flow, because those measures are used for internal management goals and decision-making, and because they provide additional insight into financial performance.

In addition, management uses these and other non-GAAP measures, such as adjusted net income, adjusted earnings per share and adjusted operating margin, to provide a better understanding of core performance for purposes of period-to-period comparison. For a full reconciliation of non-GAAP supplemental information, please refer to yesterday's press release and our periodic SEC filings. We encourage participants on the call this morning to access the live webcast and supporting materials on Plexus' website at www.plexus.com, by clicking on Investor Relations at the top of the page.

Joining me today are Todd Kelsey, President and Chief Executive Officer; Steve Frisch, Executive Vice President and Chief Operating Officer; and Pat Jermain, Senior Vice President and Chief Financial Officer. Consistent with prior earnings calls, Todd will provide summary comments before turning the call over to Steve and Pat for further details.

Let me now turn the call over to Todd Kelsey. Todd?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Thank you, Susan, and good morning, everyone. Please begin with our fiscal second quarter results on Slide 3. After the close of the market yesterday, we reported results for our fiscal second quarter of 2018. We finished the quarter with record revenue of $699 million. The result was near the high-end of our guidance range and up approximately 16% from the comparable quarter last year.

Our Industrial/Commercial markets sector outperformed strengthening during the quarter, as a result of robust demand in the semiconductor capital equipment space. Our Healthcare/Life Sciences and Aerospace and Defense market sectors achieved solid sequential growth as we benefited from new program ramps and improving end markets. We incurred a $13.2 million expense impacting our GAAP earnings per share results, as a consequence of the previously announced bonus for non-executive full-time employees. Our diluted GAAP EPS was $0.36, excluding the bonus impact, we delivered non-GAAP diluted EPS of $0.74 including $0.13 of stock-based compensation expense. The non-GAAP EPS result was above the midpoint of our guidance range as we benefited from better than anticipated revenue coupled with operating performance in line with previous expectations.

Our return on invested capital was 15.6%. This represents an economic return of 610 basis points above our weighted average cost of capital, well above our 500 basis point goal.

Next, I will highlight a few significant accomplishments within the fiscal second quarter. In response to recent U.S. tax reform, we announced a revised capital allocation strategy on February 20, 2018 that supports a more effective capital structure. The tax changes allow for the efficient repatriation of more than $500 million of our overseas cash.

I will review some of the key components of our revised capital allocation strategy. One of our top priorities is to allocate capital to support our future growth. Consistent with this approach, yesterday, we announced construction of a second facility in Guadalajara, Mexico. Expanding our presence in Guadalajara is necessary to support the strong response from our customers to our first Guadalajara facility, which opened just 4 years ago.

In addition, we invested in working capital to support future growth expectations, and to hedge against the tightening electronic supply chain environment, so that we can meet our customers' delivery expectations and provide superior customer service.

We announced a follow on $200 million share repurchase program authorized by our Board of Directors. This is in addition to the $150 million authorization we are currently executing. We recently paid down our credit revolver and are in the process of securing new private placement financing with the intent of reducing our senior notes to $150 million. The combination of the repurchases and debt reduction will be significantly accretive to our earnings per share in future quarters.

Finally, we announced a one-time bonus for non-executive employees in order to reward our teams for strong operational performance, and delivering customer service excellence.

Next, our manufacturing wins were at the highest quarterly level in nearly 4 years at $255 million, positioning us for continued future growth. This resulted in trailing 4 quarter manufacturing wins of $847 million, which also represented a multi-year high. In addition, our teams booked a record $34 million of Engineering Solutions wins. When coupled with a record revenue quarter for Engineering Solutions in the fiscal second quarter, we are optimistic that we'll continue to excel with this differentiated service offering.

Advancing to our guidance for the fiscal third quarter of 2018 on Slide 4. Strong sequential growth in our Healthcare/Life Sciences, Aerospace and Defense, and Communication sectors is expected to more than offset a modest softening in our Industrial/Commercial sector. As a result, we are establishing revenue guidance of $700 million to $740 million for the fiscal third quarter, as we anticipate another quarter of record revenue. The midpoint of this guidance suggests we will achieve approximately 3% sequential quarterly revenue growth and more than 15% revenue growth from the fiscal third quarter of 2017.

We continue to anticipate that our operating margin will return to our target range of 4.7% to 5% for the remainder of fiscal 2018. Consistent with these expectations, we are guiding fiscal third quarter 2018 GAAP diluted EPS of $0.76 to $0.86. The EPS guide includes $0.13 of stock-based compensation expense.

Next, a few comments regarding the balance of fiscal 2018. Last quarter, we discussed the significant number of large program ramps that we have underway as well as our priority to invest in ensuring these transitions are successful for our customers. The progress we have achieved with the new program ramps in conjunction with improving end markets provides us increasing optimism that will attain revenue growth in line with or above our 12% target in fiscal 2018. As we look forward to fiscal 2019, our strong wins performance and improved end markets, position us well for continued revenue growth. Further, we expect our operating margin performance will be within our target range of 4.7% to 5% and we will gain benefits from our capital allocation strategy. Considering these 3 factors, we anticipate significant EPS leverage in fiscal 2019.

I'll now turn the call over to Steve for additional insight into the performance of our market sectors and operations. Steve?

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

Thank you, Todd. Good morning. Please advance to Slide 5 for review of our market sector performance during the second quarter of fiscal 2018 as well as our expectations for the sectors in the fiscal third quarter of 2018. Our Healthcare/Life Sciences sector was up 5% in the fiscal second quarter, which was in line with our expectations of a mid-single-digit increase. New program ramps with several customers provided the growth. Looking ahead to the back half of fiscal 2018, we expect the ramp of new programs to continue. As a result, we anticipate a mid-single digit revenue increase in our Healthcare/Life Sciences sector in the fiscal third quarter.

Our Industrial/Commercial sector was up 17% sequentially in the fiscal second quarter, which was above our expectations of a low double-digit increase. For the second quarter in a row, the stronger than anticipated revenue was mainly due to increased demand from customers within the semiconductor capital equipment subsector. As we look towards the fiscal third quarter, the exceptionally strong demand from our semiconductor capital equipment customers is expected to stabilize at a slightly lower revenue level. As a result, we anticipate a mid-single-digit decrease in our Industrial/Commercial sector in the fiscal third quarter.

Our Communications sector was down 26% sequentially in the fiscal second quarter of 2018. This result was in line with our expectations of a mid-20s percentage decrease. Looking ahead to the fiscal third quarter, we expect that modest end market strength and new program ramps will yield a low double-digit increase in our communications sector.

Our Aerospace and Defense sector was up 10% in the fiscal second quarter, a result that was below our expectations of a mid-teens increase. Delayed new program ramps were the main reason for the lower revenue. As we look towards the fiscal third quarter, we expect that strength in end markets and new program ramps will result in a mid-teens increase for our Aerospace and Defense sector.

Please advance to Slide 6, for an overview of the very strong wins performance for the fiscal second quarter. We won 41 new programs that we anticipate to generate $255 million in annualized revenue when fully ramped in production. A trailing 4-quarter manufacturing wins as shown by the red bars is at $847 million This results in a solid wins momentum of 32%, well above our 25% target. In addition, our Engineering Solutions group had exceptional wins of $34 million in the fiscal second quarter. The robust engineering wins in the first half of fiscal 2018 has generated a healthy backlog for the engineering team for the remainder of fiscal 2018.

Please advance to Slide 7 for further insight into the wins performance by region. The Americas region has very strong manufacturing wins of $138 million. Included in the wins results are new products from an existing customer and 2 new meaningful programs from 2 new customers. The APAC region's $114 million of new manufacturing wins was also a strong result. A large award from a new healthcare customer was the highlight for the region.

The EMEA region's manufacturing wins were [lighter] this quarter. However, with the revenue growth of the current manufacturing business projected to exceed 50% in fiscal 2018. We are comfortable with the pace of new program ramps in EMEA. The regional and sector teams are working very closely to manage aggressive growth without sacrificing our commitment to customer service excellence, and operational excellence.

Please advance to Slide 8 for further insight into wins performance by market sector. The Industrial/Commercial sector generated $123 million in wins in the fiscal second quarter, an exceptional result. Several programs associated with these wins are higher complexity finished products of which 2 are targeted to be built within our mechatronic facility in Appleton, Wisconsin.

The Healthcare/Life Sciences team produced $54 million in manufacturing wins in the fiscal second quarter, included in the wins is a meaningful program with a new customer that we believe will lead to additional opportunities in the future. The Communications sector's $48 million of wins, included a strategic manufacturing win from an existing customer for our APAC region.

Finally, our Aerospace and Defense sector won 2 programs from existing customers that we expect to have a long lifecycle. One program is in the Defense sub sector and the others in the Aerospace sub sector.

Please advance to Slide 9. We finished the fiscal second quarter with funnel of $2.4 billion of qualified manufacturing opportunities. The Healthcare/Life Sciences funnel at $1.3 billion continues to be very strong and the Aerospace and Defense funnel maintained at a healthy level. Our Industrial/Commercial and Communications funnel dipped mainly due to the conversion of opportunities to wins. As we look at the pipeline of leads that feeds our qualified manufacturing funnel, it has grown significantly and should stay in a healthy funnel.

Next, I'd like to turn to operating performance on Slide 10. Our revenue in the fiscal second quarter finished at a record $699 million. As we look to our fiscal third quarter, achieving revenue within our guidance range would result in a [fifth] consecutive quarter of growth. In line with our expectations of operating margin returning to our target range in the back half of fiscal 2018, we are guiding operating margin in the range of 4.6% to 5% for the fiscal third quarter of 2018.

Although Pat will discuss working capital in more detail in a moment, I wanted to provide some insight into our days of inventory metric. Our inventory level at 100 days in the fiscal second quarter was flat compared to the fiscal first quarter. This result was 4 days higher than we had originally planned as we have decided to take a more conservative approach with inventory management. As the supply for some electronic components continue to tighten, our supply chain team has done an outstanding job ensuring a continuity of supply. Although we are meeting our customer's commitments, we have been proactively working to provide our customers flexibility for upside in the forecast. As a result, our projected revenue growth and forecast and focus on customer service means our inventory position is higher than we'd originally planned at the beginning of fiscal 2018.

Please advance to Slide 11. Our team in Guadalajara, Mexico is doing an exceptional job at delivering customer service and operational excellence to our customers. As a result, the demand from customers is robust. In the second quarter, we made a strategic investment decision that supports the region's growth projections for fiscal 2019 and beyond. We signed a lease for the construction of a new 472,000 square foot manufacturing facility adjacent to our current facility in Guadalajara Mexico. Construction is expected to commence within this fiscal third quarter and we expect the facility to be ready in the third quarter of fiscal 2019.

A final comment, I am proud of the global Plexus team, achieving record revenue levels while committing to an operating margin back within our target range is a very good accomplishment. Delivering this forecast with a high level of customer service excellence is a great accomplishment. It is the team's commitment to exceeding the customers' expectations that is not only enabling a strong finish to fiscal 2018. It is the foundation for growth in fiscal 2019.

I'll now turn the call to Pat for detailed review of our performance -- financial performance. Pat?

Patrick John Jermain - *Plexus Corp. - Senior VP & CFO*

Thank you, Steve, and good morning, everyone. Our fiscal second quarter results are summarized on Slide 12. As Todd mentioned earlier, second quarter revenue and non-GAAP EPS were above the midpoint of our guidance. Included in gross profit for the fiscal second quarter was approximately $12.6 million of expense related to the one-time employee bonus paid at the end of March. Before consideration of the one-time bonus, adjusted gross margin was 9.4%. This result met our expectations and was consistent with the fiscal first quarter. Our seasonal compensation cost increases impacted gross margin. We managed to offset the impact through continued operational productivity and better leverage of fixed expenses with sequentially higher revenue.

Selling and administrative expense of approximately $35.6 million included $900,000 of expense related to the one-time employee bonus. As a percentage of revenue, SG&A was 5.1%, a sequential increase of 40 basis points. Contributing to the increase was the anticipated seasonal compensation headwinds, higher incentive compensation expense, along with the one-time employee bonus expense. Before consideration of the one-time employee bonus expense, adjusted operating margin of 4.4% was in line with our quarterly guidance. Included in this quarter's operating margin was approximately 65 basis points of stock-based compensation expense.

Diluted EPS at $0.36, included a detriment of $0.38 per share, as a result of the after-tax employee bonus expense. Excluding this expense, non-GAAP EPS of $0.74 was slightly above the midpoint of our guidance.

Turning now to the balance sheet on Slide 13. Return on invested capital before the one-time bonus expense was 15.6% for the fiscal second quarter, 610 basis points above our weighted average cost of capital of 9.5%. Sequentially, return on invested capital reduced 60 basis points, due in part to working capital investments to support anticipated higher revenue and longer lead times for certain inventory components.

As Todd mentioned earlier, on February 20, we outlined a revised capital allocation plan. As part of this plan, we intend to accelerate share repurchases under the 2016 authorization. During the quarter, we executed on this plan by purchasing approximately 513,000 of our shares for $31.6 million, and an average price of $61 and $0.63 per share.

Through the second quarter, we have completed half of the $150 million authorization. We intend to purchase the remaining $75 million of shares through open market purchases during the fiscal third quarter and partly through the fiscal fourth quarter. Once the 2016 authorization is complete, we plan to begin purchasing shares under the new $200 million authorization.

For the fiscal second quarter, we used $66.3 million in cash from operations, and spent $12.4 million on capital expenditures, resulting in cash outflows of approximately $79 million. Free cash flow was unfavorable to our expectations, as a result of higher working capital investments and our one-time employee bonus. At the end of the fiscal second quarter, our cash balance was just above $400 million with approximately 80% of the balance offshore. Sequentially, our cash balance reduced approximately $110 million with additional working capital investments, capital expenditures and accelerated share repurchases. Cash cycle at the end of the second quarter was 76 days, 2 days above our guidance and 9 days higher than our results in the fiscal first quarter.

Please turn to Slide 14 for details on our cash cycle. While inventory days remained consistent with the prior quarter. We increased inventory dollars by approximately $32 million to support the ramp of new customer programs and longer lead times we are experiencing with certain components. Days in receivables were 52 days, sequentially higher by 7 days primarily due to the timing of customer shipments and payments as well as selling fewer receivables under our customer factoring program. Sequentially, payable days were lower by 2 days, while customer deposits were flat.

As Todd has already provided the revenue and EPS guidance for the fiscal third quarter, I will share some additional details which are summarized on Slide 15. Fiscal third quarter gross margin is expected to be in the range of 9.5% to 9.9%. At the midpoint of this guidance, gross margin would improve 30 basis points compared to adjusted gross margin in the fiscal second quarter. Continued operational productivity and better leverage of fixed expenses with the anticipated higher revenue are both contributing to the sequential improvement. For the fiscal third quarter, we expect SG&A expense in the range of $34.5 million to $35.5 million. At the midpoint of our revenue guidance, anticipated SG&A would be 4.9% of revenue, sequentially improved by 20 basis points. Fiscal third quarter operating margin is expected to be in the range of 4.6% to 5%, which includes approximately 60 basis points of stock-based compensation expense.

A few other notes. Depreciation expense for the fiscal third quarter is expected to be approximately $12 million, consistent with fiscal second quarter. Other expense for the fiscal third quarter is expected to be in the range of $3 million to $3.3 million. We estimate an effective tax rate of 11% to 13% for the fiscal third quarter, excluding the impact of tax reform and the one-time bonus, the effective tax rate is expected to be 10% to 12% for the full-year.

Given the anticipated share repurchase activity during the fiscal third quarter, we estimate diluted weighted average shares outstanding of approximately 34 million shares. Our expectation for the balance sheet is for working capital dollars to be slightly lower than the fiscal second quarter. Based on forecasted levels of revenue, we expect a lower working capital will result in cash cycle days of 71 days to 75 days for the fiscal third quarter. At the midpoint of this guidance, cash cycle days would improve by 3 days, primarily related to increased accounts receivable factoring.

We expect free cash flow up to $15 million for the fiscal third quarter, given the need for additional working capital investments to support anticipated higher revenue and what we are experiencing with extended inventory lead times. We expect $40 million to $60 million in free cash flow for fiscal 2018.

This June, our $175 million senior notes will mature at which time we intend to refinance $150 million through a private placement. Subject to closing and funding in June, we have made arrangements with potential purchasers to refinance the senior notes under a combination of 7-year and 10-year maturities, both at rates favorable to the current notes. There have been no changes in our capital spending estimates for fiscal 2018. We still expect spending in the range of $80 million to $90 million.

One final comment. With regard to U.S. tax reform, we repatriated approximately $280 million of our cash from our APAC region during the fiscal second quarter. This cash funded working capital investments, accelerated share repurchases, rewarded non-executive employees through the one-time bonus as well as reduced borrowing under our revolving credit facility. We anticipate repatriating an additional $150 million of offshore cash during the fiscal third quarter, while continuing to execute our revised capital allocation strategy.

With that Michelle, I will now open the call for questions. We ask that you please limit yourself to 1 question and 1 follow-up. Michelle?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) I do have a question in the queue from Shawn Harrison with Longbow Research.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

Two questions, if I may. So if you look at the 12% growth target now for the year that you've highlighted. I think, part of it last time was that you would see decent growth in the Communications business and maybe that looks like it's either going to be a little bit lower, the fourth quarter or will be a little bit stronger. And so maybe just the trajectory into the end of the year within Communications, and then anything else that's changed within the other sectors, as well, looks like Industrial has got a little bit better once again.

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Yes, Shawn, this is Todd, I'll take a first crack at this and pass it off to Steve. But if we look at the 12% and what's occurring there on a sector-by-sector basis, I will start with Communications. As for Commercial maybe add a little color on the other ones. But Communications is softened a bit during the course of the year from what our earlier expectations were, and we continue to see that. Now we're expecting a couple of quarters of decent sequential growth as we end the year, but when you add that all up, it looks kind of flattish for the year, where originally we thought we're going to see some pretty good growth. Now on the flip-side, Industrial/Commercial has really done the exact opposite. I mean, we thought we'd be -- we'd struggle to grow during the year, we now look like we're going to have a really strong growth year, and we continue to see significant pull-ins from semiconductor capital equipment, but is additional strengthening within the rest of the sector there. So maybe, I'll pass it over to Steve and he can hit on that or the other 2 sectors as well.

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

Yes, I think, Todd hit those too well. I think, they kind of flip-flop from our original expectations and then in terms of Healthcare/Life Sciences, expected strong double-digit growth that we expect to see continue in the back half of '18 and into '19. In Aerospace and Defense, a very similar story, strong double-digit growth we expect to continue into '18 and so (inaudible) to the end of '18.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

If I may follow-up on kind of the semi-cap and then the comp, so. Is it -- do you think the market is weakening further within communications for your customer products or is it more of a slower ramp? And then in Industrial, obviously there's been a lot of noise with some of the earnings releases around maybe a weakening in orders for the semi-cap cycle, are you seeing kind of any of that within your order book?

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

So this is Steve, I'll probably start with Industrial/Commercial first. With respect to the semiconductor capital equipment market, we had an exceptional couple of -- past couple of quarters here really drop in demand that we were able to deliver. And so we see the forecast, not going down, it's really maybe those spikes that we saw in the last couple of quarters. The question is, are we going to see those as we finish out '18. And so our forecast as we finish '18 is staying relatively stable. Just a question in our head is, is there upside, is really the unknown for us. We see semiconductor capital equipment looking good through '18. I mean, there is conversations about it continuing into '19. So for us, we're reasonably comfortable with where semiconductor is going to be at least as we go into '19. As we take a look at the Communications space, the ramps are a little bit slower than what we would have anticipated. But they're still healthy and strong. Obviously, we've had little bit of headwind last quarter with the customer disengagement. So that put a little bit of hole that we had to fill. As we look towards the back half of the year, we expect those ramps to continue and continuous sequential growth. But overcoming kind of the headwinds that we had to fill back in, we're looking more of flattish to kind of range for the Communications sector for the fiscal -- entire fiscal '18.

Operator

The next question in the queue comes from Sherri Stern with TB.

Sherri Ann Scribner - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

It's Sherri Scribner from DB, Deutsche Bank. I guess, just looking at the strong wins, especially in the Industrial segment, I know, we've had some strengths in the semi-cap equipment business over the past couple of quarters. But you mentioned a number of new deals and I think you mentioned the mechatronics deal. Can you give us some more information about what's driving those new wins in what areas where you guys are winning new business so we can think about how that translates into revenue growth as we move into fiscal '19?

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

Sure. We're pretty excited about the Industrial/Commercial wins. As we mentioned last quarter and in this quarter, most of these wins are coming from customers outside of the semiconductor capital equipment space. A little bit of color on couple of them. One is a meaningful test and measurement device on a higher level assembly that is going to be transitioning into our APAC region. We have some automated retail as well as, I'd call it automated manufacturing products that are coming into our Appleton facility. So for us, it's a nice expansion, diversification away from some of the semiconductor capital equipment growth that we had through the beginning half of fiscal '18.

Sherri Ann Scribner - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

And then maybe just if you could provide a little bit of detail on the rationale for expanding in Guadalajara and as it relates to expanding maybe if you could provide some thoughts on what you're thinking about the current discussions about a trade war with China and how that might potentially impact your business?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Yes. It sounds good, Sherri. So this is Todd, I'll take these questions. If we look at Guadalajara and you think back to the last few years as we launched the site, we've ran above our expectations throughout the history of that site, so it ramped quickly, it got to profitability quickly, continues to grow and there continues to be a really strong demand. I think, since its opening, it's always had about right -- either the best or the second best form of any of the sites within Plexus. So as we look ahead, we look where we're at right now. We're running it at maybe a little over 50% capacity right now. But as we project out to the -- a year from now that really looks to be on the order of 70% to 80% capacity, which gets to the -- near the unhealthy level when you're talking about a strong growth area. So I think, we're bringing on additional capacity at about the right time to be able to service our customers and the strong interest there. I'd like to give a big shout out to the team there too. I mean, the reason that it had grown so fast is the execution has been spectacular as they've transitioned in new products within new sector. So that's been great. Speaking more to China and potential for trade wars. I mean, when we look at, I mean obviously there is a list of potential products that could be impacted by tariffs and they -- there are products of our customers that would fall on that list, but I think right now, it's a wait and see type approach on that as to what would really happen and how this will really play out. If we looked at it though from a bigger picture standpoint, I think, if we looked at tariffs in general. First of all, they pass to our customers, but also there could be potential that we move product around. But I think, we're in a better position than most in our space, because we're less dependent on China as a large revenue region. I mean, it's a relatively small concentration of our revenue in China. So I think, we're in a better spot than most people, but it's something that we're certainly keeping a close eye on analyzing and have contingency plans in place.

Operator

The next question comes from Sean Hannan from Needham & Company.

Sean Kilian Flanagan Hannan - *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

So on -- just stepping back in thinking at a higher level in terms of the opportunities we're looking at now for fiscal '19. If I am tracking these wins that you've been aggregating over the last many quarters. I mean, your win rates have been spectacular, they've been very consistently strong. You had a great result here this quarter. It seems that the EMS environment in terms of being able to procure incremental outsource particularly in this non-traditional markets has been very fertile ground. And so as we're lining up here, you've got good growth here, opportunities in fiscal '18. My model and I forget (inaudible) about 7% growth in fiscal '19, now I'm not asking for guidance, but it would seem to suggest at this point in time based on these wins, you folks should be looking much more at a very real opportunity for double-digit growth perhaps again in fiscal '19. So just want to see if I could check on that, and get a gut check in your reaction and any color out of that would be helpful.

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Yes. So sounds good, Sean. I mean the one thing I'll say is that I hesitate to make any predictions or projections that are that far out because of just so many things can change. But if we look at '19 right now, and of course, we're in a planning process as we speak. The first part of the year is looking good for us and that's where we have reasonable visibility. I would say in the first part of fiscal '19 and we talk about the potential to continue sequential growth into that timeframe. So then the question just becomes what happens in the back half of fiscal '19 and I think that's dependent on a few things, I mean, one would be what happens with end markets. Right now, we're seeing end markets strengthen a little bit not in great shapes, but a little bit. And then what happens with respect to wins that occur over the course of the next couple of quarters and how quickly they ramp. So I think, if we look at where we're at from our own internal view, it looks similar to where we were at this time last year looking at '18 and we talked about that being kind of high single-digit type growth. Now it turned out better than that or is looking better than that. I shouldn't turn out, we still have half a year to go. It's looking better than that for '18 as we speak. But it remains to be seen whether those same -- we hit the same things like semi cap for instance could swing things in a big way. I doubt it will be stronger than this year, so it could take us down a little bit from a comparative standpoint as we look at '19 . But a couple of things that we're excited about in '19 is, one is, we believe we're in a good position to continue the strong operating margin performance as 4.7% to 5%. That is looking good for us right now. As we look at our current view of the world. And the other one is the impact of the capital allocation strategy that we have. We think those, when you couple of those 3 things together with could be moderate to decent growth along with good operating performance and the better capital structure, we think, we could see some pretty healthy EPS leverage.

Sean Kilian Flanagan Hannan - *Needham & Company, LLC, Research Division - Senior Analyst of Smart Grid, Electronic Mfg Svcs, IT Components & Electronic Components*

The next question I have here is kind of 2 parts. So as I look at the efforts for the new facility and congratulations in terms of being able to get to more of a leasing scenario there. Just trying to understand what if any kind of incremental capital will be required to support that, given that's not all kind of your effort to put up. And then, also as part that when you do get the opportunity to open that, which it looks like it would be about a year beyond. What would your expectation be of where the existing [Guad] facility is for their overall, the percent in terms of utilization [as told] and how does that balance and offset then with the new facility. I realize some that might be a little speculative but just any insight would be helpful, because I think ultimately, we're going to have some -- could have some impacts in that short-term as that transition happens around margins, so just trying to understand your thoughts on it.

Patrick John Jermain - *Plexus Corp. - Senior VP & CFO*

Shawn, this is Pat. I'll start with your first part, and then Steve can address your second question. With regard to the CapEx, with it starting this year, we'll see some capitalization in the back half of this year, most of it will occur in the first and second quarter of fiscal '19. In total, the leasehold improvements will be about $20 million. So that's what we've got in our forecast for fiscal '19. And then, I'll let Steve talk about the capacity and ramp.

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

Sure. As Todd talked about, as you look to the back half of '19, we see the existing facility being about 80% utilized and our strategy is really a [campus] approach. So this facility is very close to the existing facility. That allows us to do a couple of things. One is, we would target each of the facilities for a different sector or a different subset of sectors, and that allows us basically to share revenue and quite frankly, it kind of [exceed] both facilities to make sure that they're healthy from a starting point. We do have expectations for the existing team that with the growth that they're going to see, we're going to get some better leverage, which will help fund some of the investments that we're going to look to in the back half of '19. Along those lines, by having more of a campus environment we have been able to share some of the higher level resources that are required for running both the facilities. So our strategy is to leverage some of the growth that we're going to get in the next year here with the growth to fund some of the investments as we look to '19, and then split revenue across the facilities, and allow both of them to grow. I think, it's a pretty decent strategy to ensure success down there going forward.

Operator

And the next question in the queue comes from Matt Sheerin with Stifel.

Matthew John Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

Just a couple of questions. One on the working capital and the inventory build, which certainly you're not the only company that's seeing a tight supply environment. But are you actually seeing any issues related to being unable to ship products for customers because of component shortages and talking to your suppliers and your procurement teams. How long do you think this environment is going to last so that you're going to see elevated inventory and working capital levels?

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

Sure, this is Steve. I'll take this one. I think our supply chain team has done a phenomenal job of seeing this coming in, and the supply chain solutions that we have in place have, from my view, assured a continuity supply with customer demand and so we've not had a problem meeting kind of our commitments to our customers as it relates to the supply. With that said, customers that are dropping in orders and maybe haven't been used to a constrained market in the past that we've been able to respond to very quickly. We're challenged a little bit at times to basically meet some of their upside demand. And so that's why talking with them and looking at the inventory positions and situations that we're at, we've been adding a little extra inventory. And I will give you an example, so if we have a customer that has upside on 2 products and it shares a common part that's a little bit challenged, and if we don't see line of sight to that entire need for that part, will chase inventory for both products with the expectation and in the attempt that we're going to able to basically deliver both, but we may not be able to. And so that's driving some high level of customer satisfaction, feedback from our customers, we're doing better than some in the industry. So pretty, pretty happy about that. In terms of how long it's going to last? We definitely see those lasting into fiscal '19, it depends on the components. There's really several that we're watching, resistors and capacitors, logic and discretes as well as memories and it varies a little bit with each of those. But definitely in some of the areas like the capacitors, we definitely see that continuing into '19 for sure.

Matthew John Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

And then, just on the semi cap strength that you've seen. Could you give us an idea of the rough percentage of revenue contribution in the Industrial/Commercial sector from semi cap, and has the growth rate within that segment been in line with the overall segment?

Patrick John Jermain - *Plexus Corp. - Senior VP & CFO*

Yes, sure. The Industrial/Commercial sector is about 14% of overall Plexus revenue, and just looking to grab the data here, here we go, it's about 45% of the -- for [F18], it's about 14% of Plexus revenue, and about 45% of the sector revenue. And from a growth rate standpoint, it's growing very rapidly. Much more than the Industrial/Commercial sector as a whole. I can get you that number quickly too.

Matthew John Sheerin - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

And is that, have you seen an expansion of customers there as well?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Yes, expansion of customers, a lot of new program wins. So I mean overall, we're up in call it the 40% to 50% range year-over-year in semi cap. I means, that's a combination of end markets and new programs.

Operator

The next question

(technical difficulty)

Jim.

Jim Suva - *Citigroup Inc, Research Division - Director*

If I heard it correctly, did you say CapEx this year of $80 million to $90 million. And then, am I correct it would dramatically decline the following year just given this year is the build-out of Mexico?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

No, Jim. Some of that build-out of Mexico is going to fall in this fiscal '19. So we will see a reduction, I expect a reduction in CapEx next year, we're going to that plan right now because we had the additional building over Malaysia this year, but with Guadalajara, mainly in next year. It's not going to go down to the historic levels, it's been the last 3 years. So you can expect some reduction, but not to the tune of where we were maybe in fiscal '17 or '16.

Jim Suva - *Citigroup Inc, Research Division - Director*

Okay, that make sense. And then what about impact on margins as that facility comes online. Will there be a suppression of operating margins, as that facility ramps up?

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

Our expectation, I mean there is going to be a little bit of a burden on it. But again, our expectation is really working with the teams to leverage out of the existing facility as it's ramping and growing to offset some or all of that. So there's definitely some more hitting, a cost hitting there, but again we're trying to offset it with improvements in other areas.

Patrick John Jermain - *Plexus Corp. - Senior VP & CFO*

One of the things that add is we're always making investments in new sites or new capabilities or new customers. So our expectations are well the new site in Guadalajara certainly wouldn't be at corporate level expectations that we don't recommend elsewhere, and our expectation is to meet the 4.7% to 5% that we talk about.

Operator

The next question in the queue comes from Paul Coster with JPMorgan.

Paul Coster - *JP Morgan Chase & Co, Research Division - Senior Analyst, Alternative Energy, and Applied and Emerging Technologies*

Thanks for taking the question, I am not sure there is many left to ask. But perhaps, you can just give us some comments on the factoring. It sounds like its sort off again, on again. What's the strategy there?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Paul, I will take that. It is definitely on. We've got the program in place, and this past quarter was a little lower than the prior quarters because in China, there was some difficulty with our bank, getting liquidity to their currency, the CNY to be able to sell those receivables. So that was something we had forecasted, executing this quarter, but did not happen. Now we are expecting to return to a similar level to the fiscal first quarter, as we go into the third quarter. So it should be at a similar level to that, and we continue to execute on the plan.

Paul Coster - *JP Morgan Chase & Co, Research Division - Senior Analyst, Alternative Energy, and Applied and Emerging Technologies*

Okay. And 1 quick follow-up, it was really sort of expression of my ignorance, but the engineering sector seems to be getting good backlog as well. What is the synergy if there is any between the engineering business and the manufacturing business?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Yes. So it's quite good. I mean, when we look at our engineering programs, our engineering revenue up in the high 90s of that business transitions into our manufacturing. Now if we look at it from a per customer standpoint or on a customer-by-customer basis, somewhere in the order of 35% to 45% of our customers are engaged with our engineering at any given point in time as well too. So a pretty good synergy. I mean, the thing, I will add to just on the success there. We ran over the last 5 years a double-digit CAGR in engineering and getting similar results again in '18. So really seeing good results from the team there as well as from our business development go-to-market people and convincing our customers of the value of that service.

Operator

The next question in the queue comes from Mitch Steves from RBC.

Mitchell Toshiro Steves - *RBC Capital Markets, LLC, Research Division - Analyst*

Sort of quick follow-up on the Communications piece. So am I hearing this correctly that essentially something changed, where you are going to expect a Q-over-Q bigger increase this quarter but a slowdown in Q4 and if that is correct. I guess, what exactly is happening from a product perspective that's causing that to occur?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

[I think] I spoke when I said that [Eric], but we're expecting sequential growth both this quarter and next quarter right now. So it's program ramps that are continuing and we talked about a number of them that are going on. So we would expect some reasonable sequential growth in each of the next 2 quarters.

Mitchell Toshiro Steves - *RBC Capital Markets, LLC, Research Division - Analyst*

And is that essentially signaling seasonality or you mean, or I guess is there any difference between of this quarter [but rest] of the quarters will look. And what you have seen over the past like [5 or 6 years] or so?

Steven J. Frisch - *Plexus Corp. - Executive VP & COO*

No, we're not expecting a difference. I think along Todd's line is the sequential quarter-over-quarter growth from new program ramps is on track with what we believe is going to happen.

Mitchell Toshiro Steves - *RBC Capital Markets, LLC, Research Division - Analyst*

And then the last one is just, what's kind of the rough revenue [where you do guys taken in] to get -- to get to 5% operating margins at this point?

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

I don't know that we necessarily think about it from a revenue standpoint, I mean certainly if we -- if things would pop in the next quarter or 2. I mean, obviously, we can do that because we get a lot more leverage. But we usually think of it in terms of transitioning in new programs and kind of keeping it at the 4.7% to 5% level.

Operator

(Operator Instructions) Next question in the queue comes from Shawn Harrison with Longbow Research.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

Few brief follow-ups. The other expense number included in the third quarter guidance, is that a combination of the other expense, interest expense or is there something else and why it's taking up sequentially?

Patrick John Jermain - *Plexus Corp. - Senior VP & CFO*

Yes, Shawn, this is Pat. I'm glad you mentioned that because this is something we haven't guided in the past and I thought it was important to guide this quarter because in looking at the analyst estimates. I think, they were a little lower than where we've got our guide at. And to answer your question, it is a combination of interest income, interest expense and foreign exchange gains and losses. And we are seeing that pick up a bit in the third quarter. With the last several quarters, we've had foreign exchange gains that we've recognized and that's obviously something we don't guide to continue, but that has helped the numbers in the prior quarter. We do see factoring expense going up and that is something that's also recorded below the line, but we are seeing improvement with interest expense as we pay down our revolver this past quarter, interest expense is coming down, but it's important to remember that bringing that cash from offshore, it was earning interest income offshore and at rates that were higher than we can get in the U.S. So all-in-all, we do see other expense going up and it was important to get that guide out to the street for their models.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

And then the benefit, whatever it may be from the new debt placement to replace $175 million outstanding that would be a September quarter benefit?

Patrick John Jermain - *Plexus Corp. - Senior VP & CFO*

It would be. Yes, it will go into effect mid-June. So mainly a fourth quarter event that will benefit us.

Shawn Matthew Harrison - *Longbow Research LLC - Senior Research Analyst*

And then lastly, I think, there is, I don't know, maybe $75 million or so left on the authorization. The expectation is you would complete that by the end of the fiscal year before you enter into the new $200 million authorization?

Patrick John Jermain - *Plexus Corp. - Senior VP & CFO*

That's correct. It really depends on market conditions. But I would expect us to go through that authorization sometime in the fiscal fourth quarter, maybe early in the fiscal fourth quarter and then start right into the $200 million authorization. So from a weighted average shares outstanding, I guided 34 million shares for the weighted average for the fiscal third quarter. So that's assuming about 400,000 share reduction this quarter, but keep in mind that's the weighted average number. So I do expect the purchasing in the third quarter to be higher than the fiscal second quarter, because our fiscal second quarter the acceleration started primarily in the month of March. And so now we'll have a full quarter of that.

Operator

There are no final questions in the queue, sir. And I will turn the call over to Mr. Todd Kelsey for any final remarks.

Todd P. Kelsey - *Plexus Corp. - President, CEO & Director*

Okay. Thank you, Michelle. So I'll be brief in closing. But I would like to thank first of all, our 16,000 Plexus employees globally. And we really appreciate your efforts in servicing our customers and going the extra mile, and that's making a difference. I also want to thank everybody who joined us on our call today. We appreciate your support and your interest in Plexus.

Operator

Ladies and gentlemen, this concludes today's teleconference. Thank you for participating. You may now disconnect.
