PLEXUS CORP
Form 10-Q
February 08, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended January 2, 2016
OR

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number 001-14423

PLEXUS CORP.
(Exact name of registrant as specified in charter)

Wisconsin	39-1344447
(State of Incorporation)	(IRS Employer Identification No.)

One Plexus Way
Neenah, Wisconsin 54957
(Address of principal executive offices)(Zip Code)
Telephone Number (920) 969-6000
(Registrant's telephone number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of February 4, 2016, there were 33,374,556 shares of Common Stock of the Company outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
PLEXUS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands, except per share data)
Unaudited

	Three Months Ended	
	January 2, 2016	January 3, 2015
Net sales	$616,664	$664,690
Cost of sales	566,605	603,276
Gross profit	50,059	61,414
Selling and administrative expenses	27,028	30,940
Restructuring charges	1,507	1,691
Operating income	21,524	28,783
Other income (expense):		
Interest expense	(3,534)	(3,777)
Interest income	932	897
Miscellaneous	(1,620)	138
Income before income taxes	17,302	26,041
Income tax expense	2,854	2,962
Net income	$14,448	$23,079
Earnings per share:		
Basic	$0.43	$0.69
Diluted	$0.42	$0.67
Weighted average shares outstanding:		
Basic	33,396	33,602
Diluted	34,062	34,439
Comprehensive income:		
Net income	$14,448	$23,079
Other comprehensive income (loss) — net of income tax:		
Derivative instrument fair value adjustments	5,744	(4,644)
Foreign currency translation adjustments	(6,606)	(5,361)
Other comprehensive loss	(862)	(10,005)
Total comprehensive income	$13,586	$13,074

The accompanying notes are an integral part of these condensed consolidated financial statements.

PLEXUS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)
Unaudited

	January 2, 2016	October 3, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$354,728	$357,106
Accounts receivable, net of allowances of $969 and $879, respectively	360,220	384,680
Inventories	549,501	569,371
Deferred income taxes	10,662	10,686
Prepaid expenses and other	23,130	22,882
Total current assets	1,298,241	1,344,725
Property, plant and equipment, net	313,656	317,351
Deferred income taxes	3,584	3,635
Other	36,559	36,677
Total non-current assets	353,799	357,663
Total assets	$1,652,040	$1,702,388
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	$2,864	$3,513
Accounts payable	368,030	400,710
Customer deposits	71,863	81,359
Accrued salaries and wages	35,715	49,270
Other accrued liabilities	40,030	44,446
Total current liabilities	518,502	579,298
Long-term debt, capital lease obligations and other financing, net of current portion	259,289	259,257
Deferred income taxes	9,664	9,664
Other liabilities	13,791	11,897
Total non-current liabilities	282,744	280,818
Total liabilities	801,246	860,116
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $.01 par value, 5,000 shares authorized, none issued or outstanding	—	—
Common stock, $.01 par value, 200,000 shares authorized, 50,558 and 50,554 shares issued, respectively, and 33,276 and 33,500 shares outstanding, respectively	506	506
Additional paid-in capital	500,888	497,488
Common stock held in treasury, at cost, 17,282 and 17,054 shares, respectively	(518,431)	(509,968)
Retained earnings	875,165	860,717
Accumulated other comprehensive loss	(7,334)	(6,471)
Total shareholders' equity	850,794	842,272
Total liabilities and shareholders' equity	$1,652,040	$1,702,388

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PLEXUS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
Unaudited

	Three Months Ended	
	January 2, 2016	January 3, 2015
Cash flows from operating activities:		
Net income	$14,448	$23,079
Adjustments to reconcile net income to cash flows provided by (used in) operating activities:		
Depreciation	12,029	12,657
Amortization of deferred financing fees	81	76
Loss (gain) on sale of property, plant and equipment	9	(86)
Deferred income tax net expense	—	95
Share-based compensation expense	3,390	3,741
Changes in operating assets and liabilities:		
Accounts receivable	22,290	(56,669)
Inventories	17,292	(16,064)
Other current and noncurrent assets	(345)	(4,722)
Accounts payable	(28,975)	(47,174)
Customer deposits	(9,168)	7,007
Other current and noncurrent liabilities	(9,785)	(12,230)
Cash flows provided by (used in) operating activities	21,266	(90,290)
Cash flows from investing activities:		
Payments for property, plant and equipment	(11,745)	(9,595)
Proceeds from sale of property, plant and equipment	14	101
Cash flows used in investing activities	(11,731)	(9,494)
Cash flows from financing activities:		
Borrowings under credit facility	139,000	152,000
Payments on debt and capital lease obligations	(140,196)	(153,052)
Debt issuance costs	(70)	—
Repurchases of common stock	(8,463)	(7,289)
Proceeds from exercise of stock options	10	2,104
Minimum tax withholding related to vesting of restricted stock	—	(465)
Cash flows used in financing activities	(9,719)	(6,702)
Effect of exchange rate changes on cash and cash equivalents	(2,194)	(420)
Net decrease in cash and cash equivalents	(2,378)	(106,906)
Cash and cash equivalents:		
Beginning of period	357,106	346,591
End of period	$354,728	$239,685

The accompanying notes are an integral part of these condensed consolidated financial statements.

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PLEXUS CORP. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED JANUARY 2, 2016 AND JANUARY 3, 2015
Unaudited

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying Condensed Consolidated Financial Statements included herein have been prepared by Plexus Corp. and its subsidiaries (together “Plexus” or the “Company”) without audit and pursuant to the rules and regulations of the United States (“U.S.”) Securities and Exchange Commission (“SEC”). In the opinion of the Company, the accompanying Condensed Consolidated Financial Statements reflect all adjustments, which include normal recurring adjustments necessary for the fair statement of the consolidated financial position of the Company as of January 2, 2016 and October 3, 2015, and the results of operations for the three months ended January 2, 2016 and January 3, 2015, and the cash flows for the same three month periods.

Certain prior period amounts have been reclassified to conform to the current period presentation.

The Company’s fiscal year ends on the Saturday closest to September 30. The Company also uses a “4-4-5” weekly accounting system for the interim periods in each quarter. Each quarter, therefore, ends on a Saturday at the end of the 4-4-5 period. Periodically, an additional week must be added to the fiscal year to re-align with the Saturday closest to September 30. The first quarter of fiscal 2015 included 14 weeks, all other fiscal quarters presented included 13 weeks.

Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted pursuant to the SEC’s rules and regulations dealing with interim financial statements. However, the Company believes that the disclosures made in the Condensed Consolidated Financial Statements included herein are adequate to make the information presented not misleading. It is suggested that these Condensed Consolidated Financial Statements be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Company’s 2015 Annual Report on Form 10-K.

The Company’s reportable segments consist of the “Americas” (“AMER”), “Asia-Pacific” (“APAC”) and “Europe, Middle Eas and Africa” (“EMEA”) segments. Refer to Note 9, "Reportable Segments," for further details on reportable segments.

Cash and Cash Equivalents

Cash and cash equivalents include short-term, highly liquid investments and are classified as Level 1 in the fair value hierarchy described below.

Fair Value of Financial Instruments

The Company holds financial instruments consisting of cash and cash equivalents, accounts receivable, certain deferred compensation assets held under trust arrangements, accounts payable, debt, derivatives, and capital lease obligations. The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and capital lease obligations as reported in the Condensed Consolidated Financial Statements approximate fair value. Derivatives and certain deferred compensation assets held under trust arrangements are recorded at fair value. Accounts receivable are reflected at net realizable value based on anticipated losses due to potentially uncollectible balances. Anticipated losses are based on management’s analysis of historical losses and changes in customers’ credit status. The fair value of the Company’s long-term debt was $249.3 million and $250.2 million as of January 2, 2016 and October 3, 2015, respectively. The carrying value of the Company’s long-term debt was $250.0 million as of both January 2, 2016 and October 3, 2015. The Company uses quoted market prices when available or discounted cash flows to calculate the fair value of its debt. If measured at fair value in the financial statements, long-term debt (including the current portion) would be classified as Level 2 in the fair value hierarchy described below. Refer to Note 4, "Derivatives and Fair Value Measurements," for further details on derivatives.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (or exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The accounting guidance establishes a fair value hierarchy based on three levels of inputs that may be used to measure fair value. The input levels are:

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Level 1: Quoted (observable) market prices in active markets for identical assets or liabilities.
Level 2: Inputs other than Level 1 that are observable, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.
Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability.

2. Inventories

Inventories as of January 2, 2016 and October 3, 2015 consisted of (in thousands):

	January 2, 2016	October 3, 2015
Raw materials	$393,733	$407,637
Work-in-process	69,443	84,472
Finished goods	86,325	77,262
Total inventories	$549,501	$569,371

Customer deposits are received by the Company to offset obsolete and excess inventory risks. The total amount of customer deposits related to inventory and included within current liabilities on the accompanying Condensed Consolidated Balance Sheets as of January 2, 2016 and October 3, 2015 was $60.0 million and $64.3 million, respectively.

3. Debt, Capital Lease Obligations and Other Financing

Debt, capital lease obligations and other financing amounts outstanding at January 2, 2016 and October 3, 2015 are summarized below (in thousands):

	January 2, 2016	October 3, 2015
Borrowings under the credit facility	$75,000	$75,000
5.20% Senior Notes, due June 15, 2018	175,000	175,000
Capital lease obligations	3,897	4,560
Non-cash financing of leased facility	8,256	8,210
Total obligations	262,153	262,770
Less: current portion	(2,864)	(3,513)
Long-term debt and capital lease obligations, net of current portion	$259,289	$259,257

The Company has a five-year senior unsecured revolving credit facility (the “Credit Facility”), which expires on May 15, 2019. In October 2015, $30.0 million of an accordion feature thereunder was exercised, increasing the maximum commitment under the Credit Facility to $265.0 million. The Credit Facility may potentially be further increased to $335.0 million, generally by mutual agreement of the Company and the lenders, subject to certain customary conditions. During the three months ended January 2, 2016, the highest daily borrowing was $204.0 million, the average daily borrowing was $173.5 million, and the Company borrowed and repaid $139.0 million of revolving borrowings under the Credit Facility.

The financial covenants (as defined under the related Credit Agreement) require that the Company maintain, as of each fiscal quarter end, a maximum total leverage ratio and a minimum interest coverage ratio. As of January 2, 2016, the Company was in compliance with all financial covenants of the Credit Agreement. Borrowings under the Credit Facility, at the Company's option, bear interest at a defined base rate or the LIBOR rate plus, in each case, an applicable margin based upon the Company's leverage ratio as defined in the Credit Agreement. Rates would increase upon negative changes in specified Company financial metrics and would decrease to no less than LIBOR plus 1.00% or base rate plus 0.00% upon reduction in the current total leverage ratio. As of January 2, 2016, the borrowing rate under the Credit Agreement was LIBOR plus 1.125% (or 1.394%). As of January 2, 2016, the $75.0 million of outstanding debt under the Credit Facility is effectively at a fixed interest rate as a result of a $75.0 million interest rate swap contract discussed in Note 4, "Derivatives and Fair Value Measurements." The Company is required to pay an annual commitment fee based on the unused revolver credit commitment based on the Company's leverage ratio; the fee was 0.175% as of January 2, 2016.

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The Company also has outstanding 5.20% Senior Notes, due on June 15, 2018 (the “Notes”). As of January 2, 2016 and October 3, 2015, $175.0 million was outstanding, and the Company was in compliance with all financial covenants relating to the Notes, which are generally consistent with those in the Credit Agreement discussed above.
In fiscal 2014, the Company capitalized certain leased property, plant and equipment related to a footprint expansion in Guadalajara, Mexico for which the Company had direct involvement in construction. The Company continued to have ongoing involvement subsequent to the completion of construction, which resulted in a non-cash financing transaction.

4. Derivatives and Fair Value Measurements

All derivatives are recognized in the accompanying Condensed Consolidated Balance Sheets at their estimated fair value. The Company uses derivatives to manage the variability of foreign currency obligations and interest rates. The Company has cash flow hedges related to variable rate debt and forecasted foreign currency obligations, in addition to non-designated hedges to manage foreign currency exposures associated with certain foreign currency denominated assets and liabilities. The Company does not enter into derivatives for speculative purposes.

ASC Topic 815-10, “Derivatives and Hedging,” requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the statement of financial position. In accordance with ASC Topic 815-10, the Company designates some foreign currency exchange contracts and float-to-fixed interest rate derivative contracts as cash flow hedges of forecasted foreign currency expenses and of variable rate interest payments, respectively.

Changes in the fair value of the derivatives that qualify as cash flow hedges are recorded in “Accumulated other comprehensive loss” in the accompanying Condensed Consolidated Balance Sheets until earnings are affected by the variability of the cash flows. In the next twelve months, the Company estimates that $4.0 million of unrealized losses, net of tax, related to foreign exchange contracts will be reclassified from other comprehensive loss into earnings. Changes in the fair value of the non-designated derivatives related to recognized foreign currency denominated assets and liabilities are recorded in "Other income (expense)" in the accompanying Condensed Consolidated Statements of Comprehensive Income.

The Company enters into forward currency exchange contracts for its Malaysian operations on a rolling basis. The Company had cash flow hedges outstanding with a notional value of $67.4 million as of January 2, 2016 and a notional value of $67.0 million as of October 3, 2015. These forward currency contracts fix the exchange rates for the settlement of future foreign currency obligations that have yet to be realized. The total fair value of the cash flow hedges was a $4.0 million liability as of January 2, 2016, and a $9.4 million liability as of October 3, 2015.

The Company had additional forward currency exchange contracts outstanding with a notional value of $50.9 million as of January 2, 2016, and there were no such contracts outstanding as of October 3, 2015. The Company has not designated these derivative instruments as hedging instruments. In accordance with ASC Topic 815-10, the net settlement amount (fair value) related to these contracts is recorded on the Condensed Consolidated Balance Sheets as either a current or long-term asset or liability, depending on the term, and as an element of "Other income (expense)." The total fair value of these derivatives was a net $0.1 million asset as of January 2, 2016.

In 2013, the Company entered into a $75.0 million notional amount interest rate swap contract which expires on May 5, 2017, related to $75.0 million of borrowings outstanding under the Company's Credit Facility. This interest rate swap pays the Company variable interest at the one month LIBOR rate, and the Company pays the counterparty a fixed interest rate. The fixed interest rate for the contract is 0.875%. Based on the terms of the interest rate swap contract and the underlying borrowings outstanding under the Credit Facility, the interest rate contract was determined to be effective, and thus qualifies as a cash flow hedge. As such, any changes in the fair value of the interest rate swap are recorded in "Accumulated other comprehensive loss" on the accompanying Condensed Consolidated Balance Sheets until earnings are affected by the variability of cash flows. The total fair value of the interest rate swap contract as of January 2, 2016 and October 3, 2015, was a $0.1 million and $0.5 million liability, respectively. The notional amount of the Company’s interest rate swap was $75.0 million as of January 2, 2016 and October 3, 2015.

The tables below present information regarding the fair values of derivative instruments (as defined in Note 1, "Basis of Presentation and Accounting Policies,") and the effects of derivative instruments on the Company’s Condensed Consolidated Financial Statements:

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Fair Values of Derivative Instruments
In thousands of dollars

	Asset Derivatives			Liability Derivatives		
		January 2, 2016	October 3, 2015		January 2, 2016	October 3, 2015
Derivatives designated as hedging instruments	Balance Sheet Classification	Fair Value	Fair Value	Balance Sheet Classification	Fair Value	Fair Value
Interest rate swaps	Prepaid expenses and other	$—	$—	Current liabilities – other	$113	$497
Forward contracts	Prepaid expenses and other	$—	$—	Current liabilities – other	$3,967	$9,408

Fair Values of Derivative Instruments
In thousands of dollars

	Asset Derivatives			Liability Derivatives		
		January 2, 2016	October 3, 2015		January 2, 2016	October 3, 2015
Derivatives not designated as hedging instruments	Balance Sheet Classification	Fair Value	Fair Value	Balance Sheet Classification	Fair Value	Fair Value
Forward contracts	Prepaid expenses and other	$66	$—	Current liabilities – other	$29	$—

Derivative Impact on Accumulated Other Comprehensive Loss
for the Three Months Ended
In thousands of dollars

	Amount of Gain (Loss) Recognized in Other Comprehensive Income ("OCI") on Derivatives (Effective Portion)	
Derivatives in Cash Flow Hedging Relationships	January 2, 2016	January 3, 2015
Interest rate swaps	$	