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PRESENTATION

Operator

Greetings, and welcome to the Jabil Third Quarter Fiscal Year 2019 Conference Call. (Operator Instructions) Please note, this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Adam Berry, Vice President, Investor Relations. Thank you, sir. You may begin.

Adam Berry - *Jabil Inc. - VP of IR*

Good afternoon, and welcome to Jabil's Third Quarter of Fiscal 2019 Earnings Call. Joining me on today's call are Chief Executive Officer, Mark Mondello; and Chief Financial Officer, Mike Dastoor.

Please note that today's call is being webcast live, and during our prepared remarks, we will be referencing slides. To follow along with the discussion and view the slides, you will need to be logged into our webcast on jabil.com. At the end of today's call, both the presentation and a replay of the call will be available on Jabil's Investor Relations website.

Please note that during today's conference call, we will be making forward-looking statements, including, among other things, those regarding our outlook for business and our expected fourth quarter and fiscal '19 net revenue and earnings. 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, 2018 and other 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.

With that, it's now my pleasure to turn the call over to CEO, Mark Mondello. Mark?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Thanks, Adam. Good afternoon. I appreciate everyone taking time to join our call today. As usual, I'll begin by offering our people a warm thanks for their hard work and continued dedication. I'm proud of the fact that keeping our people safe is a top priority for all of us here at Jabil.

Before I get into our financial results, I'll offer a few thoughts around what we're seeing in terms of trade and tariffs. Today, very few customers are moving existing production out of China. I believe this decision made by those customers is based on 3 factors: one, the deep-rooted, mature supply chain that's foundational to China; two, many of our customers don't see a reasonable payback associated with such a move; and three, a decent percentage of our China revenue is for final consumption in geographies other than the United States. With that said, if the landscape shifts and customers change their mind, Jabil's well positioned to author and implement safe and practical solutions, which best serve the needs of our customers. In fact, I believe Jabil is positioned better than most, especially when considering the commonality of our IT systems embedded throughout our seamless network of factories around the globe.

Now turning to Slide 4. Let's take a look at our third quarter results. The team generated core operating income of $186 million on revenues of $6.1 billion and core earnings per share of $0.57. This was in line with our guidance and 24% higher than last year, Q3 to Q3.

Within our EMS segment, we saw 26% revenue growth year-on-year, which is driven by cloud, point-of-sale, 5G and wireless and our industrial sector. Our DMS segment delivered a core operative margin of 2.6% for the quarter, representing a 130 basis point improvement year-on-year.

When I step back and I look at the first 9 months of the year, I see further demonstration of our financial stability. All in all, another fine quarter. Mike will provide more detail around our quarter and speak to our forward guidance during his prepared remarks.

So moving to Slide 5. You'll find the specific areas that currently have management's attention. These priorities are the foundation from which we serve our customers and our shareholders.

With that, let's take a look at Slide 6 where you'll find the first area of focus, which is market and product diversification. This colorful pie chart represents a wonderful building block of our story. Within the company, we speak frequently about the importance of diversifying our business, but diversification for the sake of diversification has little relevance. What is relevant is knowing that as we become less dependent on any single product or product family, we realize much improved reliability around our cash flows. With this improved reliability comes greater simplification of the business, enhancing our ability to execute. Our results in fiscal '18 and thus far in '19 gives us confidence that our approach is working.

I'll now turn your attention to Slide 7, where a key element of our strategy is the natural growth of our new business wins. Today, our execution has been sound, and our performance is ahead of plan. This gives us a high degree of confidence that this $2.4 billion in new business will have a favorable financial outlook in fiscal year '20 just as we committed at the beginning of the year.

For today's call, I want to provide an update on our collaboration with Johnson & Johnson Medical Device Company (sic) [Johnson & Johnson Medical Devices Companies]. But before I speak to this slide, I'm pleased to welcome our new team members from the cities of Elmira, Brandywine and Monument, the 3 J&J factory locations we transferred over to Jabil during the quarter. These new colleagues now join their peers from Torres and Albuquerque in becoming an integral part of our team. And again, welcome to all.

In terms of the collaboration itself, I'm happy to report that both wave 1 and wave 2 are now complete and completed on time. Wave 3 will be next, and we trust that it'll also be very successful and completed on time.

Our revenue forecast for this business remains in the range of $800 million to $1 billion for fiscal year '20. Thanks to everyone involved, the teamwork between Jabil and J&J has been sensational.

Now turning to Slide 8. If you consider the midpoint of our Q4 guidance provided today, fiscal year '19 remains intact and consistent with the commitments we made at the beginning of the fiscal year. Specifically, revenue looks to be $25.3 billion for the year. Core operating income would expand to $875 million at the midpoint of guidance, up 14% from a year ago. And we're on target to deliver $400 million of adjusted free cash flow, an uplift of 60% when compared to fiscal year '18.

Altogether, fiscal '19 is shaping up to be another nice year. As we move to the fourth quarter, our goals remain unchanged, putting us in good light for next year.

Speaking of fiscal year '20, let's jump to my final slide, Slide 9. When I think about the tremendous progress we've made, I conclude that our business is solid and on firm ground financially, operationally and commercially. Much like last September, we plan to have another investor briefing as we head into fiscal year '20. This briefing will be held on September 24 via webcast. We'll open the session by reporting our fourth quarter and full year results, followed by a review of our priorities and highlighting how they'll positively impact fiscal '20. Add to this a discussion on end markets and observations specific to the macro environment as it presents itself at that time. Mike will conclude the September session by offering a fiscal '20 financial outlook as we prioritize margins and cash flows. Mike will lay out how we plan to increase free cash flow roughly 25% year-on-year, fiscal '19 to '20, expand core operating margins and provide another year of double-digit core EPS growth. Mike will also break down the shape of the year by quarter in terms of expected core EPS contribution. Finally, we'll wrap up the September session by sharing a well-balanced capital return framework for which we remain fully committed.

In closing, I like our strategy. We're clear on our mission and our priorities, and what we're doing is working. Our team is experienced, and the discipline we're showing is reflected our results. I'd like to once again extend my thanks to everyone here at Jabil and all our new employees from J&J and to all of those on the call today.

With that, I'll now turn the call over to Mike.

Michael Dastoor *- Jabil Inc. - Executive VP & CFO*

Thank you, Mark, and good afternoon. I'm very pleased with the performance in both segments during Q3. During the quarter, our teams executed extremely well, delivering solid year-over-year core operating margin expansion on strong double-digit revenue growth. Our solid Q3 results are yet another proof point that our diversification strategy is working.

Net revenue for the third quarter was $6.1 billion, an increase of 13% year-over-year. GAAP operating income was $140.9 million, and our GAAP diluted earnings per share was $0.28. Core operating income came in $11 million better than the midpoint of our guidance during the quarter at $185.8 million, an increase of 24% year-over-year, representing a core operating margin of 3%.

Turning to interest and tax. Net interest expense during the quarter was approximately $58 million, above previous expectations, driven mainly by the timing and scale of our ongoing new business awards. Our core tax rate for the quarter was 30.4%, approximately 300 basis points above expectations, driven by the geographical mix of earnings.

In summary, core operating income came in stronger than expected, offset by higher interest and tax expense, which negatively impacted the quarter by approximately $0.04. Altogether, this resulted in core diluted earnings per share of $0.57, in line with expectations.

Now turning to our third quarter segment results. Revenue for our DMS segment was $2.1 billion, down 6% year-over-year. This was mainly due to continued weakness in mobility demand, offset by strength in our health care and packaging businesses. In Q3, core operating income for the segment nearly doubled on a year-over-year basis to $54.9 million and, as a percentage of sales, improved 130 basis points to 2.6%. These impressive results highlight our improved business mix and once again underscores the tremendous progress we've made in our diversification efforts.

Revenue for our EMS segment increased by 26% year-over-year to $4 billion. We continue to see exceptional growth in EMS associated with our new business wins in 5G/wireless, cloud and automotive. Core margins for the segment declined 50 basis points year-over-year to 3.3% due primarily to continued softness in the semi-cap space and costs associated with our new business awards.

Next, I'd like to outline our updated expectations for revenue in fiscal year '19 by end market. Within DMS, we now expect slightly higher growth within edge devices and accessories. Our expectations for mobility and health care and packaging remain consistent with our outlook in March. Given our updated outlook, we now expect core operating margin for DMS to come in at 3.9%, a 20 basis point improvement from a quarter ago on slightly lower revenue of $9.9 billion.

Turning to EMS. We anticipate stronger revenue in our print, point-of-sale, 5G/wireless and cloud end markets. Within our semi-cap business, we now anticipate the weakness to persist into the second half of calendar year '20. Given our updated outlook, we now expect core operating margins of 3.2% on slightly higher revenues of $15.4 billion.

Turning now to our cash flows and balance sheet. During the quarter, our days in inventory remained elevated mainly due to timing differences and came in below expectations at 64 days, a decline of only 1 day sequentially. I am confident as we move into Q4 and beyond inventory levels will contract below 60 days as growth moderates and the component market continues to normalize.

Cash flows provided by operations were $5 million in Q3, and net capital expenditures totaled $229 million. Core return on invested capital for Q3 was 14.7%, an improvement of 180 basis points over the prior year. We exited the quarter with a total debt-to-core EBITDA level of approximately 1.9x and cash balances of $694 million.

Turning now to our capital return framework. Since the inception of our capital return framework in June of 2016, we have returned approximately $1.4 billion to shareholders, including repurchases and dividends. We remain committed to balanced capital returns and look forward to outlining our capital allocation framework for FY '20 in September.

Turning now to our fourth quarter guidance. DMS segment revenue is expected to increase 4% on a year-over-year basis to $2.5 billion, while the EMS segment revenue is expected to increase 22% on a year-over-year basis to $4.1 billion. We expect total company revenue in the fourth quarter of fiscal 2019 to be in the range of $6.3 billion to $6.9 billion for an increase of approximately 14% at the midpoint of the range.

Core operating income is estimated to be in the range of $215 million to $275 million with core operating margin in the range of 3.4% to 4%. GAAP operating income is expected to be in the range of $169 million to $235 million. Core delivered earnings per share is estimated to be in the range of $0.76 to $0.96. GAAP diluted earnings per share is expected to be in the range of 47% to $0.71. The tax rate on core earnings in the fourth quarter is estimated to be in the range of 27% to 29%.

As we move into the final quarter of FY '19, I am confident in our team's ability to execute and efficiently manage working capital and generate strong cash flows. Working capital improvements will come mainly through the combination of improved inventory levels as growth moderates and the component market continues to normalize. These factors give me confidence in our ability to deliver adjusted free cash flows of $400 million for the year.

In summary, fiscal '19 is shaping up to be a great year, and we hope to build upon this positive momentum in FY '20. Moving forward, I expect growth in both earnings and free cash flow will come through meaningful margin expansion and improved working capital efficiency.

I'll now turn the call back over to Adam to begin Q&A.

Adam Berry - *Jabil Inc. - VP of IR*

Thanks, Mike. Before we begin the Q&A session, I'd like to remind our call participants that per our customer agreements, we will not address any customer- or product-specific questions. We appreciate your cooperation. Operator, we're now ready for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Adam Tindle with Raymond James.

Adam Tyler Tindle - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Okay. I just wanted to start, Mark, it looks like you're on track for the $3 EPS target that you talked about around 3 years ago based on this quarter and guidance. At the end of last fiscal year, you gave a national -- navigational beacon of $4 of EPS and a free cash flow number per share that implied a similar amount.

So the question is, I'm just hoping that maybe you can reflect on the obstacles related to the $3 that looks like you're on track to achieve and how the path to that $4 navigational beacon may be similar or different. It sounds like Mike kind of mentioned, obviously, margin improvement and cash flow improvement for the $4 rise from $3 is more revenue growth. So if you could just touch on those dynamics to start, that would be helpful.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

All right. Well, good multi-question for question 1. I think the best way to think about it, Adam, is as follows. I think all year, back starting in September, we've been talking about $400 million of free cash flow, margins at about 3.5%, core EPS in the neighborhood of $3. If you take the midpoint of our guidance, sum everything together, I think it sums it like $2.97 or $2.98, which I think puts us squarely in the neighborhood of $3. So check the box to that.

What I'm pleased with is at the beginning of the year, we thought operating income would be about $850 million. I think we took that up either in the second quarter call. First or second quarter, December or March call, we took it up to like $865 million. And now if you take the midpoint of our guidance, it's all the way up at $875 million. So one of the things I'm really pleased with is the operational earnings power of the company is stronger than we thought, and I thought we had some pretty aggressive numbers at the beginning of the year.

As I think about where the company is headed in fiscal '20 and '21, maybe a really simplistic way to think about the company financially, our tax rate overall for this year is higher than I'd like. That's just the direct calculation in which both geographies, jurisdictions' incomes generated, I think that will normalize back to a more normalized level as we move forward to '20 and '21.

In addition to that, our interest expense is a little more fluffy, for lack of better word, than we thought it would be. Beginning of the year, we thought interest expense would be in the $210 million, maybe $215 million range. It's probably going to be more like $225 million for the year. That will normalize as well. If I think of one of the ways I look at interest expense for the company is kind of as a percentage of EBITDA, we're probably 150, 200 basis points higher than what I'd call normal. But that is a bit intentional, and what I mean by that is we've taken on what I think is very, very good new business wins that's come very naturally to us. I used the term in the slide this time kind of natural growth. It wasn't forced.

And so what I think of is very short term, it's a bit of trade-off of interest expense on a temporary basis being a little higher than we thought. But it really sets the foundation nicely for fiscal '20 and '21. If I think back to the navigational beacon, I think I shared 2 slides back in September. One was the navigational beacon where I thought we'd get to or on a path to 4% operating margins. And then I showed kind of a fiscal '21 outlay where I thought we'd get to about $3.80 in earnings also with very good margins.

So I think what we'll be able to share with you in September is our plan is a little bit ahead of schedule, and I think we'll be able to share with you that by taking on a little bit more interest expense in '19, it is -- as you start seeing where we're going in '20 and then '21, as I said in my prepared remarks, one is I think you're going to see -- continue to see double-digit growth on the core EPS line. I think free cash flow next year will be in the range of about $500 million. And again, we'll continue to press on margins.

So again, all in all, if I think about what we said we'd do at the beginning of the year, where we're at today, really, really pleased with the earning power on a core upline. And certainly, the journey for us is to get the company to $4 a share in earnings as well as 4% margins.

Adam Tyler Tindle - *Raymond James & Associates, Inc., Research Division - Research Analyst*

Okay. That's helpful. And I'll keep it to one part on a quick follow-up, more near term on EMS revenue guidance for the Q4 quarter. You've had a number of customers experiencing weakness in the old E&I segment. So just maybe hoping that you can talk about the buildup for EMS revenue in Q4 because it looks still fairly healthy. Obviously, year-over-year is benefiting from ramps, but I'm just thinking on a normal seasonal sequential basis, it seems pretty stable versus the customers who are experiencing some weakness. So helping -- just trying to understand where the delta lies in terms of the strength you're seeing.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. I think one thing that's really cool is we are seeing weakness in legacy EMS business. We kind of have our EMS business broken up into 2 sectors, kind of enterprise infrastructure and then our Engineering Solutions Group (sic) [Engineered Solutions Group]. I think we'll confirm that we're seeing some weakness in legacy E&I customers. And yet, if I look at the numbers, and I have to go back and check this out, and I could have this wrong, but I think the midpoint to where we guided you and showed you on the slides where EMS revenue is going to be midpoint of guidance for 4Q. Again, I'd want to go check it, but I think that might be a record quarter in terms of revenue for EMS. And in fact, you roll that in with DMS, I think it might be a record revenue for the company overall midpoint of guidance.

So I think that just speaks to what we're up to, which is we've got deep pockets of weakness. We've been talking about semi-cap on the EMS side. We've been talking about mobility on the DMS side. And then we've got kind of this dither of different pockets of divots and weakness scattered through, as you framed it, some of the legacy customers. And yet revenue for Q4, both on the EMS segment as well as the company, you're going to be at record levels. So again, I think it speaks volumes for what we're up to in terms of the diversification of the business.

Operator

Our next question comes from the line of Steven Fox with Cross Research.

Steven Bryant Fox - *Cross Research LLC - MD*

Two questions, please. First of all, Mark, the outlook for 5G and cloud has increased significantly since the beginning of the year. Can you maybe just provide a little bit more of a detailed walk on why you're having so much success there and what you would attribute it to?

And then secondly, you guys seem to be operating from a different playbook than the rest of the industry. There's a couple of competitors that are seeing their stock price incredibly depress versus just a year ago. And I'm curious as to how that may affect you going forward if it does at all. It seems like the model that's developed over the last 3 years to be a lot different than maybe a lot of the competitors.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Thanks, Steve. So then the 5G/cloud, I think there's a couple of catalysts there. One is if I could start with 5G, there's tons of being -- tons in the media, 5G is pushed into the left. Now it's not. Maybe it is. 5G is coming. I think it's going to be transformational. There's lots being written about tensions between Huawei and the U.S. I can tell you, just in general, our legacy Wireless business is about as planned maybe a little bit stronger. On the 5G side, we're really, really pleased with our partners. I think they're positioned quite well in the overall infrastructure rollout for the U.S. and Europe, and we're fortunate to be right in the middle of that.

So today, we've taken I, think, a reasonably, slightly conservative outlook for our 5G business. But all in all, we feel pretty good on how we're positioned, and we'll see where that goes.

On the cloud side, our team has built good partnerships with the hyperscale folks as well as some of the smaller folks. And our solution is, we've talked about it before, it's an asset-light solution. It's -- I think the main thesis around it is rapid configuration, significant reduction in overall network invested capital for all parties involved. And it seems to have been adopted, embraced and, as we sit today, in relatively good shape.

I think you're correct. Again, I don't have the exact numbers in front of me, but 5G and cloud, I think, at the beginning of the year combined we said would be in the range of $3 billion. And I think today, it's in the range of closer to $4 billion. So that's just illustrative of a lot of hard work, success in terms of generating some new business and then winning some market share from maybe a few other players on the 5G side.

In terms of what we're doing, I appreciate the compliments. I think what we're doing is working. I think it's a combination of our structure, our approach. I think we're on to something here with this diversification strategy. Again, you think about our company, we've got some deep pockets of softness, and yet we're able to take our core operating income and grow it 14%, 15% year-on-year on the operating line. And again, I think it's due to the hard work of the team, but again, I also think it's fundamental to our overall strategy. So at a high level, I'd suggest we've got a lot hard work to do. We've got to keep our nose down and serve our customers. But I think a lot of it has to do with our structure and our solutions. And at least for now, it seems to be working, so we'll take it.

Operator

Our next question comes from the line of Paul Coster with JPMorgan.

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

I've got 2 questions, Mark. First up, the revenue guidance for the fourth quarter. It's quite a wide range. I'm just wondering what assumptions have gone into that. And the second question is notwithstanding your quite reassuring comments on China, I'm just wondering if there's any vulnerabilities or component shortages or other issues that have arisen that you're navigating for yourself or on behalf of your customers.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. Thanks, Paul. On the revenue guidance, we kind of used a standard range, plus or minus 10%, 12%. I think it's been that way for a while. We haven't really changed it much. In the fourth quarter, we got to be careful because in the mobility sector, we're always ramping new products, and things could go bump in the night. We don't anticipate that here. If we wanted to, I guess we could probably narrow the range a bit, but I kind of like the safety of a little bit of a wide range. If you look at our performance in the last 12 quarters or so, we've been pretty close to the center points of the range and haven't been in the outer limits, certainly not on the downside. So there's not a whole lot to that other than kind of consistency for the last 20 quarters or so in the range as we said, especially the fourth quarter again, where we're going through ramps.

In terms of China, if I think back to my prepared remarks, there's just been a lot of questions, and we felt like we'd get out in front of it early on in some commentary. And again, truth be told today, we have lots and lots of scenario planning going on with customers. I feel really good because we've got some of the greatest brands on the planet that really, really trust us to run lead for them on their scenario planning and what-if scenarios. But even with all the scenario planning going on, I just -- we're just not seeing a lot of customers moving existing production. There is some customers where they've made some choices maybe to ramp some of their new products in other geographies. I think that's really healthy. It's really good for us because it continues to help us balance factories and factory loading.

We're not seeing a lot of component shortages and certainly component shortages get any worse than they were 2, 3 quarters ago. If I had to scope that out for you, Paul, I'd say that the components' stress and strain and shortages probably peaked about 2 to 3 quarters ago. We're actually seeing the overall supply chain globally start to normalize. I think we -- if things stay the same, I think the supply chain normalizes fully by the fall time frame of 2019, which might be earlier than we had anticipated.

And I think the other thing for us is all in all, not too many customers are picking up, moving out of China. But I said in my prepared remarks, if that happens, if things were to worsen, Jabil, I think, is one of the best companies on the planet to help these brands largely around the fact that we've got an excellent global footprint. We got about 50 million square feet of manufacturing space. But I think the real interesting thing in all that, Paul, is our factories are all weaved together with a very commonized IT system, and that's really, really beneficial to the customers.

So again, we'd like things to get settled and settled as soon as possible between the U.S. and China. But again, I think we're in relatively good shape either way. I would close out that comment to say if things got really, really bad, either short term or long term, I think it's going to be tough on everybody, us included, but let's hope that, that doesn't occur.

Operator

Our next question comes from the line of Ruplu Bhattacharya with Bank of America.

Ruplu Bhattacharya - *BofA Merrill Lynch, Research Division - VP*

I have one on DMS and one on EMS. The first one on the Diversified Manufacturing Services. I was just wondering if you can just comment on the revenue and margin performance. I mean revenues were better than expected and margins significantly improved. So what drove the outperformance? Any color there would be beneficial. And did you have any revenue shift from 4Q into 3Q?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

That question was solely around DMS, correct?

Ruplu Bhattacharya - *BofA Merrill Lynch, Research Division - VP*

Right. Only on DMS.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Right. Because I heard you say 2, so let me address that and then we can come back to your EMS question, Ruplu. Yes, I'm pretty excited about the results in DMS. So we expanded margins. Q3 is always a little bit of a soft quarter for us. We have product ramps going on in the mobility space. This year is no different. But I've got to tell you, the current team we have in place running that business today is doing an outstanding job on cost management, some factory re-layouts, the ability to maybe to ramp product a little bit more efficiently, more cost-effectively. And then the other part on the DMS space is you take a look at our packaging and health care growth, even if you took it back, say, 3Q of '18 versus 3Q of '19, the growth in health care and packaging has been substantial on a percentage basis. And when you think about the margin structure and the overall business in that area, that certainly was a contributor.

So again, the revenue being up, it was, I think, DMS revenue for the quarter was up a little over $100 million. Not immaterial but not substantial. Not all of that uncommon. But what's really exciting for me is the margins on DMS. We're starting to get a better blend quarter-on-quarter and not so much volatility, and again, I think that's a good statement to our strategy.

Ruplu Bhattacharya - *BofA Merrill Lynch, Research Division - VP*

Yes. That makes sense. Then for my second question, on EMS. I guess you have a lot of new programs that are ramping. I think the slide on fiscal '19 core operating margin suggested 3.2%, which is slightly lower than what you had before. I know you're not giving guidance for fiscal '20, but just conceptually, as these programs ramp, is there any reason to think that EMS margins in fiscal '20 can't be higher than what the 3.2% that you're projecting for fiscal '19? So any puts and takes there would be helpful.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Okay. I'll try to get myself not wrapped up or get myself in trouble or too far ahead of everything. So I think we're going to roll that out with quite a bit of detail in September, but I'd be highly disappointed if our EMS margins aren't higher than 3.2% next year. And I think we'll show you a path that you'll be pleased with in September.

But again, remember, at the beginning of the year, I showed a chart. It was something along the lines of our base business in the company for fiscal '19 would be in the margin range of about 3.7% and then the new business wins. And at the time, Ruplu, we thought across the company the new business that we were taking on would be in the $2 billion range, of which the vast majority of that was in EMS. I think if you look at the numbers today, the new business platforms are going to be bumping up against $2.5 billion, so decent growth there. Very select growth, intentional growth and growth that we've been very selective and kind of letting the leash out on. And we said at the beginning of the year, that business would generate about 1%. I think Mike, either the last call or the December call, had kind of framed out and said, "Look, we're going to have a lot of investment in the front half of the year on a lot of this business growth, and then it's going to start to normalize in the back half of the year."

And again, rough numbers, if you take a look at the EMS margins, Ruplu, I think blended for Q1, Q2, first half of '19 EMS, blended out at about 2.3%, 2.4%. Back half of the year for EMS is going to be blended probably closer to 4%. So again, I think we're on an appropriate trajectory. And again, I think you and your peers will be pleased with what you'll hear in September in terms of our EMS margins for '20.

Operator

Our next question comes from the line of Matt Sheerin with Stifel.

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

Just following up on the questions related to the strong growth you're seeing in EMS and specifically the cloud area. I know there's been some big share gains. You've made some big investments in that space. But I know that there's -- it's lumpy in terms of limited number of very big players, particularly the hyperscale players. How diversified are you within that space in terms of your customer base?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Yes. Matt, so this question came up in kind of a similar format last call. Not going to get into the number of brands we serve. And then it was asked about brands, and then we're asked about hyperscale versus the small folks. We won't get into any of that. We may get into that more in the September call.

The one thing, though, that is pretty cool about that business is we've made lots of investments on a variable basis in terms of engineering and process. But in terms of fixed costs, if I was going to contrast that, say, with our mobility business that is heavily fixed cost weighted, our fixed cost investments, and for that matter, working capital investments on the cloud business, is what, maybe for lack of better word, statement, whatever, it's very, very asset-light. So it's very flexible. We can ebb and flow as volumes go up and down. And we don't have the stress and strain of the load of large fixed assets in that business, which, by the way, is a gem in terms of our solution and the potential variability of that business going forward.

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

So the swing factor there would be really working capital then and then maybe some variable labor costs or assembly-related costs.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

That's right. I would characterize it as that business is -- has a high, high degree of a variable cost infrastructure, which we can ebb and flow quite quickly. So I feel comfortable with our solution being well matched with that marketplace.

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

Okay. Great. And then your commentary on free cash flow improving 25% or so next year. Is that also kind of a function of working capital coming down? I mean you're going to -- you plan to grow your operating profits, but you also talked about the component environment being more favorable and plans to bring down inventory, working capital. Is that how we get there? And also, I guess CapEx.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Matt, I'll take -- I'll catch my breath for a minute and let Mike take that one.

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Matt, so the increase in free cash flow for next year is a combination of the improvement in margin. Obviously, our EBIT goes up, and working capital normalizes. I think I mentioned in the past that inventory is at a higher level than we'd like it to be. Each day of working capital, each day of inventory is about $60 million, so you see improvements coming through on an annualized basis. Just 1 or 2 days, and you're getting there. We're about -- I'd expect a completely normalized inventory run rate to be around 55 days. Right now we're at 64. I think we'll be down to 60 relatively soon in Q4. And going forward, if we take a day or 2 out, the free cash flow number 25% sounds highly achievable.

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

Okay. And just quickly, have you given a CapEx guide for next year yet? I may have missed that.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

No, you didn't miss it. We haven't given it, but we'll be talking about that in September for sure.

Operator

Our next question comes from the line of Steve Milunovich with Wolfe Research.

Steven Mark Milunovich - *Wolfe Research, LLC - MD of Equity Research*

While many of the semiconductor companies had predicted a second half bounce-back this year, you guys had pushed out your semi-cap improvements to 2020. And now you're pushing it out to the second half. So I guess what are you seeing that's causing you to do that? And how much confidence do you have in that?

Mark T. Mondello - *Jabil Inc. - CEO & Director*

I don't know that we have a high degree of confidence in it. We have as much confidence, Steve, as our market intelligence would tell us. We've got great relationships with big brands there. And again, remember, our capital equipment is both front end and back end, so we pay a lot of attention to both. I actually think that we're starting to frame out -- timeframe and periods for recovery is pretty consistent with the overall marketplace. So I think I'd be surprised if people are going to start seeing a big recovery in semi-cap by this fall. I think our take anyway has been that the market -- there was a small probability that we'd see some degree of modest recovery in the fall of '19. That probably won't happen. I think the modest recoveries will start, if anything, very late in calendar '19 and then will start picking momentum up for recovery in early '20 and into the, say, late spring, early summer. The nice thing is I think the snapback on that business isn't going to be a step function. I think it'll be improvement over time. So I would hope to see our semi-cap business start to perform better in our 1Q of '20 and then see the gradual progression from there.

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

Steven, when Mark mentioned EPS growth rates of 10% plus and free cash flow of plus 25% in FY '20, the semi-cap issue has already been considered in there.

Operator

Our next question comes from the line of Mark Delaney with Goldman Sachs.

Mark Trevor Delaney - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

First was on health care. If I recall properly this year, the J&J business was supposed to be about $200 million, and the slides have it for $800 million to $1 billion for next year. I think it's supposed to go from around EBIT breakeven to 2.5% to 3% EBIT margin next year. And I just want to better understand what needs to be done in order to get the margins up to the targeted range and what kind of linearity there may be as that's achieved.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Okay. Thanks, Mark. Yes, I think the one thing I feel very good about is we came out with the announcement of the deal very, very early in the year. And if anything, I was going to say nothing's changed, but actually, there has been change, and it's all been changed to the positive.

There's different ways of transference of capability, leadership, people and insights. Those are all [plan] or ahead of plan. And the difference between this year and next year is so I think you're spot on. I think revenue this year for the overall relationship will be in the $250 million to $300 million range. I think that next year, we'll still be in the $800 million to $1 billion range. I think this year, we'll be close to breakeven, maybe a hair above. But I think it's fair to say, breakeven all around. And then next year, I think your numbers of 2.5% to 3% make sense. And again, I would see that as a natural slope up from there as we move to fiscal '21 and beyond.

And the biggest issue is, again, the complexity and just the overall magnitude of the business in terms of IT systems, bringing the teams over, payroll, administrative types of things. The safety part of it is we've acquired an excellent team. So unlike other transactions where we have to scramble around, add headcount, train inexperienced, we acquired a fabulous group of people.

On my prepared remarks today, I talked about the second wave of 3 sites coming on board. Those teams there, everybody is exceptional as the first 2 factories in Torres and Albuquerque. And then the other thing that's just kind of amazing to me is we felt like we were going to gather really, really good marketable capabilities as part of this deal, and those capabilities and what we plan to do with them are well ahead of expectations. So it's pretty exciting.

Mark Trevor Delaney - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

And my follow-up on the free cash flow guidance for next -- well, for this year but that was implied for next quarter. Mike, I know you talked about taking the inventory days down to 60 or below. I think with the higher revenue, that doesn't drop that much of a change in inventory dollars quarter-to-quarter given the higher volumes that are projected. So maybe just a little bit more detail on what drives the increased working capital from a dollars perspective for next quarter to get to the free cash flow guidance.

Michael Dastoor - *Jabil Inc. - Executive VP & CFO*

It's just a combination of all working capital metrics. If you go back to the last couple of years, Q4 has been an extremely strong quarter from a cash flow perspective. If you take that as a percentage of revenues, Q4 of this year is extremely consistent with those trends. I feel really good. It's a combination of our working capital. It's a combination of the EBITDA that we'll be generating and all of the metrics that make up the free cash flow number.

Operator

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

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

I only have one question, but I just certainly hope the answer is not both. And the question is, you have clearly, honorably and impressively outperformed your peers for revenue growth. So the question is, did that mostly come from your partnership with customers who had seen new product ramps and share gains? Or have there been execution issues like some of your competitors that you've been more agile to take advantage of? Again, congratulations on the great growth, which is clearly stronger than your peers.

Mark T. Mondello - *Jabil Inc. - CEO & Director*

Well, thanks, Jim. I appreciate the compliment. I don't want to comment on our peers. I think we have plenty in front of us to focus on. I do think, Jim, there's a differentiation with our IT systems. I said in my prepared remarks, and I put it in there intentionally, our team is really experienced. And sometimes, with experience, people get a little tired. Our team is experienced and fully wound up, clear on a mission, clear on what our priorities are. I think our structure is outstanding in terms of decisions we're making, speed of decisions.

I would tell you that even with the uplift in operating margins this year going from $850 million to $875 million, again, at 14%, 15% growth in core operating income year-on-year, with the growth we've put on top of the company, one of the things we pride ourselves on is our factories run really, really, really efficiently and really well. I think we've got a little bit of creaking going on with some of our factories because of the growth. I bring that up because the good news is our factories' performance is only going to get better next year because growth won't be as great. And then you add to it the fact that the growth that we've taken on, and again, we've said this over and over and over again, it was really good, selective growth that adds great capabilities to the company. And the growth that we have is growth right in our sweet spot that we can execute on.

So again, I don't have an opinion or maybe I have opinions but not opinions that want to share with our competition. I've got lot of respect for the challenges that they have, but I really like what we're up to and I like our path forward.

Operator

Ladies and gentlemen, we have reached the end of our question-and-answer session, and I would like to turn the call back over to Mr. Adam Berry for any closing remarks.

Adam Berry - *Jabil Inc. - VP of IR*

Thank you for joining us today. This now concludes our event. Thank you.

Operator

This includes today's teleconference. You may now disconnect your lines at this time. Thank you for your participation, and have a wonderful day.