13-Nov-2018

Jabil, Inc. (JBL)

RBC Technology, Internet, Media and Telecommunications Conference

CORPORATE PARTICIPANTS

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

MANAGEMENT DISCUSSION SECTION

Unverified Participant

We're excited to have with us Mike Dastoor, CFO of Jabil Circuit, Jabil Inc. I should say, not Circuit. Mike, thanks for being here. Assuming we got 25-minute, 30-minute fireside chat, the goal of this is to be fairly interactive, so I'm going to spend 10 minutes, 15 minutes for the full set of questions, open up to the room after that. But, Mike, before I actually even get into my questions, maybe you want to spend a few minutes just providing us with a couple of minutes' overview on Jabil. What does Jabil do? What are your targets and aspirations of the revenue, margins, EPS? Just give us a couple of minutes of overview on Jabil then we'll dig in to the questions from there.

Michael Dastoor

Chief Financial Officer, Jabil, Inc.

Jabil has been around for about 52 years. We're really, really brief about this. We are one of the world's largest manufacturing solutions provider. We provide end-to-end solutions to our customers from design, NPI, prototyping, from advanced logistics, manufacturing, configure-to-build, configure-to-order, build-to-order. All of these end-to-end supply chain functions we provide to our customers. Today, we have about 45 million square feet of manufacturing space, we're in about 100 locations in 30 countries worldwide, so a huge global presence. Out of the 30 countries, 29 countries are not in China, so that's a big thing.

We break down our businesses to specific segments, what we call the Diversified Manufacturing Solutions and the Electronic Manufacturing Solutions. The DMS side is mainly health care, packaging, and mobility. While on the Electronics Manufacturing side, we have the traditional customers with enterprise infrastructure, storage, telcom but we're more excited about new segments that are coming up in automotive, in 5G, cloud. So really diversified, balanced portfolio between those two segments is something we've been specifically working on for the last few years.

I think we finished FY 2018 with about $22 billion of revenue, while we gave guidance on the 25th of September for FY 2019 at $24.5 billion. So over the two-year period we've grown by $5.5 billion in terms of revenue, so extremely healthy growth where we sort of – margins, we've been a little bit static in terms of margin because of the ramps associated with some of these big business award wins that we try to show that our last investor briefing.

I think overall, our aim is to get to that 4% margin. We're about 3.5%, 3.6% right now. Getting to 4%, we feel really good about that.

Q

Perfect. That's a really good overview. If you can just break up the two segments as you mentioned, right? Maybe we'll start with the Electronics Manufacturing Services segment, can you just maybe broadly talk about what are some of the big end markets that you enwalled in that space? What are the trends you guys are seeing over there?

And then I think last quarter, within the EMS bucket, you talked about cloud service provider wins. I think you mentioned one on that. Is that a new growth factor that we should start to calculate in that model as we go forward?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Yes, so the Electronics Manufacturing Services side has done really well. So in 2018, I think we grew that by about 11%. The guidance we provided recently shows another 16%, 17% increase on top of that; so some really, really good growth coming off over the last couple of years.

Where is this growth coming from? So it's being driven by some of the slightly higher margin sort of end-markets such as automotive. And again, when I say automotive, it's more electrification of cars. It's not your traditional automotive industry. We've got 5G coming up. That's supposed to be a really, really big thing for the wireless world. We're actively engaged with I think two out of the three main providers of 5G. We've mentioned cloud. Cloud to us is something that could have – potentially have big legs. I think over the next few years that could potentially grow to a substantial amount.

Q

Got it. I'll just stick to the cloud thing for a little bit. The $800 million is the number you guys threw out last quarter, right? $800 million went up. That I assume was just one customer that it was around. Is there [indiscernible] (00:04:56) you're talking about in terms of what are you exactly involved with that customer and is the potential as you say about these having legs, is it goes from one cloud provider or one hyperscaler [ph] or is that (00:05:05) maybe three, four down the road?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Right. So I think you're right with where it's one customer right now. I think we'll probably go in with other customers as well, the hyperscalers for sure. One of the things – cloud service providers have moved away over the last few years. They moved away from OEMs into an ODM type of model [ph] both Taiwanese (00:05:30) and was only done for cost reasons.

What we're seeing today is a shift from the ODM back to sort of a hybrid model. What do I mean by that? What are the factors driving the shift back to a hybrid model? It's supply chain excellence. Supply chain excellence, it's time-to-market, how soon can you deliver that, it's factory has a service or how do you create a factory close to the cloud farms, it's our EMS capability. So, you're talking about BCVA. You're talking about other pieces that we can help them in [indiscernible] (00:06:10) component standpoint. You're talking about DMS capabilities as well where you have metals, mechanicals and a deep engineering sort of capabilities. So, overall, if you look, Jabil plays across that entire supply chain and one of the things we're focusing on is how do we work with the hyperscalers on that and provide a complete solution.

And I think we've said in the past investor briefing that it's $800 million that could potentially grow over the next couple of years. We just want to make sure we take baby steps right now. So, $800 million is a big number to start with.

Q

Absolutely. And then I guess, your EMS margins have been extremely robust as well over the time you've had this double digit, this organic double-digit revenue growth, right? I think last time you were at 4.4% if I'm not mistaken of operating margins. Talk to me how sustainable are these margin levels because they're fairly impressive.

And as you start talking about some of these newer things, 5G, cloud service providers. Is the risk of these could drift lower? So, how sustainable is the operating margin in EMS as you keep ramping new businesses? Could they drift lower?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

That's a 4.4% in Q4. You're right, but that was more of a seasonal numbers. I think 4.4% is not sustainable. I think the guidance we've always provided on the EMS side is 2% to 4%. We feel good that will be in the high 3s, mid to high 3s is highly achievable there. The margins – it was like – I think it was three years ago that our margins were 2%.

Q

Absolutely.

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

We're now groomed to 3.5% and that's with ramps in there. So, the real – if you move the ramps out of that equation, the actual margin is about 3.8%, 3.9%. So, it's at the high-end of our 4% range. I think that is sustainable. We do have seasonal quarters. I think you'll see a little bit of a drop in Q1. That's closer to the 3% and close to the 3.5% average. I think you'll see the Q3, Q4 seasonality come back just as it's done in the last couple of years. So, overall, really happy with how EMS is working out for us.

Q

Perfect. We'll switch gears to the DMS side, Diversified Manufacturing Services. I guess, everyone perhaps – and correct me – just thinks about the business as Apple, one of your largest customer. But I think there is a lot more to this business than just that. So, maybe provide a quick overview, Mike, on what is DMS? What are the big sub-segments within that and what are the growth trends look like for the business in aggregate as you go forward?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

So, DMS is mainly health care, packaging, and consumer mobility. Health care, we're really, really bullish on. I think we just announced in September 25 that we entered into strategic collaboration with Johnson & Johnson, the world's largest medical device company in the world. So, I think that was – that alone would be a game changer for us. It'd be a game changer for the whole medical industry.

Why are we so excited about medical? Medical, the contractual agreements are well into double-digits. So it's not a one-year, two-year contract that we have with other EMS customers; it's long-term. The product life cycle is long. Once the product is made and it's gone through an FDA qualification, it can last for years. You're talking double digits again, so great visibility. It's highly predictable. There isn't that much of a volatility factor. The pieces that we're making for Johnson & Johnson, they're not going to go up and down, swing around wildly. I think it's going to be a sustainable growing business, so J&J, real game changer for us.

I think margins will be north of 5% – in the 5% to 6% range. We feel good about that. Just to clarify, in our FY 2019 guidance, we we've only insured about 150 million of J&J business. Going forward in FY 2020, we expect that to go up closer to $1 billion and by FY 2021, we're talking about $1.3 billion, $1.5 billion; so a substantial annual revenue coming out of J&J at a much higher margin. So I think health care is something we're really bullish on. I think this will open up other companies in this industry as well, so a great, great opportunity.

Packaging is another one albeit from a smaller base. What do we mean by packaging? It's rigid packaging, it's injection molding, it's in-mold labeling; it's barrier content; it's environment friendly materials; it's our radius design center; it's our global footprint. All of these offer a really good value proposition across the packaging solution and I would – if you incorporate electronics now, the feature of packaging is electronics, order replenishment is going to be a big feature going forward.

So overall, packaging and corporate electronics, EMS capabilities and our DMS capabilities with 3D additive manufacturing, again, makes this whole packaging piece exciting. And again, I just want to say that off a smaller base so don't expect big revenues but good growth is what we're trying to go after sale.

So those are the two main buckets that we're really, really bullish on. The mobility contributor is a little bit more volatile. We've diversified within our largest customer. We've diversified outside of our largest customer. So we spent two or three years over the last couple of years at least on a bit of diversification journey and we feel really good about it. I think the diversification is coming through. I think the DMS segment that we provided at that investor briefing showed mechanics at around $2 billion out of $24.5 billion.

So a lot of people focus on that line item. It's less than 10%. There is a lot of other things going on within the largest customer as well, but outside as well. So DMS again, very bullish on – you should see margins going up over time, especially from the health care and packaging contributions.

Q

Got it. Maybe just on the last part on DMS margins, I think last quarter was 2.7%, if I'm not mistaken. I think fiscal 2019, we have it somewhere in the mid 3%, 4% kind of range. What do you think is the delta from there towards just say 5%, 6% that you could potentially do? What are the indicators that you have so far?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Sure. So I think I talked about healthcare, I talked packaging. Those will be major contributors. So today, our healthcare business is in that $2.5 billion, healthcare and packaging. I think we provided $3 billion of guidance for FY 2019. That $2.5 billion just for the J&J collaboration will go to $4 billion, $4.5 billion very quickly. Over the next couple of years, we will double our healthcare contribution so we do think that at the higher margin will contribute – is going to be 7%, probably not in the low 5s is highly doable.

There's been a little bit of a convergence between DMS and EMS. So, a lot of our DMS customers are asking us to perform EMS type of functions for them. A lot of the EMS guys are asking us to do DMS type of functions for them. So, you see the EMS margins going higher and you're seeing the DMS margins coming down a little bit because of this portfolio mix that's taking place, but it's mainly a mix issue, nothing else. It's not that we're giving up margin or anything else.

Q

Got it. So the path to expand margins is really about revenue leverage especially in the right bucket is right. Right?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Correct. It's target. It's deliberate action with going after markets. I think one of the things we talked about again at the Investor Day was we had $2 billion of new business awards. A lot of that is targeted. So we've specifically targeted some of the EMS areas that we're good within automotive, in 5G and cloud and healthcare. Healthcare was a big component of that. It was about $150 million from that $2 billion. But going forward in the next couple of years, you look at health care doubling. The contribution would automatically driver a much, much higher margin.

Q

Got it. And maybe I'll just switch back to the EMS side and the automotive side very specifically. There seems to be a lot of angst I think in the auto central markets right now in terms of what's happened with global auto production in China and so on. When you look at these macro-centric issues, does that impact your business in a negative manner or does it create an opportunity because that perhaps forces all these OEMs to look at different ways to manufacture and different ways to go to market. So how does the slowdown impact Jabil, I guess?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Sure. So today, what are we playing again in the automotive, it's mainly electrification of cars. You're absolutely right. The traditional OEM type of business is zero to maybe negative but that's not where we're playing and we're playing in the electrification of cars. You're looking at all these hybrids. You're looking at all these electric cars coming out. There's a gazillion billion codes end up of computing in them. The components in a Tesla for instance are consumer type of goods as well. So I think overall, that piece is growing even though the rest of the automotive market is going down. It's the electrification. It's the autonomous driving infrastructure. All of that is growing quite well. And that's where we are focused on.

Q

Perfect. We will stop there. If there's any questions from the audience that Mike can help answer. All right. Hopefully, you can keep answering my questions then.

Your largest customer, the concentration you have with it always comes up as a concern, I think for shareholders in terms of, how much you want to value Jabil [indiscernible] (00:17:46) given this issue of concern you have. How do you guys – how do you think about that and maybe, is there a target concentration you would like to have with a customer and how do you reduce the exposure you have today with Apple to whatever you think the target range is?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.
A

We can't talk about specific customers. However, I think our diversification effort that we've embarked over the last two or three years, specifically is working. There is a whole bunch of diversification going on in our DMS segment, where we have a number of new customers in there. We have a number of new products that we're working on now. So overall, I think that diversification piece is working. What we are trying to do is forward-looking, where, hey let's look at healthcare, let's go healthcare by a couple of billion dollars; let's look at packaging and see if we can double the size of packaging. And that's where some of that concentration hopefully reduces back to a normalized level. So it's targeting all other areas; we don't have a percentage in mind, but we definitely like to grow other areas of the business.

Q

Got it. On the last earnings call, you guys had some more detailed projections out for fiscal – up until fiscal 2021, I should say, right? You have a lot of revenue growth that you guys expect at the same time, you expect I think margins to get to 4%, if I'm not mistaken was out of the target.

Walk me through how do we get margin expansion and strong revenue growth happen simultaneously? Because historically, and then not a Jabil comment, but industry comment is you always get either or, but it's trying to get both. So how do you – what's the confidence or what gives you the confidence or what gives you the confidence that we can get, not just a strong growth but also the margin expansion as you go forward?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.
A

So I think you've seen us grow by $3 billion in 2018, $2.5 billion again in 2019. Is it $1 billion or $2 billion in 2021? That sort of growth rate is not sustainable. I don't think we're going to grow at double digits every single year for the next 10 years. At some point in time, that growth will normalize. That's when you'll see a whole bunch of margins coming through as you move away from sort of ramp customers. Ramp is always an issue in our industry. It does hurt margins in the first year or so, depending on how long a ramp really takes.

Q

China, the tariff issues, the trade implication, constant concern, I think, the investors of late. Maybe two parts on that for you. One is just talk about Jabil's manufacturing presence today. Where it is in terms of the extent of involvement there? And then B, is China trade tariff issue's a potential opportunity for the company over time or is it creating more headwinds right now?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

That's a great question. I think today we have about 45 million square feet of manufacturing space. It's in 100 locations in 30 countries. And as I mentioned before, 29 countries of them are not China. So if the tariff situation gets worse, we have room. We're at the forefront of this issue with our customers over the last sort of six weeks to eight weeks has been more customers coming to us with a concern, hey, what happens if the tariffs do come through and we're in a good position. We have a centralized SAP system. We have centralized the ERP system. We have centralized procurement. We can look at rates. We can look at landed cost extremely quickly, so that sort of helps out customers.

Are any of these customers moving yet? No. No one's pulled the trigger to move. I think all these customers are analyzing their supply chain a little bit more. Maybe the new products they put that in outside of China as opposed to in China just to be safe, because if you want to put it in China, then have to move it out in three or four months.

So, there is a little bit of concern going on but there isn't that much of a shift – actual physical shift to manufacturing coming out of China yet. I think tariffs are – I don't think it will be good for anyone but the way we're positioned we have manufacturing space worldwide. Not many companies do that. We're one of the largest providers of manufacturing solutions on a global footprint. So, if you want to move from China, to India, to Penang, to Europe, to Mexico, to the U.S., we have facilities everywhere. It boils down to can the customer absolve the tariff or they have to move out of China; and those are the sort of models we're running for them. And like I said, there isn't anyone pulling the trigger right away. It doesn't mean it won't happen but not right now.

Q

Understood. Component shortages, capacitors, for example, have been sort of a constant concern or theme I think in the last couple of earnings calls. How does that impact? What are you guys think from that perspective? Has that impacted you guys and is the path to some of these bottlenecks get alleviated over the next quarter or so?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Yeah. So, I think shortages at MLCCs and passives for sure are continuing. They haven't been resolved yet. I think we feel it gets resolved in the middle of calendar year 2019. We don't think it's going to be anytime soon. I think you sort of seen it in our results a little bit especially on the balance sheet side, at the cash flow side where we sometimes have to hold a little bit of extra inventory because you haven't got a complete component set yet.

So, I think there is an impact of that. But hopefully, it resolves itself. I think what we're seeing in the semiconductor space where there's declines. Hopefully, that sort of catches up with the rest of the component market and the supply hopefully exceeds demand. And that's what we're waiting for right now.

Q

Right. Got it. You think – go back to the last quarter, the one concern – the one that surprised a lot of people was just how the CapEx guide was for the year, $800 million as the number of you have talked about and the implication that obviously had to your free cash numbers, right? Let's talk about, I mean, I know you talked a lot about growth factors. I get some of these. But where is $800 million of CapEx going towards, maintenance or expansion, if that's the way to break it down. And what is the right lower-term CapEx rate for people to think about?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

I think if you go back to our FY 2016 Analyst Day, we talked about roughly all the 2017 to 2019 period. We talked about $1.8 billion of CapEx at around $600 million a year.

Q

Right.

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

I think with all – that level of CapEx was to support about $20 billion of revenue. We're now at almost $25 billion of revenue and then $1.8 billion has become $2 billion. So, a lot of the CapEx is because of the growth. You're right there that it is mainly for growth. I think if you were sort of looking at a mix between maintenance and new, I think it's roughly $350 million to $400 million would be maintenance, the balance would be for growth. By the way, the Johnson & Johnson, any additional CapEx that we have to incur is already part of that $800 million. So we feel, going forward, is that $800 million go to $1 billion, no. But we're working on taking it down from $800 million to $700 million at some stage once that grew to sort of stabilizes, normalizes and you see all that CapEx just coming back.

Q

Got it. And then just on that road map that you guys had, I think you had it modeled or talked about $600 million, if I'm not mistaken, of free cash flow by 2021, fiscal 2021. Once you get there, when you get there, how do we think about capital allocation between buybacks, dividends, and M&A as well I guess, for your guys?

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Right. So I think if you look over the last few years, our capital return policy has been very balanced. It's been a balanced portfolio between buybacks, dividends, some tuck-in acquisitions. Obviously CapEx has played a part in reducing that free cash flow. I think we did $250 million last year, we're talking about $350 million in FY 2019. We do feel that $600 million is achievable. Now, the $250 million and $350 are in spite of the component shortages, you got to remember that. Hopefully when the component shortages resolved themselves, that free cash flow goes up. Our growth continues.

I think if you look at our operating income, that's gone up quite a bit year-over-year. So I think overall, the pieces are in place for a $600 million free cash flow. I think our balanced approach will continue as well once we get to the success. So for the future, it will be very similar to what we're doing today.

Q

Perfect. We've got about 60 seconds left on the clock there. So, I want to turn it back to you. Mike, if there are any closing comments that you want to address, feel free to do so. And if haven't touched on any investment pieces, investment points with Jabil, make sure you call that out as well.

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

A

Yeah. So I think the whole diversification journey that we've embarked on over the last two years or three years is really working out. You hear a lot of noise about component, you hear a lot of noise about certain customers and we don't seem to be getting impacted. I think over the years if you look at our results, they put themselves out. So that diversification story is coming together. It's no longer a story. It is reality for us. So that's the main point I want to make was the diversification. We're almost there in terms of what we want to achieve from a diversification standpoint.

Unverified Participant

Perfect. Well, that will wrap it up. Thank you very much for your time, Mike.

Michael Dastoor
Chief Financial Officer, Jabil, Inc.

Thank you.