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PRESENTATION

Operator

Greetings, and welcome to the Jabil Fourth Quarter Fiscal 2018 Earnings Call and Investor Briefing. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Adam Berry, Vice President of Investor Relations for Jabil. Please go ahead, sir.

Adam Berry *- Jabil Inc. - Senior Director of IR*

Good morning, and welcome to Jabil's Fourth Quarter and Fiscal 2018 Earnings Call and Investor Briefing. Joining me on today's call are Chief Executive Officer, Mark Mondello; and Chief Financial Officer, Mike Dastoor.

Today's agenda will begin with Mike, who will review our fourth quarter results and our first quarter guidance. Following these comments, we will transition into the investor briefing portion of the day, where both Mark and Mike will review the strategic drivers of our business. We will then open it up for your questions.

The entirety of today's call will be recorded and posted for audio playback on jabil.com in the Investors section. Our fourth quarter press release, slides and corresponding webcast are also available on our website. In these materials, you will find the earnings information that we will cover during this conference call.

Please note that during the investor briefing portion of our webcast, we will be showing videos. To view our slides and these videos live during today's session, you will need to be logged into our webcast at jabil.com. At the conclusion of today's call, all of our investor briefing materials, including slides and videos, will be posted and available.

Before handing the call over to Mike, I now ask that you follow our earnings presentation with slides on the website, beginning with our forward-looking statement. During this conference call, we will be making forward-looking statements, including, among other things, those regarding the anticipated outlook for our business such as our currently expected first quarter and fiscal year 2019 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, 2017, 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 CFO, Mike Dastoor.

Michael Dastoor - *Jabil Inc. - CFO*

Thank you, Adam, and good morning, everyone. Thank you for joining us today.

As Adam described, I'll begin today by reviewing our fourth quarter and fiscal year results. During the quarter, both segments executed extremely well, resulting in consolidated results that exceeded our expectations in terms of revenue, core earnings and core earnings per share.

Net revenue for the fourth quarter was approximately $5.8 billion, an increase of 15% year-over-year. GAAP operating income was $154 million and our GAAP diluted loss per share was $0.34. Core operating income during the quarter was $212 million, an increase of 11% year-over-year, representing a core operating margin of 3.7%. Core diluted earnings per share was $0.70, a 9% improvement over the prior year quarter.

For the full fiscal year, net revenue was $22.1 billion, up 16% year-over-year. FY '18 GAAP operating income was $542 million with GAAP net income of $86 million. GAAP net diluted earnings per share was $0.49 for the year.

Core operating income was $768 million, an increase of 15% on a year-over-year basis, representing a core operating margin of 3.5%. Core diluted earnings per share for the year was $2.62, an increase of 24% over the prior year.

I'd like to call your attention to 3 items, which impacted our GAAP results during the quarter. First, pursuant to the Tax Cuts and Jobs Act in Q4, we recorded a provisional tax expense of $111 million. This is comprised of an additional tax expense of $26 million related to the onetime transition tax and an $85 million accrual related to the foreign tax impact of a change in the indefinite reinvestment assertion on certain earnings from foreign subsidiaries. The net effect of these 2 actions allow us to more effectively return cash to the United States. As we refine our analysis, any changes to this estimate will be reflected in future periods.

Second, we incurred a onetime charge of $18 million as a result of liquidity issues experienced by one of our networking customers.

And finally, we recorded acquisition and integration-related expenses of $8 million associated with the strategic collaboration in the health care market, which Mark will highlight later in today's call.

Now turning to our fourth quarter and FY '18 segment results. Revenue for our DMS segment was $2.4 billion, an increase of 11% on a year-over-year basis, reflecting better-than-expected growth in our health care and mobility businesses. DMS represented 42% of total company revenue in the quarter. Core margins for the segment improved 20 basis points year-over-year to 2.7%.

Our EMS segment also performed extremely well in the quarter, growing revenue by 18% year-over-year to $3.4 billion. Core margins for the segment were 4.4% during the quarter. The strength in both revenue and income was driven by automotive, energy and wireless infrastructure businesses. EMS represented 58% of total company revenue in the quarter.

For the year, our DMS segment revenue was $9.8 billion, an increase of 23% over the prior year, reflecting our continued diversification efforts with broad-based growth across our businesses. As a result of these efforts, core margins for the segment improved 30 basis points to 3.2%.

Our EMS segment revenue was $12.3 billion, an increase of 11% over the prior year. The core margin for this segment was 3.7%. Clearly, our EMS team delivered an exceptional performance for the year. Our value proposition is being well received as we leverage our end-to-end engineering solutions and deep domain knowledge to expand existing relationships and win new customers. We expect this positive momentum to continue into fiscal 2019.

Turning now to our cash flows and balance sheet. Net capital expenditures for the fourth quarter were $140 billion and, for the full fiscal year, came in as expected at $686 million. Our fourth quarter cash flows from operations were very strong, coming in at $739 million, bringing total cash flows from operations for the full fiscal year to $934 million. As a result, the strong fourth quarter performance in cash flow generation, I am pleased to report that free cash flow for the fiscal year came in at approximately $248 million. Core return on invested capital for Q4 was 18.2% and grew by approximately 380 basis points on a year-over-year basis to 19.3% for the full fiscal year.

During quarter, we entered into a $350 million term loan facility and $150 million revolving credit facility. The additional liquidity improves our financial flexibility and will be used to fund near-term working capital requirements and future tuck-in acquisitions.

We exited the quarter with total debt to EBITDA levels of approximately 2x and cash balances of $1.3 billion.

Turning now to our capital return framework. As anticipated, during the fourth quarter, we fully utilized the $450 million repurchase authorization with 4.7 million shares repurchased in the quarter. Since the inception of our capital return framework in 2016, we had repurchased 33.3 million shares at an average price of $25.51, bringing our total return to shareholders, including repurchases and dividends, to approximately $1 billion. In FY '19, we intend to fully utilize the current repurchase authorization of $350 million, as we remain committed to returning capital to shareholders.

Before I review our first quarter guidance, I'd like to review 2 accounting standards. Beginning in fiscal 2019, we adopted the new revenue recognition standard commonly referred to as ASC 606 on a modified retrospective basis. Also in September, we adopted the new accounting standard ASU 2016-15, which will impact the classification of certain cash received associated with beneficial interest on our asset-backed securitization programs. The effects of this change will be applied retrospectively and is not the result of any fundamental change in our underlying business.

Turning now to our first quarter guidance on the next slide, which includes the adoption of ASC 606. DMS segment revenue is expected to increase approximately 5% on a year-over-year basis to $2.85 billion, while the EMS segment revenue is expected to increase approximately 13% on a year-over-year basis to $3.25 billion.

We expect total company revenue in the first quarter of fiscal 2019 to be in the range of $5.8 billion to $6.4 billion for an increase of 9% at the midpoint of the range. Core operating income is estimated to be in the range of $215 million to $265 million, with core operating margin in the range of 3.7% to 4.1%. Core earnings per share is estimated to be in the range of $0.79 to $0.99 per diluted share. GAAP earnings per share is expected to be in the range of $0.45 to $0.74 per diluted share. The tax rate on core earnings in the first quarter is estimated to be 26%.

In closing, we are very pleased with our fiscal 2018 performance, core earnings per share growth of 24%, free cash flows of $248 million with return to shareholders via dividends and share repurchases in the fiscal year in excess of $500 million. Our strong fiscal 2018 performance is proof that our strategy is working and positions us extremely well to deliver on our commitments as we move into fiscal 2019.

I'll now turn the call over to our CEO, Mark Mondello, who will provide additional color on our 2018 results and outline the strategic drivers of our business in fiscal 2019 and beyond.

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

Thanks, Mike, and well done. Good morning. We have lots to discuss today and lots to share. But first, as I think about our day, that makes me think about our people. Our people are special. And our team makes Jabil, Jabil. So along those lines, I'd like to begin today with a short video. Let's take a look.

(presentation)

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

You know I'm smiling. I just love the spirit. I love the passion of our people. To me, our people make all the difference. They're real, real differentiator for Jabil. And as customary, I want to say thanks to all of them. Thanks for taking great care of our customers. Thanks for making safety your priority. And certainly, thanks for your dedication and commitment.

Back in December, during our 1Q earnings call of '18, I made mention of a quote from C. S. Lewis. And to me, the quote is just so descript. It's so applicable of where the company is at today. When our team is executing, taking care of customers in the day-to-day, it's really hard to see and feel the progress that's being made. But for me, what we're doing is working. And because it's working, there has been substantial change, and it's changed for the positive. Talking and briefing you on these positives today is what's today is all about.

So let's start with last year fiscal '18. From my perspective, it was another great year. We grew revenue north of 15%, combine that with strong earnings and strong cash flows. And I'm pleased with the 3.5% core operating margin as well, especially given that we've printed these results while dealing with an extremely difficult supply chain, a components market full of constraints and uncertainties. Well done by all across our entire Jabil enterprise.

Our team is carrying positive momentum with them into fiscal '19. I like the decisions we're making and the approaches we're taking. If we look at this guide, I believe core earnings per share will grow roughly 15% year-on-year. This puts us squarely in the neighborhood of $3 a share, while expanding free cash flow 40%, up $100 million year-on-year.

And one important and fundamental observation as we move into fiscal '19. The separation between our EMS segment and our DMS segment, it's now become opaque. It has become blurred, and this in terms of our approach and our solutions offered in the marketplace. The historical bifurcation between the segments is gone, and that's intentional. And I believe this is clearly reflected in our results and our outlook going forward.

So with fiscal '19 kind of being the here and now, I think it's worthwhile to talk about how we view the business over the coming 2 to 3 years. This particular slide reflects what I would consider the possible. Our navigational beacon, if you will, our guidepost as to where we're driving the team and where we're driving the business. If we continue to make sound decisions, if we continue to execute and we're fortunate enough to keep a little bit momentum at our back, I really believe we have the opportunity to see further expansion in cash flows, $4 a share in core earnings, while bumping up against 4% in core operating margin. And we'll do so while preserving our core ROIC of 20% or greater.

So that was a lot, and it was at a high level. So one thing that I'd like to do now is just kind of step back, bring it down and walk through a few building blocks, which back up our assumption set. So if we start with fiscal '18, again, we delivered $22 billion in revenue, $770 million of core operating income and earnings per share on a core basis of $2.62. From there, if we move to fiscal '19, our guide for '19 has revenue at $24.5 billion, core operating income at $850 million and core earnings per share in the neighborhood of $3.

And there's 2 really important components of fiscal '19. One is what I would characterize as our baseline business. So if you simply take the results we posted in fiscal '18 and you grow that business by 2.5% year-on-year, revenue goes from what we delivered in '18 at $22 billion to roughly $22.5 billion to be realized in fiscal '19. We also believe that based on our management and discipline around overhead as well as different components of the business coming to maturity, we think we'll get about 20 basis points of leverage on that core business. So as shown on the slide, we think core margin on the base business will expand from roughly 350 basis points to 370 basis points. And our core operating income on that base business will expand from about $770 million to about $830 million.

The second component, which is really important and it will be a topic for much of today's discussion is new business awards. So in fiscal '19 with a lot of the effort we put in, in fiscal year '17 and '18, we've made a conscious decision to bring about $2 billion of new business, largely around new relationships into the company. That business comes with different timing around ramps to maturity as well as costs that kind of run out in front of realized revenue. So from an assumption set, we believe that $2 billion in new business awards in '19 will only deliver about 1 point of margin. And again, it's intentional, and I'll explain further. But if you sum these 2 components together, the $830 million of core operating income on the base business and the $20 million on the new business awards, it sums to the $850 million for the year on the $24.5 billion.

So I'll wrap up this slide by taking it a step further and give you an idea of what might be as we move from fiscal '19 to '20 to '21. So again, similar to the logic I just laid out for '19, there's 3 components for what might be in fiscal '21.

The first component is stepping back again and taking our fiscal '18 printed results and growing those at a compounded rate from '18 to '19 to '20 to '21 at roughly 2.5%. That takes the realized revenue in '18 of $22 billion. And we believe we should see revenue in the neighborhood of $23.5 billion to $24 billion. For this example, we used $23.7 billion. And as part of our assumption set, we think it's realistic to maybe a little bit conservative. And again, for sake of illustration, on that base business, we assume that from FY '19 to FY '21, we'll get no expansion, no leverage of margin. So again, for sake of illustration, which is the intent, the FY '18 business, as we believe we'll see it in '21, will be $23.7 billion, making roughly $885 million of core operating income at a margin of 3.7%.

A second component in '21 is really an extrapolation of the new business awards I just talked about for '19. So in these new business awards, what we anticipate is, as we ramp these new business awards, the $2 billion will convert to close to $3 billion by fiscal '21. And more importantly, the operating income that we think will be around $20 million off of that base new business award business will expand closer to $120 million. So again, about $100 million expansion of operating income from fiscal '19 to fiscal '21. We also believe that how we have that business quoted, what the outlook of the business looks like, we believe the base and the bucket of the $2 billion of new business awards will deliver us a core operating margin in the area of 4%.

And then lastly, just to kind of round out the assumption set in '21, and I don't think this is much of a stretch, today, we have about $6.5 billion to $7 billion of new business opportunities in our pipeline. And I would acknowledge the fact that none of that business at the moment is close to being closed, but it will be as we navigate through '19 and into '20. So again, because of what might be in '21 is purely an illustration and illustrative of what we're thinking and what we believe could very much be reality. We just assumed that along with the FY '18 base business that we believe will grow to $23.7 billion, the new business awards that we feel will grow into the neighborhood of $3 billion, we just added another $1 billion of growth. And again, that comes from the reality that our current pipeline is substantially higher than that. And much like '19, we assumed we'd make little or no income off of that $1 billion as we ramp those new relationships.

I think another key takeaway from the slide that's worth noting. As a management team and a leadership team, we're intentionally not maximizing core operating margins today, and we're doing so for 2 reasons. Number one, we believe it best to prioritize our ability to capture this high-quality growth and capture it now. And two, we believe this decision is best in terms of expanding Jabil's valuation over time.

So in describing our so-called building blocks, an important assumption was the $2 billion in new business awards. So I thought it might be wise to substantiate where the wins are coming from and the wins themselves. As you can see by the slide, we have about $1.7 billion of new business wins that cut across 4 distinct end markets, with another $300 million rounding out the balance of the $2 billion in new wins. I believe these wins are favorable, and they're right in our sweet spot. They're wins that can continue to help us diversify the company. They're wins that leverage our various investments that we've made. And they're wins that I think will offer dependable cash flows down the road. And most importantly, I believe these are wins, which we believe we can execute on and deliver. And as I said prior, these particular wins will ramp through fiscal '19 and '20.

So for the past few years, we've talked openly about the importance of investing, strategic investments, which enhance our solutions, investments which increase what we kind of talk about as our domain expertise. And many of these investments also elevate the performance inside of our own factories. One such investment is our investment in additive manufacturing and 3D print. I'd like to share a short video, a video which I hope will give you kind of a keen sense of how we actually leverage our investments throughout the company.

So with that, let's take a look.

(presentation)

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

A quick shout-out to our additive team and our 3D printing. They're first-rate. One point to note is our 3D additive efforts cut across the entire Jabil ecosystem, this providing tremendous leverage of our investment dollars.

Next, a complement to the new business wins and to our portfolio of investments is our steadfast goal to further diversify our earnings and cash flows. For me, diversification is key in our planning and our actions. We believe that the more diversified we become, the more robust the company will be. So to put this in context, our goal is for no single product or product set to be more than 5% of our annual cash flows or annual income. We're making tremendous progress in this area, and our financial results reflect it.

So I'm going to wrap up my presentation by sharing details on a really exciting new business award. So Jabil and Johnson & Johnson Medical Devices Companies have entered into a long-term strategic collaboration. And this collaboration will significantly expand what is currently our 12-year relationship and partnership with JJMD. This collaboration expands our health care portfolio significantly. And it certainly elevates our technical capabilities and leverages our CNC experience. Financially, this deal will be neutral to fiscal '19 core earnings. Integration costs and charges directly associated with the deal will be in the range of $80 million. The real interesting part about this deal is that the cash outlay will largely be applied to working capital and inventory. We believe the annual revenue will grow to an excess of $1 billion annually.

As part of the deal and based on the strategic nature of the deal, we'll be acquiring 14 sites from Johnson & Johnson. And we'll be supporting and protecting the J&J brand in areas of endo, surgical, spine, trauma and instrumentation. I feel this collaboration has wonderful potential. We also think it will be truly transformational. And I want to say thanks to all involved.

So in closing my portion of the presentation, I'll say again, what we're doing is working. What we're doing is reflected in our results and our outlook. We're seeing double-digit growth, growth of revenue, growth of core operating income and growth of core earnings per share.

With that, I'll hand the presentation over to Mike, where Mike will offer a bit more color specific to fiscal '19. Thank you.

Michael Dastoor - *Jabil Inc. - CFO*

Thank you, Mark. I'd like to thank everyone, again, for your interest in Jabil.

You just heard Mark describe incredible growth in several end markets in the last few minutes. This growth we're seeing, it's almost like an episodic growth. FY '18 saw us adding $3 billion of revenues. We're projecting to add another $2.5 billion in FY '19. That's $5.5 billion in 2 years. That is unprecedented growth in Jabil history.

Considering this growth, I thought it be useful to sort of provide insight into the financial metrics that I, as CFO, am focusing on to the rest of the organization, the way we're driving the rest of the team. There's 3 metrics that are key to my level of detail.

Operating margins. First, let me assure you, the team is focused on operating margins, operating margins through diversification, operating margins through cost optimization. Diversification through targeted growth in selected end markets, which will help us with cash flow streams and earnings, which are predictable and lower volatility. Cost optimization and SG&A leverage across our worldwide brand. So overall, those 2 areas of focus on operating margin.

Secondly, earnings per share. Earnings per share has gone from $1.86 to $1.11 to $1.262. And now we're projecting $3. That's a 17% CAGR from '16 to '19. We will continue to focus on that EPS.

Last but not least, free cash flows. Free cash flow through optimization of working capital, disciplined CapEx management approach and cash allocation. I really feel we're on the right path, and I'm confident that we will deliver on our commitments for FY '19.

Turning to revenue expectations for FY '19. You heard Mark on why diversification was so important for the company. I'd like to provide you with a deeper look into this diversification. It's a -- the diversification shows our balanced portfolio for FY '19, as a result of deliberate actions in targeted areas of growth. Some of these areas that I'd like to highlight on this slide, areas that provide confidence in future earnings and cash flows due to long life cycle nature of products in Industrial & Energy and in regulated markets, like health care and automotive. Areas that we have invested capabilities, additive, 3D, the video that you just watched, that gives us disproportionate advantages as segment leaders. Areas where we have deep domain expertise complemented by investments in capabilities, such as RF, antenna integration and server platforms in markets like 5G and cloud. All this will result in lower volatility and more predictable earnings.

While our diversification efforts are well manifested in revenues, it's taking slightly longer to show up in margins for real legitimate reasons. Let me try and explain why. Mark talked about $2 billion of new wins in FY '19 with ramps across 4 main areas. Let me provide some color firstly on what we mean by ramp costs. Ramp costs are startup costs associated with operational inefficiencies and suboptimal utilization of assets in the very early stages of production in the form of lower yields and higher costs. Some of these costs actually show up pre revenues, and I think Mark referred to that. Why are ramp costs so important suddenly? 2 reasons. The sheer size of the new wins we're to get, just about $3 billion in '18 and $2.5 billion in '19, $5.5 billion stands out. It's the complexity as well. We've gone from a build -- a build-to-print sort of model to an end-to-end solution model, where we provide a number of services. This complexity adds to our ramp cost in the early stages of production.

Let's look at the left side of this -- of the 4 boxes that Mark talked about. Health care is a good example. Our ramps in health care take much longer due to regulations and FDA qualifications. But once they qualified, it's an annuity-like earnings. They go on for a number of years, much reduced volatility, and the customer relationships are relatively sticky. Likewise, automotive where similar ramp times due to safety and quality controls lead to longer ramp times. These ramps do not expect any contribution in FY '19. And I want to highlight that left side. We do not expect any contributions in FY '19.

Conversely on the cloud and the 5G side, the right side of the chart, due to our domain expertise, it takes slightly shorter periods to ramp. How should one think about the timing of these ramps into quarter? We expect about $15 million to $20 million of costs pre-revenues in the first half, so the cost will hit us before the revenues do, and we expect that to be in the range of $15 million to $20 million in the first half of FY '19. That would be offset by contributions in Q3 and Q4, netting to a total $20 million contribution in FY '19. And I think that is important to shape first half, second half for the year.

Moving onto cash flows. As I highlighted in my previous -- on my -- in my prepared remarks, strong cash flows in Q4 of '18 through working capital optimization, discipline in CapEx management and cash allocation led to about $250 million of free cash flows.

Mark talked about the supply chain constraints in certain components. We expect those constraints to go on to the second half of calendar year '19, so we don't expect that situation to improve till then. We do believe the tightness in the supply chain is a temporary phenomenon, though, and will alleviate over time. It is definitely not a structural change in our working capital demands.

For FY '19, we expect free cash flow to be in the region of $350 million with a CapEx of $800 million, which approximates to about 3% of revenues. For FY '19, I would expect the free cash flow generation to follow a similar interquarter trend as FY '18 did.

One thing I'd like to highlight is 1 day of sales cycle is equal to about $60 million in working capital, so volatility interquarter can be relatively high depending on whether you take 1 or 2 days off or you add a day or 2 on your working capital cycle.

Beyond FY '19, we expect a solid income growth and our disciplined working capital management and our CapEx management to lead to strong performance in cash flows.

Core return on invested capital. Earlier, I mentioned focused targeted growth in end markets with higher returns, higher returns through operating margins or higher returns on invested capital. In FY '18, we launched about $3 billion of revenue. Quite a bit of that was in the DMS segment. And we leveraged our existing infrastructure, which not only led to better margins. I think it was a 30 basis point improvement in FY '18. But it also helped ROIC to grow by 380 basis points in FY '19 to 19 point -- sorry, in FY '18 to 19.3%. We expect our core ROIC to be around 20% in FY '19, as we absorb new business and continue our focus on all aspects of this critical financial metric.

In closing, I'm confident that we will deliver our commitments in FY '19. As highlighted, we're completely focused on diversification, on strong management of cash flows and free cash flow conversion.

I would now like to hand the call back to Adam.

Adam Berry - *Jabil Inc. - Senior Director of IR*

Thank you, Mike. As 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 are now ready for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today is coming from Adam Tindle from Raymond James Financial.

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

Mark, I just wanted to started -- start on the new business awards. What has changed to drive the inflection in new wins? Is it market share gains? Is it customers moving more from in-sourcing to outsourcing? And I had -- have a follow-up on that.

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

We certainly have seen -- we have certainly seen some customers moving to outsourcing. But I would think, as I mentioned in my prepared remarks in the presentation, we're -- I really like our approach. Our approach is divvied up into very, very intentional sectors where, over the last 3 to 4 years, with the investments we've made, both in capabilities and then just kind of this domain expertise with people, I think we were just taking better solutions to the marketplace. And I also think that the macro in certain areas, right now, is -- has given us some help. So I would say it's those 3 areas, Adam.

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

Okay. And I know you mentioned that there's going to be some cost in front of the revenue with the bulk being cloud customers in terms of the win breakdown. We've seen others in the supply chain get pressured on profitability by those customers at times. Can you just maybe talk about the contract structures and maybe any protections or guarantees on returns of the contracts?

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

I can't. I wish I could. I can't. But we're well aware of that. And again, I think we do a pretty good job overall. And I think it applies to the new business wins in terms of commercial terms and contracts with customers. I think we got a pretty good track record there.

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

Okay. Maybe I can get one in for Mike real quick then. Mike, you've been through multiple areas. We've seen areas in Jabil with high CapEx and little free cash flow, but setting up for strong growth. We've seen areas of attenuated CapEx and returning cash to shareholders via the buyback. Can you maybe just reflect on those times and help us understand your capital allocation beliefs?

Michael Dastoor - *Jabil Inc. - CFO*

Yes. I think our discipline on CapEx management has increased tenfold. We're totally focused on growth areas. I think one of the key things we're doing on the diversification side is to focus on end markets where we're targeting high returns. And that's how we manage our CapEx flows as well. We do think working capital management is another area that we're focusing on and that obviously helps our cash flow from ops. And we feel really good about that.

Operator

Our next question today is coming from Amit Daryanani from RBC Capital Markets.

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

Your first half, when I look at the November quarter guide, I think the implication is operating margin is up about 20 basis points sequentially. Can you walk through -- is that expectation or expansions that are going to come more from the DMS or the EMS side? And kind of what's driving that?

Michael Dastoor - *Jabil Inc. - CFO*

Amit, I'll take that. In my -- the ramp slide that I showed, I think I talked about some of those costs for ramps coming pre-revenue, so the costs are obviously in production -- it's production facilities. It's pre-ramp cost. It's things that we're doing in our sites before we even start manufacturing. So I indicated there's about $15 million to $20 million of those costs coming in on the first half, so some of that is related to Q1 and some of it is Q2.

Amit Jawaharlaz Daryanani - *RBC Capital Markets, LLC, Research Division - Analyst*

On the Johnson & Johnson engagement that you guys talked about, can you just talk about -- I think you mentioned the 14 sites you're taking over. Geographically, where are these sites located? And once you get past the initial ramp with Johnson & Johnson, what's the margin profile of this business that you're looking? Is it going to be like the long-term DMS target or something different, just the Johnson breakdown of the site and what do you think the margin profile once you passed the initial ramp? That will be helpful.

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

Yes. So we'll be able to share more detail and actually want to share more detail over time. For now, we're in, as you'll be familiar, with kind of applicable consultative processes. And once we get through all that, then we'll come out and provide a bit more detail and scope of the entire collaborative partnership. But again, it's a -- it's, in my mind, a very, very transformational strategic opportunity.

Operator

Our next question today is coming from Steven Fox from Cross Research.

Steven Bryant Fox - *Cross Research LLC - MD*

I had a couple of questions based on the slides. First off, if I look at just the base business that you highlighted going into '19 and eventually '21, looks like the incremental margins you're getting off of that is low double digits in '19 and then more like 6% to 7% if we look over a 3-year period. I was curious if you could just sort of explain those incremental margins, how they change and what a normalized incremental margin you think is for the company going forward. And then I have a follow-up.

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

Steve, it's Mark. Maybe you could help me a little bit with your question. I think in -- when I was kind of going through and indexing through the slides, I felt what I had communicated and maybe I didn't do a very good job of it is, is that the base business from '18 that we just printed was right at 3.5% core margins op margins. And as we just step that base business from '18 to '19, we have fairly modest growth assumptions around that base business of about 2.5%. And I think what the slide showed is these margins would actually expand by about 20 basis points.

Steven Bryant Fox - *Cross Research LLC - MD*

Right. And so what I was wondering, Mark, is that the incremental change in dollars is about $500 million roughly and you get $60 million of profits off of that next $500 million. But then if I looked at the 3-year slide, you get $1.7 billion -- I'm sorry, yes, $1.7 billion of incremental sales and you generate, like, $150 million off of that. So I'm trying to understand how that leverage is coming up.

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

Yes, yes. Okay. All right. Yes, yes. I didn't understand your question that way. That's just simply the product mix and where we're at. There's a lot of dollars that we're ramping that aren't in the new business wins from years past. So that's all about time to maturity.

Steven Bryant Fox - *Cross Research LLC - MD*

So is the longer-term incremental margin sort of a normalized -- what you could get on -- the type of leverage you get on normalized volumes?

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

Yes. And I think -- and by the way, I think that's a consideration when we are talking about what could be in fiscal '21 with us driving to $4 a share and 4 points of operating margin.

Steven Bryant Fox - *Cross Research LLC - MD*

Okay. That's helpful. And then just on the diversification slide, I might be pushing my luck a little bit on this one. But if you were to sort of give us a sense for where some of the growth is most robust within all those different breakdowns that you gave versus where maybe it's more normalized. There's like -- it looks like there's, like, about 10 different categories, but maybe a little more highlights on -- going forward how that growth looks like.

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

Yes. I think you're pushing your luck a little bit. I think if you just referred back to -- I think a good proxy for that is, if you saw and go back to both one of my slides and I think Mike duplicated the slide actually, that kind of highlighted the 4 areas in terms of new wins. And I would add, too, that if I go back maybe 12, 18 months, we've also had some nice wins in the area of energy. So I'd say, there's 5, 6 end markets that are driving that.

Operator

Our next question today is coming from Ruplu Bhattacharya from Bank of America Merrill Lynch.

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

Mike, you mentioned about component cost. I was wondering you're guiding fiscal '19 revenue to $24.5 billion. How much of that is impacted by component costs? Like, how much would you say component costs are harming or reducing revenue in the next year?

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

Ruplu, this is Mark. So this is a topic that we've been queried on quite a bit. So I'll start kind of, fundamentally, calendar -- late calendar '17 and certainly all of calendar '18, and we think probably the first 3, 4, 5, 6 month of calendar '19. For those of us that have been around this business for a long time, it has been what I would think is the most highly constrained, complicated, difficult component markets that we've seen. And when we go through that, it's just -- it's hard to plan production. It's hard to run your factories optimally. It does shake up kind of product mix and revenue. What it doesn't do so much for us, though, is we don't tend to absorb the escalating costs. We have really good commercial terms. We split those risks with our customers. With some customers, we recovered 100%. Some customers, we split 50-50. So for me, the constriction of material, the difficulty in the supply chain, the difficulty that, that does in terms of -- I don't know, what we're shipping today, Ruplu, but we're probably shipping $80 million to $100 million of hardware out the company every day, it just makes running the network of factories more complicated. And I think that's where some of the additional cost come from, not so much from the escalating components.

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

Okay, okay. That's helpful. My next question, I just wanted to ask you about the slide that has fiscal '18, '19 and '21. When I look at the section for fiscal '21, you've got fiscal '18 baseline growing 2.5%. And you also have the new wins from fiscal '19 growing to $3 billion. And then I see the other line of $1 billion, right? Does that include both the new wins from fiscal '20 and fiscal '21? And I guess, my question would be, do you think the win rate slows down after fiscal '18, '19 because as you've got fiscal '18 and fiscal '19 wins and then you've grouped them other -- into another category? So does that include both fiscal '20 wins and '21 wins?

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

That's more just a -- an illustrative plug. All that I'm trying to show there is as we index towards fiscal '21, as the new wins from '19 get to maturity, if you will, I just -- we're not going to be standing still. We are going to book new wins. And that was nothing more than a plug number. The intention being that it doesn't take a significant amount of new wins for us to make fiscal '21 turn out. That's all.

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

Okay. And then last question is, Mike, you're guiding $800 million for CapEx for next year. Like, you've invested significantly, like, 2 or 3 years ago in Green Point. So where do you think -- can you give us a split of where that CapEx spend will be, in which segments or which end markets or which geographic region?

Michael Dastoor - *Jabil Inc. - CFO*

We haven't broken that out, Ruplu. But I think it's all across. It's not in any specific segment. Obviously, the growth areas will be ones that we focus on and, like I mentioned, the diversification in the end markets. We're trying to deliberately take actions in certain end markets. So CapEx is more targeted towards that.

Operator

Your next question today is coming from Alvin Park from Stifel.

Alvin J. Park - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

This is Alvin speaking half -- on behalf of Matt Sheerin. I think, on the call, you mentioned that you -- the supply constraint should extend to the second half of calendar year '19. If you could give more details on if it's a widespread phenomenon or if it's still constituted on a certain past component? And secondly, if -- for fiscal year '19 and fiscal year '20 or beyond, do you expect potential cash flow increases assuming that inventory would wind down since you don't have to stock up much backup supply?

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

Yes. So I think what I said is -- or I meant to say is the constrained component market would go through the back half of calendar 2018 and into the first number of 3, 4 months, if you will, call it, first half of calendar '19. I don't think the market will settle or abate completely as we get to the back half of '19, but we'll start seeing some relief. We believe, as we start moving through the spring and summer time of '19, we think the market will get better. In terms of -- what was your second question?

Alvin J. Park - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

So in terms of cash flows.

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

Cash flows, right? Yes. Could you ask that again because I'm not sure I understood you correctly?

Alvin J. Park - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

So the cash flow guide takes into effect the potential benefits you might see from less working capital requirements, specifically involving inventory.

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

Well, I think what's going to happen is, is I actually think the working capital is going to continue to expand on an absolute basis based on the $5 billion, $6 billion of growth that we're seeing. But in terms of days in inventory and what not, as the supply chain rationalizes, as we can run our factories in a more normalized basis, as we can serve our customers with our planning tools in a more normalized basis, that will improve. But yes, the information in terms of both EBITDA, in terms of free cash flow and cash flow from operations that we anticipate for '19 and then the model -- or the illustration we showed for '21 does anticipate that.

Alvin J. Park - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

I see. Okay. And then in terms of the core EPS guide of roughly $3 for fiscal '19 and the 50% year-over-year growth, how much -- how heavily will that be concentrated on overall sales and margin improvement versus share buyback programs that you have in place?

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

I'd just say that -- I'd say the $3 a share, again, it's a combination of both growth of the business, financial returns or op income tied to that business, plus the share buyback and then, of course, tax and interest expense.

Operator

Our next question today is coming from Jim Suva from Citi.

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

You both gave a lot of details on the financial model long term and the bridges, which is great. On the Johnson & Johnson plant acquisitions, is that included in CapEx or cash flow? And how should we just think about that for modeling versus some of the financial metrics that you just gave out? I think you said neutral to EPS and then growing. Is that correct?

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

Yes, Jim. I said we anticipate the deal to be neutral to core EPS for fiscal '19. And then in terms of the $800 million that Mike talked about in CapEx for '19, the J&J deal is included in that number.

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

Got you. Okay. And then near term, this quarter, your revenues materially beat your guidance expectations, but earnings kind of really did not. Is that due to, like, a pull-in of these investments you're doing in the future that kind of near term pressure things? Or was it something else, like mix-related or inefficiencies due to the complexity of the supply chain because it seems like you're talking about longer-term pressures on margins the next year or so? But I just want to make sure this quarter, the report of the disconnect from upside to sales to margins.

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

Yes. If you're talking about 4Q of '18, if I think through the math on that, Jim, we overshot the midpoint of revenue by about $350 million. And then our midpoint on the operating line was about $200 million of core operating income. I think we published about $212 million. So we got about $12 million of op income leverage on the $350 million. I don't know what the math is. It feels to me like that's a -- like, 3%, 3.5%. And then the only reason we didn't get more leverage is, again, because of some -- the early expense that Mike talked about on some of these ramps. But all in all, when I look at the additional revenue and the upside to the midpoint of our operating income, the leverage wasn't bad.

Operator

Our next question today is coming from Paul Chung from JPMorgan.

Jeangul Chung - *JP Morgan Chase & Co, Research Division - Analyst*

This is Paul Chung on for Coster. So thanks for the end market diversification slide. It's very helpful. So just wanted to get a sense. Are you going to provide this level of detail moving forward? I know you mentioned the bifurcation of DMS and EMS doesn't really make sense anymore. And also, will you provide some margin profiles for each respective end market? And then which markets in your view are kind of driving the most margin upside relative to your corporate average?

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

Okay. That was like 4 questions in 1, I think. So in terms of are we going to provide this going forward, I think what we'll probably talk about -- Mike and I will talk about going forward is kind of on an exception basis. So we'll kind of use the deck that we shared today as kind of foundational for '19. And then on an exception basis, if things have gotten way out of line, we'll talk about it and address it. In terms of my comments on DMS, EMS, I just want to be sure you're clear, right? We're still going to report our business in an EMS, DMS segment. I think if you look at what the teams have done in terms of taking our EMS margins from roughly 2.2% bumping into the high 3s and towards 4, our approach to all of our businesses today, our original thesis around the nomenclature of DMS was really about giving investors higher acuity, higher visibility to businesses that were no longer build-to-print, no longer EMS-like, and that was whatever it was, 6, 7 years ago. Today, when I think about the nature of -- and the intent of Diversified Manufacturing, meaning new solutions to the marketplace, mechanics, full product design, really, us having product expertise, us taking kind of a functional spec or conceptual ideas and being able to take that all the way through to design, product, supply chain and delivering the product, that really cuts across the businesses today, whether it be in automotive or health care, whether it be in AR, VR, 5G, cloud, industrial, et cetera. So my commentary was really around our approach in terms of solutions, in terms of how we go after the business, in terms of how we care for customers, there's not a big differentiation between our DMS and our EMS segments. What was the third question?

Jeangul Chung - *JP Morgan Chase & Co, Research Division - Analyst*

Just the margin profile and kind of end markets.

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

So we're -- yes. At this point, we don't intend to break out the margins by sector. We'll continue to break out the margins by DMS, EMS segment through fiscal '19. And then we'll see what we decide to do as we move into fiscal year '20.

Jeangul Chung - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. Then if we take a step back at looking at fiscal year '18, very strong revenues. How has the kind of pricing environment been with competition? And then moving into '19, are you seeing some of those competitive pressures at all? And then anything you can mention on the tariff noise as well? Are you winning -- are you gaining share from some of those partners that are more affected by that?

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

On the pricing side, I wouldn't say there's no relief in pricing. I would say that the pricing environment we live in today is as -- this will sound like an interesting word, but it's as normal as it's ever been. And normal for us is we've got to be creative. We've got to come up with good solutions. We've got to earn our pay. But when I cut across the dozen or so sectors in the business, there's nothing there that is suggesting that we have issues with pricing, I don't think, really, in anywhere in our business. And I think we've been very cautious and select in the new business awards. One point, I think, I failed to mention, and I think it's important. As CEO of the company, I've not sat -- in the last 12 to 14 months, I've not sat in one meeting and ask people to drive top line growth. Not a single meeting. And I think that's a reflection of -- I don't want people to be confused. We're not out chasing growth for the sake of growth. For me, our whole objective is to make the company more valuable within a reasonable time window. And again, I think we've expanded valuation, but we certainly -- I don't think have expanded it enough. So these wins -- these $2 billion of wins are a direct reflection of the quality of services and solutions that are being accepted in the marketplace. But by no means are we out covering the streets with salespeople trying to grab top line growth, not in our strategy at all. In terms of the trade and tariff issue, I think that -- it's -- it continues to be a moving target. It depends. You wake up one day and there's a tweet. You wake up 48 hours later, something else is going on. So it's a very complicated issue in terms of what's going to be, how bad will it get. There's a conversation that it's just going to be kind of a little bit of a tit-for-tat bit. And then there's people that have the opinion that it could extrapolate to something much bigger. If the trade, tariff issues, and now I'm talking specifically with China, if those were to escalate in a way that we don't anticipate, but if they were, it absolutely is going to affect our business, as it will affect everybody's business. If the trade and tariffs end up continuing to be some postering going back and forth and there's some reasonable resolution to them over time, I think that Jabil is really, really well positioned. We have a wonderful global footprint. We got great capabilities. We're the largest kind of pure manufacturing company that's U.S. domiciled, I think, in the world. All of our factories are connected with a single incident around our IT solutions. So we move product and inventory around seamlessly every day. So in terms of -- as we sit today, we probably run, I don't know, a dozen or so sensitivity scenarios for our customers every month, and they're very appreciative of that. Some have acted on it, some have not. But I try not to get too obsessive about how bad things can get. With that said, we do kind of do planning scenarios internally on what we would do. But assuming this thing doesn't blow up in a big way, I think Jabil is really well positioned to serve the marketplace in terms of trade and tariff issues.

Jeangul Chung - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. Great. And then my last question is on free cash flow. Looks like ramp-up cost, working cap investments should probably weigh on '19, as well. When should we expect kind of free cash flow to normalize? And what are those normalized levels in your view?

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

Yes. You're welcome. I actually like our free cash flow for '19. I think in '18, it was $250 million. It would have been greater than that if we weren't dealing with the growth and weren't dealing with the supply chain constraints. In '19, I think what the slide suggested is we are going to expand free cash flow by about $100 million or 40% year-on-year from '18 to '19. And then kind of the how it could be slide suggest that free cash flow could be something much greater than that in the $600 million range. So with all said and how we're running the business, all the different moving parts in terms of kind of what future cash flows could look like, I'm quite pleased.

Operator

(Operator Instructions) We've reached the end of our question-and-answer session. I'd like to turn the floor back over to Adam for any further or closing comments.

Adam Berry - *Jabil Inc. - Senior Director of IR*

Thank you, everyone, for joining us today. This now concludes our event. Thank you for your interest in Jabil.

Operator

That does conclude today's teleconference and webinar. You may disconnect your line at this time and have a wonderful today. We thank you for your participation today.
