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Spotlight Shines on Indonesia

The low labor costs of Indonesia are no secret, and some EMS providers have taken advantage of them, particularly for labor-intensive work. But as locations go, Indonesia has not offered the supply base or infrastructure necessary to become a major center for EMS in Asia. Indonesia has remained a bit player in an EMS theater dominated by China at center stage. But recently, **Hon Hai Precision Industry** has shown an interest in Indonesia, bringing the country onstage and into the spotlight.

Initial reports out of Indonesia, citing a government minister, put the likely size of a Hon Hai investment in the country at $1 billion. In response, Hon Hai said it is evaluating the feasibility of investing in Indonesia but has not yet decided whether to fund a manufacturing base there, reported *CNA*, Taiwan's official news agency. Hon Hai chairman Terry Gou visited the country this month, a sure sign that Hon Hai's is exploring the possibility of manufacturing in Indonesia.

The Jakarta Post later reported the minister as saying the company may invest between $8 billion and $10 billion in Indonesia over five years. Referring to the $10 billion figure, which was also reported in a Taiwan newspaper, Hon Hai merely stated via the Taiwan Stock Exchange that "the company currently does not have any plan to invest in Indonesia." By including the word "currently," the statement does not rule out the possibility of a plan in the near future.

Indonesia's labor rates are certainly one attraction for EMS providers. According to the *Jakarta Post*, the minimum monthly wage in the capital city of Jakarta, the most expensive place to live, is a bit more than $160, and other regions require half that amount. By contrast, Shenzhen, China, has set its pay floor at 1,500 yuan a month (about $237).

But Indonesia is no longer just a low labor-cost play. The country possesses the world's fourth largest population and Southeast Asia's largest economy. Indonesia's gross domestic product grew 6.5% last year, and the IMF estimates GDP growth of 6.1% in 2012. Foreign investment continues to flow into the country, and some say Indonesia deserves to be added to the BRIC group of developing economies (Jan. 2011, p. 2). The continued growth of Indonesia's economy, despite what is happening in other parts of the world, makes it more and more attractive to OEMs, particularly those supplying automotive, consumer and communications infrastructure products.

Last year, **Riverwood Solutions** named Indonesia as the most attractive country location for incremental EMS fixed capital investment over the next five years. The provider of managed supply chain services and operations consulting made this announcement during its inaugural Outsourced Manufacturing Academy.

"The country has a relatively skilled, very low cost labor force that is currently not subject to some of the inflationary pressures we are seeing in China. The population growth rate of around 1.5% and the more balanced trade accounts should keep employment-related costs relatively stable there for some time," said Ron Keith, Riverwood's CEO.

A number of EMS providers al-

Some articles in this issue

ready operate in Indonesia. The list of providers with Indonesian factories includes **Beyonics Technology**, **Flextronics, PCI**, **Sanmina-SCI**, **SIIX** and **V.S. Industry**. (Note that this may not be an exhaustive list.) The island of Batam, near Singapore, has been a popular location for EMS plants in Indonesia. EMS operations have also sprung up near Jakarta on the island of Java. For example, V.S. Industry plans to start work on its second factory in Bekasi, which is adjacent to Jakarta (March, p. 8). According to Malaysian newspaper *The Star*, the 200,000-ft^2 facility will turn out energy storage fuse boxes for a US-based customer.

Although at least a half dozen providers have invested in Indonesia, it's not without its drawbacks. "Indonesia does not have as developed of a transport and logistics infrastructure as China, Malaysia and Thailand, but it's very well positioned geographically. A significant investment from Hon Hai would serve as a catalyst for both logistics infrastructure improvements and additional supply base investments by some of Foxconn's major suppliers," said Keith.

Hon Hai's evaluation of Indonesia has put it in the spotlight. If Hon Hai decides to make a major investment there, Indonesia would be in a better position to play a greater role on the EMS stage.

M&A

Soft First Half for M&A

The EMS industry saw a slowdown in M&A deals done in the first half of 2012 versus the year-earlier period as deal-making in Europe declined precipitously.

According to *MMI's* count, 13 M&A transactions closed in the EMS industry during the first half of the year, compared with 18 in the first half of 2011 (Chart 1). That's a decrease of 28%. If M&A activity doesn't surge in the second half to erase this shortfall, then EMS industry M&A will have fallen in 2012 for the second year in a row.

A sharp decline in the number of European acquisitions made in the first half dragged the industry total downward. Four acquisitions of European operations took place in the first half, representing a drop of 60% year over year (Chart 2). *MMI* had predicted that M&A activity in Europe would probably fall off in 2012 due to Europe's economic troubles (Jan., p. 3). In the first half of 2011, Europe accounted for 56% of the transactions; a year later the European share had dropped to 31% (Chart 3, p. 3).

But the number of first-half deals did not decline in the other two regions. In both North America and Asia, there was one more operation acquired in the first half of 2012 than in the same period a year ago (Chart 2). With the drop-off in Europe, North America laid claim to a majority of the deals done in the first six months (Chart 3).

Despite the overall drop in deals made during the first six months of 2012, a substantial increase occurred in cases where one EMS provider acquired an operation from another provider. During the first half, nine such deals went through, up 50% from six transactions closed in the year-earlier period (Chart 4, p. 3). Indeed, buying a competitor's operation was by far the most popular type of transaction completed in the first half.

These deals can offer geographic expansion, complementary customers, diversification, more revenue, increased capacity and additional capabilities. Depending on the buyer's needs, one or more of these benefits will act as motivation for a deal. But it takes two to tango, and there would have been no increase in acquisitions of EMS operations without an increase in sellers of said operations. The pressure to win more business in the current flattish environment probably compelled some sellers to seek out a larger organization that would make them more competitive.

During the first half, EMS companies purchased four EMS operations based in the US. **American Computer Development, Inc.** (MD) bought assets of **Fawn Electronics** (NC); **Anu-**

Chart 1: EMS Industry M&A Deals

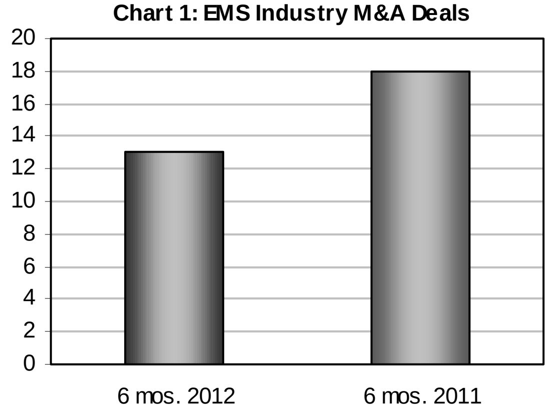


Chart 2: Deal Breakdown by Target's Region Comparing First Half 2012 Versus the First Half 2011

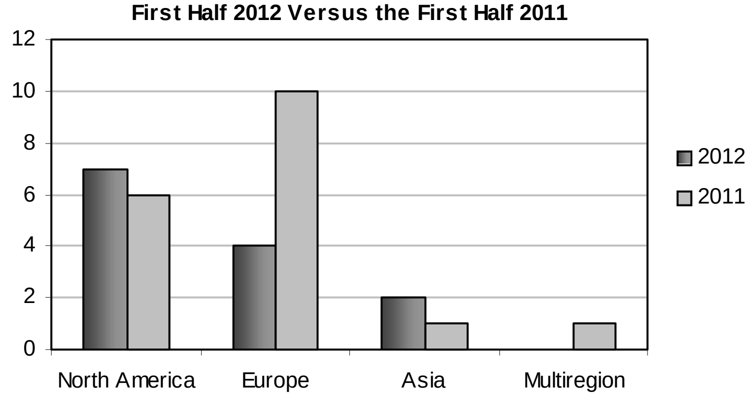


Chart 3: Percentage of Deals by Target's Region

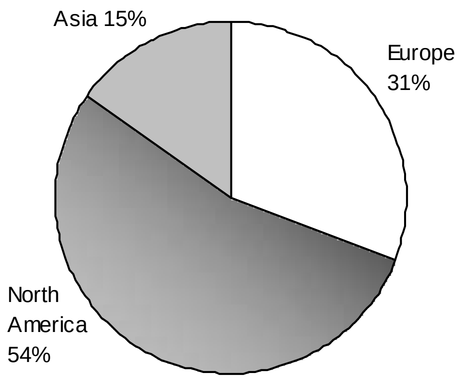
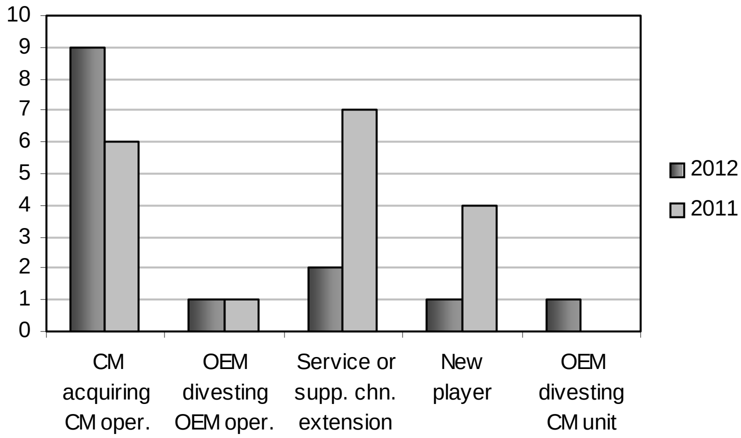


Chart 4: Deal Breakdown for the First Half 2012 Versus the First Half 2011



va Manufacturing Services (FL) acquired **Coast Electronic Manufacturing** (FL); France's **AsteelFlash Group** purchased **Catalyst Manufacturing Services** (NY); and tier-one provider **Flextronics** added **Stellar Microelectronics** (CA). The latter deal was an exception to the rule that says tier-one providers don't need to engage in such M&A activity. Also in North America, Canadian providers **Artaflex** and **Adeptron Technologies** combined in a reverse takeover of Adeptron by Artaflex.

In Europe, EMS industry buyers acquired three operations there. US-based **API Technologies** picked up **C-MAC Aerospace Limited** of the UK; Belgium's **Connect Group** purchased Dutch EMS provider **Halin Group**; and French EMS company **éolane** bought an Estonia operation formerly part of **Elcoteq**, which declared bankruptcy in 2011.

Turning to Asia, *MMI* found just one EMS operation acquired on that continent. Canada-based **SMTC** bought out **Alco Electronics**' share in their joint-venture factory in China.

Except for the SMTC deal, all of the acquisitions of EMS operations resulted in the loss of an independent EMS provider, defined as consolidation. So eight out of the nine acquisitions were consolidation deals.

An additional consolidation deal occurred when **Plexus** obtained assets and people from a **Kontron** manufacturing operation in Malaysia. Although this deal was primarily an OEM asset divestiture, it also included a contract manufacturing business. Plexus' acquisition of this business eliminated another independent EMS operation.

Adding the Plexus-Kontron transaction to the eight consolidation deals previously counted means that nine consolidation deals occurred in the first half, compared with five tallied for the year-ago period. The year-over-year increase amounts to 80%, reflecting not an unusual amount of consolidation but a recovery from a lull in such activity during the first half of 2011 (Chart 5). This year's total of nine was slightly above a nine-year average of 7.9 first-half consolidations deals per annum.

The aforementioned Plexus-Kontron deal was the only OEM asset divestiture identified for the first half. (This deal is unusual in that it falls under two categories: an OEM divesting an OEM operation and an OEM divesting an EMS unit. It is therefore

Chart 5: First-Half Consolidation Deals Over Time

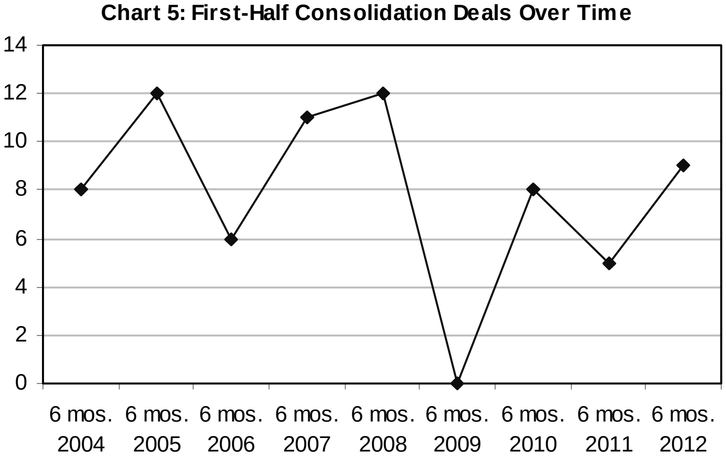
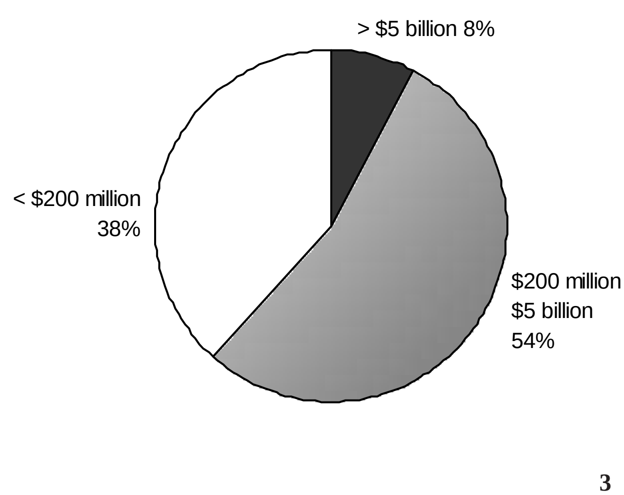
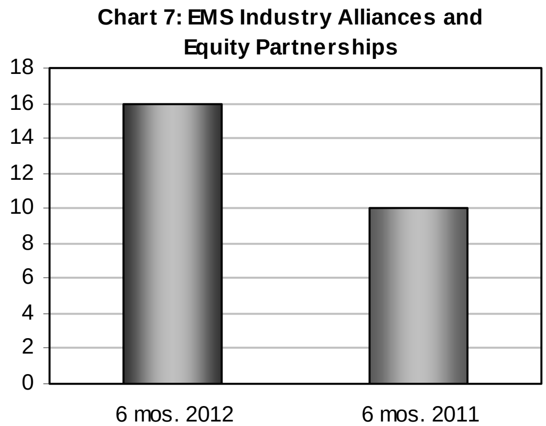
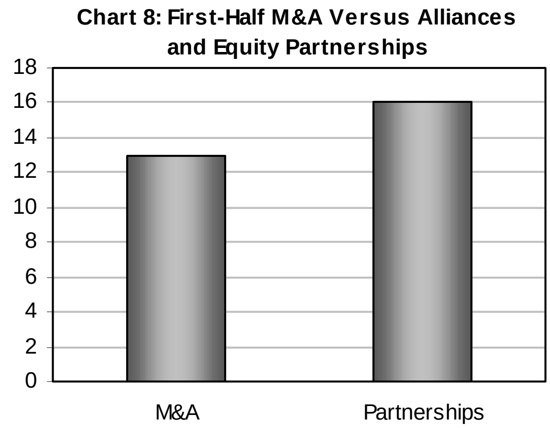


Chart 6: Percentage of Deals by Size of Acquirer







counted twice in Chart 4, p. 3.) Having peaked in popularity at the turn of the century, OEM divestitures have fallen out of favor for the most part in the EMS industry.

Another type of deal arises when an EMS provider makes an acquisition to expand its capabilities horizontally or vertically. Called a service or supply chain extension, transactions of this kind usually occur in numbers that approach, if not exceed, the level of EMS operations acquired. But not this year. Just two capabilities deals took place in the first half versus seven in the same period a year ago. Sweden's **PartnerTech** acquired **Aerodyn**, a contract manufacturer of heavy ship components, for PartnerTech's machining business, and **SigmaTron International** (IL) bought **Spitfire Control** (IL), an electronic controls ODM focusing on the appliance industry.

It is not clear why capability deals lost popularity in the first half. But if this phenomenon persists throughout the year, then some explaining is in order.

The final category in this analysis covers transactions where a new EMS player emerges from the sale of a manufacturing business. In the first half, one new player, component supplier **Airborn** (TX), made its entry with the acquisition of **AESCO** (MA and OH), a contract manufacturer and electronic distributor. In contrast, four new-player deals closed in the first half of 2011.

Buyers with sales of $200 million to $5 billion made the majority of first-half deals. These companies accounted for 54% of the transactions completed during the period. Acquirers with sales of less than $200 million contributed 38% of first half-deals, while tier-one providers whose sales exceeded $5 billion were responsible for just 8% (Chart 6, p. 3).

Of course, there are alternatives to making an acquisition when a provider needs to add a capability or expand its geographic reach. Form an alliance, take a minority stake in a partner or form a joint venture. Such partnerships can also give a company access to technology that it covets. Indeed, arrangements of this kind seemed to have struck a chord in the first half as the number of alliances and equity partnerships surged by 60% year over year to 16 (Chart 7). If such arrangements continue at this pace in the second half of the year, they will set a new high. What's more, there were more alliances and equity partnerships in the first half than M&A transactions (Chart 8). In 13 previous years of tracking, such partnering had never outnumbered M&A in any given year.

The most popular motive for forging an alliance or equity partnership in the first half was to add a capability to an EMS provider's service offering. Seven providers were involved in eight such arrangements (one provider, **Firstronic**, was in two). In contrast, on only two occasions did a provider gain a capability through an acquisition. Thus, in the first half there was much more interest in partnering for a capability than buying it.

Design was the capability most frequently sought from a partner. AsteelFlash, Firstronic, **Kimball Electronics Group**, **OnCore Manufacturing** and **Thames Gateway Manufacturing Centre** each teamed up with a partner on the design side.

A desire to expand geographic reach offers another reason that providers agree to cooperate with another company. AsteelFlash, **Bittele Electronics**, **ESCATEC** and **Jabil** each found an ally that will allow them to serve customers in a new country or region.

Sometimes, a provider will team up a partner in order to gain access to technology. Technology formed a basis for partnering by **Flextronics Automotive**, **Hon Hai** (twice) and **Sanmina-SCI** (for the latter, see News, p. 7).

Editor's note: First-half 2012 statistics published here should be treated as preliminary. It is possible that *MMI* will come across additional first-half transactions after this article is published. Also be advised that this analysis excludes private equity deals as well as divestitures by EMS providers unless the operations sold are retained within the EMS industry.

Results

Some Quarterly Results

Flextronics. Revenue for its fiscal Q1 ended June 29 amounted to $6.0 billion, down 6% sequentially and 20% year over year. The year-over-year decline resulted almost entirely from a business model shift to significantly less high-velocity business. Non-GAAP EPS of $0.23 decreased 4% sequentially but rose 10% year over year. Both revenue and non-GAAP EPS were within guidance.

The company recorded non-GAAP operating income of $177 million, up 12% sequentially but down 12% year over year. GAAP net income from continuing operations was $137 million, down 3% sequentially but up 1% year over year. Note that all operating and net income figures for the March quarter were adjusted downward by $32 million, as a subsequent event, to write off inventory and accounts receivable related to a solar customer. For the June quarter, Flextronics earned GAAP EPS of $0.20 from continuing operations, flat versus the March quarter and 11% higher than in the year-ago period.

At 46% of sales, Integrated Networks Solutions business declined 2% sequentially and year over year. Slightly below expectations of stable revenue, this performance reflected continued strength of some new wins offset by some softening across most of the company's top customers in the last month of the quarter. Comprising 17% of total revenue, Industrial and Emerging Industries (IEI) sales grew 7% from the prior quarter, in line with expectations. The increase was fueled by solid growth of the company's capital equipment business together with several new customer program ramps. On a year-over-year basis, IEI sales fell 10%.

Sales from the High Reliability Solutions group, which contributed 11% of total revenue, rose 4% sequentially and 20% year over year. The sequential growth was in line with expectations. High Velocity Solutions (HVS) business shrank to 26% of company sales from 31% in the prior quarter as business dropped 22% sequentially and 48% year over year. Within expectations, the sequential decline resulted from continued reduction of business with the company's largest mobile customer, **RIM**.

Non-GAAP gross margin came in at 6%, up 40 basis points sequentially, while non-GAAP operating margin equaled 3%, up 50 basis points sequentially.

Guidance the September quarter includes revenue of $5.9 billion to $6.3 billion, non-GAAP operating margin of 3% to 3.3%, and non-GAAP EPS of $0.21 to $0.25. At the midpoint of sales guidance, Flextronics expects stable to slightly growing sales versus the prior quarter for all of its business groups except for HVS, whose sales are projected to grow by mid single digits.

Jabil. For its fiscal Q3 ended May 31, sales totaled $4.25 billion, up 0.3% sequentially and 0.5% year over year. Non-GAAP EPS amounted to $0.64, up 10% from the prior quarter and the year-earlier period. GAAP EPS stood at $0.48, an increase of 4% sequentially and 2% year over year. Sales and non-GAAP EPS were within guidance, while GAAP EPS was one cent below the low end of guidance. GAAP EPS would have been well within expectations were it not for a $10.1-million charge taken for a distressed customer in the solar industry. The company earned GAAP net income of $101.3 million, up 4% sequentially but down 3% from a year earlier.

Non-GAAP operating margin for the May quarter came in at 4.5%, up 30 basis points from the prior quarter and the year-ago period. Non-GAAP operating income of $190.3 million rose 8% sequentially and 7% year over year. Non-GAAP EBITDA margin reached 6.5%, its highest level since 2005.

Revenue from Diversified Manufacturing Services grew 22% year over year, driven largely by strength in Jabil's Specialized Services sector. DMS represented 44% of the company's sales in the quarter. The segment's non-GAAP operating margin of 6.5% improved by 60 basis points sequentially and 30 basis points year over year.

Accounting for 31% of total revenue, Enterprise and Infrastructure business dropped 4% from a year earlier. Still, the business exceeded expectations, and the quarter saw strength in storage. Non-GAAP operating margin for the E&I segment was 2.2%, up 50 basis points sequentially but down 170 basis points year over year.

Sales from the company's High Velocity segment fell 20% year over year, driven by continued weakness in handset volumes. Excluding handset business, the segment is performing very well, Jabil noted. The segment's non-GAAP operating margin amounted to 3.7%, down 30 basis points from the prior quarter but up 150 basis points from a year earlier. This margin remained above the company's target for the segment.

For the August quarter, Jabil expects revenue of $4.1 billion to $4.35 billion, non-GAAP operating margin of 4.1% to 4.6%, non-GAAP EPS of $0.54 to $0.66, and GAAP EPS of $0.43 to $0.55. On a year-over-year basis, the company estimates that DMS sales for the quarter will increase 17%, and that E&I and High Velocity sales will decline 5% and 22% respectively.

Plexus. Fiscal Q3 sales for the quarter ended June 30 totaled $609 million, up 6% sequentially and 9% year over year. EPS of $0.66 rose 18% sequentially and 14% year over year. Sales were slightly above the midpoint of guidance, while EPS came in at the high end of the guidance range. EPS benefited from foreign currency exchange gains and a reduction in estimated tax rate; together, the two factors raised EPS $0.04 above the company's expectations. Plexus earned net income of $23.5 million, up 7% from the same period a year ago.

In the June quarter, the company's networking/communications sector grew about 13% sequentially, on balance a bit stronger than expected when guidance was set in April. Plexus anticipates that sector revenue in the September quarter will be sequentially flat to slightly up, reflecting a softening in the company's expectations from a quarter ago. In the September quarter, the company is starting to ramp a new customer program that is offsetting, in part, some of the broader weakness in this sector.

Medical sector revenues increased some 11% sequentially, slightly softer performance than earlier expectations. The company's medical sector forecast has softened modestly for the September quarter versus the company's view in April. Plexus expects medical revenue to go up sequentially in the low single-digit percentage range.

Industrial/commercial sales were down about 1% sequentially in the June quarter, a result that was marginally weaker than earlier expectations. The company anticipates that a continuing inventory correction combined with further end market weakness will cause sales to decline sequentially in the mid teens percentage range in the September quarter.

June quarter business in the defense/security/aerospace sector fell about 4% sequentially, in line with expectations. For the September quarter, the company expects sequential growth of 20% or more for this sector, driven primarily by new program wins.

Gross margin for the quarter was 9.4%, down 10 basis points sequentially and 30 basis points year over year. Operating margin stood at 4.5%, unchanged from both the prior quarter and the year-earlier period. Plexus said it may be difficult to achieve its 5% operating margin target in an environment where its revenue growth is heavily biased toward ramping new programs versus end-market growth of mature programs. Facility expansions are also weighing on operating margin.

Guidance for the September quarter calls for revenue of $590 million to $620 million and EPS of $0.60 to $0.66, the latter excluding any unexpected restructuring charges.

Sanmina-SCI. For its fiscal Q3 ended June 30, the company recorded revenue of $1.55 billion, up 6% sequentially but down 7% year over year. Non-GAAP EPS was $0.26, down 4% sequentially and 38% year over year. Revenue beat the high-end of guidance, while non-GAAP EPS came in at the low end of guidance. The provider earned GAAP net income of $8.9 million, compared with a loss of $1.4 million in the prior quarter and net income of $9.4 million in the year-earlier period. GAAP results included a $4.2-million charge associated with the redemption of $100 million of debt.

Non-GAAP gross margin for the June quarter amounted to 6.8%, down 60 basis points sequentially and 120 basis points year over year. Gross margin was lower than the company had anticipated primarily due to lower profitability in the components business and a one-time foreign exchange exposure that was not fully hedged. Non-GAAP operating margin equaled 2.8%, down 30 basis points from the prior quarter and 110 basis points from the year-earlier period.

Sanmina-SCI said weak demand in the components business exerted a drag on overall profitability. Components revenue, which continues to be a challenge, fell 2% sequentially and 19% year over year. The company said the components business was a disappointment, and it is evaluating alternatives to quickly improve profitability in this business.

Sequential revenue growth in the company's communications networks and defense/industrial/medical segments more than offset continued weakness in its multimedia segment. Sales from communications networks rose 12.9% from the prior quarter, while sales from the defense/industrial/medical area went up 8.6%. Enterprise computing and storage business declined 1.5% sequentially, and multimedia segment revenue dropped 14.3%, mainly driven by set-top box business.

Based on new projects and forecasts from strategic customers, Sanmina-SCI expects modest sequential revenue growth and margin expansion in the September quarter. In the outlook for the quarter, the company is forecasting revenue of $1.575 billion to $1.625 billion, non-GAAP gross margin of 6.9% to 7.3%, non-GAAP operating margin of 3% to 3.2%, and non-GAAP EPS of $0.32 to $0.38. The company is projecting sequential growth in the September quarter for all segments except multimedia, whose decline will again be mainly driven by set-top box business.

News

Canadian Provider to Expand into US

Canadian EMS provider **Artaflex** (Markham, Ontario) intends to gain a US presence by acquiring **MTI International**, an EMS provider based in Milwaukee, WI. Publicly held Artaflex has entered into a definitive agreement to acquire MTI for a cash purchase price of up to US$12.75 million plus cash held by MTI as of the closing date less excluded liabilities and subject to working capital adjustments.

Founded in 1975, MTI specializes as a full-service provider of high-value, complex, low to medium-volume assembly including PCBs, box build and system integration and to a lesser extent thick-film hybrid circuits. MTI focuses on four under-penetrated markets: defense/aerospace, industrial, medical and automotive.

"Our management team at Artaflex has had significant experience acquiring and growing operations in the US over the past 20 years, and with MTI as a base, we will be able to leverage that combined knowledge again," said Paul Walker, CEO of Artaflex. Walker was one of the founders of **SMTC**, a Top 50 EMS provider, and served as its CEO.

To fund the acquisition and related expenses, Artaflex has entered into letters of intent with **Kilmer Capital Partners** for a CDN$15.3-million financing package.

The acquisition is expected to close on or about August 1st.

Technology alliance…The Defense and Aerospace Division of **Sanmina-SCI** (San Jose, CA) has entered into an exclusive marketing agreement with **Adacel Systems** (Orlando, FL) for a version of Adacel's speech recognition system that will be at the heart of Sanmina-SCI's Voice Initiated Command Execution system. The division is developing the initial VICE system for a new version of the **Boeing** Apache helicopter.

Some new business...**ArrayPower** (Sunnyvale, CA) has selected **Flextronics** (Singapore) as its global partner for production of the ArrayPower Sequenced Inverter. Flextronics is also serving as production partner for **Precise Biometrics'** Tactivo, a smart casing for tablets and smartphones that includes an embedded fingerprint and smart card reader. ...**Amazon** and **Foxconn International Holdings** are said to be collaborating to develop a smartphone for Amazon, *Bloomberg* reported. FIH is the handset subsidiary of **Hon Hai Precision Industry** (Tucheng City, Taiwan)….**Cooper Bussmann** (St. Louis, MO) recently contracted **Kimball Electronics Group** (Jasper, IN) to manufacture products the utilize surge and fusing technologies. This contract involves a wide variety of fuses for the electrical, electronics and transportation industries.

Facility investments…Hon Hai plans to locate a robot production site in China's Henan province, which would be the company's second one in China after a robot site in Shanxi province, according to published reports. Among other recent investments in China, Hon Hai put $35 million into an energy management project in Nanyang, Henan province. *CENS* reported that the venture aims to supply LED streetlights in China….**Creation Technologies** (Burnaby, BC, Canada) has opened its second facility in Silicon Valley to meet the growing demand of existing customers and the demand of new customers. The company's existing Santa Clara unit almost doubled its revenues last year. With over 79,000 ft^2, the new Milpitas plant more than doubles Creation's manufacturing capacity in Silicon Valley. …**Suntron** (Phoenix, AZ) has expanded its factory in Tijuana, Mexico, by 27,275 ft^2, bringing the facility's footprint to 106,000 ft^2. The additional space includes a class 100,000 clean room. Suntron has also added large-scale systems integration services within the Tijuana facility. What's more, the company has opened a class 10,000 clean room at its Phoenix facility. Clean rooms are one way to attract medical business.

Foxconn wages in China to double next year?...Foxconn (Hon Hai) intends to double the average monthly wages of its Chinese workers to 4,400 yuan next year from the current level of 2,200 yuan, according to reports by two Taiwan-based websites, which cited remarks made by Hon Hai chairman Terry Gou in May. One website, *Digitimes*, reported that the increase would go into effect by August 2013, while the other, *Want China Times*, wrote that it would take effect by the end of 2013.

More labor groups target Chinese factories…Following the **Fair Labor Association's** report on Foxconn operations that manufacture for **Apple**, two other labor groups issued reports on Chinese factories in the electronics supply chain. **China Labor Watch** (New York, NY) released the results of its investigation of ten factories in Apple's supply chain. Among the factories covered in the report were Foxconn's Guanlan operation and a **Jabil** Materials Technology Group facility, both in Shenzhen. Jabil spokesperson Beth Walters told *MMI*, "When a report such as this is issued, Jabil will certainly investigate any claims and will remedy any irregular findings in a timely, responsive fashion."

A second group, the **Institute for Global Labour and Human Rights** (Pittsburgh, PA), published a report on the factories of **VTech** (Hong Kong), a cordless telephone manufacturer that also provides contract manufacturing services. VTech issued a point-by-point rebuttal of allegations made in the report, which incidentally made no reference to VTech's contract manufacturing business.

Corrections…Due to a typographical error, the June edition on page 3 presented **Sparton's** March quarter sales as $55.0 billion. The figure should have been $55.0 million. …Page 7 of the June edition reported that **SMTC** had bought out its Chinese joint venture partner, **Alco Electronics**. This statement was inadequate because SMTC did not acquire Alco. Instead, SMTC bought out Alco's share in a joint-venture factory in Dongguan, China.

More Risk in Mexico

As regional manufacturing gains momentum, Mexico, it appears, stands to benefit from this trend. Mexico, as the EMS world knows, is a natural choice for OEMs seeking cost reductions for products that are both made and sold in North America. And a sputtering US economy provides motivation for cost cutting. So a swing toward regional manufacturing will put Mexico in the catbird seat. Or will it?

Until recently, *MMI* would not have questioned the Mexico option. The country has long been a host for EMS operations both on the border and in the interior. Sure, there were risks associated with Mexico, but no place was risk-free. What's more, the EMS industry's experience in Mexico showed that the risks were usually outweighed by the savings offered by a lower-cost Mexico site. But the risk-benefit analysis of Mexico's past may not apply to its future.

Crime, especially drug-related violence, has been a risk of manufacturing in Mexico for some time now. Lately, however, the risk has increased as mass murders by drug cartels have escalated. The violence is not confined to one or two areas in Mexico. For instance, Wikipedia lists five states in which massacres have occurred since 2011.

In May, 49 mutilated corpses turned up near the city of Monterrey in Northern Mexico. Four days before that, 18 decapitated and dismembered bodies were found in the vicinity of Guadalajara, a major EMS hub in Mexico. Guadalajara, a university town, had not been associated with this kind of violence until November of last year when 26 dead bodies appeared in the city's downtown. All three atrocities have been attributed to the Zetas, an especially violent cartel that is in a turf war with the Sinaloa cartel. The two cartels have emerged as the heavy hitters in Mexico's drug war.

But it is the rise of the Zetas that is perhaps most disturbing. Unlike the other cartels, the Zetas were formed as a paramilitary organization by deserters from Mexico's special forces. As a criminal syndicate, the Zetas are your worst nightmare. Their activities are not confined to drugs; the July 2nd issue of the *New Yorker* reported that they specialize in "kidnapping, extortion, murder, robbery, human smuggling and product piracy." According to the *New Yorker* article, the Zetas are now present in 17 states of Mexico, and their numbers are estimated at more than 10,000. With a goal of spreading terror, the Zetas engage in violence of mind-boggling proportions. Though 18 bodies were discovered in May near Guadalajara, the Zetas had intended to abduct and murder 50 ordinary people, the *New Yorker* reported.

That the Zetas are moving into formerly peaceful Guadalajara is one indication that the Mexican government has been unable to stop the cartels. As the cartels have gained strength across Mexico, they have become a greater threat to law-abiding citizens and those who visit Mexico.

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