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Aftermarket Services Gaining More Respect

For years, repair was the last and perhaps least item listed for many a full-service offering in the EMS industry. This aftermarket service satisfied customers who wanted their EMS provider to repair the assemblies it manufactured. But aftermarket repair for the most part remained an adjunct to manufacturing. Today is a different story. More and more providers are treating repair and other aftermarket services as a growth business in its own right rather than a service add-on. As a result, these companies are placing greater emphasis on aftermarket services (AMS).

• Take **Celestica**. In early 2010, the company acquired an AMS firm, **Invec Solutions**. The deal gave Celestica proprietary software for reverse logistics and an AMS center in the UK (Jan., p. 7). Celestica is also backing its AMS business in other ways. The provider recently put an executive VP, John Boucher, in charge of its aftermarket services business. His previous position at Celestica was executive VP, Sales and Supply Chain Solutions. The company believes that his supply chain expertise matches up with the need for supply chain capabilities on the AMS side.

In addition, Celestica is investing in people, processes and tools for serving not only the OEM market but also new markets, such as carriers, that are called out on Celestica's AMS roadmap. The roadmap also brings the company into another new market, retail, and Invec software will pave the way for that market entry.

• AMS has taken a prominent role in a new organization going into effect next month at **Elcoteq**. The company will basically consist of two business segments, EMS and AMS. By putting AMS operations in their own segment, the company aims to establish stronger and more focused management for its AMS business. Elcoteq plans to expand both the geographical footprint and service offering of its AMS business. Currently, AMS represents about 10% of Elcoteq's sales.

Under Elcoteq's redefined strategy of providing a full scope of life cycle services, the company will place special emphasis on growing aftermarket services, supported by its engineering and fulfillment services. One of the company's goals is to increase the relative weight of AMS customers. Elcoteq signaled its pursuit of AMS business in the first quarter of 2010 when it qualified to be an AMS supplier for **Nokia** devices (Feb., p. 8). Elcoteq's life cycle services approach applies to both product and service companies, indicating that the company will not restrict its sales efforts to OEM markets.

• With about $1.5 billion in revenue and 18,000 to 20,000 employees, **Flextronics'** AMS business is the largest one in the EMS industry. That is, with the possible exception of behemoth **Hon Hai**, which of course has said nothing about its AMS operations. Flextronics' AMS operations benefited greatly from Flextronics' 2007 acquisition of **Solectron**, which had a large AMS organization of its own, perhaps the largest AMS business at that time. A May presentation by Flextronics showed that it expects its aftermarket services revenue to increase by 10% to 20% in its fiscal 2011 (ending March 2011) over fiscal 2010. Flextronics is not only focused on growing its AMS

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business, but also differentiating it.

The company's Retail Technical Services unit is used by Flextronics as an example of how its AMS offerings differ from others. According to the RTS website, the unit has 5,000 employees providing service in 1,100 retail stores. (In May, Flextronics reported 4,000 in-store employees.) Recently, Flextronics made a move that further differentiates its offerings within the RTS unit. The company launched Firedog, an RTS division specializing in technical installation and maintenance for home and office equipment (July, p. 7).

• **Jabil Circuit** was among the first EMS companies, if not the first, to put its AMS organization on a separate footing. The provider's Aftermarket Services Division employs about 12,000 people across 15 facilities. For fiscal 2010 ended Aug. 31, the division's sales, which represented 6% of company revenue, increased 12% from a year earlier. Jabil pointed out that it did not rely on multiple acquisitions to grow its AMS business, but followed a strategy of building one facility at a time from scratch. The company reported that every one of its AMS facilities is adding business and people, albeit at different rates.

Jabil is planning to expand its AMS suite of services. "When you execute well, customers ask you to do more and more and expand your service offering. And that's what we're experiencing here," Hartmut Liebel, Jabil's Aftermarket Services Division president, told *MMI*.

• Large providers are not the only ones with an interest in AMS. In 2009, Sweden's **PartnerTech** announced that it was planning to reinforce its logistics and after-sales offering to better serve its customers. The plan is paying off as many customers are seeking solutions for final assembly, distribution and service near their own customers. For example, **Axis Communications**, a provider of network cameras, chose PartnerTech to set up and run a distribution and service center for all Axis products intended for North and South America. What's more, PartnerTech's new plant in Myslowice, Poland, serves as a hub for rapid distribution throughout Europe, according to the company. In addition, PartnerTech has strengthened its customer service operations in the U.S., which include distribution for the U.S. market.

Why the interest in AMS?

The appeal of aftermarket services is multidimensional. They offer EMS providers a large market of potential business beyond the traditional EMS space. Jabil estimates the size of the AMS market at about $200 billion to $210 billion. The company's research indicates that about 20% to 30% of the market is outsourced, with significant variations among market segments. According to Jabil's Hartmut Liebel, the mobile segment is about 80% to 95% outsourced at the high end of the spectrum, and the medical segment is about 2% to 5% contracted out at the low end. Not only is the AMS market large, but it offers outsourcing-driven growth, especially from the least penetrated segments. This is music to an EMS provider's ears.

Providers also like the financial metrics of AMS activities, which typically offer a favorable margin mix. Take Flextronics. Its AMS business generates operating margins in mid-single digits, which are greater than corporate average margins, Flextronics reported during its Investor and Analyst Day in May. The business generates more than 15% of the company's free cash flow. Then there's Jabil. For the quarter ended Aug. 31, Jabil's AMS Division produced a non-GAAP operating margin of 8.2%, compared with 4.1% for the entire company.

AMS business tends to be sticky, another characteristic that EMS providers look for. "It's very difficult to switch providers. Clients make significant bets for multiple years," said Liebel.

Landing an AMS order such as board repair job can also start a relationship with desirable customer, especially for a smaller provider that otherwise might have a tough time getting the customer's attention. Once inside the customer's organization, the provider is then in a position to seek production orders. Repair work "gives us a shot on production," said Mike Thompson, CEO of **I. Technical Services** in Georgia (and an *MMI* adviser). He reported that 80% of ITS's business started in the back end.

Aftermarket services also complete an end-to-end offering at the back end, giving providers the ability to sell a life-cycle solution for a customer's product. The life-cycle concept has been around a long time, and some OEMs have adopted it. But they are the exceptions. For the most part, EMS providers today do not have end-to-end responsibility. On the back end, the reason has to do with how outsourcing decisions are made within OEMs.

Jabil's customers offer an illustration. "The vast majority of Jabil's customers, all players in the broader outsourced world, still make separate decisions as to who their manufacturing partner is and who their aftermarket outsourcing partner is," said Liebel. He feels confident that with some exceptions the same is true for other AMS providers as well. Still, Jabil pointed out that some of its larger customers do take advantage of its end-to-end services.

John Boucher, Celestica's aforementioned executive VP, sees a convergence trend in OEM decision making, where COOs are increasingly taking ownership of AMS in addition to manufacturing. If you pull the organization chart of the top 10 OEMs, "you will find more and more [COOs] have responsibility of service operations than say three years ago," he said.

Another AMS trend involves the purchase of spare parts. Much of the business done by AMS providers, many of them small shops, is consignment-based with respect to spare parts. "To me, the aftermarket business in the electronics space is where the EMS business was some 10 to 15 years ago in terms of supply chain," said Boucher. Just as the EMS business emerged when it converted from consignment to turnkey, the aftermarket business "is now going to more of an end-to-end turnkey [solution]," he said.

The conversion to turnkey is one more incentive for EMS providers who are pursuing AMS as long as they can handle spare parts management.

Market Data

Big Numbers Put Up in First Half

First-half results for 20 of the world's largest contract manufacturers show that the outsourcing business can still achieve a period of high growth. Together, the 20 companies increased their first-half sales by 37.8% year over year. Sales for the 20 CMs, consisting of 11 EMS providers and nine ODMs, totaled $131.8 billion in the first half, up from $95.6 billion in year-earlier period.

Given the uncertain state of the U.S. economy, growth at such a high rate may be short lived. But 2010's growth should end up well into double-digit territory for this group, barring a wholesale collapse of demand.

With sales converted into U.S. dollars, five of these CMs boosted their

Table 1: Q2 and Six-Month 2010 Results for Twenty of the Largest Contract Manufacturers (M US$ or %)

Company (in order of 6-mo. sales)	Primary business	Headquarters	Reports in US$	Q2 '10 sales	Q1 '10 sales	Qtr.-qtr. chg.	Q2 '09 sales	Yr.-yr. chg.	Q2 '10 net profit	Q1 '10 net profit	Q2 '09 net profit	Q1-2 '10 sales	Q1-2 '09 sales	Yr.-yr. chg.	Q1-2 '10 net profit	Q1-2 '09 net profit
Hon Hai (Foxconn)	EMS	Taiwan	No	20,542	17,055	20.4	13,113	56.7	526	564	454	37,597	24,250	55.0	1,090	847
Quanta Computer	ODM	Taiwan	No	9,267	7,914	17.1	5,474	69.3	160	167	148	17,181	10,363	65.8	327	277
Compal Electronics	ODM	Taiwan	No	7,132	7,173	-0.6	4,036	76.7	202	267	98	14,305	7,569	89.0	469	180
Flextronics	EMS	Singapore	Yes	6,566	5,940	10.5	5,783	13.5	118	60	(154)	12,506	11,365	10.0	178	(394)
Wistron	ODM	Taiwan	No	4,678	4,491	4.2	3,846	21.6	93	85	57	9,169	7,159	28.1	178	99
Pegatron*	ODM	Taiwan	No	3,263	3,452	-5.5	2,846	14.7	53	56	15	6,716	5,291	26.9	109	30
Jabil Circuit	EMS	Florida	Yes	3,456	3,005	15.0	2,615	32.1	52	30	(29)	6,460	5,503	17.4	82	(895)
Inventec	ODM	Taiwan	No	2,908	2,808	3.6	3,228	-9.9	36	36	28	5,717	6,140	-6.9	72	70
TPV Technology	ODM	Taiwan	Yes	3,063	2,385	28.4	1,716	78.5	40	40	40	5,449	3,096	76.0	80	55
Sanmina-SCI	EMS	California	Yes	1,625	1,528	6.4	1,209	34.4	22	10	(42)	3,153	2,404	31.1	32	(79)
Celestica	EMS	Canada	Yes	1,585	1,518	4.4	1,402	13.1	(6)	26	5	3,104	2,872	8.1	20	25
Qisda	ODM	Taiwan	No	1,022	1,174	-13.0	1,113	-8.2	28	54	(13)	2,195	2,094	4.9	83	-76
Cal-Comp Electronics	EMS	Thailand	No	913	831	9.9	797	14.6	16	12	13	1,744	1,483	17.6	28	16
Benchmark Electronics	EMS	Texas	Yes	589	572	3.1	482	22.3	21	18	12	1,161	979	18.7	39	21
Plexus	EMS	Wisconsin	Yes	536	491	9.2	379	41.7	24	21	9	1,027	768	33.9	45	14
AmTRAN Technology	ODM	Taiwan	No	512	439	16.5	469	9.1	16	12	15	951	964	-1.4	27	28
Venture	EMS	Singapore	No	469	456	2.9	575	-18.3	33	28	41	925	1,054	-12.2	61	60
Universal Scientific Industrial	EMS	Taiwan	No	463	454	1.8	362	27.7	17	17	11	917	677	35.5	34	18
Ability Enterprise	ODM	Taiwan	No	434	352	23.6	227	91.7	23	19	17	786	380	106.6	42	25
Elcoteq	EMS	Luxembourg	No	423	305	38.7	594	-28.7	(7)	56	(30)	728	1,206	-39.6	48	(89)
Total/avg.				**69,448**	**62,342**	**11.4**	**50,266**	**38.2**	**1,468**	**1,576**	**697**	**131,790**	**95,616**	**37.8**	**3,044**	**231**

Results in non-U.S. currencies were converted to U.S. dollars by applying a three-month average exchange rate for the corresponding quarter. Average exchange rates were based on monthly 2009 and 2010 data from the U.S. Federal Reserve. *Results correspond to Pegatron's core DMS business.

Chart 1: First-Half Percentage Growth Year Over Year

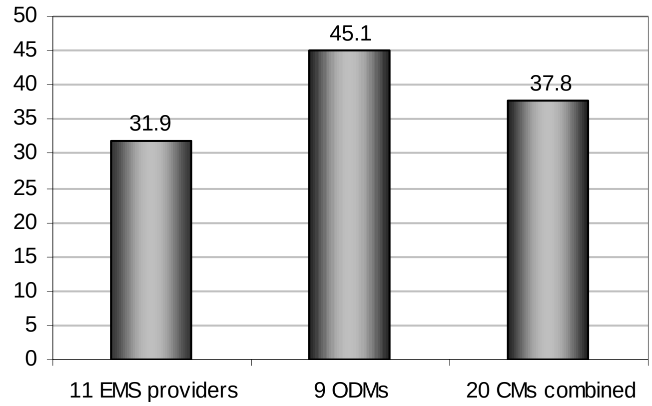
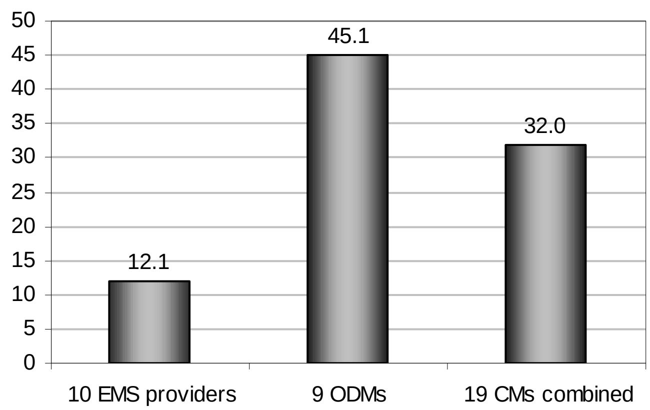


Chart 2: First-Half Percentage Growth Year Over Year Excluding Hon Hai



first-half revenue by more than 50% (Table 1, p. 3). All but one are ODMs. The growth leader was ODM **Ability Enterprise**, which more than doubled its first-half sales.

The group of 20 earned a combined net profit of $3.04 billion in the period, up dramatically from $231 million a year earlier. Composite net margin for the first half stood at 2.31%, and all 20 CMs reported positive bottom lines.

Based on data from the group's 11 EMS providers and nine ODMs, the growth gap between the two sides of the outsourcing space continued through the first half. First-half sales growth for the EMS providers amounted to 31.9%, compared with 45.1% for the ODMs (Chart 1). So EMS growth lagged ODM growth by 13.2 percentage points.

The gap would have been much greater without the contribution of **Hon Hai Precision Industry**, far and away the world's largest contract manufacturer, whose sales are counted on the EMS side. Excluding Hon Hai, the growth disparity balloons to 33 percentage points (Chart 2).

Still, the growth gap narrowed to 4.5 percentage points in Q2. Combined Q2 sales on the EMS side grew by 36.1% year over year, while the ODM total went up by 40.6%. In addition, the EMS providers bested their ODM counterparts in terms of Q2 sequential growth, 15.6% to 6.9% (Table 2).

Q2 sales for the entire group totaled $69.4 billion, up 11.4% sequentially and 38.2% year over year. **Elcoteq** posted the highest sequential growth, followed by **TPV Technology**. Q2 revenue fell from the prior quarter at three companies, all of them ODMs. On a year-over-year basis, 15 companies achieved double-digit increases in their Q2 sales. Four out of the remaining five experienced sales declines (Table 1).

In Q2, the group's net profit did not follow the sequential increase in sales. Aggregate net profit was $1.47 billion, down 6.9% from the prior quarter's $1.58 billion. Composite net margin for Q2 equaled 2.11%, 42 basis points below the Q1 margin. Still, combined net profit in Q2 rose 111% year over year. **Venture** produced the highest Q2 net margin, 7.02%, with Ability Enterprise coming in second at 5.24%.

In the past, the ODM business was often portrayed as being more profitable than EMS. But the Q2 data analyzed here do not support this supposition. Composite net margin for the EMS providers in Q2 was 18 basis points higher than that calculated for the ODMs (Table 2). However, it must be pointed out that Hon Hai's net profit in Q2 represented 64% of the EMS total. Without Hon Hai, the EMS margin slips to 1.74%, 28 basis points below the ODM margin.

When companies were ranked by first-half sales, Hon Hai remained in the top spot with a virtually insurmountable lead. **Quanta Computer** retained its second-place rank from 2009 (May, p. 2). **Compal Electronics** moved up to third from last year's fourth position, while **Flextronics** dropped to fourth from third in 2009. **Wistron** and **Pegatron** held on to fifth and sixth place respectively. **Jabil Circuit** and **Inventec** traded places, with Jabil advancing to seventh and Inventec dropping to eighth. **TPV Technology** stayed in ninth position, and **Sanmina-SCI** edged out **Celestica** for tenth place.

Table 2: Comparing Results Where Companies are Grouped by Primary Business (M US$ or %)

No. of companies	Primary business	Q2 '10 sales	Q1 '10 sales	Qtr.-qtr. chg.	Q2 '09 sales	Yr.-yr. chg.	Q2 '10 net profit	Q2 '10 net margin	Q1 '10 net profit	Q2 '09 net profit	Q1-2 '10 sales	Q1-2 '09 sales	Yr.-yr. chg.	Q1-2 '10 net profit	Q1-2 '09 net profit
11	EMS	37,168	32,154	15.6	27,310	36.1	816	2.20	841	292	69,322	52,560	31.9	1,657	(456)
9	ODM	32,280	30,188	6.9	22,956	40.6	652	2.02	735	405	62,468	43,056	45.1	1,387	687
20		69,448	62,342	11.4	50,266	38.2	1,468	2.11	1,576	697	131,790	95,616	37.8	3,044	231

Hon Hai achieves high growth despite its size

Hon Hai's consolidated sales for the first half totaled $37.6 billion, as converted by *MMI* into U.S. currency. If second-half sales at least keep pace with the first-half, then Hon Hai will be at $75 billion or more this year. Yet the company managed to grow by 55% in U.S. dollars (47.6% in NT dollars) in the first half versus the year-earlier period. Of course, demand recovery contributed to Hon Hai's growth in the first half, but demand alone could not account for a sales increase of this magnitude. An unknown amount of new business also factored in here, and the company gained market share with a higher than average growth rate. Hon Hai represented 28.5% of the contract manufacturing group's first-half revenue.

However, Hon Hai's net income growth in the first half did not keep pace with the surge in sales. Net profit rose 28.6% in U.S. dollars (22.4% in NT dollars), as margins retreated from the first half of 2009. Gross margin for the first half of 2010 came in at 8.35%, down 99 basis points from a year ago. The company reported a first-half operating margin of 3.33%, 69 basis points below the year-earlier level. Net margin slipped by 60 basis points to 2.89%.

Hon Hai's first-half net income, which amounted to $1.09 billion, took a hit from its handset subsidiary, **Foxconn International Holdings**, in which Hon Hai holds a 71.1% stake**.** For the first half, FIH recorded a comprehensive loss of $140.6 million (attributable to owners of the company), of which Hon Hai shareholders are presumably responsible for 71.1%. According to FIH, lower pricing, changes in product mix, higher depreciation expenses and impairment losses affected its operating results.

FIH's 2.1% increase in first-half revenue stood in stark contrast to the high growth in other parts of Hon Hai's business (Table 3). The handset unit represented 8.6% of Hon Hai's sales for the period.

Hon Hai's consolidated sales for Q2 were $20.5 billion, up 20.4% (20.1% in NT dollars) from the prior quarter. But Q2 net profit of $526 million declined sequentially by 6.7% (6.9% in NT dollars).

The law of large numbers says as companies grow large it becomes more and more difficult to maintain a high growth rate because so much additional revenue is required to achieve the same rate. Although Hon Hai defied the law of large numbers in the first half, the company is acknowledging that its size will limit how fast the company can grow in the future. This month, Hon Hai chairman Terry Gou told *Bloomberg Businessweek* that he is reducing the company's growth target to 15% for future years from its longstanding goal of 30%.

Editor's note: This analysis presents a rough approximation of EMS versus ODM sales since a number of the contract manufacturers listed here do both EMS and ODM work. Companies were classified as EMS or ODM based on which model represents their primary business.

The group of 20 CMs listed here includes one change from a nearly identical list used for a Q1 analysis (June, p. 3). Elcoteq was added to the current list, while **Inventec Appliances** dropped off as Elcoteq's first-half sales surpassed those of Inventec Appliances.

Table 3: Components of Hon Hai's Consolidated Sales

Sales Component	Q1-2 '10 sales (M US$)	Q1-2 '09 sales (M US$)	Yr.-yr. chg. (%)	% of sales
Hon Hai non-consolidated	29,156	17,678	64.9	77.5
Foxconn International Holdings	3,229	3,162	2.1	8.6
Other units	5,211	3,410	52.8	13.9
Hon Hai consolidated	37,597	24,250	55.0	100

Robust Q2 for North American Group

For a group of ten mid-tier and smaller EMS providers based in North America, combined Q2 sales were $615.6 million, up 20.1% year over year. Together, these providers generated almost the same Q2 growth as that collectively produced by the six largest U.S.-traded EMS companies, whose Q2 revenue increased by 21.0% from the year-ago quarter (Aug., p. 4). Based on these results, recovery of the EMS market in Q2 benefited the group of ten mid-tier and smaller providers as much as it did their large counterparts.

First-half sales figures tell nearly the same story. In the aggregate, the ten North-America based providers accounted for first-half revenue of $1.19 billion, representing 15.6% growth from a year earlier, compared with 14.7% for their larger competitors.

Seven out of ten providers in the mid-tier and smaller group grew their Q2 sales by more than 20% year over year. **SMTC** posted the group's highest growth rate at 81.9%, followed by **IEC Electronics** at 50.4% (table, p. 6). On a sequential basis, the group's Q2 sales increased by 7.9%, with six providers in double digits led by **Key Tronic** and **CTS Electronics Manufacturing Solutions** at 19.7% and 19.1% respectively.

The group of ten mid-tier and smaller providers consists of seven stand-alone EMS companies, all publicly traded, and three EMS units within larger publicly-held corporations. The seven stand-alone providers report gross profit, while the three EMS units

Organization	Q2 '10 sales	Q1 '10 sales	Qtr.-qtr. chg.	Q2 '09 sales	Yr.-yr. chg.	Q2 '10 gross marg.	Q1 '10 gross marg.	Q2 '09 gross marg.	Q2 '10 oper. marg.	Q1 '10 oper. marg.	Q2 '09 oper. marg.	Q2 '10 net income	Q1 '10 net income	Q2 '09 net income	Q1-2 '10 sales	Q1-2 '09 sales	Yr.-yr. chg.	Q1-2 '10 net inc.	Q1-2 '09 net inc.
Q2 and Six-Month 2010 GAAP Results for Ten Mid-tier and Smaller EMS Providers Based in North America (M$ or %)																			
Stand-Alone EMS Providers																			
LaBarge	82.4	74.7	10.3	64.8	27.3	19.8	20.6	17.9	9.4	9.4	7.0	4.8	4.1	2.6	157.1	137.0	14.7	8.9	6.4
SMTC	71.2	61.4	16.1	39.2	81.9	11.7	10.4	10.2	5.2	4.3	2.4	3.2	2.1	0.4 [1]	132.6	84.1	57.6	5.2	(0.5) [1]
Key Tronic	61.9	51.7	19.7	45.5	36.1	10.7	10.1	5.8	4.9	4.3	0.7	2.3	4.4	0.3	113.6	89.7	26.6	6.7	0.5
Sparton	40.0 [2]	38.6	3.6	58.8	-31.9	13.8	14.3	7.7	5.6	0.8	-11.9	2.1	0.7	(8.8)	78.7	113.4	-30.6	2.8	(9.6)
SigmaTron International [3]	38.1	35.0	8.8	26.3	44.6	12.2	13.8	8.6	4.2	4.2	-1.2	0.9	1.7	(0.4)	73.0	53.5	36.5	2.6	(0.3)
IEC Electronics	26.1	25.2	3.4	17.3	50.4	17.8	15.9	16.1	8.7	7.9	7.7	1.2	1.0	0.9	51.3	33.7	52.4	2.3	3.5
Nortech Systems	24.7	21.7	13.6	19.9	24.2	12.6	12.1	5.5	2.0	1.5	-11.2	0.1	0.1	(1.5)	46.4	41.4	12.1	0.2	(2.8)
Subtotal/avg.	**344.4**	**308.4**	**11.7**	**271.7**	**26.7**	**14.3**	**14.3**	**10.6**	**6.1**	**5.2**	**-0.9**	**14.6**	**14.1**	**-6.6**	**652.7**	**552.7**	**18.1**	**28.8**	**(2.7)**
EMS Units of Larger Public Companies																			
Kimball Electronics Group	186.5	190.1	-1.9	152.3	22.4				1.5	5.3	-2.5	2.5	10.8	(0.7)	376.7	293.0	28.6	13.3	(10.3)
CTS Electronics Mfg. Solutions	66.6	56.0	19.1	70.8	-5.9				-0.3	-4.8	1.5				122.6	146.6	-16.4		
Raven Industries unit (EMS) [3]	18.1	16.3	10.9	17.9	0.9				15.6 [4]	19.2 [4]	16.5 [4]				34.4	34.1	0.8		
Total/avg.	**615.6**	**570.8**	**7.9**	**512.8**	**20.1**										**1,186.3**	**1,026.4**	**15.6**		

[1] Net income results are for continuing operations. [2] Sparton's Defense and Security Systems (non-EMS) represented about 43% of Q2 '10 sales.
[3] Q2 results are for the quarter ended July 31. [4] Segment operating income excluded corporate expenses.

do not. Composite gross margin for the seven stand-alone providers amounted to 14.3% in Q2, the same as in Q1, but up 370 basis points from the year-earlier period. All seven providers achieved double-digit gross margins for Q2, with **LaBarge's** 19.8% taking top honors (table).

Q2 operating margin for the seven stand-alone providers was 6.1%, an improvement of 90 basis points over the prior quarter. Again, LaBarge was the margin leader at 9.4%. IEC came in second with a margin of 8.7% (table).

However, this composite operating margin dropped to 4.0% when operating results for two of the EMS units were added. (**Kimball International** and CTS report operating income of their EMS units, while **Raven Industries** does not provide a comparable figure.) Still, the 4.0% operating margin, representing nine out of the ten mid-tier and smaller providers, was 130 basis points above what the six largest U.S.-traded providers were able to achieve as a group.

Net income is recorded for eight out of ten providers in the mid-tier and smaller group (the seven stand-alone companies plus Kimball Electronics Group). The eight providers collectively earned first-half net income of $42.1 million on sales of $1.03 billion for a net margin of 4.1%.

News

Cal-Comp To Acquire U.S. Provider

Also plans to make other investments

Cal-Comp Electronics (Bangkok, Thailand), a top-10 EMS provider, intends to purchase an EMS company in the U.S. for $20 million. In a financial report, the company stated that it will make the investment to expand its business base in North America and support customer needs. The company expects the acquisition to be completed this year.

In addition, the company plans to spend $3 million in the third quarter to gain control of two companies in the U.S. and Mexico. The provider will buy 100% interest in the first company and 98% interest in the second. Cal-Comp stated that it will take this step to expand its market in the U.S. and strengthen competitiveness.

Since Asia-centric Cal-Comp currently lacks a production site in North America, these investments will also give the company a manufacturing presence in the region.

Until recently, all of the provider's manufacturing operations were located in Thailand and China. As of Dec. 31, 2009, there were at six Cal-Comp factories in Thailand and five in Suzhou, China. *MMI* has learned that Cal-Comp has set up a 5,200-m^2 plant in Warsaw, Poland, and that the plant is operational.

With an operation in Poland underway, Cal-Comp intends to invest $1 million in the third quarter in order to establish a subsidiary there. The objective is to gain greater access to the European market and to meet customer demand.

Cal-Comp is member of **New Kinpo Group**, and EMS provider **Kinpo Electronics**, another group member, effectively owns a 45.6% interest in Cal-Comp, according to Cal-Comp's 2009 annual report. New Kinpo is a subset of the **Kinpo Group**, which also includes ODM **Compal Electronics**. Compal holds a 6.45% stake in Cal-Comp.

*Deals done…***IEC Electronics** (Newark, NY), a publicly-held EMS company, has acquired **Celmet** (Rochester, NY), a manufacturer of metal chassis and assemblies, for about $2 million in cash. Celmet had 2009 revenue of just over $3.6 million. The acquisition leverages the customers of both companies and enables IEC to extend its capabilities, according to a company statement….**Celestica** (Toronto, Canada) has completed its previously announced acquisition of **Allied Panels Entwicklungs-und Produktions GmbH**, a medical engineering and manufacturing service provider based in Austria (July, p. 5). The company will now be referred to as AlliedPanels, a Celestica healthcare company.

*Some new business…***Brammo** (Ashland, OR) has selected **Flextronics** (Singapore) as its global manufacturing partner for the production of plug-in electric motorcycles and components. According to a statement from the two companies, this partnership enables Brammo to rapidly scale its production in order to meet growing international demand for its products….**Apple** is also using **Hon Hai Precision Industry** (Tucheng City, Taiwan) to manufacture the new Apple TV, Taiwan's *Digitimes* reported….Publicly-held **SMTC** (Markham, Ontario, Canada) will manufacture integrated control cabinets for **FEI's** Titan transmission electron microscopes by employing the sheet metal fabrication, PCB assembly and cable harness assembly capabilities of SMTC's Chihuahua, Mexico, campus….**CTS Electronics Manufacturing Solutions** (Bloomingdale, IL), a unit of publicly-held CTS, will produce PCB and box build assemblies for two next-generation biometric security device products going to the Asian market. Awarded by a major North American supplier of products and services for managing human identity, these programs are expected to generate about $20 million in revenue over two years….IEC Electronics has received orders of about $5.1 million from a military and defense customer and about $5.6 million from a medical customer. The military order is an exclusive program for a helicopter missile launch platform that is ultimately being used by the U.S. Department of Defense….Top 50 provider **Kitron** (Billingstad, Norway), through a Norwegian subsidiary, has gained new orders of about NOK 67 million ($11.1 million) within the medical equipment segment.

*New operations…*Reportedly, Hon Hai has begun building a second factory in Zhengzhou, China, one of the locations designated by the company for its inland expansion (Aug., p. 1). The new plant in Henan province will produce mobile phones and will start out in Q1 with a capacity of 100,000 units a month, reported *Digitimes*, citing industry sources. Hon Hai's first plant there, which is already in production, makes mobile-phone components, according to *Digitimes.* Also, Hon Hai is indirectly investing $43 million in its Russian subsidiary, **Foxconn Rus**. Hon Hai's Russian operation reportedly started production this year near St. Petersburg (May, p. 8). ...Flextronics has opened a roughly one million-ft^2 facility at Ganzhou in China's Jiangxi province to support its Power operations (June, p. 7). The provider has completed phase one of a two-phase build-out there….*MMI* has confirmed that Celestica plans to set up an R&D center in Taipei, Taiwan. ...EMS provider **Federal Electronics** (Cranston, RI) will open a 30,000-ft^2 plant at Hermosillo in Mexico's Sonora state. Scheduled to be shipping product by October, the facility will initially supply cable assemblies, wire harnesses, fiber optic interconnect assemblies and higher-level assemblies to various industries. Plans are underway to introduce SMT and through-hole assemblies….**Delta Group Electronics** (Albuquerque, NM), an EMS company with five assembly sites in the U.S., has begun construction of a 36,000-ft^2 building in Fayetteville, AR. The new structure will serve customers throughout Arkansas, Oklahoma, Kansas and Missouri. Delta Group expanded into this market in 2008 with the acquisition of **Bitworks**, an EMS company in Prairie Grove, AR. Operations in Prairie Grove will move to Fayetteville.

*Alliance…***Adeptron** (Markham, Ontario, Canada), an EMS provider listed in Canada, has partnered with an unnamed EMS provider in Mexico. This new partner can also provide procurement through offices in Hong Kong and Japan. At 42,000-ft^2, the Mexican factory assembles and integrates products such as plasma and LCD TVs, marine GPS devices, mobile and Bluetooth devices, and climate control devices.

New CEO...Effective Oct. 1, top 50 EMS provider **Enics** (Zürich, Switzerland) has appointed Dirk Zimanky president and CEO to succeed Reijo Itkonen, who will retire next year. One of Enics' cofounders, Zimanky led Customer Relationship Management at the company.

How Much of a Threat Is Hon Hai?

Hon Hai's 55% growth (in U.S. dollars) in the first half seems otherworldly. How can a company with $59.3 billion in sales last year manage to grow that much in the first half? The company provides little color to explain its results, but clearly it has been good at attracting customers such as **Apple** that have developed winning products. Hon Hai's low-cost producer strategy continues to serve it well.

The company now dwarfs all other players in the EMS industry. Based on first-half sales, Hon Hai is three times the size of its nearest EMS competitor, **Flextronics**. But it can be argued that for EMS competitors the most worrisome thing about Hon Hai is not its size but its market share gains, especially in the first half of 2010. While Hon Hai was growing at 55%, the remaining nine companies in the EMS top 10 collectively increased their sales by 12.1%. That's a huge difference, reflecting a significant loss in combined market share for the other players.

Is Hon Hai becoming the **Walmart** of the EMS industry? Certainly, both companies share a low-price mentality, and both are dominant players in their respective industries. The rise of Walmart resulted in a retail industry with few competitors. But despite the ascent of Hon Hai, the EMS industry is still rife with competitors of all sizes. Hon Hai has not caused widespread consolidation. And for good reason.

Unlike consumers who make weekly trips to Walmart, OEMs often spread their business around. The Ciscos and RIMs of the outsourcing world would not want to be confined to a single EMS provider. Second, Hon Hai cannot be all things to all OEMs. A small- or mid-sized OEM, for example, may prefer being a significant part of a provider's sales in order to assure the provider's undivided attention. Third, Hon Hai is known for being a high-volume manufacturer. If the secretive company has a low-volume, high-mix unit, it has not disclosed such a unit. Nor would many OEMs associate Hon Hai with low volumes, *MMI* believes. Lastly, Hon Hai built its reputation serving computer and consumer electronics OEMs. It remains to be seen whether the company has the wherewithal to penetrate nontraditional markets such as medical and defense.

While 55% growth is eye-popping, Hon Hai cannot maintain this pace over the long term. The company has said as much (see p. 5). As its growth rates come down, so too will its market share gains. Moreover, a case can be made that it is the ODMs who have the most to fear from Hon Hai as it is rapidly taking share in the notebook space.

In the past, no company was able to hold on to the position of the industry's largest player. In the early days it was **SCI Systems**, which gave way to **Solectron**, which in turn was overtaken by **Flextronics**. But the emergence of Hon Hai has changed this dynamic. Hon Hai has so outdistanced itself from the competition that it will remain in the top spot for the foreseeable future. Does this mean that Hon Hai will cause a massive reduction in the number of industry players? *MMI*'s answer is no.

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