

Michael Marks Interview With EMS Now

October 20, 2008

Q: EMS Now - With the tremendous inflation in wages, facilities and even the RMB in China, what impact will this have on the general flow of manufacturing outsourcing over the next 5 years or so? What are your thoughts on Vietnam vs. China 5 years out??

A: Marks – I'm not sure that it's really going to have that much of an impact on China. Sure you are starting to see some product moving back on-shore, or more likely to Mexico or Malaysia, but really it's not that much. China still has 300 million people that are underemployed – compare that to Vietnam with a total population of around 90M and much less developed infrastructure and supply chains. But to be sure, new EMS business that is getting placed is giving a lot more thought to China than they have over the past few years when China was the answer in almost every situation. The world is getting a lot more complicated, and there are a lot of factors to be considered. But China is going to be the world's factory for the rest of our lifetime, although you will see more competition on the low end and you will see people hedging their bets and spreading business around.

Q: EMS Now - It seems to me that outsourcing 1.0 was capacity based. Outsourcing 2.0 was the divestiture of huge OEM assets. Outsourcing 3.0 has been the wave of vertical integration including design and ODM. What does outsourcing 4.0 look like??

A: Marks – Wow, That's a great question and I haven't really thought about it that way. You know I'm not really sure that it's going to look a lot different than 4.0. I think the strategies that we employed at Flex were pretty sound and created a valuable offering for our customers – but today it seems increasingly hard for the big guys to get paid for that value. I actually think that you may see some undoing of the various strategies over time if these companies do not start driving some shareholder value. It's possible that you may see a wave of EMS divestitures with some of these companies splitting themselves up into parts to try and unlock some value. Combining some of these higher margin businesses into the EMS offering just hasn't driven the overall margins up or added much shareholder value as OEMs continue to grind on price.

Q: EMS Now - Every major publicly traded EMS Company is trading at a significant discount to net book value - why?? Does this suggest that asset deployment in the EMS industry will slow down going forward??

A: Marks – I guess it's because investors think it's not a very attractive business to be in. I don't really think it will change capital deployment that much. There are plenty of measures of asset and overall financial performance and I think some of the EMS companies do a pretty decent job at it. Clearly the EMS guys are out of favor with Wall Street right now – and they might stay that way forever. But the industry is still growing at double digits right now and that's pretty attractive to some people. So I think assets will continue to get deployed to support demand, but perhaps at a slower rate such that you see a bit of margin expansion, at least for the big, financially sound players.

Q: EMS Now - You teach a graduate class in supply chain management at Stanford - what do you tell your students about the EMS industry going forward??

A: Marks – We don't really talk a lot about the EMS industry specifically, but more so as an example of what's happening in the supply chain. Look, the EMS business is huge and it has become an incredibly important part of the global supply chain – it has fundamentally changed the way product companies run their business and how they deploy capital. The development of the EMS business has contributed a lot to the pace of global product innovation as OEMs now have a less complex business model and fewer demands on their intellectual and physical capital. Understanding the key aspects of the supply chain and key trends is what we talk about in class, and the EMS and ODM players are pretty much how things get built in the electronics business.

Q: EMS Now - When you took Flextronics public in 1994, you were doing about \$100M in sales. Did you ever imagine Flex would become a \$32B company in less than 15 years? Where will it be in another 15 years??

A: Marks – (laughs).....No way!!! Look, my plan was pretty simple at Flex in the early 1990s. Clean it up, get sales to \$250M, and sell the thing off. We had a very specific plan around that and the board had bought into it. Back then there was SCI and Solectron that were both well over a billion and we were like 23rd in the industry. Then in 1996 we had this opportunity to buy the facilities from Ericsson and we instantly doubled the company. Suddenly we were the largest guy in Europe, the largest guy in Telecom and we thought “we can take on the big guys!” You know we used to have a saying at Flex – it was part of our culture and you saw it in lots of our presentations – “it's not the big that eat the small.....its the fast that eat the slow.” Over the years we just executed better, worked really hard and had a good strategy. Pretty soon we were in the top 5 and then number 1

So as for the second part, what will Flextronics look like in 15 years – who really knows!! I suspect we'll see \$100B in sales within the next 10 years, but beyond that it's anybody's guess.

Q: EMS Now - You recently made an investment in Riverwood Solutions, a service company that helps people outsource and optimize their supply chain. What was your rationale and how do you see this business playing out??

A: Marks – Since I've left Flex, my phone rings at least once a week – some company looking for operations talent or supply chain help or something. The rapid growth of the EMS industry has caused most of the real operating talent to move to either the big EMS players or the big OEMs like Apple and Dell, so midsized companies just can't attract the talent they need. When a group of ex-Flextronics executives approached me about creating a new company that helps smaller companies design, implement, and manage their supply chains I thought it was a great idea. So they assembled a bunch of serious operations and supply chain talent and put together a model that really works. These guys are now out there saving companies tons of money – I think it's a great model! I told them the other day they should do all of their work for free and just take a small piece of what they save everybody.

Q: EMS Now – Do you have any general advice for the average user of EMS services??

A: Marks – Yes, Absolutely I do!! Make sure your supplier is making a fair return! So many companies just grind the suppliers down to where there is absolutely no margin and no return in the business, and then they try and push more risk to the EMS side of the table. It creates animosity between the two teams and between the two companies. Then the EMS player under-resources the project to try and make at least a few bucks – performance suffers – and then the OEM gets all pissed off and wants to leave. Look, if your supplier can't make a fair return on the business they will either find a way to hide some money from you, or they'll end up kicking you out. Either way it's expensive and counter productive.

If your readers want a better EMS experience, tell them to let the EMS supplier make a reasonable return on both capital and effort. They will have a better, more productive, and in the long run a lower total cost supply chain.