

BENCHMARK ELECTRONICS INC  
Form 10-Q  
November 09, 2005

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005.**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM TO .**

Commission File Number: 1-10560

**BENCHMARK ELECTRONICS, INC.**

(Exact name of registrant as specified in its charter)

**Texas**  
(State or other jurisdiction  
of incorporation or organization)

**3000 Technology Drive**  
**Angleton, Texas**  
(Address of principal executive offices)

**74-2211011**  
(I.R.S. Employer  
Identification No.)

**77515**  
(Zip Code)

(979) 849-6550

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(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes  No

As of November 4, 2005 there were 41,991,379 Common Shares of Benchmark Electronics, Inc., par value \$0.10 per share, outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets

(amounts in thousands)

	September 30, 2005 (unaudited)	December 31, 2004
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 125,756	\$ 124,862
Short-term investments	195,480	242,506
Accounts receivable, net of allowance for doubtful accounts of \$6,311 and \$6,985, respectively	302,254	251,305
Inventories, net	317,568	256,876
Prepaid expenses and other assets	25,728	15,576
Deferred tax asset	10,614	10,444
Total current assets	977,400	901,569
Property, plant and equipment	278,543	250,169
Accumulated depreciation	(190,646)	(178,600)
Net property, plant and equipment	87,897	71,569
Goodwill, net	112,990	112,853
Other, net	6,487	6,010
	\$ 1,184,774	\$ 1,092,001
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 283,115	\$ 257,054
Income taxes payable	36,195	28,075
Accrued liabilities	38,875	46,502
Total current liabilities	358,185	331,631
Other long-term liabilities	2,531	2,431
Deferred tax liability	6,927	6,422
Shareholders' equity:		
Preferred shares, \$0.10 par value; 5,000 shares authorized, none issued		
Common shares, \$0.10 par value; 85,000 shares authorized; issued 41,945 and 41,676, respectively; outstanding 41,871 and 41,602, respectively	4,187	4,160
Additional paid-in capital	557,520	552,503
Retained earnings	262,617	206,683
Accumulated other comprehensive loss	(7,012)	(11,648)
Less treasury shares, at cost; 74 shares	(181)	(181)
Total shareholders' equity	817,131	751,517

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Commitments and contingencies

\$	1,184,774	\$	1,092,001
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See accompanying notes to condensed consolidated financial statements.

## BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Income

(amounts in thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Sales	\$ 561,452	\$ 504,750	\$ 1,631,851	\$ 1,477,108
Cost of sales	521,148	466,232	1,515,316	1,363,084
Gross profit	40,304	38,518	116,535	114,024
Selling, general and administrative expenses	15,617	14,553	46,307	45,604
Income from operations	24,687	23,965	70,228	68,420
Interest expense	(86)	(392)	(238)	(1,551)
Other income	2,062	849	4,688	2,603
Income before income taxes	26,663	24,422	74,678	69,472
Income tax expense	6,356	6,389	18,744	18,688
Net income	\$ 20,307	\$ 18,033	\$ 55,934	\$ 50,784
Earnings per share:				
Basic	\$ 0.49	\$ 0.44	\$ 1.34	\$ 1.24
Diluted	\$ 0.47	\$ 0.43	\$ 1.31	\$ 1.20
Weighted average number of shares outstanding:				
Basic	41,824	41,123	41,720	41,042
Diluted	42,770	42,313	42,751	42,387

See accompanying notes to condensed consolidated financial statements.

## BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

(amounts in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2005	2004
Cash flows from operating activities:		
Net income	\$ 55,934	\$ 50,784
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	19,660	20,400
Deferred income taxes	335	1,538
Asset impairments		1,417
Gain on the sale of property, plant and equipment	(55)	(1,427)
Accrued compensation expense		164
Federal tax benefit of stock options exercised	848	1,472
Other	643	
Changes in operating assets and liabilities:		
Accounts receivable	(50,338)	(50,641)
Inventories	(60,076)	(51,126)
Prepaid expenses and other assets	(10,131)	(1,862)
Accounts payable	25,892	708
Accrued liabilities	(7,688)	(3,402)
Income taxes	8,105	8,560
Net cash used in operations	(16,871)	(23,415)
Cash flows from investing activities:		
Purchases of short-term investments	(239,320)	(106,000)
Proceeds from sales and maturities of short-term investments	286,346	112,705
Additions to property, plant and equipment	(34,020)	(9,424)
Proceeds from the sale of property, plant and equipment	249	4,687
Additions to purchased software	(1,829)	(239)
Net cash provided by investing activities	11,426	1,729
Cash flows from financing activities:		
Proceeds from stock options exercised	3,159	3,321
Proceeds from employee stock purchase plan	1,037	921
Debt issuance cost	(412)	
Principal payments on other long-term debt		(21,013)
Net cash provided by (used in) financing activities	3,784	(16,771)
Effect of exchange rate changes	2,555	715
Net increase in cash and cash equivalents	894	(37,742)
Cash and cash equivalents at beginning of year	124,862	117,310
Cash and cash equivalents at September 30	\$ 125,756	\$ 79,568
Supplemental disclosures of cash flow information:		
Income taxes paid, net	\$ 9,296	\$ 7,081
Interest paid	\$ 296	\$ 587

See accompanying notes to condensed consolidated financial statements.

**BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(amounts in thousands, unless otherwise noted)**

**(unaudited)**

**Note 1 Basis of Presentation**

Benchmark Electronics, Inc. (the Company) is a Texas corporation in the business of manufacturing electronics and provides services to original equipment manufacturers (OEMs) of computers and related products for business enterprises, medical devices, industrial control equipment, testing and instrumentation products and telecommunication equipment. The Company has manufacturing operations located in the Americas, Asia and Europe.

The condensed consolidated financial statements included herein have been prepared by the Company without audit pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The financial statements reflect all normal and recurring adjustments which in the opinion of management are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in accordance with generally accepted accounting principles. Actual results could differ from those estimates.

Certain reclassifications of prior period amounts have been made to conform to the current presentation.



**Note 2 Accounting for Stock-Based Compensation**

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25, issued in March 2000, to account for its stock option plans and its Employee Stock Purchase Plan. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price.

Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), which replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. In addition, the adoption of SFAS No. 123R requires additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. SFAS No. 123R is effective January 1, 2006 for calendar year companies. Accordingly, the Company will implement the revised standard in the first quarter of 2006.

On May 11, 2005, in response to SFAS 123R, the Company's Board of Directors approved accelerating the vesting of out-of-the-money, unvested stock options held by current employees, including executive officers, and the Chairman of the Board of Directors. No options held by non-employee directors were subject to acceleration. An option was considered out-of-the-money if the stated option exercise price was greater than the closing price, \$28.30, of the Company's common shares on the day the Board of Directors approved the acceleration. The accelerated vesting was effective as of May 11, 2005.

The decision to accelerate vesting of these options was made to avoid recognizing compensation cost in the statement of income in future financial statements upon the effectiveness of SFAS No. 123R. It is estimated that the maximum future compensation expense that will be avoided, based on the Company's implementation date for SFAS No. 123R of January 1, 2006, is approximately \$6.8 million, of which approximately \$2.5 million is related to options held by executive officers and the Chairman of the Board of the Company. The vesting acceleration did not result in the recognition of compensation expense in net income for the three or nine months ended September 30, 2005. The pro-forma results presented in the table below include approximately \$8.3 million (\$5.0 million, net of tax) of compensation expense for the nine months ended September 30, 2005 resulting from the vesting acceleration.

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As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income, as reported	\$ 20,307	\$ 18,033	\$ 55,934	\$ 50,784
Add stock-based compensation expense included in reported net income, net of related tax effects				98
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(215)	(535)	(7,083)	(2,025)
Net income, as adjusted	\$ 20,092	\$ 17,498	\$ 48,851	\$ 48,857
Earnings per share:				
Basic, as reported	\$ 0.49	\$ 0.44	\$ 1.34	\$ 1.24
Basic, as adjusted	\$ 0.48	\$ 0.43	\$ 1.17	\$ 1.19
Diluted, as reported	\$ 0.47	\$ 0.43	\$ 1.31	\$ 1.20
Diluted, as adjusted	\$ 0.47	\$ 0.42	\$ 1.14	\$ 1.16

These adjusted results may not be indicative of the future results for the full fiscal year due to potential grants, vesting and other factors. The fair value of each option grant and Employee Stock Purchase Plan purchase right is estimated on the date of grant using the Black-Scholes option-pricing model. The assumptions used to value the option grants and purchase rights during the nine months ended September 30, 2005 and 2004 were as follows:

	2005	2004
<b>Stock Options</b>		
Expected life of options	4-5 years	5 years
Weighted-average volatility	57.9%	62%
Risk-free interest rate	3.77-4.06%	3.9%
Dividend yield	zero	zero

	2005	2004
<b>Employee Stock Purchase Plan</b>		
Expected life of purchase right	6 months	6 months
Volatility	26.5%	37.4%
Risk-free interest rate	2.59%	1.00%
Dividend yield	zero	zero



**Note 3 Earnings Per Share**

Basic earnings per share is computed using the weighted average number of shares outstanding. Diluted earnings per share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to outstanding stock equivalents during the three and nine months ended September 30, 2005 and 2004. Stock equivalents include common shares issuable upon the exercise of stock options and other equity instruments, and are computed using the treasury stock method.

The following table sets forth the calculation of basic and diluted earnings per share.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2005		2004		2005		2004	
Numerator for basic and diluted earnings per share net income	\$	20,307	\$	18,033	\$	55,934	\$	50,784
Denominator for basic earnings per share-weighted average number of common shares outstanding during the period		41,824		41,123		41,720		41,042
Incremental common shares attributable to exercise of outstanding dilutive options		946		1,190		1,031		1,345
Denominator for diluted earnings per share		42,770		42,313		42,751		42,387
Basic earnings per share	\$	0.49	\$	0.44	\$	1.34	\$	1.24
Diluted earnings per share	\$	0.47	\$	0.43	\$	1.31	\$	1.20

Options to purchase 1.1 million common shares for the three and nine months ended September 30, 2005 were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price of the common shares for the period. Options to purchase 0.5 million common shares for the three and nine months ended September 30, 2004 were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price of the common shares for the period.

**Note 4 Goodwill**

Goodwill associated the Company's business segments and changes in those amounts during the nine-month period ended September 30, 2005 were as follows:

	Americas		Asia		Total	
Goodwill, December 31, 2004	\$	106,785	\$	6,068	\$	112,853
Currency translation adjustment		137				137
Goodwill, September 30, 2005	\$	106,922	\$	6,068	\$	112,990

**Note 5 Borrowing Facilities**

On January 20, 2005, the Company entered into a three-year, \$100 million Credit Agreement (the Credit Agreement) by and among the Company; the Banks party thereto; JPMorgan Chase Bank, N.A. as administrative agent, collateral agent and issuing lender; and Fleet National Bank, Wells Fargo Bank and Comerica Bank as co-documentation agents. This new credit facility has a \$100 million three-year revolving credit line for general corporate purposes which can be increased to a total of \$200 million.

Interest on outstanding borrowings under the Credit Agreement is payable quarterly, at the Company's option, at either the bank's Eurodollar rate plus 1.00% to 1.75% or its prime rate plus 0.00% to 0.25%, based upon the Company's debt ratio as specified in the Credit Agreement. A commitment fee of 0.20% to 0.35% per annum on the unused portion of the revolving facility is payable quarterly in arrears. As of September 30, 2005, the Company had no borrowings outstanding under the Credit Agreement and \$100 million was available for future borrowings.

The Credit Agreement is secured by the Company's domestic inventory and accounts receivable, 100% of the stock of the Company's domestic subsidiaries, 65% of the voting capital stock of each direct foreign subsidiary and substantially all of the other tangible and intangible assets of the Company and its domestic subsidiaries. The Credit Agreement contains customary financial covenants as to working capital, interest coverage, debt leverage, fixed charges, and consolidated net worth, and restricts the ability of the Company to incur additional debt, pay dividends, sell assets, and to merge or consolidate with other persons, without the consent of the banks. As of September 30, 2005, the Company was in compliance with all such covenants and restrictions.

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The Company's Thailand subsidiary has a Credit Agreement with Kasikornbank Public Company Limited (formerly Thai Farmers Bank Public Company Limited) and Bank of Ayudhya Public Company Limited (the Thai Credit Agreement). The Thai Credit Agreement provides that the lenders will make available to the Company's Thailand subsidiary up to approximately \$28.5 million in revolving loans and machinery loans for a term of five years through September 2006. The Thai Credit Agreement is secured by land, buildings and machinery in Thailand. In addition, the Thai Credit Agreement provides for approximately \$1.8 million (72.0 million Thai baht) in working capital availability in the form of working capital loans (20.0 million Thai baht) and bank guarantees (52.0 million Thai baht). As of September 30, 2005, the Company's Thailand subsidiary had no working capital borrowings outstanding.

### Note 6 Inventories

Inventory costs are summarized as follows:

	September 30, 2005	December 31, 2004
Raw materials	\$ 226,835	\$ 180,629
Work in process	75,939	57,044
Finished goods	27,951	32,520
Obsolescence reserve	(13,157)	(13,317)
	\$ 317,568	\$ 256,876

### Note 7 Income Taxes

Income tax expense (benefit) consists of the following:

	2005	Nine Months Ended September 30, 2004
Federal Current	\$ 13,597	14,263
Foreign Current	4,205	(726)
State Current	607	3,613
Deferred	335	1,538
Total	\$ 18,744	\$ 18,688

Income tax expense differs from the amount computed by applying the U.S. federal statutory income tax rate to income before income tax primarily due to the impact of foreign income taxes, state income taxes (net of federal benefit) and tax-exempt interest income.

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The Company considers earnings from foreign subsidiaries to be indefinitely reinvested and, accordingly, no provision for U.S. federal and state income taxes has been made for these earnings. Upon distribution of foreign subsidiary earnings in the form of dividends or otherwise, such distributed earnings would be reportable for U.S. income tax purposes (subject to adjustment for foreign tax credits).

The Company has been granted certain tax incentives, including tax holidays, for its subsidiaries in China, Ireland, and Thailand. These tax incentives, including tax holidays, expire through 2010, and are subject to certain conditions with which the Company has been able to and expects to be able to continue to comply. The net impact of these tax incentives was to lower income tax expense for the nine month periods ended September 30, 2005 and 2004 by approximately \$5.0 million (approximately \$0.12 per diluted share) and \$0.9 million (approximately \$0.02 per diluted share), respectively.

**Note 8 Segment and Geographic Information**

The Company has 16 manufacturing facilities in the Americas, Asia and Europe to serve its customers. The Company is operated and managed geographically. The Company's management evaluates performance and allocates the Company's resources on a geographic basis. Intersegment sales are generally recorded at prices that approximate arm's length transactions. Operating segments' measure of profitability is based on income from operations. The accounting policies for the reportable operating segments are the same as for the Company taken as a whole.

Information about operating segments for the three and nine months ended September 30, 2005 and 2004 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Net sales:</b>				
Americas	\$ 486,856	\$ 457,643	\$ 1,409,550	\$ 1,360,551
Asia	154,316	104,741	425,461	287,512
Europe	43,920	48,000	153,764	153,137
Elimination of intersegment sales	(123,640)	(105,634)	(356,924)	(324,092)
	\$ 561,452	\$ 504,750	\$ 1,631,851	\$ 1,477,108
<b>Depreciation and amortization:</b>				
Americas	\$ 3,315	\$ 3,758	\$ 10,646	\$ 11,861
Asia	2,071	1,583	5,787	4,689
Europe	336	367	1,053	1,329
Corporate	804	736	2,174	2,521
	\$ 6,526	\$ 6,444	\$ 19,660	\$ 20,400
<b>Income from operations:</b>				
Americas	\$ 18,251	\$ 22,319	\$ 55,714	\$ 64,203
Asia	12,392	5,467	33,229	13,484
Europe	312	1,253	(2,210)	5,538
Corporate and intersegment eliminations	(6,268)	(5,074)	(16,505)	(14,805)
	\$ 24,687	\$ 23,965	\$ 70,228	\$ 68,420
<b>Capital expenditures:</b>				
Americas	\$ 7,066	\$ 2,519	\$ 19,099	\$ 4,408
Asia	6,407	3,171	14,829	4,877
Europe	59	48	92	139
	\$ 13,532	\$ 5,738	\$ 34,020	\$ 9,424

	September 30, 2005	December 31, 2004
<b>Total assets:</b>		
Americas	\$ 902,538	\$ 860,785
Asia	227,998	173,003
Europe	45,331	49,116
Corporate	8,907	9,097
	\$ 1,184,774	\$ 1,092,001





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The following enterprise-wide information is provided in accordance with SFAS No. 131. Geographic net sales information reflects the destination of the product shipped. Long-lived assets information is based on the physical location of the asset.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net sales derived from:				
Printed circuit boards	\$ 437,273	\$ 380,765	\$ 1,283,314	\$ 1,110,757
Systems integration	124,179	123,985	348,537	366,351
	\$ 561,452	\$ 504,750	\$ 1,631,851	\$ 1,477,108
Geographic net sales:				
United States	\$ 449,078	\$ 392,631	\$ 1,275,902	\$ 1,159,030
Asia	18,382	24,322	47,900	57,569
Europe	89,551	81,005	295,294	243,190
Other	4,441	6,792	12,755	17,319
	\$ 561,452	\$ 504,750	\$ 1,631,851	\$ 1,477,108

	September 30, 2005	December 31, 2004
Long-lived assets:		
United States	\$ 47,340	\$ 41,620
Asia	38,631	29,480
Europe	1,338	2,466
Other	7,075	4,013
	\$ 94,384	\$ 77,579

**Note 9 Comprehensive Income**

Comprehensive income includes net income and the change in the cumulative translation adjustment. Comprehensive income for the three and nine months ended September 30, 2005 and 2004 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income	\$ 20,307	\$ 18,033	\$ 55,934	\$ 50,784
Cumulative translation adjustment	1,222	1,386	4,636	859
Comprehensive income	\$ 21,529	\$ 19,419	\$ 60,570	\$ 51,643



#### **Note 10 Contingencies**

The Company is involved in various legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations.

One of the legal actions involves a payable dispute with a former customer of a predecessor company (AVEX) acquired by the Company in 1999. The lawsuit alleges that the Company owes the former customer approximately \$12 million in unsubstantiated claims for past due invoices. The Company denies responsibility for these unsubstantiated claims and has filed a counterclaim against the former customer for non payment of receivables. The Company intends to vigorously defend against the former customer's allegations and pursue its claim against the former customer. At the present time, the Company is unable to reasonably estimate the probable loss, if any, associated with these matters.

The Company is subject to examination by tax authorities for varying periods in various US and foreign taxing jurisdictions. During the course of such examinations disputes occur as to matters of fact and/or law. Also, in most taxing jurisdictions the passage of time without examination will result in the expiration of applicable statutes of limitations thereby precluding the taxing authority from conducting an examination of the tax period(s) for which such statute of limitation has expired. The Company believes that it has adequately provided for its tax liabilities.

#### **Note 11 Impact of Recently Issued Accounting Standards**

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs* an amendment of ARB No. 43, Chapter 4 (SFAS No. 151). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, handling costs and wasted material (spoilage). Among other provisions, the new rule requires that such items be recognized as current-period charges, regardless of whether they meet the criterion of *so abnormal* as stated in ARB No. 43. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company does not expect that adoption of SFAS No. 151 will have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

In December 2004, the FASB issued SFAS No. 123R. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The Company will adopt SFAS No. 123R on January 1, 2006. The pro forma disclosures previously permitted under SFAS No. 123 no longer will be an alternative to financial statement recognition. The Company is currently considering the modified prospective method of transition and expects that adoption of SFAS No. 123R will have a material impact on the Company's consolidated financial position and consolidated results of operations. Based on preliminary estimates, the future compensation cost to be recognized as a result of the adoption of SFAS No. 123R for the year ended December 31, 2006 will be \$0.5 million. In addition, for any new awards that may be granted during the fourth quarter of 2005, the Company may incur additional expense during 2006 that cannot yet be quantified. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow as required under current accounting literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the adoption. See Note 2 above.



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In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, which expresses views of the SEC staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations, and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. The Company will consider the guidance of this SAB as it adopts SFAS No. 123R.

In December 2004, the FASB issued FASB Staff Position (FSP) No. FAS 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (the Jobs Act) which provides a practical exception to the SFAS No. 109 requirement to reflect the effect of a new tax law in the period of enactment by allowing additional time beyond the financial reporting period to evaluate the effects on plans for reinvestment or repatriation of unremitted foreign earnings. Although the Company has not yet completed its evaluation of the impact of the repatriation provisions of the Jobs Act, the Company does not expect that these provisions will have a material impact on its consolidated financial position, consolidated results of operations, or liquidity. Accordingly, as provided for in FSP No. 109-2, the Company has not adjusted its tax expense or deferred tax liability to reflect the repatriation provisions of the Jobs Act.

In December 2004, the FASB issued FSP No. FAS 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004, indicating that this deduction should be accounted for as a special deduction in accordance with the provisions of SFAS No. 109. Beginning in 2005, the Company recognizes the allowable deductions as qualifying activity occurs.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions (SFAS No. 153). This statement amends APB Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Under SFAS No. 153, if a nonmonetary exchange of similar productive assets meets a commercial-substance criterion and the fair value is determinable, the transaction must be accounted for at fair value resulting in recognition of any gain or loss. The provisions of SFAS No. 153 are effective for nonmonetary transactions in fiscal periods that begin after June 15, 2005. The Company does not anticipate that the implementation of this standard will have a material impact on its consolidated financial position, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS No. 154). SFAS No. 154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date SFAS No. 154 was issued. The Company does not expect the adoption of this standard to have a material impact on its consolidated financial position, results of operations or cash flows.

In June 2005, the FASB issued FSP No. FAS 143-1, *Accounting for Electronic Equipment Waste Obligations*, that provides guidance on how commercial users and producers of electronic equipment should recognize and measure asset retirement obligations associated with the European Directive 2002/96/EC on Waste Electrical and Electronic Equipment (the Directive). In the third quarter of 2005, the Company adopted FSP FAS 143-1 in those European Union (EU) member countries where the Directive had been transposed into country-specific laws. The adoption of the FSP in the third quarter of 2005 did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In September 2005, the Emerging Issues Task Force (EITF) issued EITF 05-06, *Determining the Amortization Period for Leasehold Improvements after Lease Inception or Acquired in a Business Combination*. EITF 05-06 requires that leasehold improvements acquired in a business combination be capitalized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date of acquisition. EITF 05-06 also requires leasehold improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term should be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured (as defined in paragraph 5 of SFAS No. 13) at the date the leasehold improvements are purchased. EITF 05-06 is effective for leasehold improvements that are purchased or acquired in reporting periods beginning after June 29, 2005. Early adoption of the consensus is permitted in periods for which financial statements have not been issued. The Company does not believe that the adoption of EITF 05-06 will have a material impact on its consolidated financial position, results of operations or cash flows.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

References in this report to the Company, Benchmark, we, or us mean Benchmark Electronics, Inc. together with its subsidiaries. The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are identified as any statement that does not relate strictly to historical or current facts. They use words such as anticipate, believe, intend, plan, projection, forecast, strategy, position, continue, estimate, expect, may, will, or the other variations of them or comparable terminology. In particular, statements, express or implied, concerning future operating results or the ability to generate sales, income or cash flow are forward-looking statements. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions, including those discussed under the heading Risk Factors below. The future results of our operations may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated.

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto.

### OVERVIEW

We are in the business of manufacturing electronics and provide our services to original equipment manufacturers (OEMs) of computers and related products for business enterprises, medical devices, industrial control equipment, testing and instrumentation products, and telecommunication equipment. The services that we provide are commonly referred to as electronics manufacturing services (EMS). We offer our customers comprehensive and integrated design and manufacturing services, from initial product design to volume production and direct order fulfillment. We also provide specialized engineering services, including product design, printed circuit board layout, prototyping and test development. We believe that we have developed strengths in the manufacturing process for large, complex, high-density printed circuit boards as well as the ability to manufacture high and low volume products in lower cost regions such as Latin and South America and Southeast Asia.

As our customers have continued to expand their globalization strategy during the past several years, we have continued to make the necessary changes to align our business operations with our customers' demand. These changes include, among other activities, moving production between facilities, reducing staff levels, realigning our business processes and reorganizing our management. We continue to evaluate our operations and may need to make additional changes to realign our facilities and operations in the future. If we make such changes, we may incur incremental charges and our financial condition and results of operations may suffer. We believe that our global manufacturing presence of 16 facilities in eight countries increases our ability to be responsive to our customers' needs by providing accelerated time-to-market and time-to-volume production of high quality products. These capabilities should enable us to build stronger strategic relationships with our customers and to become a more integral part of their operations. Our customers face challenges in planning, procuring and managing their inventories efficiently due to customer demand fluctuations, product design changes, short product life cycles and component price fluctuations. We employ production management systems to manage their procurement and



manufacturing processes in an efficient and cost-effective manner so that, where possible, components arrive on a just-in-time, as-and-when needed basis. We are a significant purchaser of electronic components and other raw materials, and can capitalize on the economies of scale associated with our relationships with suppliers to negotiate price discounts, obtain components and other raw materials that are in short supply, and return excess components. Our expertise in supply chain management and our relationships with suppliers across the supply chain enables us to reduce our customers' cost of goods sold and inventory exposure.

We recognize revenue from the sale of circuit board assemblies, systems and excess inventory when the goods are shipped, title and risk of ownership have passed, the price to the buyer is fixed and determinable and recoverability is reasonably assured. To a lesser extent, revenue is also recognized from non-manufacturing services, such as product design, circuit board layout, and test development. Service related revenues are recognized when the service is rendered and the costs related to these services are expensed as incurred. We assume no significant obligations after product shipment as we typically warrant workmanship only. Therefore our warranty provisions are insignificant.

Our cost of sales includes the cost of materials, electronic components and other materials that comprise the products we manufacture, the cost of labor and manufacturing overhead, and adjustments for excess and obsolete inventory. Our procurement of materials for production requires us to commit significant working capital to our operations and to manage the purchasing, receiving, inspection and stocking of materials. Although we bear the risk of fluctuations in the cost of materials and excess scrap, we periodically negotiate cost of materials adjustments with our customers. Revenue from each product that we manufacture includes the total of the costs of materials in that product and the cost of the labor and manufacturing overhead costs allocated to that product. Our gross margin for any product depends on the proportionate mix of the cost of materials in the product and the cost of labor and manufacturing overhead allocated to the product. We typically have the potential to realize higher gross margins on products where the proportionate level of labor and manufacturing overhead is greater than that of materials. As we gain experience in manufacturing a product, we usually achieve increased efficiencies, which result in lower labor and manufacturing overhead costs for that product and higher gross margins.

## Summary of Results

Sales for the third quarter of 2005 increased 11.2% to \$561.5 million compared to \$504.8 million for the same period of 2004. The increase in our sales reflects new program revenues from both existing and new customers. Sales to our largest customer, Sun Microsystems, Inc., decreased to 26.4% of our sales in the third quarter of 2005 from 27.4% of our sales in the third quarter of 2004. During the third quarter of 2005, the level of concentration among our top customers as a percentage of revenues decreased as revenues from our remaining customer base expanded. Sales to our two largest customers increased to \$227.8 million in the third quarter of 2005 from \$219.2 million in the third quarter of 2004, an increase of 3.9%. Sales to our customers, other than our two largest customers, increased to \$333.7 million in the third quarter of 2005 from \$285.6 million in the third quarter of 2004, an increase of 16.8%. We expect sales to our largest customer to remain in the high 20% range of total sales for the remainder of 2005.

Our gross profit as a percentage of sales for the third quarter decreased to 7.2% in 2005 from 7.6% in 2004 because of the current market pricing trends, new program ramps and product transitions that have affected our margins during 2005. These activities continue to impact the level of efficiency in our production and negatively impacted our gross profit. We do expect that a number of our new and higher volume programs with customers will remain subject to competitive

constraints on the margin that may be realized from these programs and that these constraints could exert downward pressure on our margins in the near future.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management's discussion and analysis of financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. Our significant accounting policies are summarized in Note 1 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2004. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to allowance for doubtful accounts, inventories, deferred taxes, impairment of long-lived assets, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

### **Allowance for doubtful accounts**

Our accounts receivable balance is recorded net of allowances for amounts not expected to be collected from our customers. Because our accounts receivable are typically unsecured, we periodically evaluate the collectibility of our accounts based on a combination of factors, including a particular customer's ability to pay as well as the age of the receivables. To evaluate a specific customer's ability to pay, we analyze financial statements, payment history, third-party credit analysis reports and various information or disclosures by the customer or other publicly available information. In cases where the evidence suggests a customer may not be able to satisfy its obligation to us, we set up a specific reserve in an amount we determine appropriate for the perceived risk. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

### **Inventory obsolescence reserve**

We purchase inventory based on forecasted demand and record inventory at the lower of cost or market. We reserve for estimated obsolescence as necessary in an amount equal to the difference between the cost of inventory and estimated market value based on assumptions of future demands and market conditions. We evaluate our inventory valuation on a quarterly basis based on current and forecasted usage and the latest forecasts of product demand and production requirements from our customers. Customers frequently make changes to their forecasts, requiring us to make changes to our inventory purchases, commitments, and production scheduling and may require us to cancel open purchase commitments with our vendors. This process may lead to on-hand inventory quantities and on-order purchase commitments that are in excess of our customer's revised needs, or parts that become obsolete before use in production. We record inventory reserves on excess and obsolete inventory. These reserves are established on inventory which we have determined that our customers are not responsible for or on inventory that we believe our customers are unable to fulfill their obligation to ultimately purchase such inventory from us. If actual market conditions are less favorable than those we projected, additional inventory write downs may be required.

## Income Taxes

We estimate our income tax provision in each of the jurisdictions in which we operate, including estimating exposures related to examinations by taxing authorities. We must also make judgments regarding the ability to realize the deferred tax assets. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to subsequently determine that we would be able to realize our deferred tax assets in excess of our net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Similarly, should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would reduce income in the period such determination was made.

We are subject to examination by tax authorities for varying periods in various US and foreign taxing jurisdictions. During the course of such examinations disputes occur as to matters of fact and/or law. Also, in most taxing jurisdictions the passage of time without examination will result in the expiration of applicable statutes of limitations thereby precluding the taxing authority from conducting an examination of the tax period(s) for which such statute of limitation has expired. We believe that we have adequately provided for our tax liabilities.

## Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge would be recognized by the amount that the carrying amount of the asset exceeds the fair value of the asset.

Goodwill and intangible assets not subject to amortization are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss would be recognized to the extent that the carrying amount exceeds the asset's fair value. We completed the annual impairment test during the fourth quarter of 2004 and determined that no impairment existed as of the date of the impairment test. Goodwill is measured at the reporting unit level, which we have determined to be consistent with our operating segments as defined in Note 8 Segment and Geographic Information to the Condensed Consolidated Financial Statements, by determining the fair values of the reporting units using a discounted cash flow model and comparing those fair values to the carrying values, including goodwill, of the reporting unit. As of September 30, 2005, we had net goodwill of approximately \$113.0 million. Circumstances that may lead to impairment of goodwill include unforeseen decreases in future performance or industry demand, and the restructuring of our operations as a result of a change in our business strategy.

**RESULTS OF OPERATIONS**

The following table presents the percentage relationship that certain items in our Condensed Consolidated Statements of Income bear to sales for the periods indicated. The financial information and the discussion below should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	92.8	92.4	92.9	92.3
Gross profit	7.2	7.6	7.1	7.7
Selling, general and administrative expenses	2.8	2.9	2.8	3.1
Income from operations	4.4	4.7	4.3	4.6
Interest expense	(0.0)	(0.1)	(0.0)	(0.1)
Other income	0.4	0.2	0.3	0.2
Income before income taxes	4.7	4.8	4.6	4.7
Income tax expense	1.1	1.3	1.2	1.3
Net income	3.6%	3.5%	3.4%	3.4%

**Sales**

Sales for the third quarter of 2005 were \$561.5 million, an 11.2% increase from sales of \$504.8 million for the same quarter in 2004. The increase of \$56.7 million resulted from increased sales under new programs and increased activity with existing customers. This increase included a \$56.5 million increase in printed circuit board assembly (PCBA) sales volume and a \$0.2 million increase attributable to sales activity with existing systems integration customers. Sales for the nine months ended September 30, 2005 were \$1.6 billion, a 10.5% increase from sales of \$1.5 billion for the same period in 2004. The increase of \$154.7 million resulted from increased sales under new programs and increased activity with existing customers. This net increase included a \$172.5 million increase in printed circuit board assembly (PCBA) sales volume. This increase was offset by a \$17.8 million net decrease attributable to sales activity with existing systems integration customers.

A substantial percentage of our sales have been made to a small number of customers, and the loss of a major customer, if not replaced, would adversely affect us. During the third quarter of 2005, our two largest customers together represented 40.6% of our sales, with one customer accounting for 26.4% of our sales. Sales to our largest customer, Sun Microsystems, Inc., decreased to 26.4% of our sales in the third quarter of 2005 from 27.4% of our sales in the third quarter of 2004. During the third quarter of 2005, the level of concentration among our top customers as a percentage of revenues decreased as revenues from our remaining customer base expanded. Sales to our two largest customers increased to \$227.8 million in the third quarter of 2005 from \$219.2 million in the third quarter of 2004, an increase of 3.9%. Sales to our customers, other than our two largest customers, increased to \$333.7 million in the third quarter of 2005 from \$285.6 million in the third quarter of 2004, an increase of 16.8%. We expect sales to our largest customer to remain in the high 20% range of total sales for the remainder of 2005. Our future sales are dependent on the success of our customers, some of which operate in businesses associated with rapid technological change and consequent product obsolescence. Developments adverse to our major customers or their products, or the failure of a major customer to pay for components or services, could have an adverse effect on us.

Our manufacturing and assembly operations include printed circuit boards and subsystem assembly, box build and systems integration. Systems integration is the process of integrating subsystem and printed circuit board assemblies and, often, downloading and integrating software, to produce a fully configured product. Systems integration is a value-added service that is not separable from our overall contract manufacturing service. Sales from the operation of our systems integration facilities represented 21.4% and 24.8% of our sales for the nine months ended September 30, 2005 and 2004, respectively.

We have 16 manufacturing facilities in the Americas, Asia and Europe to serve our customers. We are operated and managed geographically. See Note 8 to the Condensed Consolidated Financial Statements.

The percentage of our sales by region for the three and nine months ended September 30, 2005 and 2004 were as follows:

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2004	2005	2004	2005
Americas	72.3%	75.1%	71.1%	75.8%
Asia	25.0	19.8	25.0	18.9
Europe	2.7	5.1	3.9	5.3
	100.0%	100.0%	100.0%	100.0%

Our Americas region includes facilities in Angleton, Texas, Beaverton, Oregon, Campinas, Brazil, Guadalajara, Mexico, Hudson, New Hampshire, Huntsville, Alabama, Loveland, Colorado, Redmond, Washington and Winona, Minnesota. There are two facilities in Huntsville, Alabama a systems integration facility and a PCBA facility. The Loveland and Redmond facilities provide systems integration services. In March 2005, we closed our Manassas, Virginia PCBA facility.

Our Asia region includes facilities in Ayudhaya and Korat, Thailand and Suzhou, China. The Korat, Thailand facility began operations in September 2004. There are two facilities in Ayudhaya, Thailand a systems integration facility that began operations in 2005 and a PCBA facility we acquired in 2002. In the fourth quarter of 2004, the Singapore facility ceased systems integration operations.

Our Europe region includes facilities in Dublin, Ireland and Leicester, England. The Dublin facility provides systems integration services.

Our international operations are subject to the risks of doing business abroad. These dynamics have not had a material adverse effect on our results of operations through September 30, 2005. However, we cannot assure you that there will not be an adverse impact in the future. See RISK FACTORS for factors pertaining to our international sales and fluctuations in the exchange rates of foreign currency and for further discussion of potential adverse effects in operating results associated with the risks of doing business abroad. During the first nine months of 2005 and 2004, 34.6% and 30.1%, respectively, of our sales were from our operations outside of the United States.

## **Americas**

Sales in the Americas during the quarter ended September 30, 2005 increased \$26.9 million, or 7.1%, compared to the same period of 2004. This net increase included a \$14.1 million increase in PCBA sales volume attributable to sales under new programs and increased activity with existing customers and a \$12.8 million net increase in sales activity with existing systems integration customers. Sales in the Americas during the nine months ended September 30, 2005 increased \$41.6 million, or 3.7%, compared to the same period of 2004. This net increase included a \$37.3 million increase in PCBA sales volume attributable to sales under new programs and increased activity with existing customers and a \$4.3 million net increase in sales activity with existing systems integration customers.

## **Asia**

Sales in Asia during the quarter ended September 30, 2005 increased \$40.5 million, or 40.5%, compared to the same period of 2004. This net increase included a \$45.2 million net increase in PCBA sales volumes attributable to the impact of ramping new programs in Asia and transferring existing customer business to Asia. This increase was offset by a \$4.7 million net decrease attributable to sales activity with existing systems integration customers. In the fourth quarter of 2004, the Singapore facility ceased systems integration operations and currently provides engineering and international purchasing services. Sales in Asia during the nine months ended September 30, 2005 increased \$128.3 million, or 45.9%, compared to the same period of 2004. This net increase included a \$143.2 million net increase in PCBA sales volumes attributable to the impact of ramping new programs in Asia and transferring existing customer business to Asia. This increase was offset by a \$14.9 million net decrease attributable to sales activity with existing systems integration customers.

## **Europe**

Sales in Europe during the quarter ended September 30, 2005 decreased \$—10.7 million, or 42.0%, compared to the same period of 2004. This net decrease included a \$7.9 million decrease in sales volumes from systems integration customers, and a \$2.8 million net decrease in overall PCBA sales volume. Sales in Europe during the nine months ended September 30, 2005 decreased \$—15.1 million, or 19.3%, compared to the same period of 2004. This net decrease included an \$8.0 million decrease in overall PCBA sales volume and a \$7.1 million net decrease in sales volumes from systems integration customers. The overall decrease in sales volume in Europe is a result of lower demand for our customers products in Europe and the transfer of production for some customers to lower cost production geographies.

## **Gross Profit**

Gross profit increased 4.6% to \$40.3 million for the third quarter of 2005 from \$38.5 million in the same quarter of 2004. Gross profit as a percentage of sales for the three months ended September 30, 2005 and 2004, respectively, decreased to 7.2% from 7.6%. Gross profit increased 2.2% to \$116.5 million for the first nine months of 2005 from \$114.0 million in the same period of 2004. Gross profit as a percentage of sales for the nine months ended September 30, 2005 and 2004, respectively, decreased to 7.1% from 7.7%. Gross profit as a percentage of sales decreased because of the effect of current market pricing trends, new program ramps and product transitions during 2005. These activities combined to impact the level of efficiency in our production and negatively impacted our gross profit. Typically, a new program will contribute relatively less to our gross profit in its early stages, as manufacturing volumes are low and result in inefficiencies and unabsorbed manufacturing overhead costs. As volumes increase, the contribution to gross profit often increases due to the ability to leverage improved utilization rates and overhead absorption. In addition, different programs can contribute different gross profits depending on factors such as the types of services involved, location of production, size of the program, complexity of the product,

and level of material costs associated with the various products. As a result, our gross profit varies from period to period.

We expect that a number of our higher volume programs with customers will remain subject to competitive restraints on the margin that may be realized from these programs and that these restraints could exert downward pressure on our margins in the near future. For the foreseeable future, our gross profit is expected to depend primarily on facility utilization, product mix, start-up of new programs and pricing within the electronics industry. The gross margins at each facility and for Benchmark as a whole are expected to continue to fluctuate. Increases in start-up costs associated with new programs and pricing within the electronics industry also could adversely impact our gross margin as they did during the first nine months of 2005.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses were \$15.6 million and \$14.6 million in the third quarters of 2005 and 2004, respectively, and \$46.3 million and \$45.6 million in the first nine months of 2005 and 2004, respectively. Selling, general and administrative expenses as a percentage of sales decreased from 2.9% for the third quarter of 2004 to 2.8% for the third quarter of 2005 and decreased from 3.1% for the first nine months of 2004 to 2.8% for the first nine months of 2005. The decrease in selling, general and administrative expenses as a percentage of sales is primarily associated with the increase in sales.

### **Interest Expense**

Interest expense for the three and nine-month periods ended September 30, 2005 and 2004 was approximately \$0.1 million and \$0.2 million for 2005 and \$0.4 million and \$1.6 million for 2004, respectively. The decrease is primarily due to lower fees associated with the three-year \$100 million credit agreement entered into on January 20, 2005.

### **Income Tax Expense**

Income tax expense of \$18.7 million represented an effective tax rate of 25.1% for the nine months ended September 30, 2005, compared with \$18.7 million at an effective tax rate of 26.9% for the same period in 2004. The decrease in the effective tax rate is primarily due to higher estimated income tax benefits for 2005 in foreign tax jurisdictions as compared to 2004 and net income tax benefits related to certain previously filed U.S. tax returns. See Note 7 to the Condensed Consolidated Financial Statements.

### **Net Income**

We reported net income for the three and nine-month periods ended September 30, 2005 of approximately \$20.3 million and \$55.9 million, or diluted earnings of \$0.47 per share and \$1.31 per share, compared with \$18.0 million and \$50.8 million, or diluted earnings of \$0.43 per share and \$1.20 per share, respectively, for the same periods of 2004. The net increases in net income of \$2.3 million and \$5.2 million, respectively, during the three and nine-month periods ended September 30, 2005 and 2004 were due to the factors discussed above.

## LIQUIDITY AND CAPITAL RESOURCES

We have historically financed our growth and operations through funds generated from operations, proceeds from the sale of our securities and funds borrowed under our credit facilities. Cash and cash equivalents increased to \$125.8 million at September 30, 2005 from \$124.9 million at December 31, 2004.

Cash used in operating activities was \$16.9 million in the first nine months of 2005. The cash used in operations during the first nine months of 2005 consisted primarily of \$55.9 million of net income adjusted for \$19.7 million of depreciation and amortization, and a \$25.9 million increase in accounts payable, offset by a \$50.3 million increase in accounts receivable and a \$60.1 million increase in inventories. Working capital was \$619.2 million at September 30, 2005 and \$569.9 million at December 31, 2004. Our days sales outstanding of 48 days and our inventory turns of 6.6 times reflect the impact of the level of new program activities.

We expect increases in working capital to support the anticipated growth in sales. We are continuing the practice of purchasing components only after customer orders are received, which mitigates, but does not eliminate the risk of loss on inventories. Supplies of electronic components and other materials used in operations are subject to industry-wide shortages. In certain instances, suppliers may allocate available quantities to us. We did not experience shortages of electronic components and other material supplies during the reporting period. If shortages of these components and other material supplies used in operations occur, vendors may not ship the quantities we need for production and we may be forced to delay shipments, which would increase backorders.

Cash provided by investing activities was \$11.4 million for the nine months ended September 30, 2005. Capital expenditures of \$34.0 million were primarily concentrated in manufacturing production equipment in Asia and the Americas to support our ongoing business and to expand certain existing manufacturing operations and included \$5.9 million for the purchase of manufacturing and office facilities in Minnesota that we previously leased.

Cash provided by financing activities was \$3.8 million for the nine months ended September 30, 2005. During 2005, we received \$4.2 million from the exercise of stock options and the employee stock purchase plan, and paid \$0.4 million in debt issuance costs. See Note 5 to the Condensed Consolidated Financial Statements.

We have a \$100.0 million three-year revolving credit line with a syndicate of commercial banks for general corporate purposes which can be increased to a total of \$200.0 million. We are entitled to borrow under the revolving credit line up to \$100.0 million. Interest on the revolving credit line is payable quarterly, at our option, at either the bank's Eurodollar rate plus 1.00% to 1.75% or its prime rate plus 0.00% to 0.25%, based upon our debt ratio as specified in the agreement. A commitment fee of 0.20% to 0.35% per annum on the unused portion of the revolving credit facility is payable quarterly in arrears. As of September 30, 2005, we had no borrowings outstanding under the revolving credit line and \$100.0 million was available for future borrowings.

The revolving credit facility is secured by our domestic inventory and accounts receivable, 100% of the stock of our domestic subsidiaries, and 65% of the voting capital stock of each direct foreign subsidiary and substantially all of our and our domestic subsidiaries' other tangible and intangible assets. The revolving credit facility contains customary financial covenants as to working capital, interest coverage, debt leverage, fixed charges, and consolidated net worth, and restricts our ability to incur additional debt, pay dividends, sell assets and to merge or consolidate with other





persons without the consent of the banks. At September 30, 2005, we were in compliance with all such restrictions.

Our Thailand subsidiary has a credit agreement with Kasikornbank Public Company (formerly Thai Farmers Bank Public Company Limited) and Bank of Ayudhya Public Company Limited (the Thai Credit Agreement). The Thai Credit Agreement provides that the lenders will make available to our Thailand subsidiary up to approximately \$28.5 million in revolving loans, and machinery loans through September 2006. The Thai Credit Agreement is secured by land, buildings and machinery in Thailand. In addition, the Thai Credit Agreement provides for approximately \$1.8 million (72.0 million Thai baht) in working capital availability in the form of working capital loans (20.0 million Thai baht) and bank guarantees (52.0 million Thai baht). As of September 30, 2005, our Thailand subsidiary had no working capital borrowings outstanding.

Our operations, and the operations of businesses we acquire, are subject to certain foreign, federal, state and local regulatory requirements relating to environmental, waste management, health and safety matters. We believe we operate in substantial compliance with all applicable requirements and we seek to ensure that newly acquired businesses comply or will comply substantially with applicable requirements. To date the costs of compliance and workplace and environmental remediation have not been material to us. However, material costs and liabilities may arise from these requirements or from new, modified or more stringent requirements in the future. In addition, our past, current and future operations, and the operations of businesses we have or may acquire, may give rise to claims of exposure by employees or the public, or to other claims or liabilities relating to environmental, waste management or health and safety concerns.

At September 30, 2005, we had cash and cash equivalents totaling \$125.8 million, short-term investments totaling \$195.5 million and \$128.5 million available for borrowings under our revolving credit lines. We believe that during the next twelve months, our capital expenditures will be approximately \$40 million, principally for machinery and equipment to support our ongoing business and expansion in Asia. Management believes that our existing cash and short-term investment balances and funds generated from operations will be sufficient to permit us to meet our liquidity requirements over the next twelve months. Management further believes that our ongoing cash flows from operations and any borrowings we may incur under our credit facilities will enable us to meet future operating cash requirements in future years. Should we desire to consummate significant acquisition opportunities, our capital needs would increase and could possibly result in our need to increase available borrowings under our revolving credit facility or access public or private debt and equity markets. There can be no assurance, however, that we would be successful in raising additional debt or equity on terms that we would consider acceptable.

## **CONTRACTUAL OBLIGATIONS**

We have certain contractual obligations for operating leases that were summarized in a table of Contractual Obligations in our Annual Report on Form 10-K for the year ended December 31, 2004. There have been no material changes to our contractual obligations, outside of the ordinary course of our business, since December 31, 2004.

## **OFF-BALANCE SHEET ARRANGEMENTS**

We do not have any off-balance sheet financing or unconsolidated special purpose entities.



## **RISK FACTORS**

### **The loss of a major customer would adversely affect us.**

A substantial percentage of our sales have been made to a small number of customers, and the loss of a major customer, if not replaced, would adversely affect us. During the third quarter of 2005, our two largest customers together represented 40.6% of our sales, with one customer accounting for 26.4% of our sales. Our future sales are dependent on the success of our customers, some of which operate in businesses associated with rapid technological change and consequent product obsolescence. Developments adverse to our major customers or their products, or the failure of a major customer to pay for components or services, could have an adverse effect on us.

We expect to continue to depend on the sales from our largest customers and any material delay, cancellation or reduction of orders from these or other significant customers would have a material adverse effect on our results of operations. In addition, we generate significant accounts receivable in connection with providing manufacturing services to our customers. If one or more of our customers were to become insolvent or otherwise unable to pay for the manufacturing services provided by us, our operating results and financial condition would be adversely affected.

### **We are dependent on the success of our customers.**

We are dependent on the continued growth, viability and financial stability of our customers. Our customers are original equipment manufacturers of:

computers and related products for business enterprises;

medical devices;

industrial control equipment;

testing and instrumentation products; and

telecommunication equipment.

These industries are, to a varying extent, subject to rapid technological change, vigorous competition and short product life cycles. When our customers are adversely affected by these factors, we may be similarly affected.

### **We operate in a highly competitive industry.**

We compete against many providers of electronics manufacturing services. Certain of our competitors have substantially greater resources and more geographically diversified international operations than we do. Our competitors include large independent manufacturers such as Celestica, Inc., Flextronics International Ltd., Hon Hai Precision Industry Co., Ltd., Jabil Circuit, Inc., Sanmina-SCI Corporation and Solectron

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Corporation. In addition, we may in the future encounter competition from other large electronic manufacturers that are selling, or may begin to sell, electronics manufacturing services.

We also face competition from the manufacturing operations of our current and future customers, who are continually evaluating the merits of manufacturing products internally against the advantages of outsourcing to electronics manufacturing services providers. In addition, in recent years, original design manufacturers (ODMs), companies that provide design and manufacturing services to OEMs, have significantly increased their share of outsourced manufacturing services

provided to OEMs in several markets, such as notebook and desktop computers, personal computer motherboards, and consumer electronic products. Competition from ODMs may increase if our business in these markets grows or if ODMs expand further into or beyond these markets.

During periods of recession in the electronics industry, our competitive advantages in the areas of quick turnaround manufacturing and responsive customer service may be of reduced importance to electronics OEMs, who may become more price sensitive. We may also be at a competitive disadvantage with respect to price when compared to manufacturers with lower cost structures, particularly those with more offshore facilities located where labor and other costs are lower.

We experience intense competition, which can intensify further as more companies enter the markets in which we operate, as existing competitors expand capacity and as the industry consolidates. The availability of excess manufacturing capacity at many of our competitors creates intense pricing and competitive pressure on the EMS industry as a whole and Benchmark in particular. To compete effectively, we must continue to provide technologically advanced manufacturing services, maintain strict quality standards, respond flexibly and rapidly to customers' design and schedule changes and deliver products globally on a reliable basis at competitive prices. Our inability to do so could have an adverse effect on us.

**We may experience fluctuations in quarterly results.**

Our quarterly results may vary significantly depending on various factors, many of which are beyond our control. These factors include:

the volume of customer orders relative to our capacity;

customer introduction and market acceptance of new products;

changes in demand for customer products;

pricing and other competitive pressures;

the timing of our expenditures in anticipation of future orders;

our effectiveness in managing manufacturing processes;

changes in cost and availability of labor and components;

changes in our product mix;

changes in economic conditions; and

local factors and events that may affect our production volume, such as local holidays.

Additionally, as is the case with many high technology companies, a significant portion of our shipments typically occurs in the last few weeks of a quarter. As a result, our sales may shift from one quarter to the next, having a significant effect on reported results.



**Most of our customers do not commit to long-term production schedules, which makes it difficult for us to schedule production and achieve maximum efficiency of our manufacturing capacity.**

The volume and timing of sales to our customers may vary due to:

- variation in demand for our customers' products;
- our customers' attempts to manage their inventory;
- electronic design changes;
- changes in our customers' manufacturing strategy; and
- acquisitions of or consolidations among customers.

Due in part to these factors, most of our customers do not commit to firm production schedules for more than one quarter in advance. Our inability to forecast the level of customer orders with certainty makes it difficult to schedule production and maximize utilization of manufacturing capacity. In the past, we have been required to increase staffing and other expenses in order to meet the anticipated demand of our customers. Anticipated orders from many of our customers have, in the past, failed to materialize or delivery schedules have been deferred as a result of changes in our customers' business needs, thereby adversely affecting our results of operations. On other occasions, our customers have required rapid increases in production, which have placed an excessive burden on our resources. Such customer order fluctuations and deferrals have had a material adverse effect on us in the past, and we may experience such effects in the future. A business downturn resulting from any of these external factors could have a material adverse effect on our operating income.

**Our customers may cancel their orders, change production quantities or delay production.**

EMS providers must provide increasingly rapid product turnaround for their customers. We generally do not obtain firm, long-term purchase commitments from our customers and we continue to experience reduced lead-times in customer orders. Customers may cancel their orders, change production quantities or delay production for a number of reasons. The success of our customers' products in the market affects our business. Cancellations, reductions or delay by a significant customer or by a group of customers could negatively impact our operating income.

In addition, we make significant decisions, including determining the levels of business that we will seek and accept, production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimate of customer requirements. The short-term nature of our customers' commitments and the possibility of rapid changes in demand for their products reduces our ability to accurately estimate the future requirements of those customers.

On occasion, customers may require rapid increases in production, which can stress our resources and reduce operating margins. In addition, because many of our costs and operating expenses are relatively fixed, a reduction in customer demand can harm our gross profits and operating results.





**Start-up costs and inefficiencies related to new or transferred programs can adversely affect our operating results and such costs may not be recoverable if such new programs or transferred programs are cancelled.**

Start-up costs, the management of labor and equipment resources in connection with the establishment of new programs and new customer relationships, and the need to estimate required resources in advance can adversely affect our gross margins and operating results. These factors are particularly evident in the early stages of the life cycle of new products and new programs or program transfers and in the opening of new facilities such as our systems integration facility in Ayudhaya, Thailand. The effects of these start-up costs and inefficiencies can also occur when we re-open inactive facilities, such as our facility in Korat, Thailand, which began production in the third quarter of 2004. These factors also affect our ability to efficiently use labor and equipment. Due to the improved economy and our increased marketing efforts, we are currently managing a number of new programs. Consequently, our exposure to these factors has increased. In addition, if any of these new programs or new customer relationships were terminated, our operating results could be harmed, particularly in the short term. We may not be able to recoup these start-up costs or replace anticipated new program revenues.

**Complications with the implementation of our new information systems could disrupt our operations and cause unanticipated increases in our costs.**

We have completed the installation of an Enterprise Resource Planning system in most of our manufacturing sites and in our corporate location. Throughout 2005 and 2006, we expect that we will complete the installation of this system in certain of our remaining plants to replace the existing Manufacturing Resource Planning systems and financial information systems used by these sites. Complications with the implementation of these information systems could result in material adverse consequences, including disruption of operations, loss of information and unanticipated increases in cost.

**We are exposed to general economic conditions, which could have a material adverse impact on our business, operating results and financial condition.**

Our business is cyclical and has experienced economic and industry downturns. If the economic conditions and demand for our customers products deteriorate, we may experience a material adverse impact on our business, operating results and financial condition.

In cases where the evidence suggests a customer may not be able to satisfy its obligation to us, we set up reserves in an amount we determine appropriate for the perceived risk. There can be no assurance that our reserves will be adequate to meet this risk. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional receivable and inventory reserves may be required.

**We may encounter significant delays or defaults in payments owed to us by customers for products we have manufactured or components that are unique to particular customers.**

We structure our agreements with customers to mitigate our risks related to obsolete or unsold inventory. However, enforcement of these contracts may result in material expense and delay in payment for inventory. If any of our significant customers become unable or unwilling to purchase such inventory, our business may be materially harmed.



**We may be affected by consolidation in the electronics industry.**

As a result of the current economic climate, consolidation in the electronics industry may increase. Consolidation in the electronics industry could result in an increase in excess manufacturing capacity as companies seek to close plants or take other steps to increase efficiencies and realize synergies of mergers. The availability of excess manufacturing capacity could create increased pricing and competitive pressures for the electronics manufacturing services industry as a whole and our business in particular. In addition, consolidation could also result in an increasing number of very large electronics companies offering products in multiple sectors of the electronics industry. The growth of these large companies, with significant purchasing and marketing power, could also result in increased pricing and competitive pressures for us. Accordingly, industry consolidation could harm our business.

**We are subject to the risk of increased taxes.**

We base our tax position upon the anticipated nature and conduct of our business and upon our understanding of the tax laws of the various countries in which we have assets or conduct activities. Our tax position, however, is subject to review and possible challenge by taxing authorities and to possible changes in law. We cannot determine in advance the extent to which some jurisdictions may assess additional tax or interest and penalties on such additional taxes.

Several countries in which we are located allow for tax holidays or provide other tax incentives to attract and retain business. We have obtained holidays or other incentives where available. Our taxes could increase if certain tax holidays or incentives are retracted, or if they are not renewed upon expiration, or tax rates applicable to us in such jurisdictions are otherwise increased. In addition, further acquisitions may cause our effective tax rate to increase.

**We are exposed to intangible asset risk.**

We have recorded goodwill in connection with business acquisitions. We are required to perform goodwill impairment tests at least on an annual basis and whenever events or circumstances indicate that the carrying value may not be recoverable from estimated future cash flows. As a result of our annual and other periodic evaluations, we may determine that the intangible asset values need to be written down to their fair values, which could result in material charges that could be adverse to our operating results and financial position.

**There are inherent uncertainties involved in estimates, judgments and assumptions used in the preparation of financial statements in accordance with US GAAP. Any changes in estimates, judgments and assumptions could have a material adverse effect on our business, financial position and results of operations.**

The condensed consolidated financial statements included in the periodic reports we file with the Securities and Exchange Commission are prepared in accordance with accounting principles generally accepted in the United States (US GAAP). The preparation of financial statements in accordance with US GAAP involves making estimates, judgments and assumptions that affect reported amounts of assets (including intangible assets), liabilities and related reserves, revenues, expenses and income. Estimates, judgments and assumptions are inherently subject to change in the future, and any such changes could result in corresponding changes to the amounts of assets, liabilities, revenues, expenses and income. Any such changes could have a material adverse effect on our financial position and results of operations.



**Our international operations may be subject to certain risks.**

We currently operate outside the United States in Brazil, China, England, Ireland, Mexico, Singapore and Thailand. During the first nine months of 2005 and 2004, 34.6% and 30.1%, respectively, of our sales were from our international operations. These international operations may be subject to a number of risks, including:

difficulties in staffing and managing foreign operations;

political and economic instability;

unexpected changes in regulatory requirements and laws;

longer customer payment cycles and difficulty collecting accounts receivable;

export duties, import controls and trade barriers (including quotas);

governmental restrictions on the transfer of funds;

burdens of complying with a wide variety of foreign laws and labor practices;

fluctuations in currency exchange rates, which could affect component costs, local payroll, utility and other expenses; and

inability to utilize net operating losses incurred by our foreign operations to reduce our U.S. income taxes.

In addition, several of the countries where we operate have emerging or developing economies, which may be subject to greater currency volatility, negative growth, high inflation, limited availability of foreign exchange and other risks. These factors may harm our results of operations, and any measures that we may implement to reduce the effect of volatile currencies and other risks of our international operations may not be effective. In our experience, entry into new international markets requires considerable management time as well as start-up expenses for market development, hiring and establishing office facilities before any significant revenues are generated. As a result, initial operations in a new market may operate at low margins or may be unprofitable.

We cannot assure you that our international operations will contribute positively to our business, financial conditions or results of operations.

**We are involved in legal proceedings. An unfavorable decision in any of these proceedings could have a material adverse effect on us.**

In the past, we have been notified of claims relating to various matters including intellectual property rights, contractual matters or other issues arising in the ordinary course of business. In the event of such a claim, we may be required to spend a significant amount of money to defend or otherwise address the claim. Any litigation, even where a claim is without merit, could result in substantial costs and diversion of resources. Accordingly, the resolution or adjudication of such disputes, even those encountered in the ordinary course of business, could have a material adverse effect on our business, consolidated financial conditions and results of operations. See Note 10 to the condensed consolidated financial statements.

**Our success will continue to depend to a significant extent on our executives.**

We depend significantly on certain key executives, including, but not limited to, Cary T. Fu, Gayla J. Delly and Steven A. Barton. The unexpected loss of the services of any one of these executive officers would have an adverse effect on us.

**We must successfully integrate the operations of acquired companies to maintain profitability.**

Our capabilities have continued to grow through acquisitions and we may pursue additional acquisitions over time. These acquisitions involve risks, including:

integration and management of the operations;

retention of key personnel;

integration of purchasing operations and information systems;

retention of the customer base of acquired businesses;

management of an increasingly larger and more geographically disparate business; and

diversion of management's attention from other ongoing business concerns.

Our profitability will suffer if we are unable to successfully integrate and manage any future acquisitions that we might pursue, or if we do not achieve sufficient revenue to offset the increased expenses associated with these acquisitions.

**We must maintain our technological and manufacturing process expertise.**

The market for our manufacturing services is characterized by rapidly changing technology and continuing process development. We are continually evaluating the advantages and feasibility of new manufacturing processes. We believe that our future success will depend upon our ability to develop and provide manufacturing services which meet our customers' changing needs. This requires that we maintain technological leadership and successfully anticipate or respond to technological changes in manufacturing processes on a cost-effective and timely basis. We cannot assure you that our process development efforts will be successful.

**Environmental laws may expose us to financial liability and restrictions on operations.**

We are subject to a variety of federal, state, local and foreign environmental laws and regulations relating to environmental, waste management, and health and safety concerns, including the handling, storage, discharge and disposal of hazardous materials used in or derived from our manufacturing processes. If we or companies we acquire have failed or fail in the future to comply with such laws and regulations, then we could incur liabilities and fines and our operations could be suspended. Such laws and regulations could also restrict our ability to modify or expand our facilities, could require us to acquire costly equipment, or could impose other significant expenditures. In addition, our operations may give rise to claims of property contamination or human exposure to hazardous chemicals or conditions.



**Shortages or price increases of components specified by our customers would delay shipments and adversely affect our profitability.**

Substantially all of our sales are derived from electronics manufacturing services in which we purchase components specified by our customers. In the past, supply shortages have substantially curtailed production of all assemblies using a particular component. In addition, industry-wide shortages of electronic components, particularly of memory and logic devices, have occurred. If shortages of these components occur or if components received are defective, we may be forced to delay shipments, which could have an adverse effect on our profit margins. Because of the continued increase in demand for surface mount components, we anticipate component shortages and longer lead times for certain components to occur from time to time. Also, we typically bear the risk of component price increases that occur between periodic repricings during the term of a customer contract. Accordingly, certain component price increases could adversely affect our gross profit margins.

**Our stock price is volatile.**

Our common shares have experienced significant price volatility, and such volatility may continue in the future. The price of our common shares could fluctuate widely in response to a range of factors, including variations in our reported financial results and changing conditions in the economy in general or in our industry in particular. In addition, stock markets generally experience significant price and volume volatility from time to time which may affect the market price of our common shares for reasons unrelated to our performance.

**Provisions in our charter documents and state law may make it harder for others to obtain control of our company even though some shareholders might consider such a development to be favorable.**

Our shareholder rights plan, provisions of our amended and restated articles of incorporation and the Texas Business Corporation Act may delay, inhibit or prevent someone from gaining control of our company through a tender offer, business combination, proxy contest or some other method. These provisions include:

- a poison pill shareholder rights plan;
- a statutory restriction on the ability of shareholders to take action by less than unanimous written consent; and
- a statutory restriction on business combinations with some types of interested shareholders.

**Recently enacted changes to financial accounting standards will affect our reported results of operations and could result in a decrease in the value of your shares.**

There has been an ongoing public debate as to whether employee stock option and employee stock purchase plan shares should be treated as a compensation expense. In December 2004, the Financial Accounting Standards Board published amendments to financial accounting standards that will require that awards under such plans be treated as compensation expense using the fair value method. This amendment will be effective for our first quarter of 2006. Based on preliminary estimates, the future compensation cost to be recognized as a result of the adoption of this revised standard for the year ended December 31, 2006 will be \$0.5 million. In addition, for any new awards that may be granted during the fourth quarter of 2005, we may incur additional expense during 2006 that cannot yet be quantified. See Note 2 to the Condensed Consolidated Financial Statements.



### **Impact of Governmental Regulation**

Our worldwide operations are subject to local laws and regulations. Of particular note at this time are two European Union (EU) directives, the first of which is the Restriction of Certain Hazardous Substances Directive (RoHS). Effective July 1, 2006, this directive restricts the distribution of products within the EU containing certain substances, including lead. While the enabling legislation of most EU member countries has not yet been enacted, and the implementing details not yet known, it appears we will not be able to sell non-RoHS compliant products to most customers who intend to sell their finished goods into the EU after the effective date. In addition, industry analysts indicate that similar legislation in the U.S. and Asia will eventually follow.

The second directive is the Waste Electrical and Electronic Equipment Directive, effective August 13, 2005, under which a manufacturer or importer will be required, at its own cost, to take back and recycle all of the products it manufactured in or imported into the EU.

Both directives will affect the worldwide electronics, and electronics components, industries as a whole, and collaborative efforts among suppliers, distributors and customers to develop compliant processes have begun. The cost of such efforts, the degree to which we will be expected to absorb such costs, the impact that the directive may have on product shipments, and our liability for non-compliant product is not yet known, but could have a material effect on our operations and results. If we or our customers fail in the future to comply with such laws and regulations, then we could incur liabilities and fines and our operations could be suspended.

Recently, the Chinese government revalued its currency against the U.S. dollar. The Chinese currency has held relatively fixed to the U.S. dollar for numerous years, but now the Chinese government appears to be adopting a managed float policy (allowing its currency to move in a tight range up or down from the previous day's close). As our Asian operations expand, our failure to adequately hedge foreign currency transactions and/or currency exposures associated with assets and liabilities denominated in non-functional currencies could adversely affect our financial condition, results of operations and cash flows.

### **We could incur a significant amount of debt in the future.**

We have the ability to borrow approximately \$128.5 million under our Credit Agreement and the Thai Credit Agreement. In addition, we could incur additional indebtedness in the future in the form of bank loans, notes or convertible securities. An increase in the level of our indebtedness, among other things, could:

- make it difficult for us to obtain any necessary financing in the future for other acquisitions, working capital, capital expenditures, debt service requirements or other purposes;

- limit our flexibility in planning for, or reacting to changes in, our business; and

- make us more vulnerable in the event of a downturn in our business.

There can be no assurance that we will be able to meet any future debt service obligations.



**We may be exposed to interest rate fluctuations.**

We will have exposure to interest rate risk under our variable rate revolving credit facilities to the extent we incur indebtedness under such facilities. These facilities' interest rates are based on the spread over the bank's Eurodollar rate or its prime rate.

**Recently enacted changes in the securities laws and regulations are likely to increase our costs.**

The Sarbanes-Oxley Act of 2002 that became law in July 2002 has required changes in some of our corporate governance, securities disclosure and compliance practices. In response to the requirements of that Act, the Securities and Exchange Commission and the New York Stock Exchange have promulgated new rules on a variety of subjects. Compliance with these new rules has increased our legal and financial and accounting costs, and we expect these increased costs to continue indefinitely. These developments may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be forced to accept reduced coverage or incur substantially higher costs to obtain coverage. Likewise, these developments may make it more difficult for us to attract and retain qualified members of our board of directors or qualified executive officers.

**Our business may be impacted by geopolitical events.**

As a global business, we operate and have customers located in many countries. Geopolitical events such as terrorist acts may effect the overall economic environment and negatively impact the demand for our customers' products. As a result, customer orders may be lower and our financial results may be adversely affected.

**Our business may be impacted by hurricanes, epidemics and other natural disasters.**

Hurricanes, epidemics and other natural disasters could negatively impact our business. In some countries in which we operate, such as China and Thailand, potential outbreaks of severe acute respiratory syndrome and/or bird flu could disrupt our manufacturing operations, reduce demand for our customers' products and increase supply chain costs. Some of our facilities, including our corporate headquarters, are located in areas which may be impacted by hurricanes and/or other natural disasters.

### Item 3 Quantitative and Qualitative Disclosures About Market Risk

Our international sales are a significant portion of our net sales; we are exposed to risks associated with operating internationally, including the following:

Foreign currency exchange risk;

Import and export duties, taxes and regulatory changes;

Inflationary economies or currencies; and

Economic and political instability.

We do not use derivative financial instruments for speculative purposes. Our practice is to maintain a hedged position for certain significant transaction exposures. These exposures are primarily, but not limited to, vendor payments and inter-company balances in currencies other than the currency in which our foreign operation primarily generates and expends cash. Our international operations in some instances operate in a natural hedge because both operating expenses and a portion of sales are denominated in local currency. In the future, significant transactions involving our international operations may cause us to consider engaging in hedging transactions to attempt to mitigate our exposure to fluctuations in foreign exchange rates. As of September 30, 2005, we did not have any foreign currency hedges. Our sales are substantially denominated in U.S. dollars. Our primary foreign currency cash flows are generated in certain European countries and Brazil.

### Item 4 Controls and Procedures

Our management has evaluated, with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, our CEO and CFO have concluded that, as of such date, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting that occurred during the fiscal period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our management, including our CEO and CFO, does not expect that our disclosure controls and internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls

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can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any

design will succeed in achieving its stated goals under all potential future conditions; over time, a control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Exhibits 31.1 and 31.2 are the Certifications of the CEO and the CFO, respectively. The Certifications are required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certifications ). This Item of this report, which you are currently reading, is the information concerning the Evaluation referred to in the Section 302 Certifications and this information should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics presented.

## **PART II OTHER INFORMATION**

### **Item 1 Legal Proceedings**

We are involved in various legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position or results of operations.

One of the legal actions involves a payable dispute with a former customer of a predecessor company (AVEX) acquired by us in 1999. The lawsuit alleges that we owe the former customer approximately \$12 million in unsubstantiated claims for past due invoices. We deny responsibility for these unsubstantiated claims and have filed a counterclaim against the former customer for non payment of receivables. Management intends to vigorously pursue its claim against the former customer and defend against the former customer's allegations. At the present time, we are unable to reasonably estimate the probable loss, if any, associated with these matters.

### **Item 2 Unregistered Sales Of Equity Securities And Use Of Proceeds**

None.

### **Item 3 Defaults Upon Senior Securities**

None.

### **Item 4 Submission of Matters to a Vote of Security Holders**

None.

### **Item 5 Other Information**

None.



**Item 6 Exhibits**

(a) Exhibits.

31.1 Section 302 Certification of Chief Executive Officer

31.2 Section 302 Certification of Chief Financial Officer

32.1 Section 1350 Certification of Chief Executive Officer

32.2 Section 1350 Certification of Chief Financial Officer

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on November 7, 2005.

BENCHMARK ELECTRONICS, INC.  
(Registrant)

By: /s/ Cary T. Fu  
Cary T. Fu  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Gayla J. Delly  
Gayla J. Delly  
Chief Financial Officer  
(Principal Financial Officer)

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer