

BENCHMARK ELECTRONICS INC  
Form 10-Q  
May 10, 2007

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

Washington, D.C. 20549

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2007.

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)

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

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

**77515**  
(Zip Code)

**(979) 849-6550**  
(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 a large accelerated filer, or a non-accelerated filer. See definition of large accelerated filer and non-accelerated filer in Rule 12b-2 of the Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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As of May 8, 2007 there were 72,631,402 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

(in thousands, except par value)	March 31, 2007 (unaudited)	December 31, 2006
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 151,570	\$ 123,872
Short-term investments	105,660	100,460
Accounts receivable, net of allowance for doubtful accounts of \$1,190 and \$1,430, respectively	512,464	462,953
Inventories, net	463,528	420,347
Prepaid expenses and other assets	72,129	56,444
Deferred income taxes	19,722	6,534
Total current assets	1,325,073	1,170,610
Property, plant and equipment, net	163,073	110,912
Goodwill, net	297,778	112,999
Other, net	28,292	11,599
	\$ 1,814,216	\$ 1,406,120
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Notes payable and current installments of long-term debt and capital lease obligations	\$ 5,816	\$
Convertible debt	5,000	
Accounts payable	416,873	335,470
Income taxes payable	4,838	31,300
Accrued liabilities	81,248	42,948
Total current liabilities	513,775	409,718
Long-term debt and capital lease obligations, less current installments	12,581	
Other long-term liabilities	30,488	2,306
Deferred income taxes	9,506	9,074
Shareholders' equity:		
Preferred shares, \$0.10 par value; 5,000 shares authorized, none issued		
Common shares, \$0.10 par value; 145,000 shares authorized; issued 72,240 and 64,862, respectively; outstanding 72,129 and 64,751, respectively	7,213	6,475
Additional paid-in capital	803,268	586,349
Retained earnings	442,760	398,949
Accumulated other comprehensive loss	(5,103)	(6,479)
Less treasury shares, at cost; 111 shares	(272)	(272)
Total shareholders' equity	1,247,866	985,022
Commitments and contingencies		
	\$ 1,814,216	\$ 1,406,120

See accompanying notes to condensed consolidated financial statements.

## BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Income

(unaudited)

(in thousands, except per share data)	Three Months Ended	
	March 31,	
	2007	2006
Sales	\$ 752,482	\$ 651,244
Cost of sales	697,994	605,878
Gross profit	54,488	45,366
Selling, general and administrative expenses	23,248	16,370
Amortization of intangibles	447	
Restructuring charges and integration costs	3,345	2,769
Income from operations	27,448	26,227
Interest expense	(811 )	(86 )
Other income	1,715	1,689
Income before income taxes	28,352	27,830
Income tax expense	3,876	1,308
Net income	\$ 24,476	\$ 26,522
Earnings per share:		
Basic	\$ 0.34	\$ 0.42
Diluted	\$ 0.34	\$ 0.41
Weighted average number of shares outstanding:		
Basic	71,435	63,601
Diluted	72,465	64,825

See accompanying notes to condensed consolidated financial statements.

**BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES**

**Condensed Consolidated Statements of Comprehensive Income**

(unaudited)

(in thousands)	Three Months Ended	
	March 31, 2007	2006
Net income	\$ 24,476	\$ 26,522
Other comprehensive income:		
Foreign currency translation adjustments	1,376	1,247
Comprehensive income	\$ 25,852	\$ 27,769

Accumulated unrealized foreign currency translation losses were \$5.0 million and \$6.4 million at March 31, 2007 and December 31, 2006. Foreign currency translation adjustments consist of adjustments to consolidate subsidiaries that use the local currency as their functional currency and transaction gains and losses related to intercompany dollar-denominated debt that is not expected to be repaid in the foreseeable future.

See accompanying notes to condensed consolidated financial statements.

**BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES****Condensed Consolidated Statement of Shareholders Equity****(unaudited)**

(in thousands)	Shares	Common shares	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Treasury shares	Total shareholders equity
Balances, December 31, 2006	64,751	\$ 6,475	586,349	398,949	(6,479	) (272	) 985,022
Adoption of FIN 48				19,335			19,335
Stock-based compensation expense			628				628
Merger	7,301	730	215,235				215,965
Stock options exercised	77	8	803				811
Federal tax benefit of stock options exercised			253				253
Comprehensive income				24,476	1,376		25,852
Balances, March 31, 2007	72,129	\$ 7,213	803,268	442,760	(5,103	) (272	) 1,247,866

See accompanying notes to consolidated financial statements.

## BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)	Three Months Ended	
	March 31, 2007	2006
Cash flows from operating activities:		
Net income	\$ 24,476	\$ 26,522
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	10,629	6,403
Deferred income taxes	1,296	512
Gain on the sale of property, plant and equipment	(128 )	(28 )
Asset impairment	273	
Stock-based compensation expense	628	486
Federal tax benefit of stock options exercised	8	739
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	83,218	(80,693 )
Inventories	24,177	(41,456 )
Prepaid expenses and other assets	(3,584 )	1,100
Accounts payable	(43,001 )	34,350
Accrued liabilities	(5,106 )	13,312
Income taxes	1,657	(3,213 )
Net cash provided by (used in) operations	94,543	(41,966 )
Cash flows from investing activities:		
Purchases of short-term investments	(156,875 )	(70,750 )
Proceeds from sales and maturities of short-term investments	151,675	114,575
Additions to property, plant and equipment	(7,525 )	(9,448 )
Proceeds from the sale of property, plant and equipment	165	140
Additions to purchased software	(53 )	(107 )
Net cash acquired in acquisitions	9,548	
Net cash provided by (used in) investing activities	(3,065 )	34,410
Cash flows from financing activities:		
Proceeds from stock options exercised	811	8,727
Federal tax benefit of stock options exercised	245	2,856
Principal payments on long-term debt and capital lease obligations	(83,033 )	
Proceeds from long-term debt	16,760	
Stock split costs		(66 )
Net cash provided by (used in) financing activities	(65,217 )	11,517
Effect of exchange rate changes	1,437	839
Net increase in cash and cash equivalents	27,698	4,800
Cash and cash equivalents at beginning of year	123,872	110,845
Cash and cash equivalents at March 31	\$ 151,570	\$ 115,645

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**

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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 year ended December 31, 2006.

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 Acquisitions**

## Edgar Filing: BENCHMARK ELECTRONICS INC - Form 10-Q

Effective January 8, 2007, the Company acquired Pemstar Inc. (Pemstar), a publicly traded electronics manufacturing services (EMS) company headquartered in Rochester, Minnesota (the Merger). Pursuant to the Agreement and Plan of Merger among the Company and Pemstar dated October 16, 2006 (the Merger Agreement), each issued and outstanding share of common stock, par value \$0.01 per share, of Pemstar was converted into the right to receive 0.16 of a common share, par value \$0.10 per share, of the Company. With the closing of the Merger, Pemstar became a wholly-owned subsidiary of the Company. With the acquisition of Pemstar, the Company's global operations now include 24 facilities in nine countries. This acquisition expanded the Company's customer base and deepened its engineering and systems integration capabilities.

The aggregate purchase price was \$221.3 million, including common shares valued at \$202.5 million, stock options and warrants valued at \$9.0 million, conversion feature of debt valued at \$4.8 million and estimated acquisition costs of \$5.0 million. The value of the 7.3 million common shares issued was based on the average market price of the Company's common shares over the 2-day period before and after the terms of the acquisition were agreed to and announced.

As a direct result of the Merger, we assumed approximately \$89.4 million of indebtedness. Since the acquisition date of January 8, 2007, this indebtedness has been reduced by approximately \$66.3 million.

7

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The Company is accounting for the Merger utilizing the accounting principles promulgated by Statement of Financial Accounting Standards (SFAS) Nos. 141 and 142. Therefore, the results of operations of the Pemstar operations since January 8, 2007 have been included in the accompanying consolidated statement of income. The preliminary allocation of the net purchase price of the Merger resulted in goodwill of approximately \$180.0 million. The ultimate allocation of the purchase price may differ from the amounts included in these financial statements. Adjustments to the purchase price allocations, if any, are expected to be finalized by the end of 2007, and will be reflected in future filings. Management does not expect these adjustments, if any, to have a material effect on the Company's financial position or results of operations. In connection with the Merger, the Company amended its Amended and Restated Credit Agreement dated June 23, 2000 to permit the Merger.

The following is an estimate of the purchase price for Pemstar and the preliminary purchase price allocation (in thousands):

Acquisition of the outstanding common stock of Pemstar at \$4.44 share for 45.6 million shares	\$ 202,475
Estimated fair value of Pemstar stock options and warrants	9,021
Estimated fair value of the conversion feature of debt	4,773
Acquisition costs	5,021
<b>Total purchase price</b>	<b>\$ 221,290</b>
<b>Current assets</b>	<b>\$ 227,217</b>
Property, plant and equipment	54,013
Deferred taxes	11,286
Goodwill	180,049
Intangible assets	17,877
Other assets	7,151
<b>Total assets acquired</b>	<b>497,593</b>
<b>Current liabilities</b>	<b>184,158</b>
Long-term debt, capital lease obligations and other long-term liabilities	92,145
<b>Total liabilities assumed</b>	<b>276,303</b>
<b>Net assets acquired</b>	<b>\$ 221,290</b>

On March 1, 2007, we terminated the joint venture agreement and acquired for \$5.3 million the remaining 40% minority interest in the Company's Romanian subsidiary. We acquired the 60% interest in the Merger discussed above. The purchase price in excess of the 40% minority interest liability resulted in goodwill of \$4.7 million.

The following summary pro forma condensed consolidated financial information reflects the acquisition of Pemstar as if it had occurred on January 1, 2006 for purposes of the statements of operations. The summary pro forma information is not necessarily representative of what the Company's results of operations would have been had the acquisition of Pemstar in fact occurred on January 1, 2006 and is not intended to project the Company's results of operations for any future period or date. Pro forma results of operations for the three months ended March 31, 2007 related to the Merger have not been presented since the operating results for Pemstar for the period up to the date of acquisition are immaterial.

Pro forma condensed consolidated financial information for the three months ended March 31, 2006 (unaudited):

	<b>Three months ended March 31, 2006</b>
Net sales	\$ 777,205
Gross profit	\$ 57,700
Income from operations	\$ 29,433
Net income	\$ 26,779
Earnings per share:	
Basic	\$ 0.38
Diluted	\$ 0.37
Weighted average number of shares outstanding:	
Basic	70,903
Diluted	72,745



**Note 3 Stock-Based Compensation**

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The Company's stock awards plan permits the grant of a variety of types of awards, including stock options, restricted stock awards, stock appreciation rights, performance awards, and phantom stock awards, or any combination thereof, to key employees of the Company. The stock options granted to employees are granted with an exercise price equal to the market price of the Company's stock on the date of grant, vest over a four-year period from the date of grant and have a term of ten years. Members of the Board of Directors of the Company who are not employees of the Company participate in a separate stock option plan that provides for the granting of stock options upon the occurrence of the non-employee director's election or re-election to the Board of Directors. All awards under the non-employee director stock option plan are fully vested upon the date of grant and have a term of ten years. As of March 31, 2007, 5.6 million additional options may be granted under the Company's existing plans.

Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (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 total compensation cost recognized for stock-option awards was \$0.6 million (\$0.4 million, net of tax or \$0.01 per diluted and basic share) and \$0.5 million (\$0.4 million, net of tax or \$0.01 per diluted and basic share) for the three month periods ended March 31, 2007 and 2006. The compensation expense for stock-based awards includes an estimate for forfeitures and is recognized over the vesting period of the options using the straight-line method. SFAS No. 123R requires that cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for stock-based awards (excess tax benefits) be classified as cash flows from financing activities.

As of March 31, 2007, there was approximately \$7.8 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted-average period of 3.1 years.

During the three months ended March 31, 2007 and 2006, the Company issued 0.4 million and 1.0 million options, respectively. In connection with the Merger, all outstanding Pemstar options were converted into options of the Company at the 0.160 exchange ratio on January 8, 2007. These were the only options issued during the three months ended March 31, 2007. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The weighted average assumptions used to value the options converted from Pemstar during the three months ended March 31, 2007 and the option grants during the three months ended March 31, 2006 were as follows:

	<b>Three months ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
Expected term of options	2.1 years	4.4 years
Expected volatility	27 %	46 %
Risk-free interest rate	4.86 %	4.39 %
Dividend yield	zero	zero

The expected term of the options represents the estimated period of time until exercise and is based on historical experience, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. Expected stock



price volatility is based on the historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury zero-coupon rates in effect at the time of grant with an equivalent remaining term. The dividend yield reflects that the Company has not paid any cash dividends since inception.

The weighted average fair value per option granted during the three months ended March 31, 2007 and 2006 was \$9.24 and \$5.74, respectively. The total cash received as a result of stock option exercises for three months ended March 31, 2007 and 2006 was approximately \$0.8 million and \$8.7 million, respectively. The tax benefit realized as a result of the stock option exercises was \$0.3 million and \$3.6 million during 2007 and 2006. For the three months ended March 31, 2007 and 2006, the total intrinsic value of stock options exercised was \$0.9 million and \$11.9 million, respectively.

The following table summarizes the activities relating to the Company's stock option plans:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2006	5,716	\$ 18.54	6.37	
Granted				
Converted from Merger	369	\$ 25.48		
Exercised	(77 )	\$ 10.56		
Canceled	(80 )	\$ 23.71		
Outstanding at March 31, 2007	5,928	\$ 19.01	6.03	\$ 24,962
Exercisable at March 31, 2007	4,308	\$ 16.81	4.86	\$ 24,962

The aggregate intrinsic value in the table above is before income taxes and is calculated as the difference between the exercise price of the underlying options and the Company's closing stock price of \$20.66 as of the last business day of the period ended March 31, 2007 for options that had exercise prices that were lower than the market price.

**Note 4 Earnings Per Share**

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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 months ended March 31, 2007 and 2006. 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.

	<b>Three Months Ended</b>	
	<b>March 31,</b>	<b>2006</b>
	<b>2007</b>	<b>2006</b>
Numerator for basic earnings per share - net income	\$ 24,476	\$ 26,522
Interest expense on outstanding equity instruments, net of tax	115	
Numerator for diluted earnings per share	\$ 24,591	\$ 26,522
Denominator for basic earnings per share - weighted average number of common shares outstanding during the period	71,435	63,601
Incremental common shares attributable to exercise of outstanding dilutive options	541	1,224
Incremental common shares attributable to conversion of 6.5% convertible debt	351	
Incremental common shares attributable to exercise of warrants	138	
Denominator for diluted earnings per share	72,465	64,825
Basic earnings per share	\$ 0.34	\$ 0.42
Diluted earnings per share	\$ 0.34	\$ 0.41

Options to purchase 3.2 million and 0.7 million common shares for the three months ended March 31, 2007 and 2006, respectively 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.

As March 31, 2007, the Company has outstanding warrants to purchase common shares as follows:

Shares	Exercise Price	Expiration Date
126,130	\$ 14.25	May 1, 2009
160,000	\$ 12.50	May 1, 2009
40,000	\$ 10.125	July 18, 2009

These warrants were assumed in the Merger.

**Note 5 Goodwill and Intangible Assets**

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Goodwill associated with each of the Company's business segments and changes in those amounts during the three-month period ended March 31, 2007 were as follows:

	Americas	Asia	Europe	Total
Goodwill, December 31, 2006	\$ 106,931	\$ 6,068	\$	\$ 112,999
Acquisitions	117,649	47,498	19,622	184,769
Currency translation adjustment	10			10
Goodwill, March 31, 2007	\$ 224,590	\$ 53,566	\$ 19,622	\$ 297,778

Identifiable intangible assets totaling \$17.9 million consist of customer relationships acquired in the Merger. Amortization of intangible assets for the three months ended March 31, 2007 totaled \$0.4 million. Amortization of these intangible assets for 2007 through 2017 will be approximately \$1.8 million per year.

### **Note 6 Borrowing Facilities**

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Notes payable, long-term debt and capital lease obligations outstanding as of March 31, 2007 consists of the following:

Notes payable and long-term debt	\$ 5,599
Capital lease obligations	12,798
Total	18,397
Less current notes payable and current installments	5,816
Notes payable, long-term debt and capital lease obligations, less current installments	\$ 12,581

In connection with the Merger, the Company assumed \$89.4 million of debt. Subsequent to the Merger the Company has repaid \$66.3 million of this debt. Prior to the Merger, the Company had no outstanding debt.

As of March 31, 2007, the Company has \$5 million in convertible senior subordinated notes outstanding. These notes were assumed in the Merger, bear interest at 6.5% and matured on May 1, 2007. The notes are convertible into Benchmark common shares at a conversion price of \$14.25 per share. During May 2007, these notes were converted into 0.3 million common shares at the request of the noteholders.

Under the terms of a Credit Agreement (the Credit Agreement), the Company has a \$100 million three-year revolving credit line for general corporate purposes which can be increased to a total of \$200 million and which expires January 20, 2008. 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 (based upon the Company's debt ratio) on the unused portion of the revolving credit line is payable quarterly in arrears. As of March 31, 2007, 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, 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 March 31, 2007, the Company was in compliance with all such covenants and restrictions.

The Company's Thailand subsidiary has a credit agreement with Kasikornbank Public Company Limited (the Thai Credit Agreement). The Thai Credit Agreement provides that the lender will make available to the Company's Thailand subsidiary up to approximately \$16 million in revolving loans and machinery loans. The Thai Credit Agreement is secured by land, buildings and machinery in Thailand. In addition, the Thai Credit Agreement provides for approximately \$1.9 million (62 million Thai baht) in working capital availability in the form of working capital loans (10 million Thai baht) and bank guarantees (52 million Thai baht). Availability of funds under the Thai Credit Agreement is reviewed annually and is currently accessible through September 2007. As of March 31, 2007, the Company's Thailand subsidiary had no working capital borrowings outstanding.

In addition, the Company has two other available banking facilities assumed in the Merger which are in the process of being terminated. There are no amounts outstanding under these two facilities.

14

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**Note 7 Inventories**



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Inventory costs are summarized as follows:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Raw materials	\$ 330,256	\$ 296,814
Work in process	97,805	90,787
Finished goods	35,467	32,746
	\$ 463,528	\$ 420,347

**Note 8 Income Taxes**

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Income tax expense (benefit) consists of the following:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
Federal Current	\$ 1,199	\$ (96 )
Foreign Current	1,028	301
State Current	353	591
Deferred	1,296	512
	<b>\$ 3,876</b>	<b>\$ 1,308</b>

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.

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 on various dates through 2010, and are subject to certain conditions with which the Company expects to comply. The net impact of these tax incentives was to lower income tax expense for the three month periods ended March 31, 2007 and 2006 by approximately \$4.3 million (approximately \$0.06 per diluted share) and \$3.3 million (approximately \$0.05 per diluted share), respectively.

15

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**Note 9 Segment and Geographic Information**

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The Company has 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.

The Company has three reportable operating segments: the Americas, Europe, and Asia. Information about operating segments was as follows:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	<b>2006</b>
	<b>2007</b>	
<b>Net sales:</b>		
Americas	\$ 560,323	\$ 591,817
Asia	225,966	182,240
Europe	98,721	85,154
Elimination of intersegment sales	(132,528 )	(207,967 )
	<b>\$ 752,482</b>	<b>\$ 651,244</b>
<b>Depreciation and amortization:</b>		
Americas	\$ 5,375	\$ 3,303
Asia	3,837	2,283
Europe	683	192
Corporate	734	625
	<b>\$ 10,629</b>	<b>\$ 6,403</b>
<b>Income from operations:</b>		
Americas	\$ 14,873	\$ 21,421
Asia	16,326	12,537
Europe	42	(1,199 )
Corporate, other and intersegment eliminations	(3,793 )	(6,532 )
	<b>\$ 27,448</b>	<b>\$ 26,227</b>
<b>Capital expenditures:</b>		
Americas	\$ 1,359	\$ 5,744
Asia	5,958	3,529
Europe	208	175
	<b>\$ 7,525</b>	<b>\$ 9,448</b>
	<b>March 31,</b>	<b>December 31,</b>
	<b>2007</b>	<b>2006</b>
<b>Total assets:</b>		
Americas	\$ 1,134,763	\$ 977,432
Asia	514,223	333,945
Europe	162,731	89,003
Corporate and other	2,499	5,740
	<b>\$ 1,814,216</b>	<b>\$ 1,406,120</b>

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.

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>Geographic net sales:</b>		
United States	\$ 566,688	\$ 496,575
Asia	46,707	22,797
Europe	130,325	127,289
Other Foreign	8,762	4,583
	\$ 752,482	\$ 651,244
	<b>March 31,</b>	<b>December 31,</b>
	<b>2007</b>	<b>2006</b>
<b>Long-lived assets:</b>		
United States	\$ 97,488	\$ 66,491
Asia	73,553	45,287
Europe	11,335	1,419
Other	8,989	9,314
	\$ 191,365	\$ 122,511

**Note 10 Supplemental Cash Flow Information**

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The following is additional information concerning supplemental disclosures of cash payments.

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
Income taxes paid, net	\$ 807	\$ 381
Interest paid	\$ 520	\$ 53

**Note 11 Contingencies**

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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.

The following legal proceedings were acquired in the Merger and are considered outside the ordinary course of business.

On June 16, 2005 a putative class action was filed by an individual shareholder against Pemstar and certain of its officers and directors. The lawsuit is pending in the United States District Court for the District Court of Minnesota and is captioned: In re PEMSTAR INC. Securities Litigation, Civil Action No. 05-CV-01182 JMR/FLN. The lawsuit alleges violations of Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934 and Section 11 of the Securities Act of 1933. An Amended Complaint was filed on November 28, 2005. The plaintiff alleges, in essence, that the defendants defrauded Pemstar's shareholders by failing to timely disclose the circumstances around the discrepancies in the accounting of the Mexico facility that generated a restatement. The lawsuit also alleges that the registration statement filed by Pemstar in connection

17

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with a secondary offering contained false, material misrepresentations. The plaintiff seeks to represent a class of persons who purchased Pemstar stock from January 30, 2003 through and including January 12, 2005. The Amended Complaint does not specify an amount of damages. The Company and the individuals will vigorously defend against the claim and believe the lawsuit is without merit.

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 12 Impact of Recently Issued Accounting Standards**



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On January 1, 2007, we adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. Under FIN 48, the Company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets the more-likely-than-not recognition threshold, the position is measured to determine the amount of benefit to recognize in the financial statements. FIN 48 applies to all tax positions related to income taxes subject to SFAS No. 109, Accounting for Income Taxes. The cumulative effect of adopting FIN 48 was a \$19.3 million decrease to income taxes payable with a corresponding increase to the January 1, 2007 balance of retained earnings for tax benefits not previously recognized.

The total balance of the reserve for uncertain income tax positions as of the date of adoption was \$16.8 million. The reserve is classified as a current or long-term liability in the consolidated balance sheet based on the Company's expectation of when the items will be settled. Included in the total reserve is accrued interest of \$0.2 million. There are no penalties accrued as of the date of adoption. If the total amount of the unrecognized tax positions as of the date of adoption were recognized, the Company's income tax expense would have decreased by \$16.8 million. The Company records interest expense and penalties accrued in relation to uncertain income tax positions as a component of current income tax expense.

As of March 31, 2007, the total amount of the reserve for uncertain tax positions including interest and penalties is \$34.6 million and it is classified as a current or long-term liability in the consolidated balance sheet based on the Company's expectation of when the items will be settled. Interest and penalties are included in the total reserve of approximately \$2.0 million and \$1.6 million, respectively. The increase in the total reserve is primarily the result of the addition of uncertain tax positions acquired from Pemstar. The analysis of the uncertain tax positions related to Pemstar for both US and foreign jurisdictions under FIN 48 was performed as of the acquisition date. Any adjustments recorded related to the uncertain tax positions of the Pemstar acquisition was recognized as part of a business combination pursuant to SFAS No. 141.

During the next twelve months, it is reasonably possible that the reserve for uncertain tax positions will decrease by approximately \$6.9 million as it relates to certain US and foreign income tax benefits for worthless stock deductions, and income tax audits due to the expiration of the statute of limitations or final audit settlements in respective countries. If realized, the

Company's income tax expense would decrease by \$6.9 million. As of January 1, 2007, the Company's business locations in the United States, Ireland, Mexico, Thailand, Singapore, Netherlands, China, and Luxembourg remain open to examination by the various local taxing authorities, in total or in part, for years ended 2001 to 2006, respectively.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands the requisite disclosures for fair value measurements. SFAS No. 157 is effective in fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of adopting SFAS No. 157 on its consolidated results of operations and financial condition.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS No. 159 on its consolidated financial position and results of operations.

**Note 13 Restructuring Charges and Integration Costs**

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The Company has undertaken initiatives to restructure its business operations with the intention of improving utilization and realizing cost savings in the future. These initiatives have included changing the number and location of production facilities, largely to align capacity and infrastructure with current and anticipated customer demand. This alignment includes transferring programs from higher cost geographies to lower cost geographies. The process of restructuring entails, among other activities, moving production between facilities, reducing staff levels, realigning our business processes and reorganizing our management.

The Company recognized restructuring charges during 2006 related to reductions in workforce and the re-sizing and closure of certain facilities. These charges were recorded pursuant to plans developed and approved by management. Restructuring charges associated with these realignment efforts, primarily related to the closure of the Company's Leicester, England and Loveland, Colorado facilities, were approximately \$4.7 million (\$4.0 million net of tax) during the year ended December 31, 2006.

The following table summarizes the respective payments and the remaining accrued balance as of March 31, 2007 for estimated restructuring charges incurred during the year ended December 31, 2006:

	<b>Severance</b>	<b>Facility Lease Costs</b>	<b>Other Exit Costs</b>	<b>Total Costs</b>
Balance as of December 31, 2006	\$ 200	\$ 57	\$ 142	\$ 399
Payments	(144 )	(14 )	(142 )	(300 )
Balance as of March 31, 2007	\$ 56	\$ 43	\$	\$ 99

Accruals related to restructuring activities are recorded in accrued liabilities in the accompanying consolidated balance sheets. The Company expects to pay all 2006 restructuring charges by June 30, 2007.

The Company recognized restructuring charges during 2007 related to reductions in workforce and the re-sizing of certain facilities. These charges were recorded pursuant to plans developed and approved by management. Restructuring charges associated with these realignment efforts, primarily related to the transfer of the Company's PCBA operations in Dublin, Ireland to Romania, were approximately \$0.8 million (0.7 million net of tax) during the three months ended March 31, 2007.

The following table summarizes the respective payments and the remaining accrued balance as of March 31, 2007 for estimated restructuring charges incurred during the three months ended March 31, 2007:

	<b>Severance</b>	<b>Other Exit Costs</b>	<b>Total Costs</b>
Balance as of December 31, 2006	\$	\$	\$
Provision for charges incurred	521	314	835
Payments	(348 )	(4 )	(352 )
Non-cash charges incurred		(273 )	(273 )
Balance as of March 31, 2007	\$ 173	\$ 37	\$ 210

Accruals related to restructuring activities are recorded in accrued liabilities in the accompanying consolidated balance sheets. The Company expects to pay all 2007 restructuring charges by June 30, 2007.

In connection with the Pemstar acquisition, a total of \$2.5 million (\$1.9 million net of tax) in integration costs were incurred during the three months ended March 31, 2007.

**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 Part II, Item 1A of this report. 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**

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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. 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 PCBAs and, often, downloading and integrating software, to produce a fully configured product. 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 Brazil, China, Mexico, Romania and Thailand.

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. Restructuring charges associated with these realignment efforts, primarily related to the closure of our Leicester, England and Loveland, Colorado facilities, were approximately \$4.7 million (pre-tax) during the year ended December 31, 2006. During the three months ended March 31, 2007, we incurred \$0.8 million (pre-tax), primarily related to the transfer of the Company's PCBA operations in Dublin, Ireland to Brasov, Romania, as we continue to expand our low-cost capacity while realigning and further strengthen our global footprint to support

21

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continued business opportunities. These efforts will continue throughout 2007. We believe that our global manufacturing presence 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. Revenue from design, development and engineering services is recognized when the services are performed and collectibility is reasonably certain. Such services provided under fixed price contracts are accounted for using the percentage of completion method. 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 sales price, 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.

#### **Recent Acquisition**

## Edgar Filing: BENCHMARK ELECTRONICS INC - Form 10-Q

Effective January 8, 2007, we acquired Pemstar Inc. (Pemstar), a publicly traded EMS company headquartered in Rochester, Minnesota (the Merger). Pursuant to the Agreement and Plan of Merger among Benchmark and Pemstar dated October 16, 2006 (the Merger Agreement), each issued and outstanding share of common stock, par value \$0.01 per share, of Pemstar was converted into the right to receive 0.16 of a common share, par value \$0.10 per share, of Benchmark. With the closing of the Merger, Pemstar became a wholly-owned subsidiary of Benchmark. With the acquisition of Pemstar, our global operations now include 24 facilities in nine countries. This acquisition expanded our customer base and deepened our engineering and systems integration capabilities.

22

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The aggregate purchase price was \$221.3 million, including common shares valued at \$202.5 million, stock options and warrants valued at \$9.0 million, conversion feature of debt valued at \$4.8 million and estimated acquisition costs of \$5.0 million. The value of the 7.3 million common shares issued was based on the average market price of our common shares over the 2-day period before and after the terms of the acquisition were agreed to and announced.

As a direct result of the Merger, we assumed approximately \$89.4 million of indebtedness. Since the acquisition date of January 8, 2007, this indebtedness has been reduced by approximately \$66.3 million.

We are accounting for the Merger utilizing the accounting principles promulgated by Statement of Financial Accounting Standards (SFAS) Nos. 141 and 142. Therefore, the results of operations of the Pemstar operations since January 8, 2007 have been included in the accompanying consolidated statements of income. The preliminary allocation of the net purchase price of the Merger resulted in goodwill of approximately \$180.0 million.

The inclusion of the operations of the acquired facilities in Benchmark's accounts is responsible for a substantial portion of the variations in the results of our operations (including components thereof) from period to period. The effects of the Merger on our financial condition and our reported results of operations should be considered when reading the financial information contained herein.

The Merger constitutes a significant expansion of our operations. Accordingly, the potential effect of the Merger on our future financial condition, liquidity and results of operations should be considered when reading the historical financial information and related discussions set forth in the following section. See Note 2 to the Condensed Consolidated Financial Statements.

#### **Summary of Results**

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Sales for the three months ended March 31, 2007 increased 16% to \$752.5 million compared to \$651.2 million for the same period of 2006. The increase in our sales is primarily a result of the Merger. Sales to our largest customer, Sun Microsystems, Inc., represented 25% of our sales in 2007 compared to 37% of our sales in 2006. Sales to our largest customer decreased to \$190.8 million in 2007 from \$243.4 million in 2006. For the remainder of 2007, we expect that revenues from our top customer will remain in the mid 20% range, excluding new program ramps.

Our gross profit as a percentage of sales increased to 7.2% in 2007 from 7.0% in 2006. We do experience fluctuations in gross profit from period to period. Comparing 2007 to 2006, the fluctuations were due primarily to changes in production levels, production mix, inventory levels, new program ramps, product crossovers and other factors, including the impacts of the Merger. 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. New programs can contribute relatively less to our gross profit in their early stages when manufacturing volumes are usually lower, resulting in inefficiencies and unabsorbed manufacturing overhead costs. In addition, a number of our new and higher volume programs remain subject to competitive constraints that could exert downward pressure on our margins in the near future.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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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

23

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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, 2006. 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 consolidated financial statements.

**Allowance for doubtful accounts**

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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 allowance 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 valuation reserve**

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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**

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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

24

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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 limitations has expired. We believe that we have adequately provided for our tax liabilities.

**Impairment of Long-Lived Assets**



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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 2006 and determined that no impairment existed as of the date of the impairment test. Goodwill and intangible assets are measured at the reporting unit level, which we have determined to be consistent with our operating segments as defined in Note 9 to the Condensed Consolidated Financial Statements in Item 1 of this report, 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 March 31, 2007, we had net goodwill of approximately \$297.8 million, including \$184.8 million resulting from 2007 acquisitions. 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.

### **Stock-Based Compensation**

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In accordance with the provisions of SFAS No. 123 (Revised 2004) and the Security and Exchange Commission Staff Accounting Bulletin No. 107 (SAB 107), we began recognizing stock-based compensation expense in our consolidated statement of income on January 1, 2006. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Option pricing models require the input of subjective assumptions, including the expected life of the option and the expected stock price volatility. Judgment is also required in estimating the number of option awards that are expected to vest as a result of satisfaction of time-based vesting schedules. If actual results or future changes in estimates differ significantly from our current estimates, stock-based compensation could increase or decrease. See Note 3 to the Condensed Consolidated Financial Statements.

25

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**Recently Enacted Accounting Principles**

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See Note 12 to the Condensed Consolidated Financial Statements for a discussion of recently enacted accounting principles.

### 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 in Item 1 of this report.

	Three months ended March 31,			
	2007		2006	
Sales	100.0	%	100.0	%
Cost of sales	92.8		93.0	
Gross profit	7.2		7.0	
Selling, general and administrative expenses	3.1		2.5	
Amortization of intangibles	0.1			
Restructuring charges and integration costs	0.4		0.4	
Income from operations	3.6		4.0	
Other income, net	0.2		0.2	
Income before income taxes	3.8		4.3	
Income tax expense	0.5		0.2	
Net income	3.3	%	4.1	%

### Sales

Sales for the first quarter of 2007 were \$752.5 million, a 16% increase from sales of \$651.2 million for the same quarter in 2006. The increase of \$101.2 million is primarily a result of the Merger.

The following table sets forth, for the periods indicated, the percentages of our sales by industry sector.

	Three months ended March 31,			
	2007		2006	
Computers and related products for business enterprises	52	%	58	%
Telecommunications equipment	14		12	
Industrial controls equipment	13		12	
Medical devices	14		13	
Testing and instrumentation products	7		5	
	100	%	100	%

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. Sales to our largest customer, Sun Microsystems, Inc., represented 25% of our sales during the first quarter of 2007 compared to 37% of our sales in 2006. Sales to our largest customer decreased to \$190.8 million in 2007

from \$243.4 million in 2006. For the remainder of 2007, we expect that revenues from our top customer will remain in the mid 20% range, excluding new program ramps. 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 international operations are subject to the risks of doing business abroad. These risks have not had a material adverse effect on our results of operations through March 31, 2007. However, we can make no assurances that there will not be an adverse impact in the future. See Part II, Item 1A 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 three months of 2007 and 2006, 40% and 34%, respectively, of our sales were from our international operations.

**Gross Profit**

Gross profit increased 20% to \$54.5 million for the three months ended March 31, 2007 from \$45.4 million in 2006. Gross profit as a percentage of sales increased to 7.2% during the first quarter of 2007 from 7.0% in 2006. We do experience fluctuations in gross profit from period to period. Comparing 2007 to 2006, the fluctuations were due primarily to changes in production levels, production mix, inventory levels, new program ramps, product crossovers and other factors, including the impacts of the Merger. 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. New programs can contribute relatively less to our gross profit in their early stages when manufacturing volumes are usually lower, resulting in inefficiencies and unabsorbed manufacturing overhead costs. In addition, a number of our new and higher volume programs remain subject to competitive constraints that could exert downward pressure on our margins in the near future.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses were \$23.2 million in 2007, an increase of 42% from \$16.4 million in 2006. Selling, general and administrative expenses, as a percentage of sales, were 3.1% and 2.5%, respectively, in 2007 and 2006. The increase in selling, general and administrative expenses is primarily associated with the Merger.

**Restructuring Charges and Integration Costs**



We recognized \$3.3 million and \$2.8 million in restructuring charges and integration costs during the first three months of 2007 and 2006, respectively, related to reductions in workforce and the re-sizing and closure of certain facilities and the integration of the facilities acquired in the Merger. In connection with these activities, we recorded restructuring charges for employee termination costs and other restructuring and integration related costs.

The recognition of the restructuring charges requires that we make certain judgments and estimates regarding the nature, timing and amount of costs associated with the planned exit activity. To the extent our actual results in exiting these facilities differ from our estimates and assumptions, we may be required to revise the estimates of future liabilities, requiring the recognition of additional restructuring charges or the reduction of liabilities already recognized.

27

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At the end of each reporting period, we evaluate the remaining accrued balances to ensure that no excess accruals are retained and the utilization of the provisions are for their intended purpose in accordance with developed exit plans. See Note 13 to the Condensed Consolidated Financial Statements in Item 1 of this report.

**Interest Expense**

Interest expense for the three-month periods ended March 31, 2007 and 2006 was \$0.8 million and \$0.1 million, respectively. The increase is primarily due to interest expense on the debt assumed in the Merger. See Note 6 to the Condensed Consolidated Financial Statements in Item 1 of this report.

**Income Tax Expense**

Income tax expense of \$3.9 million represented an effective tax rate of 13.7% for the three months ended March 31, 2007, compared with \$1.3 million at an effective tax rate of 4.7% for the same period in 2006. The increase in the effective tax rate is primarily due to a tax benefit of \$4.8 million related to the closure of our Leicester, England facility recorded in the first quarter of 2006 offset by an increase in tax-exempt income in certain foreign locations in the first quarter of 2007. See Note 8 to the Condensed Consolidated Financial Statements in Item 1 of this report.

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**Net Income**

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We reported net income of approximately \$24.5 million, or diluted earnings per share of \$0.34 for the first three months of 2007, compared with net income of approximately \$26.5 million, or diluted earnings per share of \$0.41 for the same period of 2006. The net decrease of \$2.0 million from 2006 was primarily due to the tax benefit of \$4.8 million recorded in 2006, offset by the other factors discussed above.

**LIQUIDITY AND CAPITAL RESOURCES**

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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 \$151.6 million at March 31, 2007 from \$123.9 million at December 31, 2006.

Cash provided by operating activities was \$94.5 million in 2007. The cash provided by operations during 2007 consisted primarily of \$24.5 million of net income adjusted for \$10.6 million of depreciation and amortization, an \$83.2 million decrease in accounts receivable, a \$24.2 million decrease in inventories offset by a \$43.0 million decrease in accounts payable. Working capital was \$811.3 million at March 31, 2007 and \$760.9 million at December 31, 2006. The increase in working capital during 2007 is primarily due to the increased level of business activity resulting from the Merger.

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

28

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not ship the quantities we need for production and we may be forced to delay shipments, which would increase backorders.

Cash used in investing activities was \$3.1 million for the three months ended March 31, 2007 primarily due to the purchase of additional property, plant and equipment and short-term investments offset by the sales and maturity of our short-term investments and the net cash acquired in the Merger. Capital expenditures of \$7.5 million were primarily concentrated in manufacturing production equipment in Asia to support our ongoing business and to expand certain existing manufacturing operations.

Cash used in financing activities was \$65.2 million for the three months ended March 31, 2007. During 2007, we received \$0.8 million from the exercise of stock options and \$0.2 million in federal tax benefits of stock options exercised. As a direct result of the Merger, we assumed approximately \$89.4 million of indebtedness. Since the acquisition date of January 8, 2007, this indebtedness has been reduced by approximately \$66.3 million.

Under the terms of a Credit Agreement (the Credit Agreement), we have a \$100.0 million three-year revolving credit line for general corporate purposes which can be increased to a total of \$200.0 million and which will expire on January 20, 2008. Interest on outstanding borrowings under the Credit Agreement 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 Credit Agreement. A commitment fee of 0.20% to 0.35% per annum (based upon our debt ratio) on the unused portion of the revolving credit line is payable quarterly in arrears. As of March 31, 2007, we had no borrowings outstanding under the Credit Agreement and \$100.0 million was available for future borrowings.

The Credit Agreement 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 Credit Agreement contains customary financial covenants as to working capital, 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. As of March 31, 2007, we were in compliance with all such covenants and restrictions.

Our Thailand subsidiary has a credit agreement with Kasikornbank Public Company (the Thai Credit Agreement). The Thai Credit Agreement provides that the lender will make available to our Thailand subsidiary up to approximately \$16 million in revolving loans and machinery loans. The Thai Credit Agreement is secured by land, buildings and machinery in Thailand. In addition, the Thai Credit Agreement provides for approximately \$1.9 million (62 million Thai baht) in working capital availability in the form of working capital loans (10 million Thai baht) and bank guarantees (52 million Thai baht). Availability of funds under the Thai Credit Agreement is reviewed annually and is currently accessible through September 2007. As of March 31, 2007, 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.

As of March 31, 2007, we had cash and cash equivalents totaling \$151.6 million, short-term investments totaling \$105.7 million and \$100.0 million available for borrowings under our revolving credit line. We believe that during the next twelve months, our capital expenditures will be approximately \$30 to \$40 million, principally for machinery and equipment to support our ongoing business around the globe, in addition to our planned expansion in Asia, primarily a new building in China. 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 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**

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We have certain contractual obligations that extend out beyond 2007 under lease obligations. Non-cancelable purchase commitments do not typically extend beyond the normal lead-time of several weeks. Purchase orders beyond this time frame are typically cancelable. We do not utilize off-balance sheet financing techniques other than traditional operating leases and we have not guaranteed the obligations of any entity that is not one of our wholly-owned subsidiaries. The total contractual cash obligations in existence at March 31, 2007 due pursuant to contractual commitments are:

(in thousands)	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating Lease Obligations	\$ 54,418	\$ 12,249	\$ 22,833	\$ 7,571	\$ 11,765
Capital Lease Obligations	26,428	1,429	3,088	2,951	18,960
Total Obligations	\$ 80,846	\$ 13,678	\$ 25,921	\$ 10,522	\$ 30,725





**OFF-BALANCE SHEET ARRANGEMENTS**

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As of March 31, 2007, we did not have any significant off-balance sheet arrangements. See Note 11 to the Condensed Consolidated Financial Statements in Item 1 of this report.

### 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. As of March 31, 2007, we did not have any foreign currency hedges. 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. These exposures are primarily, but not limited to, vendor payments and inter-company balances in currencies other than the currency in which our foreign operations primarily generate and expend 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. Our sales are substantially denominated in U.S. dollars. Our foreign currency cash flows are generated in certain Asian and European countries, Mexico and Brazil. With the acquisition of Pemstar, our foreign currency cash flows have increased.

We are also exposed to market risk for changes in interest rates, a portion of which relates to our short-term investment portfolio. We do not use derivative financial instruments in our investment portfolio. We place cash and cash equivalents and investments with various major financial institutions. We protect our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by generally investing in investment grade securities. As of March 31, 2007, the outstanding amount in the short-term investment portfolio was \$105.7 million of auction rate securities with an average return of 3.7%.

**Item 4 Controls and Procedures**

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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.

On January 8, 2007, we completed the Merger, at which time Pemstar became a subsidiary of the Company. See Note 2 to the condensed consolidated financial statements contained in this Quarterly Report for further details of the Merger. We will be incorporating internal controls over financial reporting related to Pemstar into our assessment of our internal control over financial reporting for 2007. Other than the changes relating to Pemstar, there have been no changes in our internal control over financial reporting that occurred during the fiscal period covered by this Quarterly Report on Form 10-Q that have materially affected, or are 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 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 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**

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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.

The following legal proceedings were acquired in the Merger and are considered outside the ordinary course of business.

On June 16, 2005 a putative class action was filed by an individual shareholder against Pemstar and certain of its officers and directors. The lawsuit is pending in the United States District Court for the District Court of Minnesota and is captioned: In re PEMSTAR INC. Securities Litigation, Civil Action No. 05-CV-01182 JMR/FLN. The lawsuit alleges violations of Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934 and Section 11 of the Securities Act of 1933. An Amended Complaint was filed on November 28, 2005. The plaintiff alleges, in essence, that the defendants defrauded Pemstar's shareholders by failing to timely disclose the circumstances around the discrepancies in the accounting of the Mexico facility that generated a restatement. The lawsuit also alleges that the registration statement filed by Pemstar in connection with a secondary offering contained false, material misrepresentations. The plaintiff seeks to represent a class of persons who purchased Pemstar stock from January 30, 2003 through and including January 12, 2005. The Amended Complaint does not specify an amount of damages. The Company and the individuals will vigorously defend against the claim and believe the lawsuit is without merit.

### Item 1A. **Risk Factors.**

There are no material changes to the risk factors set forth in Part I, Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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.**

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

33

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**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 May 10, 2007.

BENCHMARK ELECTRONICS, INC.  
(Registrant)

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

By: */s/ Donald F. Adam*  
Donald F. Adam  
Chief Financial Officer  
(Principal Financial Officer)

34

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**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

35

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