BENCHMARK ELECTRONICS INC
Form 10-Q
November 09, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2011.

¨ 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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting

company" in Rule 12b–2 of the Act.

Large accelerated filer þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of November 7, 2011 there were 57,762,994 Common Shares of Benchmark Electronics, Inc., par value $0.10 per share, outstanding.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands, except par value)	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 253,845	$ 346,345
Accounts receivable, net of allowance for doubtful accounts of $552 and $586, respectively	462,532	455,930
Inventories, net	429,785	361,570
Prepaid expenses and other assets	32,098	43,979
Income taxes receivable	10,486	2,437
Deferred income taxes	6,606	8,090
Total current assets	1,195,352	1,218,351
Long-term investments	24,795	35,297
Property, plant and equipment, net of accumulated depreciation of $318,987 and $302,944, respectively	156,381	127,442
Goodwill, net	37,912	37,912
Deferred income taxes	32,554	19,735
Other, net	37,371	38,331
	$ 1,484,365	$ 1,477,068
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of capital lease obligations	$ 401	$ 362
Accounts payable	277,297	258,422
Income taxes payable	3,456	4,846
Accrued liabilities	48,694	58,844
Total current liabilities	329,848	322,474
Capital lease obligations, less current installments	10,709	11,019
Other long-term liabilities	24,860	24,350
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 – 58,035 and 61,196, respectively; outstanding – 57,924 and 61,085, respectively	5,792	6,109
Additional paid-in capital	675,452	707,138
Retained earnings	446,937	413,212
Accumulated other comprehensive loss	(8,961)	(6,962)
Less treasury shares, at cost; 111 shares	(272)	(272)
Total shareholders' equity	1,118,948	1,119,225
Commitments and contingencies		
	$ 1,484,365	$ 1,477,068

See accompanying notes to condensed consolidated financial statements.

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BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Income
(unaudited)

(in thousands, except per share data)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Sales	$570,083	$613,864	$1,693,944	$1,775,218
Cost of sales	535,448	566,672	1,583,934	1,636,535
Gross profit	34,635	47,192	110,010	138,683
Selling, general and administrative expenses	22,874	23,379	67,822	68,927
Restructuring charges	145	452	625	2,149
Income from operations	11,616	23,361	41,563	67,607
Interest expense	(334)	(343)	(997)	(1,022)
Interest income	446	394	1,293	1,208
Other income (expense)	(202)	1,212	94	162
Income before income taxes	11,526	24,624	41,953	67,955
Income tax expense (benefit)	(8,341)	2,155	(7,128)	7,207
Net income	$19,867	$22,469	$49,081	$60,748
Earnings per share:				
Basic	$0.34	$0.36	$0.82	$0.97
Diluted	$0.34	$0.36	$0.81	$0.96
Weighted-average number of shares outstanding:				
Basic	58,615	61,712	59,889	62,597
Diluted	58,879	62,103	60,391	63,162

See accompanying notes to condensed consolidated financial statements.

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Net income	$19,867	$22,469	$49,081	$60,748
Other comprehensive income (loss):				
Foreign currency translation adjustments	(9,013)	6,283	(3,176)	(1,740)
Unrealized gain (loss) on investments, net of tax	(156)	543	598	791
Other	546	(30)	579	(29)
Comprehensive income	$11,244	$29,265	$47,082	$59,770

The components of accumulated other comprehensive loss are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Foreign currency translation adjustments	$ (5,947)	$ (2,771)
Unrealized loss on investments, net of tax	(3,255)	(3,853)
Other	241	(338)
Accumulated other comprehensive loss	$ (8,961)	$ (6,962)

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, 2010	61,085	$ 6,109	$ 707,138	$ 413,212	$ (6,962)	$ (272)	$ 1,119,225
Stock-based compensation expense	—	—	4,102	—	—	—	4,102
Shares repurchased and retired	(3,488)	(349)	(37,483)	(15,356)	—	—	(53,188)
Stock options exercised	144	14	1,592	—	—	—	1,606
Issuance of restricted shares, net of forfeitures	183	18	(18)	—	—	—	—
Excess tax benefit of stock-based compensation	—	—	121	—	—	—	121
Comprehensive income	—	—	—	49,081	(1,999)	—	47,082
Balances, September 30, 2011	57,924	$ 5,792	$ 675,452	$ 446,937	$ (8,961)	$ (272)	$ 1,118,948

See accompanying notes to condensed consolidated financial statements.

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income	$49,081	$60,748
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	26,154	30,216
Deferred income taxes	(11,485)	(2,624)
Gain on the sale of property, plant and equipment	(35)	(69)
Asset impairment	24	105
Stock-based compensation expense	4,102	4,376
Excess tax benefits from stock-based compensation	(35)	(846)
Changes in operating assets and liabilities:		
Accounts receivable	(7,049)	(10,804)
Inventories	(69,514)	(65,831)
Prepaid expenses and other assets	8,615	(13,866)
Accounts payable	19,426	(10,056)
Accrued liabilities	(9,837)	(560)
Income taxes	(9,281)	4,348
Net cash provided by (used in) operations	166	(4,863)
Cash flows from investing activities:		
Proceeds from sales and redemptions of investments	11,100	10,225
Additions to property, plant and equipment	(49,756)	(28,934)
Proceeds from the sale of property, plant and equipment	186	231
Additions to purchased software	(540)	(117)
Net cash used in investing activities	(39,010)	(18,595)
Cash flows from financing activities:		
Proceeds from stock options exercised	1,606	1,746
Excess tax benefits from stock-based compensation	35	846
Principal payments on capital lease obligations	(272)	(223)
Share repurchases	(53,188)	(53,577)
Net cash used in financing activities	(51,819)	(51,208)
Effect of exchange rate changes	(1,837)	(278)
Net decrease in cash and cash equivalents	(92,500)	(74,944)
Cash and cash equivalents at beginning of year	346,345	421,243
Cash and cash equivalents at September 30	$253,845	$346,299

See accompanying notes to condensed consolidated financial statements.

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(amounts in thousands, except per share data, unless otherwise noted)
(unaudited)

Note 1 – Basis of Presentation
Benchmark Electronics, Inc. (the Company) is a Texas corporation that provides worldwide integrated electronic manufacturing services. The Company provides services to original equipment manufacturers (OEMs) of computers and related products for business enterprises, medical devices, industrial control equipment, which includes equipment for the aerospace and defense industry, 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 an 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, 2010.

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.

During the second quarter of 2011, management of the Company identified immaterial errors related to costs incorrectly capitalized to inventory and accounting for consigned inventory at one of the Company's foreign locations. The Company has revised its previously reported 2011, 2010 and 2009 consolidated financial statements to reflect the corrections of these immaterial errors. The correction for the September 30, 2010 period resulted in a $1.3 million increase in cost of goods sold and a $1.3 million ($0.02 per diluted share) decrease in net income as previously reported for the nine months ended September 30, 2010 and a $0.5 million increase in cost of goods sold and a $0.5 million ($0.01 per diluted share) decrease in net income as previously reported for the three months ended September 30, 2010. Associated adjustments were also made to decrease inventory by $0.7 million, increase accounts payable by $1.1 million and decrease retained earnings by $1.8 million, in each case, as of September 30, 2010. The correction for the December 31, 2010 period resulted in a $0.7 million decrease in inventory, a $1.1 million increase in accounts payable and a $1.8 million decrease in retained earnings, in each case, as of December 31, 2010. The correction for the 2011 period relates to the three months ended March 31, 2011. This correction resulted in a $0.8 million increase in cost of goods sold and a $0.8 million ($0.01 per diluted share) decrease in net income as previously reported. The revisions had no impact on the Company's net cash flows from operating activities for any of these periods.

Note 2 – Stock-Based Compensation

The Benchmark Electronics, Inc. 2000 Stock Awards Plan (the 2000 Plan) and the Benchmark Electronics, Inc. 2010 Omnibus Incentive Compensation Plan (the 2010 Plan) authorize the Company, upon recommendation of the compensation committee of the Board of Directors, to grant a variety of types of awards, including stock options, restricted share awards, restricted stock units, stock appreciation rights, performance compensation awards, phantom stock awards and deferred share units, or any combination thereof, to any director, officer, employee or consultant (including any prospective director, officer, employee or consultant) of the Company. Stock options are granted to employees with an exercise price equal to the market price of the Company's common shares on the date of grant, generally vest over a four-year period from the date of grant and have a term of ten years. Restricted shares, restricted stock units and phantom stock awards granted to employees generally vest over a four-year period from the date of grant, subject to the continued employment of the employee by the Company. The 2000 Plan expired on February 16, 2010 and no additional grants can be made under that plan. The 2010 Plan was approved by the Company's shareholders on May 18, 2010 and replaced the 2000 Plan. Members of the Board of Directors who are not employees of the Company participate in the Benchmark Electronics, Inc. 2002 Stock Option Plan for Non-Employee Directors (the 2002 Plan) that authorizes the granting of stock options upon the occurrence of the non-employee director's election or re-election to the Board of Directors. The 2002 Plan was approved by the Company's shareholders on May 14, 2002. All awards under the 2002 Plan are fully vested upon the date of grant and have a term of ten years. Non-employee directors may also receive equity awards under the 2010 Plan. In 2011, these awards have been in the form of restricted stock units, which vest in equal quarterly installments over a one year period, starting from the grant date. As of September 30, 2011, 4.4 million additional common shares are available for issuance under the Company's existing plans.

All share-based payments to employees, including grants of employee stock options, are recognized in the financial statements based on their fair values. The total compensation cost recognized for stock-based awards was $1.5 million and $4.1 million for the three and nine months ended September 30, 2011, respectively, and $1.2 million and $4.4 million for the three and nine months ended September 30, 2010, respectively. The total income tax benefit recognized in the income statement for stock-based awards was $0.7 million and $1.5 million for the three and nine months ended September 30, 2011, respectively, and $0.6 million and $1.5 million for the three and nine months ended September 30, 2010, respectively. The compensation expense for stock-based awards includes an estimate for forfeitures and is recognized over the vesting period of the awards using the straight-line method. Cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for stock-based awards (excess tax benefits) are classified as cash flows from financing activities. Awards of restricted shares, restricted stock units, performance restricted stock units and phantom stock are valued at the closing market price of the Company's common shares on the date of grant. For restricted stock unit awards with performance conditions, compensation expense is currently based on the target number of shares that would vest if 100% of the target performance goal is achieved, which was considered the probable outcome at the grant date. Throughout the requisite service period, management monitors the probability of achievement of the performance conditions. If it becomes probable, based on the Company's expectation of performance during the measurement period, that more or less than the current estimate of the awarded shares will vest, an adjustment to stock-based compensation expense will be recognized as a change in accounting estimate.

The Company did not issue any options during the three months ended September 30, 2011 or 2010. The Company issued 399 thousand stock options during the nine months ended September 30, 2011, and 61 thousand stock options during the nine months ended September 30, 2010. The weighted-average assumptions used to value the options granted during the three and nine months ended September 30, 2011 and 2010 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Expected term of options	—	—	6.2 years	7.0 years
Expected volatility	—	—	41 %	40 %
Risk-free interest rate	—	—	2.674 %	2.94 %
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 plan participant behavior. Separate groups of plan participants 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 common shares. 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 and does not anticipate paying cash dividends in the foreseeable future.

The Company issued performance based restricted stock unit awards to employees during the nine months ended September 30, 2011. The number of performance based restricted stock unit awards that will ultimately be earned will not be determined until the end of the performance period, which is December 31, 2014, and may vary from as low as zero to as high as three times the target number, 0.1 million shares, depending on the level of achievement of certain performance goals. The level of achievement of these goals is based upon the audited financial results for the last full calendar year within the performance period (the year ending December 31, 2014) as compared to the base year (the year ended December 31, 2010). The Company's performance goals consist of certain levels of achievement using the following financial metrics: revenue growth, operating income margin expansion, and return on invested capital. If the Company's performance goals are not met, the applicable performance based restricted stock unit awards will not vest and will be forfeited.

As of September 30, 2011, there was approximately $5.4 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted-average period of 1.4 years. As of September 30, 2011, there was $4.8 million of total unrecognized compensation cost related to restricted share awards. That cost is expected to be recognized over a weighted-average period of 2.7 years. As of September 30, 2011, there was $1.6 million of total unrecognized compensation cost related to restricted stock units and phantom stock awards. That cost is expected to be recognized over a weighted-average period of 2.2 years. As of September 30, 2011, there was $1.5 million of total unrecognized compensation cost related to performance based restricted stock units. That cost is expected to be recognized over a weighted-average period of 3.4 years.

The weighted-average fair value per option granted during the nine months ended September 30, 2011 was $8.14. The total cash received as a result of stock option exercises for the nine months ended September 30, 2011 and 2010 was $1.6 million and $1.7 million, respectively. The actual tax benefit realized as a result of stock option exercises and the vesting of other share-based awards during the nine months ended September 30, 2011 and 2010 was $0.4 million and $1.3 million, respectively, which has been recorded as an increase to additional paid-in capital. For the nine months ended September 30, 2011 and 2010, the total intrinsic value of stock options exercised was $0.9 million and $0.9 million, respectively.

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

(in thousands, except per share data)	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2010	4,825	$19.18	5.58	
Granted	399	$18.56		
Exercised	(144)	$11.18		
Forfeited or expired	(232)	$19.43		
Outstanding at September 30, 2011	4,848	$19.36	5.26	$1,277
Exercisable at September 30, 2011	3,320	$20.67	4.08	$1,091

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 $13.01 as of the last business day of the period ended September 30, 2011 for options that had exercise prices that were below the closing price.

The following table summarizes the activities related to the Company's restricted shares:

(in thousands, except per share data)	Shares	Weighted-Average Grant Date Fair Value
Nonvested shares outstanding at December 31, 2010	178	$17.17
Granted	195	$18.57
Vested	(10)	$17.54
Forfeited	(20)	$17.74
Nonvested shares outstanding at September 30, 2011	343	$17.92

The following table summarizes the activities related to the Company's time based restricted stock units and phantom stock awards:

(in thousands, except per share data)	Shares	Weighted-Average Grant Date Fair Value
Nonvested shares outstanding at December 31, 2010	47	$17.05
Granted	86	$17.77
Vested	(9)	$16.66
Forfeited	(12)	$16.87
Nonvested shares outstanding at September 30, 2011	112	$17.65

The following table summarizes the activities related to the Company's performance based restricted stock unit awards:

(in thousands, except per share data)	Shares	Weighted-Average Grant Date Fair Value
Nonvested shares outstanding at December 31, 2010	—	—
Granted(1)	93	$18.57
Forfeited	—	—
Nonvested shares outstanding at September 30, 2011	93	$18.57

(1) Represents target number of shares that can vest based on the achievement of certain performance criteria.

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, 2011 and 2010. Stock equivalents include common shares issuable upon the exercise of stock options and other equity instruments, and are computed using the treasury stock method. Under the treasury stock method, the exercise price of a share, the amount of compensation cost, if any, for future service that the Company has not yet recognized and the amount of estimated tax benefits that would be recorded in paid-in-capital, if any, when the share is exercised are assumed to be used to repurchase shares in the current period.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2011	2010	2011	2010
Net income	$19,867	$22,469	$49,081	$60,748
Denominator for basic earnings per share - weighted-average number of common shares outstanding during the period	58,615	61,712	59,889	62,597
Incremental common shares attributable to exercise of outstanding dilutive options	177	305	298	474
Incremental common shares attributable to outstanding restricted shares, restricted stock units and phantom stock	87	86	204	91
Denominator for diluted earnings per share	58,879	62,103	60,391	63,162
Basic earnings per share	$0.34	$0.36	$0.82	$0.97
Diluted earnings per share	$0.34	$0.36	$0.81	$0.96

Options to purchase 3.8 million and 3.5 million common shares for the three and nine months ended September 30, 2011, 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. Options to purchase 3.7 million and 2.9 million common shares for the three and nine months ended September 30, 2010, 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.

Note 4 – Goodwill and Other Intangible Assets
Goodwill associated with the Company's Asia business segment totaled $37.9 million at September 30, 2011 and December 31, 2010.

Other intangible assets included in other long-term assets in the accompanying condensed consolidated balance sheet as of September 30, 2011 and December 31, 2010 were as follows:

(in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$17,839	$ (8,510)	$9,329
Technology licenses	11,300	(5,815)	5,485
Other	868	(112)	756
Other intangible assets, September 30, 2011	$30,007	$ (14,437)	$15,570

(in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$17,807	$ (7,165)	$10,642
Technology licenses	11,300	(4,144)	7,156
Other	868	(94)	774
Other intangible assets, December 31, 2010	$29,975	$ (11,403)	$18,572

Customer relationships are being amortized on a straight-line basis over a period of ten years. Technology licenses are being amortized over their estimated useful lives in proportion to the economic benefits consumed. Amortization of other intangible assets for the nine months ended September 30, 2011 and 2010 was $3.0 million and $3.3 million, respectively.

The estimated future amortization expense of other intangible assets for each of the next five years is as follows (in thousands):

Year ending December 31,	Amount
2011 (remaining three months)	$1,627
2012	2,597
2013	3,080
2014	4,068
2015	1,812

Note 5 – Borrowing Facilities
Under the terms of a credit agreement (the Credit Agreement), the Company has a $100 million five-year revolving credit facility to be used for general corporate purposes with a maturity date of December 21, 2012. The Credit Agreement includes an accordion feature under which total commitments under the facility may be increased by an additional $100 million, subject to satisfaction of certain conditions and lender approval.

Interest on outstanding borrowings under the Credit Agreement is payable quarterly, at the Company's option, at either LIBOR plus 0.75% to 1.75% or a 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 0.15% 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 September 30, 2011, 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, repurchase shares, sell assets and merge or consolidate with other persons. As of September 30, 2011, the Company was in compliance with all such covenants and restrictions.

The Company's Thailand subsidiary has a multi-purpose credit facility with Kasikornbank Public Company Limited (the Thai Credit Facility) that provides for approximately $11.2 million (350 million Thai baht) in working capital availability. The Thai Credit Facility is secured by land and buildings in Thailand. The availability of funds under the Thai Credit Facility is reviewed annually and is currently accessible through October 2012. As of September 30, 2011, the Company's Thailand subsidiary had no working capital borrowings outstanding.

Note 6 – Inventories

Inventory costs are summarized as follows:

(in thousands)	September 30, 2011	December 31, 2010
Raw materials	$ 308,126	$ 274,245
Work in process	83,778	60,776
Finished goods	37,881	26,549
	$ 429,785	$ 361,570

Note 7 – Income Taxes

Income tax expense (benefit) consists of the following:

	Nine Months Ended September 30,	
(in thousands)	2011	2010
Federal – Current	$ 169	$ 3,052
Foreign – Current	4,023	6,406
State – Current	165	373
Deferred	(11,485)	(2,624)
	$ (7,128)	$ 7,207

In 2011, 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 tax incentives and tax holidays in foreign locations, including a $0.6 million discrete tax benefit as a result of a 2010 tax rate incentive received by a subsidiary in China during the first quarter of 2011, state income taxes (net of federal benefit), a $16.3 million net decrease in valuation allowances on deferred tax assets and $7.1 million of additional reserves for uncertain tax benefits.

Significant management judgment is required in determining the period in which the reversal of a valuation allowance should occur. The Company considers all available evidence, both positive and negative, in making this determination, including historical income, projected future income, the expected timing of the reversals of existing temporary differences and the implementation of tax-planning strategies. As of September 30, 2011, the Company evaluated the recoverability of its deferred tax assets using the criteria described above and concluded that the Company's projected future taxable income in the U.S. is sufficient to utilize additional net operating loss carryforwards and other deferred tax assets. As a result, the Company reduced its valuation allowance by $17.5 million in the U.S. and, at the same time, increased its valuation allowance by $1.2 million in foreign jurisdictions. This net decrease was a discrete event and $16.3 million was recorded as a tax benefit in the consolidated statement of income during the third quarter of 2011. The Company may determine it will be able to realize all or a portion of its deferred tax assets in the U.S. in the foreseeable future. Upon such determination, an adjustment to the valuation allowance related to its deferred tax assets could cause a material increase to net income in the period such determination is made.

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). Determination of the amount of any unrecognized deferred tax liability on these undistributed earnings is not practical.

The Company has been granted certain tax incentives, including tax holidays, for its subsidiaries in China, Malaysia and Thailand. These tax incentives, including tax holidays, expire on various dates through 2015 and are subject to certain conditions with which the Company expects to comply. The impact of these tax incentives was to lower income tax expense for the nine month periods ended September 30, 2011 and 2010 by approximately $9.9 million (approximately $0.16 per diluted share) and $6.7 million (approximately $0.11 per diluted share), respectively.

As of September 30, 2011, the total amount of the reserve for uncertain tax benefits including interest and penalties is $25.3 million. The reserve is classified as long-term in the consolidated balance sheet unless cash settlement is expected in the next 12 months. The amount of accrued potential interest and penalties on unrecognized tax benefits included in the reserve as of September 30, 2011 is $1.8 million and $1.6 million, respectively. The Company's subsidiary in Thailand has filed for a refund of $8.3 million of previously paid income taxes, which is included in other assets. The Thailand tax authorities are currently conducting an examination of the applicable filings. During the three months ended September 30, 2011, the Company recorded a reserve for uncertain tax benefits of $7.1 million against this receivable.

The Company and its subsidiaries in Brazil, China, Ireland, Luxembourg, Malaysia, Mexico, the Netherlands, Romania, Singapore, Thailand and the United States remain open to examination by the various local taxing authorities, in total or in part, for fiscal years 2004 to 2010.

The Company is subject to examination by tax authorities for varying periods in various U.S. and foreign tax jurisdictions. During the course of such examinations, disputes may occur as to matters of fact and/or law. In most tax 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 8 – Segment and Geographic Information

The Company has manufacturing facilities in the Americas, Asia and Europe to serve its customers. The Company is operated and managed geographically, and 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, Asia, and Europe. Information about operating segments was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Net sales:				
Americas	$316,446	$392,153	$982,117	$1,134,922
Asia	250,361	222,548	688,809	638,529
Europe	36,956	38,637	123,709	121,705
Elimination of intersegment sales	(33,680)	(39,474)	(100,691)	(119,938)
	$570,083	$613,864	$1,693,944	$1,775,218
Depreciation and amortization:				
Americas	$4,005	$4,800	$12,262	$15,251
Asia	3,289	3,388	9,456	10,132
Europe	652	717	1,982	2,156
Corporate	821	893	2,454	2,677
	$8,767	$9,798	$26,154	$30,216
Income from operations:				
Americas	$9,426	$16,569	$35,987	$47,342
Asia	10,807	14,946	29,718	44,250
Europe	570	1,607	1,965	4,091
Corporate and intersegment eliminations	(9,187)	(9,761)	(26,107)	(28,076)
	$11,616	$23,361	$41,563	$67,607
Capital expenditures:				
Americas	$886	$3,782	$11,958	$13,814
Asia	8,420	4,864	32,837	12,922
Europe	2,875	713	3,630	1,570
Corporate	1,288	447	1,871	745
	$13,469	$9,806	$50,296	$29,051

	September 30, 2011	December 31, 2010
Total assets:		
Americas	$ 587,806	$ 583,724
Asia	632,406	515,414
Europe	211,790	243,872
Corporate and other	52,363	134,058
	$ 1,484,365	$ 1,477,068

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Geographic net sales information reflects the destination of the product shipped. Long-lived assets information is based on the physical location of the asset.

(in thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Geographic net sales:				
United States	$395,415	$452,617	$1,151,548	$1,316,912
Asia	86,493	58,270	243,791	149,811
Europe	76,037	90,919	258,748	271,819
Other Foreign	12,138	12,058	39,857	36,676
	$570,083	$613,864	$1,693,944	$1,775,218

	September 30, 2011	December 31, 2010
Long-lived assets:		
United States	$ 71,344	$ 72,386
Asia	94,098	67,365
Europe	12,035	9,785
Other	16,275	16,237
	$ 193,752	$ 165,773

Note 9 – Supplemental Cash Flow Information

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

(in thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Income taxes paid (refunded), net	$(47)	$1,774	$6,914	$5,345
Interest paid	320	369	969	1,032

Note 10 – Contingencies

On June 3, 2007, Power Paper, Ltd. (Power Paper), a limited liability company from Israel filed suit against Pemstar Inc. (Pemstar) in U.S. District Court in Minnesota. Pemstar was a Minnesota public company that was acquired by the Company in January 2007. Power Paper’s claim sought damages of up to $22.8 million based on an alleged breach of contract. The trial, which began on September 12, 2011, resulted in a jury verdict in favor of Pemstar.

In addition to the matter described above, 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 other matters will not have a material adverse effect on the Company’s consolidated financial position, results of operations or cash flows.

Note 11 – Impact of Recently Enacted Accounting Standards

In October 2009, the Financial Accounting Standards Board (FASB) issued amendments to the accounting and disclosure for revenue recognition. These amendments modify the criteria for recognizing revenue in multiple element arrangements. The Company adopted the provisions of this guidance prospectively to new or materially modified arrangements beginning January 1, 2011. The adoption of this new guidance did not have a material impact on the Company’s consolidated financial position and results of operations.

In October 2009, the FASB issued guidance which amends the scope of existing software revenue recognition accounting. Tangible products containing software components and non-software components that function together to deliver the product’s essential functionality would be scoped out of the accounting guidance on software and accounted for based on other appropriate revenue recognition guidance. The Company adopted the provisions of this guidance prospectively to new or materially modified arrangements beginning January 1, 2011. The adoption of this new guidance did not have a material impact on the Company’s consolidated financial position and results of operations.

In January 2010, the FASB issued guidance that requires a roll forward of activities on purchases, sales, issuances and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements) effective January 1, 2011 for the Company. Adoption of this new guidance is for disclosure purposes only and did not have any impact on the Company’s consolidated financial position or results of operations.

In September 2011, the FASB issued an accounting standards update that allows an entity the option to perform a qualitative assessment in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. Based on this qualitative assessment, if the fair value of a reporting unit is not less than its carrying amount, the entity is not required to perform the two-step goodwill impairment test. The standards update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company does not expect the adoption of this standard to have a material impact on the Company’s consolidated financial statements and footnote disclosures.

The Company has determined that all other recently issued accounting standards will not have a material impact on its consolidated financial position, results of operations and cash flows, or do not apply to its operations.

Note 12 – Restructuring Charges
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 business processes and reorganizing management.

The Company recognized restructuring charges during 2011, 2010 and 2009 primarily related to capacity reduction and reductions in workforce in certain facilities worldwide. These charges were recorded pursuant to plans developed and approved by management. The Company expects to incur approximately $3.4 million in additional restructuring charges primarily related to the closure of the Dublin facility during the fourth quarter of 2011.

The following table summarizes the 2011 activity in the accrued restructuring balances related to the various restructuring activities described above:

(in thousands)	Balance as of December 31, 2010	Restructuring Charges	Cash Payment	Foreign Exchange Adjustments	Balance as of September 30, 2011
2011 Restructuring:					
Severance	$ —	$ 1,075	$(1,251)	$ 9	$ (167)
	—	1,075	(1,251)	9	(167)
2010 Restructuring:					
Severance	1,767	(503)	(1,311)	87	40
Other exit costs	709	74	(770)	3	16
	2,476	(429)	(2,081)	90	56
2009 Restructuring:					
Lease facility costs	1,506	—	(542)	68	1,032
Other exit costs	27	(21)	(6)	—	—
	1,533	(21)	(548)	68	1,032
Total	$ 4,009	$ 625	$(3,880)	$ 167	$ 921

Note 13 – Fair Value
Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A three-tier fair value hierarchy of inputs is employed to determine fair value measurements. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets and liabilities. Level 2 inputs are observable prices that are not quoted on active exchanges, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable. Level 3 inputs are unobservable inputs employed for measuring the fair value of assets or liabilities. This hierarchy required the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

The carrying amounts of cash equivalents, accounts receivable, accrued liabilities, accounts payable and capital lease obligations approximate fair value. As of September 30, 2011, $28.1 million (par value) of long-term investments were recorded at fair value. The long-term investments consist of auction rate securities, primarily secured by guaranteed student loans backed by a U.S. government agency, and are classified as available-for-sale. These investments are of a high credit quality with a majority having AAA type credit ratings because of the government agency guarantee and other insurance. Auction rate securities are adjustable rate debt instruments whose interest rates were intended to reset every 7 to 35 days through an auction process. Overall changes in the global credit and capital markets led to failed auctions for these securities beginning in early 2008. These failed auctions, in addition to overall global economic conditions, impacted the liquidity of these investments and resulted in the Company continuing to hold these securities beyond their typical auction reset dates. The market for these types of securities remains illiquid as of September 30, 2011. These securities are classified as long-term investments and the contractual maturity of these securities is over ten years.

These long-term investments were valued using Level 3 inputs as of September 30, 2011, as the assets were subject to valuation using significant unobservable inputs. The Company estimated the fair value of each security with the assistance of an independent valuation firm using a discounted cash flow model to calculate the present value of projected cash flows based on a number of inputs and assumptions including the security structure and terms, the current market conditions and the related impact on the expected weighted-average life, interest rate estimates and default risk of the securities.

As of September 30, 2011, the Company has recorded an unrealized loss of $3.3 million on its long-term investments based upon this valuation. This unrealized loss reduced the fair value of the Company's auction rate securities as of September 30, 2011 to $24.8 million. These investments have been in an unrealized loss position for greater than 12 months. During the nine months ended September 30, 2011 and 2010, the Company recorded unrealized gains of $0.6 million and $0.8 million, respectively, on its long-term investments.

The Company conducts periodic reviews to identify and evaluate each investment that has an unrealized loss. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. Due to the unrealized losses on the auction rate securities held, the Company has assessed whether the calculated impairment is other-than-temporary. In performing this assessment, even though the Company has no intention to sell the securities before the amortized cost basis is recovered and believes it is more-likely-than-not that it will not be required to sell the securities prior to recovery, the Company has performed additional analyses to determine if a portion of the unrealized loss is considered a credit loss. A credit loss would be identified as the amount of the principal cash flows not expected to be received over the remaining term of the security as projected using the Company's best estimates. The Company has assessed each security for credit impairment, taking into account factors such as (i) the length of time and the extent to which fair value has been below cost; (ii) activity in the market of the issuer which may indicate adverse credit conditions; (iii) the payment structure of the security; and (iv) the failure of the issuer of the security to make scheduled payments. The Company used an independent valuation firm to assist in

making these assessments.

Based on these assessments, the Company has determined that there is no credit loss associated with its auction rate securities as of September 30, 2011, as shown by the cash flows expected to be received over the remaining life of the securities.

The following table provides a reconciliation of the beginning and ending balance of the Company's auction rate securities classified as long-term investments measured at fair value using significant unobservable inputs (Level 3 inputs):

(in thousands)	2011	2010
Balance as of January 1	$35,297	$45,686
Net unrealized gains included in other comprehensive loss	598	791
Sales of investments at par value	(11,100)	(10,225)
Balance as of September 30	$24,795	$36,252
Unrealized losses still held as of September 30	$3,255	$3,598

The cumulative unrealized loss is included as a component of accumulated other comprehensive loss within shareholders' equity in the accompanying consolidated balance sheet. As of September 30, 2011, there were no long-term investments measured at fair value using Level 1 or Level 2 inputs. All income generated from these investments is recorded as interest income.

Note 14 – Subsequent Event

As a result of the flooding in Thailand, the Company suspended its operations in Ayudhaya. Local officials have estimated that the flooding will continue through the middle of November 2011, at which time they will begin to pump water from the industrial park.

The Company's Thailand facilities are among its largest, generating 20-25% of the Company's revenue in 2011. As a result, the impact on revenue and operations will be significant for the next several fiscal quarters. The Company is evaluating the situation on an on-going basis and is working to mitigate the impact to the Company and its customers. The Company carries property and business interruption insurance that it believes is appropriate and adequate in this situation. The Company's combined limit for real and personal property as well as business interruption insurance is approximately $300 million.

The Company and its customers are developing contingency and recovery plans that aim to enable the Company to meet customer needs. As part of those plans, the Company restarted production at its Korat, Thailand facility in November 2011 and is shifting production from the Ayudhaya facility to its various other sites around the globe. As a result of the capital purchases associated with the Company's contingency plans, it anticipates higher than normal capital expenditures in the fourth quarter of 2011, in an amount in the range of $20 to $25 million.

Because the situation in Thailand is still evolving, significant uncertainty remains regarding the ultimate financial impact the flooding will have on the Company.

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 those terms or 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, including but not limited to uncertainties concerning the recent flooding in Thailand, the extent of damage to our facilities and equipment, the timeframe for the flood waters in Thailand receding, the restoration of operations and associated costs with such restoration, our ability to effectively shift production from our Ayudhaya facilities to other facilities in order to maintain supply continuity for our customers and the recovery of insurance proceeds associated with our business interruption coverage. Undue reliance should not be placed 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 a worldwide provider of integrated electronic manufacturing services. We provide our services to original equipment manufacturers (OEMs) of computers and related products for business enterprises, medical devices, industrial control equipment, which includes equipment for the aerospace and defense industry, 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, including direct order fulfillment and post deployment services. Our manufacturing and assembly operations include printed circuit boards and subsystem assembly, box build and systems integration, the process of integrating subsystems and, often, downloading and integrating software, to produce a fully configured product. As part of our design service offerings, we also provide a broad range of custom assembly equipment. The assembly solutions are designed to meet our customers' specific requirements and include mechanized stations, automated cells, and full automated assembly lines. Our recently added precision technology manufacturing capabilities complement our proven electronic manufacturing expertise by providing further vertical integration of critical mechanical components. These capabilities include precision machining, advanced metal joining, and functional testing for multiple industries including medical, instrumentation, aerospace and semiconductor capital equipment. We are also able to 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, Malaysia, Mexico, Romania and Thailand.

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 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 manufactured products built to customer specifications and excess inventory when title and risk of ownership have passed, the price to the buyer is fixed and determinable and collectibility is reasonably assured, which generally is when the goods are shipped. 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 not significant.

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. 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. Our operating results are impacted by the level of capacity utilization of manufacturing facilities. Operating income margins have generally improved during periods of high production volume and high capacity utilization. During periods of low production volume, we generally have idle capacity and reduced operating income margins.

Severe Flooding in Thailand and Suspension of Thailand Operations

As a result of the flooding in Thailand, our previously announced suspension of operations in Ayudhaya continues to be in effect. Local officials have estimated that the flooding will continue through the middle of November 2011, at which time they will begin to pump water from the industrial park.

The Ayudhaya, Thailand facilities are among our largest, generating 20-25% of our revenue in 2011. As a result, the impact on revenue and operations will be significant for the next several fiscal quarters. We are evaluating the situation on an on-going basis and are working to mitigate the impact to us and our customers. We carry property and business interruption insurance that we believe is appropriate and adequate in this situation. Our combined limit for real and personal property as well as business interruption insurance is approximately $300 million.

We and our customers are developing contingency and recovery plans that aim to enable us to meet customer needs. As part of those plans, we restarted production at our Korat, Thailand facility in November 2011 and we are shifting production from the Ayudhaya facility to our various other sites around the globe. As a result of the capital purchases associated with our contingency plans, we anticipate higher than normal capital expenditures in the fourth quarter of 2011, in an amount in the range of $20 to $25 million.

Summary of Results

Sales for the three months ended September 30, 2011 decreased 7% to $570.1 million compared to $613.9 million for the same period of 2010. During the three months ended September 30, 2011, sales to customers in the testing and instrumentation industry, computers and related products for business enterprises industry, and medical devices industry decreased 40%, 17% and 10%, respectively, from 2010. These decreases were partially offset by a 10% and 5% increase in sales to customers in the telecommunication equipment industry and industrial control equipment industry, respectively, during the same period.

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. 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 ten largest customers represented 50% and 45% of our sales in the three months ended September 30, 2011 and 2010, respectively. Our largest customer, International Business Machines Corporation, represented 11% of our sales during the three months ended September 30, 2011.

Our gross profit as a percentage of sales decreased to 6.1% for the three months ended September 30, 2011 from 7.7% in the same period of 2010 primarily due to lower sales volumes, product mix, new program ramp costs and capacity expansion costs primarily in Asia. We experience fluctuations in gross profit from period to period. Different programs 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. Moreover, 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. During periods of low production volume, we generally have idle capacity and reduced gross profit.

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, 2010. 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 ongoing basis, we evaluate our estimates, including those related to accounts receivable, inventories, income taxes, long-lived assets, stock-based compensation 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 materially 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.

Accounts Receivable

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.

Inventories

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 customers' revised needs, or parts that become obsolete before use in production. In addition, the shifting of production from Ayudhaya, Thailand to Korat, Thailand and various other sites around the globe may lead to on-hand inventory quantities in excess of our customers' needs. We record inventory reserves on excess and obsolete inventory. These reserves are established on inventory which we have determined our customers are not responsible for or on inventory which we believe our customers will be unable to fulfill their obligation to ultimately purchase. 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 uncertain tax positions. 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 valuation allowance 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 assets in the future, an adjustment to the valuation allowance would reduce income in the period such determination was made. We may be able to realize all or a portion of our deferred tax assets in the U.S. in the foreseeable future. Upon such determination, an adjustment to the valuation allowance related to our deferred tax assets could cause a material increase to net income in the period such determination is made.

As of September 30, 2011, we evaluated the recoverability of our deferred tax assets using the criteria described above and concluded that our projected future taxable income in the U.S. is sufficient to utilize additional net operating loss carryforwards and other deferred tax assets. As a result, we reduced our valuation allowance by $17.5 million in the U.S. and, at the same time, increased our valuation allowance by $1.2 million in foreign jurisdictions. This net decrease was a discrete event and $16.3 million was recorded as a tax benefit in our consolidated statement of income during the third quarter of 2011.

We are subject to examination by tax authorities for varying periods in various U.S. and foreign tax jurisdictions. During the course of such examinations, disputes may occur as to matters of fact and/or law. In most tax 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.

Our subsidiary in Thailand has filed for a refund of $8.3 million of previously paid income taxes, which is included in other assets. The Thailand tax authorities are currently conducting an examination of the applicable filings. During the three months ended September 30, 2011, we recorded a reserve for uncertain tax benefits of $7.1 million against this receivable.

Long-Lived Assets
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 comparing 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 is tested annually for impairment and is 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. Goodwill is measured at the reporting unit level, which we have determined to be consistent with our operating segments as defined in Note 8 to the Condensed Consolidated Financial Statements in Item 1 of this report by determining the fair values of the reporting units and comparing those fair values to the carrying values, including goodwill, of the reporting units. We completed the annual impairment test during the fourth quarter of 2010 and determined that no impairment existed as of December 31, 2010. We estimated that the fair value of our Asia business segment exceeded its carrying amount by approximately 117% at the time our 2010 impairment test was performed. Because the situation in Thailand is still evolving, significant uncertainty remains regarding the ultimate financial impact the flooding will have on our Asia business segment and its fair value. As of September 30,

2011, we had goodwill associated with our Asia business segment of approximately $37.9 million. Circumstances that may lead to future impairment of goodwill include unforeseen decreases in future performance or industry demand, the restructuring of our operations as a result of a change in our business strategy or other factors.

Stock-Based Compensation

We recognize stock-based compensation expense in our consolidated statements of income. 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 stock-based 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. For restricted stock unit awards with performance conditions, compensation expense is initially based on the target number of shares that would vest if 100% of the target performance goal is achieved, which was considered the probable outcome on the grant date. Throughout the service period, management monitors the probability of achievement of the performance condition. If it becomes probable, based on our expectation of performance during the measurement period, that more or less than the current estimate of the awarded shares will vest, an adjustment to stock-based compensation expense will be recognized as a change in accounting estimate. See Note 2 to the Condensed Consolidated Financial Statements in Item 1 of this report.

Recently Enacted Accounting Principles

See Note 11 to the Condensed Consolidated Financial Statements in Item 1 of this report 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 September 30,				Nine Months Ended September 30,			
	2011		2010		2011		2010	
Sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	93.9		92.3		93.5		92.2	
Gross profit	6.1		7.7		6.5		7.8	
Selling, general and administrative expenses								