

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  
SEPTEMBER 30, 2004.

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)

**74-2211011**  
(I.R.S. Employer  
Identification Number)

**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 an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

As of November 4, 2004 there were 41,319,798 shares of Benchmark Electronics, Inc. Common Stock, par value \$0.10 per share, outstanding.

## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

#### BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES Condensed Consolidated Balance Sheets (amounts in thousands)

	<b>September 30, <u>2004</u></b> (unaudited)	<b>December 31, <u>2003</u></b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 311,693	\$ 356,140
Accounts receivable, net of allowance for doubtful accounts of \$6,416 and \$6,475, respectively	259,705	208,810
Inventories, net	289,800	238,629
Prepaid expenses and other assets	20,298	18,215
Deferred tax asset	<u>9,806</u>	<u>9,898</u>
Total current assets	<u>891,302</u>	<u>831,692</u>
Property, plant and equipment	225,204	223,335
Accumulated depreciation	<u>(153,767)</u>	<u>(138,070)</u>
Net property, plant and equipment	<u>71,437</u>	<u>85,265</u>
Goodwill, net	113,474	113,478
Other, net	<u>5,824</u>	<u>7,603</u>
	<u>\$1,082,037</u>	<u>\$1,038,038</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Current installments of other long-term debt	\$ 15	\$ 21,017
Accounts payable	268,847	268,034
Income taxes payable	27,369	18,809
Accrued liabilities	<u>54,846</u>	<u>57,953</u>
Total current liabilities	351,077	365,813
Other long-term debt, excluding current installments	-	11
Other long-term liability	2,665	2,886
Deferred tax liability	6,449	5,003
Shareholders' equity:		
Preferred shares, \$0.10 par value; 5,000 shares authorized, none issued	-	-
Common shares, \$0.10 par value; 85,000 shares authorized; issued – 41,274 and 40,976, respectively; outstanding – 41,200 and 40,902, respectively	4,120	4,090
Additional paid-in capital	544,370	538,522
Retained earnings	186,476	135,692
Accumulated other comprehensive loss	(12,939)	(13,798)
Less treasury shares, at cost; 74 shares	<u>(181)</u>	<u>(181)</u>
Total shareholders' equity	721,846	664,325
Commitments and contingencies		
	<u>\$1,082,037</u>	<u>\$1,038,038</u>

See accompanying notes to condensed consolidated financial statements.

**BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Income**  
(amounts in thousands, except per share data)  
(unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
Sales	\$ 504,750	\$ 455,352	\$ 1,477,108	\$ 1,352,770
Cost of sales	<u>466,232</u>	<u>418,382</u>	<u>1,363,084</u>	<u>1,243,271</u>
Gross profit	38,518	36,970	114,024	109,499
Selling, general and administrative expenses	14,553	16,330	45,604	49,244
Contract settlement	<u>-</u>	<u>-</u>	<u>-</u>	<u>(8,108)</u>
Income from operations	23,965	20,640	68,420	68,363
Interest expense	(392)	(1,976)	(1,551)	(6,895)
Other income	<u>849</u>	<u>967</u>	<u>2,603</u>	<u>1,635</u>
Income before income taxes	24,422	19,631	69,472	63,103
Income tax expense	<u>6,389</u>	<u>6,687</u>	<u>18,688</u>	<u>21,076</u>
Net income	\$ <u>18,033</u>	\$ <u>12,944</u>	\$ <u>50,784</u>	\$ <u>42,027</u>
Earnings per share (see note 1):				
Basic	\$ <u>0.44</u>	\$ <u>0.34</u>	\$ <u>1.24</u>	\$ <u>1.13</u>
Diluted	\$ <u>0.43</u>	\$ <u>0.32</u>	\$ <u>1.20</u>	\$ <u>1.08</u>
Weighted average number of shares outstanding (see note 1):				
Basic	<u>41,123</u>	<u>38,074</u>	<u>41,042</u>	<u>37,273</u>
Diluted	<u>42,313</u>	<u>41,660</u>	<u>42,387</u>	<u>41,014</u>

See accompanying notes to condensed consolidated financial statements.

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>
Cash flows from operating activities:		
Net income	\$ 50,784	\$ 42,027
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	20,400	21,959
Deferred income taxes	1,538	1,219
Asset impairments	1,417	-
Gain on the sale of property, plant and equipment	(1,427)	(110)
Accrued compensation expense	164	-
Non-cash interest expense on convertible subordinated notes	-	307
Federal tax benefit of stock options exercised	1,472	2,914
Changes in operating assets and liabilities:		
Accounts receivable	(50,641)	(19,820)
Inventories	(51,126)	(9,310)
Prepaid expenses and other assets	(1,862)	(3,580)
Accounts payable	708	12,653
Accrued liabilities	(3,402)	(12,067)
Income taxes	<u>8,560</u>	<u>5,621</u>
Net cash provided by (used in) operations	<u>(23,415)</u>	<u>41,813</u>
Cash flows from investing activities:		
Additions to property, plant and equipment	(9,424)	(8,822)
Proceeds from the sale of property, plant and equipment	4,687	400
Additions to capitalized software	<u>(239)</u>	<u>(611)</u>
Net cash used in investing activities	<u>(4,976)</u>	<u>(9,033)</u>
Cash flows from financing activities:		
Proceeds from stock options exercised	3,321	11,071
Proceeds from employee stock purchase plan	921	686
Principal payments on other long-term debt	<u>(21,013)</u>	<u>(30,437)</u>
Net cash used in financing activities	<u>(16,771)</u>	<u>(18,680)</u>
Effect of exchange rate changes	<u>715</u>	<u>2,111</u>
Net increase (decrease) in cash and cash equivalents	(44,447)	16,211
Cash and cash equivalents at beginning of year	<u>356,140</u>	<u>312,576</u>
Cash and cash equivalents at September 30	<u>\$311,693</u>	<u>\$328,787</u>
Supplemental disclosures of cash flow information:		
Income taxes paid, net of refunds received	<u>\$ 7,081</u>	<u>\$ 11,408</u>
Interest paid	<u>\$ 587</u>	<u>\$ 7,827</u>

See accompanying notes to condensed consolidated financial statements.

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

**Note 1 - Basis of Presentation**

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

The condensed consolidated financial statements included herein have been prepared by the Company without audit pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The financial statements reflect all normal and recurring adjustments which in the opinion of management are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

On October 22, 2003, the Board of Directors declared a three-for-two stock split effected in the form of a stock dividend payable on November 13, 2003, to shareholders of record as of November 6, 2003. Shareholders' equity has been restated to give retroactive recognition to the stock split in prior periods by reclassifying from additional paid-in capital to common stock the par value of the additional shares arising from the split. All share and per share data appearing in these condensed consolidated financial statements and notes thereto have been retroactively adjusted for the stock split.

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

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

## Note 2 – Accounting for Stock-Based Compensation

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to Employees”, and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44, “Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25”, issued in March 2000, to account for its stock option plans and its Employee Stock Purchase Plan. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Statement of Financial Accounting Standards (SFAS) No. 123, “Accounting for Stock-Based Compensation”, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
Net income, as reported	\$18,033	\$12,944	\$50,784	\$42,027
Add stock-based compensation expense included in reported net income, net of related tax effects	-	-	98	-
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	<u>(535)</u>	<u>(316)</u>	<u>(1,873)</u>	<u>(1,334)</u>
Net income, as adjusted	<u>\$17,498</u>	<u>\$12,628</u>	<u>\$49,009</u>	<u>\$40,693</u>
Earnings per share:				
Basic, as reported	\$0.44	\$0.34	\$1.24	\$1.13
Basic, as adjusted	\$0.43	\$0.33	\$1.19	\$1.09
Diluted, as reported	\$0.43	\$0.32	\$1.20	\$1.08
Diluted, as adjusted	\$0.42	\$0.31	\$1.16	\$1.05

These adjusted results may not be indicative of the future results for the full fiscal year due to potential grants, vesting and other factors. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The assumptions used to value the option grants in the first nine months of 2004 and 2003 were as follows:

	<b><u>2004</u></b>	<b><u>2003</u></b>
Expected life of options	5 years	4 to 5 years
Volatility	62%	55%
Risk-free interest rate	3.90%	2.55% to 2.92%
Dividend yield	zero	zero

### Note 3 – Earnings Per Share

Basic earnings per share is computed using the weighted average number of shares outstanding. Diluted earnings per share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to outstanding stock equivalents during the three and nine months ended September 30, 2004 and 2003. 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>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
Numerator for basic earnings per share - net income	\$18,033	\$12,944	\$50,784	\$42,027
Interest expense on 6% convertible debt, net of tax	<u>-</u>	<u>570</u>	<u>-</u>	<u>2,187</u>
Numerator for diluted earnings per share	<u>\$18,033</u>	<u>\$13,514</u>	<u>\$50,784</u>	<u>\$44,214</u>
Denominator for basic earnings per share - weighted average number of common shares outstanding during the period	41,123	38,074	41,042	37,273
Incremental common shares attributable to exercise of outstanding dilutive options	1,190	1,439	1,345	1,035
Incremental common shares attributable to conversion of 6% convertible debt	<u>-</u>	<u>2,147</u>	<u>-</u>	<u>2,706</u>
Denominator for diluted earnings per share	<u>42,313</u>	<u>41,660</u>	<u>42,387</u>	<u>41,014</u>
Basic earnings per share	<u>\$ 0.44</u>	<u>\$ 0.34</u>	<u>\$ 1.24</u>	<u>\$ 1.13</u>
Diluted earnings per share	<u>\$ 0.43</u>	<u>\$ 0.32</u>	<u>\$ 1.20</u>	<u>\$ 1.08</u>

Options to purchase 0.5 million shares of common stock for the three and nine months ended September 30, 2004 and 2003, 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 stock for the period.

#### Note 4 – Goodwill

Goodwill associated with each of the Company's business segments and changes in those amounts during the three and nine-month periods ended September 30, 2004 were as follows:

	<u>Americas</u>	<u>Europe</u>	<u>Asia</u>	<u>Total</u>
Goodwill, June 30, 2004	\$106,815	\$ —	\$6,675	\$113,490
Currency translation adjustment	<u>(16)</u>	<u>—</u>	<u>—</u>	<u>(16)</u>
Goodwill, September 30, 2004	<u>\$106,799</u>	<u>\$ —</u>	<u>\$6,675</u>	<u>\$113,474</u>
Goodwill, December 31, 2003	\$106,803	\$ —	\$6,675	\$113,478
Currency translation adjustment	<u>(4)</u>	<u>—</u>	<u>—</u>	<u>(4)</u>
Goodwill, September 30, 2004	<u>\$106,799</u>	<u>\$ —</u>	<u>\$6,675</u>	<u>\$113,474</u>

#### Note 5 – Borrowing Facilities

The Company had a five-year term loan (the Term Loan) through a syndicate of commercial banks that matured on September 30, 2004. On January 22, 2004, the Company repaid all amounts outstanding under the Term Loan.

The Company had a \$175 million revolving line of credit facility (the Revolving Credit Facility) with a syndicate of commercial banks that was scheduled to mature on September 30, 2004. On September 23, 2004, the Company amended the Revolving Credit Facility to extend the maturity date to December 31, 2004. In connection with the amendment, the lenders' commitments were reduced from \$175 million to \$158.9 million. The Company is entitled to borrow under the Revolving Credit Facility up to the lesser of \$158.9 million or the sum of 75% of its eligible accounts receivable, 45% of its eligible inventories and 50% of its eligible fixed assets. Interest on the Revolving Credit Facility is payable quarterly, at the Company's option, at either the bank's Eurodollar rate plus 1.25% to 3.00% or its prime rate plus 0.00% to 1.75%, based upon the Company's debt ratio as specified in the agreement. A commitment fee of 0.375% to 0.500% per annum on the unused portion of the Revolving Credit Facility is payable quarterly in arrears. As of September 30, 2004, the Company had no borrowings outstanding under the Revolving Credit Facility, \$1.2 million in outstanding letters of credit and \$157.7 million was available for future borrowings.

The Revolving Credit Facility is secured by the Company's domestic inventory and accounts receivable, 100% of the stock of the Company's domestic subsidiaries, and 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 Revolving Credit Facility contains customary financial covenants as to working capital, interest coverage, debt leverage, fixed charges, and consolidated net worth, and restricts the ability of the Company to incur additional debt, pay dividends, sell assets, and to merge or consolidate with other persons, without the consent of the banks. At September 30, 2004, the Company was in compliance with all such restrictions.

The Company's Thailand subsidiary has a Credit Agreement with Thai Farmers Bank Public Company Limited and Bank of Ayudhya Public Company Limited (the Thai Credit Agreement). The Thai Credit Agreement provides that the lenders will make available to the Company's Thailand subsidiary up to approximately \$53.5 million in revolving loans, term loans and machinery loans for a term of five years through September 2006. The Thai Credit Agreement is secured by land, buildings and machinery in Thailand. In addition, the Thai Credit Agreement provides for approximately \$1.4 million (60.0 million Thai baht) in working capital availability. At September 30, 2004, the Company's Thailand subsidiary had no borrowings outstanding.

During the third quarter of 2003, the Company called its outstanding 6% Convertible Subordinated Notes due August 15, 2006 (the Notes) for redemption. All of the Notes were converted, at the holders' option, into approximately 3.0 million shares of the Company's common stock on September 5, 2003, net of related interest and deferred financing costs.

#### Note 6 - Inventories

Inventory costs are summarized as follows:

	<b>September 30, <u>2004</u></b>	<b>December 31, <u>2003</u></b>
Raw materials	\$ 192,533	\$ 166,257
Work in process	76,372	52,294
Finished goods	36,048	38,345
Obsolescence reserve	<u>(15,153)</u>	<u>(18,267)</u>
	<b><u>\$ 289,800</u></b>	<b><u>\$ 238,629</u></b>

Changes to the inventory obsolescence reserve are summarized as follows:

	<b>Balance at December 31, <u>2003</u></b>	<b>Charges (Credits) to <u>Operations</u></b>	<b><u>Other</u></b>	<b><u>Disposals</u></b>	<b>Balance at September 30, <u>2004</u></b>
Obsolescence reserve	\$ 18,267	(1,344)	(25)	(1,745)	\$ 15,153

## Note 7 - Income Taxes

Income tax expense consists of the following:

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>
Federal – Current	\$ 14,263	\$ 18,137
Foreign – Current	(726)	(1,099)
State – Current	3,613	2,819
Deferred	<u>1,538</u>	<u>1,219</u>
Total	<u>\$ 18,688</u>	<u>\$ 21,076</u>

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

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

The Company has been granted certain tax incentives, including tax holidays, for its subsidiaries in China, Ireland, and Thailand. These tax incentives, including tax holidays, expire through 2010, and are subject to certain conditions with which the Company expects to comply. The net impact of these tax incentives was to lower income tax expense for the nine month periods ended September 30, 2004 and 2003 by approximately \$0.9 million and \$2.3 million, respectively.

## Note 8 - Business Segments and Geographic Areas

The Company has 17 manufacturing facilities in the Americas, Europe and Asia to serve its customers. The Company is operated and managed geographically. The Company's management evaluates performance and allocates the Company's resources on a geographic basis. Intersegment sales are generally recorded at prices that approximate arm's length transactions. Operating segments' measure of profitability is based on income from operations. The accounting policies for the reportable operating segments are the same as for the Company taken as a whole.

Information about operating segments for the three and nine months ended September 30, 2004 and 2003 was as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
Net sales:				
Americas	\$ 457,643	\$ 441,657	\$ 1,360,551	\$ 1,313,123
Europe	48,000	70,382	153,137	237,974
Asia	104,741	62,614	287,512	173,977
Elimination of intersegment sales	<u>(105,634)</u>	<u>(119,301)</u>	<u>(324,092)</u>	<u>(372,304)</u>
	<u>\$ 504,750</u>	<u>\$ 455,352</u>	<u>\$ 1,477,108</u>	<u>\$ 1,352,770</u>
Depreciation and amortization:				
Americas	\$ 3,758	\$ 4,140	\$ 11,861	\$ 13,052
Europe	367	665	1,329	2,081
Asia	1,583	1,416	4,689	4,020
Corporate	<u>736</u>	<u>917</u>	<u>2,521</u>	<u>2,806</u>
	<u>\$ 6,444</u>	<u>\$ 7,138</u>	<u>\$ 20,400</u>	<u>\$ 21,959</u>
Income from operations:				
Americas	\$ 22,319	\$ 24,530	\$ 64,203	\$ 83,266
Europe	1,253	(822)	5,538	(6,118)
Asia	5,467	3,822	13,484	5,649
Corporate and intersegment eliminations	<u>(5,074)</u>	<u>(6,890)</u>	<u>(14,805)</u>	<u>(14,434)</u>
	<u>\$ 23,965</u>	<u>\$ 20,640</u>	<u>\$ 68,420</u>	<u>\$ 68,363</u>
Capital expenditures:				
Americas	\$ 2,519	\$ 2,298	\$ 4,408	\$ 3,980
Europe	48	57	139	225
Asia	<u>3,171</u>	<u>2,707</u>	<u>4,877</u>	<u>4,617</u>
	<u>\$ 5,738</u>	<u>\$ 5,062</u>	<u>\$ 9,424</u>	<u>\$ 8,822</u>
			<b>September 30, <u>2004</u></b>	<b>December 31, <u>2003</u></b>
Total assets:				
Americas	\$ 855,310		\$ 822,963	
Europe	54,848		66,557	
Asia	160,031		136,898	
Corporate	<u>11,848</u>		<u>11,620</u>	
	<u>\$ 1,082,037</u>		<u>\$ 1,038,038</u>	

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 September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
Net sales derived from:				
Printed circuit boards	\$ 380,765	\$ 351,608	\$1,110,757	\$1,068,865
Systems integration and box build	<u>123,985</u>	<u>103,744</u>	<u>366,351</u>	<u>283,905</u>
	<u>\$ 504,750</u>	<u>\$ 455,352</u>	<u>\$1,477,108</u>	<u>\$1,352,770</u>
Geographic net sales:				
United States	\$ 392,631	\$ 356,968	\$1,159,030	\$1,035,550
Europe	81,005	80,179	243,190	266,450
Asia and other	<u>31,114</u>	<u>18,205</u>	<u>74,888</u>	<u>50,770</u>
	<u>\$ 504,750</u>	<u>\$ 455,352</u>	<u>\$1,477,108</u>	<u>\$1,352,770</u>

	<b>September 30, <u>2004</u></b>	<b>December 31, <u>2003</u></b>
Long-lived assets:		
United States	\$ 40,863	\$ 50,312
Europe	2,825	8,365
Asia and other	<u>33,573</u>	<u>34,191</u>
	<u>\$ 77,261</u>	<u>\$ 92,868</u>

## Note 9 – Comprehensive Income

Comprehensive income includes net income, the change in the cumulative translation adjustment and the effect of accounting for cash flow hedging derivatives. Comprehensive income for the three and nine months ended September 30, 2004 and 2003 was as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>
Net income	\$ 18,033	\$ 12,944	\$50,784	\$42,027
Cumulative translation adjustment	1,386	198	859	3,484
Hedge accounting for derivative financial instruments, net of tax	-	<u>138</u>	-	<u>428</u>
Comprehensive income	<u>\$ 19,419</u>	<u>\$ 13,280</u>	<u>\$51,643</u>	<u>\$45,939</u>

Changes in the fair value of interest rate swaps designated as hedging instruments that effectively offset the variability of cash flows associated with variable-rate, long-term debt obligations are recognized in accumulated other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment of the hedged interest payments in the same period in which the related interest affects earnings. For the three and nine months ended September 30, 2003, the Company reclassified \$137 and \$460, respectively, into interest expense.

## **Note 10 – Contingencies**

The Company filed a lawsuit against J.M. Huber Corporation (the Seller) in the United States District Court for the Southern District of Texas for breach of contract, fraud and negligent misrepresentation on December 14, 1999 seeking an unspecified amount of damages in connection with the Amended and Restated Stock Purchase Agreement dated August 12, 1999 between the parties whereby the Company acquired all of the stock of AVEX Electronics, Inc. from Seller. On January 5, 2000, Seller filed suit in the United States District Court for the Southern District of New York alleging that the Company failed to comply with certain obligations under the contract requiring the Company to register shares of its common stock issued to Seller as partial consideration for the acquisition. Seller's suit was consolidated with the Company's suit in the United States District Court for the Southern District of Texas (the Court). On January 29, 2004, the Company served its First Request for Production of Documents on the Seller. On April 8, 2004, the Court held a status conference with the parties. Following such status conference, the Court issued an order instructing the parties to engage in discovery. The parties submitted their most recent status report to the Court on August 30, 2004. Subsequently, the parties began negotiation of a release and settlement disposing of all claims between the parties. On November 2, 2004, having been advised that a settlement had been reached in principle between the parties, the Court dismissed the case with prejudice, except that the parties may move for reinstatement by December 29, 2004, only because the approval of the settlement could not be obtained by the principals.

On April 14, 2000, the Company, along with numerous other companies, was named as a defendant in a lawsuit filed in the United States District Court for the District of Arizona by the Lemelson Medical, Education & Research Foundation (Lemelson). The lawsuit alleges that the Company has infringed certain of Lemelson's patents relating to machine vision and bar code technology utilized in machines the Company has purchased. On November 2, 2000, the Company filed an Answer, Affirmative Defenses, and a Motion to Stay based upon Declaratory Judgment Actions filed by Cognex and Symbol, manufacturers of the equipment at issue. On March 29, 2001, the Court granted the defendants' Motion to Stay and ordered that the lawsuit be stayed pending the entry of a final non-appealable judgment in the cases filed by Cognex and Symbol (the Symbol/Cognex case). On January 24, 2004, the trial court in the Symbol/Cognex case held that the Lemelson patents are invalid, unenforceable and were not infringed. On June 23, 2004, Lemelson filed a Notice of Appeal to the U.S. Court of Appeals for the Federal Circuit from the final judgment in the Symbol/Cognex case. Resolution of the appeal in the Symbol/Cognex case is estimated to take one to three years. Lemelson's lawsuit against the Company is stayed pending the final non-appealable judgment in the Symbol/Cognex case. The Company intends to vigorously defend against such claims and pursue all rights it has against third parties. At the present time, the Company is unable to reasonably estimate the possible loss, if any, associated with these matters.

The Company is also involved in various other 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.

## **Note 11 – Contract Settlement**

During the first quarter of 2003, the Company settled and released various claims arising out of customer manufacturing agreements. In connection with the settlement of these claims, the Company recorded a non-cash gain totaling \$8.1 million.

## **Note 12 – Impact of Recently Issued Accounting Standards**

In November 2002, the Emerging Issues Task Force (EITF) of the FASB reached a consensus on EITF No. 00-21, “Accounting for Revenue Arrangements with Multiple Element Deliverables.” EITF No. 00-21 addresses how to account for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets. Revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables in the arrangement meet certain criteria. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values. The final consensus is applicable to agreements entered into in quarters beginning after June 15, 2003, with early adoption permitted. Additionally, companies are permitted to apply the consensus guidance to all existing arrangements as a cumulative effect of a change in accounting principle. The adoption of EITF No. 00-21 did not have a material effect on the Company’s financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51” (FIN 46). In December 2003, the FASB issued a revision to FIN 46 to make certain technical corrections and address certain implementation issues that had arisen. FIN 46, as revised, clarifies existing accounting literature regarding the consolidation of entities in which a company holds a “controlling financial interest”. A majority voting interest in an entity has generally been considered indicative of a controlling financial interest. FIN 46 specifies other factors (variable interests) which must be considered when determining whether a company holds a controlling financial interest in, and therefore must consolidate, an entity (variable interest entities). The adoption of FIN 46 had no impact on the Company’s overall financial position and results of operations as the Company has no interest in variable interest entities.

In April 2003, the FASB issued SFAS No. 149, “Amendments of Statement 133 on Derivative Instruments and Hedging Activities,” which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. This statement is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Company’s financial statements.

In May 2003, the FASB issued SFAS No. 150, “Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity,” which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Financial instruments that are within the scope of the statement, which previously were often classified as equity, must now be classified as liabilities. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material impact on the Company’s financial statements.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104 (SAB 104), “Revenue Recognition.” SAB 104 supercedes SAB 101, “Revenue Recognition in Financial

Statements.” The primary purpose of SAB 104 is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of EITF No. 00-21, “Revenue Arrangements with Multiple Deliverables.” Additionally, SAB 104 rescinds the SEC’s Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (the FAQ) issued with SAB 101 that had been codified in SEC Topic 13, Revenue Recognition. Selected portions of the FAQ have been incorporated into SAB 104. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The adoption of SAB 104 did not have a material impact on the Company’s financial statements.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was passed by Congress and signed into law on December 8, 2003. The Act establishes a voluntary prescription drug benefit for eligible participants beginning January 1, 2006, at which time the U.S. Government will also begin to pay a special subsidy equal to 28% of a retiree’s covered prescription drug expenses between \$250 and \$5,000 (adjusted annually for changes in Medicare per capita prescription drug costs) to employers who sponsor equivalent plans. On May 19, 2004, the FASB issued Staff Position No. FAS 106-2, “Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003”, (FSP No. 106-2), which prescribes accounting for the Act and is effective for interim periods beginning after June 15, 2004. The Company has elected to defer including the effects of the Act in any measures of liabilities and expenses reflected in the Condensed Consolidated Financial Statements and accompanying notes. Clarifying regulations related to the interpretation or determination of actuarially equivalent plans are still pending. Therefore, any such effects included in the Company’s financial statements would be subject to change once final regulations have been issued. The Company believes that the Act will not have a material impact on postretirement liabilities and benefit costs.

## **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 negative of 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 the heading Risk Factors below. The future results of our operations may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated.

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

## OVERVIEW

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

As our customers expand internationally, they increasingly require their EMS partners to have strategic regional locations and global procurement capabilities. We believe that our global manufacturing presence of 17 facilities in eight countries increases our ability to be responsive to our customers' needs by providing accelerated time-to-market and time-to-volume production of high quality products. These capabilities should enable us to build stronger strategic relationships with our customers and to become a more integral part of their operations. Our customers face challenges in planning, procuring and managing their inventories efficiently due to fluctuations in customer demand, 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.

Benchmark recognizes revenue from the sale of circuit board assemblies, systems and excess inventory when the goods are shipped, title and risk of ownership have passed, the price to the buyer is fixed and determinable and recoverability is reasonably assured. To a lesser extent, revenue is also recognized from non-manufacturing services, such as product design, circuit board layout, and test development. Service related revenues are recognized when the service is rendered and the costs related to these services are expensed as incurred.

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

product, we usually achieve increased efficiencies, which result in lower labor and manufacturing overhead costs for that product and higher gross margins.

### **Summary of Results**

Sales for the third quarter of 2004 increased 10.8% to \$504.8 million compared to \$455.4 million for the same period of 2003. The increase in our sales reflects new program revenues from both existing and new customers. During the third quarter of 2004, we continued to lower our dependence on our largest customers as revenues from our remaining customer base expanded. Sales to our largest customer, Sun Microsystems, Inc., decreased to 27.4% of our sales in the third quarter of 2004 from 42.0% of our sales in the third quarter of 2003. We expect the third quarter revenue from this customer to be the low point for 2004 from a revenue dollar standpoint due to the seasonality of this account and a new program introduction. Sales to our customers, other than our two largest customers, increased to \$285.6 million in the third quarter of 2004 from \$197.3 million in the third quarter of 2003.

Our gross profit as a percentage of sales for the third quarter was down to 7.6% in 2004 from 8.1% in 2003 because of the new program ramps, new program introduction delays and changes in the program mix during the quarter. These activities combined to impact the level of efficiency in our production and negatively impacted our gross profit. We see continued demand for services in Asia and in the engineering and design areas. As we increase our revenue base in Asia, we do not see significant changes to our business model. We do see that some of the programs may have a higher level of cost of goods sold, given the material content of the products and the lower labor costs. These same programs typically demonstrate lower levels of selling, general and administrative expenses but render the same operating margin.

### **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, 2003. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to allowance for doubtful accounts, inventories, deferred taxes, impairment of long-lived assets, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

#### **Allowance for doubtful accounts**

Our accounts receivable balance is recorded net of allowances for amounts not expected to be collected from our customers. Because our accounts receivable are typically unsecured, we periodically evaluate the collectibility of our accounts based on a combination of factors, including a particular customer's ability to pay as well as the age of the receivables. To evaluate a specific customer's ability to pay, we analyze financial statements, payment history, third-party credit analysis reports and various information or disclosures by the customer or other publicly available information. In cases where the evidence suggests a customer may not be able to satisfy its

obligation to us, we set up a specific reserve in an amount we determine appropriate for the perceived risk. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

### **Inventory obsolescence reserve**

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

### **Income Taxes**

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

### **Impairment of Long-Lived Assets**

In accordance with 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 2003 and determined that no impairment existed as of the date of the impairment test. Goodwill is measured at the reporting unit level, which we have determined to be consistent with our operating segments as defined in Note 8 to the Condensed Consolidated Financial Statements –

“Business Segments and Geographic Areas,” by determining the fair values of the reporting units using a discounted cash flow model and comparing those fair values to the carrying values, including goodwill, of the reporting unit. As of September 30, 2004 and December 31, 2003, we had net goodwill of approximately \$113.5 million. Circumstances that may lead to impairment of goodwill include unforeseen decreases in future performance or industry demand, and the restructuring of our operations as a result of a change in our business strategy.

## RESULTS OF OPERATIONS

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	<u>92.4</u>	<u>91.9</u>	<u>92.3</u>	<u>91.9</u>
Gross profit	7.6	8.1	7.7	8.1
Selling, general and administrative expenses	2.9	3.6	3.1	3.6
Contract settlement	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>(0.6)</u>
Income from operations	4.7	4.5	4.6	5.1
Interest expense	(0.1)	(0.4)	(0.1)	(0.5)
Other income	<u>0.2</u>	<u>0.2</u>	<u>0.2</u>	<u>0.1</u>
Income before income taxes	4.8	4.3	4.7	4.7
Income tax expense	<u>1.3</u>	<u>1.5</u>	<u>1.3</u>	<u>1.6</u>
Net income	<u>3.5%</u>	<u>2.8%</u>	<u>3.4%</u>	<u>3.1%</u>

### **Sales**

Sales for the third quarter of 2004 were \$504.8 million, a 10.8% increase from sales of \$455.4 million for the same quarter in 2003. The increase of \$49.4 million resulted from increased sales under new programs and increased activity with existing customers. Of this increase, \$20.2 million was attributable to the operation of our systems integration facilities and \$36.9 million to an overall increase in printed circuit board assembly (PCBA) sales volume. These increases were partially offset by a decrease of \$7.7 million primarily due to decreased demand in Europe which resulted in the consolidation and downsizing of certain manufacturing facilities.

A substantial percentage of our sales have been made to a small number of customers, and the loss of a major customer, if not replaced, would adversely affect us. During the third quarter of 2004, our two largest customers together represented 43.5% of our sales, with one customer accounting for 27.4% of our sales. Sales to our largest customer, Sun Microsystems, Inc., decreased to 27.4% of our sales in the third quarter of 2004 from 42.0% of our sales in the third quarter of 2003. During the third quarter of 2004, the level of concentration among our top customers decreased as revenues from our remaining customer base expanded. 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. Sales to our customers, other than our two largest customers, increased to \$285.6 million in the third quarter of 2004 from \$197.3 million in the third quarter of 2003, an increase of \$88.3 million. We expect the third quarter revenue from our largest customer to be the low point for 2004 from a revenue dollar standpoint due to the

seasonality of this account and a new program introduction. Developments adverse to our major customers or their products, or the failure of a major customer to pay for components or services, could have an adverse effect on us.

Our manufacturing and assembly operations include printed circuit boards and subsystem assembly, box build and systems integration. Systems integration is the process of integrating subsystem and printed circuit board assemblies and, often, downloading and integrating software, to produce a fully configured product. Systems integration is a value-added service that is not separable from our overall contract manufacturing service. Sales from the operation of our systems integration facilities represented 24.8% and 21.0% of our sales for the nine months ended September 30, 2004 and 2003, respectively.

We have 17 manufacturing facilities in the Americas, Europe and Asia to serve our customers. We are operated and managed geographically. See Note 8 to the Condensed Consolidated Financial Statements. Our facilities in the Americas provided 75.1% and 78.6% of net sales, respectively, during the third quarter of 2004 and 2003, and 75.8% and 78.2% of net sales, respectively, during the first nine months of 2004 and 2003. Our Americas region includes facilities in Angleton, Texas, Beaverton, Oregon, Campinas, Brazil, Guadalajara, Mexico, Hudson, New Hampshire, Huntsville, Alabama, Loveland, Colorado, Manassas, Virginia, Redmond, Washington and Winona, Minnesota. There are two facilities in Huntsville, Alabama - a systems integration facility and a PCBA facility. We opened the Loveland, Colorado facility in May 2003 and the Redmond, Washington facility in November 2003. Both of the Loveland and Redmond facilities provide systems integration services. Our facilities in Europe provided 5.1% and 8.0% of net sales, respectively, during the third quarter of 2004 and 2003, and 5.3% and 9.3% of net sales, respectively, during the first nine months of 2004 and 2003. Our Europe region includes facilities in Dublin, Ireland, Leicester, England and in 2003, included a facility in East Kilbride, Scotland and a facility in Cork, Ireland. The Dublin facility provides systems integration services. During the fourth quarter of 2003, we closed our East Kilbride, Scotland facility. The East Kilbride, Scotland facility was sold on August 31, 2004. During the second quarter of 2003, we closed the Cork, Ireland facility. The Cork facility was sold on April 8, 2004. Our facilities in Asia provided 19.8% and 13.4% of our net sales, respectively, during the third quarter of 2004 and 2003, and 18.9% and 12.6% of net sales, respectively, during the first nine months of 2004 and 2003. Our Asia region includes facilities in the Republic of Singapore, Ayudhaya and Korat, Thailand and Suzhou, China. The Korat, Thailand facility began operations in September 2004. The Singapore facility included both a systems integration and PCBA operation during 2003. During 2003, the PCBA facility in Singapore ceased operations.

Our international operations are subject to the risks of doing business abroad. These dynamics have not had a material adverse effect on our results of operations through September 30, 2004. However, we cannot assure you that there will not be an adverse impact in the future. See RISK FACTORS for factors pertaining to our international sales and fluctuations in the exchange rates of foreign currency and for further discussion of potential adverse effects in operating results associated with the risks of doing business abroad. During the first nine months of 2004 and 2003, 30.1% and 26.6%, respectively, of our sales were from our international operations.

### **Americas**

Sales in the Americas during the quarter ended September 30, 2004 increased \$21.4 million, or 6.0%, compared to the same period of 2003. This net increase included a \$21.8 million increase attributable to sales under new programs and increased activity with existing systems integration customers. Sales in the Americas during the nine months ended September 30, 2004 increased \$62.3 million, or 5.9%, compared to the same period of 2003. This net increase included a \$93.9

million increase attributable to sales under new programs and increased activity with existing systems integration customers. This increase was offset by a \$31.6 million net decrease in PCBA sales volume attributable to the impact of maturing programs and new product introductions.

### **Europe**

Sales in Europe during the quarter ended September 30, 2004 decreased \$10.8 million, or 29.7%, compared to the same period of 2003. This net decrease included a \$0.4 million decrease in sales volumes from systems integration customers, a \$7.7 million decrease in PCBA sales due to decreased demand which resulted in the closing of the East Kilbride, Scotland and Cork, Ireland facilities and a \$2.7 million net decrease in overall PCBA sales volume. Sales in Europe during the nine months ended September 30, 2004 decreased \$46.9 million, or 37.5%, compared to the same period of 2003. This net decrease included a \$13.9 million decrease in sales volumes from systems integration customers, a \$24.6 million decrease in PCBA sales resulting from the closing of the East Kilbride, Scotland and Cork, Ireland facilities and an \$8.4 million net decrease in overall PCBA sales volume. The overall decrease in sales volume in Europe is a result of lower demand for our customers' products in Europe and the transfer of production for some customers to lower cost production geographies.

### **Asia**

Sales in Asia during the quarter ended September 30, 2004 increased \$38.8 million, or 63.4%, compared to the same period of 2003. This net increase included a \$1.1 million decrease attributable to sales activity with existing systems integration customers and a \$39.9 million net increase in PCBA sales volumes attributable to the impact of ramping new programs in Asia and transferring existing customer business to Asia. Sales in Asia during the nine months ended September 30, 2004 increased \$109.0 million, or 64.0%, compared to the same period of 2003. This net increase included a \$2.4 million increase attributable to sales under new programs and increased activity with existing systems integration customers and a \$106.6 million net increase in PCBA sales volumes attributable to the impact of ramping new programs in Asia and transferring existing customer business to Asia.

### **Gross Profit**

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Gross profit increased 4.2% to \$38.5 million for the third quarter of 2004 from \$37.0 million in the same quarter of 2003. Gross profit as a percentage of sales for the three months ended September 30, 2004 and 2003, respectively, decreased to 7.6% from 8.1%. Gross profit increased 4.1% to \$114.0 million for the first nine months of 2004 from \$109.5 million in the same period of 2003. Gross profit as a percentage of sales for the nine months ended September 30, 2004 and 2003, respectively, decreased to 7.7% from 8.1%. Gross profit as a percentage of sales decreased because of new program ramps, new program introduction delays and a high level of mix changes during 2004. These activities combined to impact the level of efficiency in our production and negatively impacted our gross profit.

We expect that a number of our higher volume programs with customers will remain subject to competitive restraints on the margin that may be realized from these programs and that these restraints could exert downward pressure on our margins in the near future. For the foreseeable future, our gross margin is expected to depend primarily on facility utilization, product mix, start-up of new programs, pricing within the electronics industry, and the integration of acquisitions. The gross margins at each facility and for Benchmark as a whole are expected to continue to fluctuate. Increases in start-up costs associated with new programs and pricing within the electronics industry also could adversely impact our gross margin as they did during the first nine months of 2004.

The third quarter 2004 and 2003 gross profit includes charges (credits) related to reserves for excess and obsolete inventory. During the third quarter of 2004 and 2003, \$(0.4) million and \$0.3 million of (reduced) additional inventory reserves were recorded, respectively. We write down our inventories 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. 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. We record inventory reserves primarily 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.

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

Selling, general and administrative expenses were \$14.6 million and \$16.3 million in the third quarter of 2004 and 2003, respectively, and \$45.6 million and \$49.2 million in the first nine months of 2004 and 2003, respectively. Selling, general and administrative expenses as a percentage of sales decreased from 3.6% for the third quarter of 2003 to 2.9% for the third quarter of 2004, and decreased from 3.6% for the first nine months of 2003 to 3.1% for the first nine months of 2004. The decrease in selling, general and administrative expenses as a percentage of sales is primarily associated with the increase in sales and also reflects the impact of facility consolidation and downsizing which occurred in 2003.

The charge to operations for bad debt allowance declined to \$0.1 million (net of an accounts receivable recovery of \$0.6 million) in the third quarter of 2004 from \$0.4 million in the third quarter of 2003 and to \$1.3 million (net of an accounts receivable recovery of \$0.6 million) in the first nine months of 2004 from \$5.7 million in the first nine months of 2003 as a result of the improvement in the financial condition of a number of our customers.

### **Contract Settlement**

During the first quarter of 2003, we settled and released various claims arising out of customer manufacturing agreements. In connection with the settlement of these claims, we recorded a non-cash gain totaling \$8.1 million.

### **Interest Expense**

Interest expense for the three and nine-month periods ended September 30, 2004 and 2003 was approximately \$0.4 million and \$2.0 million and \$1.6 million and \$6.9 million, respectively. The decrease is primarily due to repayments of outstanding debt and to the conversion of our 6% Convertible Subordinated Notes to common stock in September 2003. See Note 5 to the Condensed Consolidated Financial Statements.

### **Income Tax Expense**

Income tax expense of \$18.7 million represented an effective tax rate of 26.9% for the nine months ended September 30, 2004, compared with \$21.1 million at an effective tax rate of 33.4% for the same period in 2003. The decrease in the effective tax rate is primarily due to higher estimated income tax benefits for 2004 in foreign tax jurisdictions as compared to 2003. See Note 7 to the Condensed Consolidated Financial Statements.

## **Net Income**

We reported net income for the three and nine-month periods ended September 30, 2004 of approximately \$18.0 million and \$50.8 million, or diluted earnings of \$0.43 and \$1.20 per share, compared with \$12.9 million and \$42.0 million, or diluted earnings of \$0.32 and \$1.08 per share, for the same periods of 2003. The increases of \$5.1 million and \$8.8 million, respectively, during the three and nine-month periods ended September 30, 2004 were due to the factors discussed above.

## **LIQUIDITY AND CAPITAL RESOURCES**

We have 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 decreased to \$311.7 million at September 30, 2004 from \$356.1 million at December 31, 2003.

Cash used in operating activities was \$23.4 million in the first nine months of 2004. The cash used in operations during the first nine months of 2004 consisted primarily of \$50.8 million of net income adjusted for \$20.4 million of depreciation and amortization, offset by \$50.6 million increase in accounts receivable and \$51.1 million increase in inventories. Working capital was \$540.2 million at September 30, 2004 and \$465.9 million at December 31, 2003. Our days sales outstanding of 46 days and our inventory turns of 6.4 times reflect the impact of the level of new program activities, mix changes, as well as the back end loading of the quarter demand by our customers.

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

Cash used in investing activities was \$5.0 million for the nine months ended September 30, 2004. Capital expenditures of \$9.4 million were primarily concentrated in manufacturing production equipment in Asia and the Americas to support our ongoing business and to expand certain existing manufacturing operations. Proceeds from the sale of property, plant and equipment of \$4.7 million include \$1.8 million from the sale of the Cork, Ireland facility in April 2004 and \$2.3 million from the sale of the East Kilbride, Scotland facility in August 2004.

Cash used in financing activities was \$16.8 million for the nine months ended September 30, 2004. During the first nine months of 2004, we made principal payments on our term loan of \$21.0 million which repaid the loan in full and received \$4.2 million from the exercise of stock options and the employee stock purchase plan. See Note 5 to the Condensed Consolidated Financial Statements.

We have a \$158.9 million revolving line of credit facility with a syndicate of commercial banks. We are entitled to borrow under the revolving credit facility up to the lesser of \$158.9 million or the sum of 75% of our eligible accounts receivable, 45% of our eligible inventories and 50% of our eligible fixed assets. Interest on the revolving credit facility and the term loan is payable

quarterly, at our option, at either the bank's Eurodollar rate plus 1.25% to 3.00% or its prime rate plus 0.00% to 1.75%, based upon our debt ratio as specified in the agreement. A commitment fee of 0.375% to 0.500% per annum on the unused portion of the revolving credit facility is payable quarterly in arrears. The revolving credit facility matures on December 30, 2004. We are currently in discussions with our lenders about the possibility of entering into a new credit facility at some time in the future. Given our current cash position, management believes the timing of entering into a new credit facility is flexible. As of September 30, 2004, we had no borrowings outstanding under the revolving credit facility, \$1.2 million outstanding letters of credit and \$157.7 million was available for future borrowings.

The revolving credit facility is secured by our domestic inventory and accounts receivable, 100% of the stock of our domestic subsidiaries, and 65% of the voting capital stock of each direct foreign subsidiary and substantially all of our and our domestic subsidiaries' other tangible and intangible assets. The revolving credit facility contain customary financial covenants as to working capital, interest coverage, debt leverage, fixed charges, and consolidated net worth, and restricts our ability to incur additional debt, pay dividends, sell assets and to merge or consolidate with other persons without the consent of the bank. At September 30, 2004, we were in compliance with all such restrictions.

Our Thailand subsidiary has a Credit Agreement with Thai Farmers Bank Public Company Limited and Bank of Ayudhya Public Company Limited (the Thai Credit Agreement). The Thai Credit Agreement provides that the lenders will make available to our Thailand subsidiary up to approximately \$53.5 million in revolving loans, term loans and machinery loans for a term of five years through September 2006. On April 1, 2003, our Thailand subsidiary repaid all amounts outstanding under the Thai Credit Agreement. The Thai Credit Agreement is secured by land, buildings and machinery in Thailand. In addition, the Thai Credit Agreement provides for approximately \$1.4 million (60.0 million Thai baht) in working capital availability. At September 30, 2004, our Thailand subsidiary had no working capital borrowings outstanding.

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

At September 30, 2004, we had cash and cash equivalents totaling \$311.7 million, total long-term debt of \$15 thousand and \$157.7 million available for borrowings under our revolving credit facility. We currently believe that during the next twelve months, our capital expenditures will be between \$40 and \$50 million, principally for machinery and equipment to support our ongoing business and expansion in Asia. Management believes that our existing cash 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 and any credit facility we may enter into in the future will enable us to meet future operating cash requirements in future years. Should we desire to consummate significant acquisition opportunities, our capital needs would increase and could possibly result in our need to increase available borrowings under our revolving credit facility or

access public or private debt and equity markets. There can be no assurance, however, that we would be successful in raising additional debt or equity on terms that we would consider acceptable.

## **RISK FACTORS**

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

A substantial percentage of our sales have been made to a small number of customers, and the loss of a major customer, if not replaced, would adversely affect us. During the first nine months of 2004, our two largest customers together represented 43.5% of our sales, with one customer accounting for 27.4% of our sales. Our future sales are dependent on the success of our customers, some of which operate in businesses associated with rapid technological change and consequent product obsolescence. As we ramp new programs and the new programs mature, we expect the percentage of sales to our two largest customers to decline. Developments adverse to our major customers or their products, or the failure of a major customer to pay for components or services, could have an adverse effect on us.

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

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

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

- the volume of customer orders relative to our capacity;
- customer introduction and market acceptance of new products;
- changes in demand for customer products;
- the timing of our expenditures in anticipation of future orders;
- our effectiveness in managing manufacturing processes;
- changes in cost and availability of labor and components;
- changes in our product mix;
- changes in economic conditions; and
- local factors and events that may affect our production volume, such as local holidays.

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

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

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

In cases where the evidence suggests a customer may not be able to satisfy its obligation to us, we set up reserves in an amount we determine appropriate for the perceived risk. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional receivable and inventory reserves may be required.

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

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

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

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

- computers and related products for business enterprises;
- medical devices;
- industrial control equipment;
- testing and instrumentation products; and
- telecommunication equipment.

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

**Long-term purchase commitments are unusual in our business and cancellations, reductions or delays in customer orders would affect our profitability.**

We do not typically obtain firm long-term purchase orders or commitments from our customers. Instead, we work closely with our customers to develop forecasts for future orders, which are not binding. Customers may cancel their orders, change production quantities from forecast volumes or delay production for a number of reasons beyond our control. Cancellations, reductions or delays by a significant customer or by a group of customers would have an adverse effect on us. As many of our costs and operating expenses are relatively fixed, a reduction in customer demand can disproportionately affect our gross margins and operating income. Our customers' products have life cycles of varying duration. In the ordinary course of business, production starts, increases, declines and stops in accordance with a product's life cycle. Should we fail to replace products reaching the end of their life cycles with new programs, or if there should be a substantial time difference between the loss of a product and the receipt of revenue from replacement production, our revenues could be adversely affected.

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

We compete against many providers of electronics manufacturing services. Certain of our competitors have substantially greater resources and more geographically diversified international

operations than we do. Our competitors include large independent manufacturers such as Celestica, Inc., Flextronics International Ltd., Jabil Circuit, Inc., Sanmina-SCI Corporation, Solectron Corporation and Venture Corporation Limited. We also face competition from the manufacturing operations of our current and future customers.

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

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

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

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

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

We currently operate outside the United States in Brazil, China, England, Ireland, Mexico, Singapore and Thailand. During the first nine months of 2004 and 2003, 30.1% and 26.6%, respectively, of our sales were from our international operations. These international operations may be subject to a number of risks, including:

- difficulties in staffing and managing foreign operations;
- political and economic instability;
- unexpected changes in regulatory requirements and laws;
- longer customer payment cycles and difficulty collecting accounts receivable;
- export duties, import controls and trade barriers (including quotas);
- governmental restrictions on the transfer of funds;
- burdens of complying with a wide variety of foreign laws and labor practices;
- fluctuations in currency exchange rates, which could affect component costs, local payroll, utility and other expenses; and
- inability to utilize net operating losses incurred by our foreign operations to reduce our U.S. income taxes.

In addition, several of the countries where we operate have emerging or developing economies, which may be subject to greater currency volatility, negative growth, high inflation, limited availability of foreign exchange and other risks. These factors may harm our results of

operations, and any measures that we may implement to reduce the effect of volatile currencies and other risks of our international operations may not be effective. In our experience, entry into new international markets requires considerable management time as well as start-up expenses for market development, hiring and establishing office facilities before any significant revenues are generated. As a result, initial operations in a new market may operate at low margins or may be unprofitable.

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

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

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

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

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

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

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

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

We have completed six acquisitions since July 1996. We may pursue additional acquisitions over time. These acquisitions involve risks, including:

- integration and management of the operations;
- retention of key personnel;
- integration of purchasing operations and information systems;
- retention of the customer base of acquired businesses;
- management of an increasingly larger and more geographically disparate business; and
- diversion of management's attention from other ongoing business concerns.

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

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

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

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

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

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

We have the ability to borrow approximately \$212.6 million under our Revolving Credit Facility and the Thai Credit Agreement. In addition, we could incur additional indebtedness in the future in the form of bank loans, notes or convertible securities. An increase in the level of our indebtedness, among other things, could:

- make it difficult for us to obtain any necessary financing in the future for other acquisitions, working capital, capital expenditures, debt service requirements or other purposes;
- limit our flexibility in planning for, or reacting to changes in, our business; and
- make us more vulnerable in the event of a downturn in our business.

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

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

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

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

**Our stock price is volatile.**

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

**We are exposed to interest rate fluctuations.**

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

**We are involved in legal proceedings related to the Avex acquisition and a patent infringement lawsuit. An unfavorable decision in any of these proceedings could have a material adverse effect on us.**

See Note 10 to the Condensed Consolidated Financial Statements for a description of these proceedings.

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

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

**If our independent auditors are unable to provide us with the attestation of the adequacy of our internal control over financial reporting as of December 31, 2004 and future year-ends as required by Section 404 of the Sarbanes-Oxley Act of 2002, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of your shares.**

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission adopted rules requiring public companies to include a report of management on the company's internal control over financial reporting in their annual reports on Form 10-K that contains an assessment by management of the effectiveness of the company's internal control over financial reporting. In addition, the public accounting firm auditing the company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal control over financial reporting. During the course of our review activities, the Company has identified certain internal control issues which management believes should be improved. The Company's review continues, but to date the Company has not identified any material weaknesses in its internal controls as defined by the Public Company Accounting Oversight Board. If our independent auditors interpret the Section 404 requirements and the related rules and regulations differently from us or if our independent auditors are not satisfied with our internal control over financial reporting or with the level at which it is documented, operated or reviewed, they may decline to attest to management's assessment or issue a qualified report. This could result in an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements, which could cause the market price of our shares to decline.

**Changes to financial accounting standards may affect our reported results of operations and could result in a decrease in the value of your shares.**

There has been an ongoing public debate as to whether employee stock option and employee stock purchase plan shares should be treated as a compensation expense and, if so, how to properly value such charges. The FASB recently published proposed amendments to financial accounting standards that would require that awards under such plans be treated as compensation expense using the fair value method. If we are required to record an expense for our stock-based compensation plans using the fair value method, we would incur significant compensation charges. Although we are currently not required to record any compensation expense using the fair value method in connection with option grants that have an exercise price at or above fair market value of our common stock and for shares issued under our employee stock purchase plan, if future laws and regulations require us to treat all stock-based compensation as a compensation expense using the fair value method our results of operations could be adversely affected.

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

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

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

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

- Foreign currency exchange risk;
- Import and export duties, taxes and regulatory changes;
- Inflationary economies or currencies; and
- Economic and political instability.

We do not use derivative financial instruments for speculative purposes. Our practice is to maintain a hedged position for certain significant transaction exposures. These exposures are primarily, but not limited to, vendor payments and inter-company balances in currencies other than the currency in which our foreign operation primarily generates and expends cash. Our international operations in some instances operate in a natural hedge because both operating expenses and a portion of sales are denominated in local currency. In the future, significant transactions involving our international operations may cause us to consider engaging in hedging transactions to attempt to mitigate our exposure to fluctuations in foreign exchange rates. As of September 30, 2004, we did not have any foreign currency hedges. Our sales are substantially denominated in U.S. dollars. Our primary foreign currency cash flows are generated in certain European countries and Brazil.

### **Item 4 – Controls and Procedures**

Our management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, 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 Chief Executive Officer and Chief Financial Officer 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 the Company in the reports filed or submitted by it 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 the Company in such reports is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

The Company is currently undergoing a comprehensive effort to comply with Section 404 of the Sarbanes-Oxley Act of 2002. Compliance is required for our year-end December 31, 2004. This effort includes documenting and testing of internal controls. During the course of our review activities, the Company has identified certain internal control issues which management believes should be improved. The Company's review continues, but to date the Company has not identified any material weaknesses in its internal controls as defined by the Public Company Accounting Oversight Board. The Company is nonetheless making improvements to its internal controls over financial reporting as a result of its review efforts. These planned improvements include additional information technology system controls, further formalization of policies and procedures, improved segregation of duties and additional monitoring controls.

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 the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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

## **PART II - OTHER INFORMATION**

### **Item 1 – Legal Proceedings**

Benchmark filed a lawsuit against J.M. Huber Corporation (the Seller) in the United States District Court for the Southern District of Texas for breach of contract, fraud and negligent misrepresentation on December 14, 1999 seeking an unspecified amount of damages in connection with the Amended and Restated Stock Purchase Agreement dated August 12, 1999 between the parties, whereby we acquired all of the stock of AVEX Electronics, Inc. from Seller. On January 5, 2000, Seller filed suit in the United States District Court for the Southern District of New York alleging that Benchmark failed to comply with certain obligations under the contract requiring us to register shares of our common stock issued to Seller as partial consideration for the acquisition. Seller's suit was consolidated with the Company's suit in the United States District Court for the Southern District of Texas (the Court). On January 29, 2004, we served our First Request for Production of Documents on the Seller. On April 8, 2004, the Court held a status conference with the parties. Following such status conference, the Court issued an order instructing the parties to engage in discovery. The parties submitted their most recent status report to the Court on August 30, 2004. Subsequently, the parties began negotiation of a release and settlement agreement disposing of all claims between the parties. On November 2, 2004, having been advised that a settlement had been reached in principle between the parties, the Court dismissed the case with prejudice, except that the parties may move for reinstatement by December 29, 2004, only because the approval of the settlement could not be obtained by the principals.

On April 14, 2000, Benchmark, along with numerous other companies, was named as a defendant in a lawsuit filed in the United States District Court for the District of Arizona by the Lemelson Medical, Education & Research Foundation (Lemelson). The lawsuit alleges that we have infringed certain of Lemelson's patents relating to machine vision and bar code technology utilized in machines Benchmark has purchased. On November 2, 2000, we filed an Answer, Affirmative Defenses, and a Motion to Stay based upon Declaratory Judgment Actions filed by Cognex and Symbol, manufacturers of the equipment at issue. On March 29, 2001, the Court granted the defendants' Motion to Stay and ordered that the lawsuit be stayed pending the entry of a final non-appealable judgment in the cases filed by Cognex and Symbol (the Symbol/Cognex case). On January 24, 2004, the trial court in the Symbol/Cognex case held that the Lemelson patents are invalid, unenforceable and were not infringed. On June 23, 2004, Lemelson filed a Notice of Appeal to the U.S. Court of Appeals for the Federal Circuit from the final judgment in the Symbol/Cognex case. Resolution of the appeal in the Symbol/Cognex case is estimated to take one to three years. Lemelson's lawsuit against Benchmark is stayed pending the final non-appealable judgment in the Symbol/Cognex case. We intend to vigorously defend against such claims and pursue all rights we have against third parties. At the present time, we are unable to reasonably estimate the possible loss, if any, associated with these matters.

Benchmark is also involved in various other 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 Benchmark's consolidated financial position or results of operations.

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

None

**Item 6 - Exhibits and Reports on Form 8-K**

(a) Exhibits.

- 31.1 Section 302 Certification of Chief Executive Officer
- 31.2 Section 302 Certification of Chief Financial Officer
- 32.1 Section 1350 Certification of Chief Executive Officer
- 32.2 Section 1350 Certification of Chief Financial Officer

(b) Reports on Form 8-K.

The Company filed the following Current Reports on Form 8-K during the quarter ended September 30, 2004:

Current Report on Form 8-K dated July 22, 2004 furnishing information relating to the Company's results for the second quarter 2004.

Current Report on Form 8-K dated September 16, 2004 announcing changes in executive officers effective September 13, 2004.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on November 8, 2004.

BENCHMARK ELECTRONICS, INC.  
(Registrant)

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

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

## EXHIBIT INDEX

**Exhibit  
Number**

**Description of Exhibit**

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