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Analyst, Needham & Company

Hello everyone. Our next presentation is SMTC. Presenters are Ed Smith, CEO; and Steve Waszak, CFO.

Edward Smith, President and Chief Executive Officer

Thank you. How's everybody this morning? Thank you for joining us. We think we have a pretty reasonable story to talk about in the EMS space. So, EMS standing for electronics manufacturing services. So, what we do? Our customers design products and then we build them. So, I'll talk about where we are, where we're going.

So, if you think about it overall, two and a half years ago, I came to SMTC, we were a \$130 million company, breakeven at best. Today, we're on the verge of \$400 million making a \$25 million plus of EBITDA. So, two and a half years, first year, we grew 50%; second year, we grew almost 50% again.

So, we've had two good years of growth in an industry that's not very well known for growth. We've been able to grow at rates much faster than our competitors. But as you'll see from here, growth isn't the only thing we look for. Profitability is important to us and how to become more profitable every day and giving our customer flexible service.

So, I'll walk you through how we got there. Then, I'll take questions at the end and we'll go from there.

[Slide 2] This is a forward-looking statement, so try to keep all of us out of trouble. So, I won't bore you with reading it to you, but we are a public company and so we are in a Microcap land as public company. So, let's hope we do good today and the stock goes up again.

It's been funny that actually the stock is I'm sure somebody will have a question for later. Last 30 days, the stock is up almost 50%. So, it's kind of been a good thing. And people ask me, why is it up 50%? And my answer is I couldn't tell you why it went down 50% and I can't tell you why it went up 50%. So, there was no real business reason why it went from \$4 to \$2. And there's no real business reason why it went from to back up to 4%. So, these are markets and sometimes these things happened. But lately, we've been on the uptrend, so that's good for us.

[Slide 3] But most important is we're a global mid-size provider of end-to-end EMS. So, we've been able to not only build boards, but we actually build boxes, bend metal, make cables. We have some factories that are pretty sophisticated.

We play in some markets that last year, were a little bit difficult. The semiconductor equipment market was very difficult for us last year. As you know, semiconductor, that market really had a negative year, that affected us.

But, we actually have had some positive markets. Test & Measurement. So, our IoT businesses in Test & Measurement. We had some customers win some pretty big IoT in the 5G space. Really, really drove our Test & Measurement business up and that will continue this year. So, we're pretty excited about that.

Our Aerospace & Defense, we showed last year, we went from \$0 million [in 2017] to \$17 million [during the first nine months of 2019]. We just announced last Friday that we won another \$31 million of defense contracts. That's pretty exciting for us considering that we started as a non-defense contractor. That's why we did buy [MC \[Assembly\]](#). It would expand our customer base and the types of customers. So, pretty significant business there.

A lot of people asked me after announcement last Friday, how quickly will that get up and running? And so in a defense space, it doesn't happen overnight. There's a lot of qualification, lot of pre-qual. They last a long time. Once you're in, you're not normally out unless you don't do a good job for a customer either in quality or in terms of on-time delivery. So, we expect to get follow-on orders to some of that defense business that we got. We think that's just a start, but we will start seeing revenue from that business in Q3 with full production up in Q4 of this year for the defense business we [announced last week](#).

The other question I get is we noted this in the press release that there's three customers. One customer is a predominance of that, that business and obviously, the other two customers are a little bit less. So, I think our Aerospace & Defense strategy is starting to get very successful. The pipeline is very robust. If we just close it a normal win rate under defense space, we will start hitting some of the targets I talked about a year ago on a defense space next year. And our ultimate goal is to be about 20% in the Aerospace & Defense, 20% in the medical, and then the rest spread out into what I call very highly regulated markets, very complex systems that we build.

You'll also see on this board, you can kind of see the path to both growth and the path to profitability. We went from being a company that was breakeven at best to making a little bit of

money at the scale of about \$200 million. Now, that we're at \$400 million, our scale actually helps us and we're starting to make what I would call world-class returns on EBITDA. So, it was pretty exciting.

I would tell you that when you start seeing EBITDA with a 7% or an 8% above it as a public company, I'll show you another slide, where we compare ourselves. To me, it's important to be the best at what you do. And really, the only measurement is our people willing to pay you for what you do a fair price and so you'll see this.

[Slide 4] On the bottom of this screen, you'll see how we've added the people as we needed them. We've done the acquisition. One of the nice things about the acquisition is we took our debt-to-leverage ratio; on the day of acquisition, it was over 4.0; today, we're under 3.0. So, we've continued to reduce the leverage in the company. And I know that was a concern for a lot of investors a year ago. It should be less of a concern and our goal is ultimately by the end of this year to have the debt-to-leverage ratio to be under 2.0 on the bank debt. So, I think it will continue to decline with the free cash flow.

Why would you invest in us? I think it's important to continue to invest in people that are growing faster than their market, more profitable than people in their market. People ask me why we're very different than other EMS providers our size? Why do we grow faster? Why are we more profitable? I want to tell you, it all happens to do with people. We have a great management team. We have a great team below that.

Our factory in Chihuahua, people talk about Mexico. I just had this deal at the night is kind of an interesting conversation. They said, hey, isn't quality in Mexico not as good in China? What about the turnover in Mexico? Our turnover in our Chihuahua plant is less than 3%. We've had that plant for more than 30 years. We have very little turnover and the quality output it up against any plant anywhere in the world in terms of quality. So, the fact that matters is, some of those misnomers are starting to get weeded out, but the reality is we don't have a lot of turnover at the very tactical level.

Our management team has been around; our manager, who runs Mexico, has been there 17 years. So, there's just not a lot of turnover and they have the time to do the things and do it right. We have local experience all over the world, both in the U.S. and in Mexico. Over 60% of our manufacturing is done in Mexico. So, this U.S. MCA people ask me the effect of it on us. It has very little effect financially, but it does have a stability effect in the whole country of Mexico. And so, the more stable Mexico is the better off things are for us.

We have a second plant in Mexico, in Zacatecas, and that one is in the middle of Mexico. And so that's a little bit of a different view of a plant. We don't build the sophisticated products there. But clearly, you have a town of about 8,000 people, our plant employs 1,300, you can kind of see the geographic mix of that. We employ most of the people in the town. And sometimes that can be a little bit challenging during the holidays, during different times a year, getting enough people to run that plant.

We're going to continue to have free cash flow. We announced last year that we would have in our 2020 plant, free cash flow over \$14 million plus. So, this will be the year of cash flow. Last year, we hit a lot of our cash up in restructuring through the integration and integration type costs. This year, we don't have those costs. So, this year should be a good free cash flow year and deleveraging year for us for sure.

[Slide 5] Any business that I would run or be in, if you're not trying to be the best, then why bother? Why waste the time? Why make the effort? And as you can see, if I were to put where we started to where we are, \$130 million to \$363 million, that's trailing 12. Q4 came in and move – we'll move that back up. Our [adjusted] gross profit being 12.1%. We show, as a public company, 9.59%, because we have amortization of intangibles from the acquisition, but that's all non-cash.

Our EBITDA, last quarter, was over 7%. We'll continue that trend and then net income excluding our China right down from closing China and moving it back to Mexico would have been 2.4%. So, we're either number one and number two in every category of the financials and we expect next year to be number one in every category.

[Slide 6] This is the leadership team. I want to spend you a lot of time here. Clearly, the one thing that makes it easier for us to get things done and move at a quicker pace as we've all worked with each other in many, many years. I don't think there's anybody in there that I haven't worked 20 plus years with. And so one of the things we were at dinner, we were joking about, joking around last night, and I don't know if it's really a joke, but somebody said, they've actually worked for you and with you in four different companies. Getting a leadership team to move four different times. He said what do you do with them to do that? And my answer is I don't think we'd get a job anywhere else. So, the reality is we're lucky that we keep getting the job somewhere, but great team. I would say best in the business. When you think about the size of our company, trying to put this type of leadership together is almost impossible.

If you look at Phil, he started at Apple and then went to Motorola. I hired him. And me and him together since 2004 have bought over a \$100 billion worth of electronic products. So, when we pick up the phone and say, hey, we need this part, or hey, you're late in this part, or we go to call CEO of Broadcom, I don't care who they are, we probably know them and say, hey, we need a favor. It changes the dynamic. Same for our customers. Our customers are amazed at some of the things we can do. I'll tell you one quick story with Phil. We had a customer, couldn't get a connector out of Germany, a German company. And he came in and said, hey, we're going to be late on this customer, I said, what are they missing? What subassembly they're missing? He said they're missing gold pins. I said where did they get them? He said they get them from TE Connectivity. So, anybody that knows that's the old Tyco.

And so I call the CEO of TE, and said, hey, can you do me a favor? Can you just take 100 of these pins and throw them into a sample bag and send them to the CEO of this company in Germany? Oh yeah, I can do that for you. We'll have that overnight and today, next thing I know our customers up and running and we get more business because guess what? They have the faith that we can get what we need to get done, done. So quite a team. Anybody knows Rich

Fitzgerald, ex-Marine. So, sometimes that's good. Sometimes, it's bad. Do you want to be his friend that's bad? If you want to work for him, it's probably good. But if we have a goal or a budget we almost always meet it. Rich is very focused on the business.

A little quick update on China. So, [we are closing China](#). We announced it last quarter and we're already moving our equipment to Mexico. I was over there last month, Steve is going over next month to do the final accounting stuff, and that might not seem like a monumental task. But if you think about where the Chinese are today, taking your equipment out and moving it to some other country for them to get the manufacturing is not the easiest task in the world. They'll find every reason for you not to get your equipment out. And we have been able to work through that and our equipments on its way to Mexico.

[Slide 7] We engage differently for our customers than most. We have a process to onboard, not only new customers, but new projects from our existing customers. So, the top is new customers. We had a medical company that needed FDA certification that would normally take about a year to get that type of customer up and running. We were able to do it in 68 days with FDA certification, registration, all the numbers, the bin numbers and all the things that they need, which to me, is just a monumental task, but our guys know what to do. They know how to bring the customer on board, they know how to get the supply chain in place, and then obviously, differentiate us in the marketplace.

New products. We do a lot of new products for our customers. Old products go away, new product start up. Sometimes, it's additional business, sometimes it's replacement business, but the reality is the faster you can get to a new product, the better your customer is in the marketplace. So, to us that's also a differentiator.

[slide 8] Global footprint. So, we are leaving some people in China for our supply chain to continue to buy parts of there. We buy a lot of plastic parts, a lot of metal, different manufactured parts in China. We are leaving a team behind to do that, that we also have a warehouse in Hong Kong to avoid tariffs and those types of things and to do logistics over in China. So, a lot of people know, hey, you're way out of the Chinese market. The reality is we still have people over there. It's like 12 people to do the buy.

In the U.S., our primary plants in the U.S. are San Jose, Fremont and Melbourne, Florida. Melbourne, Florida is our defense plant. That plant will go from being a \$50 million plant and my goal will be by end of next year to be a \$100 million plus plant. And so, you can imagine the growth we're going to see in the defense, aerospace business. They're in a place called Space Coast in Melbourne.

So, that's a positive or negative. If you want to go visit every defense contractor in the U.S. they are there, right by NASA. The negative is every defense contractor in the whole world is there. So, getting employees is becoming a challenge for all of us down there. That's probably the amount of jobs there has probably grown double-digit three years in a row. And so, their unemployment rates are very low. And so sometimes, we have to move people there. Especially, technical help down in Melbourne.

Boston, we do our NPI [or New Product Introduction]. So, we have an NPI center in Boston. We do medical work in Boston. And in San Jose, Fremont area, it's also another funny place. If you haven't been to San Jose or Fremont in the future, a place to go as fast as home prices going up. I mean, it's a place that we were once again, joking last night, I've rented an apartment there, it was \$12,000 a month and I was like, are you crazy? And you have these 2000 square foot homes that are going from \$1.4 million, \$1.3 million day-in, day-out. We are right on the same street as Tesla. So, you can imagine one mile away from Tesla. At the end of the quarter, they'd try to steal every employee we have. And at the first week of the next quarter; we get every single employee back. This is kind of a process they go through, but you only do that once or twice an our employees realize that they stay with us for a while there.

Then, we're in Chihuahua, Mexico and that place. I'll tell you what – I really liked the city of Chihuahua. If you walked out of a hotel, we stay either at Hilton or at the Courtyard, Marriott. If you walked out, you would think you were in the U.S. Starbucks on one side of the street, Buffalo Wild Wings, Chili's, whatever you need, it is right there. And then when you ask the person about Buffalo Wild Wings for something, you'd realize then you're in Mexico, because they have no clue what you're talking about. So, they feel, unless you speak Spanish, you could wind up with anything at Buffalo Wild Wings.

But it's a high-tech, aerospace, avionics city. They have two universities that focus on aerospace and avionics. They train a lot of engineers. We have no problem getting engineering talent there. They continue to grow. And so, it's pretty exciting plan for us. We have 17.5 acres in Chihuahua, we use about eight of them. So, there's a lot of talk about taking our Zacatecas plant, building another plant on there. We own all that acreage, building another plant and then moving Zacatecas up to Chihuahua. Today, that decision hasn't made, but there clearly is a thought of what we can do this way. We'll get out of the renting business down in Mexico.

And then we have Zacatecas. So, we have a nice building down there about 30 miles away as you leave the city of Zacatecas. You'll see the largest Corona plant in the world. And so, we compete with them for employees. But the reality is we're far enough away into the small city of Fresnillo that we actually have an employee base there.

And then we have Toronto, Canada. Toronto, Canada, those primarily are accounting some engineering function that was the headquarters of SMTC, continues to be the headquarters. A lot of people ask me why we don't change the headquarters. So, I won't bore you with the details, but we don't want to change audit firms. It's expensive. It takes a while to do. So, we continue to leave the official headquarters in Toronto, Canada.

And then El Paso; El Paso is our logistics center, coming out of Mexico and going into Mexico. So, we bring raw goods in through El Paso and we bring them back out through El Paso. And we're CTPAT [Customs Trade Partnership Against Terrorism] certified. So, our trucks don't get stopped at the border. We do our own customs work. We move it in. We move it out. And for many of our customers, we actually send to their end customers. They never even see the

product. We send it to their end customers, finished goods. We do that for both medical customers and non-medical customers out of El Paso.

[Slide 9] These are the type of products that we make. And so, if you look at this semiconductor equipment, you can see this machine. So, if you notice this little machine here, 6,000 different parts on it, we bend the metal. We build that from scratch. We do the top to bottom is all done internal in our factory in Mexico. So, if you think about it, if you would look at that, you wouldn't see that as a typical Tier 3 contract manufacturing, pretty sophisticated stuff there. You go down payment systems; we've been building payment system for multiple companies. For a while, we're an expert in the security and cyber security of payment systems in terms of loading firmware on credit card readers and those types of things. And so, we do a lot of payment systems. Aerospace & Defense is growing. So, I won't spend a lot of time there.

Test & Measurement, we are one of the best RF houses that I know of in terms of speed and RF communication. And so, we're doing a lot in the IoT, where people want to be able to communicate, secure and test out the communications. If you went to our plant in Melbourne, Florida, you would see we have our own phone system set up. So, we have our own network and we can test both satellite communications and non-satellite communications down there. We actually – if you've been on an airplane and you pull out your phone and you're hooked to a satellite communication, we probably built the communicator in the box in the airplane.

Medical and safety, we do a bunch of different things, medical and safety all the way from oxygen concentration machines to blood pressure testers to communication devices for hospitals.

And in the Industrial, Power and Clean Technology, it's pretty interesting, because it used to be a pretty boring space to be honest with you. You made a power supply, you made this, you made that. The fact that the matter is today, these things are smart technology, where they're relaying back how much power something's using. You go into a server form and it says, hey, this server's not using much power. The servers using more, get more power to this and they can actually lower the amount of power used in a server form by moving it around the thing. These are pretty smart sophisticated devices in what I would call pretty old technology and they've made them smart again. So, we build quite a bit of that.

And then we build some communication – network communication. If you look at that little white box up in the right corner, it actually is a satellite communication, satellite-to-ground communication and that type of stuff there. So, pretty diversified group of things, I would say people ask me what is the positive of this? We have no detrimental reliance on any one market and no detrimental reliance to any one customer. Our largest customers are 11% and then every customer beyond that is less than five.

And in the EMS space, you probably will find very few companies, if any that have that smaller detrimental reliance on one customer or one market space. So, when the semiconductor market space last year got hit, it didn't even – our sales didn't flatten out or go down and it actually just slowed our growth rate down. And so, to us, that's important that we have no detrimental reliance on a particular customer or market space.

[Slide 10] These are a little bit about the markets we serve numbers wise. As you can see, the Test & Measurement space is killing it, has all to do with 5G and the new IoT communications market. We've been first to market with our customer getting out into market. We'll win an award next month in terms of getting first to market in 5G networks.

Industrial, clean, power, as you can see, that's continuing to grow. That's all IoT. We enable our customers to be able to take a normal product and make it IoT or communication sensitive. Retail payments, I get a lot of questions of why that's down and my answer is now the chip cards are the norm. They've done a crossover in chip cards and this is more of just the same product just being built over and over. We saw a big influx when chip cards first came onto the market in the scene.

And then last but not least, I'll talk about the defense. You can see where it went from 0% to 2.3% to 6.0%, I am telling you in the next couple of years, that'll be \$100 million business for us. Anybody want to know why defense and aerospace is so important to us, that business is probably twice as profitable as our normal business. So obviously, it will continue to help us get more efficient and more profitable.

If you look down on the bottom, about all our certifications, once again, we have FDA, we have a CAGE code [The Commercial and Government Entity Code, or CAGE Code, is a unique identifier assigned to suppliers to various government or defense agencies, as well as to government agencies themselves and various organizations]. We can build products for any FDA medical customer already approved. We're approved by Apple. We're approved by many different organizations to build for them.

[Slide 11] And in the financial summary, I'll talk a little bit about long-term growth. Last year, we grew through acquisition 50% and then we grew organically 12% in the middle of the integration. This year, we plan to do better, but we still kept our long-term model at 15% to 20%.

Our gross margin, 12% to 14%, as you can see, we crossed over into the 12% range for trailing 12 in Q3. Our adjusted EBIDTA, 5% to 10% and as you can see by the first slide, I showed earlier today, we're right in the middle of that range. I continue to think we'll get better and better in that range. As we go here.

So, if you look into Q3 numbers, we did \$93 million. [Adjusted] Gross margin 12.1%, EBITDA margin 7.1%. So, for an EMS company, those numbers are, I would line them up against almost the EMS guys. If you look at 2017, \$139 million going to \$216 million and then \$216 million going to almost \$400 million. So, we are both a growth story and a profit, an efficiency story.

You can kind of look at the market capitalization. We have net debt as of the end of September of \$70 million of bank loans. Then, we had lease obligations of \$14 million. Those are real estate leases predominantly. So, with the new accounting standard, we obviously have to show the leases, but I'd separate them out, because of just accounting.

And then as you can see, our stock price \$3.55 as of the 10th [of January] and as of the last night, it was \$3.80. So, you can see we have an uptrend in the stock price. The other nice thing about the – Steve would not say this, but I will, is now that the stock price has been where it is. For that long, we now are under the new SOX rules, where we have to have implemented SOX, because once your market capitalization is over \$75 million, you have to implement SOX fully. So, I like it, Steve don't particularly care for all the extra work. He now has to do.

[Slide 12] Balance sheet. So, this is where we do have some work to do here. Our cash-to-cash conversion is 78 days. Just before the acquisition, we had cash-to-cash conversion at 58 days. As you can imagine, 20 days of cash is a lot of money. And so, we need to get work. Our operations guys need to get our inventory turns back up to six. We had them up to six a year and a half ago. Now, they're down before 4.2. So, we have some work to do on inventory turns there for sure. We took out last year on the balance sheet. We took out our Term B loan. And so, we only have a Term A and ABL any longer.

As you can see in the EMS space in terms of current assets and that we have lots of current assets, a lot of receivables, a lot of inventory as well as the way our market plays and then obviously, the current liabilities. So, kind of take a look at that.

[Slide 13] Ultimately, we're looking to build a stronger company. We want to be world-class. We want to be flexible for our customers. We measure, I could pull out my phone and look at we measure every day on our phones, how we're doing on-time delivery, quality and our NPS for our customers. And when there's something that goes wrong, as Steve knows and our operations knows, I will get on a plane and go and work on it. So, our customers have come to expect that from us and we do deliver it.

So, with that, I'd like to thank you for your time. I'll take any questions that you may have on how things go.

Q&A *[Please note the conference provider did not have microphones for the audience asking questions which caused the questions to be inaudible and not transcribed.]*

<Q>: [Question Inaudible]

<A – Ed Smith>: Jump on, it's an interesting word.

<Q>: [Question Inaudible]

<A – Ed Smith>: It would have to be a very compelling acquisition for us to do it at this point. So, the question he asked is if there was an acquisition that jumped up in the next month, would we do it? It would have to be a very compelling acquisition for us to pull the trigger. So...

<Q>: [Question Inaudible]

<A – Ed Smith>: What's CEO doesn't say that if they go forward with it. So, I look at them, so some come across my desk all the time. There hasn't been any that I say, hey, I wouldn't mind going back up to four times. So, we have really good organic growth going right now. I'm not sure that I wouldn't – organic growth way more profitable than M&A growth. I'm not so sure that I would put my money right now into M&A, where I can get it organically. So – but there are compelling ones out there sometimes. And if that came, we'd take a look, but I don't – I just don't see it right this moment.

<Q>: [Question Inaudible]

<A – Ed Smith>: All new customers, new customers, new programs. [That's why we put the announcement out](#), because it was more than 5% of our total. It was 7.7% of our total, total business for the year. I thought it was necessary for people to know new customers, new programs, if it was existing customers and existing extension, I probably wouldn't have put the...

<Q>: [Question Inaudible]

<A – Ed Smith>: We leased Fremont. We are in the process of renewing Fremont of our lease and you want to talk about renting apartment for \$12,000. Think about a building. So, it's kind of crazy.

<Q>: [Question Inaudible]

<A – Ed Smith>: Yeah. So, we feel pretty confident. So, question was with the \$31 million, do we feel pretty booked for 2020, that when you go into a year, you always have so much of a hole that you say, hey, we got to win this business, got to do this. We plan it by customer, by project. We have meetings about a week with our sales team and our operations team in Florida this closes the hole that we had for the year, plus probably a little bit, but I would say we feel very comfortable with the 2020 numbers right now. But we have a pipeline that could be pretty strong going to the end of the year. I think somebody else had a question back there. No?

Alright, well I appreciate you. I appreciate the support. Appreciate everybody's time. You guys have a great day in the restaurant. Great conference.