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**SMTC Corporation. (SMTX)
Q1 2017 Earnings Conference Call
May 17, 2017, 08:30 AM ET**

Executives

Blair McInnis - Corporate Controller
Eddie Smith - President and CEO
Roger Dunfield - CFO

Analysts

Steve Cole - Mangrove

Presentation

Operator

Good day, ladies and gentlemen and welcome to the SMTC First Quarter 2017 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference Mr. Blair McInnis, Corporate Controller. Sir, you may begin.

Blair McInnis

Thank you, Channel. Before we begin the call, I just like to remind everybody that the presentation includes statements about expected future events and financial results that are forward-looking in nature and subject to risks and uncertainties. The company cautions that actual performance will be affected by a number of factors, many of which are beyond the company's control and that future events and results may vary substantially from what the company currently foresees. Discussion of the various factors that may affect future results is contained in the Company's Annual Report on Form 10-K, on Form 10-Q and subsequent reports on Form 8-K and other filings with the Securities and Exchange Commission.

I will now pass the call over to Eddie Smith.

Eddie Smith

Thanks, Blair. Welcome and good morning ladies and gentlemen. I'm Eddie Smith, SMTC's newly appointed President and Chief Executive Officer. On this call with me today is Roger Dunfield, SMTC's Chief Financial Officer.

As many of you have seen in yesterday's press release we had a challenging quarter. Based on our revenue levels, our cost and overall were aligned. As such, we have developed a detailed strategic plan and initiated a global restructuring plan to better align our cost

structure with our current operating levels. Not only is this a cost reduction effort but this is a reorganization of the structure of the company and the way we intend to operate in the future.

The company is reorganizing its internal corporate level operations under three areas; operations, sales and then finance and administration. The company will assign responsibilities of these functions such as coding and supply chain management through our manufacturing facilities and further develop a direct line of communication for our customers through our factory leaders. We believe this new structure will better serve our customers ever-changing needs will allow us to be more flexible and responsive to those needs.

These functions will openly fall under operations and responsibility of the newly established Chief Operating Officer's position. I'd like to take an opportunity to welcome Rich Fitzgerald to SMTC as the company's new Chief Operating Officer. This is a new position created as part of the global restructuring plan. Rich will be responsible for three manufacturing facilities in Chihuahua Mexico, Dongguan China and Fremont California in addition to the Engineering and Supply Chain groups.

I have worked closely with Rich in the past and known to be a proven successful business leader. With this addition, we will focus on driving improved quality at our factories and continue to focus on achieving manufacturing efficiencies and supply chain cost reductions.

In addition, we have evaluated our strategy in Asia in relation to the current two facilities we operate in Dongguan and Suzhou, China. In order to reduce cost, improve efficiencies and better align with target markets, we are consolidating our operations in Asia resulting in a closure of the Suzhou facility.

As a result of this decision, the closure of Suzhou we'll be transferring customers in order to service them with existing capacity in our other manufacturing facilities. The wind down and closure of the Suzhou facility is expected to be substantially complete by the end of the second quarter.

The company is committed to successfully executing the strategic plan but just as important is the requirement to grow revenue. I will immediately be responsible for the sales organization which will be my primary focus. In addition to targeting new customers, we believe there are many opportunities to expand sales with our current customer base which can accelerate the timeline to revenue growth. We are also engaging with several Manufacturing Representative firms in different regions, which represents a new sales channel to accelerate growth with limited up front fixed costs.

Our goal is to have high quality Manufacturing Representatives signed in the near term. As a former board member of the Eisai, I have strong relationships with numerous manufacturing representatives and I'm confident we will achieve this goal.

I will now hand over to Roger to review the financial details. Roger.

Roger Dunfield

Thanks, Eddie. Revenue for the first quarter was \$33.2 million with adjusted EBITDA of negative \$0.3 million and a net loss of \$0.4 million compared to revenue in the first quarter of 2016 of \$41.9 million with adjusted EBITDA of \$1.4 million and net income of \$1 million.

Gross profit for the first quarter was \$3.6 million or 10.7% compared to \$4.9 million or 11.6% in the first quarter of 2016.

Adjusted gross profit, which excludes the effects of the unrealized portion of foreign exchange gains and losses on unsettled derivative financial instruments, was \$2.3 million or 6.9% compared to \$3.8 million or 9.1% in the first quarter of the prior year.

Debt net of cash was \$11.2 million an increase from the \$4.9 million from the year ended 2016. Typically we experience some seasonality in Q1 which was especially pronounced in the first quarter of 2017. Some customers delayed accepting product and as a result the timing of shipments negatively impacted revenue and our cash flow increasing working capital levels at the end of the quarter which resulted in higher debt net of cash.

Moreover, we were not able to adjust our cost structure within the quarter resulting in reduced margins and lower EBITDA than expected. The global restructuring plan discussed by Ed is expected to generate expense reductions for the remainder of 2017 of approximately \$3 million and annualized expense reductions thereafter of approximately \$5 million.

The global restructuring plan impacts our manufacturing facilities and our corporate level operations resulting in headcount reductions of approximately 210 employees. This plan includes the closure and wind down of our Suzhou facility in China which is expected to be substantially completed by the end of the second quarter in 2017.

We expect total restructuring charges to be approximately \$1.7 million of which \$1.6 million is cash payments for severance and \$0.1 million in equipment transfer and to put disposal costs. These charges will be recorded in the second quarter of 2017.

We have confidence that our plan will set the company in the right direction and appreciate the support from our bank PNC with the execution of the 12th amendment to our revolving credit and security agreement.

I will now hand the call back to Eddie to provide some closing remarks.

Eddie Smith

Thanks, Roger. The Company is starting a new phase in its history and I truly believe we are on a new path which better aligns our structure with the size of our company and positions us for topline growth which will more effectively utilize our resources to serve our customers.

I have enthusiastically accepted the appointment as President, CEO and I intend to purchase SMTC stock during the open window for insiders, which will commence early next week. I believe, we have put a strategic plan in place that will increase shareholder value. Finally, I ask that our employees customers and other stakeholders continue to put their trust in SMTC.

This is a transition period for us but I truly believe we have taken less historic steps to become a leaner, more efficient and a flexible company that will openly better serve and respond to our changing customer base.

We will now open the lines for questions. Thank you.

Question-and-Answer Session

Operator

[Operator Instructions] And our first question comes from the line of Steve Cole of Mangrove. Your line is now open.

Q - Steve Cole

Good morning, thanks for having the call. I wanted to talk about a few things, Eddie congratulations on your appointment as Permanent CEO. We are happy you are accepting the job. Could you maybe I guess I'm a little confused maybe a little bit on the run rate now, right. So we dropped -- if we kind of look back over a couple of years, the company has dropped from essentially the high 50s to 60s down to 33 this quarter, and I know on the press release you alluded somebody kind of pushing one of the customers pushing not accepting products or having but are we at the low point now? Number one, number two, what comfort do we have kind of in the pipeline and some of these initiatives that you are working like the manufacturers' dress obviously that takes a little bit of time, doesn't it and what do we do to drive revenues near term, because I'm sure, I don't need to -- and the big challenge with us think for some number of years is getting revenues up on a sustainable level.

A - Eddie Smith

Yes, so first of all good morning Steve, thanks for joining us. The revenue is the key number one thing here, right. This is not a overnight issue, this issue has been going on for a while if you look back to the history. And so, I don't think that can be solved overnight either. It wasn't created overnight and it can't be solved overnight. But I think those are two pronged approach. Right, one is to go to our existing customers and I've spent a lot of hours with our existing customers because I think that's the quickest way to get revenue to start heading back up and heading north.

Getting our existing customers to believe in us and give us more business instead of giving us less business, which has been the trend. So, I think first step is getting our existing customers to give us more business and then the second is what you pointed out is getting the manufacturers or reps and getting the right manufacturers and reps.

I will tell you one of the advantages I have is that I've been first of all in the industry for a while, and [second of all] I've been on the board and actually even the Chairman elect of the industry. So I'd know most of the reps, and I know their territories. And so I believe these six or seven reps which wanted to already signed and I expect by the end of the week most of them will be signed. I think these are the right reps, I'm already going to go out and visit some new customers next week. I'm going to [Indiscernible] very active and that's why I've brought a COO in. I'm going to take a very active role in the sales organization. I think, no

we haven't had a real good structure in the sales organization. So I think changing it can only be for the better.

So, I think I would say it's two [pronged] approach, get our existing customers to give us more which I think is the quickest way to as you would say make sure we get off the bottom and start moving it up and the second is then start adding new customers.

Q - Steve Cole

And what type of visibility do you have Eddie, as you look and -- now and then number two, kind of where is the leverage and the model, I know you talked about taking out \$3 million for the balance of the year and \$5 million on a go-forward basis. What does that do to your breakeven level now number one, and what does it do on the upside right as we start to [crack] through that level what is the incremental margin like....

A - Eddie Smith

Yes, so those are big questions, ones that we've had to spend some real time answering. So one of the things that I did in the restructuring is take what I would call more realistic approach in terms of when we looked at what is our revenue going forward, I took only revenue from customers that we either had a PO or forecast or some type of hard demand from the customer. So as we did the restructuring the costs, we said to ourselves, hey, let's stop saying we could get this, this could happen and say what will happen.

So I think what we have our expenses to a level that's more realistic to what our go-forward is, let's say that's the first part of it. The second part of it is on the leverage side of it, I think the leverage is pretty significant and I don't want to quote future numbers, but I would say that for every dollar of gross profit a significant portion of that will drop to the bottom line.

We have leveraged that as really pretty incredible now at the closing of Suzhou we really have aligned the company so that greater than 50% of our additional gross profit will drop to the bottom line as we grow.

Q - Steve Cole

And I guess one question as I heard you are mentioning that you will be buying stock in the open window and I would say we always encourage the shareholders that we have management interest in line with ours, and [Indiscernible] shareholder well, how do you see obviously you came from a big company and then I see you are CEO of it as well, maybe you can address kind of what you've seen since you've come here already and whether it gives you some progress, so I presume you put some -- for accepting that a permanent role, what gives you the comfort why you'd want to do this [Indiscernible]

A - Eddie Smith

So Steve my history is I was with a big company and then I was the CEO of a company called SMTEK which was very similar to SMTC. Smaller company, declining revenue in the EMS space, with good employees, pretty good customers, so very similar situation to be honest with you. And in that particular case we're able to successfully turn the company

around increased shareholder value is probably one of the better stories I would assume for that year, stock going from below a \$1 to over \$15 in terms of sales in 2.5 year.

Rich, the [COO] was also involved in that. So I would say, I've been through this crisis type management before and turnaround, so I don't -- it doesn't scare me. And so, I'm not -- I wasn't concerned about that. My wife has a different story. She loved me to be home. So, but the answer is, I think we have good employees. We have a great footprint. We have really some pretty good customers. And if we can get those customers that had some more belief in us and add business that they currently have available, I think it's a good start.

So, I actually think the core to start-off and build off is pretty exciting. And so, when I got here and I started looking around and say, hey, we have good employees. We have good factories. We have good customer. It gave me a lot of encouragement to say, hey, with some good leadership, some good operational leadership, some good sales leadership I think there's a story here. None of this happens overnight, right.

I love this quarter to be a little bit better, but unfortunately once I got here in February the quarter was already half way through. So, some of that stuff that happen at the end of the quarter I think if there was more time and I had more time here I probably could have work with the customer more and pick some of the stuff. So I think going forward, I feel pretty good. I wouldn't have expected the job, but I didn't believe that we could have a positive outcome at the end of it.

But none of this happens in one quarter, as you've actually alluded to. Adding customers in the EMS space, landing them to take some amount of time of on-boarding them and doing that. So, what I'll try to do in the future calls is try to give you an idea of where we are, with how many new customers we've landed and then it's time to revenue at that point.
[Indiscernible]

Q - Steve Cole

Yes. That's fine. I appreciate the answer. It's not pop out of the queue and kind of let somebody else to kick-in. Thank you, Ed.

A - Eddie Smith

You're welcome. Thanks Steve.

Operator

Thank you. And our next question comes from the line of Craig [Indiscernible].

A - Eddie Smith

Good morning, Craig.

Q - Unidentified Analyst

Ed, how are you doing? I guess I had a question on the last call, you had said, you might have more information on at this time. And I was wondering about the potential of a contract with the defense type industry, a military stock contract you'd mentioned that, that was something that brought up and then even earlier conference call. And I guess related to that are there any other potential new contracts that are possibly in the pipeline that you might to elaborate on?

A - Eddie Smith

So, there are new customers that were doing what we call NPI or New Product Introduction. So the process is you land the contract with somebody then you do qualifications, so make sure you can build their product. Then you do what they call new product introduction and then normally they have to go to market and test their market and then we get into production, based on buyings they think are necessary.

So, we do have some customers. I hate to speculate what the revenue will be from those customers, but we do have at least two customers that can have some significant impact on our business going forward that are in the NPI stage. So once again I don't think anything is overnight, but clearly its better than having no customers in the NPI stage.

Q - Unidentified Analyst

Okay. And I guess related to what you were also talking about with these cost-cutting measures. Do you see them getting us at least to a breakeven stage here in the coming quarter? I know this quarter I was able to do the math here as what we loss per share and it seems to be little over \$0.0250 of share just under \$0.03 a share, and I'm wondering do you see these cost cutting measures at least getting us to a breakeven stage in the coming quarter?

A - Eddie Smith

I think the cost-cutting stages really have two-pronged approach. One is clearly short-term that try to either elevate the loss or get it closer to the breakeven or to the small profit. And obviously to answer that directly would be given you guidance which I'll won't do. But it will clearly help the situation in where we are, Craig.

The second part of that long-term is as we add some of these new contracts and I move through the qualification NPI production. As they move through the breakeven point and the drop-through will be greater. And so clearly have a greater drop-through and a quicker path to profitability is really we're attempting to do. So, I think the drop-through would be significant greater than it had been in the past on the growth side.

Q - Unidentified Analyst

Okay. That sounds good. I guess one other brief question, I don't know if you had liberty to answer this or not. Have you really thought about how many shares you might be buying on the open market? Just some rough idea, I guess, would that be something that's probably not able to be divulged?

A - Eddie Smith

You answered your own question. I'd rather divulged it, but at this point I'm not allowed to do that, but the Form Four will tell the story once they're filed.

Q - Unidentified Analyst

That would be once you'd have done it, you mean.

A - Eddie Smith

Yes.

Q - Unidentified Analyst

I see, okay. I'm feeling great to know that you're investing. That's a good sign. Okay. Thanks a lot.

A - Eddie Smith

Well, thank you Craig. Thanks for joining us.

Operator

Thank you. And I'm showing a follow-up question from the line Steve Cole of Mangrove. Your line is now open.

Q - Steve Cole

Yes. Thanks guys, I just have a follow-up. I am curious for Rich's decision. I noticed that if you look at Avnet just a pretty decent walk through May, I think he has obviously had a pretty good history with them. I take up the attraction for this opportunity is to make some money is the respond [Indiscernible] but may you can shed some insights and how you're able to move them from there to take the job as CEO here, obviously how to be a personal relation, number one and I presume number two, the opportunity as we perceives as well?

A - Eddie Smith

So, I think, you hit the nail on the head in the question. Avnet gone through its own CEO change and some management change, and I think clearly things have changed and I think Rich at some point, we had already done – Rich has been both the customer for me early in the periods and we work together both at SMTEK, small company and then obvious at Avnet. And I think we saw what was going on here, saw what was going on where he was and saw the opportunity in one is doing, other one is these turnarounds.

So I think he's very excited. I spoke to him last night late. He's in Europe. Today otherwise he would have joined our call. But he was very excited last night. So I'm excited to have it. He is one of the best operations right now. Bringing him on will give me the opportunity to

spend more time in front of our customers which I think SMTC needs to have their executives more in front of their customers.

Q - Steve Cole

Okay. And last question, I guess, Eddie, I'm just curious, when you look at the macro picture format, on your term SMTEK and it obviously had over the number of years the Tier, 1, Tier 2 phase, I don't if its changed or kind of how would you consider the market environment today for Tier 2, Tier 3 suppliers versus what have might have done let's say five or ten years ago, and how does that macro environment change or doesn't change, you view on how [Indiscernible]. It obviously you were successful as you pointed out on turning the other business so quickly. Are those ingredients here to do the same thing given the current macro environment and how do you characterize that?

A - Eddie Smith

Yes. Everyone of our – you see the best way to kind of say is, the macro environment always going to require in the market place. Tier 2, Tier 3 contract manufacturers, and what we need to do I think going forward is look like a Tier 2, Tier 3 and act like one, be a little more flexible in terms of flexibility to our customers. We have the footprint of a Tier 2 and we need to get our capability of Tier 2, Tier 3 and so actually think there's a good opportunity long term for us to kind of turnaround this top line and get people to believe in us, some customers to come our way.

I've had lot of very positive conversations with both customers previously we've dealt with and potential new customers, and it's been pretty positive. I can say that there's really been a lot of negative. So I think the customer think is the number one thing we need to solve and we're going to go, I'm going to go spend a lot of very direct time solving it, but none of it is overnight as you know.

Q - Steve Cole

Yes. Certainly I appreciate it Eddie. Thanks again for the time.

A - Eddie Smith

Thank you.

Operator

Thank you. [Operator Instructions] Our next question comes from the line of Craig [Indiscernible]. Your line is now open.

Q - Unidentified Analyst

So I just want to go back briefly to my first question on potential new contracts and it's definitely related to that. I know the previous CEO had some potential new contracts that we thought were going to go through and unfortunately they never did I don't know if new customer is the way to where that seems to me one of them definitely was a new customer.

I can't think of the name of that company, but something related to the communications industry and that unfortunately would have been a big contract if we could have landed it and we never did. But, are you in touch with any of these potential new customers that he was trying to land and stuff that maybe fell through or other things that he was working on and if you can shed any light on those possibilities if any of those [Indiscernible]?

A - Eddie Smith

Yes. So, any of the customers that we're recording or that we had been calling on, we've gone through that pipeline, and I'm not sure exactly which ones you're referring to. We've then added some new customers to our pipeline. I visited a pretty significant customer the other day which we're now on the call state with, but I'm not only the one to talk about a contract to we're actually starting to build for customer, because in our industry until we actually start building in production all we have is lot of verbal commitments and until we have some hard commitments, so I probably won't comment on these calls about them. So we're chasing, Craig everything that was in the pipeline and we'll continue to chase it.

Q - Unidentified Analyst

So that would include some things that fell through with the old CEO that he was trying not to land, it looked like we had a couple of big new hits and they didn't go through for us and I guess that's kind of what I was thinking about directly. I don't know if that contributed to his demise or anything like that. I just wasn't sure if we were able to land any of these previous contexts or if we had any good prospects with them?

A - Eddie Smith

Yes. I've been more happy to – I'll take a second look at the pipeline even though we spend a pretty extensive amount of time, but now that you say that I'll try to go back and figure out what those were and who they were.

Q - Unidentified Analyst

Pretty clear, I wish that could be helpful on the names I just cannot recall them. [Indiscernible] call the name?

A - Eddie Smith

I'll go back and read the transcripts and see if there's a name in it. And then I'll go back and ask some of the people here what he is referring to.

Q - Unidentified Analyst

Okay. Sounds good. Thanks.

A - Eddie Smith

Thank you.

End of Q&A**Operator**

Thank you. I'm showing no further questions on the lines now.

Eddie Smith

Okay. Thank you all for joining the call and for your continued support of our company, SMPC. We expect our next earnings call to take place in August. So I look forward to seeing you all there. Thanks again for your time and effort and your support. You have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This conclude today's program and you may all disconnect. Everyone, have a great day.