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SMTX - Q4 2019 SMTC Corp Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the SMTC Corporation Fourth Quarter and Full Year 2019 Results Conference Call. (Operator Instructions)

Please note, this event is being recorded. I would now like to turn the conference over to Blair McInnis, VP Finance. Please go ahead.

Blair McInnis - *SMTC Corporation - VP of Finance & Corporate Controller*

Thank you. Before we begin the call, I'd like to remind everybody that the presentation will include statements about expected future events, 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, Form 10-Q and subsequent reports on Form 8-K and other filings with the Securities and Exchange Commission.

All forward-looking statements are made as of the date of this call, and except as required by law, we do not intend to update this information. The conference call will also be available for audio replay in the Investor Relations section of SMTC's website at www.smtc.com.

I will now pass the call over to Eddie Smith, SMTC's President and Chief Executive Officer.

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Thank you, Blair. Welcome, and good morning, ladies and gentlemen. I'm Eddie Smith, SMTC's President and Chief Executive Officer. On this call with me today is Rich Fitzgerald, our Chief Operating Officer; and Steve Waszak, SMTC's Chief Financial Officer.

I'm pleased to report that we made significant progress in 2019 building a stronger company that positions SMTC for long-term success. We expanded our customer base, including new business in several attractive, highly regulated, high-growth markets. Through a number of initiatives, we improved our operational efficiencies to achieve best-of-breed margins that our industry can support. We successfully integrated MC Assembly within a year of the acquisition. We have completed closing down our Chinese manufacturing operations in Dongguan, and we strengthened our balance sheet with numerous steps taken to reduce indebtedness and improve our terms.

Strong execution by the team resulted in an increase in our revenue to \$373 million for the year, which was up 72% over reported 2018 revenues, and also up 8% on a pro forma basis, which assumes MC Assembly have been part of SMTC for all of 2018. Our successful integration of MC Assembly



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resulted in higher economies of scale, which can be seen at the bottom line, as the increases in our adjusted net income and EBITDA metrics outpaced our revenue growth.

Our revenue growth, combined with focus on operational efficiency, resulted in a best-in-class fourth quarter adjusted EBITDA of 7.7% on revenues. And our full year adjusted net income increased by 162% to \$6.9 million.

I will now turn over the call to Steve, who will review the fourth quarter and full year numbers in more detail; and provide our 2020 guidance. After Steve's review and comments, I will come back and share some further thoughts about the state of the business, our markets and our opportunities before we open the call to questions. Steve?

Steven M. Waszak - SMTC Corporation - CFO and Senior VP of Mergers & Acquisitions

Thank you, Eddie. Good morning, everyone, and thank you for taking time to join us on this week.

First, let me clarify some terminology I'll be using to discuss our financial results. I'll be referencing numbers for 2019, which includes combined SMTC and MC Assembly's results. 2018 year-to-date, which includes as previously reported GAAP numbers by SMTC, which as a reminder, includes SMTC Assembly from acquisition date of November 9, 2018. And finally, you will hear a pro forma which -- this includes SMTC and MC Assembly, assuming MC was part of SMTC for the entire year of 2018. Finally, I will also be referencing certain non-GAAP numbers, including adjusted gross margin, adjusted net income and adjusted EBITDA. Please refer to the press release we issued yesterday for a reconciliation between GAAP and the adjusted results as well as any pro forma numbers we reference on today's call.

With that, let me proceed to the numbers. Our revenue in the fourth quarter 2019 was \$90.2 million, up 11.6% compared to \$80.9 million as previously reported in the fourth quarter of 2018. On a pro forma basis, our revenues decreased 8.6% in Q4 '19 compared with the fourth quarter of 2018. During the fourth quarter of 2019, we had one [10%+] (corrected by company after the call) customer.

For the full year, revenue was \$372.5 million, which represented, as Eddie said, a year-over-year increase of 72.4%. On a pro forma basis, revenues increased 8% over 2018. Included in our earnings release is a table that breaks down our sales by industry sector. This table shows our revenue growth in 2019 was driven by sales to our test and measurement customers, which were up 159% or \$72.8 million from \$45.8 million a year ago, followed by revenue growth in our power and clean technology businesses which increased by 174% or \$49.1 million from \$28.3 million in 2018. Our avionics, aerospace and defense business, revenue increased by 384%, or \$19.6 million from \$5.1 million in 2018. And then lastly, our medical revenues increased by 44.9% from \$14.1 million from \$31.1 million in 2018.

Our GAAP gross profit for the fourth quarter of 2019 was \$10.5 million or 11.6% of revenue, up from \$8.3 million or 10.3% of revenue in 2018. Our Q4 2019 adjusted gross profit was \$12.2 million or 13.5% of revenue, which excludes non-cash \$1.7 million of amortization of intangibles recorded in connection with our acquisition of MC Assemblies. In comparison to Q4 2018, adjusted gross profit was \$9.3 million or 11.6% of revenue. This year-over-year increase in gross profit was primarily due to improved efficiencies and product mix.

For the full year, our GAAP gross profit was \$37 million or 9.9% of revenue compared to \$21.7 million or 10% of revenue in 2018. Our 2019 adjusted gross profit was \$44.2 million or 11.9% of revenues, up from \$22.4 million or 10% of revenues in 2018. On a pro forma basis in 2018, our gross profit was \$28.8 million or 8.3% of revenues, and our pro forma adjusted gross profit was \$35.8 million and 10.4% of revenues.

Selling, general and administrative expenses for the fourth quarter of 2019 was \$7.1 million, down from \$7.2 million reported in the fourth quarter a year ago. As a percent of revenues, SG&A expenses decreased to 7.9% in Q4 '19 from 8.9% in the fourth quarter a year ago. SG&A on a pro forma basis in Q4 '18 was \$9.9 million or 10% of revenues. SG&A was \$27 million or 7.3% of revenues for the full year of '19. In comparison, SG&A in 2018 was \$18.1 million or 8.4% of revenues. And on a pro forma basis, SG&A was \$28.3 million or 8.2% of revenues into 2018.

We reported a GAAP net income of \$1 million in the fourth quarter of 2019 and adjusted net income of \$2.9 million. In comparison, the company reported a net loss of \$1.2 million in the same period a year ago.



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For the full year, we reported a GAAP net loss of \$6 million or \$0.23 -- or negative \$0.23 a share, which included restructuring charges of \$8 million, primarily related to the closure of China manufacturing operations; and \$7.2 million related to the amortization of intangibles related to our acquisition of MC Assemblies. In comparison, we recorded a GAAP net loss of \$0.5 million a year ago.

Our adjusted net income in 2019 was \$6.9 million or \$0.25 a share, which was a significant improvement compared to the \$2.6 million in 2018 in a pro forma adjusted net loss of \$183,000. Adjusted EBITDA in Q4 2019 increased to \$7 million or 7.7% of revenues, as Ed reported, from \$5.3 million or 6.6% of revenues and \$6.5 million or 6.6% of revenues on a pro forma basis compared to the fourth quarter a year ago.

For the full year, adjusted EBITDA improved to \$24.8 million or 6.7% of revenues from \$10.2 million or 4.7% of revenues. On a pro forma basis, adjusted EBITDA increased from \$18.1 million or 5.2% revenues in 2018. This -- the improvements in adjusted EBITDA was due to gains from operational efficiencies and synergies we achieved from the integration of MC Assembly.

Now I'd like to comment on the balance sheet and other key metrics -- financial metrics that were reported for the fourth quarter. Our cash-to-cash cycles over the quarter averaged 80 days, with DSOs of 63 days and DPOs of 74 days. Inventory turns were 4.0 in the fourth quarter of 2019.

Our balance sheet deleveraging strategy is progressing on track. Net debt at the end of the fourth quarter was \$82.1 million, down \$10.2 million from the fourth quarter a year ago and down \$2.3 million from the prior quarter. Net debt, excluding our finance and operating lease obligations, was \$68.3 million at the end of the year as compared to \$80.8 million at the end of 2018.

We remain focused on reducing our debt-to-EBITDA ratio. Since the MC Assembly acquisition, we have reduced our debt-to-EBITDA ratio, excluding leases, to 2.82 from 4.67 with proceeds from our Rights Offerings and Direct Registered Offerings, both completed in June 2019, as well as from our improved performance in 2019. Based on our current projections, we are targeting to achieve a debt-to-EBITDA ratio less than 2.25, excluding leases by the end of 2020.

Now since our market capitalization exceeded \$75 million at June 30, 2019, we were required to initiate compliance with Section 404(b) of the Sarbanes-Oxley Act of 2002, and our external auditors opine on our internal accounting controls over financial reporting as of December 29, 2019. Management is required to certify that we have designed such internal controls over financial reporting or cost external controls over financial report to be designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the reporting for -- of our 10-K for external purposes in accordance with generally accepted accounting principles in the United States of America.

Including in our 2019 annual report on 10-K to be filed today, we will report a material weakness in our controls related information technology general controls in the areas of user access and program change management over the systems that support the company's financial reporting processes. There has been no misstatements identified in the financial statements as a result of these deficiencies. PricewaterhouseCoopers LLP, our independent registered public accounting firm, is responsible for auditing the company's financial statements and auditing our internal controls over financial reporting. PricewaterhouseCooper LLP did not identify any material weakness -- I mean, any misstatements, excuse me, any misstatements in our audited company's 2019 financial statements, and has issued an unqualified opinion on the financial statements, and an adverse opinion on our internal controls over financial reporting due to the aforementioned material weaknesses in the audit report.

Remediation efforts have begun. The material weaknesses will not be considered remediated until the applicable controls operate for a sufficient period of time, and management has concluded through testing that these controls are operating effectively. The company expects that the remediation of these material weaknesses will be completed prior to the end of fiscal year 2020.

Finally, recognizing customer demand can change due to additional supply chain interruptions. At this time, we have seen low impact on our business as a result of coronavirus. Based on the current forecast, we are reaffirming the guidance we previously provided on September 19, 2019, for the full year of 2020, and projecting revenue in the range between \$390 million to \$410 million. As was the case in 2019, we expect our adjusted EBITDA to accelerate faster than our revenue growth. Our current outlook for 2020 for our adjusted EBITDA is to range between \$29 million to \$31 million, an improvement of 17% to 25% compared to 2019.

With that, here is Eddie for some additional comments on our business. Thank you.

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Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Thank you, Steve. While 2019 presented a number of microeconomic challenges, our supply chain team anticipated and proactively addressed a number of issues, including component shortages and uncertainties about tariffs during the first half of the year, with component lead times collapsing and inventory balancing across the supply chain during the second half of the year. We believe inventory reductions programs by our customers to balance against decreased component lead times are coming to an end.

As we enter 2020, let me quickly report that we are carefully monitoring the impact of COVID-19, or the coronavirus. Just as we did last year, we remain committed on supporting our customers and keeping them abreast of the evolving conditions. Through proactive and creative solutions, including in some cases, setting up alternative sources to our China supply chain, our global supply chain led by Phil Wehrli, our senior Vice President of Supply Chain, has thus far mitigated, as Steve's comments indicated, the impact from coronavirus. We look forward ahead, and we are working closely with our suppliers to ensure continuity of components, including multi-layer ceramic capacitors, or MLCC, where lead times may increase in the second half of 2020 due to raw material challenges.

Now let me share with you some comments on the progress we made last year and articulate the reasons for the enthusiasm behind our expectations for another great year of growth and improving performance in 2020. As we remain focused on achieving leadership positions in each of the key metrics, those being revenues, gross margin, EBITDA margin and net margin percentage.

First, we believe we are continuing to gain market share and expect to grow faster the overall EMS market. In the fourth quarter, we continued to expand our customer base with multi-year awards totaling in excess of \$31 million from 3 globally leading avionics, aerospace and defense technology companies, which we announced on January 8. Thus far, in the first quarter of 2020, we have added another 4 new customers and 4 programs from existing customers with potential revenue in excess of \$20 million.

Second, during the fourth quarter, we successfully completed 32 new product introductions and prototypes at our new NPI Manufacturing Design Center of Excellence in Billerica, Massachusetts, which we opened in the third quarter of 2019. This capability and a similar one we are expanding in Fremont, California, provides SMTC with a differentiator and offers our customers with a world-class quick turn manufacturing capability that can accelerate the launch of their products and the flexibility to scale production from other low-cost sites.

Third, in order to develop even stronger relationships and capture a larger portion of our customers' business, we are currently expanding our class-1000 cleanroom wire bonding capability at our Fremont facility.

Fourth, as I mentioned at the start of the call, we've completed the closure of Chinese manufacturing operations in Dongguan. The transfer of manufacturing equipment from China to Florida, Fremont and Mexico is proceeding. While we're winding down the manufacturing function, we are maintaining a small team in China to support our global engineering, supply chain and supplier quality engineering activities.

And finally, to further reduce costs, improved production efficiencies, we have several ongoing global initiatives involving lean Sigma programs.

Let me conclude by reiterating what I reported last quarter, we remain committed to further deleveraging our balance sheet, achieving industry-leading performance metrics, growing our business to become the premier Tier 3 EMS segment leader, making our company an even stronger company that delights our customers with superior service, taking care of our employees and rewarding our stockholders with enhanced shareholder value.

With that, Steve, Rich and I will take questions from those on the call today.



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

The first question today comes from Christian Schwab of Craig-Hallum Capital Group.

Christian David Schwab - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Great. Congratulations on doing a great job of navigating the coronavirus supply chain issues and demand changes so far. When you're looking at the rest of the year and the full year guidance, can you give us a little bit more clarity? Obviously, the aerospace and defense business is extremely strong. But can you highlight a few of the other areas where your visibility and confidence is high?

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Yes. So, thank you, Christian, first of all, and thanks for joining us.

The aerospace, defense business is an interesting one, right, because it's government work, it's long-term and that's why we've been growing there fastest as we can. It's also a very profitable business. The other part of the business that we see coming back this year that last year wasn't as strong is the capital equipment markets. The big pieces of machinery, our semiconductor equipment market, the test and measurement market have been strong. And this was a -- it's always a very tricky time, right? The call couldn't have been, and our earnings release couldn't have been in a later time. We haven't -- we've seen no change by our customers in demand, and I use the word yet. Because I also realized yesterday, when I watched the media and the news, every hour, the situation was changing. I then look -- wake up this morning and everything's closing. The NBA is closing, NHL's closing, Major League Baseball's closing. And then I wake up this morning and because I believe the stimulus package is working its way through Congress, the S&P limits on the upside now have been implemented because the market is moving back up. I think we're in for a rough time trying to -- what's really going to happen? Is it positive? Is it negative? But right now, we're in some pretty good markets, Christian. I think the capital equipment markets, the aerospace and defense markets are going to stay strong. I don't see that changing in the short term.

I think there's markets I keep an eye on. The 5G market, I think, clearly is a market that is interesting. And then we're in the payment market. And that one I also keep an eye on because if people don't leave their house and they're not using credit cards in machines, then will they change those machines? So, yes, I think we're in for a little bit of a turbulent time. And I told somebody the other day, they said, "You look very calm through this." And I said, listen, we've lived through 2001, the dot-com bust, we lived through 2008, 2009, the big recession. We've lived through SARS. We lived through the Avian flu. I mean, what we need to do is react to the information we have as we get it and do that as quickly as possible. So. I look at it. Every day, we take a look at what's going on. But so far, our customers have not changed their demand. And that's been one positive out of all this.

Christian David Schwab - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

And then if you -- thinking back on the previous disruptions in business, could you remind us just how long your lead times are? And if there are changes in that, how quickly you've seen that in the past?

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Yes. So, I've had a couple of different looks at this, right? In 2001, I was in the EMS business. And then in 2008, 2009, I was on the distribution side of the business. And so, what I would say is the last year, lead times were way out, they're out, average over 26 weeks, then tariffs hit and they collapsed to an average of 8 weeks. And I am hearing things that the MLCC market, and that's why we, in particular, focused on that market in our notes here, is starting to move out again. But with this flu that we have going on, MLCCs are going to be driven by the car market. And I'm reading



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reports that the car markets now weakened back up. So maybe that won't be the problem. But these things will happen pretty quickly, Christian. I would say within 30 days, you normally can get a good feel of where it's headed, and then you got to react as quickly as possible. So, we -- as soon as things happened, we locked down our first quarter, we moved things to other countries, and we did what we had to do to lock down our first quarter. Then we took a look and saw -- kind of walk you through, we took a look customer by customer, part by part, whether COCs, which is Certificate of Origin. And we knew that we had problems with about 12 suppliers. We will let down to problems with 2 suppliers. And I, once again, told somebody the other day, interesting enough, the problem suppliers are the same suppliers we have problems with day in, day out anyway. This just gives them an excuse of why we have problems with them. So, we're used to managing these suppliers and I think we're going to see the real -- what is really going on probably in the next 2 or 3 weeks in terms of underlying demand and how much of that changes. But the stimulus will have some effect on it. So, I'm hoping that gets done as quickly as possible.

Operator

The next question comes from Mike Crawford of B. Riley FBR.

Michael Roy Crawford - B. Riley FBR, Inc., Research Division - Senior MD, Co-Head of The Discovery Group & Senior Analyst

Thanks for talking about the supply chain, Eddie, could you talk about your factory capacity utilization? Where you are in each of the facilities and where you'd like to be at year-end, if you hit this \$390 million to \$410 million targeted revenue range?

Edward J. Smith - SMTC Corporation - President, CEO & Director

Yes. So that's actually a great question, Mike. So first of all, thanks for being with us, and thanks for the question because it's a question that I get asked a lot by our customers. As they see the growth, they always get nervous, do you have enough capacity to take more products on from us. So, I'll walk through the facilities real quick.

Billerica, which -- we turned it into an NPI facility, today, we probably could double to triple that business with really limited -- just adding people, limited equipment additions.

Florida, we will probably, as we grow here, need to add some very specific equipment on. We've built that into our budget. So, we will need some capital equipment, but we expect that to grow 60% this year with the aerospace, defense, and we probably have another 60% to 70% growth we could do the following year with just some capital equipment investment.

Chihuahua, we are moving our equipment from Dongguan, China to Mexico to our Zacatecas and Chihuahua plants with a little bit of that equipment going to our Fremont and Florida plant. And what I would say is, and I think there's going to be more near shoring, I think the one thing that's a positive for us long-term on this flu is people will be bringing more things back to Mexico. Our Mexico plant, particularly in Chihuahua, used to do over \$200 million. So, it has the capability to grow probably another 50% or 60% without us having to add any space and just add some equipment, which today is on a boat from China to Chihuahua. And so today, they're running probably about 60%, 70% and they're going to continue to grow. Zacatecas, we probably are running closer to 70%, Mike. And we feel pretty comfortable because most of our Mexican growth is in Chihuahua, not in Zacatecas. Zacatecas, we have some availability of online because we've wound down a couple of projects for customers over the last couple of quarters, and we've got that more efficient from the MC side.

As far as Fremont, we're moving a couple of customers from Fremont to Chihuahua. We're going to do that over Q1, Q2. And so, Fremont probably could double their size, so they're about 50% capacity today.

But the fact that we closed China, we took our CapEx budget down by 50% because we're taking our equipment from China and moving it into our other plants. So they have not had to invest in Capex. And it gave us capacity in growth market of China. I believe we're going to see, because of this virus, people are not going to want to put their products as far away as things have gotten tougher. And I think Mexico could become one of our highlights, and the fact that we're there in a big presence, I think that's pretty exciting for us long term.



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Michael Roy Crawford - *B. Riley FBR, Inc., Research Division - Senior MD, Co-Head of The Discovery Group & Senior Analyst*

Okay. Great. Just one other question. Maybe this one's better for Steve. With the leverage reduction targets you talked about, are there any of the Term A or Revolver covenants that we should watch more closely than others for Q1 or after in 2020?

Steven M. Waszak - *SMTC Corporation - CFO and Senior VP of Mergers & Acquisitions*

Thanks, Mike. So consistent with -- as we've had in '19, our closest ratio, our tightest ratio that we monitor is the debt-to-EBITDA ratio on -- it's a trailing 12-month calculation. So, we'll continue to watch that one very, very closely as we go through the year.

We are certainly in the midst of trying to move even further in our debt leverage plans to loosen some of that up. But today, I would say, that's the one, to keep an eye is the debt-to-EBITDA ratio.

Michael Roy Crawford - *B. Riley FBR, Inc., Research Division - Senior MD, Co-Head of The Discovery Group & Senior Analyst*

All right. Thank you. Thank you very much.

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Thanks, Mike. I appreciate it.

Operator

The next question comes from Alan Greenberg of Legend Cap Opportunity.

Evan Greenberg - *Legend Capital Management*

It's Evan Greenberg, actually, but that's okay. Ed, you did a terrific job of navigating this environment.

Number one, that's already been said, this question has kind of been asked, so -- but I'll ask it anyway. Digging a little deeper, I wanted to get an understanding, we know the defense area is really not impacted by this at all. Are there any specific -- and I think 5G is going to be a very good area because people are being more reliant on their phones now. Are there any specific areas of medical devices or any areas that this may be a counter trend for you where you'll see a pickup in business? And are there any specific areas where you're expecting a fall off because of all of the stoppage just because of coronavirus, specifically? Or have you seen any in any areas? Or do you not have anything that's that economically dependent?

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Well, we do have a couple of customers in areas that touch a consumer, our payment system, like I said on the call, I'm very concerned about the payment systems because people don't want to touch things and putting credit cards into things is going to be of concern. I think people don't like to go to restaurants during these type of chaotic times. So, we're keeping -- we build some products for restaurants. So we built some payment systems. Those are 2 areas, I think, are most likely to be negatively affected, but I think on the other hand, that will outweigh that is, I believe, because we're in Mexico. And we have capabilities and capacity that our Mexico facilities will continue to grow long term faster than the market, because I think people are going to get out of China, but that's a personal thing. So, we're excited, but we'll keep an eye on those two other markets through the turbulent times.



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Operator

The next question comes from Steve Kohl of Mangrove.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

Good morning guys.

I had a couple of questions. I wanted to chat a little bit about aerospace and defense and regulated markets. So you talk -- if you look at kind of the road map and where you say that we're picking up, let's say, \$20 million to \$40 million net from '19 to '20. Eddie, you mentioned you may have some follow-ups on retail. You mentioned capital equipment can be up. If I'm doing my math right, aren't we just almost recapturing that entire delta just in aerospace, defense in Melbourne. And then that's excluding kind of the pickup that we might get on the capital equipment side beyond that or maybe if you can fill me in on -- and us on medical, other opportunities or where we see that? So, I'm just trying to tie out kind of bridging these numbers on where are the potential upsides and you already talked about payment on the other side?

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Yes, I mean -- so we announced the customers and we announced numbers, and obviously, we don't start at 100%. Today, we announced the numbers, right? And so, there's a ramp-up period. Some of that's not so good because it takes -- actually you got to hire people first, you got to get the supply chain in place, there's cost to that. And then eventually, you start doing revenue and then you start making money. And that space can be 6 months, 9 months and a little bit longer if things don't go well. So -- but at the same time, we're doing that, Steve, there's always some amount of churn in the business. And in unsure times, the churn always looks worse because you don't get the customers up as fast as some of this goes down. And so I would say, I do believe that the aerospace and defense is going to drive our overall growth this year of the company.

I think medical has not grown as fast for us as I would like. It's an area we need to spend some time and get some focus. And then I think in some areas that have actually churned have been some industrial products. So, we feel comfortable with the \$390 million into \$410 million. I think we're pretty deep into the Q1. And so, my answer is what's going to happen long term. And I think the reality is, I think, Mexico is going to become a big manufacturing center for things that come into the U.S. So, to not go through number by number, we do have a bridge, I'll be more than happy to share that with you off-line that shows the bridge between the numbers.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

Do you feel -- when you go back to the aerospace, defense stuff, Eddie, when does that -- it starts to hit what in the back half in Melbourne, as you guys are seeing it now? I mean, where are you in the testing process there? And looking at history, do you feel pretty comfortable in that ramp starting kind of in the June time frame? Or when do you see that picking up on some of those programs you announced back at the first part of the year? And even last year, I think you had some in the fourth quarter.

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Yes. So, some we've already started doing the qualification. So, this quarter, we will see some small ones. Q2, that will pick up. And in Q3 and Q4, I would hope to be, everything -- if everything goes well, to be in production in Q3, Q4 on every project we've announced. So, I'd say qualifications and moving to some production is low in Q1, a little bit bigger in Q2, and then I would expect most of what we've already announced to be in production by Q3, Q4.



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Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

And turning to test and measurement, where are you at? What types of test and measurement are you doing there? Is an analytical test and measurement? Is it test and measurement on the capital equipment side? Or is it a mix?

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

It's -- in our test and measurement business, it goes all the way from oscillators and 5G test fixtures, all the way to image sensing and comparison. So, it goes across the whole broad market of test and measurement.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

Okay. And last question, just looking at the plants in Mexico. When you look at this year, you mentioned, I think they're both around 70%, if I heard you right Eddie? About 60% or 70%. How do you see that playing out? And I know you had some in Zacatecas. I can't remember if Zacatecas trial, I think one of them had some -- the labor situation is a little bit different. How is that working out? And where are you at on kind of base-loading those facilities and moving stuff between them?

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Yes. So, when I say 70%, it's 70% the way it sits today, right? When we get our Chinese equipment, we'll expand the capacity. It is easier for us to get labor in Chihuahua than in Zacatecas. So obviously, that's a place where we'd put more business, where we can get more labor. Zacatecas is in the middle of the country, it's a small town. So, we're actually in a little town called Fresnillo, about 35 miles outside of Zacatecas. But the reality is, I think we have plenty of capacity. I don't think capacity is an issue for us. And with the new equipment, it actually has lowered our CapEx expense in growing that capacity. So that will make us a higher margin business. So that part is exciting, to be honest with you, for sure.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Edward Smith for any closing remarks.

Edward J. Smith - *SMTC Corporation - President, CEO & Director*

Thank you. In closing, I want to, once again, thank our employees, leadership team, business partners, distributors and our stockholders for their continued support, and look forward to reporting our progress to our various stakeholders over the next several quarters. I want to thank you for taking time and spending your day with us. You have a great day.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.



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