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Q4 2018 SMTC Corp Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the SMTC Corporation Fourth Quarter and Fiscal Year 2018 Results Conference Call. (Operator Instructions) And please note that today's event is being recorded.

And I would now like to turn the conference over to Blair McInnis, Vice President of 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 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. Discussions 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. All forward-looking statements are made as of the date of this call. And expect as required by law, we do not intend to update this information. This conference call will also be available for audio replay in the Investor Relations section of SMTC's website at www.smtc.com.

SMTC will be participating at the 31st Annual Roth Conference next week, March 18 and 19, in Dana Point, California. Information about this event has been posted on the Investor Relations section of our website.

I will now pass the call over to Eddie Smith, the company'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 continue to execute throughout 2018 and we closed the year as SMTC stand-alone with robust increases in sales, margins and cash flow exceeding the targets indicated by our business plan and our guidance provided during the second half of 2018. Perhaps, it's important with the transformative acquisition of MC Assembly during the fourth quarter of 2018. It's hard to believe that, that was just 120 days ago. I'm pleased to report the integration of MC Assembly is proceeding well and has put us on a path to enhance growth within important end markets.

Let me quickly review the results we announced after the close of the market yesterday. For the fourth quarter, including MC's operations for the 52 days following the close of the acquisition, we reported revenue of \$80.9 million, up 109.3% from the comparable period last year and 50.6% from the prior quarter.

For SMTC stand-alone, without the contribution from MC Assembly, revenue in Q4 was \$57.3 million compared to \$38.6 million in Q4 2017, an increase of 48.4% over the prior year and 6.7% over the prior quarter. Our stand-alone revenue exceeded the high end of our



prior guidance issued back in July 23 and the midpoint of the guidance for Q4 of \$49.5 million by 16%.

Now going back to including MC operations in 2018, following the close of the acquisition announced on November 9, our Q4 gross margin was 10.3% compared to 7.5% in the same quarter a year ago. Our fourth quarter adjusted EBITDA was \$5.3 million, which represents \$4.1 million improvement compared to the \$1.2 million in Q4 of 2017.

We reported a net loss of \$1.2 million or \$0.05 a share compared to a net loss of \$0.9 million or \$0.05 a share we reported in the fourth quarter of 2017. Adjusting for the merger and acquisition cost of \$1.7 million, our net income was \$500,000 or \$0.002 per share compared to the loss of \$900,000 in the fourth quarter of 2017, an improvement of \$2.6 million.

For the full year, our revenue increased 55% to \$216,100,000 compared to \$139.2 million in fiscal 2017 with \$23.5 million attributable to the acquisition of MC Assembly. Excluding the revenue contribution from MC Assembly, our SMTC stand-alone revenue grew by 38.4% for the full year.

On a pro forma basis, assuming MC Assembly had been part of SMTC for 12 months in 2018 and 2017, the combined revenue for both SMTC and MC in 2018 would have been \$342 million, up from -- up 18.8% from \$288.5 million in 2017. Our gross margin was 10.0%, an increase from 7.8% of revenue reported in 2017. We reported a net loss of \$400,000 or \$0.02 a share, which represents \$7.4 million improvement, compared to a net loss of \$7.8 million or \$0.48 per share reported in fiscal 2017.

Adjusting for merger and acquisition costs, adjusted net income was \$1.3 million or \$0.07 a share for 2018 compared to a loss of \$7.8 million in 2017, an improvement of \$9.1 million.

Adjusted EBITDA was \$10.2 million for 2018, which represents \$11.7 million of improvement compared to a negative \$1.5 million in fiscal 2017. While the numbers indicate a significant improvement over the prior year, they do not fully tell the story of the profound changes that have taken place at SMTC over the past year.

Let me just mention a few of those things. First, we strengthened our team. Key to any successful company is having a proven management team that is capable, experienced with the right industry relationships and can work well together in calm waters with success presented with challenges. During the past year, I've assembled a leadership team at SMTC with whom I have worked with in the past at Avnet and elsewhere, where we built the multi-billion company, and/or at SMTEK, where we significantly increased the enterprise value before selling the company. We now -- that now includes our COO, CFO, Global Supply Chain Leader and our Head of Sales and Marketing.

Second, we stabilized and then expanded the business with existing customers, and we won business from 12 new SMTC customers, while MC Assembly added another 10 new customers they had secured in 2018, by instilling a customer-driven culture, taking the time to understand our customers' businesses, and the needs and then working to deliver on what we promised. Admittedly, that is a work in process.

Third, we made pursuit of operational excellence in every aspect of our business, our mantra, included in our investor slide presentations and a series of graphs that indicate our performance relative to our peers for revenue, gross profit, net income and adjusted EBITDA.

Our performance over the past year shows improvements on every metric as we continue to strive to be the market-segment leader in each category. I've often said that we want to be the best at SMTC, and we manage this in mind every day.

As you may have seen the company filed or will file our 10-K for 2018, a proxy and a Form S-3 for a new shelf filing within the next 24 hours.

Our Annual Shareholder Meeting has been set for May 9, 2019, with the record date of March 27, 2019, to be held at our facility in Melbourne, Florida.



Let me turn it over to Steve Waszak, our CFO.

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

Thank you, Eddie. Good morning, everyone. I want to thank first the long-time shareholders for your continued support and confidence and welcome all of the shareholders who are new to SMTC Corporation. Thank you for joining this morning.

I know there's a lot of numbers that we've talked about today on the call with the acquisition, stub periods and everything else. To help you understand better, the company will file our 10-K and proxy post today's call. Our annual meeting has been set for May 9, 2019, with the record date of May 27, 2019, and it will be held at our Melbourne facility here in Florida.

As Eddie has commented this morning on our Q4 and full year 2018 results, both when using MC's operations since our acquisition in November 2018 and with SMTC as a stand-alone entity. My comments will primarily address the results including SMTC's operations for the period following the acquisition in November.

To reiterate, our revenues for the fourth quarter were total of \$80.9 million, comprised of \$38.6 million for the same quarter in 2017. Approximately \$209,000 of the revenue reported in Q4 '18 was due to the impact of the new revenue accounting standards, ASC 606. That said, the remainder of the 109.3% same quarter year-over-year growth in revenues was fueled by the organic growth of SMTC on a stand-alone basis plus \$23.5 million coming from the MC Assembly customers during the 52 days since we acquired SMTC in Q4. During Q4, we had no 10% customers in that period.

For the full year, revenues increased by \$76.9 million or 55.2% in 2018 to a total of \$216.1 million compared to \$139.2 million in 2017 with SMTC contributing [30.5%] (corrected by the company after the call) of our year-over-year increase. The impact of the adoption of ASC 606 accounted for about 2% of our year-over-year increase. We saw growth across all sectors that we have targeted with the biggest gains coming from customers in the test and measurement industry, power and technology, medical and telecom, networking and communication sectors.

Additionally, our gross profit for the fourth quarter was \$8.3 million or 10.3% of revenues compared to \$2.9 million or 7.5% of revenues in the same quarter of 2017. Adjusted gross profit for the fourth quarter, which excludes the impact of unrealized exchange gains or losses, was \$8.3 million or 10.2% as a percentage of revenues compared to \$3.4 million or 8.9% for the quarter in 2017.

For the full year, gross profits increased to \$21.9 million in 2018 from \$10.8 million in 2017. Gross margin percentage has increased to 10.1% in 2018 compared to 7.8% in the prior year.

When excluding the impact of the unrealized gains -- exchange gains or losses on foreign exchange contracts, the adjusted gross margin percentage increased to 10% in 2018, up from 7.1% in the prior year. The increase in gross profit was primarily the result of increased revenues impacting the company's ability to really cover the variable and fixed cost overheads in addition to improved product mix resulting in increasing margins.

Operating expenses, which comprise of selling, administrative and general costs, were \$7.3 million in Q4 2018, of which about \$1.7 million of those were M&A acquisition costs, compared to \$3.1 million recorded in the same period of 2017. For the full year, operating expenses increased to \$18.2 million in 2018 from \$14 million in 2017. However, these expenses decreased to 8.4% of revenues in 2018, down from 10% in 2017. The year-over-year dollar increase was primarily related to the acquisition of MC Assembly.

Finally, the company reported net loss of \$1.2 million for the fourth quarter. In comparison, the company reported a loss of approximately \$904,000 in the same period a year ago. As Eddie mentioned, excluding the fourth quarter merger and acquisition expenses associated with MC Assembly transaction, our adjusted net income was a positive in that period as compared to a loss, the \$904,000 loss in the quarter for 2017.

Adjusted EBITDA was \$5.3 million in the fourth quarter 2018 compared to \$2.4 million in the same period -- the same quarter a year ago. The increase in the fourth quarter adjusted EBITDA compared to the same period in the prior year was due to primarily higher gross



margins that we talked about and a higher revenue.

For the full year, adjusted EBITDA, as Eddie commented, was \$10.3 million, which represented an improvement of \$11.8 million primarily driven by the increased revenue, ability to cover fixed costs and additional incremental provisions and impairment charges incurred in the prior year.

Now before I return the call back to Eddie, I'd like to comment a little bit on the balance sheet and -- for the quarter. At the end of the fourth quarter, we had \$1.6 million in cash. Net debt at the end of the year increased to \$92.3 million compared to \$14.7 million at the end of 2017. Now that increase was due primarily to about \$68 million of term debt and assumed capital leases as a result of the MC acquisition. At the end of the year, we had \$14 million of funds available to borrow under revolving facility with PNC bank.

\$2.5 million of cash was utilized in the fourth quarter for operations primarily to support increase in working capital growth of accounts receivable and inventory for supporting the expanding of revenues in the same quarter compared to the prior year. Most importantly, our cash-to-cash cycle was 67 days compared to 64 days at December 31, 2017, with DSO at approximately 65 days and DPO at approximately 79 years.

And inventory turnover on annualized basis was 4.4x for the fourth quarter of 2018. Now with strong cash flows an improvement in our cash-to-cash cycles with working capital efficiencies as we go forward, particularly as integration strategies are realized through the year, we are committed to deleveraging our balance sheet. This is a high priority for us. A key in balancing my focus is to align the financial capacity for the continued growth, as Eddie mentions, from the combined SMT and MC acquisition.

Finally, as Eddie mentioned, we continue to see strong demand for our customers in the first quarter 2019. We currently expect revenues for the first quarter to range between \$96 million to \$100 million. And we expect adjusted EBITDA to range between \$5.3 million and \$5.8 million, continuing our expansion of EBITDA to approximately 5.5% of revenues. For the full year of '19, we expect to see accelerated revenues over the 2018 levels.

Now let me hand the call back to Eddie and provide some additional comments before we open for questions. Thank you.

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

To summarize, we remain on track with our business plans. Our integration of MC Assembly is proceeding well, and we believe we have significantly enhanced our capabilities that is enabling SMTC to even serve our growing base of customers while positioning SMTC for an even faster and more profitable growth trajectory.

As I look ahead, we are committed to deleveraging our balance sheet, achieving industry-leading performance metrics and growing our business to become the best Tier 3 EMS market segment leader.

I look forward to updating you on the progress on future earnings calls as we make SMTC an even stronger company that delights its customers with superior service, rewards the stockholders with enhanced shareholder value and takes care of its employees.

With that, let's take questions from those on the call today.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And today's first questioner will be Mike Crawford with B. Riley FBR.



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

Thanks. Eddie, great to hear the integration with MC is proceeding well. And I'm wondering, given that the growth you're seeing across your business from new and existing customers, if you've further decided the strategic thinking around your footprint, in particular what to do with 2 Mexico facilities if you're going to accelerate the move to get out of the shelter status at the one? And also, what to do with your Fremont location?

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

Yes, it's a great question, Mike. And first of all, thanks for asking it. We clearly evaluate every day about all our facilities. And having 2 facilities in Mexico spread that far apart is something that we take a look at every day. As of this moment, we have not made any decision on what to do there. We actually have increased our space in Zacatecas because of the growth. So in Q1, we've added a couple of new customers and actually needed to increase our space in Zacatecas. So I don't see any immediate need at this point or a way for us to consolidate the Mexico facilities. I think we're actually going to expand in both places.

As far as our footprint in North America. Clearly, California, and specifically to what you asked in Fremont, is not the easiest place for us to do business. I would say it's one of the more challenging places where we do business. We're right near the Tesla factory, and as they expand, it make it much harder for us to attract employees and more expensive for us to track employees.

We continue to work with our customers to find what's the most appropriate place to be. And we will -- as soon as we have any final decisions on any of our plants, we'll be more than happy to announce them. But at this point, we're just working on trying to make all the plants more efficient.

I will tell you an interesting commentary about that. Clearly, with the tariff unsurety, it continues to push customers that would have been over in China into Mexico. We have quite a bit of quoting demands and existing demand in Mexico, probably much more than I thought as a percentage of our revenue. So the tariff continues to move or you can call it on-shoring of customers.

As far as the shelter, there's nothing to report there. We continue to develop our relationship with the people who run the shelter and obviously supply the employees that we have working for us. We are making some minor changes where the leadership team is going to report to us directly. And we are going to put some leadership down there from our China plant. We're actually moving our General Manager from our China plant to our Zacatecas plant to oversee the shelter and all of that. So there are changes going on, and there's no doubt about it. I think those will continue and we'll continue to evaluate. But today, there's really nothing to announce in any of those areas.

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

Thank you. Just one more. So I know it's a little early to think about next acquisition since you're still digesting MCA. But you also have expressed 2 potential, say, tactical progressions going forward. One, focusing on becoming like \$1 billion revenue contract manufacturer EMS provider, which might entail slightly lower margins just given the sheer volume of products that might have to flow through to achieve that versus maybe targeting something more like \$500 million in revenue but with much higher industry-leading margins. And I'm wondering if you have had any further decisions on which of those tacts you're more likely to pursue in the near term?

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

Yes, in near term, we want to be the best Tier 3 EMS company with the best financial metrics. So I don't see any of that changing through 2019 and probably a portion of 2020. But I would tell you that there's no doubt about it, the efficiency we've been able to gain here and the growth of customers, which I thought would slow down during the integration, which didn't happen, we continue to add customers. And that's kind of why we're eating up some inventory dollars and some cash flow is because we're adding a significant amount of new customers, like -- which I thought would have slowed a little bit but didn't. So at this point, I think we're going to stay focused on making the integration as efficient as possible, becoming the leading Tier 3 EMS provider in terms of financial metrics and growing faster than the industry, which all of those are not only happening but are realistic to continue for the rest of 2019.

Operator

And our next questioner today will be Christian Schwab with Craig-Hallum Capital Group.



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

Hey, congratulations on a great quarter and a great start to the year. As we look at the strong revenue growth on a combined basis, I think you said from \$285 million to \$342 million at roughly 20% top line growth. Can you give us insight what percentage of that is new customer-driven? What percentage of that is increased share of customer wallet spend? Because customers have more confidence in your ability to not only manufacture but do it efficiently on the EMS side versus just generic customer revenue top line growth of your customers. Is there any way to think about that?

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

Yes. So we think about that a lot, right? Because when I started this journey 2 years ago, my number one priority was to become really operational excellent, highest-quality, best on-time delivery and to grow with our existing customers first, right? It's the most efficient way to grow because you already have inventory for them, you already have receivables. They know who you are, and it's the known. So we measure that. And I'll give you those numbers in a second. We then measure how many new customers and what our pipeline looks like. So right now, Christian, it's about a 50-50 split on that growth between new programs, new divisions of existing customers and outright just new logos or new companies that we had not done business with before.

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

Okay. Fabulous. And then I think, Steve, I heard in your prepared comments that you expect revenue growth to continue in 2019 at levels greater than 2018. I just want to make sure I heard that correctly and wanted to make sure that you were making that comparison on a combined revenue basis, is that accurate?

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

Yes, what I would say on that just so I'm hearing your question right, Christian, and thanks for the questions. I think the world of Eddie and his team, but I don't think we can get the same percentage of revenue growth in '19 over '18 as we're in the 40% -- 40% to 50% quarter-over-quarter many times. We will definitely have -- we definitely see the outlook to see increased absolute dollar revenues in '19 over '18. As the percentage, though, I would say, we're not locked in as to where that percentage is going to be. It will be double-digit, but whether it's coming close to something of '18 on the growth, we're not there yet in that perspective. But certainly in terms of absolute dollars, '19 will be stronger than '18. No question.

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

Here's what I'd say, Christian, just so we don't get ahead of ourselves on that number of the top line revenue. You get the law of big numbers, right, the combined entity numbers. And if you view it as a trailing 12 months somewhere in the \$350 million range at the close of Q4 between the 2 companies, you're going to be a double-digit growth for sure. You're probably not going to see 30% or 40%, which was some of the numbers SMTC did on a stand-alone basis, but you're definitely going to see something above double digits.

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

Right. And then given the type of new customer-driven and design wins that you have, which can kind of vary from \$0.5 million worth of yearly business to maybe upwards of \$3 million, I think, roughly. Yes, the law of big number catches us, right.

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

Yes, yes. No doubt. And you have the other thing that clearly, what we try to avoid or what we try to set up here is to have multi-market segments, right? Each company have -- we're really good in certain market segments and we try to expand the number of market segments. I do think as the year progresses, we're going to grow on some markets, defense, aero, in particular, we're going to grow. We're going to grow in some of the IoT-type markets and the RF, which we do a really good job. But I definitely think certain markets in the U.S. are going to slow down or flatten out, and that could have some muting effect on the overall growth. But clearly, we'll still grow double digits. Will we grow 30%? Probably not. But we'll grow more than 10% for sure.

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

And then lastly, can you remind me as we -- what you see is the opportunity with the acquisition, the scale that you have and expansion of customers. If you're successful driving further operational excellence yourself inside your existing factory footprint, what type of EBITDA margins do you think is a realistic goal, potentially looking out a few years? Not a comment regarding something beyond Q1 in 2019, but something around 2020, 2021, what you think is a realistic opportunity?

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

Yes, I think, if you said somewhere above 7% and below 10%, maybe closer to 7% than it is to 10%. I think that's very realistic. I actually think we will get above 7% before this year ends. So I don't know, if anybody, it's anywhere near 10% today. So I'm not sure that that's realistic. But where we are today is definitely not where I want to be.

When we put out our guidance for Q1, I actually think, we'll continue to get stronger as the year as the synergies are realized. You have 2 ways to get more profitable here, right? You're going to have the synergy side, which we have a specific number for. But the side that we've -- actually that's more exciting to me is the efficiency side of our business, right?

MC, one of the reasons they were accretive to us is their MVA is significantly higher than the MVA that we get at SMTC. If we can take the efficiency we have at SMTC and move it to MC, we could get much closer to the 10% than where we are today. So we have some work to do there, no doubt, we're not done with that work. I was hoping to get some of it done a little quicker. But we're working on the synergy side of it. Now we're going to start working on the efficiency side of it.

Operator

(Operator Instructions) And the next questioner will be Steve Kohl with Mangrove.

Steven Kohl *Mangrove Capital - Analyst*

Yeah, good morning guys. Congratulations on a great quarter. I wanted to talk a little bit about kind of the geography and the landscape of your plants. I know -- we know Mexico is going well, I've got that. Could you spend a little bit about -- talking about the strategic importance of the Billerica, up in Boston and then in Melbourne, and how these plants are doing and the strategy to get more medical, let's say, up north and more aero down south? And have we had some successes there? Or how do you expect to fill those plants and get the efficiencies there? And what's a realistic -- I know the qualification cycles are probably a little bit longer and some of that stuff. But how you're feeling on moving towards that strategic plan on increasing? And I presume that's where the business will largely fall in those 2 plants. So clarify that if you could.

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

Sure. It's a great question, one that when we did the acquisition, we said -- the first question I think that was asked by Mike Crawford is, do we need all the plants? Should we combine some plants and do all of that? Which was never easy in EMS space for sure. But let me first start by saying, all of our plants this quarter, in Q4, became profitable on a site contribution basis. And that was not the case in Q3 and back. So every plant, including the ones that you mentioned, are now profitable.

So the reason that we liked MC, and it continues to be one of the reasons we liked MC, is their plant in Melbourne is really set up very well for defense and aerospace business. It's in the middle of space coast, as they call it, down here. You have some of the biggest Tier 1 government contractors. And that business clearly can help this plant. If we land another \$10 million or \$15 million per year customer in Melbourne and Florida plant, I think our plant will be one of the better plants around. Rich and his team have worked on the Melbourne plant, and we've changed the structure of MC to have general managers in each plant. Rich has done a great job with that of hiring people that are very capable.

Our plant in Billerica will continue to drive in the medical space and in what I would call highly regulated industries, so not just medical but highly regulated industries. That plant needs to grow. And we are quoting some business, and we'll continue to quote business. So I think in the end that plant will also be a good plant.

Our plant in Fremont is a little bit more based on the, what I would call, test and measurement, Internet of Things, those type of things.

We continue to see is there value in moving some of that business down to Mexico only because of the tariff regulations of bringing parts into the U.S.

And then obviously, we have the 2 plants in Mexico, which both make significant profit, but both can become more efficient and make more profit.

And then last, but not least, we have a Dongguan plant. Our Dongguan plant, we had a couple of years ago, taken our Suzhou plant and combined it with Dongguan. And so Dongguan is probably one of the rising stars, even though it's not one of our biggest plants. Rich and team have done a great job making that plant not only profitable but much more stable than it was in China a while back. So we have good customers in China.

We need some new customers in Melbourne and Billerica. I think our Mexico plants, they have some capacity to expand. But clearly, we are going to have to make some investment in Mexico to continue to expand at the rate we're expanding. But right now we like the footprint. But we continue to evaluate, I will always continue to evaluate what markets we're in, what geographies we're in and are they in appropriate geographies.

Steven Kohl *Mangrove Capital - Analyst*

When you look at -- I guess the -- one thing I've always intrigued is this MVA discussion and as you accelerate. So just so I've got this right. I mean, SMTX was more efficient but the MVA is higher on MC. So how do we reconcile that? So I know Rich -- I presume Rich and his team are working diligently. I know the margin profile is higher. But where are they getting that? Where is that -- is that a higher gross margin that's driving them for MC? Or what's the component of MVA that's better that you hope to improve potentially at SMTX on the core front?

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

Yes. So if you think about it, the MVA is what we call the material value-added. So it's basically the difference of the price of the hard components or the hardware versus what we get for the product. And that's the amount of money that you spend in labor and all those different things. And so MC's was about 30% higher than SMTC's. And so if you had the same efficiency, as we have at SMTC's factories at the MC factories, you would obviously drop to both gross margin and into, ultimately, EBITDA a significant amount of money. And we have work to do there. Rich is working on making things more efficient in the factories. It doesn't happen overnight because you're changing processes, you're changing people and strategy, and so that takes a little bit longer. And so I think that's where -- I don't know if, Rich, you want to add anything to that about the differentiated MVAs to the profit?

Rich Fitzgerald *SMTC Corporation - COO*

Thank you, Eddie. Steve as Eddie said, in the MVA model, you know there are efficiencies to be had. We'll continue to work on those. The separation also is in the market spaces that we serve and one of the differentiators in the acquisition as you're aware. So that was helpful as well.

Operator

And our next questioner today will be Craig Butz, a private investor.

Craig Butz - *Private Investor*

Yes, I'm wondering about the potential for new contracts or customers coming up. I think I have discussed that before on previous call, and I'm just -- I think you had -- would have prompted to me to ask that in the past was that you had mentioned we were maybe close to getting some new customers or contracts. And so I was just wondering if you could give some updates on that.

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

Sure. I think in my comments I talked about how many new customers. So we had some new customers in Q4. So we had almost 10 new customers in the combined entity. And in Q1, so far, we've landed 6 new logos, Craig. So it takes time for us to qualify the customer, go

through the process, go through the NPI process. But clearly, we are adding new customers both in Q4 and Q1. Our funnel looks pretty robust to me. So I expect that to continue for the rest of the year. So we continue to add on new customers. Matter of fact, I would say, at a rate that was surprisingly faster than I expected during the integration.

Craig Butz - Private Investor

Okay. In regards to that what you just said, I know we have just had that big contract announced with MC, is there anything you might want to elaborate on that? Or any other ones coming up the pipeline with MC?

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

I would love to elaborate, but if you -- on all our contracts, but what I have avoided doing is going out with press release after press release or customer by customer because I think it becomes then a little bit messy for people to figure out how much additional business, what additional profit and what are we doing. Here's what I will say, we did announce the Navy contract with the government, and the reason we announced that one in particular is because it's a prime contract with the U.S. government direct, not through a third party. So we are actually building for the U.S. government directly. And that has all kinds of different requirements, different things to do. And -- but it also gives us a GSA number and opportunity to do business with the government without the very likely and complicated quoting process. So we announced that one because I think that changes the game in the defense space for us as we're already qualified by the federal government directly in the defense space. So we announced that one. I don't expect to change our position on announcing contract by contract. But we will on these calls try to give you more clarity on how many new customers, how many are new logos and how many are new programs in existing customers. So we'll try to do that for the next call.

Craig Butz - Private Investor

Okay. That sounds good. I guess, I have one, if you want to call it a negative question, I don't know, but what about if this tariff situation goes downhill that they're worried about with China. Obviously, there is a potential for the increases to go up substantially if they can't come up with a deal. And I'm just wondering how that could negatively affect us if that happens.

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

Yes, that's always one we keep a quite the eye on. The -- we keep the eye on. So far, it's been positive for us because the more tariffs there's been, the more customers of onshore product and expanding our Mexico footprint. So, so far, it's been an overall positive. The negatives are that our customers that we're building in the 3 plants in the U.S., in Melbourne, Billerica and Fremont, sometime they caught up paying more for components. And obviously, that puts pressure on them and puts pressure on us. So I would hope that we come to a deal and move on from this subject. But no doubt about it, there's always risk associated with these type of things of what it is, how much and when. So here's what I'd say. I don't know if it'll be solved or not solved, all I know is that I can react to what I ultimately know. And when they make whatever decisions, we'll react to that from there. And then you asked about the customer, I'll just -- one of our customers, yesterday, we won supplier of the year. So one of the MC customers -- so that makes us happy that in the integration, we didn't mess those types of things up so. So with that, I hope it answers your question.

Craig Butz - Private Investor

Yes, sounds good to me. I don't know if you're able to elaborate it all speaking of MC as far as the debt load that we acquired from them and how that's working out for us.

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

Yes, as Steve said, we continue to look at the balance sheet to try to deleverage it as quickly as possible. When you talk about multiples of the EBITDA versus debt, I'd like it to be less than 3. Right now it's closer to 4. And so sooner or the quicker we can do that through free cash flow or any other methodology, lowering your inventory, doing those type of things, we will continue to do that. So we will continue to try to deleverage our balance sheet as quickly as possible.

Craig Butz - Private Investor

Okay sounds good. Thanks a lot, and it's been a great year so far.

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

Thank you.



Rich Fitzgerald *SMTC Corporation - COO*

Thank you, Craig.

Operator

And this will conclude our question-and-answer session. I would now like to turn the conference back over to Eddie Smith for any closing remarks.

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

Thank you, operator. In closing, I want to thank our employees who've had just an incredible year and have worked really hard. When you have growth in the 40%, 50% range for SMTC employees is pretty incredible. I want to thank the MC employees through the integration who have stood up and taken a leadership opportunity. I want to thank our leadership team as this has been quite the year of transformation, our business partners, distributors and our investors for their support, and look forward to reporting our progress to various stakeholders over the next several quarters. And then I want to thank all of you for attending our conference call. Have a great day.

Operator

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

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