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**21st Annual Needham Growth Conference
January 16, 2019**

Unidentified Needham Representative

Hi, everyone. Welcome to the 21st Annual Needham Growth Conference. I'd like to welcome Eddie Smith, CEO of [SMTX](#).

[Edward J. Smith](#), President and Chief Executive Officer, Director

Good afternoon, and thanks for joining us. Thank you for Needham for having us and appreciate everybody's attendance. So, I think you're going to hear today about a company's been pretty exciting.

When I first started going out in the road shows and talking about the company, we had a market cap about \$18 million, small company in a turnaround. Then we finished that phase of our company. We started getting hyper growth. Last year 2017 over 2018, we had about 40% growth and then we just did what I would call transformative acquisition. And so, we look like a completely different company today. I'm pretty excited to present where we are, where we're going, and I will spend some time doing that.

So we play in the EMS space, and the best way to describe it as electronic manufacturing services. We make things. If you design an electronic product, we make the board, we may put metal around it, we may put it in a box, it will make a product for a customer.

We have three plants in the U.S. three – two in Mexico and one over in China, Dongguan, China.

So, we are really best at what I call high mix, low-to-mid volume. And we need to stay in our lane. That makes it a much more profitable company when we do that and our customers like that. We put a new leadership team in place and then had a significant impact in terms of growth.

As you can see [our growth Q3 year-on-year](#), we had 56% growth, and for the year we had about 35% growth. When you add Q4 in, which we preannounced, you're going to see that number of

34% jump over 40%. And so a pretty good year of organic growth. This was all organic growth, selling more to our existing customers, landing new customers, and growing pretty significantly. [On November 9](#), we announced an acquisition. We bought a company called [MC Assembly & Test](#). It was a private company, headquartered out of Melbourne, Florida. And so we'll talk a little bit about that in a little bit.

We're recognized for our quality. So, you might say, why would a company give us more business in our space, why would our existing customers or new customers give us business? That has to do with how we service them, our on-time delivery or quality. We are best-in-class when it comes to quality and we're very proud of that. So, we won a leadership award from Frost & Sullivan on a quality and how we handle our customers.

We service product lifecycle. We're don't only build stuff, we repair stuff for our customers. We also fulfill their orders. So out of our Texas, El Paso Logistics Center, we can actually fulfill customer's orders. So we can go from end-to-end with our customers.

Interesting enough, our facility in Chihuahua, Mexico, if you ever went to you would be really amazed at how technologically sound that is. It used to build Zenith TVs 30 years ago. We bought it and turned it into a contract manufacturing facility, so it's actually well-equipped.

[We combined two leaders in the industry in our space](#). Scale matters and made both of the companies more profitable. You'll hear a little bit about the synergies created, over \$6 million of synergies between two companies our size, both companies being about \$150 million. When we started the conversation, SMTC growing to almost \$200 million; at the end of the conversation, you'll see being able to get \$6 million soon is just pretty significant.

We've diversified our end markets. We have one market that's 25%, the rest of the markets are 20% and below, so we diversified our end markets. We also diversified our customers. We have very little customers as we have one customer a 11%, everybody else is 6% and under. So we have a lot of diversification. If one customer decide to leave, this would not cause very much of a problem for us. When I first came here we had much less diversification both in end markets and in customers.

We also grew in three spaces that I think are key through the acquisition. We grew with defense aerospace business. So now we deal with companies that are prime contractors for the government, PRS, L3 companies like that. We also added to a medical portfolio and we deal with some of the top medical companies in the country. But most important is this IoT. We've added some industrial IoT companies through our portfolio and I think we'll see some significant growth from the IoT in the industrial IoT.

We had no customer overlap between the two companies. We had one customer that had the same parent company, but no divisional overlap. So we had no overlap and that helped also in the combination. And as for us, it's a scale game. Anybody knows how contract manufacturing is, the stronger you can make your factories, the bigger you can make your factories or the stronger they become, the more profitable that they become.

We have complementary footprint. We were thinking about expanding our plants in Chihuahua. We now don't have to do that because we have another plant in Mexico, we can expand that also. And then the cost synergies which we talked about. To get that \$6 million, it will cost us about \$2 million of cash to get \$6 million.

This shows you the overlap in terms of customers and what they make in the marketplaces they're in. So if you kind of take a look, there were both done in the mid 80s, one 1984, one 1985. And as you can see, the square footage and the employees about the same amount of employees there.

We believe then we finish all of this, and I'll show you a slide on this. We will be in the top quartile in all the operated metrics that we produce. So we were on our way to do that. Last time I presented at a conference, we were either the number one, two or three in many of the metrics. This will put us into the either number one or two spot in every metric. We want to get double-digit growth. As you saw the 40% growth of the organic business, we want to increase our business with our existing customers. We want to become the provider of choice and then we want to drive M&A which we've just done and increase our SAM and gain scale.

As you can see, our goal to be number one or number two in every one of those, these numbers are with just SMTC not after acquisition, this is before acquisition. As you can see, we moved up from here all the way up to the number three spot here, for the number two spot here, three and in two spot. When you put the acquisition together without pre-announcing any numbers, it will help all those numbers and be accretive to our financial metrics.

Ultimately, I have a one philosophy. If you can't be number one in a space, then you shouldn't waste your time in that space. You should move on and find something else to do. We will be when we're done 2019, 2020 we'll be number one in all of these metrics.

We put together a leadership team that I think clearly differentiates who we are versus any of our competitors. I started my career at Avnet. I went into the EMS business back in the year 2000, not the greatest time, the dot-com bubble busted. But I was able to take a stock from \$0.35 and sell a company in two years at \$15.23 during the dot-com bust in the electronics industry. So this is not the first time I've taken an EMS company and guided it forward.

When I went back to Avnet, we had a \$1.2 billion business. We grew it to \$4 billion of components in the U.S. and then we started our greenfield business in the embedded computing space and grew that from greenfield to \$2.2 billion in seven years. So if one thing you take out of it, I like to grow companies, I find that to be the most exciting part of the business.

[Rich Fitzgerald](#), so Rich has been in the business a long time. He's worked for CTS, Intel, and in Avnet, reporting my global operations. [Steve Waszak](#), he's been both the CEO and now he's the CFO, but he's been around. He's been with Deloitte, BTI, so BTI was a Bain company, Ciena, and then with SMTEK International when he was on the board of SMTEK International. And then [Terry Wegman](#) came out of Avnet. So a very seasoned group. I don't think in this space there's too many management teams and leadership teams that show this type of seasoning.

If you'd see the stock here, a nice sort of run from 2017 to 2018. If we were to add on November and December, so this shows it at \$3.50 today closed at \$5.50. So you would have it somewhere right about there over the next two months. We thought that would be bragging, adding those two months on. So we left the slide. But even in this chaotic marketplace that we're in, in 24 months we've been able to take the stock from \$1.20 to \$5.50. And if you think about it and you take interest in 12 months, we've been able to take it from \$2.80 to \$5.50.

And somebody asked me a question a little earlier today, said, hey, are you satisfied? My answer is, I still think we're undervalued. People don't understand the value we're going to unlock in the stock. And they started laughing. We'll see what that means, as we go here.

This kind of gives you some of the key things that are up here on the screen. We made the right hires, we restructured the company. And then once we have stability and growth, we then did M&A.

Our global footprint - and I talked a little bit about this a little bit earlier we're in Fremont, California with an NPI center, Melbourne, Florida, where we do our defense and aero business. We are up in Boston, Massachusetts in Billerica to be exact, where we do our medical business. And then we do high volume manufacturing in Chihuahua and Zacatecas. Once again, high volume manufacturing to us, it would be considered low- to medium-manufacturing to most EMS providers.

Toronto used to be the headquarters of SMTC and El Paso's our logistics center. People ask me why El Paso. El Paso interesting enough, you could hit any part of the United States, East Coast, West Coast in two days, it doesn't matter where you are, by ground transportation. So it's the center of the hub of the trucking hub. We also have these facilities in Dongguan, China and Hong Kong. A lot of people talk about tariffs. We're able to help with the tariffs by having places in Mexico and through our Dongguan in China our facilities, where we can build things and ship them non-tariffs.

Markets we serve - we serve the medical market, the semiconductor equipment market, the retail payment market. So one of the kind of interesting things, if you go to a gas station, you put your credit card in, it's probable that the place you put your credit card in the gas station, we built that payment system. We build a lot of different retail payment systems, tested measurement markets, industrial power and clean technology. We have a lot of IoT equipment here in the power market, telecommunication network and in defense era. We are both a prime contractor for the U.S. government and its here to a contractor for the U.S. government.

Kind of our manufacturing discipline - I wouldn't want to steal Rich's thing. We've won the Frost & Sullivan Award for product quality, growth, leadership and customer value. The most important, Rich came out of Intel, which was Copy Exact. And so if you know a lot about how Intel builds things and what they built, you'll see that this is a very similar to the Intel methodology.

Probably most important slide here. Q3, we had revenues in 2018 of \$53 million, gross margin 9.8%, adjusted EBITDA 2.4%, and now those were some of the slides and earnings per share,

\$0.4 earnings per share. If you go back a year ago, there were losses and kind of see the fiscal year going back.

Our long-term goal is that gross margin is 12% to 14%. We want to grow about 20% per year, where we want adjusted EBITDA margin 6% to 10%. You may say, why is 6% to 10% so important because as I showed you on the other slide, the best companies in our industry or at 5%. We would be double the best companies in our industry if we are at 6% to 10%, then we expect to get there but in the next year or so.

Our income statement - I won't bore you too much of this, but as you can see SG&A will continue to go down as a percentage because as we grow and we do the synergies with MC, obviously getting rid of \$6 million worth of expense will lower our SG&A and we'll have a better earnings. I won't bore you with too much of this. Although, I will say, I think this will continue to get better and better.

Balance sheet highlights - so this one's a pretty important. We are a capital intensive company. As you can see by property, plant and equipment, we've bought some new equipment down for our Chihuahua plant for our expansion and you could see our assets clearly continually go up.

So, something important. But most important is how we manage our cash. Our cash-to-cash conversion cycle being 63 days. When you look once again in the industry and you check everybody's cash-to-cash, in our space most are in the high-70s, low-80s. So we're about 20% to 30% better than our best competitors. And so we'll continue to do that.

Our inventory turns are down a little bit and that is very intentional. I've gone out and acquired inventory because the supply chain is very tight on parts pieces. If you know anything about the electronic supply chain, lead times went from 12 weeks to about 2.5 years ago to the 26 to 50 week lead times. So we're a little bit tighter here that I like, by next year we'll have this up in the 5.5 to 6 again where we're used to and net debt at the time was \$11.8. Since the acquisition, our net debt has significantly increased in the amount that we paid for MC.

So really just to give you the overview, we were two customer driven companies, now we're a stronger company, we're the most flexible in our industry because of our supply chain excellence, there is nobody. And I could say this with no hesitation that those supply chain is as good as we do. And you might say, is that important. 70% of our revenue is driven by supply chain. You better be good at it. And then we have one vision and a strong management team.

So with that, what would the consolidated combined companies look like: A \$323 million company with about \$17.6 million of EBITDA. If you think about what I talk about when I started the company breaking even doing about \$130 million in less than two years, we're now a \$320 million company making 17.5% EBITDA, a significant difference between two years ago and where we are today.

Why would you do it if you're investing? Because we have very little significant customer concentration, so the risk profile is very low. We're a global footprint and so interesting with the geo times that we have in the global, we move customers around based on how their markets are,

free cash flow generation, why we deleverage. Focus on the most attractive end markets. We just added military, medical, which are very attractive to us. Favorable industry trends provide backdrop for performance and we're accelerating our year-over-year growth. So not many people can say in the electronics market today, they're growing at this pace, they are in the EMS space that we are. And then the MC acquisition which was accretive and transformation at the same time.

So with that, I'll take any questions that you may have.

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

Q: [Question Inaudible]

A – Edward J. Smith: So, the government shutdown has had little effect on us on the overall business. The only real place that it has any effect is government contracting. And we just sold a little in the government contracting as a percentage of our business that we already have contracts that we're working on. And so it's just really a delay of getting new contracts and new orders, those types of things. So it's had very insignificant effect on us so far.

Q: [Question Inaudible]

A – Edward J. Smith: The question is do we see many more transactions in the next 12 months to 18 months. I actually don't think we'll see very many transactions. If the right transaction comes along, we'll do it, but what I really would like to do is take our free cash flow and take our debt down first, before we go out and acquire somebody.

So the way we structured the debt was \$65 million from TCW and we broke that down to a Term A and Term B. We'd like to take the Term B loan out first before we would even think about another acquisition. So it'd have to be a pretty – really pretty exciting deal before we would do that until we take out. And we think we'll take that Term B out mid to late mid-year. So until then, I don't see another deal. Plus we have to take the integration and get that accomplished. Putting two companies together that are of equal size, is no easy task for sure and so it's working. What?

Q: [Question Inaudible]

A – Edward J. Smith: I'm sure you could, but it's some work, we got some work to do. But we won't do anything that would jeopardize the first acquisition before we do the next one.

Q: [Question Inaudible]

A – Edward J. Smith: That's pretty \$6 million.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. So \$6.3 million, \$2 million came almost immediately through our purchasing synergies where we purchase from the same suppliers and we had a lower price in one company other terms conditions with our suppliers. So one-third of it we already – we got almost immediately.

The second-third we had a people synergy or a layoff as some people would call it last week. And so we took care of significant portion of that. I'm working on the last third of the synergy and that will take probably another quarter or so before the last \$2 million comes in. But if you take this \$6.3 million and add it to the \$17.6 million from last year, you're looking about \$24 million, \$25 million of combined.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. So the last two is actually – and this becomes more complicated. I'll try to give it to you as best. We run our own people in Mexico and there's no cost to that. We pay ourselves, we manage our own people. The last two is based on – we have a company that manages our people at MC, they're called "shelter" companies. They use pretty often down in Mexico. So we're going to cut some costs there and some costs out of Mexico into the tune of \$2 million. So we got some work to do there, that doesn't happen overnight, but we'll have that done Q2...

Q: [Question Inaudible]

A – Edward J. Smith: It's a little bit more difficult than that. It comes to laws and things and HR-type things.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. So we actually had three plants too, the other two are our support facilities, either engineering facilities, finance facilities of that. So, their facility down in Zacatecas has more people because they run PCB straight through. We have less people per square foot, if you think about it that way because some of our facilities build metal shops, LCDs, wiring cable, and it takes less people per square foot to manage those businesses. But we will get more efficient in both plants by the time this is all said and done. And so if you think about, I would think about it this way, dollars per person. We'll get both of them to be more efficient on dollars per person or gross profit per person.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. So why would somebody give me business over the big guys, has to do with the type of business that they give us. It's high mix. So the big guys don't want to switch over their lines constantly. And so – and it's low volume. So when you talk about the big guys, the Tier 1s, they wouldn't want most of this business anyway, it'd be too expensive. So they want low mix and high volume. We want high mix, low volume. And so there's additional costs. And as you can tell, when you look at the big ones there, their margins in 5%, 6% range, so they

get a lower margin. We get a higher margin because we have to pay more costs than the changeover of the factories and those type of things.

So it goes to a longer-term question. When we get to be \$600 million, do we want to go compete with the big ones to get bigger or do we want to make a good profit staying at that level? And I think up until the \$500 million, \$600 million range, we can grow really well. There's plenty of business out there and we can keep our profit at the level that I think acceptable is 8% to 10% EBIDTA. If we wanted to get into the billion dollar market, I think will affect our profitability because we'll have to start competing the next level up, the Tier2, Tier 1.

Q: [Question Inaudible]

A – Edward J. Smith: I can do the best I can, I wasn't here, but I was a supplier to the company. So I'll give you from an outside perspective and then what I heard from different people. They were not very customer centric or customer focused. They also weren't the most flexible and they weren't the highest quality. So they lost some pretty significant customers. And they lost – I would call it the recipe of what they wanted to be. So when they started losing the customers, they started going chasing the business that goes to Tier1. So they started dealing with companies like Ericsson and those type of companies.

And when they started chasing the business, guess what happened to the companies that they were traditionally really strong at? They said, well, if you're going to be a Tier1, then I don't want to be here because you're not flexible enough and you're not focused on me. And so the combination of those things, customers moved on. When I came in, the first thing I said is, let's decide what we want to be high mix, low volume, and let's go talk to our customers about that business. Let's not go chase business. That would be either unprofitable. We'd be competing with people we can't compete with and irritate all the other customers at the same time.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. Lead times on components are really stretched out right now in the home marketplace. If you would try to get tantalum capacitors today, people would tell you one year from now if you went out looking for them.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. I've been asked that question a lot today. We have not seen it. Our customers give us six months of pretty strong demand. And then they give us a view into the 12 months. And we see a very little weakness in our demands and almost any vertical. Now you might get a particular product that drops off because it didn't do well in a particular market replaced by that. But we don't see a significant drop off in the math.

Q: [Question Inaudible]

A – Edward J. Smith: This is another question I get asked a couple of times today. I think we've picked markets and customers that today are either shielded from it or we just don't see it.

We grew 40%, I'm mean, the numbers don't lie, right? I mean, I could sit here and debate should – is the economic – what?

Q: [Question Inaudible]

A – Edward J. Smith: Well, I don't think our accountants lie. So we're still growing 40%. Should we regrow at 50%, but the market is down suddenly. Maybe that's the weakness that I see. We still are continuing to take market share from our competitors and maybe that's why we don't see the weakness in the marketplace.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. So we're very flexible. So customers give us more business than we probably deserve at our size with them. We also saw many EMS providers and you can look it up, they're public and you can read them, all complain about the supply chain. I missed this much revenue because of my supply chain. I miss this much revenue because of my supply chain. I miss this much revenue. You can go look at almost every public one, somewhere it talks about tariffs or supply chain.

We do not experience that same thing. Maybe because I came out of the biggest supply chain provider in the world, and so did Rich and so did our Chief Supply Chain Officer. But we do not see the weakness that you're talking about. Maybe it will come, but we don't see it in our forecast from our customers. We see year-on-year growth still from our customers.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. We definitely see an uptick in our Mexico plants. Our Mexico plants were growing faster than 40% because of the tariffs. So instead of building in China to ship the whole product here, that maybe tariffed, they'll go build in Mexico and it comes into the U.S. on a harmonic code that is not tariffed. So that is clearly reshoring going on.

Q: [Question Inaudible]

A – Edward J. Smith: I think also IP concern. I think it's a plethora of economic reasons. I also think the cost of logistics has gone up, so the FedEx and boat and all those things. I also think you have wage inflation in China, which was pretty significant and people don't talk a lot about it, but China is no longer the low cost regional leader over in Asia. There's a big thought on my mind and I'll go over there in February and take a look at this about moving our plant out of China to somewhere in Southeast Asia, which is more stable with the wage inflation than what we're seeing in China. China was a great solution. I'm not so sure it's the perfect solution any longer in terms of low cost. I think, we – if the product is right, we could build something in Mexico at a lower cost landed than you could do it in China.

Q: [Question Inaudible]

A – Edward J. Smith: Yes. So the quoting is probably the most important part of the whole thing and landing the customer at the proper price for what you’re doing and getting paid or fair value, I guess you could say. The last time I ran one of these companies, like I said, we took the stock from \$0.38 to \$15.23 and we did that by charging the right price and having the right quality and all that. But there’s always the risk that if your competitors’ price incorrectly, it forces you to price incorrectly. So there’s always that risk. Today we don’t see that, but that could happen clearly and they could force us as we try to grow to price incorrectly.

But you’re right, the industry has an overall looks. If I was an investor and I look at Tier 3 EMS companies and I looked at the very best one has an EBITDA margin of 4.47% or 5%, I would say why, but as I’m telling you, we’re not going to be at 4.47%. If I go back to the slide here, we’re at 4.47% as a standalone company, combined and scale will jump out somewhere over here. And with that jump, and that’s right out of the box without being super efficient yet. So you’re right, if I was an investor, these are numbers would not make me very happy. I think that’s what you were saying, right, why are we different.

Q: [Question Inaudible]

A – Edward J. Smith: That could potentially – that’s a great comment about China. That could potentially help our margins long-term. The geopolitical thing to me today in the world we live in is the biggest potential upside. It’s also the biggest potential risk.

Q: [Question Inaudible]

A – Edward J. Smith: I always love that.

Q: [Question Inaudible]

A – Edward J. Smith: I think it starts with first having the right process, right? So taking their forecast and blowing that out to our supply chain, then having the right people manage that process. And then when all that fails, having the favorite nation status and being able to get what you need when you’re in a crisis. But, clearly – so when the tantalum capacitors got really tight two years ago or so, I probably knew before anybody else.

So besides being at Avnet, I used to sit on a Board of Directors of the ECIA, Electronic Components Industry Association. So I could see the data coming in and saying, okay, the market’s getting really, really tight. And so I went out and placed a year supply on order for ASAP delivery. So I covered my customers for a year. That’s why the turns went down. And that’s why we see very little of that type of risk. So there is a rest to it because we have inventory, but on the other hand, we were ahead of our competitors in terms of...

Q: [Question Inaudible]

A – Edward J. Smith: So I don’t sit in their seat, but I’m going to give you my view of the industry. Maybe I shouldn’t do this. Every time I do this gets me in all kinds of trouble, but I’ll give you the best I can. The ASPs had fallen to such a level because from 2008, 2009 demand

and drafts so significantly. And when it came out of there, ASPs were so low that many of the component manufacturers said, I'm not going to put anymore of CapEx because building more doesn't make me anymore money.

And so by the time the ASPs started rising and they said, okay, I'll do CapEx now. It was almost too late, because in that industry to put a new fab together only takes four or five years and it became too late. So lead times jumped out and that's just compounded the issue over and over, but I think ASPs where the start of, I'm not going to put more CapEx into this, it's not worth it.

Q: [Question Inaudible]

A – Edward J. Smith: Yes.

Q: [Question Inaudible]

A – Edward J. Smith: No that's – no that's from me going out and taking risk of buying tantalum capacitors and long lead time parts. We are not feeling the effect of the China cold, but I have heard it from, here you go, this was the inventory turns you're talking about. I've heard about the China call has been – a couple of days at CES last week and a lot of people were complaining about how bad it was. This was well thought out saying if I make a couple million dollar investment on the front side, how much profit can I make on the backside? And we decided to make for a half turn to keep our customers and grow at 40% seemed like a pretty reasonable thing. So I'll take one more question because we're almost out of time.

Q: [Question Inaudible]

A – Edward J. Smith: With that, if you have my card, I'd be more than happy to talk to you even longer about some of this stuff and help you out. So thank you very much.