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SMTX - Q1 2020 SMTC Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to your SMTC Corporation's First Quarter 2020 Financial Results Conference Call. (Operator Instructions) At this time, it is my pleasure to turn the floor over to Blair McInnis. Sir, the floor is yours.

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.

Discussion of the various factors that may affect future results is contained in the company's annual report on Form 10-K, quarterly reports 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 except as required by law, we do not intend to update this information.

During the call, we will also reference certain non-GAAP measures, including adjusted gross profit, adjusted net income and adjusted EBITDA. Please refer to the press release we issued yesterday for reconciliations between GAAP and adjusted results. Management believes that these non-GAAP financial measures, when used in conjunction with GAAP financial measures, provide useful information about operating results, enhance the overall understanding of past financial performance and future prospects and allow for greater transparency with respect to the key metrics SMTC uses in its financial and operational decision-making.

These non-GAAP financial measures are also frequently used by analysts, investors and other interested parties to evaluate companies in SMTC's industry. The presentation of this financial information is not intended to be considered in isolation or as a substitute for or superior to the financial information prepared and presented in accordance with GAAP, and should not be construed as inference that SMTC's future results will be unaffected by any items adjusted for in these non-GAAP financial measures.

Finally, this 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. 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.

First, before discussing the quarter and our results, which came in better than our internal budgets, I want to acknowledge that as a result of the emergence of COVID-19 pandemic, we're living and working in a time that is unlike anything we've seen before. I'd like to applaud the dedication and hard work of our entire SMTC team, and the support of our suppliers, our customers and our partners. I would also like to thank our shareholders for their continued patience and support during these trying times.

I am pleased to report that our focus on operational excellence is paying off as we continue to move our company forward and report a first quarter 5.4% sequential increase in revenue

During what is typically a seasonally slow quarter, while at the same time, navigating through the health, safety and supply chain challenges resulting from the emergence of the COVID-19 pandemic.

During the first quarter, we were awarded programs from four new customers, plus additional new programs from five existing customers that have the potential of generating in excess of $50 million of revenue over time. We are excited that our new business funnel continues to grow with an additional $7 million in new programs awarded to date during April and May.

On balance, our business remains intact. The SMTC team has demonstrated resilience during these challenging times. Our leadership team, myself included, is in weekly, and in sometimes daily contact with our customers and suppliers to make sure we are on top of the evolving situation.

While we need to make some incremental investments in the first half of the year to support the launch of new products before they reach volume production later this year and into 2021, we are simultaneously taking other steps to limit our expenses, including putting a pause on hiring for new positions and reducing our Q2 capital expenditure plans which Steve will discuss.

While we are pleased with our growing sales funnel and business prospects, given the unpredictability of the current COVID-19 pandemic environment, we decided it would be prudent to formally withdraw our full year guidance until such time that visibility returns to pre-COVID-19 levels. We are keeping the lines of communication open to provide reliable and timely information, both internally and externally. We look forward to the day when COVID-19 pandemic comes to an end and we can resume providing annual guidance that reflects our confidence in our ability to achieve industry-leading financial metrics.

Let me wrap up my introductory remarks by saying that the safety of our employees remains a top priority for SMTC as we continue to meet our customers' requirements. Rich Fitzgerald, our Chief Operating Officer, will discuss in detail the actions we have taken to ensure the health and wellness of our employees and their families, and our efforts to keep our production up and running responsibly to meet our customers' delivery requirements.

After Rich addresses the steps we have taken, Steve Waszak, our CFO, will discuss our first quarter results in more detail, including the support of new programs and the expenses we have incurred as a result of our efforts to protect the health, safety and wellness of our employees in light of the COVID-19 pandemic. Steve will also share with you our thoughts for the second quarter before I return some additional commentary on our business, our goals, and the markets we serve before we open the call to questions.

With that, Rich Fitzgerald.

Richard E. Fitzgerald - *SMTC Corporation - COO*

Thank you, Eddie. Good morning. I would like to provide you an update on SMTC's COVID-19 global business continuity plan.

First, I would like to thank our customers, employees and channel partners during this time, as everyone has been instrumental in helping SMTC address the challenges that COVID-19 pandemic presents. As Eddie said, the health, safety and wellness of our employees and their families has been and continues to be our top priority. The ability to keep our business operations running, while continuing to provide regular communication to all stakeholders, has become the regular operating rhythm for the SMTC team. Currently, all of our facilities around the world remain in operation and in accordance with all applicable health and safety regulations.

As early signs of a potential pandemic were emerging in Asia in late January, we quickly began working on global initiatives to pull forward our supply chain and begin working on our business continuity plans. As we began feeling the effects of raw material and logistics challenges, with some of our key suppliers nearing shutdown, we quickly moved most of our ocean freight to air, increasing our freight costs to ensure business continuity for our customers. We also began conducting daily conversations with our channel partners and customers to align immediate needs versus non-critical demand. This became and continues to be our new paradigm.

Shortly after the California state government announced the first stay-at-home orders in the nation, we quickly responded and implemented a plan to comply with state requirements to protect the health and safety of our Fremont, California, employees and developed our business continuity plans for all of our other sites around the globe. This included working with respective governments globally, our customers and our leadership team to define specific plans for each site. We quickly defined essential business customers across the globe and worked closely with our clients to ensure that we had the proper letters of exemption to continue operations. We then worked with local governments where our operations are located to obtain additional documentation necessary for each of our sites to remain open.

Following closely CDC recommendations, we quickly implemented the following measures at all of our facilities: We immediately stopped all travel for all employees globally. We limited access to all factories to essential employees only. We instructed all non-essential personnel to work remotely. We required all employees with pre-existing conditions, and in Mexico tose over the age of 55, to stay at home with pay. We strictly enforced and encouraged anyone who was feeling ill to stay home. We instituted strict rules around hygiene at our facilities, including temperature metering and required the wearing of face masks. We modified shift patterns to ensure social distancing at our sites and limited the number of access points to each site. And we continue to have medical personnel routinely check on our employees and have provided proper personal protective equipment to our employees to support their health, safety and wellness.

Given the current outlook with the phased approach and the reduced stay-at-home orders being implemented in various locations, we continue to enforce our rigorous standards to protect our employees, while responsibly addressing our customers' delivery needs.

We will continue to align our plans and bring some of our nonessential employees back to work in a safe and controlled manner. All travel will continue to be halted until further notice. We will continue to communicate with our global employees through videos and our world-class clients and channel partners through frequent and regular dialogue.

I am extremely proud of the work the team has done to address the challenges of the COVID-19 pandemic. And the social responsibility that our employees have demonstrated through donations of goods and supplies to local hospitals to help in the local communities that we all work in.

With that said, stay safe. I'll turn the call over to Steve.

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

Thank you, Rich, and thank you for your incredible leadership, and I want to thank all of our SMTC employees for their commitment and dedication and our customers and partners as we work together through the challenges of this period. Now let me discuss the financial results.

Revenue for the first quarter 2020 was $95.1 million, up 5.4% compared to the prior quarter and [7.3%] (corrected by company after the call) from the first quarter a year ago. During the first quarter of 2020, we had one 10% customer.

Included in our earnings release is a table that breaks down our sales by industry sector. This table shows that nearly all of our markets we serve were relatively stable, with strong growth in our avionics, aerospace and defense business, which increased by 35% to $10.4 million compared to $7.7 million and $7 million in the prior quarter and the same year ago, respectively.

Our gross profit for the first quarter of 2020 was $9.6 million, or 10.1% of revenues, compared to $10.5 million, or 11.6% of revenues, in the prior quarter and $8.6 million, or 8.4%, in the same quarter a year ago. The sequential decline in gross profit was primarily due to program management, production certification and start-up expenses for new customer program start-ups and labor inefficiencies, which resulted from the use of temporary staff to replace employees on leave with medical conditions that put them at higher risk for COVID-19 and certain supply chain logistic expenses incurred to meet our customer delivery schedules.

Our Q1 2020 adjusted gross profit was $11.7 million or 12.3% of revenue, excluding noncash charge of $1.5 million in Q1 of amortization of intangibles recorded in connection with our acquisition in 2018 of MC Assembly and unrealized foreign currency loss on unsettled forward exchange contracts. In comparison, our Q4 2019 adjusted gross profit was $12.2 million or 13.5% of revenue, while adjusted gross profit for the same period a year ago was $10.5 million or 10.2% of revenue.

Selling, general and administrative expenses for the first quarter of 2020 was $7.2 million, essentially flat compared to the $7.1 million reported in the fourth quarter of 2019 and $6.8 million in the same quarter a year ago. As a percentage of revenue, SG&A expenses decreased to 7.6% in the first quarter of 2020 from 7.9% in the prior quarter.

We reported net income of $775,000 in the first quarter of 2020 compared to $1 million in the prior quarter and $1.2 million in the same quarter a year ago. Adjusted net income for the first quarter of 2020 was $2.2 million. In comparison, we reported adjusted net income of $2.9 million in the prior quarter and $707,000 in the same period a year ago.

Adjusted EBITDA in the first quarter of 2020 was $6.2 million compared to $7 million in the prior quarter and $5.5 million in the same quarter a year ago.

Now I'd like to comment on the balance sheet and a few other key financial metrics that we reported in the first quarter. Our cash-to-cash cycle over the quarter averaged 72 days compared to 80 days in the fourth quarter of 2019, with DSOs at 60 days and DPO at 68 days for the first quarter of 2020. Inventory turns were 4.5 turns.

Our deleveraging focus continues. Net debt at the end of the first quarter was $83.6 million compared to $82.1 million in the prior quarter and down from $95.9 million in the same quarter a year ago. Net debt as of March 29, 2020, includes a $3.6 million increase for extension of our facility lease at our Fremont, California, site. Net debt, excluding our financial and operating lease obligations at the end of the first quarter, was $68.3 million compared to $69.7 million at the end of the prior quarter and $81 million at the end of the same quarter a year ago. At the end of the quarter, we had $31.2 million available under our asset-based lending credit facility.

To ensure we manage our cash effectively, in the second quarter, we instituted a hiring pause for new positions, reduced our capital expenditures to core needs, which represented a 50% reduction from our internal plans, amongst other containment measures across the board.

We remain focused on reducing our debt leverage ratio. Since the MC acquisition in Q4 2018, we reduced our debt-to-adjusted EBITDA ratio, excluding lease obligations, from 4.67 to 2.68, with proceeds from our rights offerings and registered direct offering completed in June 2019 as well as from improvements in operating performance. Based on our current projections, we are targeting to achieve a debt-to-adjusted EBITDA ratio of less than 2.2, excluding leases by the end of 2020.

We expect revenues in the second quarter of 2020 to range between $96 million to $99 million and adjusted EBITDA to range between $5.7 million and $6.4 million, which [excludes] (corrected by company after the call) $1.2 million of COVID-19 direct-related expenses based on our current demand and supply chain visibility and assuming our facilities continue to operate at current levels as outlined by Rich.

Concluding, while we believe we have thus far been successful in mitigating the impacts of COVID-19, and are very, very encouraged by our success in winning new business, we also recognize the potential for negative impacts of the COVID-19 pandemic on our business, such as change in customer demand, supply chain or product shipment interruptions, new or changing government regulations, impacts on our employees or manufacturing facilities and lastly, the impacts of the global economy. Thus, as Eddie mentioned, it is prudent to withdraw the guidance we provided on September 19, 2019, and reaffirmed on March 12, 2020, for the full year 2020 until such time that that visibility returns to pre-COVID-19 levels.

With that said, I'd like to return it back to Eddie for some comments on our business. And again, thank you for your participation today.

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

Thank you, Steve. 2019 was a challenging year where SMTC made great progress. I suspect this year will be similar with challenges to overcome and progress to be made. I believe we're on track for a year of even stronger and more consistent financial performance before the emergence of COVID-19 pandemic. At this point in time, our customer demand in our first half looks strong. There remains a fair degree of industry uncertainty regarding the balance of the year.

Fortunately, many of our customers are operating in industries deemed essential, including defense, medical and test and measurement systems. As a result, all of our facilities currently remain open, and we continue to operate each of our facilities responsibly and in accordance with all applicable health and safety regulations. Where necessary, we are using temporary staff in place for those employees with medical conditions that put them at risk for COVID-19.

We've also successfully migrated most of our customers from the China manufacturing operations we closed in the fourth quarter and have the final pieces of equipment on boats back to North America to be redeployed upon arrival to our facilities.

During the first quarter, the EMS industry experienced increasing lead times from suppliers in China, India and Italy due to COVID-19 pandemic-related production interruptions and shelter-in-place regulations. Drawing on key supplier relationships that we have developed over the years and out-of-box thinking, our supply chain team has done a great job proactively working around many obstacles, expediting materials, setting up new sources of supplies and anticipating potential component shortages.

Amid the challenges presented by COVID-19 pandemic, we launched 12 new programs through our Boston and Fremont new production facilities. Our engineer and production staff have been hard at work making sure these new customer programs have solid program management in place, have obtained the proper production certifications and that their start-up process are working smoothly.

Our sales team has been successful in continuing to gain market share. We continue to grow deeper and wider with our customers. We've already secured a dozen or so new customer programs this year with the potential of generating revenue in excess of $57 million over time. We are seeing increased success with our avionics, aerospace and defense business. We expect our test and measurement, 5G customers, along with our data center, power and energy customers to support our second half growth in 2020.

And finally, as I mentioned on our last call, to further reduce costs and improve production efficiencies, we have several ongoing global initiatives, including Lean Sigma programs.

Let me conclude by reiterating what I said in my introductory remarks that we are carefully monitoring the impacts of the COVID-19 pandemic on our business. And as Richard discussed, the team has been proactive in making sure our employees are healthy, safe and that our customer requirements are met. This remains our top priority.

And finally, we remain committed to further deleveraging our balance sheet, achieving industry-leading performance metrics, including revenue, gross margin, EBITDA margin and net margin percentage, 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 of you on the call today.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from Mike Crawford with B. Riley.

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

Eddie and Steve, can you marry possible your goal, the target of 2.2x or less leverage by year-end with the fact that you just guided for Q2 only and not for the rest of the year?

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

Yes. So it's -- so first of all, good morning, Mike. How are you?

So we still have a business that's running strong. We still have forecasts from our customers. We still have orders from our customers. What we don't know, Mike, is what are the government's going to do? When are they going to open up the world again? What is going to happen to the underlying demand as unemployment continues to increase. And so we thought it was prudent, even though the business was running well and we do get a pretty significant look into our customers' future, we just don't know what's going to happen with some of the big things that we don't control in the macroeconomic world. So we decided to pull the guidance. What we do know is what our customers' forecasts are today, what our supply chain is doing today and that our plants are up and manufacturing with their efficiency in the high 90s percent.

So with that being said, we feel comfortable with the year. I just don't feel comfortable with the macroeconomic environment. And so when you think about the debt to leverage ratio and you think about our guidance in Q2 versus Q1, so for the first half of the year, even in the middle of this pandemic, we will meet or exceed many of our metrics. The fact of the matter is, I just don't know enough about Q4 and Q3 and what the government is going to do.

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

Okay. Two more, if you don't mind. So one, could you just comment on these 12 new programs and the $57 million of potential future work, what's the duration of those programs? And also how many of those might have already been disclosed in prior releases, where you talked about new aerospace and defense awards versus new awards subsequent to the last time we had this type of update?

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

Yes. So it's a great question because, as Rich said, we can't allow people in our factories. And so the question is going to become, can we virtually get approvals from our customers using GoPros, iPads in terms of the manufacturing process. So in a normalized environment, I would tell you that, that $57 million is spurred over the second half of this year and all of 2021. So I would tell you, it's an 18-month type projection. That's first. Second is, a significant portion of this was announced in the 1 press release we put out in March. So you heard -- I think we split out the April -- March and April new wins of $7 million. I think most of the $50 million have been announced previously, Mike. The good part or the fun part of this, more than 75% of it is in the defense and aero business. And as you know, that's not going to be subject to a lot of government regulation or how the economy does. That's going to be systems that are going to be consistent over a period of time.

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

Okay. Great. And then last question is, you've been through situations, maybe not the pandemic, but with a fall-off in demand before and then a subsequent rebound in Avnet in 2008, 2009. And at that point, what were some of the leading indicators you saw when your revenue came (inaudible)?

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

Yes. So I just had this conversation. This is a pretty phenomenal. Maybe I was born at the wrong year, I told somebody. I've been through the 2001 dot-com bust when I was the CEO -- got my first CEO role, where revenue went down by 50%, and then a year later went back up. Then you had the 2005 semiconductor industry crisis, the 2008, 2009 recession. And in 2008, 2009, which you asked about specifically, our revenue went from $6.2 billion in 4 quarters down to $3 billion. And in 5 quarters later, it was back up to $6.2 billion in my division. So what I tell people is because people always say, "Hey, you're pretty calm through all of this." And my answer is, this is going to continue to happen for different reasons, maybe not a pandemic, but we had the tsunami over in Japan. You had the floods in Thailand, which shut down the [thing]. And exactly what you just said, there are certain things that we see that will trigger us to make decisions.

So in January, when COVID first started, Rich and myself happen to be over, finishing up the completion of closing our China plant and negotiating with the landlords and other people. And it was clear something was not right. Lead times had jumped out overnight. People were telling us there were shortages and business hadn't gone up that much. So why would there be shortages? And it became clear that some factories were being closed. And so we immediately pulled in, as Rich said, and moved things from being boat freight to airfreight, we pulled in our orders.

I think you're going to see some of those same types of things where lead times are going to jock you around. If you think about Malaysia and right now, Malaysia is in the shelter-in-place essential business. There's a lot of semiconductor packaging and test houses there. They're operating at about 60%. There was a whole negotiation that went on with the government. They're operating with 60% capacity. That's probably okay in the marketplace. But when it opens back up and you need 100% demand and you're only operating at 60, lead times will go up. So Mike, we will continue every day. We put it out on our website updates once a month. But we will continue to operate watching lead times daily, watching book-to-bill daily, we get these numbers. And when we start seeing signs that things are coming back, we'll make the appropriate moves.

And then you have what I call all the crazy things that happen in the world we live in, which is because planes are not flying as regularly to China and back, the passenger planes, you have less cargo, and you got to work around that. And we've been able to do that with our experience. But we will be able to tell what's going on probably sooner than most. I just hate to have yearly guidance out when we just don't know what governments are going to do. When you talk about them with trillions of dollars, they pass these laws, "Hey, we'll just throw out a couple of trillion dollars to keep the economy going." What happens if they stop doing that and those things. So yes, we'll have a pretty good handle on what's going on to that.

I don't know if that answers it correctly, but...

Operator

And our next question comes from Christian Schwab with Craig-Hallum Capital Group.

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

So as we think, Steve, about gross margins throughout the course of the year and the pluses and minuses of the environment that has already been discussed, how should we be thinking about gross margins? I know you're not giving official guidance, but should it remain in similar levels that we've been at?

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

Yes, Christian, welcome and thank you. Yes, we believe gross margins in our outlook should remain stable to what we have in the first quarter. We don't see at this point yet the growth because we've got some COVID expenses. Both direct and indirect costs are related to COVID. What we've done is talked about our direct costs, our redundant labor that we have to have because some people have to stay at home, yet we need to stay in full production capacity, things in that nature. There's also some indirect costs around the inefficiencies of realigning factories and locker rooms and all that stuff that just take time and that nature. So there's a lot of inefficiency. We have to organize more buses for social distancing for our folks. It just -- those kind of things, which we didn't include some of that, which will still put some pressure on gross margins relative to some of these contracts that are coming in that we've announced that have higher margins or higher MVA percentages. So net-net, I would hold the course on margins as we look today over the next 2 to 3 quarters.

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

Okay. Perfect. And then -- then my last question, any -- a follow-up to the earlier question regarding the new design wins ramping, the majority of that being in aerospace and defense. Last quarter, we kind of talked about reaching production levels in Q3 and Q4 for that majority of those design wins. Is that still the case? Or has that been delayed or pushed out for some of the reasons that we've talked about, about ramping new products and people not being able to hit factories? I'm just wondering if that's part of -- I guess, what I'm really trying to get to is, is that part of the reason why we just want to not give guidance for the entire year until we could see if these are going to ramp as previously expected or is that not at all the case?

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

Yes. So my hesitation of giving yearly guidance is really not about the defense aero customers. They will stay intact. They'll keep moving forward. As a matter of fact, some of them are trying to push us to move even quicker because we have been, I believe, more efficient than some other EMS providers and staying open and producing products. So I think that specific to aerospace and defense, that has nothing to do with my guidance. My actually concern of why we pulled the guidance really has to do with more of the macro world. So I would say, stick with your original thesis that Q3, Q4, those defense and aero customers will come on board. It's pretty innovative people get when you can't travel. I never expected in my life to be sitting in a car, doing Zoom meetings or having my engineers wear GoPros, while they're working on board so that the engineer on the other side can see it. But companies have adapted. And so Christian, I don't see a change in the defense and aero business. I'm more worried about the consumer-type stuff, if I was to worry, payment systems, this and that. And I actually think, long term, they will do really well. Because I think people will go away from touching a credit card and wanting to hand things to other people. You'll start seeing touchless payment systems and all that. I just don't think you'll see them today, tomorrow. And the last is all of this government money, these trillions of dollars they keep approving, when does it stop? And when does unemployment start going back to a more normalized level? That's really why we pulled the guidance. It doesn't have to do with the customers.

Operator

(Operator Instructions) And we'll move next to Steve Kohl with Mangrove.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

An excellent job in dealing with the most difficult and unprecedented environment. I had a few questions, as I'm sure you're not surprised. Let me talk a little bit about your customer kind of end market closure. And I think you mentioned a bunch of them are deemed essential. I guess, let me rephrase the question a little bit and just talk about what percentage of revenue -- customer revenue is deemed essential rather than numbers of customers? It's maybe an opening question. I've got a few follow-ups.

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

Yes. So this is a tricky one because publicly, disclosing what's essential and what's not allows people to start saying, "We don't agree that's essential." So at this point, I would tell you, a significant portion of our business is deemed essential. I don't believe we're going to give out a percentage of that.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

Okay. Let me talk a little bit, Eddie, on aerospace and defense for a sec. Just so I'm clear, is all of it or predominantly all of it coming out of Melbourne? So in that 10-point 10 and 7 number, is that all Melbourne? Or is it something out of Fremont or somewhere else in the system?

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

Both. Predominant of it's Melbourne, but some of it goes to our Boston and Fremont sites. So the good news is we're not just growing in Mexico, we're also growing in the U.S.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

Okay. And the expectation still is when you look at that ramp in aerospace and defense in Melbourne for the balance of the year, what are some of the obstacles that you see there? Is it a people constraint since that business should be doing better? Or what are some of the -- do you see that being an issue? Because if I remember right, we're still looking for a pretty big bounce in Melbourne, aren't we, for the balance of the year?

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

Yes. So Melbourne is going to continue to grow through the balance of the year. That's where we do a significant portion of our military aerospace business. Getting people has not been the issue, Steve. So we probably have invested before the curve. So it's really not an issue in terms of the people's part of it. I think the supply chain, even though it's military, aerospace and defense business, the supply chain still is one of the trickier bits of it. And then the last real bit is a lot of customers -- when you do aerospace, defense, you have to do qualification bills. They have to come in, qualify the process, maybe qualify, confirm a coding, maybe qualify the (inaudible) is a lot of qualification done in the aerospace, defense, in particular, when you get into the space-type programs that we have, you need the qualification. I think Christian asked a pretty good question about how do you work around that? Right now, we're trying to do with GoPros, iPads, different things. But maybe not all of it can go that way. So when do they lift the requirements, the shelter in place, and allow people back in our buildings may become critical to us in Q3 and Q4.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

You see longer term, and this is a question, I guess, a lot of companies are getting right now is, over the last several months, obviously, we haven't traveled, businesses are having to adjust. Do you see long-term structural changes here that would lead to a lower cost structure with lower travel -- lower -- where we can take out some costs that we might not have thought we could have done before the pandemic? Or how do you see that going forward?

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

So the good news is we've been able to win some customers without traveling that much. And so expenses on travel are down. The bad news is, it's all a matter of what my competitor and other people in the industry. So I think there'll be this new Zoom phenomenon, whatever you want to call, meetings across IP, will clearly lower the cost of travel and the cost of sales. People will do more meetings, I think, going forward. I think companies will have more people who work from home going forward. So I think there was an initial infrastructure investment, and then I think there'll be a savings in travel.

Steven Andrew Kohl - *Mangrove Capital Partners - Partner*

And last question, could you spend a second just talking about the ebbs and flows within some of the customer end market verticals. So -- I know that, obviously, defense and aero is good. I got the retail a little soft, obviously, potentially. But have you seen other opportunities within -- I'm just curious, if other things come up that you've responded to that may be other opportunities? Or what's happening in that area? What some of the sales folks are targeting?

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

Yes. So we are right now in the process of quoting ventilators in multiple places in the world. And the question is going to be, do all these countries need as many ventilators that they're talking about. So there is clearly some opportunity there. We also are operating on some new technologies that we're involved in terms of killing these types of viruses and UV light, testing some of those things. I would tell you -- so I think there's opportunity on specific products, I think that we're going after and we're focused on. I think some products will go soft. My experience in all of these crises that we've had, and I walked through them earlier, has been that there's a lumpiness coming out of them. That you have good quarters because you win some new products. Some products won't take off, some products will, and that the marketplace gets much more lumpy coming out of these things than just straight up to the right or just straight down.

Operator

And with that, I'll turn the call back over to Eddie Smith for final comments.

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

Okay. Well, I want to first of all thank everybody for their time and focus. So in closing, I want to thank our employees, our 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, and then for all of you for attending. Thank you. Have a great day.

Operator

And that does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time, and have a great day.