Note: Readers should refer to the audio replays, when available, on our website (www.smtc.com) for clarification and accuracy.

Third Quarter 2020
Conference Call Prepared Remarks

Operator

Good morning, ladies, and gentlemen, and welcome to the SMTC Third Quarter 2020 Earnings Call. (Operator Instructions) As a reminder, this conference call will be recorded.

I would now like to introduce your host for today's conference, Mr. Blair McInnis, Vice President of Finance. You may begin.

Blair McInnis

Thank you. Before we begin the call, I would 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, EBITDA 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 to investors 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. The Company's management believes that adjusting for the additional temporary costs attributable to the COVID-19 pandemic allows for a better comparison of the Company's performance to prior periods, which is consistent with the Company's financial covenants in its financing agreements. These Non-GAAP Financial Measures are used by management to manage and monitor SMTC's performance, and 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 an 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 be available on the Investor Relations section of SMTC's website that includes the link to today's webcast at www.smtc.com. The Company has also posted a slide deck which interested parties can find next to the link for today's webcast. We will be referring to these slides from time to time during our call this morning.

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

Eddie Smith

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, our Chief Financial Officer.

As I did last quarter, I want to again thank the entire SMTC team and our supply chain partners for their hard work and dedication as we continue to operate our business with the added challenges brought on by the global fight against the COVID-19 pandemic. I would also like to thank our stockholders for their continued patience and support during these trying times.

Before I provide a quick financial recap, I want to note that while we are pleased with our business execution across all facet of our operations and response to the challenges posed by the COVID pandemic, the fight isn’t over yet. Our COVID-19 prevention activities go beyond the basic requirements that are prescribed by the various governments and health care agencies. As a result of these actions, and our ability to remain focused, our facilities remain open and in operation, and we look forward to the day when the pandemic is behind us and when we expect to emerge as even a stronger and more profitable company.

As one can see on slide 3, revenue for the third quarter was $99.5 million, up 12.3% from the $88.7 million reported in the same quarter a year ago, and up 10.1% from the $90.4 million reported in the prior quarter. Customer demand during the third quarter of 2020 continued to track to our internal plans as we expanded our customer base and increased our market share. We’ve been successful with our end-markets diversification, dedication to putting the customer first and adapting our sales and onboarding processes to address the challenges posed by the COVID-19 pandemic. While these processes may be a little different, and perhaps take a little longer and require more meticulous planning, we expect to continue to gain market share and grow our sales funnel.

During the third quarter of 2020, we continued to operate as a COVID-compliant safe workplace and incurred $1.3 million to protect our employees and their families. Adhering to the health and safety action plans that we discussed on our previous conference calls, and by carefully managing our expenses and business operations, we were able to once again generate improving bottom line results, including an adjusted EBITDA of $7.5 million, or 7.6% of revenues that enabled us to report EPS of $0.04 and an adjusted EPS of 13 cents per share as noted on slide 4.

I am pleased by the trust our customers have put in us as our business development teams continue to expand SMTC's market share and expand our sales funnel. We have been successful in securing $46 million in new awards and bookings during the third quarter, primarily from five new customers and one existing customers in the Aerospace, Defense and Industrial IoT markets.

Let me quickly share with you just one example of why we are winning new customers and expanding business with our existing customers before Steve discusses the Q3 financial results and provides our outlook for the balance of the year and our initial expectations for 2021. Recently, after an extensive supplier evaluation process that involved dozens of EMS providers, and because of our track record of superior supply chain management, we were selected by a leading multi-billion-dollar a year international supplier of sophisticated hardware and software products, as one of their two global preferred suppliers. This customer, who provides products to a variety of growth industries, including many we are targeting such as Aerospace, Defense, Industrial IoT, Test and Measurement, and Medical and Safety, also values our leadership team's ability and willingness to develop flexible, innovative and strategic solutions to its complex manufacturing requirements. Manufacturing for this customer award started in Q2 2020 and will continue into 2021 at four of our facilities in North America.

I want to thank Rich who has decided to pursue other opportunities for his leadership and guidance over the past three-and-a-half-years, during which time SMTC tripled in size with increased profitability and customer satisfaction. Rich will continue in his current COO role during the search for his successor which is expected to be completed by the end of the first quarter of 2021.

Steve Waszak, our CFO, will now discuss our third quarter results in more detail. After Steve's remarks, I will provide some additional commentary before we open the call to questions.

Steve Waszak

Thank you, Eddie.

Now let me discuss our financial results, which you can see, on slide 5. Revenue in the third quarter of 2020 was $99.5 million, compared to $90.4 million in the prior quarter, and $88.7 million from the third quarter a year ago. During the third quarter of 2020, we had two 10%-plus customers that accounted for 11.7% and 11.1%, respectively. As Eddie noted, we are pleased with the top-line growth and strength provided by our end-market diversification and believe that we'll continue to gain market share as we manage though this COVID-19 pandemic.

Our gross profit for the third quarter of 2020 was $11.1 million or 11.2% of revenues. This compares to $10.7 million or 11.8% of revenues in prior quarter.

Our Q3 2020 adjusted gross profit was $12.5 million or 12.6% of revenues excluding $354 thousand for non-cash amortization of intangibles, recorded in connection with our acquisition of MC Assembly, $1.3 million of COVID-19 related costs, and $261 thousand of non-cash unrealized foreign exchange gain on unsettled forward exchange contracts. The $1.3 million in incremental cost incurred to address COVID-19 issues includes-temporary labor in-lieu of at-risk employees required to stay at home, cleaning and disinfecting, and health care monitoring.

In comparison, our Q2 2020 adjusted gross profit was $11.7 million or 13.0% of revenues.

Selling, general and administrative expense for the third quarter of 2020 was $6.7 million, a reduction compared to $7.1 million reported in the second quarter of 2020. The lower SG&A expense in Q3 relative to the prior quarter was primarily due to reduced professional services rendered related to SOX compliance. As a percent of revenues, SG&A expenses decreased from 7.9% of revenues in the prior quarter to 6.7% of revenues in the third quarter of 2020. In comparison, SG&A was 7.4% of revenues in Q3 2019.

We reported net income of $1.2 million in the third quarter of 2020, compared to $995 thousand in the prior quarter and a net loss of $5.7 million in the same quarter a year ago.

Adjusted net income in the third quarter of 2020 was $3.8 million. In comparison, we reported adjusted net income of $2.4 million in the prior quarter and adjusted net income of $2.1 million in the same period a year ago.

Adjusted EBITDA in the third quarter of 2020 was $7.5 million, or 7.6% of revenues, compared to adjusted EBITDA of $6.4 million or 7.1% of revenues in the prior quarter and $6.3 million or 7.1% of revenues in the same quarter a year ago.

Reconciliations of adjusted net income, adjusted gross profit, and adjusted EBITDA are included in the press release we issued after the market closed yesterday.

Now, I'd like to comment on the Balance Sheet and other key financial metrics that were reported for the third quarter. As you can see on slide 5, our cash-to-cash cycle averaged 81 days, compared with 82 days during Q2 2020. Third quarter 2020 DSO was 59 days, DPO at 75 days. Inventory turns for Q3 2020 were 3.8 turns, compared to 4.0 turns in Q2 2020. Capital expenditures were approximately $1.4 million gross in Q3 2020.

Net debt at the end of the third quarter of 2020 was $85.9 million compared to $84.6 million in the second quarter. Both periods include $3.6 million for the extension of the Company's Fremont, CA facility lease in February 2020. In comparison, net debt was $84.4 million in the same quarter a year ago.

Net debt, excluding our finance and operating lease obligations, at the end of the third quarter was $68.9 million, compared to $68.4 million at the end of the prior quarter. As of September 27, 2020, our debt-to-trailing-twelve-month adjusted EBITDA ratio, excluding leases was 2.55, significantly lower than the 4.67 ratio when we acquired MC Assembly in November 2018. Including capital leases, our debt-to-trailing-twelve-month adjusted EBITDA ratio was 2.94, which is in-line with our public company peers. We continue to expect that we will be able to further reduce our debt-to-EBITDA ratio exiting 2020.

Our financial priorities during this COVID-19 pandemic remain focused on tight control over expenses, carefully managing our working capital and leveraging fixed-costs as revenues expand, and managing strong relationships with our partners to ensure financial flexibility so we can adjust as needed and support our operations through the continuing COVID-19 pandemic and that uncertainty it creates.

At the end of the quarter, and subject to debt covenants, we had $30.5 million available under our asset-based lending credit facility. To ensure covenant flexibility, as we continue to navigate through the continuing COVID-19 pandemic, we recently also further amended our credit facilities.

As noted on slide 6, based on our current demand and supply chain visibility, and assuming our facilities continue to operate at currently planned levels, we are reaffirming at the higher end of our prior guidance issued on August 5, 2020. We now expect revenues to range between $195 million and $205 million and adjusted EBITDA to range between $14 million and $15 million for the second half of 2020.

Further, with continued sales momentum and planned operational efficiencies, we currently expect 2021 revenues to range between $430 million and $450 million with adjusted EBITDA to range between $33.0 million and $37.0 million, consistent with the revenue [growth] and adjusted EBITDA margin targets in our long-term financial model. Based upon our revenue outlook, we expect improvements in our cash-to-cash days as we move through 2021.

With that said, here's Eddie for some additional comments on our business. Thank you.

Eddie Smith

Thank you, Steve.

Q3 was a strong quarter. Our operations and supply chain teams continued to perform exceptionally well working around the challenges presented by the COVID-19 pandemic.

If you are following along with our posted slides, turn to slide 7. I am pleased that we are starting to see an acceleration of customer programs moving through the customer certification process, into new product introduction phase and entering production that will continue to ramp in 2021. Over the last two quarters our engineering and production staff in Boston and Fremont successfully launched 11 new product introductions, or NPI, programs.

Our business development and sales team continues to expand our business with $46 million in new multi-year customer orders in Q3 from five new customers and one existing customer.

As noted on slide 8, we remain focused on growing our market share in key markets that play to our strengths, including Industrial IoT, the regulated medical markets, and markets of customers supporting the defense and aerospace industry. During the third quarter, we continued to see robust strength with some defense and space programs, which offset softness in commercial avionics. We also benefited from a rebound by our semiconductor customers. These markets provide a stable and solid base to profitably grow our business in the years ahead.

As slides 9 and 10 illustrate, we are making progress and remained focused on achieving and maintaining a leadership position in terms of operational performance among our Tier III EMS peers, including revenue growth, gross margin, EBITDA margin and net margin percentage.

In short, we are on track to, and potentially, exceed our internal plans. We remain focused on deleveraging and prudently managing our balance sheet, generating returns for our shareholders that rank us among the top of our peer group, as we stay committed to being a very customer-focused company that provides superior service together with operational excellence.

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

Q&A

Eddie Smith

Thank you, operator.

In closing, I want to, once again, thank our employees, leadership team, business partners, distributors and our stockholders for their continued support and look forward to reporting our progress to our various stakeholders as we go forward. Thank you.

Operator

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