

# Mossberg's Investor Digest

## Best Idea Profile:

## SMTC Corporation (NASDAQ:SMTX)

### DESCRIPTION:

SMTC Corporation provides electronics manufacturing services to original equipment manufacturers and emerging technology companies in the fields of industrial, medical, computing, communications, medical and renewable energy. Industrial and Communications segments each represent well over a third of SMTC's revenues. These services include product design, prototype manufacturing, "low volume-high mix" and "high volume-low mix" manufacturing and system-level assemblies. Corporate headquarters are in Toronto, with the U.S. head office in San Jose, California. It has manufacturing capabilities in California, Mexico, and China. Its facility in Mexico is SMTC's largest assembly operation with 215,000 square feet. SMTC has more than 2,200 full-time employees and was founded in 1985.

### KEY INVESTMENT CONSIDERATIONS:

**Industry Growth** – Original equipment manufacturers are increasingly using contract electronics manufacturing such as SMTC because of the benefits they enjoy through outsourcing: cost reduction, improved cash cycles and flexibility. The electronic manufacturing services industry is estimated to have grown at a compound annual growth rate of 5.3% through 2013, and represents a \$127 billion market.

**Aggressive Management** – SMTC has cleaned house relative to its management. As of May 2013, there is an interim president and chief executive, as well as new executives in operations, engineering and quality. They have extensive experience in electronic manufacturing and are committed to aggressively addressing working capital issues at the company, while working to install productivity and quality initiatives. Executives have visited all the facilities, met with key customers, vendors and bankers in an effort to significantly improve SMTC's outlook. The new executive chairman is charged with the search for a permanent CEO.

**Second Quarter House Cleaning** – Working capital has become an issue with the company's lenders. However, in the second quarter, SMTC reduced receivables by \$8 million, inventories by \$10 million and working capital by \$6 million, compared with the first quarter. Debt, net of cash, was reduced almost \$9 million. This effort will continue as the company is still in violation of its debt covenants, but had them adjusted and waived in the second quarter. Management expects

profitability will improve in the third and fourth quarters but has suspended guidance.

**Impact of Unusual Charges** – Management detailed \$6.7 million of expenses which it considered unusual in the second quarter, making this a complicated quarter to evaluate. Of that, \$1.2 million came from executive severances, and there may be some more in the next quarter. Also, \$4.6 million was in non-recurring expenses: \$2.1 million in unrealized foreign exchange loss on derivatives, \$1.3 million from closing its Canadian manufacturing facility, and \$1.2 million in other non-recurring costs. The facility closing is a positive for the company in that it will reduce ongoing expenses without displacement of these customers as they were in large part transitioned to other facilities.

### VALUATION:

The stock took a significant hit, on relatively high volume, following its first quarter earnings announcement, and is currently off almost 18% since the beginning of the year. The stock appears to be more stable recently with new management showing an ability to address working capital needs.

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Investment Data (as of 9/26/13)

<b>Recent Price</b>	<b>\$1.97</b>
52-Week Range	\$1.60 - \$3.15
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	16 M
Average Trading Volume (3 mos)	27k
Market Capitalization	\$32 M
Cash	\$3 M
Long-term Debt	\$25 M
Enterprise Value (EV)	\$55 M
Book Value	\$2.33
TTM Revenue	\$279 M
P/ Revenue	0.1x
TTM EPS	\$(0.16)
P/ EPS	NA
TTM EBITDA	\$5.7 M
EV/ EBITDA	9.7x

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