

SMTC CORP
Form 10-Q/A
June 22, 2004
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 4, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 0-31051

SMTC CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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DELAWARE
(STATE OR OTHER JURISDICTION

98-0197680
(I.R.S. EMPLOYER

OF INCORPORATION OR ORGANIZATION)

IDENTIFICATION NO.)

635 HOOD ROAD

MARKHAM, ONTARIO, CANADA L3R 4N6

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

(905) 479-1810

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Indicate by check mark whether SMTC Corporation: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No .

As of May 7, 2004, SMTC Corporation had 24,375,718 shares of common stock, par value \$0.01 per share, and one share of special voting stock, par value \$0.01 per share, outstanding. As of May 7, 2004, SMTC Corporation's subsidiary, SMTC Manufacturing Corporation of Canada, had 4,314,061 exchangeable shares outstanding, each of which is exchangeable into one share of common stock of SMTC Corporation.

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Explanatory Note

This amendment on Form 10-Q/A is filed to amend Part I, Item 2., Management's Discussion and Analysis of Financial Condition and Results of Operations, due to a production error in connection with the preparation of the Registrant's Quarterly Report on Form 10-Q filed on May 19, 2004.

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The consolidated financial statements and our selected consolidated financial data have been prepared in accordance with United States GAAP.

Consolidated Statement of Operations Data(a):

(in millions, except per share amounts)

(Unaudited)

	Three months ended	
	April 4,	March 30,
	2004	2003
Revenue	\$ 69.4	\$ 81.5
Cost of sales	62.6	73.6
Gross profit	6.8	7.9
Selling, general and administrative expenses (b)	4.3	4.7
Amortization	1.1	1.0
Restructuring charges (b)		0.2
Operating earnings	1.4	2.0
Interest	1.3	1.5
Earnings (loss) before income taxes and discontinued operations	0.1	0.5
Income tax expense	0.1	0.2
Earnings (loss) from continuing operations	0.0	0.3
Loss from discontinued operations (c)		(0.3)
Earnings (loss)	\$ 0.0	\$ 0.0
Earnings (loss) per common share:		
Basic earnings (loss) per share from continuing operations	\$ 0.00	\$ 0.01
Loss per share from discontinued operations		(0.01)
Basic earnings (loss) per share	\$ 0.00	\$ 0.00
Diluted earnings (loss) per share	\$ 0.00	\$ 0.00

Weighted average number of shares outstanding:		
Basic	28.7	28.7
Diluted	28.7	29.0

- (a) The consolidated financial statements have been presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business for a reasonable period of time. As a consequence, the consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

The Company has incurred significant losses in fiscal 2001, 2002 and 2003, including costs associated with the restructuring of its operations resulting in a deficiency in shareholders' equity at April 4, 2004. The Company's long-term debt has been classified as a current liability at April 4, 2004 due to the maturity of the debt on October 1, 2004 (Refer to note 5 to our April 4, 2004 interim consolidated financial statements), resulting in a significant working capital deficiency as at April 4, 2004. In addition, absent the completion of the recapitalization (described below), the Company believes that it is unlikely that it will be in compliance with the existing financial covenants in the current credit agreement in the second

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quarter of 2004. Should the Company be unable to refinance the debt, subject to reasonable and achievable covenants, the Company expects that it will not be able to satisfy its indebtedness and other obligations. If the Company were unable to repay such amounts, the lenders could proceed against any collateral granted to them to secure the indebtedness. Substantially all of the Company's assets have been pledged to the lenders as collateral for the Company's obligations under the senior facility.

On February 17, 2004, the Company announced a proposed recapitalization, as described in note 1 to our April 4, 2004 interim consolidated financial statements. The effect of this recapitalization would be to lower the Company's overall indebtedness at closing by approximately \$37.0 million, extend the term of the majority of the remaining indebtedness and provide additional liquidity. The proposed transactions are subject to the receipt of all necessary stockholder, regulatory and stock exchange approvals and definitive agreements and other customary conditions. The ability of the Company to continue as a going concern and to realize the carrying value of its assets and the discharge of its liabilities in the normal course of business is dependent upon the Company being able to refinance its existing debt as described above. However, there can be no assurances that the Company will be successful in its refinancing efforts and, accordingly, may not have sufficient working capital to fund future operations.

Our consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate for our financial statements, then adjustments would be necessary in the carrying value of assets and liabilities, the reported revenue and expenses, and the balance sheet classifications used.

- (b) The Company recorded restructuring charges of \$0.2 million during the first quarter of 2003 relating to severance costs associated with the closure of the Austin facility and resizing of other facilities. Refer to note 9 to our April 4, 2004 interim consolidated financial statements.

The Company recorded an adjustment to other charges of \$0.3 million during the first quarter of 2004 relating to proceeds from the sale of an asset previously written off. This amount has been recorded in selling, general and administrative expenses. Refer to note 9 to our April 4, 2004 interim consolidated financial statements.

- (c) During the third quarter of 2003, the Company sold the manufacturing operations of the Appleton facility for cash proceeds of \$3.1 million. Refer to note 10 to our April 4, 2004 interim consolidated financial statements.

Consolidated Balance Sheet Data:

(in millions)

	April 4, 2004 (Unaudited)	December 31, 2003
Cash	\$ 0.2	\$ 0.2
Working capital (deficiency)	(53.1)	(55.2)
Total assets	109.9	108.8
Total debt, including current maturities	70.5	70.1
Shareholders' equity (deficiency)	(21.4)	(21.3)

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We provide advanced electronics manufacturing services, or EMS, to electronics industry original equipment manufacturers, or OEMs, primarily in the industrial, enterprise computing and networking, and communications market segments. We currently service our customers through five manufacturing and technology centers strategically located in key technology corridors in the United States, Canada and the cost-effective location of Mexico. Our full range of value-added supply chain services include product design, procurement, prototyping, advanced cable and harness interconnect, high-precision enclosures, printed circuit board assembly, test, final system build, comprehensive supply chain management, packaging, global distribution and after sales support.

As the technology sector grew rapidly in the years 1999 and 2000, we sought to take advantage of such growth and completed several acquisitions, including Zenith Electronics' facility in Chihuahua, W.F. Wood's high precision enclosure manufacturing site in Boston, Massachusetts, Pensar Corporation, an EMS company specializing in design engineering and headquartered in Appleton, Wisconsin and Qualtron Teoranta, a provider of specialized cable and harness interconnect assemblies, based in Donegal, Ireland with a subsidiary in Haverhill, Massachusetts. When the technology sector declined, we found ourselves with significant excess capacity and incurred significant operating losses. As a result, in fiscal year 2001, we began an operational restructuring that is substantially complete today and involved closing six and selling one of our manufacturing facilities. As a result of the restructuring of our business, the debt outstanding under our existing credit facility cannot be supported by our current business model. Accordingly, we have negotiated a restructuring of the debt under our existing credit agreement as part of an overall recapitalization of the Company that is subject to stockholder approval.

In 2002, we began pursuing a plan to restructure, refinance and restore profitability and growth to the Company, which we continued to execute during 2003. The first phase involved a major operational restructuring that aligned our cost structure with expected revenue and focused operations in key cost-effective geographic locations. This phase was substantially completed in the fall of 2003 and involved the closure of our sites in Donegal, Ireland, Austin, Texas, Charlotte, North Carolina and the sale of our Appleton, Wisconsin manufacturing operations. Our operational restructuring plan has been substantially completed, and we expect to incur limited additional charges related to its implementation.

In late 2003, we initiated the second phase to recapitalize the Company through several refinancing transactions that, upon closing, we believe would strengthen our balance sheet and provide additional financial flexibility. The proposed recapitalization of the Company consists of three main components: a private placement of equity securities that closed into escrow pending stockholder approval, a new secured credit facility and a transaction with the Company's current lenders to repay a portion of the Company's existing debt and restructure the balance of the Company's existing debt. We refer to the proposed recapitalization in this report as the Recapitalization Transaction. The closing of the Recapitalization Transaction is subject to stockholder approval and certain other conditions.

The following summary briefly describes the material terms of the Recapitalization Transaction.

Private Placement of Equity Securities

The private placement consisted of a committed private placement fully underwritten by a syndicate of Canadian investment dealers comprised of Orion Securities Inc., CIBC World Markets Inc., GMP Securities Limited and RBC Dominion Securities Inc. (collectively, the Underwriters)

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of 33,350,000 Special Warrants of SMTC Canada (each a Special Warrant and, collectively, the Special Warrants) to qualified investors at a price of Cdn\$1.20 (approximately US\$0.90) per Special Warrant, representing an aggregate amount of issue of Cdn\$40.02 million, Cdn\$37.3 million net of underwriting expenses, or approximately US\$28.7 million, US\$26.7 million net of underwriting expenses, based on the exchange rate on March 3, 2004) (the Offering). The Company completed the private placement of Special Warrants on March 3, 2004 (the Closing Date). The net proceeds from the Offering are being held in escrow pending receipt of stockholder approval and satisfaction of certain other conditions and, upon release from escrow, will be used for debt reduction, as part of a concurrent

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agreement with the Company's lenders, and working capital. The private placement includes the following terms:

Each Special Warrant is exercisable, without any additional consideration, into one unit consisting of one exchangeable share of SMTC Canada, and one half of a warrant to purchase an exchangeable share. Each whole warrant will be exercisable for one exchangeable share of SMTC Canada at an exercise price of CDN\$1.85 per share for a period of 60 months following the closing of the Offering.

Subject to satisfaction of applicable legal requirements, each exchangeable share can be exchanged on a one-for-one basis for one share of the common stock of the Company. Each exchangeable share, as nearly as practicable, is the economic equivalent of a share of our common stock and is entitled to dividend and liquidation rights and participation in a tender offer, share exchange offer, issuer bid, take-over bid or similar transaction with respect to the common stock to the same extent and on an economically equivalent basis as the holders of SMTC common stock. Holders of the exchangeable shares are able to exercise essentially the same voting rights with respect to the Company as they would have if they had exchanged their exchangeable shares for our common stock.

Subject to adjustment and subject to release of the escrowed proceeds, the Special Warrants will be exercisable for units on the earlier of: (i) the sixth business day after the date on which a receipt has been issued by applicable Canadian securities regulatory authorities for a prospectus qualifying the distribution of the exchangeable shares and warrants issuable upon exercise of the Special Warrants (the Prospectus Qualification Date), and (ii) March 4, 2005. If the Prospectus Qualification Date has not occurred on or before June 1, 2004 or if the Company has not registered in the United States the common stock underlying the exchangeable shares issuable in connection with the offering by July 1, 2004, each Special Warrant shall thereafter entitle the holder to receive upon exercise, without payment of additional consideration, 1.1 units in lieu of one unit.

Agreement with the Company's Current Lenders

The proposed Recapitalization Transaction includes an agreement with the Company's current lenders, for which a binding term sheet has been signed, under which the Company will satisfy its debt under its existing credit facility by:

repaying \$40 million of debt at par;

exchanging \$10 million of debt for \$10 million of the Company's common stock and warrants valued on the same terms as the private placement; and

converting up to a limit of \$27.5 million into second lien subordinated debt with maturity ranging from four to five years. In the unlikely event the remaining debt exceeds this limit, the difference will be repaid at par.

In addition, all warrants in connection with the current credit facility issued and to be issued to the current lenders (the Lender Warrants) will be cancelled. The Company agreed to issue such Lender Warrants to purchase our common stock if we did not meet certain EBITDA (earnings before interest expense, income taxes, depreciation and amortization) targets in connection with an amendment to our existing credit facility in December 2002. As a result of our shortfall in achieving such EBITDA targets, we have issued, or are currently obligated to issue, a total of 2,199,804 warrants with exercise prices ranging from \$0.61 per share to \$1.04 per share.

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Our existing credit facility, which we are seeking to refinance in connection with an agreement with current lenders, consists of a revolving credit facility of \$80 million and a term loan with an outstanding balance of \$6,941,694 at April 4, 2004, which bear interest at the U.S. base rate plus 0.25% to 2.50%. The existing credit facility also contains several financial and other covenants, including minimum cumulative consolidated EBITDA and maximum total revolving extensions of credit which were based on a business plan for the Company that is inconsistent with the Company's current capacity. The existing credit facility was entered into at a time when the

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Company operated six facilities and had revenue of \$527 million for the prior fiscal year. In response to the general economic downturn in 2001 and 2002, the Company undertook a restructuring program aimed at reducing its cost structure. The Company now operates only five facilities and had revenue of \$306.1 million during fiscal 2003. As a result, the Company has repeatedly found itself in violation of the covenants under the current credit agreement and has repeatedly required amendments to and waivers of such covenants. Absent approval of proposals related to the Recapitalization Transaction by our stockholders at our 2004 Annual Meeting of Stockholders, which will allow the consummation of the Recapitalization Transaction, the Company expects it will violate covenants under its current credit agreement by June 2004, including the minimum availability and maximum revolver covenants. The minimum availability covenant measures the spread between the Company's borrowing base and borrowings under the revolver. Prior to June 30, 2004, the Company is not required to maintain any spread, but following June 30, 2004 it will be required to maintain a \$3 million spread, at which point the Company expects it will violate the covenant. The maximum revolver covenant measures the total permitted borrowings under the revolver, which are limited to \$77 million. While the Company is currently in compliance with this covenant, it anticipates violating the covenant in June 2004 when it is required to make a \$4 million amortization payment on its term loans.

New Secured Credit Facility

In connection with the proposed Recapitalization Transaction, the Company intends to enter into new asset-based credit facilities with Congress Financial Corporation and its affiliates for which letters of intent have been signed. The new credit facilities will be available to the Company's U.S. and Canadian operating entities in a maximum amount of \$40 million (to be allocated as between Canada and the U.S. as agreed to by the Company and Congress). The new credit facilities will include a term loan of up to \$2 million, which will bear interest at the reference rate plus 1.00% and a revolving loan that will bear interest at the reference rate plus 0.50%. The reference rate will be the Canadian prime rate for the loans in Canada and the U.S. prime rate for the loans in the United States. The new credit facilities will provide for customary fees, including a 1.00% closing fee, an unused line fee and a termination fee of up to 2.00%.

The borrowing base for the revolving loan facilities to be provided by Congress will be calculated using a formula based on (i) the lesser of 50% of the value of the eligible inventory of the Company's U.S. and Canadian operating entities valued at the lower of cost or market value, or 85% of such inventory's appraised value, both subject to a \$5 million cap and (ii) 85% of the eligible accounts receivable of those entities.

The new credit facilities will include a single financial covenant which will require the Company to maintain a specified level of consolidated EBITDA. The Company will be required to achieve consolidated EBITDA of \$5.0 million cumulatively for the first two quarters of 2004, \$7.5 million cumulatively for the first three quarters of 2004 and \$11.0 million cumulatively for 2004 in total. Thereafter, it will be required to maintain consolidated EBITDA of \$11.0 million on a rolling four quarter basis. The covenant levels are being negotiated in light of the Company's current business plan.

The new credit facilities will be secured against the assets of the Company's U.S. and Canadian operations. The security interest granted to Congress will rank senior to any security in favor of the current lenders whose facilities are being restructured.

The new credit facilities will include representations, warranties, covenants and events of default that are customary for asset-based credit facilities.

The Company expects to draw approximately \$12.5 million under the new credit facilities at the closing of the Recapitalization Transaction. The actual amount to be drawn will depend on the amount of the Company's outstanding indebtedness to our current lenders and the amount of expenses the Company incurs to consummate the Recapitalization Transaction.

The terms of the new credit facilities described above are based on the letter of intent and the current state of negotiations, but are subject to continued negotiation.

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Certain Effects of the Recapitalization Transaction

The effect of this refinancing would be to lower the Company's overall indebtedness at the closing of the Recapitalization Transaction by approximately \$37 million, extend the term of the majority of the remaining indebtedness and provide additional liquidity. The level of indebtedness under the existing lenders' facility at April 4, 2004 was \$70.5 million.

Currently outstanding shares will be 39% of the outstanding shares after the Recapitalization Transaction and 30% of the outstanding shares upon the exercise of the private placement warrants and the warrants that will be issued to our current lenders (with such exercise generating approximately CDN\$41.1 million in additional proceeds for the Company).

Need for the Recapitalization Transaction

Our Board of Directors has approved the proposal for the Recapitalization Transaction. We believe that the Recapitalization Transaction is in the best interests of the Company and the stockholders due to:

the over-leveraged capital structure of the Company;

the increased liquidity and working capital availability afforded by the refinancing;

the high probability of default under our credit agreement absent a refinancing;

the lack of a more favorable offer to the Recapitalization Transaction proposal following a process undertaken to identify potential purchasers of all or part of the Company; and

the less favorable alternative to the Company and the stockholders that resulted from the negotiations with our current lenders regarding a stand alone refinancing.

We believe that the likely outcome for the Company if the Recapitalization Transaction is not completed would be negative. If the Recapitalization Transaction had not been agreed to with the Company's lenders prior to the issuance of the Company's financial results for fiscal year 2003, the Company believes that suppliers and customers would have reacted negatively to the going concern qualification in the Company's accountants' audit opinion. Further, the Company will likely be in default of other covenants under the terms of its existing credit agreement no later than the end of June 2004. Absent the agreement with the current lenders on the Recapitalization Transaction, upon an event of default, the lenders could have decided to resort to their collateral, consisting of substantially all of the Company's assets and in which event reorganization proceedings under the Bankruptcy Code could have been one of the possible consequences. If the Recapitalization Transaction is not approved by the stockholders, the Company will likely face a high probability of an event of default with its current lenders no later than the end of June 2004.

As a result of the restructuring of the Company and market conditions in the period 2001 to 2002, we incurred significant operating losses. As a result of the late stages of the restructuring of the Company, the continued downturn in the technology sector and the over-leveraged capital structure of the Company, the Company continued to experience losses during fiscal 2003. The losses from fiscal 2001 through 2003 resulted in our repeated non-compliance with certain financial covenants contained in our credit agreement and repeated amendments to our credit

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agreement. The Company was in compliance with the amended financial covenants at December 31, 2003 and April 4, 2004. Continued compliance with the amended financial covenants through October 1, 2004, the term of the existing credit facility, is unlikely. In the event of non-compliance (and absent the completion of the Recapitalization Transaction), the Company's lenders have the ability to demand repayment of the outstanding amounts under the existing credit facility.

Corporate History

SMTC Corporation is the result of the July 1999 combination of Surface Mount and HTM. Surface Mount was established in Toronto, Ontario in 1985. HTM was established in Denver, Colorado in 1990. SMTC was established in Delaware in 1998. After the combination, we purchased Zenith Electronics' facility in Chihuahua, Mexico, which expanded our cost-effective manufacturing capabilities in an important geographic

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region. In September 1999, we established a manufacturing presence in the Northeastern United States and expanded our value-added services to include high precision enclosure capabilities by acquiring Boston, Massachusetts based W.F. Wood. In July 2000, we acquired Pensar Corporation, an EMS company specializing in design engineering and headquartered in Appleton, Wisconsin. On July 27, 2000, we consummated an initial public offering of 6,625,000 shares of our common stock and 4,375,000 exchangeable shares of our subsidiary SMTC Manufacturing Corporation of Canada, or SMTC Canada. Each exchangeable share of SMTC Canada is exchangeable at the option of the holder at any time into one share of our common stock, subject to compliance with applicable securities laws. On August 18, 2000, we sold an additional 1,650,000 shares of common stock upon exercise of the underwriters' over-allotment option. In November 2000, we acquired Qualtron Teoranta, a provider of specialized cable and harness interconnect assemblies, based in Donegal, Ireland and with a subsidiary in Haverhill, Massachusetts. In fiscal 2001, we closed our facilities in Denver, Colorado and Haverhill, Massachusetts. In fiscal 2002, we closed our facility in Cork, Ireland. In fiscal 2003, we closed our facilities in Donegal, Ireland, Austin, Texas and Charlotte, North Carolina and sold the majority of our operations in Appleton, Wisconsin.

Results of Operations

Our contractual arrangements with our key customers generally provide a framework for our overall relationship with our customer. Revenue from the sale of products is recognized when goods are shipped to customers since title has passed to the customer, persuasive evidence of an arrangement exists, performance has occurred, all customer-specified test criteria have been met and the earnings process is complete. The Company also derives revenue from engineering and design services. Service revenue is recognized as services are performed. Actual production volumes are based on purchase orders for the delivery of products. Typically, these orders do not commit to firm production schedules for more than 30 to 90 days in advance. To minimize inventory risk, generally we order materials and components only to the extent necessary to satisfy existing customer forecasts or purchase orders. Fluctuations in material costs typically are passed through to customers. We may agree, upon request from our customers, to temporarily delay shipments, which causes a corresponding delay in our revenue recognition.

Our fiscal year end is December 31. The consolidated financial statements of SMTC are prepared in accordance with United States GAAP, which conforms in all material respects to Canadian GAAP, except as disclosed in Note 19 to the December 31, 2003 annual consolidated financial statements. In 2001 the amortization and the write-down of goodwill related to the Qualtron Teoranta acquisition are \$0.2 million and \$2.2 million lower, respectively, under Canadian GAAP. Under United States GAAP, the shares issued as consideration in the Qualtron Teoranta acquisition were valued using the share price at the announcement date of the acquisition and under Canadian GAAP, the shares were valued on the consummation date. In 2002, the transitional goodwill impairment charge of \$55.6 million was recognized in opening retained earnings under Canadian GAAP. Under United States GAAP, the cumulative adjustment was recognized in earnings during 2002. There were no Canadian GAAP differences in 2003.

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The following table sets forth certain operating data as a percentage of revenue for the periods ended:

(Unaudited)

	Three months ended	
	April 4, 2004	March 30, 2003
Revenue	100.0%	100.0%
Cost of sales	90.2	90.3
Gross profit	9.8	9.7
Selling, general and administrative expenses	6.2	5.8
Amortization	1.6	1.2
Restructuring charges		0.3
Operating earnings	2.0	2.4
Interest	1.9	1.8
Earnings (loss) before income taxes and discontinued operations	0.1	0.6
Income tax expense	0.1	0.2
Earnings (loss) from continuing operations	0.0	0.4
Loss from discontinued operations		(0.4)
Earnings (loss)	0.0%	0.0%

Quarter ended April 4, 2004 compared to quarter ended March 30, 2003

Revenue decreased \$12.1 million, or 14.9%, from \$81.5 million for the first quarter of 2003 to \$69.4 million for the first quarter of 2004. The decline in revenue primarily resulted from lower production volume from Alcatel as certain programs near completion resulting in approximately \$9.0 million in lower revenue in the quarter. Revenue was also lower from IBM, which was partially offset by increases from Square D and Ingenico. During the first quarter of 2004 the Company continued its focus on the industrial sector resulting in a substantial change to the product mix from the first quarter of 2003. The industrial sector represented 58% of total sales for the first quarter of 2004, compared to 51% for the same period in 2003. The proportion of sales to both the enterprise computing and networking and the communications sectors declined to 29% and 13% respectively during the first quarter of 2004 from 35% and 14% respectively for the same period in 2003.

During the first quarter of 2004 we recorded approximately \$2.1 million of sales of raw materials inventory to customers, which carried no margin, compared to \$2.2 million for the same period in 2003. The Company purchases raw materials based on customer purchase orders. To the extent the customer requires these orders to be altered or changed, the customer is generally obligated to purchase the original on-order raw material.

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Due to changes in market conditions, the life cycle of products, the nature of specific programs and other factors, customer volumes produced by the Company typically vary from quarter to quarter. Through the course of the current year, we expect that business for certain customers is likely to grow as customer programs ramp up to meet market demand. Conversely, we also expect business for certain customers to decline as certain product programs near completion. For the first quarter, the Company's ten largest customers represented approximately 88% of revenue. Revenue from our three largest customers was \$13.8 million from IBM, \$11.8 million from Ingenico and \$11.1 million from Square D representing 19.9%, 17.1% and 16.0%, respectively, of total revenue for the period. This compares with revenue from IBM of \$20.0 million, Alcatel of \$12.9 million and Ingenico of \$8.4 million for the first quarter of 2003 representing 24.5%, 15.8% and 10.3%, respectively, of total revenue for the period. No other customers represented more than 10% of revenue in either period. Through the balance of the current year, we expect the revenue mix from our various customers to change such that Square D is likely not to represent over 10% of our revenues in the latter half of the year as its major program with SMTC nears completion. We also expect growth from a number of current and new customers through the last two quarters although there can be no assurance such growth will be achieved.

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The Company operates in a highly competitive and dynamic marketplace in which current and prospective customers from time to time seek to lower their costs through a competitive tendering process among EMS providers. This process creates an opportunity to increase revenue to the extent we are successful in the tender process, however there is also the potential for revenue decline to the extent we are unsuccessful in this process. Furthermore, even if we are successful, there is potential for our margins to decline. If we lose any of our larger product lines manufactured for one of our customers, we could experience further declines in revenue.

During the first quarter of 2004, 59.8% of our revenue was manufactured in Mexico, 22.0% in Canada, and 18.2% in the United States. For the first quarter of 2003, 43.0% of our revenue was manufactured in the United States, 33.1% in Mexico, 22.1% in Canada and 1.8% in Europe. We expect to continue to increase the portion of revenue attributable to our Chihuahua, Mexico and Markham, Ontario, Canada facilities, with the transfer of certain production from other facilities. We terminated manufacturing in Europe during the second quarter of 2003.

Gross Profit

Gross profit decreased \$1.1 million from \$7.9 million, or 9.7% of revenue, for the first quarter of 2003 to \$6.8 million, or 9.8% of revenue, for the first quarter of 2004. The decline in absolute dollar gross profit primarily is due to the effect of the lower revenue during the first quarter of 2004.

The Company writes down estimated obsolete or excess inventory for the difference between the cost of inventory and estimated realizable value based upon customer forecasts, shrinkage, the aging and future demand of the inventory, past experience with specific customers and the ability to sell back inventory to customers or suppliers. If these estimates change, additional write-downs may be required.

Selling, General & Administrative Expenses

Selling, general and administrative expenses decreased \$0.4 million from \$4.7 million for the first quarter of 2003 to \$4.3 million for the first quarter of 2004. Selling, general and administrative expenses for the first quarter of 2004 include an adjustment of \$0.3 million related to proceeds received on the sale of an asset previously written off. Excluding this adjustment, selling, general and administrative expenses decreased \$0.1 million from \$4.7 million, or 5.8% of revenue, for the first quarter of 2003, to \$4.6 million, or 6.6% of revenue for the first quarter of 2004. The increase in selling, general and administrative expenses as a percentage of revenue is a result of lower revenue.

The Company determines the allowance for doubtful accounts for estimated credit losses based on the length of time the receivables have been outstanding, customer and industry concentrations, the current business environment and historical experience.

Amortization

Amortization of intangible assets of \$1.1 million for the first quarter of 2004 and \$1.0 million for the first quarter of 2003 include the amortization of deferred finance costs related to the establishment of our senior credit facility in July 2000 and subsequent amendments thereto.

The costs associated with our amended and restated senior credit facility are being amortized over the remaining term of the debt. We will likely write off a portion of deferred financing costs following the closing of the Recapitalization Transaction.

Restructuring and Other Charges

The Company recorded restructuring charges of \$0.2 million during the first quarter of 2003 relating to severance costs associated with the closure of the Austin facility and resizing of other facilities.

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Approximately \$9.1 million of the restructuring charges remained unpaid at April 4, 2004. We expect the majority of the remaining restructuring accrual related to severance charges and equipment lease obligations to be paid by the end of fiscal year 2005. We are attempting to negotiate a settlement of the remaining facility lease obligations.

The restructuring charges are based on certain estimates and assumptions using the best available information at the time and are subject to change.

Interest Expense

Interest expense decreased \$0.2 million from \$1.5 million for the first quarter of 2003 to \$1.3 million for the first quarter of 2004 due to lower average debt outstanding during the first quarter of 2004 combined with lower interest rates. The weighted average interest rates with respect to the debt for first quarter of 2003 and 2004 were 7.6% and 7.2%, respectively.

Income Tax Expense

For the first quarter of 2004 an income tax expense \$0.1 million was recorded on a pre-tax income of \$0.1 million. The majority of the income tax expense relates to minimum taxes in certain jurisdictions thereby increasing the Company's effective income tax rate.

For the first quarter of 2003 an income tax expense of \$0.2 million was recorded on a pre-tax earnings before discontinued operations of \$0.5 million resulting in an effective tax rate of 40%.

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of its deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. Management considers the scheduled reversal of deferred tax liabilities, change of control limitations, projected future taxable income and tax planning strategies in making this assessment. FASB Statement No. 109, Accounting for Income Taxes, states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence, such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. As a result of the quarterly review undertaken at the end of the second quarter of 2003, the Company concluded that given the weakness and uncertainty in the current economic environment, it was appropriate to establish a full valuation allowance for the deferred tax assets arising from its operations in the jurisdictions to which the deferred tax assets relate. As a result, the total valuation allowance for deferred tax assets in all jurisdictions worldwide increased from approximately \$34.5 million at December 31, 2002 to approximately \$68.4 million at December 31, 2003. In addition, the Company expects to provide a full valuation allowance on future tax benefits until it can demonstrate a sustained level of profitability that establishes its ability to utilize the assets in the jurisdictions to which the assets relate.

At December 31, 2003, the Company had total net operating loss carryforwards of approximately \$142.4 million, of which \$4.2 million will expire in 2010, \$0.3 million will expire in 2011, \$1.3 million will expire in 2012, \$1.6 million will expire in 2018, \$81.2 million will expire in 2021, \$20.2 million will expire in 2022 and \$33.6 million will expire in 2023. The Recapitalization Transaction may limit our ability to utilize a significant portion of our tax losses in the future.

Discontinued Operations

During the third quarter of 2003, the Company sold the manufacturing operations of the Appleton facility for cash proceeds of \$3.1 million and recorded a loss on disposal of \$0.2 million.

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The following information included in discontinued operations relates to the sale of the Appleton manufacturing operations:

(in millions)	Quarter ended	
	April 4, 2004	March 30, 2003
Revenue	\$	\$ 4.4
Loss from discontinued operations	\$	\$ 0.3

Liquidity and Capital Resources

Our principal sources of liquidity are cash provided from operations and borrowings under our existing credit facility. In the past, we have also relied on our access to the capital markets. Our principal uses of cash have been to finance mergers and acquisitions, to meet debt service requirements and to finance capital expenditures and working capital requirements. We anticipate our principal uses of cash in the future will be to meet debt service requirements and to finance capital expenditures and working capital requirements.

Three months ended April 4, 2004 Liquidity:

Net cash provided by operating activities for the first quarter of 2004 was \$0.3 million. Inventory turns (excluding the inventory related to discontinued operations) declined to 7 times at the end of the first quarter of 2004 from 8 times for the same period in 2003. Accounts receivable days sales outstanding (excluding the accounts receivable related to discontinued operations) decreased to 50 days at the end of the first quarter of 2004 from 61 days for the same period in 2003. During the first quarter of 2004, the Company made \$1.4 million of restructuring payments.

Net cash used in financing activities for the first quarter of 2004 of \$0.2 million consists of the increase in long-term debt of \$0.4 million offset by the repayment of capital leases of \$0.1 million and deferred financing fees of \$0.5 million.

Net cash used in investing activities for the first quarter of 2004 was negligible.

Three months ended March 30, 2003 Liquidity:

Net cash provided by operating activities for first quarter of 2003 was \$1.6 million. Cash was generated largely from net earnings and the collection of accounts receivable, partially offset by a decline in accounts payable and accrued liabilities.

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Net cash used in financing activities for the first quarter of 2003 was \$1.8 million due to the net repayment of long-term debt of \$1.7 million, consisting of the repayment of the term component of the credit facility of \$3.7 million, offset by an increase to the revolving component of the credit facility of \$2.0 million and the repayment of capital leases of \$0.1 million.

Net cash used in investing activities for the first quarter of 2003 was negligible.

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Capital Resources

As a result of restructuring actions and market conditions we have incurred losses during 2001, 2002 and 2003, which resulted in our repeated non-compliance with financial covenants contained in our credit agreement and repeated amendments to our credit agreement to revise the financial covenants to be more consistent with our actual and forecasted revenue levels. In connection with an amendment to our credit facility in December 2002, the Company agreed to issue warrants to the lenders to purchase common stock at an exercise price equal to the fair market value on the date of the grant if we did not meet certain EBITDA targets. As a result of our shortfall in achieving such EBITDA targets, we have issued, or are currently obligated to issue, a total of 2,199,804 warrants. If the Recapitalization Transaction is approved and consummated, all of the warrants issued, and to be issued, pursuant to the December 2002 amendment will be cancelled and the debt under the current credit agreement will be restructured.

As a result of the restructuring of our business and the continuing downturn in the market, the debt outstanding under our existing credit facility cannot be supported by our current business model and it is no longer sufficient to continue to seek amendments to our credit agreement. Accordingly, we have negotiated a restructuring of the debt under our existing credit agreement as part of an overall recapitalization of the Company that is subject to stockholder approval.

As described in greater detail under Management's Discussion and Analysis of Financial Condition and Results of Operations Overview, in 2004, the Company proposes to effectuate a Recapitalization Transaction through three main components: a private placement of equity securities, a transaction with the Company's current lenders to repay a portion of and restructure a portion of the Company's existing debt and a new secured credit facility:

On March 3, 2004, the Company closed a fully underwritten, committed private placement of 33,350,000 Special Warrants of SMTC Canada to qualified investors at a price of CDN\$1.20 (approximately US\$0.90) per Special Warrant, representing an aggregate amount of issue of CDN\$40.02 million, CDN\$37.3 million net of underwriting expenses, or approximately US 28.7 million, US \$26.7 million net of underwriting expenses, based on the exchange rate on March 3, 2004. The net proceeds are being held in escrow pending receipt of stockholder approval and satisfaction of other conditions and, upon release from escrow, will be used for debt reduction, as part of a concurrent agreement with the Company's lenders, and working capital.

The Company has entered into a binding term sheet with its current lenders under which the Company will satisfy its debt under its existing credit facility by repaying \$40 million of debt at par; exchanging \$10 million of debt for \$10 million of the Company's common stock and warrants valued on the same terms as the private placement; and converting up to a limit of \$27.5 million, into second lien subordinated debt with maturity ranging from four to five years. In the unlikely event the remaining debt exceeds this limit, the difference will be repaid at par.

The Company has entered into a letter of intent with Congress Financial Corporation (Canada) for a new, 3-year \$40 million credit facility, subject to certain borrowing base conditions.

We expect that the effect of the refinancing will be to lower the Company's overall indebtedness at the closing of the Recapitalization Transaction by approximately \$37 million, extend the term of the majority of the remaining indebtedness and provide additional liquidity. The level of indebtedness under the existing lenders' facility at April 4, 2004 was US\$70.5 million.

If we complete the Recapitalization Transaction, our management believes that cash generated from operations, available cash and amounts available under our senior credit facility will be adequate to meet our debt service requirements, capital expenditures and working capital needs

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at our current level of operations and organic growth through the next twelve months, although no assurance can be given in this regard, particularly with respect to amounts available under our credit facility, as discussed above. Further, there can be no

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assurance that our business will generate sufficient cash flow from operations or that future borrowings will be available to enable us to service our indebtedness. Our future operating performance and ability to service or refinance indebtedness will be subject to future economic conditions and to financial, business and other factors, certain of which are beyond our control.

If we do not complete the Recapitalization Transaction, we would likely be in default of covenants under our existing credit agreement no later than the end of June 2004. Upon an event of default, our lenders would have the right to proceed against all of the collateral granted to them to secure our indebtedness, consisting of substantially all of our assets, and reorganization proceedings under the Bankruptcy Code could be a possible consequence. In this circumstance, our management believes that cash generated from operations, available cash and amounts available under our existing credit facility would not be adequate to meet our debt service requirements, capital expenditures and working capital needs at our current level of operations and organic growth through the next twelve months.

In the normal course of business, the Company may be subject to litigation and claims from customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts, where required. Although it is not possible to estimate the extent of potential costs, if any, management believes that ultimate resolution of such contingencies would not have a material adverse effect on the financial position, results of operations and cash flows of the Company.

Critical Accounting Policies

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Note 3 to the December 31, 2003 Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following critical accounting policies are affected significantly by judgments, assumptions and estimates used in the preparation of financial statements. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Allowance for Doubtful Accounts

The Company evaluates the collectibility of accounts receivable and records an allowance for doubtful accounts, which reduces the accounts receivable to the amount management reasonably believes will be collected. A specific allowance is recorded against customer accounts receivable that are considered to be impaired based on the Company's knowledge of the financial condition of its customers. In determining the amount of the allowance, the Company considers factors, including the length of time the accounts receivable have been outstanding, customer and industry concentrations, the current business environment and historical experience.

Inventory Valuation

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Inventories are valued, on a first-in, first-out basis, at the lower of cost and replacement cost for raw materials and at the lower of cost and net realizable value for work in progress and finished goods. Inventories include an application of relevant overhead. The Company writes down estimated obsolete or excess inventory for the difference between the cost of inventory and estimated net realizable value based upon customer forecasts, shrinkage, the aging and future demand of the inventory, past experience with specific customers, and the ability to sell inventory to customers or on return to suppliers. If these assumptions change, additional write-downs may be required.

Restructuring and Other Charges

In response to excess capacity caused by the slowing technology end market, the Company recorded restructuring and other charges aimed at reducing its cost structure. In connection with exit activities, the Company recorded charges for inventory write-downs, employee termination costs, lease and other contractual obligations, long-lived asset impairment and other exit-related costs. These charges were incurred pursuant to

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formal plans developed by management. The recognition of restructuring and other charges required the Company to make certain judgments and estimates regarding the nature, timing and amount of costs associated with the planned exit activities. The estimates of future liabilities may change, requiring the recording of additional charges or the reduction of liabilities already recorded. At the end of each reporting period, the Company evaluates the remaining accrued balances to ensure that no excess accruals are retained and the utilization of the provision are for their intended purposes in accordance with the developed exit plans.

Long-lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with FASB Statement No. 144, Accounting for Impairment or Disposal of Long-Lived Assets (Statement 144). Under Statement 144 assets must be classified as either held-for-use or available-for-sale. An impairment loss is recognized when the carrying amount of an asset that is held and used exceeds the projected undiscounted future net cash flows expected from its use and disposal, and is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is measured by discounted cash flows when quoted market prices are not available. For assets available-for-sale, an impairment loss is recognized when the carrying amount exceeds the fair value less costs to sell. In accordance with the provisions of Statement 144, the Company has presented the closure of its Cork facility in 2002 and sale of its Appleton facility in 2003 as discontinued operations.

Income Tax Valuation Allowance

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of its deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. Management considers the scheduled reversal of deferred tax liabilities, change of control limitations, projected future taxable income and tax planning strategies in making this assessment. FASB Statement No. 109, Accounting for Income Taxes, states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence, such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. Based upon consideration of these factors, management believes the recorded valuation allowance related to all of its loss carryforwards is appropriate.

FORWARD-LOOKING STATEMENTS

A number of the matters and subject areas discussed in this Form 10-Q are forward-looking in nature. The discussion of such matters and subject areas is qualified by the inherent risks and uncertainties surrounding future expectations generally; these expectations may differ materially from SMTC's actual future experience involving any one or more of such matters and subject areas. SMTC cautions readers that all statements other than statements of historical facts included in this quarterly Form 10-Q regarding SMTC's financial position and business strategy may constitute forward-looking statements. All of these forward-looking statements are based upon estimates and assumptions made by SMTC's management, which although believed to be reasonable, are inherently uncertain. Therefore, undue reliance should not be placed on such estimates and statements. No assurance can be given that any of such estimates or statements will be realized, and it is likely that actual results will differ materially from those contemplated by such forward-looking statements. Factors that may cause such differences include: (1) the failure of stockholders to approve our pending recapitalization transactions; (2) increased competition; (3) increased costs; (4) the inability to implement our business plan and maintain covenant compliance under our credit agreement; (5) the loss or retirement of key members of management; (6) increases in SMTC's cost of borrowings or lack of availability of debt or equity capital on terms considered reasonable by management; (7) adverse state, federal or foreign legislation or regulation or adverse determinations by regulators; (8) changes in general economic conditions in the markets in which SMTC may compete and fluctuations in demand in the electronics industry; (9) the inability to manage inventory levels efficiently in light of changes in market conditions; and (10) the inability to sustain historical margins as the industry develops. SMTC has attempted to identify certain of the factors that it currently believes may cause actual future experiences to differ from SMTC's current

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expectations regarding the relevant matter or subject area. In addition to the items specifically discussed in the foregoing, SMTC's business and results of operations are subject to the risks and uncertainties described under the heading "Factors That May Affect Future Results" below. The operations and results of SMTC's business may also be subject to the effect of other risks and uncertainties. Such risks and uncertainties include, but are not limited to, items described from time to time in SMTC's reports filed with the Securities and Exchange Commission.

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FACTORS THAT MAY AFFECT FUTURE RESULTS

RISKS RELATED TO THE RECAPITALIZATION TRANSACTION

If we fail to complete the Recapitalization Transaction, we would likely have an event of default under the terms of our existing credit agreement and would not likely be able to negotiate a transaction on equal or more favorable terms.

If the Recapitalization Transaction is not approved at our 2004 Annual Meeting of Stockholders to be held on May 20, 2004, we expect that we would not be able to negotiate a transaction on terms as favorable as the Recapitalization Transaction. We also expect that we would likely be in default under our existing credit agreement no later than June 2004 due to noncompliance with several covenants including the minimum availability and maximum revolver covenants. Upon a default, the lenders under our current credit facility could resort to their collateral consisting of substantially all of our assets and reorganization proceedings under the U.S. Bankruptcy Code and/or the Canadian Companies Creditors Arrangement Act could be one of the possible consequences.

If we complete the Recapitalization Transaction, current stockholders will be subject to significant dilution.

Currently outstanding shares will be 39% of the outstanding shares after the Recapitalization Transaction and 30% of the outstanding shares upon the exercise of the warrants sold pursuant to the private placement and the debt exchange that are part of the Recapitalization Transaction (with such exercise generating approximately Cdn\$41.1 million in additional proceeds for the Company), if we complete the Recapitalization Transaction.

The Company is currently exposed to foreign currency exchange risk on the proceeds of the recapitalization in escrow.

As part of the Recapitalization Transaction, we have agreed to repay \$40 million in cash to our existing lenders. This amount will be generated by borrowings under our new working capital facility and from the proceeds of our equity offering, which, net of underwriting expenses, total CDN\$37.3 million and are held in escrow. We will be required to convert the escrowed proceeds, upon stockholder approval, to satisfy the obligations to our existing lenders. In the event the Canadian dollar weakens relative to the U.S. dollar, it will have an adverse effect on our ability to purchase U.S. dollars in the amount of approximately US\$200,000 for every \$.01 change in the Canadian dollar/U.S. dollar exchange rate.

The Company's ability to use existing net operating losses to offset future taxable income may be subject to certain limitations.

Section 382 of the Internal Revenue Code imposes a limitation on a corporation's use of net operating loss (NOL) carryforwards following an ownership change . Whether or not the Recapitalization Transaction results in an ownership change for purposes of Section 382 depends upon whether the exchangeable shares of SMTC Canada are treated as shares of the Company under U.S. tax principles. Because the tax law governing the exchangeable shares is unclear, it is uncertain whether Section 382 will apply to the Recapitalization Transaction. If applicable, Section 382 would limit the amount of NOLs available to offset taxable income in future years and would preclude the full utilization of the

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Company's NOLs. As of December 31, 2003, the Company had total net operating loss carryforwards (both U.S. and Canadian) of approximately \$142.4 million.

We will not be entitled to a refund of the underwriters' fees if the Recapitalization Transaction is not completed.

We paid 6% of the gross proceeds on the sale of Special Warrants, or approximately \$1,800,000, as cash commission to the underwriters at the closing into escrow. In the event our stockholders do not approve the Recapitalization Transaction, all of the escrowed funds will be returned to the purchasers of the Special Warrants, and we will not be entitled to a refund of the commission and expenses paid to the underwriters.

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We may have to issue to the purchasers of the Special Warrants, units exchangeable for exchangeable shares and exchangeable share purchase warrants of SMTC Canada on the same terms as the private placement.

In the event that we do not obtain our stockholders' approval for the Recapitalization Transaction by June 1, 2004, then, subject to Nasdaq approval, the purchasers of Special Warrants will be allowed, for a period of five business days following the date on which our stockholders declined to approve the offering of the Special Warrants, to subscribe, on a pro rated basis, for units representing (i) an aggregate number of underlying exchangeable shares that does not exceed 25% of all such issued and outstanding exchangeable shares and (ii) an aggregate number of underlying shares of our common stock that, together with the underlying shares of common stock issuable on exchange of the securities described in (i), does not exceed 19.9% of the issued and outstanding shares of common stock of the Company. The purchasers will be able to subscribe (the Allowable Subscription) for these units on the same terms as the offering of the Special Warrants.

We may have to pay the purchasers of the Special Warrants an additional amount if we enter into an alternative business transaction.

If we fail to obtain stockholder approval for the Recapitalization Transaction and then, on or prior to February 17, 2005, we complete an equity issuance for greater than 10% of the number of shares of our common stock and exchangeable shares outstanding as of February 17, 2004 or a transaction that results in a change of control of the Company, which we refer to as an Alternative Business Transaction, we will be required to pay to each purchaser of Special Warrants (with respect to the number of exchangeable shares included in Special Warrants that were held in escrow for the benefit of such purchaser (or its assignees) at the time the stockholders declined to approve the Recapitalization Transaction minus the number of exchangeable shares purchased by such purchaser (or its assignees) pursuant to the Allowable Subscription) an amount equal to one-half of the difference between the average market price of the exchangeable shares at the close of business for the period that is ten trading days immediately preceding the date of the stockholders' meeting called to approve the Recapitalization Transaction and the subscription price of the units for which the Special Warrants are exercisable, in part. This fee would likely have the effect of making it more difficult for us to find another party interested in a transaction and would further reduce the likelihood that we would be able to negotiate a transaction on equal or more favorable terms. If a stockholders' meeting had been held on April 2, 2004 at which the proposals related to the Recapitalization Transaction failed to obtain stockholder approval and an Alternative Business Transaction were completed on or prior to February 17, 2005, the Company would have been required to pay the Purchasers an aggregate of approximately CDN\$1,950,000 under this provision.

RISKS RELATED TO OUR BUSINESS AND INDUSTRY

We are exposed to general economic conditions, which could have a material adverse impact on our business, operating results and financial condition.

As a result of recent unfavorable economic conditions and reduced capital spending, our sales have declined in during the first quarter of 2004 from fiscal year 2003 and 2002. In particular, sales to OEMs in the telecommunications and enterprise computing and networking industries worldwide were impacted during 2003. If economic conditions worsen or fail to improve, we may experience a material adverse impact on our business, operating results and financial condition.

A majority of our revenue comes from a small number of customers; if we lose any of our larger customers, our revenue could decline significantly.

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The Company operates in a highly competitive and dynamic marketplace in which current and prospective customers often seek to lower their costs through a competitive tendering process among EMS providers. This process creates an opportunity to increase revenue to the extent we are successful in the tender process, however, there is also the potential for revenue decline to the extent we are unsuccessful in the process. Furthermore, even if we are successful, there is the potential for our margins to decrease.

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Our largest three customers in the first quarter of 2004 were IBM, Ingenico and Square D, which represented approximately 19.9%, 17.1% and 16.0%, respectively, of our total revenue in the first quarter of 2004. Our top ten largest customers (including IBM, Ingenico and Square D) collectively represented approximately 88% of our total revenue in the first quarter of 2004. Through the balance of the current year, we expect the revenue mix from our various customers to change such that Square D is likely not to represent over 10% of our revenues in the latter half of the year as its major program with SMTC nears completion. We expect to continue to depend upon a relatively small number of customers for a significant percentage of our revenue. In addition to having a limited number of customers, we manufacture a limited number of products for each of our customers. If we lose any of our largest customers or any product line manufactured for one of our largest customers, we could experience a significant reduction in our revenue. Also, the insolvency of one or more of our largest customers or the inability of one or more of our largest customers to pay for its orders could decrease revenue. As many of our costs and operating expenses are relatively fixed, a reduction in net revenue can decrease our profit margins and adversely affect our business, financial condition and results of operations.

Our industry is very competitive and we may not be successful if we fail to compete effectively.

The electronics manufacturing services (EMS) industry is highly competitive. We compete against numerous domestic and foreign EMS providers including Celestica Inc., Flextronics International Ltd., Jabil Circuit, Inc., Sanmina-SCI, Inc., Solectron Corporation, Benchmark Electronics Inc., Pemstar Inc. and Plexus Corp. In addition, we may in the future encounter competition from other large electronics manufacturers that are selling, or may begin to sell, electronics manufacturing services. Many of our competitors have international operations, and some have substantially greater manufacturing, financial, research and development and marketing resources and lower cost structures than us. We also face competition from the manufacturing operations of current and potential customers, which are continually evaluating the merits of manufacturing products internally versus the advantages of using external manufacturers.

We may experience variability in our operating results, which could negatively impact the price of our shares.

Our annual and quarterly results have fluctuated in the past. The reasons for these fluctuations may similarly affect us in the future. Prospective investors should not rely on results of operations in any past period to indicate what our results will be for any future period. Our operating results may fluctuate in the future as a result of many factors, including:

variations in the timing and volume of customer orders relative to our manufacturing capacity;

variations in the timing of shipments of products to customers;

introduction and market acceptance of our customers' new products;

changes in demand for our customers' existing products;

the accuracy of our customers' forecasts of future production requirements;

effectiveness in managing our manufacturing processes and inventory levels;

changes in competitive and economic conditions generally or in our customers' markets;

willingness of suppliers to supply the Company on normal credit terms; and

changes in the cost or availability of components or skilled labor.

In addition, most of our customers typically do not commit to firm production schedules more than 30 to 90 days in advance. Accordingly, we cannot forecast the level of customer orders with certainty. This makes it difficult to schedule production to maximize utilization of our manufacturing capacity. In the past, we have been required to increase staffing, purchase materials and incur other expenses to meet the anticipated demand of our customers. Sometimes anticipated orders from certain customers have failed to materialize, and at times delivery schedules have been deferred as a result of changes in a customer's business needs. Any material delay,

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cancellation or reduction of orders from our largest customers could cause our revenue to decline significantly. In addition, as many of our costs and operating expenses are relatively fixed, a reduction in customer demand can decrease our gross margins and adversely affect our business, financial condition and results of operations. On other occasions, customers have required rapid and unexpected increases in production, which have placed burdens on our manufacturing capacity and adversely affected costs.

Any of these factors or a combination of these factors could have a material adverse effect on our business, financial condition and results of operations.

We are dependent upon the electronics industry, which produces technologically advanced products with short life cycles.

Many of our customers are in the electronics industry, which is characterized by intense competition, short product life-cycles and significant fluctuations in product demand. In addition, the electronics industry is generally subject to rapid technological change and product obsolescence. If our customers are unable to create products that keep pace with the changing technological environment, their products could become obsolete and the demand for our services could significantly decline. Our success is largely dependent on the success achieved by our customers in developing and marketing their products. Furthermore, this industry is subject to economic cycles and has in the past experienced downturns. A continued recession or a downturn in the electronics industry would likely have a material adverse effect on our business, financial condition and results of operations.

Shortage or price fluctuation in component parts specified by our customers could delay product shipment and affect our profitability.

A substantial portion of our revenue is derived from turnkey manufacturing. In turnkey manufacturing, we provide both the materials and the manufacturing services. If we fail to manage our inventory effectively, we may bear the risk of fluctuations in materials costs, scrap and excess inventory, all of which can have a material adverse effect on our business, financial condition and results of operations. We are required to forecast our future inventory requirements based upon the anticipated demands of our customers. Inaccuracies in making these forecasts or estimates could result in a shortage or an excess of materials. In addition, delays, cancellations or reductions of orders by our customers could result in an excess of materials. A shortage of materials could lengthen production schedules and increase costs. An excess of materials may increase the costs of maintaining inventory and may increase the risk of inventory obsolescence, both of which may increase expenses and decrease profit margins and operating income.

Many of the products we manufacture require one or more components that we order from sole-source suppliers. Supply shortages for a particular component can delay productions of all products using that component or cause cost increases in the services we provide. In addition, in the past, some of the materials we use, such as memory and logic devices, have been subject to industry-wide shortages. As a result, suppliers allocate available quantities among their customers, and we have not been able to obtain all of the materials required. Our inability to obtain these materials could slow production or assembly, delay shipments to our customers, increase costs and reduce operating income. Also, we may bear the risk of periodic component price increases. Accordingly, some component price increases could increase costs and reduce operating income. Also we rely on a variety of common carriers for materials transportation, and we route materials through various world ports. A work stoppage, strike or shutdown of a major port or airport could result in manufacturing and shipping delays or expediting charges, which could have a material adverse effect on our business, financial condition and results of operations.

We have experienced significant growth and significant retrenchment in a short period of time.

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Since 1995, we have completed seven acquisitions. Acquisitions may involve numerous risks, including difficulty in integrating operations, technologies, systems, and products and services of acquired companies; diversion of management's attention and disruption of operations; increased expenses and working capital requirements; entering markets in which we have limited or no prior experience and where competitors in such markets have stronger market positions; and the potential loss of key employees and customers of acquired companies. In addition, acquisitions may involve financial risks, such as the potential liabilities of the acquired businesses, the dilutive effect of the issuance of additional equity securities, the incurrence of additional debt, the financial impact of transaction expenses and the amortization of goodwill and other intangible assets involved in any transactions that are accounted for using the purchase method of accounting, and possible adverse tax and accounting effects.

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In 2001 we implemented an operational restructuring plan that called for significant retrenchment. We closed our Denver and Haverhill facilities and resized operations in Mexico and Ireland in an effort to reduce our cost structure. In February 2002 the main customer of our Cork, Ireland facility was placed into administration as part of a financial restructuring. As a result, on March 19, 2002, we announced that we were closing our Cork, Ireland facility and that we were taking steps to place the subsidiary that operates that facility in voluntary administration. During the third quarter of 2002, the Company took further steps to realign its cost structure and plant capacity. Furthermore, in 2003, we closed our sites in Austin, Texas, Donegal, Ireland and Charlotte, North Carolina and sold our manufacturing operations in Appleton, Wisconsin. Retrenchment has caused, and is expected to continue to cause, strain on our infrastructure, including our managerial, technical and other resources. We may experience inefficiencies as we complete the operational integration from closed facilities to currently operating facilities and may experience delays in meeting the needs of transferred customers. In addition, we are reducing the geographic dispersion of our operations, which may make it harder for us to compete and may cause us to lose customers. The loss of customers could have a material adverse effect on our business, financial condition and results of operations.

Our rapid growth and subsequent retrenchment has placed and will continue to place a significant strain on management, on our financial resources, and on our information, operating and financial systems. If we are unable to manage effectively, it may have a material adverse effect on our business, financial condition and results of operations.

If we are unable to respond to rapidly changing technology and process development, we may not be able to compete effectively.

The market for our products and services is characterized by rapidly changing technology and continuing process development. The future success of our business will depend in large part upon our ability to maintain and enhance our technological capabilities, to develop and market products and services that meet changing customer needs, and to successfully anticipate or respond to technological changes on a cost-effective and timely basis. In addition, the EMS industry could in the future encounter competition from new or revised technologies that render existing technology less competitive or obsolete or that reduce the demand for our services. There can be no assurance that we will effectively respond to the technological requirements of the changing market. To the extent we determine that new technologies and equipment are required to remain competitive, the development, acquisition and implementation of such technologies and equipment may require us to make significant capital investments. There can be no assurance that capital will be available for these purposes in the future or that investments in new technologies will result in commercially viable technological processes.

Our business will suffer if we are unable to attract and retain key personnel and skilled employees.

Our business depends on our ability to continue to recruit, train and retain skilled employees, particularly executive management, engineering and sales personnel. Recruiting personnel in our industry is highly competitive. We are currently seeking a new President and Chief Executive Officer to replace our current interim President and Chief Executive Officer and a new Chief Financial Officer to replace our current interim Chief Financial Officer. Our ability to successfully implement our business plan depends in part on our ability to attract and retain a new President and Chief Executive Officer and a new Chief Financial Officer and to retain key management and existing employees. There can be no assurance that we will be able to attract and retain a new President and Chief Executive Officer and a new Chief Financial Officer or to retain our executive officers and key personnel or attract qualified management in the future. In connection with our restructuring, we significantly reduced our workforce. If we receive a significant volume of new orders, we may have difficulty recruiting skilled workers back into our workforce to respond to such orders and accordingly may experience delays that could adversely effect our ability to meet customers' delivery schedules.

Risks particular to our international manufacturing operations could adversely affect our overall results.

Our international manufacturing operations are subject to inherent risks, including:

fluctuations in the value of currencies and high levels of inflation;

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longer payment cycles and greater difficulty in collecting amounts receivable;

unexpected changes in and the burdens and costs of compliance with a variety of foreign laws;

political and economic instability;

increases in duties and taxation;

imposition of restrictions on currency conversion or the transfer of funds;

trade restrictions; and

dependence on key customers.

We are subject to a variety of environmental laws, which expose us to potential financial liability.

Our operations are regulated under a number of federal, state, provincial, local and foreign environmental and safety laws and regulations, which govern, among other things, the discharge of hazardous materials into the air and water as well as the handling, storage and disposal of such materials. Compliance with these environmental laws is a major consideration for us because we use metals and other hazardous materials in our manufacturing processes. We may be liable under environmental laws for the cost of cleaning up properties we own or operate if they are or become contaminated by the release of hazardous materials, regardless of whether we caused such release. In addition we, along with any other person who arranges for the disposal of our wastes, may be liable for costs associated with an investigation and remediation of sites at which we have arranged for the disposal of hazardous wastes, if such sites become contaminated, even if we fully comply with applicable environmental laws. In the event of a contamination or violation of environmental laws, we could be held liable for damages including fines, penalties and the costs of remedial actions and could also be subject to revocation of our discharge permits. Any such revocations could require us to cease or limit production at one or more of our facilities, thereby having a material adverse effect on our operations. Environmental laws could also become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with any violation, which could have a material adverse effect on our business, financial condition and results of operations.

RISKS RELATED TO OUR CAPITAL STRUCTURE

Our indebtedness could adversely affect our financial health and severely limit our ability to plan for or respond to changes in our business.

At April 4, 2004, we had \$70.5 million of indebtedness under our senior credit facility. If the Recapitalization Transaction is approved by stockholders at our Annual Meeting and ultimately consummated, it will reduce our debt, but we will remain highly leveraged. Under our new senior facility, we will have a secured revolving credit and term loan facility of up to \$40 million. In addition, we will have up to \$27.5 million in second lien subordinated term debt. This debt, whether under our existing senior credit facility or the facilities that would be put in place as part of the Recapitalization Transaction, could have adverse consequences for our business, including:

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We will be more vulnerable to adverse general economic conditions;

We will be required to dedicate a substantial portion of our cash flow from operations to repayment of debt, limiting the availability of cash for other purposes;

We may have difficulty obtaining financing in the future for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes;

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We may have limited flexibility in planning for, or reacting to, changes in our business and industry;

We could be limited by financial and other restrictive covenants in our credit arrangements in our borrowing of additional funds; and

We may fail to comply with the covenants under which we borrowed our indebtedness which could result in an event of default. If an event of default occurs and is not cured or waived, it could result in all amounts outstanding, together with accrued interest, becoming immediately due and payable. If we were unable to repay such amounts, the lenders could proceed against any collateral granted to them to secure that indebtedness. There can be no assurance that we will maintain compliance with the covenants under our credit agreement.

There can be no assurance that our leverage and such restrictions will not materially adversely affect our ability to finance our future operations or capital needs or to engage in other business activities. In addition, our ability to pay principal and interest on our indebtedness to meet our financial and restrictive covenants and to satisfy our other debt obligations will depend upon our future operating performance, which will be affected by prevailing economic conditions and financial, business and other factors, certain of which are beyond our control, as well as the availability of revolving credit borrowings under our senior credit facility or successor facilities.

We face significant restrictions on our ability to operate under the terms of our current credit agreement and would face similar restrictions under the terms of the credit arrangements that would be implemented in the Recapitalization Transaction.

The terms of our current credit agreement restrict, among other things, our ability to incur additional indebtedness, complete acquisitions, pay dividends or make certain other restricted payments, consummate certain asset sales, make capital expenditures, incur cash restructuring costs, enter into certain transactions with affiliates, merge, consolidate or sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of our assets. We are also required to maintain specified financial ratios and satisfy certain monthly and quarterly financial condition tests, which further restrict our ability to operate as we choose. We would face similar restrictions and requirements under the credit arrangements that are part of the Recapitalization Transaction.

If we are not able to comply with these covenants and tests, customers may lose confidence in us and reduce or eliminate their orders with us which may have a material adverse effect on our business, financial condition and results of operations.

Substantially all of our assets and those of our subsidiaries are pledged as security under our senior credit facility and would be similarly pledged under the credit arrangements that would be effected in the Recapitalization Transaction.

Institutional investors and certain members of management have significant influence over our business, and could delay, deter or prevent a change of control or other business combination.

Certain of our institutional investors have representatives on our Board of Directors, including investment funds affiliated with Bain Capital, LLC and investment funds affiliated with Celerity Partners. By virtue of such stock ownership and Board representation, certain of our institutional investors have a significant influence over all matters submitted to our stockholders, including the election of our directors, and exercise significant control over our business policies and affairs. Such concentration of voting power could have the effect of delaying, deterring or preventing a change of control or other business combination that might otherwise be beneficial to our stockholders.

Provisions in our charter documents and state law may make it harder for others to obtain control of us even though some stockholders might consider such a development favorable.

Provisions in our charter, by-laws and certain provisions under Delaware law may have the effect of delaying or preventing a change of control or changes in our management that stockholders consider favorable or beneficial. If a change of control or change in management is delayed or prevented, the market price of our shares could suffer.

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Our Common Stock May Be Delisted From The Nasdaq National Market.

On April 22, 2004, we received notification from Nasdaq Listing Qualifications that our common stock failed to maintain a minimum market value of publicly held shares of \$15,000,000 and a minimum bid price of \$1.00 per share for continued listing on The Nasdaq National Market. Under NASD Marketplace Rules, Nasdaq has provided us with a grace period of 90 calendar days, or until July 21, 2004, to regain compliance with the minimum market value of publicly held shares requirement and a grace period of 180 calendar days, or until October 19, 2004, to comply with the minimum bid price requirement. If we fail to comply with either requirement by the end of the applicable grace period (and, in the case of the minimum bid price requirement, we are not granted an extension to the grace period, as permitted under Marketplace Rules), our common stock may be delisted from trading on The Nasdaq National Market. While we believe that successful completion of the Recapitalization Transaction and, to the extent necessary, the reverse stock split described below, prior to the applicable deadlines should enable us to regain compliance, there can be no assurance that our common stock will regain compliance with these minimum continued listing requirements or that we will continue to satisfy the other listing requirements of The Nasdaq National Market. Our failure to comply with the Marketplace Rules or promptly to cure noncompliance with such Rules could result in our common stock being delisted, and the liquidity of our stock could be materially impaired.

RISKS ASSOCIATED WITH OUR PROPOSED CHARTER AMENDMENTS

The issuance of additional authorized shares of common stock may dilute the voting power and equity interest of present stockholders and may prevent a hostile takeover of the Company.

We are seeking stockholder approval to amend our charter to increase the number of shares of common stock authorized for issuance under our charter. Prior to such an amendment, if all of our existing authorized shares were issued, current shares outstanding would be approximately 47.8% of the total outstanding shares. If such an amendment is approved and all of the then authorized shares were issued, current shares outstanding would be approximately 22.1% of the total outstanding shares. Finally, if such an amendment is approved and all of the authorized shares were issued, current shares outstanding and all shares issuable in connection with the Recapitalization Transaction would be approximately 73.3% of the total shares outstanding. It is not possible to predict in advance whether the issuance of additional shares will have a dilutive effect on earnings per share as it depends on the specific events associated with a particular transaction. Shares of authorized but unissued common stock may be issued from time to time by our Board of Directors without further stockholder action unless such action is required by Delaware law, under which the Company is incorporated, our charter, or the rules of the Nasdaq National Market System. Additional authorized but unissued shares of common stock might be used in the context of a defense against or response to possible or threatened hostile takeovers.

We cannot predict the effect that a reverse stock split would have on the market value of our common stock and our ability to comply with Nasdaq's maintenance standards.

We are seeking stockholder approval to effect a reverse stock split. While our Board of Directors believes that the common stock and exchangeable shares would trade at higher prices after the consummation of the reverse stock split, there can be no assurance that the increase in the trading price will occur, or, if it does occur, that it will equal or exceed the price that is the product of the market price of our common stock and exchangeable shares prior to the reverse stock split times the selected reverse stock split ratio. In some cases, the total market capitalization of a company following a reverse stock split is lower, and may be substantially lower, than the total market capitalization before the reverse stock split. In addition, the fewer number of shares that will be available to trade will possibly cause the trading market of our common stock and exchangeable shares to become less liquid, which could have an adverse effect on the price of our common stock and exchangeable shares.

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There can be no assurance that the reverse stock split will result in us complying with the \$1.00 minimum bid requirement for continued listing. Even if we regain compliance with Nasdaq's \$1.00 minimum bid price requirement, we must continue to satisfy other Nasdaq maintenance standards to remain on The Nasdaq National Market. In addition to a minimum bid price of at least \$1.00 per share, we are required to have (a) total assets and total revenue of at least \$50 million, (b) at least 1,100,000 shares publicly held by persons other than

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officers, directors and beneficial owners of greater than 10% of our total outstanding shares; (c) a market value of publicly held shares of at least \$15 million; and (d) at least 400 stockholders who own at least 100 shares. We cannot offer any assurance that the common stock will continue to meet The Nasdaq National Market continued listing requirements following the reverse stock split.

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PART II OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) List of Exhibits:

- 31.1 Certification of John Caldwell pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated June 22, 2004.
- 31.2 Certification of Linda Millage pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated June 22, 2004.
- 32.1 Certification of John Caldwell, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated June 22, 2004.
- 32.2 Certification of Linda Millage, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated June 22, 2004.

(b) Reports on Form 8-K:

On February 18, 2004, the Company filed a Current Report on Form 8-K under Item 5 regarding its entry into binding agreements for the refinancing of the Company.

On March 12, 2004, the Company furnished a Current Report on Form 8-K under Item 12 regarding the issuance of a press release announcing the Company's financial results for the fourth quarter ended December 31, 2003.

On March 12, 2004, the Company furnished a Current Report on Form 8-K under Item 12 regarding a teleconference announcing the Company's financial results for the fourth quarter ended December 31, 2003.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, SMTC Corporation has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

SMTC CORPORATION

By: /s/ John Caldwell

Name: John Caldwell
Title: President and CEO

By: /s/ Linda Millage

Name: Linda Millage
Title: Principal Financial Officer

Date: June 22, 2004

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