FINAL TRANSCRIPT

Baylin Technologies Inc.

First Quarter Results Conference Call

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PRESENTATION

Operator

Good morning. My name is Lisa, and I'll be your conference Operator today. At this time, I would like to welcome everyone to the Baylin Technologies Inc. First Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. Thank you.

I'll now turn the call over to Randy Dewey, President and CEO of Baylin Technologies. Please go ahead.

Randy Dewey — President and Chief Executive Officer, Baylin Technologies Inc.

Thank you, Operator. Hello and welcome, everyone. Thank you for joining us this morning for our first quarter 2019 earnings call for Baylin Technologies. Joining me is our Chief Financial Officer, Mr. Michael Wolfe. We will both be available for questions at the end of the presentation.

But before we begin, let me make it clear that our comments today will include statements and answers to questions that could imply future events, such as our 2019 prospects and financial performance, and could include the use of non-GAAP and non-IFRS measures. Now it is obvious these statements are subject to risks, uncertainties, and assumptions. Accordingly, actual performance could differ materially from statements made today, so do not place undue reliance upon them.

We also disclaim our obligation to update forward-looking statements except as required by law. I ask that you read our legal disclaimer and refer you to the risks and assumptions outline in our public disclosures, in particular, the section outlined Forward-Looking Statements and Risk Factors in our Annual Information Form for the year ending December 31, 2018, in our filings, which are available on SEDAR.

Q1 results were released after market yesterday. The press release, unaudited interim financial statements, as well as the MD&A are available on SEDAR as well as on our website at baylintech.com.

In Q1, revenue grew to 39 million in the first quarter of 2019, an increase of 9.6 million or 33 percent over the first quarter of 2018. The increase is primarily due to strong revenue from Asia Pacific, Embedded Antennas, as well as Advantech Wireless Products combined with the revenue from Alga Microwave, which we acquired in July 2018.

Revenue from Asia Pacific Products increased by 33 percent, revenue from Embedded Products increased by 13 percent, and revenue from Advantech Products increased by 36 percent compared to the first quarter in 2018. These increases were slightly offset by a 6 percent decrease in wireless infrastructure revenue, which was impacted by a US carrier delay in the approval of one of our small cell products.

Asia Pacific's revenue in Q1 continued to be positively impacted by successful product launches by our major Asia Pacific customer.

Advantech's revenue increased significantly in Q1 compared to the first quarter in 2018 despite the ongoing disruption in January due to the move from Advantech Wireless' previous facility to the Alga facility.

Gross margins were 36.7 percent in the quarter, which is slightly higher than in the prior year. However, it was somewhat lower than we were targeting due to the sales mix.

Asia Pacific revenue was higher in percentage of total revenue compared to previous quarters, and the move of Advantech Wireless' operation into Alga Microwave caused some disruption, which did pull down the margin slightly.

Adjusted EBITDA in Q1 was 3.5 million compared to 1.4 million in the prior year. Adjusted EBITDA as a percentage of revenue increased to 9 percent in Q1 from 4.9 percent in the first quarter of 2018. This improvement was despite the items that negatively impacted gross margin in the quarter that I just noted.

I'd like to turn the call over to Michael to provide you with a little bit more detail on our financial results. Michael?

Michael Wolfe — Chief Financial Officer, Baylin Technologies Inc.

Thanks, Randy. As Randy discussed, we are pleased with first quarter financial performance. Trailing 12-month revenue has increased to 145.8 million as at March 31, 2019, as a result of organic growth and the acquisitions completed in 2018. Trailing 12-month adjusted EBITDA has increased to $17.4 million as at March 31, 2019.

These trailing 12-month figures do not include annualization of Alga's financial results, which was acquired in July 2018.

In January 2018, in connection with the acquisition of Advantech Wireless, we entered into a $33 million term loan with Crown Capital. The result of the Company's strong 2018 financial performance, we were able to complete a refinancing of the Crown Capital loan.

In March, we entered into a credit agreement with RBC and HSBC, establishing a revolving credit facility up to $20 million and a US$21 million term loan. We used the term loan advance and a portion of the revolving credit facility to repay Crown Capital.

Repayment of the Crown loan resulted in a prepayment penalty of $990,000 and the write-off of unamortized debt issuance costs in the amount of $2.8 million. Both of these onetime expenses were included in finance expense in the first quarter.

Interest rate on the revolver and term loan is currently 5 percent. The interest rate on the Crown loan was 9 percent. In the first year, subsequent to the refinancing, we expect to lower our interest expense by approximately $1.3 million. This is primarily due to the lower interest rate, but also in part due to the quarterly principal repayments which will decrease the term loan balance during the year.

At March 31, 2019, we had a cash balance of $12.4 million. During the quarter, noncash working capital increased by $8.5 million primarily due to an increase in Asia Pacific and Advantech's accounts receivables due to higher sales in the latter part of the quarter.

Other uses of cash in the quarter included an earnout payment to the vendors of Alga Microwave and capital expenditures of $1.8 million, primarily relating to the Alga facility renovations and upgrades and capacity expansion at our Vietnam facility.

March 31, 2019, we had access to approximately $25.5 million of revolving credit facilities, which 6.74 million was utilized. In total, we currently have outstanding short- and long-term debt in the amount of $51.6 million.

At March 31, 2019, our net debt to trailing 12-month adjusted EBITDA, annualized for the Alga acquisition, was approximately 2.1 to 1. While we believe this is a conservative amount of debt relative to our cash flow from operations, we expect the leverage ratio to decline as operating cash flow increases going forward and the term loan principal payments are made.

Net loss for the first quarter of $5.9 million included the prepayment fee write-off of deferred financing charges, other nonrecurring expenses, and amortization of intangibles. Excluding these items, the net loss was $0.3 million.

New accounting standard for leases became effective January 1. The new standard requires lessees to recognize lease contracts that were previously recorded as operating leases on the balance sheet resulting in a right-of-use asset and corresponding lease liability. As at March 31, 2019, the right-of-use asset was $3.9 million and the lease liability was $4.3 million.

Now I'll turn the call back to Randy for his concluding remarks.

Randy Dewey

We are pleased with the Asia Pacific revenue growth in the quarter, especially in light of the revenue decline in 2018 compared to 2017. The momentum that started in Q4 has carried over into Q1, and we expect it to continue through Q2 and Q3 this year.

We are also pleased with the progress that has occurred at Advantech Wireless since the acquisition in January 2018. In the first few months of owning Advantech Wireless, a considerable amount of time was spent separating the divisions we acquired from the divisions that the owner continued to own and operate. While the divisions had distinctly different product lines at the time of the acquisition, the manufacturing, sales, IT, accounting functions were fully integrated.

Advantech Wireless' President, John Restivo, and the Vice President of Global Sales, Tony Radford, along with the rest of the management team have made significant operational improvements, and we can expect to continue to realize the financial benefits during the remainder of the year.

Since the acquisition in July of last year, Alga Microwave, with Michael Perelshtein's leadership, continues to perform as we expected. Michael was instrumental in getting the renovations at the Alga facility completed in a very short period of time to accommodate the move of Advantech and has been a key contributor to the operational improvements at Advantech as well.

We are holding our annual general meeting today at 11:00 a.m. and hope to see you there. That concludes my formal remarks.

And with that, Operator, I'd like to open up the call for questions.

Q&A

Operator

Thank you. At this time, I would like to remind everyone, in order to ask a question, press *, then the number 1 on your telephone keypad. We'll pause for just a moment to compile a Q&A roster.

And our first question comes from the line of Kevin Krishnaratne from Paradigm Capital. Your line is open.

Kevin Krishnaratne — Paradigm Capital

Hey, there. Good morning. First a question, Randy, just on Mobile, if you don't mind digging a little bit deeper. I know you mentioned strength from a particular large agent vendor in the quarter. In some of the previous quarters, you'd seen some strength from smaller Chinese and Indian vendors I believe. So I just want to get your thoughts on—you mentioned accelerating growth in Q2, Q3. Just if you could talk about the mix and the type of vendors and any commentary you could provide with regards to that segment.

Randy Dewey

If you look at what I mentioned in the call. we had a 6 percent decrease in the wireless infrastructure, but that decrease was fully made up because we hit the revenue expectation.. And that came from Mobile. So there was strength from a major product launch in Q1 that really shored up some of the revenue challenge that we had as a result of the one division being a little softer, so.

But of course, as you know, the mix also affects margin, which is why we were slightly soft on EBITDA than anticipated so. But that comes as a result of having a little larger Mobile concentration than originally anticipated.

Kevin Krishnaratne

Right. But as you look into Q2 and coming quarters, are you seeing interest from a growing mix of vendors?

Randy Dewey

Yes. We continue to add customers quarter over quarter. I think our last presentation that we have posted on our website, we're talking 800 customers now on; our way to 900 customers. So what we're seeing from the diversification of our revenue is also coming a very significant diversification of our customer base. So the types of products and the types of diversification we have today is vastly different than where we were several years ago, of course. And it's certainly proven out in the financials, which I think one of the real positive notes of the quarter is that you can see, even though we were softer in one division, we're stronger in another division. And having that diversification of customers and diversification of product line plays to be helpful when you have the various ebbs and flows of business, obviously.

Kevin Krishnaratne

Great. Thanks for that. And so second to that, on the other segment on infrastructure, which did see some softness, in the MD&A, you mentioned there was a delay related to an approval that had since been received in Q2. Does that revenue get booked in Q2? How do we think about how that revenue shakes out versus the balance of the year?

Randy Dewey

So it did get fully approved. And that we were certainly thankful for. It was a lot. It was like four-and-a-half months slower than anticipated. So once it was approved, then we started to see the engineering related to that product roll out. So it was a couple weeks before we ended up seeing the purchase order. So it had an impact, slight impact, in Q2 just because the orders came closer to halfway through the quarter than at the beginning of the quarter. But we're not concerned about the consensus on our infrastructure group for the year. But any shortfalls, the 6 percent in Q1, will be made up more specifically in the second half of the year as opposed to in Q2.

Kevin Krishnaratne

Okay. Thanks for that. And just is that related to small cell or base station? How do we think about what that would have related to?

Randy Dewey

Yeah. Small cell for sure. And base station, we have launched products, we are working through certain molligation (phon) efforts and getting approval for our RET. So there are still some technical aspects to our base station product line that are working through some of the final stages of approval. Very confident that's going to move through. We've seen some good progress on that front.

We have other products, lots of base station antennas are being developed right now. Once that RET is finally approved, then we'll see a much more diversified rollout there so. But we expect that more towards Q3, and that hasn't been something that we had—it's in the numbers that are in the consensus. Most everything is related to DAS, small cell, and some of the in-building and outdoor DAS product line, not the base station.

So base station for me is sort of upside to that if we can get that all accomplished by Q3, which is where we're looking, that should be a positive for us from a momentum perspective.

Kevin Krishnaratne

Okay. Thanks, Randy. One last one from me. Just a clarification. With regards to the gross margin impact due to the overtime, can we take the add back to the EBITDA, the 485,000, is that fully related to what we'd see in the gross margin impact?

Randy Dewey

Michael?

Michael Wolfe

Those adjustments were unrelated to the ones Randy's just been talking about. So that wasn't the reason for the lower gross margin in the period. Those adjustments all hit the G&A line, not cost of goods sale.

Kevin Krishnaratne

How—okay. Thank you. So what would have been the gross margin impact related to the overtime?

Michael Wolfe

For the sales mix and the disruption at Advantech, I think without that we would be closer to the margin that we had in 2018, so high—

Kevin Krishnaratne

Okay.

Michael Wolfe

37, 38.

Kevin Krishnaratne

37, 38. All right. Thanks a lot. I'll pass the line.

Operator

Our next question comes from the line of Gavin Fairweather from Cormark. Your line is open.

Gavin Fairweather — Cormark

Hey, there. Good morning.

Randy Dewey

Hey, Gavin.

Gavin Fairweather

Just wanted to start out on the cost savings. I know that you've consolidated your facilities, I guess, late in December. Curious how much of your target has been realized there and is visible in the Q1 numbers.

Randy Dewey

So the integration certainly was completed and the physical move was accomplished in the timeline that we had in front of us, which was a pretty aggressive timeline. I would say 50 percent of our synergy target has been realized but, as you know, certain things take time. Like there's certain leases expire for facilities that we do not occupy anymore.

So through the course of 2019, we anticipate to realize the items that were related to the synergies. The full impact of the financial improvement, we would expect that in 2020.

But you're going to get, certainly, portions of that being realized in the quarters. I would say it's smaller in Q1, the amount, just because a lot of stuff would be starting to show up more in Q2 and 3 and 4, then, of course, the full year of 2020 is what we anticipate would be the brunt of the synergies' and the financial impact would be realized.

Gavin Fairweather

Okay. That's helpful. And then within the satellite division, I know on the last call, we kind of chatted about some supply chain issues that, at the time, I think were in the process of normalizing. I just wanted to get an update on that and whether that supply chain is fully back to normal now.

Randy Dewey

Yes. And that cleared through Q1. It certainly was still present as the year crossed, but by the time we got halfway through February, we have seen a lot more of that product, that raw material, come through. And now the supplier is in a much better position. So we're not plagued with that issue.

The only thing we're plagued with is the acquires (phon) related to that issue, and that was that kind of compiled over our Q3 into Q4. And it's great in the sense that we have a very strong and healthy backlog. It was unfortunate that we couldn't have cleared that backlog and had a better book-to-bill rate than we experienced in 2018.

But now that that issue is resolved and the move is resolved, we're seeing a lot better throughput in book-to-bill rates out of Advantech and Alga today on both fronts.

Gavin Fairweather

Yeah. Of course, it happened at the same time as you were moving. Right?

Randy Dewey

Yes. That's right. It happened just as we got a double whammy there.

Gavin Fairweather

And then maybe just one last one for Michael. From reading through your disclosures on IFRS 16, am I reading correctly? it's about a $1 million impact on the EBITDA line. Is that roughly the quantum there, or?

Michael Wolfe

No, I—

Gavin Fairweather

It’s on the lease expenses.

Michael Wolfe

It’d be a little under 300,000, $280,000.

Gavin Fairweather

In a quarter? Or for the full year?

Michael Wolfe

For the quarter. Yeah.

Gavin Fairweather

Okay. Got it. Okay. That’s it from me. Thank you.

Operator

Our next question comes from the line of Andrew McGee from National Bank. Your line is open.

Andrew McGee — National Bank

Hi. Good morning, guys. I just wanted to dig a little bit more onto the non-mobile side and actually, more specifically, on carrier spending. And as we think about small cells and base stations alongside some of these mergers that are happening in the US, I’m hoping that you can provide a little visibility into how your backlog is forming. And possibly—I know it’s hard to pin, but at what point this year, you think that maybe you’ll see an inflection point in the growth rates?

Randy Dewey

So great question. So obviously, you’ve got T-Mobile and Sprint merging, and that’s been a bit delayed. And you’ve got two carriers that are sitting on ice waiting for final approval. AT&T had announced that this year was the year of small cell. There's obviously, Verizon's got in a pretty aggressive plan for small cell build-out. So the carriers are each and individually challenged with various, not setbacks, but various delays and, in certain areas, various accelerations.

So because we are diversified in the sense that we deal with all the carriers in North America, where some are strong and others are weaker in the proliferation of the build-out of their network, we certainly feel those ebbs and flows at times.

However, that being said, small cell was a little slower out of the gate, and you can see that certainly in what we talked about earlier in the call. But we're seeing that the momentum for that has turned out the beginning of May so to speak. So I think you'll start to see really more of the—if you're looking for an inflection point, the inflection point's probably more like Q3, not necessarily Q2, though we have a strong enough backlog that I'm not worried about some of the consensus numbers for the infrastructure group for Q2, and certainly, the overall of the Company, so. But if you're asking specifically about infrastructure, I would say Q3 is more of your inflection point.

Andrew McGee

Okay. Thanks. And maybe just digging a little bit more on your backlog. I know you guys don't disclose that number, but would you be able to help in terms of giving us a sense in the order of magnitude and how much that might have built in the last year over the last few quarters? Is it a double-digit percent? Is it up significantly more than that? Just any kind of comments on that would be helpful.

Randy Dewey

Certainly, double digits. From this time last year to this time this year, it's definitely up double digits. Certainly, it'll be on the lower side of double digits than the higher side of double digits, but it is up double digits for sure.

If you think about it, and I think we mentioned on the previous call that we have launched more products in 2018 than any year prior. In fact, if you were to take in infrastructure, the previous five years we hadn't launched as many products as we did in 2018. So we have a much broader and deeper and stronger product offering today than we did 12 months ago. And there's demand behind each one of those products.

So we are definitely up as it relates to the back order. Are we subject to certain delays when it comes to certain products? Yeah. Sure. That happens at times. But we're not overly concerned about it on a full year trajectory.

Andrew McGee

Okay. Great. And then maybe just one for Michael. Now that the facility consolidation is pretty much complete, what do you expect the normalized OpEx level to look like? And should we expect to see maybe a build in investments here as we look throughout the year? Or should it be a walk down as you realize synergies?

Michael Wolfe

I think Q1 is probably a fairly good run rate for the year in terms of total OpEx, and over time, we expect that to decrease as a percentage of revenue, not in absolute dollars necessarily but in the percentage of revenue. And we will get some of the pickup in G&A this year from the continued synergies that we're going to realize. But I would say Q1, again, is probably a good run rate.

Andrew McGee

Okay. Great. And then just my last question here. You've restructured your Crown debt to more traditional financing rates, which is great. I'm wondering, Randy, if you have any thoughts on any future M&A now that you could potentially look at more attractive accretion levels?

Randy Dewey

So we've certainly been on record that M&A is definitely part of our strategy, the inorganic aspect of it. I think we mentioned, though, in the previous couple of quarters that we wanted to digest what we had accomplished in 2018. And I think you've heard the sentiment on the calls that we feel like integration is complete. There's still lots of things to do, but we're over the lion's share, certainly, of those efforts.

And so, yes. Our attention has turned to other opportunities, and, of course, once you do acquisitions and you're on record, your inbound calls start to go up no doubt. So we've certainly been fielding opportunities. But I think we've demonstrated historically a level of patience. We're not just acquiring for the sake of acquiring. We want to acquire in areas that are important to the Company, important to the foundation of Baylin.

So we will continue to be patient, yet very—a high degree of scrutiny on these acquisitions and these opportunities. They have to be accretive, and they have to be important to the future of Baylin and certainly fundamentally sound as it relates to continuing to strengthen our core of our company. So yes. We are thinking about that. We are turning our attention towards that in 2019.

Andrew McGee

Great. Thanks. I'll pass the line.

Operator

Okay. And if anybody would like to ask a question, please press *, 1 on your telephone keypad.

Your next question comes from Bill Zhang from Raymond James. Your line is open.

Bill Zhang — Raymond James

Hi. Morning, guys. Just one question for me. Do you guys expect free cash flow to be positive in each of the next three quarters? Or can we expect some more onetime cash expenses? Maybe a little colour on that?

Michael Wolfe

Well, it's always difficult to figure out exactly the nonworking capital changes between quarters, especially at the end of any particular quarter, but that will really depend on the sales volumes and how the mix is between the different quarters. But it is the target to be cash flow positive in the next three quarters. Yes.

Bill Zhang

Okay. Thank you.

Operator

Again, if anybody would like to ask a question, please press *, 1 on your telephone keypad.

I have no further questions. I turn the call back over to the presenters for closing remarks.

Randy Dewey

So in closing, there's three—for me, three key takeaways for this quarter that I'd like to certainly leave with the participants on the call. And the first is that what you're seeing, I think, in the press releases that we've issued and the financial results that you've seen in Q1 here is that there's continued momentum that has carried on from 2018 into 2019, and we're certainly bullish on the trajectory for sure.

The second was that the acquisitions, they've been integrated, and the synergies continue to be realized, and there's more to come.

And third is that the RBC and HSBC, getting a Tier 1 bank and the type of credibility that comes with that to take out the loan that we had, and the support from them has been exceptional. I think, obviously, having a 5 percent interest rate and a good term loan and a line of credit and very diversified instruments that they've offered us certainly is just a good demonstration of the support from the Canadian banks. And we're very appreciative of that.

So thank you for all your support and the questions and the participation on the call today. Thank you very much, everyone.

Operator

This concludes today's conference call. You may now disconnect.