# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended October 1, 2017**

**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)**

| **DELAWARE** | **98-0197680** |
|---|---|
| **(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)** | **(I.R.S. EMPLOYER IDENTIFICATION NO.)** |

**7050 WOODBINE AVE.**
**MARKHAM, ONTARIO, CANADA L3R 4G8**
**(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)**

**(905) 479-1810**
**(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)**

Indicate by check mark whether the registrant: (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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of October 27, 2017, SMTC Corporation had 16,825,197 shares of common stock, par value $0.01 per share, outstanding.

**SMTC CORPORATION**

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**Part I FINANCIAL INFORMATION**

**Item 1 Financial Statements**

**SMTC CORPORATION**
**Interim Consolidated Balance Sheets**
(Expressed in thousands of U.S. dollars)
(Unaudited)

| | October 1, 2017 | January 1, 2017 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ 2,935 | $ 8,503 |
| Accounts receivable — net (note 4) | 23,165 | 22,624 |
| Inventories (note 4) | 21,217 | 20,674 |
| Prepaid expenses and other assets | 1,689 | 2,453 |
| Derivative assets (note 10) | 182 | — |
| Income taxes receivable | 17 | 17 |
| Total current assets: | 49,205 | 54,271 |
| Property, plant and equipment — net (note 4) | 10,962 | 14,437 |
| Deferred income taxes — net | 469 | 226 |
| Deferred financing costs — net | 102 | 70 |
| Total assets: | $ 60,738 | $ 69,004 |
| | | |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities: | | |
| Revolving credit facility (note 5) | $ 5,909 | $ 2,731 |
| Accounts payable | 20,344 | 23,078 |
| Accrued liabilities (note 4) | 5,814 | 4,604 |
| Derivative liabilities (note 10) | — | 1,256 |
| Income taxes payable | 46 | 190 |
| Current portion of long-term debt (note 5) | 2,000 | 2,000 |
| Current portion of capital lease obligations | 171 | 389 |
| Total current liabilities: | 34,284 | 34,248 |
| Long-term debt (note 5) | 6,500 | 8,000 |
| Capital lease obligations | 135 | 269 |
| | | |
| Shareholders' equity: | | |
| Capital stock (note 6) | 394 | 391 |
| Additional paid-in capital | 265,198 | 264,928 |
| Deficit | (245,773) | (238,832) |
| Total shareholder's equity | 19,819 | 26,487 |
| Total liabilities and shareholder's equity | $ 60,738 | $ 69,004 |

Commitments (note 12)

See accompanying notes to interim consolidated financial statements.

**SMTC CORPORATION**
**Interim Consolidated Statements of Operations and Comprehensive Income (Loss)**

(Expressed in thousands of U.S. dollars, except number of shares and per share amounts)
(Unaudited)

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | October 1, 2017 | October 2, 2016 | October 1, 2017 | October 2, 2016 |
| Revenue | $ 34,417 | $ 42,683 | $ 100,590 | $ 128,218 |
| Cost of sales (note 10) | 31,443 | 39,049 | 92,639 | 116,615 |
| Gross profit | 2,974 | 3,634 | 7,951 | 11,603 |
| | | | | |
| Selling, general and administrative expenses | 2,952 | 3,493 | 10,824 | 10,406 |
| Impairment of property, plant and equipment (note 4) | — | — | 1,601 | — |
| Gain on disposal of property, plant and equipment | (60) | (20) | (60) | (25) |
| Restructuring charges (note 11) | 326 | — | 1,677 | 176 |
| Operating earnings (loss) | (244) | 161 | (6,091) | 1,046 |
| Interest expense (note 4) | 229 | 164 | 625 | 598 |
| Earnings (loss) before income taxes | (473) | (3) | (6,716) | 448 |
| Income tax expense (recovery) (note 7): | | | | |
| Current | 173 | 97 | 468 | 200 |
| Deferred | (95) | (81) | (243) | (96) |
| | 78 | 16 | 225 | 104 |
| Net earnings (loss) and comprehensive income (loss) | $ (551) | $ (19) | $ (6,941) | $ 344 |
| | | | | |
| Earnings (loss) per share of common stock: | | | | |
| Basic | $ (0.03) | $ (0.00) | $ (0.41) | $ 0.02 |
| Diluted | $ (0.03) | $ (0.00) | $ (0.41) | $ 0.02 |
| Weighted average number of shares outstanding (note 8): | | | | |
| Basic | 16,824,538 | 16,510,180 | 16,764,257 | 16,502,081 |
| Diluted | 16,824,538 | 16,510,180 | 16,764,257 | 17,550,155 |

See accompanying notes to interim consolidated financial statements.

**SMTC CORPORATION**
**Interim Consolidated Statements of Changes in Shareholders’ Equity**
(Expressed in thousands of U.S. dollars, except number of shares)
(Unaudited)

| | Common Shares | Capital stock | Additional paid-in capital | Deficit | Total shareholders’ equity |
|---|---|---|---|---|---|
| Balance, January 1, 2017 | 16,510,180 | $ 391 | $ 264,928 | $ (238,832) | $ 26,487 |
| RSU vested and issued in common shares | 315,017 | 3 | (3) | — | — |
| Stock-based compensation | — | — | 273 | — | 273 |
| Net loss | — | — | — | (6,941) | (6,941) |
| Balance, October 1, 2017 | 16,825,197 | $ 394 | $ 265,198 | $ (245,773) | $ 19,819 |

See accompanying notes to interim consolidated financial statements.

**SMTC CORPORATION**
**Interim Consolidated Statements of Cash Flows**
(Expressed in thousands of U.S. dollars)
(Unaudited)

| | Nine months ended | |
|---|---|---|
| | **October 1, 2017** | **October 2, 2016** |
| Cash provided by (used in): | | |
| **Operations:** | | |
| Net earnings (loss) | $ (6,941) | $ 344 |
| Items not involving cash: | | |
| Depreciation | 2,789 | 3,066 |
| Unrealized foreign exchange gain on unsettled forward exchange contracts | (1,438) | (995) |
| Impairment of property, plant and equipment | 1,601 | — |
| Gain on sale of property, plant and equipment | (60) | (25) |
| Deferred income taxes | (243) | (96) |
| Amortization of deferred financing fees | 19 | 26 |
| Stock-based compensation | 273 | 343 |
| Change in non-cash operating working capital: | | |
| Accounts receivable | (541) | 6,220 |
| Inventories | (543) | 2,886 |
| Prepaid expenses and other assets | 764 | 40 |
| Income taxes receivable/payable | (144) | 20 |
| Accounts payable | (2,581) | (5,244) |
| Accrued liabilities | 1,179 | (742) |
| Total cash used in operations | (5,866) | 5,843 |
| | | |
| **Financing:** | | |
| Net advance (repayment) of revolving credit facility | 3,178 | (2,681) |
| Repayment of long-term debt | (1,500) | (500) |
| Principal payment of capital lease obligations | (352) | (429) |
| Proceeds from sales leaseback | — | 509 |
| Deferred financing fees | (51) | — |
| Total cash provided by financing | 1,275 | (3,101) |
| | | |
| **Investing:** | | |
| Change in restricted cash | — | 268 |
| Purchase of property, plant and equipment | (1,314) | (1,864) |
| Proceeds for leasehold improvement | 56 | — |
| Proceeds from sale of property, plant and equipment | 281 | 126 |
| Total cash used in investing | (977) | (1,470) |
| | | |
| Increase (decrease) in cash | (5,568) | 1,272 |
| Cash, beginning of period | 8,503 | 6,099 |
| Cash, end of the period | $ 2,935 | $ 7,371 |
| | | |
| ***Supplemental Information*** | | |
| Property, plant and equipment acquired that was included in accounts payable and accrued liabilities | 71 | 36 |

See accompanying notes to interim consolidated financial statements.

**SMTC CORPORATION**
**Notes to Interim Consolidated Financial Statements**

## 1. Nature of the business

SMTC Corporation (the "Company") is a worldwide provider of advanced electronics manufacturing services to original equipment manufacturers. The Company services its customers through manufacturing and technology centers located in the United States, Mexico and China. All facilities provide a full suite of integrated manufacturing services including assembly, testing, box build, final product integration, and expanded supply chain capabilities. In addition, the Company operates an international sourcing and procurement office in Hong Kong.

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with the accounting principles and methods of application disclosed in the audited consolidated financial statements within the Company's Annual Report on Form 10-K for the fiscal period ended January 1, 2017 ("Form 10-K") filed with the Securities and Exchange Commission (the "SEC") on March 9, 2017. The accompanying unaudited interim consolidated financial statements include adjustments of a normal, recurring nature that are, in the opinion of management, necessary for a fair statement of the consolidated financial statements under generally accepted accounting principles in the United States ("U.S. GAAP"). These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements contained in the Company's Form 10-K. The consolidated balance sheet at January 1, 2017 was derived from the audited annual consolidated financial statements contained in the Company's Form 10-K, but does not contain all of the footnote disclosures from the annual consolidated financial statements. The results of Operations for the interim periods are not necessarily indicative of results that may be expected for any other interim period or the full year.

Unless otherwise specified or the context requires otherwise, all statements in these notes to the interim consolidated financial statements regarding financial figures are expressed in thousands of U.S. dollars.

## 2. Assessment of Liquidity and Management's Plans

As at October 1, 2017, the Company's liquidity is comprised of $2,935 in cash on hand and $7,106 of funds available to borrow under the Company's revolving credit facility ("PNC Revolving Credit facility"). The Company funds its operations by regularly utilizing its PNC Facilities (as defined below, refer to Note 5). The Company manages its capital requirements through budgeting and forecasting processes while monitoring for compliance with bank covenants under the PNC Facilities. Funds available under the PNC Revolving Credit Facility are managed on a weekly basis based on the cash flow requirements of the various operating segments. Cash collected from business operations is immediately applied towards paying down the PNC Revolving Credit Facility, which has a maximum limit of $30,000, of which $7,106 in funds were available to borrow as at October 1, 2017 which was limited by certain borrowing base restrictions under the PNC Facilities.

The Company has experienced significant reductions in revenue throughout fiscal 2016 and the first nine months of 2017 when compared to prior periods, which significantly impacts its operating cash flows. The Company incurred a net loss of $344 for the year ended January 1, 2017 and a net loss in the first nine months of 2017 of $6,941. Revenues have declined due to the loss of customers that represented a large concentration of the Company's business. The Company believes this loss of customers is largely due to competitive pressures from larger organizations. The decline in revenues has directly impacted the Company's gross profit and its ability to generate cash flows from operations.

Given the Company's results of operations in this challenging business environment, in accordance with ASC 205-40 management is required to consider whether these conditions give rise to substantial doubt about the Company's ability to meet its obligations within one year from the financial statement issuance date, and if so, whether management's plans to negate these conditions will alleviate this substantial doubt.

In order to address the Company's liquidity, on May 15, 2017, the Board of Directors of the Company approved a corporate restructuring plan (the "Restructuring Plan") for its manufacturing facilities and corporate level operations, which included the closure of the Suzhou, China facility ("Suzhou Facility") and a reduction in its labor force. The Restructuring Plan has delivered cost savings during the quarter and is expected to deliver annualized cost savings during the remainder of 2017 and thereafter. The Restructuring Plan, including the wind down and closure of the Suzhou Facility was initiated in the second quarter of 2017 and was substantially completed at the end of the third quarter of 2017.

Also, effective May 15, 2017, the Company entered into the Twelfth Amendment to the PNC Facilities, which amended its financial covenant requirement for the quarter ended April 2, 2017 and adjusted these financial covenant requirements and conditions for future periods as well (refer to note 5). The Company is in compliance with the financial covenants included in the PNC Facilities as at October 1, 2017. The Company anticipates that it will continue to be in compliance with the amended financial covenants in the PNC Facilities.

In accordance with Accounting Standards Codification 205-40, the Company believes that the actions described above are probable of mitigating substantial doubt about the Company's ability to meet its obligations within one year from the financial statement issuance date. Management believes that the revised 2017 forecast and budget, specifically as it relates to cost reduction initiatives, liquidity and working capital management has been effectively implemented and that, when combined with the Twelfth Amendment to its PNC Facilities and the Restructuring Plan, it is probable that these actions will mitigate any substantial doubt and satisfy our estimated liquidity needs, for at least but not limited to, the next twelve months from the issuance date of these financial statements.

## 3. Recent Adopted Accounting Pronouncements

In July 2015, the FASB published ASU 2015-11: Simplifying the Measurement of Inventory (Topic 330). The amendments in this Update more closely align the measurement of inventory in U.S. GAAP with the measurement of inventory in International Financial Reporting Standards (IFRS). FASB has amended some of the other guidance in Topic 330 to more clearly articulate the requirements for the measurement and disclosure of inventory. However, the FASB does not intend for those clarifications to result in any changes in practice. Other than the change in the subsequent measurement guidance from the lower of cost or market to the lower of cost and net realizable value for inventory within the scope of this Update, there are no other substantive changes to the guidance on measurement of inventory. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The adoption of ASU 2015-11 had no impact on the consolidated financial statements.

In November 2015, the FASB published ASU 2015-17: Income Taxes (Topic 740). The amendment requires that deferred tax assets and liabilities be classified as non-current in a classified statement of financial position. The amendments in this Update are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The adoption of ASU 2015-17 resulted in the presentation of the Company's deferred tax assets as non-current. The deferred tax assets reported in the prior periods have been reclassified to conform to the current presentation.

In March 2016, the FASB published ASU 2016-09: Compensation – Stock Compensation (Topic 718). The amendment simplifies several aspects of accounting for share-based payment transactions including income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows and accounting for forfeitures. Some of the areas for simplification apply only to nonpublic entities. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The adoption of ASU 2016-09 had no impact on the consolidated financial statements.

**Recent Accounting Pronouncements Not Yet Adopted**

In March 2016, the FASB published ASU 2016-08: Revenue from Contracts with Customers (Topic 606). The amendment clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB published ASU 2016-10: Revenue from Contracts with Customers (Topic 606), which clarified application of the standard in identifying performance obligations and licensing arrangements. In May 2016, the FASB published ASU 2016-12: Revenue from Contracts with Customers (Topic 606), which included narrow-scope improvements and practical expedients. Specifically the update addresses application of collectability, presentation of sales taxes, noncash consideration, and completed contracts and contract modifications at transition. In May 2014, the FASB published ASU 2014-09: Revenue from Contracts with Customers (Topic 606), which supersedes (i) revenue recognition requirements in Topic 605 and most related industry-specific guidance, and (ii) cost guidance included in Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts, and amends existing requirements for recognition of a gain/loss on the transfer of nonfinancial assets that are not in a contract with a customer (for example, assets within the scope of Topic 360, Property, Plant, and Equipment, and intangible assets within the scope of Topic 350, Intangibles—Goodwill and Other) to be consistent with the new requirements. In August 2015, the FASB published ASU 2015-14 Topic 606 which effectively postponed the effective adoption requirement by one year such that the standard is effective for years beginning after December 15, 2017 including interim periods with those years. Management is currently evaluating the impact of the new standard, analyzing and performing a diagnostic on the various revenue streams within our manufacturing services. We are considering the potential impact on the timing of revenue recognition related to certain finished good materials that are shipped to a third party hub location and we are considering the presentation of revenue recognized in relation to part sales. We anticipate a modified retrospective adoption effective January 1, 2018.

In January 2016, the FASB published ASU 2016-01: Financial Instruments - Overall (Topic 825-10). The amendment addresses certain aspects of recognition, measurement, presentation and disclosure of financial assets and liabilities. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The impact of adoption of the standard has not yet been determined.

In February 2016, the FASB published ASU 2016-02: Leases (Topic 842). The amendment proposes that all lessees should recognize the assets and liabilities that arise from leases. Elections may be available for those leases with terms of 12 months or less. The amendment still retains the distinction between finance leases and operating leases. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The impact of the adoption of the standard is expected to result in the recognition of all leases with the corresponding assets and liabilities recorded in the consolidated financial statements. Management is currently evaluating the qualitative and quantitative impact of this standard.

In May 2016, the FASB published ASU 2016-13 Financial Instruments – Credit losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The main objective of this Update is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this Update replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendment is effective for years beginning after December 15, 2019 including interim periods with those years. Early adoption is permitted only for those annual reporting periods beginning on or after December 15, 2018. The Company continues to evaluate the impact of this accounting standard. The impact of adoption of the standard has not yet been determined.

In August 2016, the FASB published ASU 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This Accounting Standards Update addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendment is effective for years beginning after December 15, 2017 including interim periods with those years. Early adoption is permitted. The adoption of ASU 2016-15 is not expected to impact the consolidated financial statements.

In November 2016, the FASB published ASU 2016-18 Statement of Cash Flows (Topic 230): Restricted Cash. This update addresses the requirement that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendment is effective for years beginning after December 15, 2017 including interim periods with those years. Early adoption is permitted. The impact of adoption of the standard is expected to result in a modification to the current presentation of the statement of cash flows such that restricted cash is not presented as an investing activity, but is presented as part of the net change in cash from beginning to the ending balance.

## 4. Interim Consolidated financial statement details

The following consolidated financial statement details are presented as of the period ended for the consolidated balance sheets and for the periods ended for each of the consolidated statements of operations and comprehensive income (loss).

**Consolidated Balance Sheets**

***Accounts receivable – net:***

| | October 1, 2017 | January 1, 2017 |
|---|---|---|
| Trade accounts receivable | $ 23,866 | $ 22,284 |
| Other receivables | 284 | 511 |
| Allowance for doubtful accounts (a) | (985) | (171) |
| Accounts receivable—net | $ 23,165 | $ 22,624 |

(a) The increase in the allowance for doubtful accounts from January 1, 2017 to October 1, 2017 predominantly related to one customer for which management has concluded a provision was required for the outstanding accounts receivable due to the deterioration of the credit risk associated with one customer.

***Inventories:***

| | October 1, 2017 | January 1, 2017 |
|---|---|---|
| Raw materials (a) | $ 15,948 | $ 14,863 |
| Work in process | 2,614 | 1,557 |
| Finished goods | 2,139 | 3,678 |
| Parts | 516 | 576 |
| Inventories | $ 21,217 | $ 20,674 |

(a) Raw materials are recorded net of a provision for obsolescence as at October 1, 2017 and January 1, 2017 of $827 and $442 respectively. The increase in the provision for obsolescence was due primarily to an identified collection risk related to aged inventory for a small number of customers.

**4. Interim Consolidated financial statement details cont'd**

***Property, plant and equipment – net:***

| | October 1, 2017 | January 1, 2017 |
|---|---|---|
| Cost: | | |
| Land | $ 1,648 | $ 1,648 |
| Buildings | 9,852 | 9,852 |
| Machinery and equipment (a) (b) (c) | 30,308 | 31,615 |
| Office furniture and equipment | 532 | 556 |
| Computer hardware and software | 3,118 | 3,544 |
| Leasehold improvements | 2,127 | 2,129 |
| | 47,585 | 49,344 |
| Less accumulated depreciation: | | |
| Land | — | — |
| Buildings | (8,508) | (8,174) |
| Machinery and equipment (a) (b) (c) | (24,160) | (22,460) |
| Office furniture and equipment | (405) | (438) |
| Computer hardware and software | (2,516) | (2,842) |
| Leasehold improvements | (1,034) | (993) |
| | (36,623) | (34,907) |
| Property, plant and equipment—net | $ 10,962 | $ 14,437 |

(a) Included within machinery and equipment were assets under capital leases with costs of $533 and $2,193 and associated accumulated depreciation of $207 and $673 as of October 1, 2017 and January 1, 2017, respectively. The related depreciation expense for the three months ended October 1, 2017 and October 2, 2016 was $15 and $78, respectively. The related depreciation expense for the nine months ended October 1, 2017 and October 2, 2016 was $148 and $233, respectively. An impairment charge of $97 was allocated to machinery and equipment under capital lease for the nine months ended October 1, 2017. During the three months ended October 1, 2017, no machinery and equipment under capital lease was purchased and transferred to machinery and equipment owned.

(b) In accordance with ASC 360-10, the Company is required to evaluate for impairment when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Upon the occurrence of a triggering event, the Company assesses whether the estimated undiscounted cash flows expected from the use of the asset and the residual value from the ultimate disposal of the asset exceeds the carrying value. In 2017, the Company identified that operating results for its U.S. segment asset group did not meet its forecasted results, which was considered a triggering event related to its U.S. segment asset group. The Company estimated undiscounted cash flows and determined the carrying amounts was exceeded by the recoverable amount, and therefore performed a discounted cash flow analysis. The difference between the discounted cash flows and the carrying amount resulted in an impairment loss of $1,025 which was recorded in 2017. The net carrying amount of the U.S. asset group is $1,255. The estimate of discounted cash flows is sensitive to certain key assumptions, for instance, if our revenue projections are lower by 1%, the impairment would increase by $110. If there was a 1% increase in the weighted average cost of capital, the impairment would increase by $37. The Company calculated the impairment loss by discounting the future cash flows which was determined to represent the fair value of the asset group and deducted this from the carrying amount of the segment asset group. No triggering events were noted related to the U.S. segment for the three months ended October 1, 2017, and no additional impairment charge has been recorded.

In 2017, the Company also identified that operating results for its China segment asset group did not meet forecasted results, which was considered a triggering event related to its China segment asset group. The net carrying amount of the China asset group is $1,510. The Company estimated undiscounted cash flows and determined a recoverable amount of $1,122 in excess of the net carrying value, therefore no impairment loss has been recorded in the third quarter of 2017. The key assumptions included in these cash flows are projected revenue based on management's revised forecast and corresponding margins. The estimate of undiscounted cash flows are sensitive to these key assumptions, for instance, if our revenue projections are lower by 1%, the recoverable amount in excess of the carrying amount would be reduced to $641. As such, the Company continues to monitor for impairment triggers each quarter, which may result in future impairments in this asset group. There were no changes to any of the key assumptions used in evaluating this asset group for impairment during the third quarter of 2017.

(c) During 2017, the Company removed fully depreciated assets that were no longer in use with a cost and accumulated depreciation value of $870. The China segment impaired assets from machinery and equipment with net book value of $446.The corporate segment also impaired assets with net book value of $130. A total impairment loss was recorded of $576 in 2017.

## 4. Interim Consolidated financial statement details cont'd

***Accrued liabilities:***

| | October 1, 2017 | January 1, 2017 |
|---|---|---|
| Customer related | $ 1,808 | $ 898 |
| Payroll | 2,540 | 2,134 |
| Professional services | 368 | 281 |
| Restructuring (note 11) | 185 | 27 |
| Vendor related | 396 | 613 |
| Other | 517 | 651 |
| Accrued liabilities | $ 5,814 | $ 4,604 |

**<u>Interim consolidated statements of operations and comprehensive income (loss)</u>**

***Interest expense:***

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | October 1, 2017 | October 2, 2016 | October 1, 2017 | October 2, 2016 |
| Revolving credit facility | $ 100 | $ 83 | $ 243 | $ 373 |
| Long-term debt | 116 | 52 | 342 | 145 |
| Amortization of deferred financing fees | 8 | 9 | 19 | 26 |
| Obligations under capital leases | 5 | 20 | 21 | 54 |
| Interest expense | $ 229 | $ 164 | $ 625 | $ 598 |

## 5. Debt

***(a) Revolving credit and long-term debt facilities***

The Company borrows money under a Revolving Credit and Security Agreement with PNC Bank, National Association ("PNC") which governs the PNC Revolving Credit Facility and a Long-Term Debt Facility ("PNC Facilities"). The PNC Facilities have a term ending on January 2, 2021. Advances made under the PNC Revolving Credit Facility bear interest at the U.S. base rate plus 0.75%. The applicable interest rate for the Long-Term Debt Facility is U.S. base rate plus 1.25%. The base commercial lending rate should approximate prime rate. The weighted average interest rate increased to 4.8% for the first nine months of 2017 compared to 4.2% for the first nine months of 2016.

As at October 1, 2017, the funds available to borrow under the PNC Revolving Credit Facility after deducting the current borrowing base conditions was $7,106 (January 1, 2017 - $7,377). The maximum amount of funds that could be available under the PNC Revolving Credit Facility is $30,000. However, availability under the PNC Revolving Credit Facility is subject to certain conditions, including borrowing base conditions based on eligible inventory and accounts receivable, and certain conditions as determined by the lender. The Company is required to use a "lock-box" arrangement for the PNC Revolving Credit Facility, whereby remittances from customers are swept daily to reduce the borrowings under this facility.

On May 15, 2017, the Company entered into the Twelfth Amendment ("Twelfth Amendment") of the Revolving Credit and Security Agreement, which was initially entered into on September 14, 2011 with PNC Bank, National Association, as agent for the Lender.

Pursuant to the Twelfth Amendment, the Lender has modified the definition of EBITDA (as defined in the Twelfth Amendment) to include additional exclusions and limits.

In addition, the Lender has increased the interest rates by 0.25% during the quarter in accordance with the Twelfth Amendment; however if the Company maintains a specified fixed charge coverage ratio for a predetermined period of time and maintains its compliance with the terms of the PNC Facilities, interest rates will be reduced to the U.S. base rate plus 0.25% on advances made under the PNC Revolving Credit Facility and U.S. base rate plus 0.75% on advances made under the Long-Term Debt Facility.

The PNC Long-Term Debt Facility consists of a term loan of $10,000 that matures on January 2, 2021 with quarterly principal payments of $500 with the remaining balance due at maturity.

At October 1, 2017, $5,909 (January 1, 2017 - $2,731) was outstanding under the PNC Revolving Credit Facility and is classified as a current liability based on the requirement to hold a "lock-box" under the terms of the PNC Revolving Credit Facility. At October 1, 2017, $8,500 (January 1, 2017 – $10,000) was outstanding under the PNC Long-Term Debt Facility.

The PNC Facilities are a joint and several obligations of the Company and its subsidiaries that are borrowers under the facilities and are jointly and severally guaranteed by other subsidiaries of the Company. Repayment under the PNC Facilities is collateralized by the assets of the Company and each of its subsidiaries.

***(b) Covenants***

The Revolving Credit and Security Agreement contains certain financial and non-financial covenants.

As defined under the Twelfth Amendment, the Company was required to maintain a minimum EBITDA for the twelve months ended July 2, 2017 and the three months ended October 1, 2017. Subsequent thereafter, the financial covenant relating to a minimum consolidated fixed charge coverage ratio is in effect for the three months ended December 31, 2017, six months ended April 1, 2018, nine months ended July 1, 2018, twelve months ended September 30, 2018 and thereafter on a rolling twelve month basis until January 2, 2021. The financial covenants also require that the Company limit unfunded capital expenditures (all as defined in the credit agreement governing the PNC Facilities).

The Company is in compliance with the financial covenants included in the PNC Facilities as of October 1, 2017.

## 6. Capital stock

**Common shares**

***Issued and outstanding:***

The issued and outstanding number of common shares included in shareholders' equity consisted of the following:

| | Number of shares | $ |
|---|---|---|
| Balance at January 1, 2017 | 16,510,180 | 391 |
| Share issuance | 315,017 | 3 |
| Balance at October 1, 2017 | 16,825,197 | 394 |

**Stock Options**

For more detailed information regarding the Company 's stock option arrangements, see Note 6 of the consolidated financial statements within the Company's Form 10-K for the fiscal period ended January 1, 2017. The Company granted 1,343,716 stock options during the nine month period ended October 1, 2017. A summary of stock option activity for the nine month period ended October 1, 2017 is as follows:

| | Number of options | Weighted average exercise price | Aggregate intrinsic value | Weighted average remaining contractual term (years) |
|---|---|---|---|---|
| Outstanding at January 1, 2017 | 616,766 | $ 1.82 | 8 | 5.6 |
| Options granted | 1,343,716 | $ 1.24 | | |
| Expired | (111,282) | 1.84 | | |
| Forfeited | (40,721) | 1.80 | | |
| Outstanding at October 1, 2017 | 1,808,479 | $ 1.39 | $ 97 | 8.7 |
| Exercisable at October 1, 2017 | 333,798 | $ 1.92 | $ — | 4.2 |

During the nine month period ended October 1, 2017, 1,343,716 stock options were granted to the executive officers of the Company. The stock options have an exercise price per share equal to the Company per share closing price on the grant date, and will vest at 20% of the covered shares upon the Company's average closing share price being above each of $2.00, $3.00, $4.00, $5.00 and $6.00 for a 90 day period. If the share price does not meet the average closing share prices specified, the stock options will not vest. In the event of a Change in Control Event (as defined in the respective employment agreement), the options shall immediately expire to the extent they remain unvested; provided, however, the Company's board of directors may, in its sole discretion, accelerate vesting effective immediately prior to, but contingent on, a Change in Control Event. To ensure alignment with shareholders, the options may not be exercised, and no option shares may be sold, within 180 days of any portion of the options vesting, unless a Change in Control Event occurs. The options shall otherwise reflect the Company's standard terms and conditions for employee option grants, including a ten-year term, and will vest with respect to whole shares only.

A binomial model was utilized to determine the fair value of the stock options issued during the nine months ended October 1, 2017. The following weighted average assumptions were used in calculating the estimated fair value of the stock options issued during the quarter with performance conditions used to compute stock-based compensation expense:

| **Binomial Model weighted-average assumptions** | | **Nine months ended October 1, 2017** |
|---|---|---|
| Expected dividend yield | | 0.0% |
| Expected volatility | | 42.7% |
| Expected forfeiture | | 30.0% |
| Risk-free interest rate | | 1.02% |
| Expected option life in years | | 5.0 |
| **Weighted-average stock option fair value per option granted** | $ | 0.29 |

Stock-based compensation recognized during the three month period ended October 1, 2017 and October 2, 2016 related to the stock options was $22 and $20, respectively. During the nine month period ended October 1, 2017 and October 2, 2016, the Company recorded stock-based compensation expense and a corresponding increase in additional paid-in capital of $45 and $62, respectively.

**Restricted Stock Units**

For more detailed information regarding the Company 's restricted stock units ("RSU") arrangements, see Note 6 of the consolidated financial statements within the Company's Form 10-K for the fiscal period ended January 1, 2017. Each RSU entitles the holder to one share of the Company's common stock. The Company issued 111,200 RSU's during the nine months ended October 1, 2017. A summary of the RSU activity for the nine month period ended October 1, 2017 is as follows:

| | **Outstanding RSU** | | **Weighted average stock price** | **Weighted average remaining contractual term (years)** |
|---|---|---|---|---|
| Outstanding balance at January 1, 2017 | 1,090,126 | $ | 1.22 | 1.01 |
| RSU's granted | 111,200 | $ | 1.39 | |
| RSU's vested and issued in shares | (315,017) | | 1.80 | |
| RSU's forfeited | (261,606) | | 0.89 | |
| Outstanding balance at October 1, 2017 | 624,703 | $ | 1.06 | 0.91 |

Certain RSUs outstanding have a market condition such that the awards are vested and issuable only if the market price of the Company's stock meets or exceeds a specified target during the vesting period. If the market condition is not met, the RSUs will not vest and will be forfeited.

Stock based compensation recognized during the three month period ended October 1, 2017 and October 2, 2016 related to the restricted stock units was $55 and $99, respectively. Stock based compensation recognized during the nine month period ended October 1, 2017 and October 2, 2016 related to the restricted stock units was $228 and $281, respectively.

## 7. Income taxes

During the three months period ended October 1, 2017 and October 2, 2016, the Company recorded current income tax expenses of $173 and $97, respectively on minimum taxes and taxes on profits in certain foreign jurisdictions. The increased minimum taxes was due to increased taxable income related to the Mexican operations. For the three months period ended October 1, 2017 and October 2, 2016, deferred tax recovery of $95 and $81, respectively was recorded on temporary differences related to the Mexican operations. During the nine months period ended October 1, 2017 and October 2, 2016, the Company recorded current income tax expense of $468 and $200, respectively on minimum taxes and taxes on profits in certain foreign jurisdictions. For the nine months period ended October 1, 2017 and October 2, 2016 deferred tax recoveries of $243 and $96, respectively was recorded on temporary differences related to the Mexican operations.

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. Guidance under ASC 740, Income Taxes, ("ASC 740") 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. The U.S., Canadian and Asian jurisdictions continue to have a full valuation allowance recorded against the deferred tax assets.

## 8. Earnings (loss) per common share

The following table details the weighted average number of common shares outstanding for the purposes of computing basic and diluted earnings per common share for the following periods:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | October 1, 2017 | October 2, 2016 | October 1, 2017 | October 2, 2016 |
| Basic weighted average shares outstanding | 16,824,538 | 16,510,180 | 16,764,257 | 16,502,081 |
| Dilutive stock awards [1] [a] [b] | — | — | — | 1,048,074 |
| Diluted weighted average shares outstanding | 16,824,538 | 16,510,180 | 16,764,257 | 17,550,155 |

(1) Dilutive stock awards include outstanding RSU's and in-the money stock options determined using the treasury stock method

(a) Dilutive options were determined using the treasury stock method, using an average price of $1.27 per share for three months ended October 1, 2017. As a result of the net loss for the three months ended October 1, 2017, diluted earnings per share was calculated using the basic weighted average shares outstanding as the effect of potential common shares would have been anti-dilutive. Had there been net income for the three months ended October 1, 2017, dilutive stock awards would have been calculated as 663,400 shares. For the nine months ended October 1, 2017, dilutive options were determined using the treasury stock method, using an average price of $1.31 per share. Total dilutive stock awards were calculated as 696,177 shares.

(b) Dilutive options were determined using the treasury stock method, using an average price of $1.52 per share for three months ended October 2, 2016. As a result of the net loss for the three months ended October 2, 2016, diluted earnings per share was calculated using the basic weighted average shares outstanding as the effect of potential common shares would have been anti-dilutive. Had there been net income for the three months ended October 2, 2016, dilutive stock awards would have been calculated as 1,046,730 shares. For the nine months ended October 2, 2016, dilutive options were determined using the treasury stock method, using an average price of $1.47 per share. Total dilutive stock awards were calculated as 1,048,074 shares.

## 9. Segmented information

**General description**

The Company is operated and managed geographically and has production facilities in the United States, Mexico and China. The Company utilizes reportable segment's site contribution (site revenues minus operating expenses, excluding unrealized foreign exchange gain (loss) on unsettled forward exchange contracts, corporate allocations and restructuring expenses) to monitor reportable segment performance. Site contribution is utilized by the chief operating decision-maker as the indicator of reportable segment performance, as it reflects costs which our operating site management is directly responsible for. Intersegment adjustments reflect intersegment sales that are generally recorded at prices that approximate arm's-length transactions. In assessing the performance of the reportable segments, management attributes site revenue to the reportable segment that ships the product to the customer, irrespective of the product's destination. Information about the reportable segments is as follows:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | October 1, 2017 | October 2, 2016 | October 1, 2017 | October 2, 2016 |
| **Revenues** | | | | |
| Mexico | $ 23,907 | $ 24,857 | $ 70,394 | $ 77,321 |
| China | 6,934 | 15,134 | 23,031 | 41,891 |
| U.S. | 6,319 | 5,009 | 15,229 | 15,689 |
| Total | $ 37,160 | $ 45,000 | $ 108,654 | $ 134,901 |
| | | | | |
| **Intersegment revenue** | | | | |
| Mexico | $ — | $ (141) | $ (12) | $ (396) |
| China | (2,640) | (2,108) | (7,810) | (5,952) |
| U.S. | (103) | (68) | (242) | (335) |
| Total | $ (2,743) | $ (2,317) | $ (8,064) | $ (6,683) |
| | | | | |
| **Net external revenue** | | | | |
| Mexico | $ 23,907 | $ 24,716 | $ 70,382 | $ 76,925 |
| China | 4,294 | 13,026 | 15,221 | 35,939 |
| U.S. | 6,216 | 4,941 | 14,987 | 15,354 |
| Total segment revenue (which also equals consolidated revenue) | $ 34,417 | $ 42,683 | $ 100,590 | $ 128,218 |
| | | | | |
| **Site Contribution** | | | | |
| Mexico | $ 2,346 | $ 1,642 | $ 5,031 | $ 6,513 |
| China | 146 | 1,643 | (1,028) | 2,808 |
| U.S. | (55) | (331) | (2,169) | (771) |
| Total | $ 2,437 | $ 2,954 | $ 1,834 | $ 8,550 |
| | | | | |
| Corporate allocations | 2,237 | 2,789 | 7,686 | 8,323 |
| Unrealized foreign exchange (gain) loss on unsettled forward exchange contracts | 118 | 4 | (1,438) | (995) |
| Interest | 229 | 164 | 625 | 598 |
| Restructuring charges | 326 | — | 1,677 | 176 |
| Earnings (loss) before income taxes | $ (473) | $ (3) | $ (6,716) | $ 448 |

**Additions to property, plant and equipment**

The following table contains additions to property, plant and equipment including those acquired through capital leases for the three and nine months ended October 1, 2017 and October 2, 2016:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | October 1, 2017 | October 2, 2016 | October 1, 2017 | October 2, 2016 |
| Mexico | $ 220 | $ 256 | $ 400 | $ 590 |
| China | 59 | 95 | 134 | 575 |
| U.S. | 171 | 12 | 480 | 303 |
| Segment total | 450 | 363 | 1,014 | 1,468 |
| Corporate and other | — | 14 | 124 | 185 |
| Total | $ 450 | $ 377 | $ 1,138 | $ 1,653 |

**Property, plant and equipment** [(a)]

| | October 1, 2017 | January 1, 2017 |
|---|---|---|
| Mexico | $ 7,988 | $ 8,858 |
| China | 1,510 | 3,046 |
| U.S. | 1,254 | 2,314 |
| Corporate and other | 210 | 219 |
| Segment assets | $ 10,962 | $ 14,437 |

(a) Property, plant and equipment information is based on the principal location of the asset.

**Geographic revenues**

The following table contains geographic revenues based on the product shipment destination, for the three and nine months ended October 1, 2017 and October 2, 2016:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | October 1, 2017 | October 2, 2016 | October 1, 2017 | October 2, 2016 |
| U.S. | $ 27,044 | $ 29,470 | $ 77,219 | $ 83,848 |
| Canada | 4,390 | 9,132 | 14,894 | 32,832 |
| Europe | — | 592 | — | 1,497 |
| China | 1,488 | 1,751 | 3,844 | 4,403 |
| Africa | 1,495 | 1,738 | 4,633 | 5,638 |
| Total | $ 34,417 | $ 42,683 | $ 100,590 | $ 128,218 |

**Significant customers and concentration of credit risk:**

Sales of the Company's products are concentrated in certain cases among specific customers in the same industry. The Company is subject to concentrations of credit risk in trade receivables. The Company considers concentrations of credit risk in establishing the allowance for doubtful accounts and believes the recorded allowances are adequate. The increase in the allowance for doubtful accounts from January 1, 2017 to October 1, 2017 predominantly related to one customer for which management has concluded a provision was required for the outstanding accounts receivable due to the deterioration of the credit risk associated with one customer.

The Company expects to continue to depend upon a relatively small number of customers for a significant percentage of its revenue. In addition to having a limited number of customers, the Company manufactures a limited number of products for each customer. If the Company loses any of its larger customers or any product line manufactured for one of its larger customers, it could experience a significant reduction in revenue. Also, the insolvency of one or more of its larger customers or the inability of one or more of its larger customers to pay for its orders could decrease revenue. As many costs and operating expenses are relatively fixed, a reduction in net revenue can decrease profit margins and adversely affect the business, financial condition and results of operations.

During the three months ended October 1, 2017, two customers exceeded 10% of total revenues representing 14.0% and 12.8% respectively (October 2, 2016 – two customers represented 15.6% and 10.2%, respectively) of total revenue for the three months ended October 1, 2017. During the nine months ended October 1, 2017, two customers individually comprised 12.3% and 11.5% (October 2, 2016 – two customers individually comprised 15.8% and 15.4%) of total revenue.

As of October 1, 2017, one customer exceeded 10% of the Company's accounts receivable representing 15.3% of total accounts receivable, (January 1, 2017, one customer represented 11.8% of the Company's accounts receivable).

## 10. Derivative financial instruments

The Company enters into forward foreign exchange contracts to reduce its exposure to foreign exchange currency rate fluctuations related to a portion of the forecasted Canadian dollar and Mexican Peso denominated payroll, rent and utility cash flows for the three remaining months of fiscal 2017 and a portion of the first nine months of fiscal 2018. These contracts are effective economic hedges but do not qualify for hedge accounting under ASC 815 "Derivatives and Hedging". Accordingly, changes in the fair value of these derivative contracts are recognized into cost of sales in the consolidated statement of operations and comprehensive income (loss). The Company does not enter into forward foreign exchange contracts for trading or speculative purposes.

The following table presents a summary of the outstanding foreign currency forward contracts as at October 1, 2017:

| Currency | Buy/Sell | Foreign Currency Amount | Notional Contract Value in USD |
|---|---|---|---|
| Canadian Dollar | Buy | CAD 3,020 | $ 2,323 |
| Mexican Peso | Buy | MXN 154,000 | $ 8,171 |

The unrealized loss recognized in earnings for the three month period as a result of revaluing the outstanding instruments to fair value on October 1, 2017 was $118 (October 2, 2016 – unrealized loss $4), and the unrealized gain for the nine month period ended October 1, 2017 was $1,438 (October 2, 2016 – unrealized gain $995), which was included in cost of sales in the consolidated statement of operations and comprehensive income (loss). The realized gain on the settled contracts for the three months period ended October 1, 2017 was $271 (October 2, 2016 – realized loss $619), and the realized loss for the nine month period ended October 1, 2017 was $179 (October 2, 2016 – realized loss $2,197), which is included in cost of sales in the consolidated statement of operations and comprehensive income (loss). Fair value was determined using the market approach with valuation based on market observables (Level 2 quantitative inputs in the hierarchy set forth under ASC 820 "Fair Value Measurements").

| | **October 1, 2017** | **January 1, 2017** |
|---|---|---|
| Average USD:CAD contract rate | 1.30 | 1.34 |
| Average USD:CAD mark-to-market rate | 1.25 | 1.34 |
| Average USD:PESO contract rate | 18.85 | 18.47 |
| Average USD:PESO mark-to-market rate | 18.66 | 21.20 |

The derivative asset as at October 1, 2017 was $182 ($Nil as at January 1, 2017) and derivative liability as at October 1, 2017 was Nil ($1,256 as at January 1, 2017) which reflected the fair market value of the unsettled forward foreign exchange contracts.

Foreign exchange gains and losses are recorded in cost of sales in the consolidated statement of operations and comprehensive loss pertaining to translation of foreign denominated transactions during the period in addition to foreign denominated monetary assets and liabilities at the end of the reporting period. The total aggregate translated foreign exchange gain of $67 was recognized for the three months ended October 1, 2017 (October 2, 2016 – gain of $99). The total aggregate translated foreign exchange loss of $13 was recognized for the nine months ended October 1, 2017 (October 2, 2016 – gain of $203).

## 11. Restructuring charges

During the nine months ended October 1, 2017, in accordance with the Restructuring Plan communicated on May 15, 2017, restructuring charges of $1.6 million were incurred related to 49 full-time equivalents ("FTEs") in Mexico, 105 FTEs in China, 22 FTEs in the U.S., and 12 FTEs in Canada. Additional charges were incurred related to the closure of the Suzhou facility, including ongoing administrative staff charges to close the facility. During the three months ended October 1, 2017, additional charges of $0.3 million were incurred related to this restructuring plan, with a restructuring accrual balance of $0.2 million. It is expected that the restructuring accrual will be paid by the fourth quarter of 2017.

| | | Severance |
|---|---|---|
| Balance as at January 1, 2017 | $ | 27 |
| Charges | | 1,677 |
| Payments | | (1,519) |
| Balance as at October 1, 2017 | $ | 185 |

## 12. Commitments

Purchase obligations not recorded on the consolidated balance sheet as at October 1, 2017 consist of open non-cancellable purchase orders for raw materials for $12,834 (October 2, 2016 - $15,753), which are expected to be received within 12 months of the purchase order issue date.

**Item 2 Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*Where we say “we”, “us”, “our”, the “Company” or “SMTC”, we mean SMTC Corporation or SMTC Corporation and its subsidiaries, as the context may require. Where we refer to the “industry”, we mean the electronics manufacturing services industry.*

*You should read this Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) in combination with the accompanying unaudited interim consolidated financial statements and related notes as well as the audited consolidated financial statements and the accompanying notes to the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) included within the Company’s Annual Report on Form 10-K filed on March 9, 2017. This quarterly report and other communications made by us contain forward –looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. The forward-looking statements in this quarterly report regarding the electronics manufacturing services industry, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements include numerous risks and uncertainties, some of which are as described in the “Risk Factors” section in the Annual Report on Form 10-K filed on March 9, 2017, as updated by Item 1A in Part II of this quarterly report. Statements using words such as “could”, “expects”, “may”, “anticipates”, “believes”, “intends”, “estimates”, “plans”, “envisions”, “seeks” and other similar language are considered forward looking statements under applicable securities laws. These statements are based on our current expectations, estimates, forecasts and projections about the operating environment, economies and markets in which we operate. These statements are subject to important assumptions, risks and uncertainties, which are difficult to predict and the actual outcome may be materially different. Except as required by applicable law, we undertake no intention or obligation to update these forward-looking statements after the date of this quarterly report, even though our situation may change in the future. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.*

*This MD&A contains discussion in U.S. dollars (US$) unless specifically stated otherwise.*

**Background**

SMTC Corporation is a mid-tier provider of end-to-end electronics manufacturing services, or EMS, including product design and sustaining engineering services, printed circuit board assembly, or PCBA, production, enclosure fabrication, systems integration and comprehensive testing services. SMTC facilities span a broad footprint in the United States, Mexico, and China, with approximately 1,093 employees of which 1,040 are full-time employees. SMTC’s services extend over the entire electronic product life cycle from the development and introduction of new products through to growth, maturity and end-of-life phases. SMTC offers fully integrated contract manufacturing services with a distinctive approach to global original equipment manufacturers, or OEMs, and technology companies primarily within the industrial, computing and communications, power and energy and medical market segments. In addition, the Company operates an international sourcing and procurement office in Hong Kong.

**Results of Operations**

The interim consolidated financial statements of SMTC are prepared in accordance with U.S. GAAP.

**Quarter ended October 1, 2017 compared with the quarter ended October 2, 2016:**

The following table sets forth summarized operating results in millions of US$ for the periods indicated:

| | Three months ended October 1, 2017 | | Three months ended October 2, 2016 | | Change 2016 to 2017 | |
|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % |
| Revenue | 34.4 | 100.0 | 42.7 | 100.0 | (8.3) | (19.4) |
| Cost of sales | 31.4 | 91.3 | 39.1 | 91.6 | (7.7) | (19.7) |
| Gross profit | 3.0 | 8.7 | 3.6 | 8.4 | (0.6) | (16.7) |
| Selling, general and administrative expense | 3.0 | 8.7 | 3.5 | 8.2 | (0.5) | (14.3) |
| Gain on sale of property, plant and equipment | (0.1) | (0.3) | — | — | (0.1) | — |
| Restructuring charges | 0.3 | 0.9 | — | — | 0.3 | — |
| Operating earnings (loss) | (0.2) | (0.6) | 0.1 | 0.2 | (0.3) | (300.0) |
| Interest expense | 0.2 | 0.6 | 0.1 | 0.5 | 0.0 | |
| Loss before income taxes | (0.4) | (1.2) | (0.0) | 0.0 | (0.3) | (300.0) |
| Income tax expense | 0.1 | 0.3 | 0.0 | 0.0 | 0.1 | 100.0 |
| Net loss | (0.5) | (1.5) | (0.0) | 0.0) | (0.4) | (400.0) |

***Revenue***

| Industry Sector | Three months ended October 1, 2017 | | Three months ended October 2, 2016 | | Change | |
|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % |
| Industrial | 16.4 | 47.7 | 15.9 | 37.2 | 0.5 | 3.1 |
| Networking and Communications | 11.9 | 34.6 | 16.1 | 37.7 | (4.2) | (26.1) |
| Power and Energy | 2.8 | 8.1 | 2.5 | 6.0 | 0.3 | 12.0 |
| Medical | 3.3 | 9.6 | 8.2 | 19.2 | (4.9) | (59.8) |
| **Total** | 34.4 | 100.0 | 42.7 | 100.0 | (8.3) | (19.4) |

Revenue decreased by $8.3 million from $42.7 million for the third quarter of 2016 to $34.4 million for the third quarter of 2017. The decrease was primarily the result of reduced volumes of $6.3 million due to two customers in the networking and communications sector. One of these customers was previously serviced out of the Mexico facility whereby the product reached end of life and the other customer serviced out of the China facility transferred a portion of its business to other contract manufacturers. One medical customer serviced out of China had slower end customer demand which resulted in a reduction quarter over quarter of $4.3 million. One long standing industrial customer serviced out of Mexico had slower end customer demand which resulted in a reduction quarter over quarter of $2.2 million. This was offset by an increase in revenue from another industrial customer serviced out of the Mexico facility, which represented an increase in revenue quarter over quarter of $1.9 million. A networking and communications customer in Mexico increased quarter over quarter by $1.2 million. And, there was also an increase in revenue related to one new customer in the power and energy sector serviced out of Mexico resulting in a quarter over quarter increase of $1.2 million in revenue. The Company also had new embedded business customer revenue serviced out of the U.S. facility in the quarter, which was not earned in previous quarters.

During the third quarter of 2017 and 2016, the Company recorded approximately $0.7 million and $2.8 million, respectively, of sales of raw materials inventory to customers, which carried limited margin. The Company purchases raw materials based on customer purchase orders. When a customer requires an order to be altered or changed, the customer is generally obligated to purchase the original on-order raw material at cost, to the extent the materials are not consumed within a specified period.

Due to changes in market conditions, the life cycle of products, the nature of specific programs and other factors, revenues from a particular customer typically varies from quarter-to-quarter and year-to-year. The Company's ten largest customers represented 74.1% of revenue during the third quarter of 2017, compared with 78.4% in the third quarter of 2016. Revenue from the two largest customers during the third quarter of 2017 were $4.8 million and $4.4 million representing 14.0% and 12.8% respectively. This compares with revenues from the largest customers during the third quarter of 2016 which were $6.6 million and $4.4 million representing 15.6% and 10.2% respectively. No other customers represented more than 10% of revenue in either period.

During the third quarter of 2017, 69.5% of our revenue was attributable to production from our operations in Mexico, 12.5% in China and 18.0% in the U.S. During the third quarter of 2016, 57.9% of our revenue was attributable to production from our operations in Mexico, 30.5% in China and 11.6% in the U.S.

***Gross Profit***

Gross profit for the third quarter of 2017 decreased by $0.6 million to $3.0 million or 8.6% of revenue compared with $3.6 million or 8.5% of revenue for the same period in 2016. When removing the impact of the unrealized foreign exchange loss on unsettled forward contracts the adjusted gross profit percentage in the third quarter of 2017 was 9.0% compared to 8.5% in the same period of prior year. The decrease in gross profit was due to the decrease in revenue compared to the same period in prior year. The increase in gross profit percentage was due to improved margins based on product mix in addition to reduced manufacturing expenses.

**Non-GAAP Gross Profit and Adjusted Gross Profit Reconciliation:**

The Company presents this adjusted gross profit amount as we evaluate gross margins internally excluding the unrealized foreign exchange gain (loss) on unsettled forward exchange contracts as this is not a relevant financial indicator to evaluate the Company's operating performance. Below is the reconciliation from the U.S. GAAP measure of gross profit to adjusted gross profit (in thousands):

| | Three months ended October 1, 2017 | Three months ended October 2, 2016 |
|---|---|---|
| Gross profit | $ 2,974 | $ 3,634 |
| Add: | | |
| | | |
| Unrealized foreign exchange loss on unsettled forward exchange contracts | 118 | 4 |
| Adjusted gross profit | $ 3,092 | $ 3,638 |
| Adjusted gross profit percentage | 9.0% | 8.5% |

The Company entered into forward foreign exchange contracts to reduce its exposure to foreign exchange currency rate fluctuations related to forecasted Canadian dollar and Mexican peso expenditures. These contracts were effective as hedges from an economic perspective, but did not meet the requirements for hedge accounting under ASC Topic 815 "Derivatives and Hedging". Accordingly, changes in the fair value of these contracts were recognized into cost of sales in the consolidated statement of operations and comprehensive loss. Included in cost of sales for the third quarter of 2017 was an unrealized loss recognized as a result of revaluing the instruments to fair value of $0.1 million, and a realized gain of $0.3 million. Included in cost of sales for the third quarter of 2016 was a nominal unrealized loss recognized as a result of revaluing the instruments to fair value of less than $0.01 million, and a realized loss of $0.6 million.

| | October 1, 2017 | October 2, 2016 |
|---|---|---|
| Average USD:CAD contract rate | 1.30 | 1.33 |
| Average USD:CAD mark-to-market rate | 1.25 | 1.31 |
| Average USD:PESO contract rate | 18.85 | 17.66 |
| Average USD:PESO mark-to-market rate | 18.66 | 19.74 |

**Non-GAAP EBITDA and Adjusted EBITDA Reconciliation:**

Management has presented EBITDA and adjusted EBITDA, as it is utilized to monitor performance against budget as well as compliance with bank covenants. We also believe EBITDA and adjusted EBITDA provides useful information to investors in understanding and evaluating our operating results in the same manner as management.

Below is the reconciliation of net earnings (loss) to EBITDA and adjusted EBITDA, both of which are non-GAAP measures (in thousands).

| | Three months ended October 1, 2017 | Three months ended October 2, 2016 |
|---|---|---|
| Net loss | $ (551) | $ (19) |
| Add: | | |
| | | |
| Depreciation | 839 | 1,045 |
| Interest | 229 | 164 |
| Taxes | 78 | 16 |
| EBITDA | $ 595 | $ 1,206 |
| | | |
| Add: | | |
| | | |
| Stock based compensation | 77 | 119 |
| Restructuring | 326 | — |
| Unrealized foreign exchange loss on unsettled forward exchange contracts | 118 | 4 |
| Adjusted EBITDA | $ 1,116 | $ 1,329 |

Adjusted EBITDA decreased to $1.1 million in the third quarter of 2017 from $1.3 million for the same period in the prior year mainly due to lower revenue and gross profit.

***Selling, General and Administrative Expenses***

Selling, general and administrative expenses decreased by $0.5 million during the third quarter of 2017 to $3.0 million compared to $3.5 million in the third quarter of 2016. The reduced selling, general and administrative expenses was primarily the result of the 2017 restructuring plan, which resulted in corporate and site administrative labor reductions.

***Restructuring Expense***

During the three months ended October 1, 2017, the Company recorded $0.3 million in restructuring charges made up predominantly of severance charges and additional charges related to the closure of the Suzhou Facility in accordance with the restructuring plan as announced on May 15, 2017. The closure of the Suzhou Facility was initiated in the second quarter of 2017 and was substantially completed by the end of the third quarter 2017.

***Interest Expense***

Interest expense was $0.2 million in the third quarter of 2017 and 2016. The average debt balance was reduced in the third quarter 2017 compared to the same period in 2016, however it was offset by the increased weighted average interest rates in the three months ended October 1, 2017 compared to the same period in the prior year. The weighted average interest rates with respect to the debt were 5.3% and 4.1% for the third quarters of 2017 and 2016, respectively.

***Income Tax Expense***

The Company recorded income tax expense of $0.1 million in the third quarter of 2017 and $0.02 million in the third quarter of 2016, due to minimum taxes and taxes on profits in certain jurisdictions. For the third quarters of 2017 and 2016 a deferred income tax recovery of $0.1 million was recorded on temporary differences related to the Mexican operations.

**Nine months ended October 1, 2017 compared with nine months ended October 2, 2016:**

The following table sets forth summarized operating results in millions of US$ for the periods indicated:

| | Nine months ended October 1, 2017 | | Nine months ended October 2, 2016 | | Change 2016 to 2017 | |
|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % |
| Revenue | 100.6 | 100.0 | 128.2 | 100.0 | (27.6) | (21.5) |
| Cost of sales | 92.6 | 92.0 | 116.6 | 91.0 | (24.0) | (20.6) |
| Gross profit | 8.0 | 8.0 | 11.6 | 9.0 | (3.6) | (31.0) |
| Selling, general and administrative expenses | 10.8 | 10.7 | 10.4 | 8.1 | 0.4 | 3.8 |
| Impairment of property, plant and equipment | 1.6 | 1.6 | — | — | 1.6 | — |
| Gain on sale of property, plant and equipment | (0.1) | (0.1) | — | — | (0.1) | — |
| Restructuring charges | 1.7 | 1.7 | 0.2 | 0.2 | 1.5 | 750.0 |
| Operating earnings (loss) | (6.1) | (6.1) | 1.0 | 0.8 | (7.1) | (710.0) |
| Interest expense | 0.6 | 0.6 | 0.6 | 0.5 | — | — |
| Earnings (loss) before income taxes | (6.7) | (6.7) | 0.4 | 0.3 | (7.1) | — |
| Income tax expense | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 100.0 |
| Net earnings (loss) | (6.9) | (6.9) | 0.3 | 0.2 | (7.2) | — |

***Revenue***

| Industry Sector | Nine months ended October 1, 2017 | | Nine months ended October 2, 2016 | | Change | |
|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % |
| Industrial | 47.8 | 47.5 | 51.7 | 40.3 | (3.9) | (7.5) |
| Networking and Communications | 32.4 | 32.2 | 53.2 | 41.5 | (20.8) | (39.1) |
| Power and Energy | 7.5 | 7.5 | 7.0 | 5.5 | 0.5 | 7.1 |
| Medical | 12.9 | 12.8 | 16.3 | 12.7 | (3.4) | (20.9) |
| **Total** | 100.6 | 100.0 | 128.2 | 100.0 | (27.6) | (21.5) |

Revenue decreased by $27.6 million, or 21.5%, from $128.2 million for the nine months period ended 2016 to $100.6 million for the nine months period ended 2017. The decrease was primarily the result of reduced volumes of $23.8 million due to two customers in the networking and communications sector. One of these customers was previously serviced out of the Mexico facility which reached end of life and the other customer serviced out of the China facility transferred a portion of its business to other contract manufacturers. One long standing industrial customer serviced out of the Mexico facility had slower end customer demand which resulted in a reduction of $7.8 million. Reductions in revenue were partially offset by volume increases with existing customers and new customer revenue, of which one customer in the power and energy sector serviced in the Mexico facility represented an increase in revenue of $2.5 million compared to the same period in the prior year. The Company also had new embedded business customer revenue serviced out of the U.S. facility in the nine months period ended 2017, which was not earned in previous quarters.

During the nine month period ended 2017, the Company recorded approximately $1.9 million of sales of raw materials inventory to customers, which carried limited margin, compared with $5.2 million for the same period in 2016. The Company purchases raw materials based on customer purchase orders. When a customer requires an order to be altered or changed, the customer is generally obligated to purchase the original on-order raw material at cost, to the extent the materials are not consumed within a specified period.

Due to changes in market conditions, the life cycle of products, the nature of specific programs and other factors, revenues from a particular customer typically varies from quarter to quarter and year to year. The Company's ten largest customers represented 74.8% of revenue from continuing operations for the nine months period ended 2017, compared with 78.6% for the same period in 2016. Revenue from the two largest customers during the nine months period ended 2017 was $12.4 million and $11.6 million, representing 12.3% and 11.5%, respectively of total revenue for the nine months period ended 2017. Revenue from the two largest customers during the nine months period ended 2016 was $20.2 million and $19.8 million, representing 15.8% and 15.4%, respectively of total revenue for the nine months period ended 2016. No other customers represented more than 10% of revenue in either period.

During the nine months period ended 2017, 70.0% of our revenue was attributable to production from our operations in Mexico, 15.1% in China and 14.9% in the US. During the nine months period ended 2016, 60.0% of our revenue was attributable to production from our operations in Mexico, 28.0% in China and 12.0% in the US.

***Gross Profit***

Gross profit for the nine months period ended 2017 decreased by $3.6 million to $8.0 million or 7.9% of revenue compared with 9.0% of revenue for the same period in 2016. However, when removing the effects of unrealized foreign exchange gains on unsettled forward exchange contracts, the adjusted gross profit is 6.5% and 8.3% for the nine months period ended 2017 and 2016, respectively. For the nine months period ended 2017, the reduction in gross margin is due to reduced revenue and the resulting impact to cover fixed costs and product mix compared to the same period in prior year. In addition, during the second quarter of 2017, there was an additional inventory provision for excess and obsolete materials of $0.5 million, which reduced gross margin.

**Non-GAAP Gross Profit and Adjusted Gross Profit Reconciliation:**

The Company presents this adjusted gross profit amount as we evaluate gross margins internally excluding the unrealized foreign exchange gain on unsettled forward exchange contracts as this is not a relevant financial indicator to evaluate the Company's operating performance. Below is the reconciliation from the U.S. GAAP measure of gross profit to adjusted gross profit (in thousands):

| | Nine months ended October 1, 2017 | Nine months ended October 2, 2016 |
|---|---|---|
| Gross profit | $ 7,951 | $ 11,603 |
| Add (deduct): | | |
| | | |
| Unrealized foreign exchange gain on unsettled forward exchange contracts | (1,438) | (995) |
| Adjusted gross profit | $ 6,513 | $ 10,608 |
| | | |
| Adjusted gross profit percentage | 6.5% | 8.3% |

The Company entered into forward foreign exchange contracts to reduce its exposure to foreign exchange currency rate fluctuations related to forecasted Canadian dollar and Mexican peso expenditures. These contracts were effective as hedges from an economic perspective, but did not meet the requirements for hedge accounting under ASC Topic 815 "Derivatives and Hedging". Accordingly, changes in the fair value of these contracts were recognized into cost of sales in the consolidated statement of operations and comprehensive income (loss). Included in cost of sales for the nine months period ended 2017 was an unrealized gain recognized as a result of revaluing the instruments to fair value of $1.4 million, and a realized loss of $0.2 million. Included in cost of sales for the nine months period ended 2016 was an unrealized gain recognized as a result of revaluing the instruments to fair value of $1.0 million, and a realized loss of $2.2 million.

| | October 1, 2017 | October 2, 2016 |
|---|---|---|
| Average USD:CAD contract rate | 1.30 | 1.33 |
| Average USD:CAD mark-to-market rate | 1.25 | 1.31 |
| Average USD:PESO contract rate | 18.85 | 17.66 |
| Average USD:PESO mark-to-market rate | 18.66 | 19.74 |

**Non-GAAP EBITDA and Adjusted EBITDA Reconciliation:**

Management has presented EBITDA and adjusted EBITDA, as it is utilized to monitor performance against budget as well as compliance with bank covenants. We also believe EBITDA and adjusted EBITDA provides useful information to investors in understanding and evaluating our operating results in the same manner as management.

Below is the reconciliation of net earnings to EBITDA and adjusted EBITDA, both of which are non-GAAP measures.

| | Nine months ended October 1, 2017 | Nine months ended October 2, 2016 |
|---|---|---|
| Net earnings (loss) | $ (6,941) | $ 344 |
| Add: | | |
| | | |
| Depreciation | 2,789 | 3,066 |
| Interest | 625 | 598 |
| Taxes | 225 | 104 |
| EBITDA (loss) | $ (3,302) | $ 4,112 |
| | | |
| Add (deduct): | | |
| | | |
| Restructuring | 1,677 | 176 |
| Stock based compensation | 273 | 343 |
| Unrealized foreign exchange gain on unsettled forward exchange contracts | (1,438) | (995) |
| Adjusted EBITDA (loss) | $ (2,790) | $ 3,636 |

Adjusted EBITDA reduced to a loss of $(2.8) million in the nine month period ended 2017 from $3.6 million for the same period in the prior year due to lower revenue and gross profit. In addition, there were charges incurred in the second quarter of 2017 for an impairment of property, plant and equipment of $1.6 million. Included in selling, general and administrative expenses was an additional provision for bad debt expense of $0.8 million incurred during the second quarter of 2017 related to amounts that management does not believe are collectible.

***Selling, General and Administrative Expenses***

Selling, general and administrative expenses increased by $0.4 million for the nine months period ended 2017 to $10.8 million compared to $10.4 million for the same period in the prior year. The increase relates primarily to an additional provision for bad debt expense of $0.8 million incurred during the second quarter of 2017 related to one customer which has experienced financial issues which management does not believe are collectible. Professional services, including audit and legal fees increased for the nine month period ended 2017 compared to the same period in the prior year. In addition the Company incurred move related costs that were not incurred in the same period last year as the corporate head office was relocated during the second quarter of 2017. These increases were partially offset by corporate headcount reductions as a result of the 2017 Restructuring Plan.

***Impairment of Property, Plant and Equipment***

An impairment loss of $1.0 million was recorded for the nine months period ended 2017 related to the U.S. segment asset group. Indicators of impairment continued to be triggered with the U.S. segment during 2017, specifically due to continued site operating losses. As a result the Company calculated the impairment loss by discounting the future cash flows which was determined to represent the fair value of the asset group and deducted $1.0 million from the carrying amount of the segment asset group. No indicators of impairment were noted for the three months ended October 1, 2017.

During the nine months period ended 2017, the Company recorded an impairment loss of $0.6 million related predominantly to machinery and equipment in the China segment. These assets were identified as part of the Company's assessment of its capital requirements and capabilities during the quarter.

***Restructuring Charges***

During the nine months ended October 1, 2017, the Company recorded $1.6 million in restructuring charges made up predominantly of severance charges and charges in relation to the closure of the Suzhou Facility in accordance with the restructuring plan announced on May 15, 2017. Restructuring charges were incurred related to 49 full-time equivalents ("FTEs") in Mexico, 105 FTEs in China, 22 FTEs in the U.S., and 12 FTEs in Canada. The closure of the Suzhou Facility was initiated in the second quarter of 2017 and was substantially complete in the third quarter of 2017.

***Interest Expense***

Interest expense was $0.6 million for the nine months period ended 2017 and 2016. The average debt balance was reduced in the nine months ended October 1, 2017 compared to the same period in 2016, however was offset by the increased weighted average interest rates in the nine months ended October 1, 2017 compared to the same period in the prior year. The weighted average interest rate increased to 4.8% for the nine months period ended 2017 compared to 4.2% for the nine months period ended 2016.

***Income Tax Expense***

During the nine month period ended 2017, the Company recorded current income tax charges of $0.5 million for taxes on profits in foreign jurisdictions. During the nine month period ended 2016, the Company recorded current income tax charges of $0.3 million for taxes on profits in foreign jurisdictions offset by tax recoveries of less than $0.1 million in the U.S. For the nine months ended October 1, 2017 deferred income tax recovery of $0.2 million was recorded on temporary differences related to the Mexican operations. For the nine months ended October 2, 2016 deferred income tax recovery of less than $0.1 million was recorded on temporary differences related to the Mexican operations.

**Liquidity**

As at October 1, 2017, the Company's liquidity is comprised of $2,935 in cash on hand and $7,106 of funds available to borrow under the PNC Revolving Credit Facility. The Company funds its operations by regularly utilizing its PNC Revolving Credit Facility.

Net cash used in operating activities for the nine months period ended October 1, 2017 was $5.9 million compared to $5.8 million provided for the nine months period ended October 2, 2016 primarily driven by a net loss from operations, in part due to cash severance charges as a result of the Restructuring Plan. In addition it is the result of a reduction in gross margin due to reduced revenues, lower margin product mix and the resulting impact to cover fixed costs compared to the same period in prior year. In addition, accounts receivable had a small number of customers with aged receivables which increased the day sales outstanding, which reduced cash provided from accounts receivable. Cash used from accounts payable decreased due to extended payment terms with some vendors. There was also an increased gain on derivative instruments. Accounts receivable days sales outstanding were 63 and 50 days for the nine months ended October 1, 2017 and October 2, 2016, respectively. The increase was largely due to a small number of customers with aged receivables. Payment plans were established for these customers, one of which has experienced worsening financial health and so a provision was recorded against this customer's aged receivables. This aged receivable which was provided for remained uncollected as at October 1, 2017, however the other aged receivable balances with overdue balances were collected during the three months ended October 1, 2017. Inventory turnover, on an annualized basis decreased to 5.8 times in the nine months period ended 2017 compared to 6.8 times in the nine months period ended 2016 due to aged inventory with delayed demand from some customers. Accounts payable days outstanding remained at 60 days for the nine months ended October 1, 2017 and October 2, 2016. While payment terms were extended by some of our key suppliers, this was offset by the reduction in inventory balances during the three months ended October 1, 2017 which reduced accounts payable accordingly.

Net cash provided by financing activities during the nine months period ended 2017 was $1.3 million compared to cash used from financing activities of $3.1 million for the nine months period ended 2016. The cash provided was the result of $3.2 million net advances of revolving debt as at October 1, 2017, compared to $2.7 million net repayments of revolving debt during the same period in 2016. The Company also made term debt repayments of $1.5 million for the nine months ended October 1, 2017, compared to term debt repayments of $0.5 million for the nine months ended October 2, 2016. The Company made principal payments for capital leases of $0.4 million for the nine months ended October 1, 2017 and October 2, 2016. There were also proceeds of $0.5 million in the second quarter of 2016 in a sales leaseback transaction that did not occur in the same period of 2017.

Net cash used in investing activities during the nine months ended October 1, 2017 and October 2, 2016 was $1.0 million and $1.5 million, respectively, primarily consisting of additions of property, plant and equipment.

**Capital Resources**

The Company borrows money under a Revolving Credit and Security Agreement with PNC Bank, National Association ("PNC") which governs the PNC Facilities. The PNC Facilities have a term ending on January 2, 2021. Advances made under the PNC Revolving Credit Facility bear interest at the U.S. base rate plus 0.75%. The applicable interest rate for the PNC Long-Term Debt Facility is U.S. base rate plus 1.25%. The base commercial lending rate should approximate prime rate. See note 5 to our consolidated financial statements in this quarterly report for additional information on our debt.

We believe that cash generated from operations, available cash and amounts available under our PNC Facilities and additional financing sources such as leasing companies and other lenders will be adequate to meet our debt service requirements, capital expenditures and working capital needs at our current level of operations for the foreseeable future, although no assurance can be given in this regard, particularly with respect to amounts available from lenders. We have agreed to a borrowing base formula under which the amount we are permitted to borrow under the PNC Revolving Credit Facility is based on our accounts receivable and inventory. Further, there can be no 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 indebtedness will be subject to future economic conditions and to financial, business and other factors, certain of which are beyond our control.

**Item 3 Quantitative and Qualitative Disclosures about Market Risk**

**Interest Rate Risk**

The PNC Facilities bears interest at a floating rates. The weighted average interest rate incurred on the PNC Facilities for the nine months ended October 1, 2017 was 4.8%. Subject to the Twelfth Amendment, advances made under the PNC Revolving Credit Facility bear interest at the U.S. base rate plus 0.75%. The applicable interest rate for the Long-Term Debt Facility is U.S. base rate plus 1.25%. The base commercial lending rate should approximate prime rate.

The impact of a 10% change in interest rates would not have a significant impact on our reported results of operations.

**Foreign Currency Exchange Risk**

As a result of operating a global business, we are exposed to exchange rate fluctuations on expenditures denominated in foreign currencies. However, most of our sales and component purchases are denominated in U.S. dollars, which limits our foreign currency risk. Our foreign exchange risk relates primarily to our Canadian, Mexican and Asian payroll, Euro based component purchases and other various operating expenses denominated in local currencies in our geographic locations. To mitigate this risk, the Company enters into forward foreign exchange contracts to reduce its exposure to foreign exchange currency rate fluctuations related to forecasted Canadian dollar and Mexican peso. The strengthening of the Canadian dollar and Mexican peso would result in an increase in costs to the organization and may lead to a reduction in reported earnings. See note 10 to the interim consolidated financial statements in this quarterly report for additional information on the forward foreign exchange contracts.

The impact of a 10% change in exchange rates would be estimated to have the following impact on cost of sales for the Company:

| | | |
|---|---|---|
| 10% increase in both the CAD and PESO foreign exchange rates (million) | $ | 0.4 |
| 10% decrease in both the CAD and PESO foreign exchange rates (million) | $ | (0.5) |

**Credit Risk**

In the normal course of operations, there is a risk that a counterparty may default on its contractual obligations to us which would result in a financial loss that could impact our reported earnings. In order to mitigate this risk, we complete credit approval procedures for new and existing customers and obtain credit insurance where it is financially viable to do so given anticipated revenue volumes, in addition to monitoring our customers' financial performance. We believe our procedures in place to mitigate customer credit risk and the respective allowance for doubtful accounts are adequate. During the nine months ended October 1, 2017, the Company recorded an additional provision for bad debt expense of $0.8 million related to one customer which experienced financial issues. This additional provision pertains to one customer, and while the Company takes measures to reduce credit risk, these charges can have a material impact on our financial performance.

There is limited risk of financial loss from defaults on our outstanding forward currency contracts as the counterparty to the transactions had a Standard and Poor's rating of A- or above as at September 30, 2017.

**Liquidity Risk**

There is a risk that we may not have sufficient cash available to satisfy our financial obligations as they come due. The financial liabilities we have recorded in the form of accounts payable, accrued liabilities and other current liabilities are primarily due within 90 days with the exception of the current portion of capital lease obligations which could exceed 90 days and our revolving debt facility which utilizes a lock-box to pay down the obligation effectively daily. Principal payments for the PNC Long-Term Debt Facility are made on a quarterly basis. As at October 1, 2017, the Company's liquidity is comprised of $2,935 in cash on hand and $7,106 of funds available to borrow under the PNC Revolving Credit facility. We believe that cash flow from operations, together with cash on hand and our PNC Revolving Credit Facility, which has a maximum credit limit of $30 million is sufficient to fund our financial obligations. However, availability under the PNC Revolving Credit Facility is subject to certain conditions, including borrowing base conditions based on eligible inventory and accounts receivable, as determined by the lender.

## Item 4 Controls and Procedures

***Evaluation of Disclosure Controls and Procedures.***

As of the end of the period covered by this quarterly report, the Company's Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer) have conducted an evaluation of the Company's disclosure controls and procedures. Based on their evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of October 1, 2017 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the applicable SEC rules and forms and (ii) accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

***Changes in Internal Control over Financial Reporting***

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended October 1, 2017 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## Part II OTHER INFORMATION

### Item 1A Risk Factors

***The Company has experienced a significant reduction in revenues in 2016 and in the first nine months of 2017, which has negatively impacted our cash flows from operations and liquidity and may continue to impact our cash flows from operations and liquidity during future periods.***

The Company has experienced significant reductions in revenue in 2016 and the first nine months of 2017 when compared to prior periods that has impacted cash flows from operations. The Company incurred a net loss in 2016 of $0.2 million and a net loss in the first nine months of 2017 of $6.9 million. Revenues have declined due to the loss of customers that represented a large concentration of the Company's business. The Company believes this loss of customers is largely due to competitive pressures from larger organizations, which competitive pressures may persist during future periods. This decline in revenues has directly impacted the Company's gross profit and its ability to generate cash flows from operations. See the discussion under Note 2 "Assessment of Liquidity and Management's Plans" in Item 1 of Part 1 of this report for additional information and discussion regarding this decline in the Company's revenue and resulting negative impact on our cash flows from operations and liquidity. Additional declines in the Company's revenues during future periods resulting from this challenging business environment may continue to negatively impact the Company's ability to generate cash flows from operations and to satisfy its liquidity needs.

During 2017, the Company included within selling, general and administrative expenses an additional provision for bad debt expenses of $0.8 million that predominately relates to amounts owed by one customer, which management does not believe are collectible. In addition, during 2017, the Company increased the provision for inventory obsolescence by approximately $0.5 million due primarily to an identified collection risk related to aged inventory for a small number of customers. The incurrence by the Company of additional bad debt expense or the need to increase the provision of inventory obsolescence during future periods could negatively impact our cash flows from operations and liquidity.

***We may be required to recognize additional impairment charges.***

Pursuant to U.S. GAAP, we are required to evaluate for impairment periodically and when events or changes in circumstances indicate that the carrying value of property, plant and equipment may not be recoverable. During 2017, the Company identified a triggering event related to property, plant and equipment in its U.S. segment asset group and recorded an impairment loss related to the U.S. segment of $1.0 million. In addition, during 2017, the Company recorded an impairment loss of 0.6 million related predominantly to machinery and equipment in the China segment. These assets were identified as part of the Company's assessment of its capital requirements and capabilities during the year. Disruptions and reductions to our business, unexpected significant declines in the operating results, divestitures and enterprise value declines may result in future impairment charges to property, plant and equipment. Any future impairment charge could substantially affect our reported results during those periods.

There are no other material changes to the risk factors disclosed in the "Risk Factors" section of the Company 's Annual Report on Form 10-K for the year ended January 1, 2017.

### Item 6 Exhibits

The exhibits listed below in the Exhibit Index are filed or furnished as part of this quarterly report, and are incorporated by reference herein.

**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 thereunto duly authorized.

**SMTC CORPORATION**

By: /s/ Edward Smith
Name: Edward Smith
Title: President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Roger Dunfield
Name: Roger Dunfield
Title: Chief Financial Officer (Principal
Financial Officer)

Date: November 2, 2017

**Item 6 Exhibits**

**EXHIBIT INDEX**

| | |
|---|---|
| 31.1* | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1** | Certification of Principal Executive Officer, 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. |
| 32.2** | Certification of Principal Financial Officer, 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. |
| 101.INS* | XBRL Instance |
| 101.SCH* | XBRL Taxonomy Extension Schema |
| 101.CAL* | XBRL Taxonomy Extension Calculation |
| 101.DEF* | XBRL Taxonomy Extension Definition |
| 101.LAB* | XBRL Taxonomy Extension Labels |
| 101.PRE* | XBRL Taxonomy Extension Presentation |

* Filed herewith
** Furnished herewith

**Exhibit 31.1**

**CERTIFICATION PURSUANT TO**
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

<u>CERTIFICATION</u>

I, Edward Smith, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SMTC Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrants fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2017

By: /s/ Edward Smith
Edward Smith
President and Chief Executive Officer

**Exhibit 31.2**

**CERTIFICATION PURSUANT TO**
**SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

CERTIFICATION

I, Roger Dunfield, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SMTC Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrants fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2017

By: /s/ Roger Dunfield
Roger Dunfield
Chief Financial Officer

**Exhibit 32.1**

**CERTIFICATION 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**

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, the undersigned, as President and Chief Executive Officer of SMTC Corporation (the "Company"), does hereby certify that to the undersigned's knowledge:

1) the Company's quarterly report on Form 10-Q for the quarter ended October 1, 2017 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Edward Smith
Edward Smith
President and Chief Executive Officer

Date: November 2, 2017

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**Exhibit 32.2**

**CERTIFICATION 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**

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, the undersigned, as Chief Financial Officer of SMTC Corporation (the "Company"), does hereby certify that to the undersigned's knowledge:

1) the Company's quarterly report on Form 10-Q for the quarter ended October 1, 2017 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Roger Dunfield
Roger Dunfield
Chief Financial Officer

Date: November 2, 2017

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.