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**FORM 10-K**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

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

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**SMTC CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**635 Hood Road, Toronto, Ontario, Canada**

(Address of Principal Executive Offices)

**98-0197680**

(IRS Employer Identification Number)

**L3R 4N6**

(Zip Code)

**Registrant's telephone number, including area code: 905-479-1810**

**Securities registered pursuant to Section 12(b) of the Act: Common stock, par value \$.01 per share.**

**Securities registered pursuant to Section 12(g) of the Act: NONE**

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of common stock of the registrant held by non-affiliates of the registrant was approximately \$25,800,000 on July 2, 2006, including the value of the common stock for which the exchangeable shares of the registrant's subsidiary, SMTC Manufacturing Corporation of Canada, are exchangeable. For purposes of the foregoing sentence, the term "affiliate" includes each director and executive officer of the registrant and each holder of more than 10% of the registrant's common stock. This determination of affiliate status is not necessarily a conclusive determination for other purposes. The computation of the aggregate market value is based upon the closing price of the common stock as reported on The Nasdaq National Market on June 30, 2006, the last business day of the registrant's most recently completed second fiscal quarter.

As of March 23, 2007, SMTC Corporation had 13,687,476 shares of common stock, par value \$0.01 per share, and one share of special voting stock, par value \$0.01 per share, outstanding. As of March 23, 2007, SMTC Corporation's subsidiary, SMTC Manufacturing Corporation of Canada, had 958,857 exchangeable shares outstanding, excluding 6,989,454 exchangeable shares owned by the Company's wholly-owned subsidiary, SMTC Nova Scotia Company, each of which is exchangeable for one share of common stock of SMTC Corporation.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement relating to the registrant's 2007 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A are incorporated by reference in Part III of this Report.

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## PART I

### FORWARD-LOOKING STATEMENTS

*This Annual Report contains forward-looking statements as defined under the federal securities laws. Actual results could vary materially. Factors that could cause actual results to vary materially are described herein and in other documents. Readers should pay particular attention to the considerations described in the section of this report entitled “Risk Factors—Factors that May Affect Future Results.” Readers should also carefully review any risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission.*

*Where we say “we”, “us”, “our”, the “Company” or “SMTC”, we mean SMTC Corporation or SMTC Corporation and its subsidiaries, as applicable. Where we refer to the “industry”, we mean the electronics manufacturing services industry. Certain statements in this Annual Report contain words such as “could”, “expects”, “may”, “anticipates”, “believes”, “intends”, “estimates”, “plans”, “envisions”, “seeks” and other similar language and are considered forward looking statements or information 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. Although we believe expectations reflected in such forward-looking statements are reasonable based upon the assumptions in this Annual Report, they may prove to be inaccurate and consequently our actual results could differ materially from our expectations set out in this Annual Report.*

#### Item 1: Business

### BUSINESS

#### Overview

SMTC Corporation (“We” or “SMTC” or the “Company”) 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, Canada, Mexico, and China, with approximately 1,300 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 networking, and communications market segments.

SMTC has customer relationships with industry leading OEMs. We developed these relationships by capitalizing on the continuing trend of OEMs to outsource non-core manufacturing services, to consolidate their supply base and to form long-term strategic partnerships with selected high quality EMS providers. We work closely with and are highly responsive to our customers throughout the design, manufacturing and distribution process, providing value-added services. We seek to grow our business through the addition of new, high quality customers and the expansion of our activity with existing customers.

Fundamental to our key benefits is our strategic manufacturing approach in working with customers premised upon gaining insight into their business and bringing innovative solutions to enhance our customers’ competitiveness and profits. SMTC lowers total cost of ownership; improves product quality and reliability; accelerates new products to market; improves service and end customer delivery; reduces working capital requirements and capital expenditures; and improves our customers’ overall margins and end customer satisfaction.

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During 2001, 2002 and 2003 we, in response to economic downturn and in particular the excess capacity caused by the slowing technology end market, commenced a restructuring program aimed at reducing our cost structure. In 2001, we focused on the improvement of capacity utilization and closed our Denver, Colorado assembly facility and our Haverhill, Massachusetts interconnect facility, re-sized our Mexico and Ireland facilities and reduced our excess equipment. In 2002, we took further steps to realign our cost structure and plant capacity. In 2003, we closed sites in Donegal, Ireland, Austin, Texas and Charlotte, North Carolina and sold our Appleton, Wisconsin manufacturing operations.

In late 2003, we developed a broad-based transformation plan designed to restructure, refinance and restore profitability and growth. This plan involved operational optimization programs, refinancing, stakeholder stabilization initiatives, strategy development and organizational renewal. With a new management team in place through 2004, we initiated and executed on each component of the plan including a recapitalization consisting of three main components: a private placement of equity securities, a new secured credit facility and a transaction with the Company's pre-existing lenders to repay a portion of the Company's pre-existing debt and restructure the balance of the Company's pre-existing debt, which we refer to as the Recapitalization Transaction. At the operations level, we redefined site mandates, reduced overhead costs and shifted production between sites to optimize efficiencies. To position the Company for growth, a new customer-centric strategy was developed and designed to clearly define and execute on a clear value proposition for customers.

Our Toronto, Ontario site serves as the Company's primary technical center of excellence, with particular emphasis on assisting current and new customers to develop, prototype and bring new products to full production. This site also continues to manufacture lower volume, higher complexity printed circuit board assemblies. Our Chihuahua, Mexico facility serves as SMTC's largest assembly operation, offering customers high quality services in a highly efficient, cost effective site. Our operations in Boston, Massachusetts specialize in high precision metal fabrication and system integration activities, while our San Jose, California operations specialize in printed circuit board assemblies, system integration and configuration and other related activities. Similarly, our engineering design services capability and our manufacturing relationship with China-based Alco Electronics Ltd., or Alco Electronics, will continue.

Having reduced capacity and costs, stabilized the stakeholder base and refinanced the balance sheet, our transformation plan was substantially completed in 2005. The focus for 2006 was to execute on a strategy for revenue growth through a combination of increasing the level of business with current customers and new customer acquisition and restoring profitability to a satisfactory level. During 2006, we gained several important new customers and added a number of new program wins within our current customer base, while at the same time maintaining operational excellence and cost containment. With these changes, the Company has been profitable for the past seven quarters.

### **Industry Background**

The EMS sector is the outsourced portion of the worldwide electronics assembly industry. There is currently considerable outsourcing of manufacturing by OEMs in response to rapidly changing markets, technologies and accelerating product life cycles as well as the need to lower total costs and convert typical fixed costs into a variable cost model. This trend is predicted to continue to increase.

Historically, OEMs were vertically integrated manufacturers that invested significantly in manufacturing assets and facilities around the world to manufacture, service and distribute their products. EMS originated as primarily labor intensive functions which were outsourced by OEMs to obtain additional capacity during periods of high demand. Early EMS providers were essentially subcontractors, providing production capacity on a transactional basis. However, with significant advances in manufacturing process technology, EMS providers developed additional capabilities and were able to improve quality and dramatically reduce OEMs' costs. Furthermore, as the capabilities of EMS companies expanded, an increasing number of OEMs adopted and relied upon EMS outsourcing strategies. Over time, OEMs engaged EMS providers to perform a broader array of manufacturing services, including design and development activities. In recent years, EMS providers have further expanded their

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range of services to include advanced manufacturing, configuration, packaging and distribution and overall supply chain management. In addition, many OEMs are reducing the number of vendors from which outsourced services are purchased, and are partnering with EMS suppliers, specializing in manufacturing and offering expertise.

By outsourcing manufacturing, OEMs take advantage of the technology and manufacturing expertise of EMS companies and focus on their core business, while leveraging the manufacturing efficiency and capital investment of EMS providers. OEMs use EMS providers to enhance their competitive position by:

- *Lowering Product Costs.* EMS providers are better able to reduce total product costs due to higher utilization of manufacturing capacity spread over a wider range of product types. Due to their scale of operations as well as established and ongoing relationships with suppliers, EMS providers are able to demonstrate better pricing and better inventory management.
- *Reducing Time-to-Market.* Electronics products are experiencing shorter product life cycles, requiring OEMs to continually reduce the time required to bring new products to market. OEMs can significantly improve product development cycles and enhance time-to-market by benefiting from the expertise and infrastructure of EMS providers. This expertise includes capabilities relating to design, quick-turn prototype development and rapid ramp-up of new products to high volume production, with the critical support of worldwide supply chain management.
- *Improving Supply Chain Management.* OEMs that manufacture internally are faced with greater complexities in planning, procurement and inventory management due to frequent design changes, short product life cycles and product demand fluctuations. OEMs can address these complexities by outsourcing to EMS providers, who possess sophisticated supply chain management capabilities and can leverage significant component procurement advantages to lower product costs.
- *Accessing Advanced Manufacturing Capabilities and Process Technologies.* Electronics products and electronics manufacturing technology have become increasingly sophisticated and complex, making it difficult for many OEMs to maintain the necessary technological expertise and focus required to efficiently manufacture products internally. By working closely with EMS providers, OEMs gain access to high quality manufacturing expertise and capabilities in the areas of advanced process, interconnect and test technologies.
- *Improving Access to Global Markets.* OEMs are generally increasing their international activities in an effort to expand sales through access to foreign markets. EMS companies with worldwide capabilities are able to offer such OEMs global manufacturing solutions enabling them to meet local content requirements and to distribute products efficiently around the world at lower costs.
- *Reducing Capital Investments.* OEMs are able to reduce their capital investments in inventory, facilities and equipment by outsourcing their manufacturing to EMS providers and allocating their resources towards their core business activities.

### **SMTC Capabilities and Performance**

SMTC's electronic manufacturing services span the entire electronic product life cycle from development and introduction of new products through to the growth, maturity and end-of-life phases.

SMTC offers two vertically integrated manufacturing streams: PCBA products and larger-scale systems. For each of these streams, SMTC provides a broad range of end-to-end manufacturing services from assembly, test, integration and box-build through to system level test, configure-to-order, and end customer order fulfillment. SMTC's core services are complemented with enclosure and precision metal fabrication, cable assembly, interconnect and engineering design services.

Our PCBA-based product manufacturing handles a wide range of assemblies, from single PCB assemblies to PCBAs integrated into box-build enclosures; from low density simple designs to high density multi-level complex designs; and from low mix high volume to high mix low volume. SMTC focuses on automation and continuous improvement using real-time system monitoring to enhance our lean manufacturing approach.

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The larger-scale systems manufacturing handles a wide range of system and subsystem assemblies, from rack assemblies to small scale subassemblies and modules, and electrical and mechanical subassembly and test through to full integration, box-build, configuration-to-order and end customer order fulfillment.

SMTC's two manufacturing streams are vertically integrated to provide better control of quality, lead times and inventory risk and to avoid the "margin stacking" that occurs when these services are provided by entities that are not well connected. Customers benefit from lower costs, better quality and shorter lead times. Our vertically integrated manufacturing services include:

*PCBA Assembly Services.* We provide advanced product assembly and system level integration and test services combined with advanced manufacturing equipment and processes. Our flexible environment allows SMTC to support medium to high mix and volume manufacturing requirements and delivering a final product directly to the end customer.

*System-Level Integration, Box-Build and Test.* Our system and subsystem assembly services involve combining a wide range of subassemblies, including PCBAs, cables and harnesses, battery boxes and connector blocks, power supplies, backplanes and thermal controls. Our test expertise encompasses the full array of technologies present in today's system-level products, including high-speed digital, radio frequency, precision analog, power, thermal and optical. We provide complete electrical and mechanical testing for cables, harnesses, PCBA's, subassemblies and systems to meet our customers' requirements and specifications. Our in-house expertise enables us to provide custom test development services to our customers and to implement their product-specific tests.

*Enclosures and Precision Metal Fabrication.* SMTC uses premium grade sheet steel, stainless steel and aluminum ensuring high quality, which we can offer at a low cost due to our buying power. Technologically advanced equipment and processes enable SMTC to produce medium to complex product enclosures and metal parts while still achieving a low overall product cost. Our soft tooling approach minimizes up front costs and provides flexibility to respond quickly to engineering changes.

*Custom Interconnect.* We are experienced in the design, development and manufacturing of interconnect assemblies such as optical and electrical cable and harness assemblies offering customers advanced expertise and low cost options.

*Engineering Services.* We provide services across the entire product life cycle including product design, prototyping, qualification testing, value and sustaining engineering through product end of life.

*Global Procurement and Supply Chain Network.* As an extension of our offering of vertically integrated manufacturing services, SMTC's Global Procurement group plays a fundamental role in managing our portfolio of assets and relationships in the most efficient manner. Our Global Procurement expertise includes outsourcing based on market conditions and demand management criteria established with the customer; building flexibility into the supply chain network; designing a supply chain specific to individual customer needs; and having the ability to proactively plan. SMTC's supply chain management team is responsible for all aspects of the Company's supply network. This team works together with its customers to establish customized inventory, logistics and distribution services to ensure that any unique delivery requirements are met. Through the use of various management tools, this team focuses on driving improved inventory turns, lowers excess and obsolete inventory risk and reduces overall costs to SMTC customers.

*Management Methods and Tools.* SMTC has a web-based system through which it can communicate, collaborate and plan throughout the entire supply chain in real-time with its customers and suppliers. This system accelerates the timeliness and effectiveness of decision making and the efficiency and flexibility with which SMTC can respond to customers experiencing unexpected market fluctuations. SMTC employs technologically advanced quality assurance systems, manufacturing process planning and continuous improvement methodologies.

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## SMTC Footprint

SMTC's full range of capabilities and operational footprint are well suited to OEMs having a range of product portfolios requiring cost competitive, medium to high mix and volume manufacturing. Our knowledge and experience in higher mix manufacturing combines a low cost approach with maximum scheduling flexibility. SMTC ensures cost competitive manufacturing through the deployment of a range of equipment matched to the mix, volume, complexity and characteristics of our customers.

Our facilities are strategically located across a broad footprint in the United States, Canada and Mexico, in addition we have a third party relationship in China, which together provide regional centers for new product introductions, low volume production as well as low cost centers for higher volume production, all tightly integrated through our "Copy-Exact" approach. Unique in its use of the "Copy-Exact" methodology to provide EMS services, SMTC facilities utilize the same manufacturing equipment and systems, and follow standardized processes. This provides truly seamless and timely transitions of manufacturing activities, allowing our customers to capitalize on cost structures well suited to the profile of their product mix, phase of product life cycle and the demands of their end markets.

PCBA facilities are located in Toronto, San Jose and Mexico (Chihuahua). In addition, we have a third party agreement with Alco Electronics in China (Chang An). Our Enclosure and System Integration and Test facility is in Boston. Our Toronto office also houses corporate and global services including our global procurement, supply chain and engineering functions and our advanced technology development groups.

## SMTC Key Benefits

We take pride in our team's professionalism, technical competence and customer focus. Our commitment to service and our attitude and approach to solving our customers' challenges in manufacturing are what assure long-term customer relationships. At SMTC, we are dedicated to ensuring customer needs are at the forefront of every decision. SMTC believes in the strategic partnership approach where significant benefits are gained by working closely as business partners. Our customers benefit from the following SMTC capabilities:

*High Quality Performance* SMTC defines its performance by the standards and performance metrics of its customers. We bring a strong record of quality and on-time delivery at a highly competitive cost.

*Customer-Tailored Solutions* A hallmark of SMTC's customer partnership model is to maintain a detailed understanding of its customers' businesses including customer's market, positioning, and performance requirements. We pride ourselves in working closely with our customers at all organizational levels to respond quickly and effectively to changing conditions allowing our customers to capitalize on opportunities.

*Flexibility* SMTC's approach to capacity utilization and scalability is to retain a footprint in key locations, configured with a capital equipment base with short-term capacity requirements which can be optimized quickly through variability in shift labor. This allows us to expand rapidly in a cost effective manner to meet changes in customer demand.

*Responsiveness* SMTC's ability and willingness to respond quickly to customer needs and changes in market demands is fundamental to its manufacturing capabilities. Our unique use of the "Copy-Exact" methodology, our cell-based manufacturing approach, web-based supply chain management system for controlling inventory, e-plenishment system with suppliers, and team-based oriented production system are each fine-tuned on every aspect towards providing responsiveness to best help our customers meet their market fluctuations.

*Manufacturing Efficiencies* Through its unique use of the "Copy-Exact" manufacturing methodology, all of SMTC's EMS facilities operate and provide EMS services utilizing identical manufacturing equipment and systems, and following standardized processes. This provides customers with truly seamless and timely

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transitions between higher-cost new product introduction or production facilities and lower-cost facilities ensuring our customers benefit by reaching their cost or volume targets as early as possible. It also gives us knowledge sharing efficiency advantages, which we ultimately pass on to our customers through lower costs and increased flexibility and responsiveness.

*Broad Range of Vertically Integrated Manufacturing Services* SMTC offers electronics manufacturing services including PCBA production, enclosure fabrication, systems integration and testing. These services are offered through two vertically integrated manufacturing streams: PCBA Products and Larger-scale Systems. For each of these streams, SMTC provides a broad range of end-to-end manufacturing services from assembly, test, integration and box-build through to system level test, configure-to-order, and end customer order fulfillment. SMTC core services are complemented with enclosure and precision metal fabrication, cable assembly, interconnect and engineering design services. This vertical integration offers SMTC customers the benefits of lower costs, better quality, and shorter lead times.

### **SMTC's Growth Strategy**

Our objective is to create increasing long term value to our stockholders through continuing growth and profitability. A cornerstone to SMTC's strategy is our customer-centric focus throughout the organization. Our key strategies include:

*Provide Outstanding Customer Service and Performance* Customer acquisition and loyalty comes from our ongoing commitment to understanding our customers' business performance requirements and our expertise in meeting or exceeding these requirements and enhancing their competitive edge. SMTC's customer focus extends to our unique offering of dedicated resources, and a detailed understanding of our customers' challenges and how we can support them in meeting their goals. Our dedicated team approach is used throughout SMTC facilities and comprises members from all functional areas working together to better understand the unique needs of the customer, their challenges and future plans. Our strong customer partnership approach includes involvement from both operational and senior executive teams, demonstrating our commitment to understanding each customer's goals, challenges, strategies, operations and products to provide a better overall solution.

*Focus on Well Defined Customer Markets* SMTC focuses on specific customer sectors that align well with our capabilities. These sectors primarily include industrial, computing and networking, and communications industries. Customers with unique medium to high mix and volume production requirements with a need for a high level of responsiveness to changing market demands are particularly well suited for our capabilities. As we continue to leverage our experience and established relationships in our existing market segments, we also are exploring opportunities such as the medical equipment industry. The medical equipment industry is demonstrating unique market characteristics and significant growth expectations that lead us to believe that it is a good fit to our medium to high mix and volume manufacturing capabilities and provides growth potential.

*Provide Advanced Technological Capabilities* We remain committed to enhancing our capabilities and value-added services to become an integral part of our customers' operations. Through our investment in assembly technologies and in design, engineering and test capabilities, we are able to provide our customers with a variety of advanced design and manufacturing solutions.

*Provide Comprehensive Service Offerings* SMTC's broad array of electronic manufacturing services spans the entire electronic product life cycle from introduction and development of new products to the support of products to growth and maturity phases. We perform advanced printed circuit board assembly and test and complement these capabilities with precision enclosure fabrication, system integration, product configuration, and build-to-order services. As products mature, we provide comprehensive value engineering services to reduce the cost of the products we produce without compromising quality or function. As products near their end of life, SMTC sustaining engineering, warranty repair, and supply chain management systems ensure continued availability and support of hard to source components while mitigating the risks associated with declining inventories. We believe that our breadth of services provides greater control over quality, delivery and costs and enables us to offer our customers a complete, end-to-end solution that is time and cost effective.

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*Maintain a Competitive, Scalable Cost Structure.* We maintain a competitive cost structure that not only delivers highly competitive pricing to customers but also is both variable and scalable as market conditions dictate. We strive to improve profitability through tight cost containment measures, performance excellence, leveraging fixed costs and increased capacity utilization. We have made key investments in manufacturing capacity and will continue to do so as we continue to grow.

### **Technology, Processes and Development**

SMTC uses advanced technology in the assembly and testing of the products we manufacture. Surface mount technology is the principal technology for the assembly of printed circuit boards. Our customer-focused factories include predominantly surface mount technology lines, which are highly flexible and are continually reconfigured to meet customer-specific product requirements.

In addition to expertise in surface mount assembly, we have capabilities in board level testing, integration and box-build through to system level test, configure-to-order, and end-customer order fulfillment. These core capabilities are complemented with enclosure and precision metal fabrication, cable assembly, interconnect and engineering design services.

SMTC focuses on automation and continuous improvement using real-time system monitoring in order to enhance our lean manufacturing approach. Our facilities use the same manufacturing equipment, as well as common manufacturing control systems, and follow standardized processes. This “Copy-Exact” methodology provides truly seamless and timely transitions between facilities and is unique among EMS providers. Customers can ramp to production in a regional facility and then quickly transition to a higher volume, lower cost facility in Mexico and China. As a result, our customers reach their cost or volume targets as early as possible. Further, “Copy-Exact” allows us to realize knowledge sharing efficiency advantages which we ultimately pass on to our customers through lower costs and increased flexibility and responsiveness.

Overall, we believe that our use of advanced technology and standardized processes combined with our technical skills, offers our customers both a high degree of expertise with manufacturing efficiencies and cost savings that position us competitively in the market.

### **Marketing and Sales**

We market our services through a focused strategy that emphasizes our competitive differentiators in servicing our customers. In addition to developing relationships with established mid-tier and larger OEMs, we also selectively target certain emerging companies. We target prospective customers in a range of sectors including industrial, computing and networking, and communications markets and are actively exploring opportunities.

We identify and pursue prospects that fit our pre-defined set of criteria and require a volume of production that complements our customer-partnership approach and supply chain offerings. We position the Company as a mid-tier outsource EMS provider offering higher responsiveness and flexibility than Tier 1 EMS companies, and lower costs with broader scalability than Tier 3’s provide. The continued loyalty of our existing customers is one of our strongest marketing tools that demonstrates our strong focus on customer attention from the executive level to the factory floor and an earned and proven history of solid performance.

SMTC has a direct sales channel model with territory assignments based on geographical coverage of our target markets in North America. Our geographical coverage is enhanced through select manufacturers’ representative companies. Our marketing and sales team works collectively to gain insight on potential customers’ business, market positioning and business challenges and focuses on a solutions-based approach to enhancing profitability, market positioning and business performance for that customer. Our customer-centric focus continues through to the execution phase of our relationships with a dedicated team-based manufacturing approach throughout all SMTC facilities.

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## **Global Procurement & Supply Chain Management**

We believe that the basis of true collaboration is seamless integration across the enterprise-wide system, encompassing the customers' worldwide facilities, our manufacturing sites, and our suppliers. Many customers rely on SMTC's one-stop-shop service to avoid difficulty brokering all of the relationships and information transfers required when outsourcing to design firms with different areas of expertise.

We provide our customers with a complete supply chain management solution, using advanced electronic schedule sharing methods with our customers and suppliers to efficiently plan, purchase, expedite and warehouse components and materials. Through its integrated supply chain network, SMTC is able to produce products without the margin stacking that occurs when these components are purchased from multiple or outside suppliers. The systems and processes we currently employ in supply chain management enable us to rapidly scale operations to meet customer needs, shift capacity in response to product demand fluctuations, reduce material costs and effectively distribute products to the end customer.

We believe that to continue to offer our customers superior services, we must work with our customers and suppliers in sharing information and making joint decisions to ensure a fast and cost-effective response to the market. Through a web-based user interface, our customers and suppliers have direct access to our supply chain management database and dynamic planning tools that allow "what if" analysis. Customers are able to monitor the availability and supply of component parts in real time. Communication is streamlined throughout the supply chain, allowing our customers to receive timely feedback and allowing us to receive real time input from our suppliers.

### **SMTC Suppliers**

With our web-based collaborative planning systems, our customers' needs are integrated with our suppliers in a more efficient and cost effective manner than is achievable through traditional electronic data interchange. In 2006, we purchased approximately \$190 million in materials. We believe this volume of procurement enhances our ability to obtain better pricing, influence component packaging and design and obtain supply of components in constrained markets.

We generally order materials and components under our agreements with customers only to the extent necessary to satisfy existing customer orders or forecasts. We have implemented specific inventory management strategies with certain suppliers such as supplier owned inventory and other SMTC supply chain velocity and flexibility programs. Fluctuations in material costs are typically passed through to customers. We may agree, upon request from our customers, to temporarily delay shipments, which causes a corresponding delay in our revenue recognition. Ultimately, however, our customers generally are responsible for all goods manufactured on their behalf.

During 2006, no suppliers represented greater than 10% of our total purchases for the year. We believe that there is a sufficient availability of raw materials and supplies to serve our needs.

### **SMTC Customers**

Our customer base of mid-tier and larger OEMs resides primarily in industrial, computing and networking and communications industries. Revenue in 2006 was attributed to the following industry sectors: 64% from industrial, 19% from communications and 17% from computing and networking.

We have focused on developing relationships with a large number of industrial customers to achieve a level of diversification and to reduce exposure to the volatility of certain electronics sectors.

We have established customer relationships with industry leading OEMs. The electronic products we assemble and manufacture can be found in a wide array of end-products including:

- High-end storage devices
- Currency recognition systems

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- Point of sale and specialty transaction terminals
  - Biometric devices
  - Mixed-class telecommunication and networking equipment
  - Telephony systems (including VoIP and IVR)
  - Computing systems equipment
  - Professional video & broadcast equipment
  - GPS navigation and positioning systems

### **Our Competition**

The EMS industry is composed of companies that provide a range of manufacturing services for OEMs, from PCBA, to design, prototyping, final system assembly, configuration, order fulfillment, repair and after-market services. The EMS market consists of Contract Manufacturers, or CMs, and Original Design Manufacturers, or ODMs. CMs manufacture products that have been designed by the OEM; ODMs also design their own products, primarily commodities, and in many instances are in direct competition with the OEMs. SMTC participates in the CM sector.

CM providers fall within one of four tiers: large/Tier 1 (revenues greater than \$1 billion) versus mid-size/Tier 2 (\$250 million to \$1 billion) versus regional companies/Tier 3 (\$20 million to \$250 million) versus small/Tier 4 (less than \$20 million). SMTC competes against all providers in North America, although the domestic and international Tier 2 providers that target the North American OEM market are its chief competitors.

SMTC is ideally positioned for mid-tier and larger OEMs (\$5 million to \$50 million outsourcing spend) looking for more flexibility and responsiveness than Tier 1 EMS companies provide, and lower costs with broader scalability than Tier 3 EMS companies provide.

Our competitors include Celestica Inc., Flextronics International Ltd., Jabil Circuit, Inc., Sanmina-SCI, Inc., Solectron Corporation, Benchmark Electronics Inc., and Plexus Corp., as well as numerous other smaller EMS providers. Certain competitors have greater manufacturing, financial, research and development and marketing resources than SMTC. We believe that the principal competitive factors in our segments of the EMS industry are product quality, flexibility and timeliness in responding to design and schedule changes, reliability in meeting product delivery schedules, pricing, technological advancement, the provision of value-added services and geographic locations.

### **Governmental Regulation**

Our operations are subject to certain federal, state, provincial and local regulatory requirements relating to environmental compliance and site cleanups, waste management and health and safety matters. In particular, we are subject to regulations pertaining to health and safety in the workplace and the use, storage, discharge and disposal of hazardous chemicals used in the manufacturing process.

Our commitment is to conduct our business in such a way that protects and preserves the environment, health and safety of our employees, our customers and the communities where we all live and operate.

In 2006, the electronics industry became subject to the European Union's Restrictions of Hazardous Substances, or RoHS, and Waste Electrical and Electronic Equipment, or WEEE, directives. Beginning on January 1, 2007, the State of California will put into effect a similar measure under the Electronic Waste Recycling Act of 2003 which requires the California Department of Toxic Substances Control to adopt regulations to prohibit the sale of electronic devices if they are prohibited from sale in the European Union because they contain certain heavy metals. Parallel initiatives are being proposed in other jurisdictions, including

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several other states in the United States and in the People's Republic of China. RoHS prohibits the use of lead, mercury and certain other specified substances in electronics products and WEEE requires industry OEMs to assume responsibility for the collection, recycling and management of waste electronic products and components. SMTC's sites are fully capable of producing RoHS compliant products as directed by our customers. In the case of WEEE, the compliance responsibility rests primarily with OEMs rather than with EMS companies. However, OEMs may turn to EMS companies for assistance in meeting their WEEE obligations.

To date, the costs of compliance and environmental remediation have not been material. Nevertheless, additional or modified requirements may be imposed in the future. If such additional or modified requirements are imposed on us, or if conditions requiring remediation are found to exist, we may be required to incur additional expenditures.

### **Common Stock Developments**

On October 4, 2004, the Company completed a reverse stock split of its issued and outstanding common stock whereby every five shares of common stock were exchanged for one common share, resulting in 7,775,181 common shares outstanding on such date. The number of authorized shares of common stock of the Company was also reduced from 130 million to 26 million shares. The Company's subsidiary, SMTC Manufacturing Corporation of Canada, completed a reverse stock split of its issued and outstanding exchangeable shares whereby every five exchangeable shares were exchanged for one exchangeable share, resulting in 6,866,152 exchangeable shares outstanding on such date. Each exchangeable share continues to be exchangeable for one share of common stock following the reverse stock split. All share amounts and per share amounts and all information relating to stock options and warrants in this Annual Report have been retroactively adjusted to reflect the reverse stock split, unless otherwise stated.

### **Our Structure and Our History**

The SMTC family of companies includes the following companies, with their jurisdictions of incorporation or organization in parentheses:

- SMTC Corporation (Delaware)
- HTM Holdings, Inc. (Delaware)
- 940862 Ontario Inc. (Ontario, Canada)
- Qualtron, Inc. (Massachusetts)
- Radio Componentes de Mexico, S.A. de C.V. (Mexico)
- SMTC de Chihuahua S.A. de C.V. (Mexico)
- SMTC Ireland Company (Ireland)
- SMTC Manufacturing Corporation of California (California)
- SMTC Manufacturing Corporation of Canada (Ontario, Canada)
- SMTC Manufacturing Corporation of Colorado (Delaware)
- SMTC Manufacturing Corporation of Massachusetts (Massachusetts)
- SMTC Manufacturing Corporation of North Carolina (North Carolina)
- SMTC Manufacturing Corporation of Texas (Texas)
- SMTC Manufacturing Corporation of Wisconsin (Wisconsin)
- SMTC Mex Holdings, Inc. (Delaware)
- SMTC Nova Scotia Company (Nova Scotia, Canada)
- SMTC R&D Teoranta (Ireland)
- SMTC Teoranta (Ireland)

Our company's present corporate structure resulted from the July 1999 combination of Surface Mount and HTM in a transaction accounted for under the purchase method of accounting as the acquisition of Surface Mount by HTM. Subsequent to the combination, all of Surface Mount's operating subsidiaries, other than SMTC Canada, SMTC Manufacturing Corporation of Ireland Limited, SMTC Teoranta, SMTC R&D Teoranta and Qualtron, Inc., have become subsidiaries of HTM.

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In August 1999, we acquired Zenith's facility in Chihuahua, Mexico, which expanded our cost-effective manufacturing capabilities in an important geographic region. In September 1999, we acquired the Boston, Massachusetts based systems integration and precision enclosures business of W.F. Wood, which expanded our operations into the Northeastern United States. In July 2000, we acquired Appleton, Wisconsin based Pensar Corporation. In November 2000, we acquired Haverhill, Massachusetts based Qualtron, Inc. in connection with the acquisition of its parent company, Qualtron Teoranta, by SMTC Canada. In 2001, we closed our Denver, Colorado and Haverhill, Massachusetts facilities. In 2002, we closed our Cork, Ireland facility. In 2003, we closed our interconnect facility in Donegal, Ireland, our Austin, Texas facility and our Charlotte, North Carolina facility. We also sold our Appleton, Wisconsin manufacturing operations during 2003.

On December 14, 2004, SMTC Manufacturing Corporation of Texas ("SMTC Texas") filed a voluntary petition for relief under chapter 7 of title 11 of the United States Code in the United States Bankruptcy Court for the Western District of Texas.

In 2005 we initiated the liquidation process for SMTC Ireland Company, SMTC R&D Teoranta and SMTC Teoranta. Additionally, we completed the liquidation of SMTC Manufacturing Corporation of Ireland.

### **Backlog**

Although we obtain firm purchase orders from our customers, our customers typically do not make firm orders for delivery of products more than 30 to 90 days in advance. We do not believe that the backlog of expected product sales covered by firm purchase orders is a meaningful measure of future sales since orders may be rescheduled or canceled.

### **Employees**

As of December 31, 2006, we employed approximately 1,300 full time employees. In addition, we employ varying levels of temporary employees as our production demands. Given the variable nature of our project flow and the quick response time required by our customers, it is critical that we be able to quickly adjust our production levels to maximize efficiency. To achieve this, our strategy has been to employ a skilled temporary labor force, as required. We use outside contractors to qualify our temporary employees on a site-by-site basis. Our production level temporary employees are compensated by the hour. We believe we are team-oriented, dynamic and results-oriented with an emphasis on customer service and quality at all levels. We believe this environment is a critical factor for us to be able to fully utilize the intellectual capital of our employees. From time to time we relocate our management level employees as needed to fill open positions at our sites. Because of our training programs, we have not experienced difficulty in adequately staffing skilled employees.

As of December 31, 2006, our only unionized employees were at our Mexico facility (701 employees). We have never experienced a work stoppage or strike and believe we have sound employee relations.

### **Item 1A: Risk Factors**

#### **FORWARD-LOOKING STATEMENTS**

A number of the matters and subject areas discussed in this Form 10-K are forward-looking in nature. The discussion of such matters and subject areas is qualified by the inherent risks and uncertainties surrounding future expectations generally; these expectations may differ materially from SMTC's actual future experience involving any one or more of such matters and subject areas. SMTC cautions readers that all statements other than statements of historical facts included in this annual report on Form 10-K regarding SMTC's financial position and business strategy may constitute forward-looking statements. All of these forward-looking statements are based upon estimates and assumptions made by SMTC's management, which although believed to be reasonable, are inherently uncertain. Therefore, undue reliance should not be placed on such estimates and statements. No assurance can be given that any of such estimates or statements will be realized, and it is likely that actual results

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will differ materially from those contemplated by such forward-looking statements. Factors that may cause such differences include: (1) increased competition; (2) increased costs; (3) the inability to implement our business plan and maintain covenant compliance under our credit agreements; (4) the loss or retirement of key members of management; (5) increases in SMTC's cost of borrowings or lack of availability of additional debt or equity capital on terms considered reasonable by management; (6) adverse state, federal or foreign legislation or regulation or adverse determinations by regulators; (7) changes in general economic conditions in the markets in which SMTC may compete and fluctuations in demand in the electronics industry; (8) the inability to manage inventory levels efficiently in light of changes in market conditions; and (9) the inability to sustain historical margins as the industry develops. SMTC has attempted to identify certain of the factors that it currently believes may cause actual future experiences to differ from SMTC's current expectations regarding the relevant matter or subject area. In addition to the items specifically discussed in the foregoing, SMTC's business and results of operations are subject to the risks and uncertainties described under the heading "Factors That May Affect Future Results" below. The operations and results of SMTC's business may also be subject to the effect of other risks and uncertainties. Such risks and uncertainties include, but are not limited to, items described from time to time in SMTC's reports filed with the Securities and Exchange Commission.

## **FACTORS THAT MAY AFFECT FUTURE RESULTS**

### **RISKS RELATED TO OUR BUSINESS AND INDUSTRY**

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

As a result of unfavorable economic conditions, reduced capital spending and changes in our customers' manufacturing requirements, our sales declined during fiscal years 2002 to 2005. In particular, sales to OEMs in the telecommunications and computing and networking industries worldwide were impacted. If the current general economic conditions change or decline we may experience a material adverse impact on our business, operating results and financial condition.

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

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

Ten customers form approximately 84% of our revenue and we expect to continue to depend upon a relatively small customer base for a significant percentage of our revenue. In addition to having a limited number of customers, we manufacture a limited number of products for each of our customers. If we lose any of our largest customers or any product line manufactured for one of our largest customers, we could experience a significant reduction in our revenue. Also, the insolvency of one or more of our largest customers or the inability of one or more of our largest customers to pay for its orders could decrease revenue. As some of our costs and operating expenses are fixed, a reduction in net revenue can decrease our profit margins and adversely affect our business, financial condition and results of operations even though we now have a track record of reducing costs.

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

The electronics manufacturing services (EMS) industry is highly competitive. We compete against numerous domestic and foreign EMS providers including Celestica Inc., Flextronics International Ltd., Jabil Circuit, Inc., Sanmina-SCI, Inc., Solectron Corporation, Benchmark Electronics Inc. and Plexus Corp. In addition, we may in the future encounter competition from other large electronics manufacturers that are selling,

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or may begin to sell, electronics manufacturing services. Many of our competitors have international operations, and some have substantially greater manufacturing, financial, research and development and marketing resources and lower cost structures than us. We also face competition from the manufacturing operations of current and potential customers, which are continually evaluating the merits of manufacturing products internally versus the advantages of using external manufacturers.

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

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

- variations in the timing and volume of customer orders relative to our manufacturing capacity;
- variations in the timing of shipments of products to customers;
- introduction and market acceptance of our customers' new products;
- changes in demand for our customers' existing products;
- the accuracy of our customers' forecasts of future production requirements;
- effectiveness in managing our manufacturing processes, inventory levels and costs;
- changes in competitive and economic conditions generally or in our customers' markets;
- willingness of suppliers to supply the Company on normal credit terms; and
- changes in the cost or availability of components or skilled labor.

In addition, most of our customers typically do not commit to firm production schedules more than 30 to 90 days in advance. Accordingly, we cannot forecast the level of customer orders with certainty. This makes it difficult to schedule production to maximize utilization of our manufacturing capacity. In the past, we have been required to increase staffing, purchase materials and incur other expenses to meet the anticipated demand of our customers. Sometimes anticipated orders from certain customers have failed to materialize, and at times delivery schedules have been deferred as a result of changes in a customer's needs. Any material delay, cancellation or reduction of orders from our larger customers could cause our revenue to decline. In addition, as many of our costs and operating expenses are relatively fixed, a reduction in customer demand can decrease our gross margins and adversely affect our business, financial condition and results of operations. On other occasions, customers have required rapid and unexpected increases in production, which have placed burdens on our manufacturing capacity and adversely affected costs.

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

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

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

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

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

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

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

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

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

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

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

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

- fluctuations in the value of currencies and high levels of inflation;
- longer payment cycles and greater difficulty in collecting amounts receivable;
- unexpected changes in and the burdens and costs of compliance with a variety of foreign laws;
- political and economic instability;
- increases in duties and taxation;
- imposition of restrictions on currency conversion or the transfer of funds;
- trade restrictions; and
- dependence on key customers.

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

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

**RISKS RELATED TO OUR CAPITAL STRUCTURE****Our indebtedness could adversely affect our financial health and severely limit our ability to plan for or respond to changes in our business.**

At December 31, 2006, we had \$18.8 million of indebtedness outstanding under our credit facilities with Wachovia Capital Finance of Canada and its affiliates (“Wachovia”), which we refer to in this report as the “Wachovia Facility.” The amount of indebtedness outstanding under the Wachovia Facility fluctuates based on our operations. On December 31, 2006, we also had \$21.9 million of second lien, subordinated term indebtedness outstanding under our restructured, pre-existing credit facility, which we refer to in this report as the “Pre-existing Facility” (and together with the Wachovia Facility, the “Credit Facilities”), with our pre-existing lenders, The Bank of Nova Scotia, General Electric Capital Corporation, Silver Point Capital L.P., Royal Bank of Canada, and Lehman Commercial Paper Inc., which we refer to in this report as the “Pre-existing Lenders.” Our debt, whether under our Wachovia Credit Facility or Pre-existing Facility, could have adverse consequences for our business, including:

- We will be more vulnerable to adverse general economic conditions.
- We will be required to dedicate a substantial portion of our cash flow from operations to repayment of debt, limiting the availability of cash for other purposes.

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- We may have difficulty obtaining financing in the future for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes.
  - We may have limited flexibility in planning for, or reacting to, changes in our business and industry.
  - We could be limited by restrictive covenants and the borrowing base formula in our credit arrangements in our borrowing of additional funds.
  - We may fail to comply with covenants under which we borrowed our indebtedness including the financial covenant under our Credit Facilities, which requires us to meet a consolidated EBITDA target on a rolling four quarter basis, which could result in an event of default. If an event of default occurs and is not cured or waived, it could result in all amounts outstanding, together with accrued interest, becoming immediately due and payable. If we were unable to repay such amounts, our lenders could proceed against any collateral granted to them to secure that indebtedness. There can be no assurance that we will maintain compliance with the covenants under our Credit Facilities.
  - Our Wachovia Facility contains subjective acceleration clauses. There can be no assurance that the lender will not exercise their rights to accelerate repayment under the terms of the agreement.

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

**We face significant restrictions on our ability to operate under the terms of our Credit Facilities.**

The terms of our Credit Facilities generally restrict, among other things, our ability to incur additional indebtedness, complete acquisitions, pay dividends or make certain other restricted payments, consummate certain asset sales, make capital expenditures, enter into certain transactions with affiliates, merge, consolidate or sell, assign, transfer, lease, convey or otherwise dispose of our assets (other than in the ordinary course of business). We are also required to maintain specified EBITDA (earnings before interest expense, income taxes, depreciation and amortization) levels under the Credit Facilities.

The Wachovia Facility also has a borrowing base formula that limits our ability to borrow based on the characteristics of our accounts receivable and inventory. Further, Wachovia has discretion to reduce availability under the Wachovia Facility.

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

Substantially all of our assets and those of our subsidiaries are pledged as security under our Credit Facilities.

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

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

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

Shares of authorized but unissued common stock may be issued from time to time by our Board of Directors without further stockholder action unless such action is required by Delaware law, under which the Company is incorporated, our charter, or the rules of the Nasdaq Global Market. Additional authorized but unissued shares of common stock might be used in the context of a defense against or response to possible or threatened hostile takeovers. It is not possible to predict in advance whether the issuance of additional shares will have a dilutive effect on earnings per share as it depends on the specific events associated with a particular transaction.

**Certain differences may exist between the trading market of our common stock and the trading market for the exchangeable shares of SMTC Canada**

Although the exchangeable shares of SMTC Canada are intended to be functionally and economically equivalent to shares of our common stock, there can be no assurance that the market price of the exchangeable shares will be identical, or even similar, to the market price of our common stock.

**Item 1B: Unresolved Staff Comments.**

None.

**Item 2: Properties**

**Facilities**

We conduct our operations within approximately 490,000 square feet of building space. We believe our facilities are currently adequate for our operating needs and provide capacity for future volume growth. Our principal service at all locations is assembly of electronic components, with the exception of the Boston facility where we manufacture precision enclosures. Our operating facilities are as follows:

<u>Location</u>	<u>Approx. Square Footage</u>	<u>Leased/Owned</u>
Toronto, Ontario	100,000	Leased
San Jose, California	37,500	Leased
Boston, Massachusetts	150,000	Leased
Chihuahua, Mexico	200,000	Owned

In addition, SMTC has a third party agreement with Alco Electronics in Chang An, China providing access to a 35,000 square foot facility designed around SMTC's "Copy-Exact" model.

All of our principal facilities are ISO certified to ISO 9001 or ISO 9002 standards. ISO 9001 and ISO 9002 are commonly recognized standards in the EMS industry that are published by the International Standardization Organization and relate to quality management systems. ISO 9001 contains requirements for quality assurance in design, development, production, installation and servicing. ISO 9002 contains requirements for quality assurance in production, installation and servicing.

The principal executive office of SMTC and SMTC Canada is located at 635 Hood Road, Toronto, Ontario, Canada L3R 4N6.

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**Item 3: Legal Proceedings**

We are a party to various legal actions arising in the ordinary course of our business. We believe that the resolution of these legal actions will not have a material adverse effect on our financial position or results of operations.

**Item 4: Submission of Matters to a Vote of Security Holders**

None.

## PART II

### Item 5: Market for Registrant's Common Equity and Related Stockholder Matters

#### Market Information

Our common stock trades on The NASDAQ Stock Market under the symbol "SMTX." The following table shows the high and low sales price for our common stock as reported by The NASDAQ Stock Market for each quarter in the years ended December 31, 2006 and 2005.

	Common Stock Price			
	2006		2005	
	High	Low	High	Low
First Quarter	\$2.66	\$1.40	\$2.09	\$1.08
Second Quarter	3.02	2.22	1.19	0.77
Third Quarter	2.89	2.25	3.48	0.78
Fourth Quarter	2.88	2.32	3.35	1.38

#### Holdings

As of March 23, 2007, there were approximately 56 holders of record of the Company's common stock.

As of March 23, 2007, the Company had 26,000,000 authorized shares of common stock, par value \$.01 per share, of which, as of such date, 13,687,476 shares were issued and outstanding. As of March 23, 2007, SMTC Corporation's subsidiary, SMTC Manufacturing Corporation of Canada, had 958,857 exchangeable shares outstanding, excluding 6,989,454 exchangeable shares owned by the Company's wholly-owned subsidiary, SMTC Nova Scotia Company, each of which is exchangeable for one share of common stock of SMTC Corporation.

#### Dividends

The Company has never declared a cash dividend on its common stock. The Board of Directors of the Company has no present intention to authorize the payment of dividends on common stock in the foreseeable future. It is the present policy of the Company to retain earnings, if any, to provide for growth and working capital needs. Further, the Company's senior credit facility restricts the Company from paying dividends.

### Item 6: Selected Financial Data

The data set forth below should be read in conjunction with our "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes thereto appearing elsewhere in this Annual Report.

Our consolidated financial statements and our selected consolidated financial data have been prepared in accordance with United States GAAP. These principles conform in all material respects to Canadian GAAP except as described in note 13 to our consolidated financial statements.

**Consolidated Statement of Operations Data:**  
(in millions, except per share amounts)

	Years Ended December 31,				
	2002	2003	2004	2005	2006
Revenue	\$ 525.2	\$306.1	\$244.6	\$228.8	\$262.8
Cost of sales	504.9	279.5	222.8	211.6	236.4
Gross profit	20.3	26.6	21.8	17.2	26.4
Selling, general and administrative expenses, including other changes (recoveries)	24.2	18.7	16.3	13.2	15.2
Amortization, including other charges (a)	2.5	4.1	2.3	—	—
Restructuring and other charges (recoveries)					
Restructuring (recoveries) charges (a)	30.4	1.1	(1.6)	0.1	(1.4)
Gain on sale of assets (a)	—	—	—	—	(1.2)
Other expenses (f)	—	—	—	—	0.8
Operating (loss) earnings	(36.8)	2.7	4.8	3.9	13.0
Interest expense	8.3	5.1	4.5	4.6	5.4
Earnings (loss) before income taxes and discontinued operations	(45.1)	(2.4)	0.3	(0.7)	7.6
Income tax (recovery) expense (c)	(1.2)	35.0	0.5	(0.6)	(2.0)
Earnings (loss) from continuing operations	(43.9)	(37.4)	(0.2)	(0.1)	9.6
Earnings (loss) from discontinued operations (d)	(8.5)	(2.4)	0.8	—	0.9
Cumulative effect of a change in accounting policy (b)	(55.6)	—	—	—	—
Net earnings (loss), also being comprehensive income (loss)	<u>\$(108.0)</u>	<u>\$ (39.8)</u>	<u>\$ 0.6</u>	<u>\$ (0.1)</u>	<u>\$ 10.5</u>
Basic earnings (loss) per share (e)					
Basic earnings (loss) per share from continuing operations	\$ (7.65)	\$ (6.51)	\$ (0.02)	\$ (0.01)	\$ 0.65
Basic earnings (loss) per share from discontinued operations	(1.48)	(0.42)	0.08	—	0.06
Loss per share from the cumulative effect of a change in accounting policy (b)	(9.69)	—	—	—	—
Basic earnings (loss) per common share	<u>\$(18.82)</u>	<u>\$ (6.93)</u>	<u>\$ 0.06</u>	<u>\$ (0.01)</u>	<u>\$ 0.71</u>
Diluted earnings (loss) per common share	<u>\$(18.82)</u>	<u>\$ (6.93)</u>	<u>\$ 0.06</u>	<u>\$ (0.01)</u>	<u>\$ 0.70</u>
Weighted average number of shares outstanding (e)					
Basic	5.7	5.7	10.9	14.6	14.6
Diluted	<u>5.7</u>	<u>5.7</u>	<u>10.9</u>	<u>14.7</u>	<u>15.0</u>

(a) 2002 Charges:

Due to the continuing economic downturn, the Company took further steps to realign its cost structure and plant capacity (the “2002 Plan”) and announced third and fourth quarter net restructuring charges of \$36.9 million related to the cost of exiting equipment and facility leases, severance costs, asset impairment charges and inventory exposures, and other facility exit costs and other charges of \$2.1 million.

Restructuring charges related to the 2002 Plan of \$6.5 million and other charges of \$0.9 million are included in cost of sales for fiscal year 2002. Other charges of \$1.0 million are included in selling, general and administrative expenses and other charges of \$0.2 million are included in amortization expense for fiscal year 2002.

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#### 2003 Charges:

During 2003, the Company recorded a net restructuring and other charge of \$1.0 million, consisting of a net adjustment to previously recorded charges related to the 2001 restructuring program aimed at reducing its cost structure and plant capacity (the "2001 Plan") and the 2002 Plan, respectively, of \$0.3 million and additional charges incurred during 2003 of \$1.3 million. During 2003, the Company also recorded an adjustment to other charges of \$0.1 million, included in selling general and administrative expenses.

#### 2004 Charges:

During 2004, the Company announced further changes to its manufacturing operations as it continued to execute its transformation plan (the "2004 Plan") and recorded restructuring charges related to severance costs of \$1.5 million. The Company also recorded adjustments to previously recorded restructuring charges related to the 2001 Plan and the 2002 Plan of \$3.8 million, an additional severance charge of \$0.4 million related to the 2002 Plan, and net other charges incurred during 2004 of \$0.3 million.

#### 2005 Charges:

During 2005, the Company recorded net restructuring charges of \$0.1 million consisting of: severance charges of \$0.2 million; a reversal of previously recorded lease and other contract obligations of \$0.2 million; a reversal of previously recorded severance charges of \$0.5 million and other charges of \$0.1 million, all related to the 2002 Plan; and severance charges of \$0.5 million related to the 2004 Plan.

#### 2006 Net recoveries:

During 2006, the Company recorded net restructuring recoveries of \$2.6 million consisting of: \$1.8 million resulting from a change in previously estimated amounts to be paid under the 2002 Plan as a result of new circumstances, a \$1.2 million gain on sale of an asset previously written down, and additional charges \$0.4 million under a plan initiated in 2006 related to the restructuring of management roles.

- (b) During 2002, the Company completed its transitional goodwill impairment test resulting in a goodwill impairment charge of \$55.6 million. Prior to January 1, 2002, goodwill was amortized on a straight-line basis over 10 years. Effective January 1, 2002, the Company discontinued amortization of all existing goodwill as a result of a new accounting standard issued in 2001.
- (c) During the second quarter of 2003 the Company performed its quarterly review of its deferred tax assets in accordance with SFAS No. 109. This review resulted in a decision to establish a full valuation allowance for deferred tax assets. Refer to note 7 to our consolidated financial statements.
- (d) During the third quarter of 2003, the Company sold the manufacturing operations of the Appleton facility for cash proceeds of \$3.1 million. The Company recorded a loss on disposal of \$0.2 million, which has been included in the loss from discontinued operations during fiscal year 2003. Refer to note 8 to our consolidated financial statements.

In February, 2002 the main customer of the Cork, Ireland facility was placed into administration as part of a financial restructuring. As a result, on March 19, 2002, the Company announced that it was closing the Cork, Ireland facility and that it was taking steps to place the subsidiary that operated that facility in voluntary administration. Refer to note 8 to our consolidated financial statements.
- (e) On October 4, 2004, the Company completed a reverse stock split of its issued and outstanding common and exchangeable shares whereby every five shares of common stock were exchanged for one share of common stock and every five exchangeable shares were exchanged for one exchangeable share, resulting in 7,775,181 common shares outstanding and 6,866,152 exchangeable shares outstanding at that date. All share information related to shares outstanding has been retroactively adjusted to reflect the reverse stock split.
- (f) In 2006, the Company incurred expenses related to advisory fees.

**Consolidated Balance Sheet Data and Other Financial Data:**  
(in millions)

	At and for the Years Ended December 31,				
	2002	2003	2004	2005	2006
Cash	\$ 0.4	\$ 0.2	\$ —	\$ —	\$ —
Working capital (deficiency)	(8.2)	(55.2)	11.6	9.6	21.3
Total assets	191.0	108.8	92.7	90.0	115.9
Total debt, including current maturities	82.6	70.1	33.9	28.5	41.0
Shareholders' equity (deficiency)	18.0	(21.3)	14.1	14.0	23.9
Capital expenditures	2.8	0.2	0.3	2.5	4.4
Cash flows from operating activities	34.8	5.5	5.6	9.5	(9.5)
Cash flows from financing activities	(44.1)	(8.9)	(5.4)	(8.0)	10.5
Cash flows from investing activities	(2.4)	3.3	(0.4)	(1.5)	(1.0)

**Quarterly Results**

The following tables set forth our unaudited historical quarterly results for the eight quarters ended December 31, 2006. This information has been prepared on the same basis as our annual consolidated financial statements and it includes all adjustments necessary for a fair presentation of the financial results of such periods. This information should be read in conjunction with our annual consolidated financial statements for the years ended December 31, 2005 and 2006. The operating results for any previous quarter are not necessarily indicative of results for any future periods.

(in millions, except per share amounts)

	Quarters Ended							
	Apr 3, 2005	July 3, 2005	Oct 2, 2005	Dec 31, 2005	Apr 2, 2006	July 2, 2006	Oct 1, 2006	Dec 31, 2006
Revenue	\$ 49.1	\$57.0	\$64.6	\$58.1	\$59.9	\$61.1	\$65.7	\$ 76.1
Gross profit (a)	2.0	4.8	5.5	4.9	6.1	6.8	5.9	7.7
Earnings (loss) from continuing operations (a)	(2.6)	0.3	0.8	1.4	1.0	1.3	5.2	2.1
Earnings (loss) (a)	(2.6)	0.3	0.8	1.4	1.0	1.3	6.1	2.1
Earnings (loss) per share from continuing operations (b)	\$(0.18)	\$0.02	\$0.05	\$0.10	\$0.06	\$0.09	\$0.35	\$ 0.14
Weighted average number of shares outstanding — diluted	14.6	14.6	14.8	14.8	14.8	14.9	14.9	15.0

- (a) Each of the quarters ended April 3, 2005 and July 3, 2005, includes restructuring charges of \$0.1 million. The quarter ended October 2, 2005 relates to the reversal of previously recorded restructuring charges of \$0.1 million. The quarter ended October 1, 2006 includes \$5 million of one-time items including an income tax recovery, proceeds from the sale of real estate, final proceeds from the sale of operations discontinued in 2002 and a net adjustment to restructuring accruals.
- (b) On October 4, 2004, the Company completed a reverse stock split of its issued and outstanding common and exchangeable shares whereby every five shares of common stock were exchanged for one share of common stock and every five exchangeable shares were exchanged for one exchangeable share, resulting in 7,775,181 common shares outstanding and 6,866,152 exchangeable shares outstanding at that date. All share information related to shares outstanding has been retroactively adjusted to reflect the reverse stock split.

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**Item 7: 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 it may apply. 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 Operation (“MD&A”) in combination with the accompanying 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 (“US GAAP”) included within this Annual Report on Form 10-K. The forward-looking statements in this discussion regarding the electronics manufacturing services industry, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements in this discussion include numerous risks and uncertainties, some of which are as described in the “Risk Factors—Factors That May Affect Future Results” section above. Certain statements in this MD&A contain words such as “could”, “expects”, “may”, “anticipates”, “believes”, “intends”, “estimates”, “plans”, “envisions”, “seeks” and other similar language and are considered forward looking statements or information 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. Although we believe expectations reflected in such forward-looking statements are reasonable based upon the assumptions in this MD&A, they may prove to be inaccurate and consequently our actual results could differ materially from our expectations set out in this MD&A. We may not update these forward-looking statements after the date of this Annual 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 US dollars unless specifically stated otherwise.

**Corporate History**

SMTC Corporation is the result of the July 1999 combination of Surface Mount and HTM. Surface Mount was established in Toronto, Ontario in 1985. HTM was established in Denver, Colorado in 1990. SMTC was established in Delaware in 1998. After the combination, we purchased Zenith Electronics’ facility in Chihuahua, Mexico, which expanded our cost-effective manufacturing capabilities in an important geographic region. In September 1999, we established a manufacturing presence in the northeastern United States and expanded our value-added services to include high precision enclosure capabilities by acquiring Boston, Massachusetts based W.F. Wood. In July 2000, we acquired Pensar Corporation, an EMS company specializing in design engineering headquartered in Appleton, Wisconsin. On July 27, 2000, we consummated an initial public offering of 1,325,000 shares of our common stock and 875,000 exchangeable shares of our subsidiary SMTC Manufacturing Corporation of Canada, or SMTC Canada. Each exchangeable share of SMTC Canada is exchangeable at the option of the holder at any time into one share of our common stock, subject to compliance with applicable securities laws. On August 18, 2000, we sold an additional 330,000 shares of common stock upon exercise of the underwriters’ over-allotment option. In November 2000, we acquired Qualtron Teoranta, a provider of specialized cable and harness interconnect assemblies, based in Donegal, Ireland and with a subsidiary in Haverhill, Massachusetts. In 2001, we closed our facilities in Denver, Colorado and Haverhill, Massachusetts. In 2002, we closed our facility in Cork, Ireland. In 2003, we closed our facilities in Donegal, Ireland, Austin, Texas and Charlotte, North Carolina and sold the majority of our operations in Appleton, Wisconsin.

**Overview****Background**

We provide advanced electronics manufacturing services, or EMS, to original equipment manufacturers, or OEMs, primarily in the industrial, computing and networking, and communications market segments. We

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currently service our customers through manufacturing and technology centers strategically located in key technology corridors in the United States, Canada, and Mexico as well as through our manufacturing relationship with China-based Alco Electronics. Our full range of value-added supply chain services include product design, procurement, prototyping, advanced cable and harness interconnect, high-precision enclosures, printed circuit board assembly, test, final system build, comprehensive supply chain management, packaging, global distribution and after sales support.

As the technology sector grew rapidly in 1999 and 2000, we sought to take advantage of such growth and completed several acquisitions. When the technology sector declined, we found ourselves with significant excess capacity and incurred significant operating losses. As a result, in 2001 and 2002, we began an operational restructuring that involved closing six, and selling one, of our manufacturing facilities.

In early 2004, we initiated a comprehensive transformation plan designed to restructure, recapitalize and restore profitability and growth. The transformation plan had several components, including operational optimization, recapitalization, strategy development and organization renewal. The recapitalization, which closed on June 1, 2004, consisted of three main components:

- a private placement of equity securities;
- a transaction with SMTC's pre-existing lenders (the "Pre-existing Lenders") to repay a portion of SMTC's pre-existing debt and restructure the balance of SMTC's pre-existing debt; and
- a new secured credit facility with Wachovia Capital Finance of Canada and its affiliates ("Wachovia"). This secured credit facility with Wachovia included a \$40 million credit facility available to the Company's U.S. and Canadian operating entities and a term loan of up to \$2 million (the "Wachovia Facilities").

The components of this recapitalization are more fully discussed in note 4 "Long-term debt and capital leases" to the accompanying consolidated financial statements and the discussion under "Capital Resources" within the "Liquidity and Capital Resources" section of this MD&A.

The operational optimization announced during 2004 consisted of changes to our manufacturing operations designed to provide greater focus on new customer and new product introduction and technical activities, improve capacity utilization, align our cost structure to expected revenue, and to enable us to become profitable on a sustained basis (the "2004 Plan").

During 2005, we continued to execute our transformation plan to restore the Company to growth and profitability and therefore announced additional optimization related charges. Having reduced capacity and costs, stabilized the stakeholder base and refinanced the balance sheet, our transformation plan was substantially complete in mid-2005. The various plans and details of these restructuring activities are more fully discussed in note 6 "Restructuring and other charges" to the accompanying consolidated financial statements.

#### **Developments in 2006**

Having completed our transformation plan, our primary focus in 2006 was centered on the execution of a strategy that would enable us to increase revenue through a combination of increasing the level of business with current customers and through new customer acquisition and would restore profitability to a satisfactory level.

We believe 2006 was a successful year in many respects for the Company, highlighted by double digit growth in revenues over 2005 and record earnings for the year culminating with our strongest fourth quarter in recent history both in revenues and from a net earnings perspective, with industry leading margin metrics. The Company has grown sequentially and year over year each and every quarter of 2006 driven by both growth and increased share of business with existing customers and the addition of new customers in 2006, while at the same time maintaining operational excellence and cost containment.

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However, we did not meet our cash generation targets as the Company invested in inventory and accounts receivables mainly the result of the supply chain side challenges, due to both external as well as internal forces. To address this issue, the Company is undertaking a number of inventory reduction initiatives. A number of other investments were made over the year in both people and equipment to support the growth in 2006 and anticipated continued growth in 2007.

In the third quarter of 2006, the Company realized a number of one-time items with a net favorable impact on net income of approximately \$5.0 million. Included in one time items were an income tax recovery, proceeds on sale of surplus real estate, final proceeds from the sale of operations discontinued in 2002 and a net adjustment to restructuring accruals.

During the year, the Company and Wachovia signed an amendment to the Wachovia Facilities which increased the amount of the term loans to \$2.0 million, repayable over a period of 36 months.

In August 2006, the Company and Wachovia signed a further amendment to the Wachovia Facilities which extended the term of the secured credit facility to October 15, 2007.

In September 2006, the Company and Wachovia amended the Wachovia Facilities to increase permitted borrowings under the secured credit facility from \$40 million to \$45 million and amended the terms to provide greater flexibility to manage working capital requirements. As a part of the debt restructuring, a Term Loan B was made available to the Company in an amount equal to \$10 million which bears a variable interest rate based on LIBOR plus five (5%) to seven (7%) percent depending on the senior leverage ratio. The Term Loan B has quarterly payments of \$0.3 million, maturing on October 15, 2007 and is secured by the Company's Mexican based assets.

The Company is currently in the process of refinancing some of its debt to address the maturity of some its debt in 2008 as well as to improve the flexibility and terms of its credit agreements.

In March 2007, the Company and Wachovia signed another amendment to the Wachovia Facilities which extended the term of the secured revolving credit facility and original term loan to April 15, 2008.

## **Results of Operations**

### *Continuing Operations*

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

The Company also derives revenue from engineering and design services. Service revenue is recognized as services are performed.

The consolidated financial statements of SMTC are prepared in accordance with US GAAP, which conforms in all material respects to Canadian GAAP, except as disclosed in note 13 of the consolidated financial statements.

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

	December 31, 2004	December 31, 2005	December 31, 2006
Revenue	100.0%	100.0%	100.0%
Cost of sales	90.6%	92.5%	89.9%
Gross profit	9.4%	7.5%	10.1%
Selling, general and administrative expenses	6.5%	5.7%	5.8%
Amortization	0.9%	—	—
Restructuring (recoveries) charges	—	—	(0.5)%
Gain on sale of assets	—	—	(0.5)%
Other expenses	—	—	0.3%
Operating earnings	2.0%	1.8%	5.0%
Interest expense	1.9%	1.9%	2.1%
Earnings (loss) from continuing operations before income taxes	0.2%	(0.1)%	2.9%
Income tax (recovery) expense			
Current	0.3%	—	(0.8)%
Deferred	(0.1)%	(0.2)%	—
	0.2%	(0.2)%	(0.8)%
Net (loss) earnings from continuing operations	(0.0)%	0.1%	3.7%

#### Year ended December 31, 2006 compared to the year ended December 31, 2005

##### Revenue

Revenue increased \$34.0 million, or 14.9%, from \$228.8 million for the year ended December 31, 2005 to \$262.8 million for the year ended December 31, 2006. The increase in revenue is largely due to the growth in revenue from Harris Broadcast Infrastructure and Digital Media (a subsidiary of Harris Corporation) (“Harris”), MEI, Inc. (formerly Mars Electronics) (“MEI”) and a longstanding industrial customer, and supported by growth in the majority of the Company’s other larger accounts during 2006 compared to 2005, partially offset by the decline in revenue from EMC Corporation (“EMC<sup>2</sup>”) and International Business Machines Corporation (“IBM”) as certain products approach end of life. Harris became a new customer in the second half of 2005 and consequently its production requirements increased during 2006 in addition to their own end market growth. The growth in MEI and our other industrial customer represents both an increase in their end market business and an increased share of their business for SMTC.

During 2006, revenue from the industrial sector represented 64.1% of revenue compared to 47.7% of revenue in 2005. The increase in the percentage of revenue generated from the industrial sector in 2006 compared to 2005 is largely due to the growth in revenue from MEI, Harris and a longstanding industrial customer during 2006. The percentage of sales attributable to the computing and networking sector was 16.9% during 2006 compared to 34.2% during 2005 resulting from the expected decline in revenue from EMC<sup>2</sup> and IBM, partially offset by the increase in revenue from other computing and networking sector customers during 2006. The percentage of sales attributable to the communications sector was 18.9% during 2006, which was relatively unchanged from 18.1% in 2005.

During 2006, we recorded approximately \$7.7 million of sales of raw materials inventory to customers, which carried no margin, compared to \$6.7 million in 2005. The Company purchases raw materials based on customer purchase orders. To the extent 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.

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 vary from year to year. The Company’s ten largest

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customers represented 83.6% of revenue during 2006, compared to 82.2% in 2005. Revenue from our three largest customers during 2006 was \$43.4 million from Ingenico S.A. (“Ingenico”), \$35.9 million from MEI and \$29.4 million from Harris, representing 16.5%, 13.7% and 11.2%, respectively, of total revenue for 2006. This compares with revenue of \$48.8 million from EMC<sup>2</sup>, \$40.6 million from Ingenico and \$24.5 million from MEI, representing 21.3%, 17.7% and 10.7%, respectively, of total revenue for 2005. No other customers represented more than 10% of revenue in either year.

During 2006, 39.1% of our revenue was attributable to our operations in Mexico, 38.7% in the US and 19.2% in Canada. During 2005, 43.9% of our revenue was attributable to our operations in Mexico, 42.2% in the US and 13.9% in Canada. The increase in Canada was the result of increased revenue from Harris. Harris was a new customer introduced in 2005. The decrease in production in the US was the result of the decreased revenue from EMC<sup>2</sup>, largely offset by revenue from a key customer in the semi-conductor test equipment market. Revenue increased in Mexico mainly due to increases in MEI and other customers, however as a percentage of the total it has somewhat declined.

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

#### *Gross Profit*

Gross profit increased from \$17.2 million, or 7.5% of revenue, for 2005 to \$26.5 million, or 10.1% of revenue, for 2006. This increase in gross profit is largely due to increased sales and a change in the customer mix from 2005. Included in gross profit for 2005 is a net recovery of restructuring and other charges of \$1.2 million which were recorded in 2004. There were no such recoveries included in the gross profit for 2006.

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

#### *Selling, General & Administrative Expenses*

Selling, general and administrative expenses increased by \$2.1 million during 2006 to \$15.2 million from \$13.1 million in 2005, but remained relatively constant as a percentage of revenue at 5.7% for 2005 and 5.8% of revenue for 2006. The increase in selling, general and administrative expenses largely reflects increases in staff and compensation increases including stock-based compensation expense of \$0.2 million.

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

#### *Restructuring and Other Charges*

During 2001 and 2002, we announced restructuring programs aimed at reducing our cost structure and plant capacity (the “2001 Plan” and the “2002 Plan,” respectively) and recorded restructuring and other charges consisting of a write-down of goodwill and other intangible assets, the costs of exiting equipment and facility leases, severance costs, asset impairment charges, inventory exposures and other facility exit costs.

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During 2004, we announced further changes to our manufacturing operations as we executed the Company's transformation plan (the "2004 Plan"). During 2004 and 2005, we recorded various adjustments to the 2001 Plan and the 2002 Plan and additional charges related to the 2004 Plan.

The transformation plan continued in 2005. Net expense for 2005 included the reversal of previously recorded lease and other contract obligations of \$0.2 million related to the settlement of various equipment leases for less than originally estimated; severance charges of \$0.7 million related to workforce reduction; a reversal of previously recorded severance charges of \$0.5 million related to change in the estimate of amounts to be paid and other facility exit costs of \$0.1 million related to costs associated with the closure of the Austin, Texas facility.

During 2006, we restructured our management to control operating costs (the "2006 Plan"). During 2006, we had a net recovery related to restructuring of \$2.6 million, or 1.0% of revenue when compared to a net expense of \$0.1 million, for 2005. The net recovery for 2006 included a recovery of \$1.8 million related to the reduction of a liability recorded as part of the 2002 Plan, a gain on the sale of an asset previously written down of \$1.2 million and recorded severance charges of \$0.5 million related to the 2006 Plan.

We expect the majority of the remaining restructuring accrual related to our various restructuring plans to be paid by the end of 2007 through borrowings under our revolving credit facility.

For more detailed disclosure related to these plans and charges recorded please refer to note 6 "Restructuring and other charges" of the accompanying consolidated financial statements.

#### *Interest Expense*

Interest expense increased by \$0.8 million from \$4.6 million in 2005, to \$5.4 million for 2006. Interest expense for 2005 included the amortization of deferred financing fees of \$1.0 million which increased in 2006 by \$0.1 million as a result of the amortization of additional financing fees incurred as part of the September 2006 amendment and the addition of the Term loan B during 2006. In addition, interest expense increased due to higher average debt balances outstanding during 2006 as compared to 2005. The weighted average interest rates with respect to the debt were 9.7% and 10.1%, for the years ended December 31, 2005 and December 31, 2006 respectively.

Included in interest expense for both 2005 and 2006 is a reduction of \$0.3 million related to the amortization of the value of the cancelled warrants.

The amortization of deferred financing fees and the value of the cancelled warrants is expected to end in 2008.

#### *Income Tax Expense*

The net tax recovery for 2006 of \$2.0 million includes a current tax recovery of \$2.2 million from the release of previously recorded income tax reserves and the receipt of a previously unrecorded tax refund offset by current year alternative minimum tax expense. The net recovery of \$0.6 million in 2005 includes a deferred tax recovery of \$0.5 million in respect of its Mexican deferred tax assets and a current recovery of \$0.1 million.

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

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quarterly reviews undertaken at the end of the second quarter of 2003, the Company concluded that given the weakness and uncertainty in the economic environment at that time, it was appropriate to establish a full valuation allowance for the deferred tax assets arising from its operations in the jurisdictions to which the deferred tax assets relate. In 2005 and 2006, it was determined by management that it was more likely than not that the deferred tax assets associated with the Mexican jurisdiction would be realized in the amount of \$0.6 million and \$0.5 million, respectively. The U.S. and Canadian jurisdictions continued to have a full valuation allowance established for the deferred tax asset.

At December 31, 2006, the Company had total net operating loss (“NOL”) carry forwards of \$74.2 million, of which \$1.3 million will expire in 2012, \$3.6 million will expire in 2014, \$0.2 million will expire in 2015, \$1.1 million will expire in 2018, \$0.1 million will expire in 2019 and the remainder will expire between 2020 and 2026.

During 2006, the Company reviewed if its tax position related to the Recapitalization Transaction would result in an ownership change for purposes of Section 382 of the Internal Revenue Code (“Section 382”), which imposes a limitation on a corporation’s use of net operating loss (“NOL”) carry forwards following an “ownership change.” The Company has concluded that the recapitalization transactions did not result in an ownership change and as such the use of the NOL carry forwards has not been limited.

#### *Retained Earnings*

In December 2006, the Company adopted Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”) which clarified the way that a company should evaluate identified unadjusted errors for materiality. SAB 108 required that the effect of misstatements that were not corrected at the end of the prior year be considered in quantifying misstatements in the current year financial statements. Two techniques were identified as being used by companies in practice to accumulate and quantify misstatements — the “rollover” approach and the “iron curtain” approach. The rollover approach, which is the approach we used, quantifies a misstatement based on the amount of the error originating in the current year income statement. Thus, this approach ignores the effects of correcting the portion of the current year balance sheet misstatement that originated in prior years. The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement’s year(s) of origination.

Using the rollover approach resulted in an accumulation of misstatements to our balance sheets that were deemed immaterial to our financial statements because the amounts that originated in each year were quantitatively and qualitatively immaterial. We have elected, as allowed under SAB 108, to reflect the effect of initially applying this guidance by adjusting the carrying amount of the respective accounts as of the beginning of 2006 and recording an offsetting adjustment to the opening balance of our retained earnings in 2006. We recorded a cumulative adjustment to increase our deficit for the adoption of SAB 108 by \$0.7 million. Included in this cumulative adjustment is a \$0.5 million decrease in property, plant and equipment relating to amortization of leasehold improvements in the years 2000 to 2005. The remaining amount includes increases in accrued liabilities and inventory of \$0.3 million and \$0.1 million, respectively, and decreases in accounts receivable, long-term debt, other assets and capital stock of \$0.1 million, \$0.2 million, \$0.1 million and \$0.1 million, respectively.

#### *Discontinued Operations*

In the third quarter of 2006, income from discontinued operations included additional proceeds from the liquidation of the Cork, Ireland facility in the amount of \$0.9 million. It is anticipated that this is the final recovery on the liquidated facility.

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### *Related Party Transactions*

Private equity funds advised by Bain Capital, LLC or its affiliates ("Bain Capital") acquired approximately 50% of the capital stock of MEI during the second quarter of 2006. Blair Hendrix, a director of the Company, is also an Operating Partner of Bain Capital, and Bain Capital may be deemed to control MEI. All transactions between the Company and MEI in 2006 were in the normal course of operations.

### **Year ended December 31, 2005 compared to the year ended December 31, 2004**

#### *Revenue*

Revenue decreased \$15.8 million, or 6.5%, from \$244.6 million in 2004 to \$228.8 million in 2005. The decline in revenue resulted from lower production volume from IBM as its program neared completion and the effect of the loss in 2004 of Square D as a customer lowering revenue by \$29.6 million in 2004 and \$22.6 million in 2005. This was partially offset by growth in revenue from EMC<sup>2</sup> of \$39.3 million for 2005 compared to 2004 and from the addition of certain other customers during 2005.

During 2005, revenue from the industrial sector represented 47.7% of revenue compared to 56.5% of revenue for 2004. The decline was largely due to the loss of Square D as a customer. The reduction in the percentage of revenue generated from the industrial sector in 2005 compared to 2004 is largely due to the effect of the loss of Square D as a customer in 2004. The percentage of revenue generated from the computing and networking sector increased from 30.5% in 2004 to 34.2% in 2005, due to the growth in revenue earned from EMC<sup>2</sup> during 2005, partially offset by the reduction in revenue earned from IBM in 2005. The increase in the percentage of revenue earned from the communications sector from 13.0% in 2004 to 18.1% in 2005, was due to the increase in revenue earned from a number of our smaller customers during 2005.

During 2005, we recorded approximately \$6.7 million of sales of raw materials inventory to customers, which carried no margin, compared to \$9.1 million in 2004. The Company purchases raw materials based on customer purchase orders. To the extent a customer requires an order to be changed, the customer is generally obligated to purchase the original on-order raw material at cost.

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 vary from year to year. During 2005, the Company's ten largest customers represented approximately 82% of revenue compared to 84% during 2004. Revenue from our three largest customers during 2005 was \$48.8 million from EMC<sup>2</sup>, \$40.6 million from Ingenico and \$24.5 million from MEI, representing 21.3%, 17.7% and 10.7%, respectively, of total revenue for 2005. This compares with revenue of \$41.0 million from IBM, \$38.7 million from Ingenico and \$24.9 million from MEI representing 16.8%, 15.8% and 10.2%, respectively, of total revenue for 2004. There were no other customers representing more than 10% of revenue in either year.

During 2005, 43.9% of our revenue was attributable to our operations in Mexico, 42.2% in the US and 13.9% in Canada. During 2004, 54.1% of our revenue was attributable to our operations in Mexico, 29.4% from the US and 16.5% from Canada. The increase in production in the US reflects the increase in revenue earned from EMC<sup>2</sup> compared to 2004. The decrease in production in Canada is due to certain product lines being transferred to our lower cost Mexico facility.

#### *Gross Profit*

Gross profit decreased \$5.8 million from \$23.0 million, or 9.4% of revenue, for 2004, to \$17.2 million, or 7.5% of revenue, for 2005. The decline in gross profit absolute dollars and as a percentage of revenue is due partially to a net recovery of restructuring and other charges of \$1.2 million recorded in 2004, including net proceeds of \$1.8 million related to the settlement of a legal claim for obsolete inventory previously written off, and another charge of \$1.0 million related to a provision against inventory caused by an unanticipated volume

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decline from a major customer that operates in a cyclical sector, offset by the recovery of a previously recorded other charge of \$0.4 million. The decline in gross profit absolute dollars is also due to the lower sales base in 2005 coupled with a change in customer mix, partially offset by improved utilization of fixed costs. The decline in the gross profit as a percentage of revenue is also due to a change in customer mix and higher variable costs as a percentage of revenue, partially offset by improved utilization of fixed costs.

#### *Selling, General & Administrative Expenses*

Selling, general and administrative expenses decreased \$2.8 million from \$16.0 million, or 6.5% of revenue, for 2004 to \$13.2 million, or 5.7% of revenue, for 2005. The decrease in selling, general and administrative expenses in both absolute dollars and as a percentage of revenue is the result of corporate-wide cost containment measures. Selling, general and administrative expenses for fiscal year 2004 include an adjustment of \$0.3 million related to proceeds received on the sale of an asset previously written off, offset by a provision for the settlement of a Mexican labor dispute of \$0.3 million.

#### *Amortization*

Amortization of intangible assets of \$2.3 million for 2004 related to the amortization of deferred finance costs related to the establishment of our senior credit facility in July 2000 and subsequent amendments thereto.

The deferred finance costs related to the recapitalization transaction that closed on June 1, 2004 are recorded as interest expense commencing the third quarter of 2004.

#### *Restructuring and Other Charges*

During the third quarter of 2004, the Company implemented the 2004 Plan, seeking to provide greater focus on new customer and new product introduction and technical activities, to improve capacity utilization and to align its cost structure to expected revenue. During 2004 and 2005, the Company recorded various adjustments to the 2001 Plan and the 2002 Plan and additional charges related to the 2004 Plan. For more detailed disclosure related to restructuring and other charges please refer to note 6 "Restructuring and other charges" of the accompanying consolidated financial statements.

During 2005 there was a net restructuring charge of \$0.1 million, compared to a net recovery for 2004 of \$1.6 million. The net restructuring charge for 2005 included: severance charges of \$0.7 million, consisting of \$0.2 million in connection with the 2002 Plan and \$0.5 million in connection with the 2004 Plan related to workforce reduction; a reversal of previously recorded severance charges of \$0.5 million related to change in the estimate of amounts to be paid and other facility exit costs of \$0.1 million related to costs associated with the closure of the Austin, Texas facility.

In comparison, the net restructuring recovery in 2004 included: the recovery of a previously recorded inventory charge of \$1.8 million for net proceeds of the same amount resulting from a favorable settlement of a four-year dispute over obsolete inventory with a former customer; the reversal of previously recorded lease and other contract obligations of \$2.0 million which included \$1.7 million in connection with the 2001 Plan associated with the settlement of a legal suit related to the facility lease in Monterrey, Mexico and \$0.3 million in connection with the 2002 Plan related to the settlement of various equipment leases for less than originally estimated; and severance charges of \$1.9 million, consisting of \$0.4 million in connection with the 2002 Plan related to a change in the estimate of amounts to be paid out and \$1.5 million in connection with the 2004 Plan related to employees in Mexico and Canada.

Other charges were nil in 2005 compared to a \$0.3 million charge in 2004. The \$0.3 million charge related to an increase in cost of sales of \$0.6 million which consisted of an inventory charge of \$1.0 million in connection with a provision against inventory caused by an unanticipated volume decline from a major customer that operates in a cyclical sector, offset by a recovery of a previously recorded inventory write down of \$0.4 million. This was offset by proceeds of \$0.3 million from the sale of an asset previously written off.

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### *Interest Expense*

Interest expense increased \$0.1 million from \$4.5 million for 2004 to \$4.6 million for 2005. Interest expense for 2004 included the amortization of deferred financing fees of \$0.5 million offset by a reduction in interest expense of \$0.2 million related to the amortization of the value of the cancelled warrants. Interest expense for 2005 includes amortization of deferred financing fees of \$1.0 million offset by a reduction in interest expense of \$0.3 million related to the amortization of the value of the cancelled warrants.

Excluding the amortization of deferred financing fees and the reduction in interest expense related to the amortization of the value of the cancelled warrants, interest expense decreased \$0.3 million from \$4.2 million for 2004 to \$3.9 million for 2005 due to lower average debt balances outstanding during 2005, partially offset by higher interest rates in 2005 as compared to 2004. The weighted average interest rates with respect to the debt for the years ended December 31, 2004 and December 31, 2005 were 7.4% and 9.7%, respectively.

We expect the majority of the remaining restructuring accrual related to the various plans to be paid by the end of 2007 by drawing on our revolving credit facility.

### *Income Tax Expense*

The net tax recovery for 2005 of \$0.6 million includes an addition to the deferred tax asset of \$0.5 million and a recovery of current taxes of \$0.1 million. The net tax expense of \$0.5 million for 2004 includes minimum tax on an intercompany dividend payment of \$0.5 million.

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of its deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. Management considers the scheduled reversal of deferred tax liabilities, change of control limitations, projected future taxable income and tax planning strategies in making this assessment. FASB Statement No. 109, Accounting for Income Taxes, states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence, such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. As a result of the quarterly reviews undertaken at the end of the second quarter of 2003, the Company concluded that given the weakness and uncertainty in the economic environment at that time, it was appropriate to establish a full valuation allowance for the deferred tax assets arising from its operations in the jurisdictions to which the deferred tax assets relate. In 2004 and 2005, it was determined by management that it was more likely than not that the deferred tax assets associated with the Mexican jurisdiction would be realized in the amount of \$0.1 million and \$0.6 million, respectively. The U.S. and Canadian jurisdictions continued to have a full valuation allowance established for the deferred tax asset.

At December 31, 2005, the Company had total net operating loss carryforwards of approximately \$77.6 million (2004 — \$105.2 million), of which \$38.0 million will expire in 2021, \$20.1 million will expire in 2022, and \$19.5 million will expire in 2023.

During 2006, the Company reviewed if its tax position related to the Recapitalization Transaction would result in an ownership change for purposes of Section 382 of the Internal Revenue Code (“Section 382”), which imposes a limitation on a corporation’s use of net operating loss (“NOL”) carry forwards following an “ownership change.” The Company has concluded that the recapitalization transactions did not result in an ownership change and as such the use of the NOL carry forwards has not been limited.

### *Discontinued Operations*

Earnings from discontinued operations during 2004 consisted primarily of proceeds from the settlement of a lawsuit of \$0.2 million and an adjustment to the remaining accrual for closing costs of \$0.2 million, both relating to the closure of the Appleton manufacturing facility, and proceeds from the liquidation of the Cork, Ireland facility of \$0.4 million.

Taxes related to income from discontinued operations were offset by the recognition of tax loss carryforwards.

### Liquidity and Capital Resources

Our principal sources of liquidity are cash provided from operations and borrowings under the Wachovia Facilities. We have also previously relied on our access to the capital markets. Our principal uses of cash have been to meet debt service requirements and to finance working capital requirements. We anticipate our principal uses of cash in the future will continue to be to meet debt service requirements and to finance working capital requirements.

The following table outlines the summary level cash flow changes for the years ended December 31:

	December 31, 2004	December 31, 2005	December 31, 2006
Cash provided by (used in):		—	
Operating activities	\$ 5.6	\$ 9.5	\$ (9.5)
Financing activities	(5.4)	(8.0)	9.6
Investing activities	(0.4)	(1.5)	(0.1)
(Decrease) Increase in cash and cash equivalents	(0.2)	—	—
Cash and cash equivalents, beginning of year	0.2	—	—
Cash, end of the year	\$ —	\$ —	\$ —

#### 2006 Liquidity

Net cash used in operating activities for 2006 was \$9.5 million. The use of cash was the result of increased working capital requirements of \$24.8 million and an increase in cash related to non-cash depreciation and other charges of \$4.9 million and net earnings of \$10.5 million which included a gain on disposition of property, plant and equipment of \$1.2 million. The net use of working capital of \$24.8 million consisted of an increase in accounts receivable and inventories of \$18.4 million and \$9.6 million, respectively, offset by an increase in accounts payable and accrued liabilities of \$1.9 million, income taxes recoverable of \$0.8 million and prepaid expenses of \$0.4 million. Accounts receivable days sales outstanding were 55 days for the fourth quarter of 2006 compared to 39 days for the same period in 2005 reflecting extended terms with certain customers. Inventory turnover on an annualized basis was at 6.1 times for 2006 and 6 times for 2005. Accounts payable days outstanding were 57 days for the fourth quarter of 2006 compared to 53 days for the same period in 2005 reflecting improved terms negotiated with certain of our suppliers. During 2005, the Company paid \$1.9 million in connection with restructuring charges when compared with \$0.5 million in 2006.

Net cash generated in financing activities during 2006 of \$9.6 million consists of the net borrowing under our credit facilities of \$11.9 million and the repayment of capital leases of \$1.7 million, offset by deferred financing fees of \$0.6 million. During 2006, we amended our 2004, 3-year \$40 million revolving credit facility and a \$1.4 million term loan facility with Wachovia increasing the maximum indebtedness to \$45 million and amended the terms to provide greater flexibility to address our working capital requirements. At December 31, 2006, we had \$18.8 million of indebtedness outstanding under the Wachovia Facilities. The Wachovia Facilities have a borrowing base formula that bases our ability to borrow on the amount and characteristics of our accounts receivable and inventory.

Net cash used in investing activities for 2006 of \$0.1 million consisted of purchase of capital assets of \$2.2 million and proceeds from discontinued operations of \$0.9 million, offset by proceeds from the sale of land of \$1.2 million.

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### *2005 Liquidity*

Net cash generated from operating activities for fiscal year 2005 was \$9.5 million. The generation of cash was the result of a net loss of \$0.1 million and an increase in deferred taxes of \$0.5 million offset by non-cash depreciation and other charges of \$7.9 million and the generation of working capital of \$2.2 million. The net generation of working capital of \$2.2 million consists of an increase in accounts receivable, a decrease in income tax payable and an increase of inventory of \$3.0 million, \$0.4 million and \$0.1 million, respectively, all of which used working capital. This was offset by a net increase in accounts payable and accrued liabilities of \$5.7 million which generated working capital. Accounts receivable days sales outstanding was 38 days for the fourth quarter of 2005 compared to 45 days for the same period last year. The reduction in days sales outstanding is due to the Company negotiating shorter credit terms with a certain customer during the second half of 2005 and improved collection activities. Inventory turned, on an annualized basis, six times for both fiscal year 2005 and fiscal year 2004. Accounts payable days outstanding was 53 days for the fourth quarter of 2005 compared to 51 days for the same period last year. The increase in accounts payable days outstanding is due to the Company negotiating improved terms with certain of its suppliers. During fiscal year 2005, the Company paid \$1.9 million in connection with restructuring charges.

Net cash used in financing activities during fiscal year 2005 of \$8.0 million consists of the net decrease in long-term debt of \$6.1 million and the repayment of capital leases of \$1.9 million. Under the Wachovia Credit Facility, we have a secured revolving credit facility of up to \$40 million. At December 31, 2005, we had \$2.7 million of indebtedness outstanding under our Wachovia Credit Facility. The Wachovia Credit Facility has a borrowing base formula that bases our ability to borrow on the amount and characteristics of our accounts receivable and inventory.

Net cash used in investing activities for fiscal year 2005 of \$1.5 million consists of the purchase of capital assets of \$2.5 million, offset by proceeds from the disposal of a vacant building in Mexico of \$1.0 million.

### *Capital Resources*

The Company effected a recapitalization transaction in 2004 through three main components: a private placement of equity securities, a transaction with our Pre-existing Lenders to repay a portion of and restructure a portion of the Company's existing debt and a new secured credit facility.

On March 3, 2004, we closed in escrow a fully underwritten, committed private placement of 33,350,000 special warrants of SMTC Canada to qualified investors at a price of C\$1.20 (approximately US\$0.90) per special warrant, representing an aggregate amount of issue of C\$40.02 million, C\$37.3 million net of underwriting expenses, or approximately US \$29.9 million, US \$27.6 million net of underwriting expenses, based on the exchange rate on March 3, 2004. The net proceeds were released from escrow on June 1, 2004 and were used for debt reduction and working capital.

On June 1, 2004 we satisfied debt that was owed to the Pre-existing Lenders by repaying \$40 million of debt at par, exchanging \$10 million of debt for \$10 million of the Company's common stock and warrants valued on the same terms as the private placement, and converting \$27.5 million of debt into second lien subordinated debt with maturity ranging from four to five years.

Also on June 1, 2004, we obtained a new, 3-year \$40 million secured credit facility, subject to certain borrowing base conditions, from Wachovia.

The Wachovia Facilities includes the following terms:

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

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- The revolving loan facility originally required a lock-box arrangement where all customer remittances were swept daily to reduce the borrowings outstanding.
  - The Wachovia Facilities include a single financial covenant that requires the Company to maintain a specified level of consolidated EBITDA and subjective acceleration clauses which would allow Wachovia to forego additional advances should they determine certain conditions exist, including those resulting in a material adverse change of the Company's business, assets, operations, prospects or financial condition. The Company was required to achieve consolidated EBITDA of \$5.0 million cumulatively for the first two quarters of 2004, \$7.5 million cumulatively for the first three quarters of 2004, which the Company achieved, and \$11.0 million cumulatively for 2004 in total. In March 2005, the Company and Wachovia signed an amendment to the Wachovia Facilities (the "March 2005 Amendment") which amended the EBITDA covenant for the year ended December 31, 2004 to \$10.0 million, and on a consolidated rolling four quarter basis, amended the EBITDA covenant for the first, second, third and fourth quarters of 2005 to \$6.5 million, \$5.0 million, \$5.0 million and \$8.0 million, respectively. Thereafter, the Company is required to maintain consolidated EBITDA of \$11.0 million on a rolling four quarter basis.
  - The Wachovia Facilities are secured by current and future assets of the Company's U.S. and Canadian operations. The security interest granted to Wachovia ranks senior to any security interest of the Pre-existing Lenders.
  - The Wachovia Facilities include representations, warranties, covenants and events of default that are customary for asset based credit facilities.

The recapitalization transaction lowered our overall indebtedness by approximately \$37.5 million, extended the term of the majority of the remaining indebtedness and provided additional liquidity. The level of indebtedness under our credit facility at May 31, 2004, just prior to the recapitalization transaction, was \$77.5 million. Immediately following the closing of the recapitalization transaction on June 1, 2004, we had approximately \$40.0 million of indebtedness outstanding under the Credit Facilities.

During the period from November 2004 and August 2005, the Company, together with Wachovia executed amendments to the Wachovia Facility reducing the EBITDA targets for the quarters ended December 31, 2004 to December 31, 2005 and allowing the Company to elect to use a springing lock box arrangement, whereby remittances from customers would be forwarded to the Company's general bank account rather than the lock-box arrangement as previously required. Also during this period the Company executed an amendment to the subordinated debt facility, which reduced the EBITDA targets for each of the four quarters in the year ending December 31, 2005.

In August 2005, we signed a further amendment to the Wachovia Facilities which removed the elimination of inventory from the availability calculation should the Company elect to change to the springing lock-box arrangement.

In June 2006, the Company and Wachovia signed a further amendment to the Wachovia Facilities which increased the amount of the term loans to \$2.0 million, repayable over a period of 36 months.

In August 2006, the Company and Wachovia signed a further amendment to the Wachovia Facilities which extends the renewal date of the revolving credit facilities to October 15, 2007.

In September 2006, the Company and Wachovia signed a fourth amending agreement to the Wachovia Facilities which increased the maximum indebtedness from \$40 million to \$45 million and amended the terms to provide greater flexibility to manage working capital requirements. As part of the debt restructuring, a Term Loan B was made available to the Company in an amount equal to \$10 million. This portion of the facilities bears a variable interest rate based on LIBOR plus five to seven percent depending on the senior leverage ratio thereunder. The Term Loan B has a quarterly repayment term of \$0.3 million maturing on October 15, 2007 and is secured by our Mexican based assets.

The Company is currently in the process of refinancing some of its debt to address the maturity of some its debt in 2007 and 2008 as well as to improve the flexibility and terms of its credit agreements.

In March 2007, the Company and Wachovia signed another amendment to the Wachovia Facilities which extended the term of the secured revolving credit facility and original term loans to April 15, 2008.

We do not foresee being precluded from exercising the option of converting to a springing lock-box based on our expected financing needs over the next 12 months; however, due to the effective cash management aspect of the current lock-box arrangement, we have no plans to move to a springing lock-box arrangement.

We believe that no conditions have occurred that would result in subjective acceleration by the lenders, nor do we believe that any such conditions will exist over the next 12 months. Furthermore, Wachovia has not informed us that any such condition or event has occurred. Because of the option to use a springing lock-box arrangement and based on our assessment of the subjective acceleration clauses, the debt under the Wachovia facility has been classified as long-term as at December 31, 2006 with the exception of Term loan B component which is currently due on October 15, 2007.

At December 31, 2006, we had \$18.8 million of indebtedness outstanding under the Wachovia Facilities and term debt, \$21.9 million of subordinated debt and \$0.3 million related to the unamortized value of the cancelled warrants related to the pre-existing facility.

We believe that cash generated from operations, available cash and amounts available under our Credit 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 and organic growth through the next twelve months, 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 Wachovia Facilities 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 or refinance indebtedness will be subject to future economic conditions and to financial, business and other factors, certain of which are beyond our control.

As at December 31, 2006, contractual repayments due within each of the next five years and thereafter are as follows:

<u>(in US\$ millions)</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Thereafter</u>	<u>Total</u>
Senior debt revolving	\$ —	\$ 7.1	\$ —	\$ —	\$ —	\$ —	\$ 7.1
Senior debt term	10.0	1.7	—	—	—	—	11.7
Subordinated debt	11.7	10.2	—	—	—	—	21.9
Capital lease obligations	0.5	0.6	0.5	0.2	0.2	—	2.0
Operating lease obligations	1.7	1.3	1.2	1.2	1.2	3.4	10.0
Total	<u>\$23.9</u>	<u>\$20.9</u>	<u>\$ 1.7</u>	<u>\$ 1.4</u>	<u>\$ 1.4</u>	<u>\$ 3.4</u>	<u>\$52.7</u>

In addition to the principal repayments in the table above, the Company is obligated to pay \$1.9 million of payment in kind interest over the remaining term of the subordinated debt in connection with the Tranche B term loan.

Included in the operating lease obligations is \$1.9 million representing lease costs for 2005, which has been recorded as part of the restructuring charges and accrued in the consolidated financial statements at December 31, 2005. There are no lease costs accrued as part of restructuring charges in 2006.

In the normal course of business, we may be subject to litigation and claims from customers, suppliers and former employees. We believe that adequate provisions have been recorded in the accounts, where required.

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Although it is not possible to estimate the extent of potential costs, if any, management believes that ultimate resolution of such contingencies would not have a material adverse effect on our financial position, results of operations or cash flows.

The Company is in compliance with the financial covenants included in its lending agreements at December 31, 2006. Continued compliance with the financial covenants through the next twelve months is dependent on the Company achieving certain forecasts. The Company believes the forecasts are based on reasonable assumptions and are achievable; however, the forecasts are dependent on a number of factors, some of which are outside the control of the Company. These include but are not limited to, general economic conditions and specifically the strength of the electronics industry and the related demand for products and services by the Company's customers. In the event of non-compliance, the Company's lenders have the ability to demand repayment of the amounts outstanding under the lending agreements, pursue other remedies or, if the Company can reach an agreement with its lenders, amend the financial covenants.

#### **Accounting changes and Recent accounting pronouncements**

Please refer to note 2 of the accompanying consolidated financial statements.

#### **Critical Accounting Estimates**

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

Note 2 to the accompanying consolidated financial statements describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following critical accounting policies are affected significantly by judgments, assumptions and estimates used in the preparation of financial statements. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

##### *Allowance for Doubtful Accounts*

We evaluate the collectibility of accounts receivable and record an allowance for doubtful accounts, which reduces the accounts receivable to the amount we reasonably believe will be collected. A specific allowance is recorded against customer accounts receivable that are considered to be impaired based on our knowledge of the financial condition of our customers. In determining the amount of the allowance, we consider factors, including the length of time the accounts receivable have been outstanding, customer and industry concentrations, the current business environment and historical experience.

##### *Inventory Valuation*

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

##### *Restructuring and Other Charges*

In response to excess capacity, we have recorded restructuring and other charges aimed at reducing our cost structure. In connection with exit activities, we have recorded charges for inventory write-downs, employee

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termination costs, lease and other contractual obligations, long-lived asset impairment and other exit-related costs. These charges were incurred pursuant to formal plans developed by management. The recognition of restructuring and other charges required us to make certain judgments and estimates regarding the nature, timing and amount of costs associated with the planned exit activities. The estimates of future liabilities may change, requiring the recording of additional charges or the reduction of liabilities already recorded. At the end of each reporting period, we evaluate the remaining accrued balances to ensure that no excess accruals are retained and the utilization of the provision are for their intended purposes in accordance with the developed exit plans.

#### *Long-lived Assets*

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

#### *Income Tax Valuation Allowance*

In assessing the realization of deferred tax assets, we consider 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. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. FASB Statement No. 109, Accounting for Income Taxes, states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence, such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. Based upon consideration of these factors, management believes the recorded valuation allowance related to deductible temporary differences and tax loss carryforwards are appropriate.

### **Item 7A: Quantitative and Qualitative Disclosures about Market Risk**

#### **Interest Rate Risk**

Our credit facilities bear interest at both floating and fixed rates. The weighted average interest rate on our credit facilities for the quarter ended December 31, 2006 was 10.5%. At December 31, 2006, our revolving credit facility of \$7.1 million bore interest at 8.75% based on the U.S. prime rate, our Tranche A term debt bore interest at 10.75% based on the U.S. base rate and Term loan B bore interest at 10.35% based on the LIBOR rate. If base rates increased by 10%, our interest expense would have increased by approximately \$0.2 million annually.

#### **Foreign Currency Exchange Risk**

Most of our sales are denominated in U.S. dollars. Most of our purchases are denominated in U.S. dollars, with the exception of Canadian and Mexican payroll and other various expenses denominated in local currencies. As a result we have relatively little exposure to foreign currency exchange risk.

### **Item 8: Financial Statements and Supplementary Data**

The information called for by this item is indexed on page F-1 of this Report and is contained on pages F-2 through F-39.

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**Item 9: Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A: Controls and Procedures**

- (a) *Evaluation of Disclosure Controls and Procedures.* As of the end of the period covered by this annual report, the Company's Chief Executive Officer and 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 Principal Financial Officer have concluded that the Company's disclosure controls and procedures are effective 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 Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and the Company's Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.
- (b) *Changes in Internal Controls and Procedures.* There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the most recent evaluation of these controls by the Company's Chief Executive Officer and Principal Financial Officer.

**Item 9B: Other Information**

On March 28, 2007, certain subsidiaries of SMTC Corporation entered into a Letter Agreement (the "US Letter Agreement") with Wachovia Capital Finance Corporation (Central) ("Wachovia") (as successor to Congress Financial Corporation (Central)) with respect to the Loan Agreement dated as of June 1, 2004 by and among Wachovia, SMTC Manufacturing Corporation of California ("SMTC California"), SMTC Manufacturing Corporation of Wisconsin ("SMTC Wisconsin"), SMTC Manufacturing Corporation of Massachusetts ("SMTC Massachusetts") and SMTC Mex Holdings, Inc. ("SMTC Mex" and together with SMTC California, SMTC Wisconsin and SMTC Massachusetts, the "US Borrowers"), as amended by the Original Amending Agreement dated March 10, 2005, as further amended by the First Amending Agreement dated March 31, 2005, as further amended by the Second Amending Agreement dated August 17, 2005, as further amended by the Third Amending Agreement dated June 12, 2006, as further amended by the Extension Letter effective as of August 2, 2006, and as further amended by the Fourth Amending Agreement effective as of September 20, 2006 (the "US Loan Agreement"). The US Letter Agreement extends the Renewal Date of the US Loan Agreement to April 15, 2008. Additionally, the US Borrowers agreed to pay the Lender an early termination fee equal to 0.50% of the US Maximum Credit (as defined in the US Loan Agreement) if the US Loan Agreement is terminated prior to October 15, 2007.

On March 13, 2007, SMTC Manufacturing Corporation of Canada ("SMTC Canada") entered into a Letter Agreement (the "Canadian Letter Agreement") with Wachovia Capital Finance Corporation (Canada) ("Wachovia Canada") (as successor to Congress Financial Corporation (Canada)) with respect to the Loan Agreement dated as of June 1, 2004 by and between Wachovia Canada and SMTC Manufacturing Corporation of Canada, as amended by the Original Amending Agreement dated March 10, 2005, as further amended by the First Amending Agreement dated March 31, 2005, as further amended by the Second Amending Agreement dated August 17, 2005, as further amended by the Third Amending Agreement dated June 12, 2006 and as further amended by the Extension Letter effective as of August 2, 2006 (the "Canadian Loan Agreement"). The Canadian Letter Agreement extends the Renewal Date of the Canadian Loan Agreement to April 15, 2008. Additionally, the Canadian Borrowers agreed to pay the Lender an early termination fee equal to 0.50% of the Canadian Maximum Credit (as defined in the Canadian Loan Agreement) if the Canadian Loan Agreement is terminated prior to October 15, 2007.

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On March 30, 2007, SMTC Canada entered into an employment agreement and a Deferred Share Unit agreement with John Caldwell, the Company's President and Chief Executive Officer. Under the terms of the agreements, Mr. Caldwell is entitled to an annual base salary of CDN\$504,000, which may be increased by the Board of Directors of SMTC Canada (the "SMTC Canada Board"). Mr. Caldwell is also entitled to receive a short term bonus which will be determined by the SMTC Canada Board, a car allowance and certain other standard benefits. In the event that Mr. Caldwell is terminated without cause or, following a change of control, is terminated without cause or constructively discharged, he is entitled to a lump sum payment of two years base salary and any target bonus determined by the SMTC Canada Board. The employment agreement provides for customary non-competition and non-solicitation provisions which continue during the term of the agreement and for two years from the date of termination. Pursuant to a Deferred Share Units agreement, within 60 days following the termination of his employment (or within 10 days following a change of control), Mr. Caldwell will be entitled to a payment in the amount of the fair market value of 36,425 shares of the Company's common stock.

On March 30, 2007, SMTC Canada entered into an employment agreement with Jane Todd, the Company's Senior Vice President Finance and Chief Executive Officer. Under the terms of the agreement, Ms. Todd is entitled to an annual base salary of CDN\$252,500, which may be increased by the SMTC Canada Board. Ms. Todd is also entitled to receive a short term bonus with a target of 50% of her base salary if certain financial and performance targets to be determined by the SMTC Canada Board are met, as well as a car allowance and certain other standard benefits. In the event that Ms. Todd is terminated without cause, she is entitled to salary continuance of twelve months plus one month for every year of service after twelve years of service, up to a maximum of eighteen months. The employment agreement provides for customary non-solicitation provisions which continue during the term of the agreement and for eighteen months from the date of termination.

On March 30, 2007, SMTC Canada entered into an employment agreement with Don Simpson, the Company's Senior Vice President, Manufacturing and Engineering. Under the terms of the agreement, Mr. Simpson is entitled to an annual base salary of CDN\$230,000, which may be increased by the SMTC Canada Board. Mr. Simpson is also entitled to receive a short term bonus with a target of 50% of his base salary if certain financial and performance targets to be determined by the SMTC Canada Board are met, as well as a car allowance and certain other standard benefits. In the event that Mr. Simpson is terminated without cause, he is entitled to salary continuance of twelve months, and after ten years of employment, an additional one month salary for every year of service after ten years. The employment agreement provides for customary non-solicitation provisions which continue during the term of the agreement and for eighteen months from the date of termination.

On March 30, 2007, SMTC Canada entered into an employment agreement with Steve Hoffrogge, the Company's Senior Vice President, Business Development. Under the terms of the agreement, Mr. Hoffrogge is entitled to an annual base salary of CDN\$274,500 (subject to gross up to provide the equivalent after tax income that he would have earned as a resident of the U.S.), which may be increased by the SMTC Canada Board. Mr. Hoffrogge is also entitled to receive a short term bonus with a target of 50% of his base salary (subject to gross up to provide the equivalent after tax income that he would have earned as a resident of the U.S.) if certain financial and performance targets to be determined by the SMTC Canada Board are met, as well as a car allowance, reimbursement for tax advice of up to CDN\$6,000 per year and certain other standard benefits. In the event that Mr. Hoffrogge is terminated without cause, he is entitled to salary continuance of twelve months plus one month for every year of service after twelve years of service, up to a maximum of eighteen months. The employment agreement provides for customary non-solicitation provisions which continue during the term of the agreement and for twelve months from the date of termination.

## PART III

### Item 10: Directors, Executive Officers and Corporate governance

The information required by this Item is included under the captions “The Proposal: Election of Directors,” “Directors and Executive Officers,” “Additional Information — Section 16(a) Beneficial Ownership Reporting Compliance,” and “Compensation Discussion and Analysis” in the proxy statement for use in connection with the Company’s 2007 Annual Meeting of Stockholders (the “Proxy Statement”) and is incorporated herein by reference.

The Company has adopted a Code of Conduct applicable to all employees, including the principal executive officer, principal financial officer, and principal accounting officer. The Code of Conduct is available on the Company’s website at <http://www.smtc.com/investor/corpgov/corpgov.htm> and in print to any stockholder who requests it. The Company intends to post on its website any amendments to, or waivers from, its Code of Conduct.

### Item 11: Executive Compensation

The information required by this Item is included under the captions “Executive Compensation and Related Information” and “Compensation Discussion and Analysis” in the Proxy Statement and is incorporated herein by reference.

### Item 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by this Item concerning security ownership of certain beneficial owners and management is included under the caption “Securities Ownership of Certain Beneficial Owners and Management” in the Proxy Statement and is incorporated herein by reference.

The Company maintains the Amended and Restated SMTC (HTM) 1998 Equity Incentive Plan (the “1998 Plan”), which was approved by the Board of Directors and the stockholders of the Company as of September 30, 1999 and which amended and restated the plan as initially adopted by the Board of Directors and the stockholders of the Company as of July 30, 1999. The Company also maintains the SMTC Corporation/SMTC Manufacturing Corporation of Canada 2000 Equity Incentive Plan (the “2000 Plan”), which was adopted by the Board of Directors and the stockholders of the Company in July of 2000. The Board of Directors and the stockholders of the Company approved an amendment to the 2000 Plan in April 2004 and May 2004, respectively (the “Amended 2000 Plan”).

The following table gives information about awards under the 1998 Plan and the Amended 2000 Plan as of December 31, 2006 and warrants granted to certain of our lenders during fiscal year 2004:

<u>Plan Category</u>	<u>Number of shares to be issued upon exercise of outstanding options, warrants and rights</u> (a)	<u>Weighted average exercise price of outstanding options, warrants and rights</u> (b)	<u>Number of shares remaining available for future issuance under equity compensation plans (excluding shares reflected in column (a))</u> (c)
Equity compensation plans			
approved by shareholders:	942,124	\$ 2.78	52,057(1)(2)(3)
Equity compensation plans not approved by shareholders:	1,116,695(4)	\$ 6.90	—
<b>Total</b>	<b>2,058,819</b>	<b>\$ 5.01</b>	<b>52,057</b>

#### Notes:

- (1) Pursuant to the terms of the Amended 2000 Plan, the Board may increase the size of the pool of shares of common stock available for the grant of awards under the Amended 2000 Plan as of the first day of each

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fiscal year of the Company during the life of the Amended 2000 Plan by an additional number of shares less than or equal to 1% of the number of shares of the Company's common stock outstanding on such date. The Board did opt to so increase the size of the pool of common stock by 128,925 shares of common stock for fiscal year 2006.

- (2) SMTC Manufacturing Corporation of Canada, a subsidiary of the Company, may issue up to a maximum of 750,000 of its exchangeable shares pursuant to the Amended 2000 Plan.
- (3) Includes 9,628 shares of Class A-1 common stock and 29 shares of Class L common stock available for issuance under the 1998 Plan; however, the Company's charter no longer provides for such classes of shares, and no further awards will be made under the 1998 Plan.
- (4) Represents warrants to purchase common stock of the Company issued to certain of the Company's lenders on June 1, 2004, as described more fully below.

*Issuance of Warrants to Certain of the Company's Lenders*

In connection with the Recapitalization Transaction, the Company entered into a debt and warrant exchange agreement with its Pre-existing Lenders on June 1, 2004. Under the terms of that agreement, the Company issued to its Pre-existing Lenders shares of common stock and 11,166,947 warrants (each warrant being exercisable for one-tenth of one share of the Company's common stock) in exchange for \$10 million of debt the Company owed to the Pre-existing Lenders. The exercise price at which shares of common stock are purchasable upon the exercise of warrants is \$6.90 per share. The warrants are immediately exercisable and expire on March 4, 2009.

**Item 13: Certain Relationships and Related Transactions and Director Independence**

The information required by this Item is included under the caption "Directors and Executive Officers —Related Party Transactions" and "Directors and Executive Officers — Director Independence" in the Proxy Statement and is incorporated herein by reference.

**Item 14: Principal Accountant Fees and Services**

The information required by this Item concerning principal accountant fees and services is included in the Proxy Statement under the caption "Independent Auditors" and is incorporated herein by reference.

**PART IV**

**Item 15: Exhibits, Financial Statement Schedules, and Reports on Form 8-K**

**(a) (1) Financial Statements.**

The financial statements filed as part of this Report are listed and indexed at page F-1.

**(a) (2) Financial Statement Schedule.**

The following financial statement schedule is filed as part of this report. All other financial statement schedules have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the Company's consolidated financial statements set forth in this Annual Report on Form 10-K and the notes thereto.

**SMTC CORPORATION**  
**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**  
**(Expressed in thousands of U.S. dollars)**

<u>Reserves for Accounts Receivable</u>	<u>Years ended December 31,</u>		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
Balance, beginning of year	(2,096)	(1,276)	(1,193)
Recovery (charge) to expense	500	—	(100)
Written off	320	83	278
Balance, end of year	<u>(1,276)</u>	<u>(1,193)</u>	<u>(1,015)</u>

**(a) (3) Exhibits.**

Listed below are all exhibits filed as part of this Report. Certain exhibits are incorporated herein by reference to (i) the Company's Registration Statement on Form S-1 originally filed on March 24, 2000 (File No. 333-33208), and (ii) documents previously filed by the Company with the Securities and Exchange Commission under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended.

<u>Exhibit #</u>	<u>Description</u>
2.1.1	Reorganization and Merger Agreement dated as of July 26, 1999. (4)
2.1.2	Amendment to Reorganization and Merger Agreement, dated as of July 27, 2000. (9)
2.2	Stock Purchase Agreement dated as of May 23, 2000 (Pensar Corporation). (3)
2.3	Stock Purchase Agreement dated as of November 22, 2000 (Qualtron Teoranta and Qualtron, Inc.). (8)
3.1.1	Amended and Restated Certificate of Incorporation (as amended by Certificate of Amendment on May 21, 2004 and Certificate of Correction on June 18, 2004). (18)
3.1.2	Amendment to Amended and Restated Certificate of Incorporation dated September 30, 2004. (25)
3.2	Amended and Restated By-Laws. (7)
3.3	Certificate of Designation. (7)
4.1.1	Stockholders Agreement dated as of July 27, 2000. (6)
4.1.2	Amended and Restated Stockholders Agreement dated as of November 22, 2000. (9)

<b>Exhibit #</b>	<b>Description</b>
4.2	Form of certificate representing shares of common stock. (3)
4.3	Exchangeable Share Provisions attaching to the exchangeable shares of SMTC Manufacturing Corporation of Canada. (7)
4.4	Exchangeable Share Support Agreement dated as of July 27, 2000 among SMTC, SMTC Manufacturing Corporation of Canada and SMTC Nova Scotia Company. (7)
4.5	Voting & Exchange Trust Agreement dated as of July 27, 2000 among SMTC, SMTC Manufacturing Corporation of Canada, CIBC Mellon Trust Company and SMTC Nova Scotia Company. (7)
10.1.1	Credit and Guarantee Agreement dated as of July 28, 1999. (4)
10.1.2	First Amendment to Credit and Guarantee Agreement, dated as of November 4, 1999. (5)
10.1.3	Second Amendment to Credit and Guarantee Agreement, dated as of December 14, 1999. (5)
10.1.4	Third Amendment to Credit and Guarantee Agreement, dated as of May 15, 2000. (4)
10.1.5	Amended and Restated Credit and Guarantee Agreement, dated as of July 27, 2000. (7)
10.1.6	First Amendment dated as of November 17, 2000 to the Amended and Restated Credit and Guarantee Agreement. (9)
10.1.7	Second Amendment dated as of December 28, 2000 to the Amended and Restated Credit and Guarantee Agreement. (9)
10.1.8	Third Amendment dated as of February 6, 2001 to the Amended and Restated Credit and Guarantee Agreement. (9)
10.1.9	Fourth Amendment and First Waiver dated as of February 11, 2002 to the Amended and Restated Credit and Guarantee Agreement. (11)
10.1.10	First Amendment dated as of February 11, 2002 to the Amended and Restated Guarantee and Collateral Agreement. (11)
10.1.11	Fifth Amendment and Second Waiver dated as of March 8, 2002 to the Amended and Restated Credit and Guarantee Agreement. (11)
10.1.12	Sixth Amendment and Third Waiver dated as of April 9, 2002 to the Amended and Restated Credit and Guarantee Agreement. (12)
10.1.13	Seventh Amendment and Fourth Waiver dated as of April 30, 2002 to the Amended and Restated Credit and Guarantee Agreement. (13)
10.1.14	Eighth Amendment and Fifth Waiver dated as of December 31, 2002 to the Amended and Restated Credit and Guarantee Agreement. (14)
10.1.15	Consent and Release dated as of August 22, 2003 to the Amended and Restated Credit and Guarantee Agreement. (16)
10.1.16	Seventh Waiver and Consent dated as of October 29, 2003 to the Amended and Restated Credit and Guarantee Agreement. (16)
10.1.17	Ninth Amendment and Eighth Waiver and Consent dated as of November 17, 2003 to the Amended and Restated Credit and Guarantee Agreement. (16)
10.1.18	Ninth Waiver and Consent dated as of February 23, 2004 to the Amended and Restated Credit and Guarantee Agreement. (16)
10.1.19	Tenth Amendment and Tenth Waiver dated as of March 30, 2004 to the Amended and Restated Credit and Guarantee Agreement. (17)

<b>Exhibit #</b>	<b>Description</b>
10.1.20	Eleventh Amendment and Eleventh Waiver and Consent dated as of April 5, 2004 to the Amended and Restated Credit and Guarantee Agreement. (17)
10.1.21	Second Amended and Restated Credit Agreement dated as of June 1, 2004 by and among HTM Holdings, Inc., Lehman Brothers Inc., The Bank Of Nova Scotia, General Electric Capital Corporation, Lehman Commercial Paper Inc. and certain lenders party thereto. (18)
10.1.22	First Amendment dated as of March 10, 2005 to the Second Amended and Restated Credit and Guarantee Agreement by and among SMTC Corporation, HTM Holdings, Inc., SMTC Manufacturing Corporation of Canada, the lenders from time to time party thereto, Lehman Brothers Inc., as advisor, lead arranger and book manager, The Bank of Nova Scotia, as syndication agent, Lehman Commercial Paper Inc., as general administrative agent and collateral monitoring agent, and General Electric Capital Corporation, as documentation agent. (23)
10.1.23	First Waiver and Consent dated April 12, 2005 to the Second Amended and Restated Credit and Guarantee Agreement by and among SMTC Corporation, HTM Holdings, Inc., SMTC Manufacturing Corporation of Canada, the lenders from time to time party thereto, Lehman Brothers Inc., as advisor, lead arranger and book manager, The Bank of Nova Scotia, as syndication agent, Lehman Commercial Paper Inc., as general administrative agent and collateral monitoring agent, and General Electric Capital Corporation, as documentation agent. (25)
10.1.24	Second Amendment and Agency Assignment Agreement dated as of June 1, 2005 by and among SMTC corporation, HTM Holdings, Inc., SMTC Manufacturing Corporation of Canada, Lehman Brothers Inc., as advisor, lead arranger and book manager, The Bank of Nova Scotia, as syndication agent, Lehman Commercial Paper Inc., individually and as general administrative agent and collateral monitoring agent, General Electric Capital Corporation, as documentation agent and a lender, and the other lenders signatory thereto. (26)
10.2.1	Amended and Restated Guarantee and Collateral Agreement dated as of July 27, 2000. (7)
10.2.2	Second Amended and Restated Guarantee and Collateral Agreement dated as of June 1, 2004 made by SMTC Corporation, HTM Holdings, Inc. and certain of their subsidiaries in favor of Lehman Commercial Paper Inc. as General Administrative Agent. (18)
10.2.3	First Amendment to Second Amended and Restated Guarantee and Collateral Agreement dated as of June 1, 2005 by SMTC Corporation and certain of its subsidiaries signatory thereto in favor of General Electric Capital corporation as General Administrative Agreement (26).
10.3.1	Canadian Loan Agreement dated as of June 1, 2004 by and between Congress Financial Corporation (Canada) and SMTC Manufacturing Corporation of Canada. (18)
10.3.2	First Amending Agreement dated as of March 10, 2005 by and between Congress Financial Corporation (Canada) and SMTC Manufacturing Corporation of Canada. (superseded in its entirety by Exhibit 10.3.3) (23)
10.3.3	First Amending Agreement dated as of March 31, 2005 by and between Congress Financial Corporation (Canada) and SMTC Manufacturing Corporation of Canada. (24)
10.4.1	US Loan Agreement dated as of June 1, 2004 by and among Congress Financial Corporation (Central), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc. (18)
10.4.2	First Amending Agreement dated as of March 10, 2005 by and among Congress Financial Corporation (Central), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc. (superseded in its entirety by Exhibit 10.4.3) (23)

<u>Exhibit #</u>	<u>Description</u>
10.4.3	First Amending Agreement dated as of March 31, 2005 by and among Congress Financial Corporation (Central), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc. (24)
10.4.4	Second Amending Agreement dated as of August 17, 2005 by and among Congress Financial Corporation (Central), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc. (28)
10.4.5	Second Amending Agreement dated as of August 17, 2005 by and between Congress Financial Corporation (Canada) and SMTC Manufacturing Corporation of Canada. (28)
10.4.6	Third Amending Agreement dated as of June 12, 2006 by and among Wachovia Capital Finance Corporation (as successor to Congress Financial Corporation (Central)), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc. (30)
10.4.7	Third Amending Agreement dated as of June 12, 2006 by and between Wachovia Capital Finance Corporation (Canada) (as successor to Congress Financial Corporation (Canada)) and SMTC Manufacturing Corporation of Canada. (30)
10.4.8	Letter Agreement effective as of August 2, 2006 by and among Wachovia Capital Finance Corporation (Central) (as successor to Congress Financial Corporation (Central)), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc. (31)
10.4.9	Letter Agreement effective as of August 2, 2006 by and between Wachovia Capital Finance Corporation (Canada) (as successor to Congress Financial Corporation (Canada)) and SMTC Manufacturing Corporation of Canada. (31)
10.4.10	Fourth Amending Agreement dated as of September 20, 2006 by and among Wachovia Capital Finance Corporation (Central) (as successor to Congress Financial Corporation (Central)), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc. (32)
10.4.11	Fourth Amending Agreement dated as of September 20, 2006 by and between Wachovia Capital Finance Corporation (Canada) (as successor to Congress Financial Corporation (Canada)) and SMTC Manufacturing Corporation of Canada. (32)
10.4.12	Letter Agreement dated as of March 13, 2007 by and among Wachovia Capital Finance Corporation (Central) (as successor to Congress Financial Corporation (Central)), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc.
10.4.13	Letter Agreement dated as of March 13, 2007 by and between Wachovia Capital Finance Corporation (Canada) (as successor to Congress Financial Corporation (Canada)) and SMTC Manufacturing Corporation of Canada.
10.5.1	Intercreditor and Subordination Agreement dated as of June 1, 2004 by and among Congress Financial Corporation (Canada), Congress Financial Corporation (Central), The Bank of Nova Scotia, General Electric Capital Corporation, Lehman Commercial Paper Inc., certain subordinated lenders party thereto, and SMTC Corporation, HTM Holdings, Inc., and certain of their subsidiaries. (19)
10.5.2	Amendment to Inter-Creditor Agreement dated as of June 1, 2005 by and among Congress Financial Corporation (Canada), Congress Financial Corporation (Central), The Bank of Nova Scotia, General Electric Capital Corporation, the other subordinated lenders signatory thereto, SMTC Corporation and certain of its subsidiaries signatory thereto. (26)

<u>Exhibit #</u>	<u>Description</u>
10.6	Underwriting Agreement dated as of March 3, 2004 by and among Orion Securities Inc., CIBC World Market Inc., GMP Securities Limited, RBC Dominion Securities Inc., SMTC Corporation and SMTC Manufacturing Corporation of Canada. (16)
10.7	Form of Subscription Agreement for Special Warrants (Non-U.S. Purchaser). (16)
10.17.1	First Amendment to Lease and Extension Agreement effective as of October 1, 2004 between Teachers Insurance and Annuity Association of America and SMTC Manufacturing Corporation of Massachusetts. (27)
10.8	Form of Subscription Agreement for Special Warrants (U.S. Purchaser). (16)
10.9	Special Warrant Indenture and Escrow Agreement dated as of March 3, 2004 between SMTC Manufacturing Corporation of Canada and CIBC Mellon Trust Company. (16)
10.10	Share Purchase Warrant Indenture dated as of March 3, 2004 between SMTC Manufacturing Corporation of Canada and CIBC Mellon Trust Company. (16)
10.11	Form of Real Property Lease dated December 22, 1998 between Third Franklin Trust and W.F. Wood, Inc. (4)
10.12	Real Property Lease dated May 9, 1995 between Logitech Ireland Limited and Ogden Atlantic Design (Europe) Limited. (5)
10.13	Lease Agreement dated as of January 1, 2003 between the Estate of Edwin A. Helwig, Barbara G. Helwig and SMTC Corporation. (15)
10.14	Real Property Lease dated as of September 15, 1998 between Warden-McPherson Developments Ltd. And The Surface Mount Technology Centre Inc. (5)
10.15	Real Property Lease dated September 3, 1999 between Airedale Realty Trust and W.F. Wood, Inc. (5)
10.16.1	Real Property Revised Lease Agreement dated January 14, 1994 between HTM Building Investors LLC and Hi-Tech Manufacturing, Inc. (2)
10.16.2	First Amendment to Lease. (2)
10.16.3	Second Amendment to Lease. (2)
10.17	Lease Agreement dated as of August 11, 2000 between SMTC Manufacturing Corporation of Massachusetts and Lincoln-Franklin LLC. (7)
10.18	Employment Agreement dated as of March 30, 2007 between John Caldwell and SMTC Manufacturing Corporation of Canada. *
10.19	Real Property Lease dated as of November 24, 2000 between Udaras Na Gaeltachta and Qualtron Teoranta. (10)
10.20	Debt and Warrant Exchange Agreement dated as of June 1, 2004 among HTM Holdings, Inc., SMTC Manufacturing Corporation of Canada, SMTC Corporation and certain debt holders. (18)
10.21	Warrant Agreement dated as of June 1, 2004 between the Company and Mellon Investor Services LLC. (18)
10.22	Amended and Restated SMTC (HTM) 1998 Equity Incentive Plan. (1)
10.23	Amended SMTC Corporation/SMTC Manufacturing Corporation of Canada 2000 Equity Incentive Plan. (18)
10.24	Guarantee by SMTC Manufacturing Corporation of California dated June 1, 2004. (18)
10.25	Guarantee by SMTC Manufacturing Corporation of Massachusetts dated June 1, 2004. (18)
10.26	Guarantee by SMTC Mex Holdings, Inc. dated June 1, 2004. (18)

<u>Exhibit #</u>	<u>Description</u>
10.27	Guarantee by SMTC Manufacturing Corporation of Wisconsin dated June 1, 2004. (18)
10.28	Guarantee by SMTC Corporation, HTM Holdings, Inc., SMTC Manufacturing Corporation of Texas and SMTC Manufacturing Corporation of North Carolina dated June 1, 2004. (18)
10.29	Guarantee by SMTC Corporation, SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Massachusetts, HTM Holdings, Inc., SMTC Manufacturing Corporation of Texas, SMTC Manufacturing Corporation of North Carolina, SMTC Manufacturing Corporation of Wisconsin, SMTC Mex Holdings, Inc., SMTC de Chihuahua, S.A. de C.V. and Radio Componentes de Mexico, S.A. de C.V. dated June 1, 2004. (18)
10.30	General Security Agreement by SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Massachusetts, SMTC Manufacturing Corporation of Wisconsin and SMTC Mex Holdings, Inc. dated June 1, 2004. (18)
10.31	General Security Agreement by SMTC Corporation, HTM Holdings, Inc., SMTC Manufacturing Corporation of Texas and SMTC Manufacturing Corporation of North Carolina dated June 1, 2004. (18)
10.32	General Security Agreement by SMTC Manufacturing Corporation of Canada dated June 1, 2004. (18)
10.33	Guarantee by 940862 Ontario Inc. and SMTC Nova Scotia Company dated June 1, 2004. (18)
10.34	General Security Agreement by 940862 Ontario Inc. and SMTC Nova Scotia Company dated June 1, 2004. (18)
10.35	Employment Agreement dated as of March 30, 2007 between Jane Todd and SMTC Manufacturing Corporation of Canada. *
10.36	Exchange Agent Agreement dated as of October 1, 2004 by and between SMTC Corporation and Mellon Investor Services LLC. (20)
10.37	Letter of Understanding dated as of November 16, 2004 by and between Congress Financial Corporation (Canada) and SMTC Corporation. (20)
10.38	Waiver and Consent dated December 13, 2004 by and among Congress Financial Corporation (Canada), Congress Financial Corporation (Central), SMTC Corporation, SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Canada, SMTC Manufacturing Corporation of Massachusetts, SMTC Manufacturing Corporation of Wisconsin and SMTC Mex Holdings. (21)
10.39	Deferred Share Units Agreement dated as of February 7, 2005 between John Caldwell and SMTC Manufacturing Corporation of Canada. (22)*
10.40	Bonus Plan dated as of February 7, 2005 provided by SMTC Manufacturing Corporation of Canada to John Caldwell. (22)*
10.41	Summary of Board Compensation. (25)
10.42	Option Grant Certificate issued by SMTC Corporation to John Caldwell, dated October 6, 2004. (25)*
10.43	Deferred Share Units Agreement dated as of March 30, 2007 between John Caldwell and SMTC Manufacturing Corporation of Canada.*
10.44	Employment Agreement dated as of March 30, 2007 between Steve Hoffrogge and SMTC Manufacturing Corporation of Canada.*
10.45	Employment Agreement dated as of March 30, 2007 between Don Simpson and SMTC Manufacturing Corporation of Canada.*

<u>Exhibit #</u>	<u>Description</u>
21.1	Subsidiaries of the registrant. (16)
23.1	Consent of KPMG LLP, Independent Auditors.
31.1	Certification of John Caldwell pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.
31.2	Certification of Jane Todd pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.
32.1	Certification of John Caldwell, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.
32.2	Certification of Jane Todd, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.

- (1) Filed as an Exhibit to the Company's Registration Statement on Form S-1 filed on March 24, 2000 (File No. 333-33208) and incorporated by reference herein.
- (2) Filed as an Exhibit to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed on May 24, 2000 (File No. 333-33208) and incorporated by reference herein.
- (3) Filed as an Exhibit to Amendment No. 2 to the Company's Registration Statement on Form S-1 filed on June 19, 2000 (File No. 333-33208) and incorporated by reference herein.
- (4) Filed as an Exhibit to Amendment No. 3 to the Company's Registration Statement on Form S-1 filed on July 10, 2000 (File No. 333-33208) and incorporated by reference herein.
- (5) Filed as an Exhibit to Amendment No. 4 to the Company's Registration Statement on Form S-1 filed on July 18, 2000 (File No. 333-33208) and incorporated by reference herein.
- (6) Filed as an Exhibit to the Company's Registration Statement on Form S-8 filed on August 22, 2000 (File No. 333-44250) and incorporated by reference herein.
- (7) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended October 1, 2000 filed on November 15, 2000 (File No. 0-31051) and incorporated by reference herein.
- (8) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on December 7, 2000 (File No. 0-31051) and incorporated by reference herein.
- (9) Filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2000 filed on April 2, 2001 (File No. 0-31051) and incorporated by reference herein.
- (10) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended July 1, 2001 filed on August 15, 2001 (File No. 0-31051) and incorporated by reference herein.
- (11) Filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2001 filed on March 29, 2002 (File No. 0-31051) and incorporated by reference herein.
- (12) Filed as an Exhibit to Post-Effective Amendment No. 3 to the Company's Registration Statement on Form S-1 on Form S-3 filed on April 23, 2002 (File No. 333-33208) and incorporated by reference herein.
- (13) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 filed on August 14, 2002 (File No. 0-31051) and incorporated by reference herein.
- (14) Filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2002 filed on March 27, 2003 (File No. 0-31051) and incorporated by reference herein.
- (15) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 30, 2003 filed on May 14, 2003 (File No. 0-31051) and incorporated by reference herein.
- (16) Filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2003 filed on March 30, 2004 (File No. 0-31051) and incorporated by reference herein.
- (17) Filed as an Exhibit to the Company's Registration Statement on Form S-1 filed on May 12, 2004 (File No. 333-115400) and incorporated by reference herein.
- (18) Filed as an Exhibit to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed on June 25, 2004 (File No. 333-115400) and incorporated by reference herein.

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- (19) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended July 4, 2004 filed on August 18, 2004 (File No. 0-31051) and incorporated by reference herein.
  - (20) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended October 3, 2004 filed on November 17, 2004 (File No. 0-31051) and incorporated by reference herein.
  - (21) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on December 16, 2004 (File No. 0-31051) and incorporated by reference herein.
  - (22) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on February 11, 2005 (File No. 0-31051) and incorporated by reference herein.
  - (23) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on March 16, 2005 (File No. 0-31051) and incorporated by reference herein.
  - (24) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on April 6, 2005 (File No. 0-31051) and incorporated by reference herein.
  - (25) Filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2004 filed on April 15, 2005 (File No. 0-31051) and incorporated by reference herein.
  - (26) Filed as an exhibit to the Company's Current Report on Form 8-K filed on June 6, 2005 (File No. 0-31051) and incorporated by reference herein.
  - (27) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the period ended April 3, 2005 filed on May 18, 2005 (File No. 0-31051) and incorporated by reference herein.
  - (28) Filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the period ended July 3, 2005 filed on August 17, 2005 (File No. 0-31051) and incorporated by reference herein.
  - (29) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on April 13, 2006 (File No. 0-31051) and incorporated by reference herein.
  - (30) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on June 16, 2006 (File No. 0-31051) and incorporated by reference herein.
  - (31) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on August 8, 2006 (File No. 0-31051) and incorporated by reference herein.
  - (32) Filed as an Exhibit to the Company's Current Report on Form 8-K filed on September 26, 2006 (File No. 0-31051) and incorporated by reference herein.
- \* Management contract or compensatory plan



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## EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Document</u>
10.4.12	Letter Agreement dated as of March 13, 2007 by and among Wachovia Capital Finance Corporation (Central) (as successor to Congress Financial Corporation (Central)), SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc.
10.4.13	Letter Agreement dated as of March 13, 2007 by and between Wachovia Capital Finance Corporation (Canada) (as successor to Congress Financial Corporation (Canada)) and SMTC Manufacturing Corporation of Canada.
10.18	Employment Agreement dated as of March 30, 2007 between John Caldwell and SMTC Manufacturing Corporation of Canada.
10.35	Employment Agreement dated as of March 30, 2007 between Jane Todd and SMTC Manufacturing Corporation of Canada.
10.43	Deferred Share Units Agreement dated as of March 30, 2007 between John Caldwell and SMTC Manufacturing Corporation of Canada.
10.44	Employment Agreement dated as of March 30, 2007 between Steve Hoffrogge and SMTC Manufacturing Corporation of Canada.
10.45	Employment Agreement dated as of March 30, 2007 between Don Simpson and SMTC Manufacturing Corporation of Canada.
23.1	Consent of KPMG LLP, Independent Auditors
31.1	Certification of John Caldwell pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.
31.2	Certification of Jane Todd pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.
32.1	Certification of John Caldwell, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.
32.2	Certification of Jane Todd, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated April 2, 2007.

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**SMTC CORPORATION**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

<a href="#"><u>Report of Independent Registered Public Accounting Firm</u></a>	F-2
<a href="#"><u>Consolidated Balance Sheets as of December 31, 2005 and 2006</u></a>	F-3
<a href="#"><u>Consolidated Statements of Operations for the years ended December 31, 2004, 2005 and 2006</u></a>	F-4
<a href="#"><u>Consolidated Statements of Changes in Shareholders' Equity (Deficiency) for the years ended December 31, 2004, 2005 and 2006</u></a>	F-5
<a href="#"><u>Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2005 and 2006</u></a>	F-6
<a href="#"><u>Notes to the Consolidated Financial Statements</u></a>	F-7

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**REPORT OF THE INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders and Board of Directors of SMTC Corporation

We have audited the accompanying consolidated balance sheets of SMTC Corporation and subsidiaries as of December 31, 2005 and 2006, and the related consolidated statements of operations, changes in shareholders' equity (deficiency) and cash flows for each of the years in the three-year period ended December 31, 2006. In connection with our audits of the consolidated financial statements, we also have audited the related financial statement schedule. These consolidated financial statements and the related financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SMTC Corporation and its subsidiaries as of December 31, 2005 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with United States generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in note 2 to the consolidated financial statements the Company changed its method of quantifying errors in 2006.

/s/ KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

April 2, 2007

**SMTC CORPORATION**  
**Consolidated Balance Sheets as of**  
**(Expressed in thousands of US dollars)**

	<u>December 31,</u> <u>2005</u>	<u>December 31,</u> <u>2006</u>
<b>Assets</b>		
Current assets:		
Accounts receivable—net (note 3)	\$ 26,899	\$ 45,160
Inventories (note 3)	33,168	42,851
Prepaid expenses	<u>1,698</u>	<u>1,280</u>
	61,765	89,291
Property, plant and equipment—net (note 3)	25,651	24,804
Other assets (note 3)	2,010	1,310
Deferred income taxes (note 7)	<u>619</u>	<u>557</u>
	<u>\$ 90,045</u>	<u>\$ 115,962</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 30,939	\$ 36,730
Accrued liabilities (note 3)	13,849	10,253
Income taxes payable	1,203	1,979
Current portion of long-term debt (note 4)	4,633	21,742
Current portion of capital lease obligations (note 4)	<u>1,542</u>	<u>541</u>
	52,166	71,245
Long-term debt (note 4)	23,857	19,295
Capital lease obligations (note 4)	—	1,531
Commitments and contingencies (note 11 )		
Shareholders' equity:		
Capital stock (note 5)	16,986	11,969
Warrants (note 5)	10,372	10,372
Loans receivable	(5)	(5)
Additional paid-in capital	239,380	244,501
Deficit	<u>(252,711)</u>	<u>(242,946)</u>
	<u>14,022</u>	<u>23,891</u>
	<u>\$ 90,045</u>	<u>\$ 115,962</u>

See accompanying notes to consolidated financial statements

**SMTC CORPORATION**  
**Consolidated Statements of Operations for the years ended**  
**(Expressed in thousands of US dollars, except number of shares and per share amounts)**

	December 31, 2004	December 31, 2005	December 31, 2006
Revenue	\$ 244,596	\$ 228,766	\$ 262,782
Cost of sales	221,563	211,619	236,351
Gross profit	23,033	17,147	26,431
Selling, general and administrative expenses	16,037	13,139	15,162
Amortization	2,330	—	—
Restructuring (note 6)			
Restructuring (recoveries) charges	(142)	99	(1,350)
Gain on sale of assets	—	(12)	(1,228)
Other expenses	—	—	826
Operating earnings	4,808	3,921	13,021
Interest expense	4,521	4,589	5,395
Earnings (loss) from continuing operations before income taxes	287	(668)	7,626
Income tax (recovery) expense (note 7)			
Current	641	(72)	(2,023)
Deferred	(135)	(484)	62
	506	(556)	(1,961)
Net (loss) earnings from continuing operations	(219)	(112)	9,587
Net earnings from discontinued operations (note 8)	837	—	874
Net earnings (loss), also being comprehensive income (loss)	\$ 618	\$ (112)	\$ 10,461
Basic earnings (loss) per share (note 9)			
—continuing operations	\$ (0.02)	\$ (0.01)	\$ 0.65
—discontinued operations	\$ 0.07	\$ —	\$ 0.06
Basic earnings (loss) per share	\$ 0.05	\$ (0.01)	\$ 0.71
Diluted earnings (loss) per share			
—continuing operations	\$ (0.02)	\$ (0.01)	\$ 0.64
—discontinued operations	\$ 0.07	\$ —	\$ 0.06
Diluted earnings (loss) per share	\$ 0.05	\$ (0.01)	\$ 0.70
Weighted average number of shares outstanding			
Basic	10,943,763	14,641,333	14,642,459
Diluted	10,943,763	14,641,333	15,025,047

See accompanying notes to consolidated financial statements.

**SMTC CORPORATION**  
**Consolidated Statements of Changes in Shareholders' Equity (Deficiency) for the years ended**  
**(Expressed in thousands of US dollars)**

	<u>Capital stock</u>	<u>Warrants</u>	<u>Loans receivable</u>	<u>Additional paid-in capital</u>	<u>Deficit</u>	<u>Total Shareholders' equity (deficiency)</u>
Balance, December 31, 2003	\$ 55,911	\$ 1,523	\$ (5)	\$174,483	\$(253,217)	\$ (21,305)
Private placement of special warrants , net of costs	18,983	7,617	—	—	—	26,600
Consideration issued upon conversion of debt, net of costs	112	2,755	—	6,754	—	9,621
Cancellation of warrants	—	(1,523)	—	123	—	(1,400)
Conversion of shares from exchangeable to common stock	(11,612)	—	—	11,612	—	—
Net earnings	—	—	—	—	618	618
Balance, December 31, 2004	63,394	10,372	(5)	192,972	(252,599)	14,134
Conversion of shares from exchangeable to common stock	(46,408)	—	—	46,408	—	—
Net loss for the period	—	—	—	—	(112)	(112)
Balance, December 31, 2005	16,986	10,372	(5)	239,380	(252,711)	14,022
Adoption of SAB 108	(86)	—	—	—	(696)	(782)
Adjusted balance, January 1, 2006	16,900	10,372	(5)	239,380	(253,407)	13,240
Conversion of shares from exchangeable to common stock	(4,934)	—	—	4,934	—	—
Stock-based compensation	—	—	—	187	—	187
Exercise of options	3	—	—	—	—	3
Net earnings for the period	—	—	—	—	10,461	10,461
Balance, December 31, 2006	<u>\$ 11,969</u>	<u>\$10,372</u>	<u>\$ (5)</u>	<u>\$244,501</u>	<u>\$(242,946)</u>	<u>\$ 23,891</u>

See accompanying notes to consolidated financial statements.

**SMTC CORPORATION**  
**Consolidated Statements of Cash Flows for the years ended**  
**(Expressed in thousands of US dollars)**

	<u>December 31,</u> <u>2004</u>	<u>December 31,</u> <u>2005</u>	<u>December 31,</u> <u>2006</u>
Cash provided by (used in):			
Operations:			
Net earnings (loss)	\$ 618	\$ (112)	\$ 10,461
Items not involving cash:			
Depreciation	5,521	4,943	4,688
Amortization	2,330	—	—
(Gain) loss on disposition of property, plant and equipment	(15)	68	(1,228)
Other	546	1,131	46
Deferred income taxes	(135)	(484)	62
Non-cash interest	803	1,753	1,949
Stock-based compensation	—	—	187
Discontinued operations	—	—	(874)
Change in non-cash operating working capital:			
Accounts receivable	17,462	(2,963)	(18,373)
Inventories	(1,562)	(143)	(9,595)
Prepaid expenses	220	4	418
Income taxes recoverable/payable	1,216	(368)	776
Accounts payable	(14,622)	4,996	5,791
Accrued liabilities	(6,741)	660	(3,847)
	<u>5,641</u>	<u>9,485</u>	<u>(9,539)</u>
Financing:			
Increase (decrease) in long-term debt	3,492	—	16,639
Repayment of long-term debt	(40,000)	(6,115)	(4,732)
Principal payment of capital lease obligations	(361)	(1,897)	(1,686)
Repayment of loans to shareholders	153	—	—
Net proceeds from issuance of shares	25,849	—	3
Net proceeds from issuance of warrants	8,972	—	—
Debt issuance and deferred financing costs	(3,515)	—	(606)
	<u>(5,410)</u>	<u>(8,012)</u>	<u>9,618</u>
Investment:			
Purchase of property, plant and equipment	(413)	(2,485)	(2,181)
Proceeds from sale of property, plant and equipment	15	1,012	1,228
Proceeds from discontinued operations	—	—	874
	<u>(398)</u>	<u>(1,473)</u>	<u>(79)</u>
(Decrease) Increase in cash and cash equivalents	(167)	—	—
Cash and cash equivalents, beginning of year	167	—	—
Cash, end of the year	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

See accompanying notes to consolidated financial statements.

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**SMTC CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**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, Canada and Mexico.

**2. Significant accounting policies**

***Basis of presentation***

The Company's accounting principles are in accordance with accounting principles generally accepted in the United States ("US GAAP") and, except as outlined in note 13, are, in all material respects, in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). These consolidated financial statements are denominated in United States ("US") dollars.

*(i) Principles of consolidation*

The financial statements of entities which are controlled by the Company through voting equity interests, referred to as subsidiaries, are consolidated. Variable Interest Entities ("VIEs") (which include, but are not limited to, special purpose entities, trusts, partnerships, certain joint ventures and other legal structures), as defined by the Financial Accounting Standards Board ("FASB") in FASB Interpretation No. ("FIN") 46 (Revised 2003), "Consolidation of Variable Interest Entities—an Interpretation of Accounting Research Bulletin No. 51," are entities in which equity investors generally do not have the characteristics of a "controlling financial interest" or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are consolidated by the Company when it is determined that it will, as the primary beneficiary, absorb the majority of the VIEs expected losses and/or expected residual returns. The Company has no interests in VIEs in any of the years presented. Inter-company accounts and transactions are eliminated upon consolidation.

*(ii) Use of estimates*

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Significant estimates include, but are not limited to, allowance for doubtful accounts, inventory valuation, deferred tax asset valuation allowance, restructuring accruals, determination of useful lives of property, plant and equipment and impairment of long-lived assets. Actual results may differ from those estimates.

*(iii) Revenue recognition*

Revenue is derived primarily from the sale of electronics equipment that has been built to customer specifications. Revenue from the sale of products is recognized when goods are shipped to customers since title has passed to the customer, persuasive evidence of an arrangement exists, performance has occurred, all customer-specified test criteria have been met and the earnings process is complete. The Company has no significant obligations after product shipment other than its standard manufacturing warranty. The Company records a provision for future warranty costs based on

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**2. Significant accounting policies (Continued)**

management's best estimate of probable claims under its product warranties. The provision is based on the terms of the warranty, which vary by customer and product, and historical experience. The Company regularly evaluates this provision.

In addition, the Company has contractual arrangements with the majority of its customers that require the customer to purchase unused inventory that the Company has purchased to fulfill that customer's forecasted manufacturing demand. Revenue from the sale of excess inventory to the customer is recognized when title passes to the customer. The Company also derives revenue from engineering and design services. Service revenue is recognized as services are performed.

For arrangements where the customer agrees to purchase products but the Company retains possession until the customer requests shipment ("bill and hold arrangements"), revenue is not recognized until delivery to the customer has occurred and all other revenue recognition criteria have been met.

*(iv) Cash and cash equivalents*

Cash and cash equivalents consist of cash on hand, balances with banks and short-term investments. All highly liquid investments with original maturities of three months or less are classified as cash and cash equivalents. The fair value of cash and cash equivalents approximates the amounts shown in the financial statements.

The Company uses a "lock-box" arrangement, whereby remittances from customers are swept daily to reduce the borrowings under the revolving credit facilities.

*(v) Allowance for doubtful accounts*

The allowance for doubtful accounts reflects management's best estimate of probable losses inherent in the accounts receivable balance. Management determines the allowance based on factors, including the length of time the receivables have been outstanding, customer and industry concentrations, the current business environment and historical experience.

*(vi) Inventories*

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

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 151 "Inventory Costs, an amendment of ARB No. 43, Chapter 4 ("SFAS 151") the Company recognizes as current period charges abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) costs. In addition fixed production overheads are allocated to inventory based on normal capacity of production facilities.

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**2. Significant accounting policies (Continued)**

*(vii) Property, plant and equipment*

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is generally calculated on a straight-line basis over the expected useful lives as follows:

Buildings	18 - 20 years
Machinery and equipment	7 years
Office furniture and equipment	7 years
Computer hardware and software	3 years
Leasehold improvements	Over shorter of the lease term or estimated useful life

*(viii) Other assets*

Long-term debt financing related costs are deferred and amortized over the term of the related debt and the related amortization is included within amortization expense or interest expense.

*(ix) Income taxes*

The Company accounts for income taxes using the asset and liability method. This approach recognizes the amount of taxes payable or refundable for the current year as well as deferred tax assets and liabilities for the future tax consequence of events recognized in the financial statements and tax returns. The effect of changes in tax rates is recognized in the year in which the rate change occurs.

In establishing the appropriate income tax related valuation allowances, the Company assesses its ability to realize its deferred tax assets based on available evidence, both positive and negative, to determine whether it is more likely than not that the deferred tax assets or a portion thereof will be realized.

*(x) Earnings (loss) per common share*

Basic earnings (loss) per share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings (loss) per share is calculated using the weighted average number of common shares plus the dilutive potential common shares outstanding during the year. Anti-dilutive potential common shares are excluded. The treasury stock method is used to compute the potential dilutive effect of stock options and warrants issued pursuant to the amended credit agreement.

*(xi) Translation of foreign currencies*

The functional currency of all foreign subsidiaries is the U.S. dollar. Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the year-end rates of exchange. Non-monetary assets and liabilities denominated in foreign currencies are translated at historical rates and revenue and expenses are translated at average exchange rates prevailing during the month of the transaction. Exchange gains or losses are reflected in the consolidated statements of operations.

*(xii) Financial instruments*

The Company accounts for derivative financial instruments in accordance with the applicable accounting standards. These standards require all derivative instruments to be recorded on the balance sheet at their respective fair values.

**SMTC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**2. Significant accounting policies (Continued)**

There were no derivative financial instruments outstanding at December 31, 2005 and 2006.

The carrying amounts of accounts receivable and accounts payable and accrued liabilities approximate fair values due to the short-term nature of these instruments. The fair values of long-term debt and capital lease obligations, including the current portion, bear rates currently available to the Company for debt with similar terms and maturities and, therefore, approximate carrying values.

*(xiii) Stock-compensation based*

Prior to January 1, 2006, the Company, as permitted under SFAS No. 123 “Accounting for Stock-based Compensation” (“SFAS 123”), applied Accounting Principles Board Opinion (“APB”) No. 25, “Accounting for Stock Issued to Employees” (“APB 25”) and related interpretations in accounting and providing disclosures for its stock-based compensation plans. Under SFAS 123 and APB 25, the Company did not expense employee stock-based compensation using the fair value based method.

In December 2004 the FASB issued SFAS No. 123R “Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment” (“SFAS 123R”) which required the measurement and recognition of compensation expense for all stock-based awards made to employees and directors based on the grant date fair value of those awards. Effective January 1, 2006, the Company adopted SFAS 123R using a fair value based method prospectively for all outstanding awards. The fair value at grant date of stock options is estimated using the Black-Scholes option-pricing model. Compensation expense is recognized over the stock option vesting period. SFAS 123R also requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The following table shows the effect on net earnings (loss) and earnings (loss) per share under the pro forma disclosure requirements of SFAS 123 (as reported) and under SFAS 123R if the respective standards were applied for the years ended December 31:

	2004		2005	
	<u>As reported</u>	<u>SFAS 123R</u>	<u>As reported</u>	<u>SFAS 123R</u>
Net earnings (loss)—reported	\$ 618	\$ 618	\$ (112)	\$ (112)
Stock-based compensation recovery (expense)	128	(206)	(235)	(197)
Net earnings (loss)—pro forma	<u>\$ 746</u>	<u>\$ 412</u>	<u>\$ (347)</u>	<u>\$ (309)</u>
Basic earnings (loss) per common share:				
Reported	\$ 0.05	\$ 0.05	\$ (0.01)	\$ (0.01)
Pro forma	<u>\$ 0.06</u>	<u>\$ 0.03</u>	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>
Diluted earnings (loss) per common share:				
Reported	\$ 0.05	\$ 0.05	\$ (0.01)	\$ (0.01)
Pro forma	<u>\$ 0.06</u>	<u>\$ 0.04</u>	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**2. Significant accounting policies (Continued)**

The following weighted average assumptions were used in computing the fair value of stock options used to compute stock-based compensation expenses both as recorded in the financial statements and for pro forma purposes for the following periods:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
<b>Black-Scholes weighted-average assumptions</b>			
Expected dividend yield	0.0%	0.0%	0.0%
Expected volatility	120.0%	103.0%	103.2%
Risk-free interest rate	3.00%	3.50%	4.68%
Expected option life in years	4	4	4
<b>Weighted-average stock option fair value per option granted</b>	<u>\$ 1.93</u>	<u>\$ 1.17</u>	<u>\$ 1.81</u>

*(xiv) Impairment of long-lived assets*

The Company tests long-lived assets or asset groups held and used for recoverability when events or changes in circumstances indicate that their carrying amount may not be recoverable. Circumstances which could trigger a review include, but are not limited to: significant decreases in the market price of the asset; significant adverse changes in the business climate or legal factors; the accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset; current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset; and a current expectation that the asset will more likely than not be sold or disposed of significantly before the end of its estimated useful life. For assets classified as available for sale, an impairment loss is recognized when the carrying amount exceeds the fair value less costs to sell.

Recoverability is assessed based on the carrying amount of the asset and the sum of the undiscounted cash flows expected to result from the use and the eventual disposal of the asset. If the carrying value of the asset is not recoverable, the impairment loss is measured as the amount by which the carrying amount exceeds fair value.

*(xv) Restructuring costs*

The Company accounts for restructuring costs related to an exit or disposal activity when a liability is incurred and can be measured at fair value.

*(xvi) Asset retirement obligations*

The Company recognizes the fair value of liabilities for asset retirement obligations when the Company incurs the obligation. There was no asset retirement obligation recorded for the years ended December 31, 2005 and 2006.

*(xvii) Guarantees*

The Company accounts for guarantees, including the recognition of a liability at the inception of certain guarantees, based on the fair value of the guarantee. The Company did not enter into any guarantees in 2004, 2005 or 2006.

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**2. Significant accounting policies (Continued)**

*(xviii) Comprehensive income:*

Comprehensive income includes all changes in equity (net assets) during a period from non-owner sources. During each of the years in the three-year period ended December 31, 2006, comprehensive income was equal to net earnings (loss).

*Comparative figures*

Some comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.

*Accounting Changes*

(i) SAB 108:

In December 2006, the Company adopted Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 clarifies the way that a company should evaluate identified unadjusted errors for materiality. SAB 108 requires that the effect of misstatements that were not corrected at the end of the prior year be considered in quantifying misstatements in the current year financial statements. Two techniques were identified as being used by companies in practice to accumulate and quantify misstatements—the "rollover" approach and the "iron curtain" approach.

The rollover approach, which is the approach the Company used, quantifies a misstatement based on the amount of the error originating in the current year income statement. Thus, this approach ignores the effects of correcting the portion of the current year balance sheet misstatement that originated in prior years. The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement's year(s) of origination.

Using the rollover approach resulted in an accumulation of misstatements to our balance sheets that were deemed immaterial to the consolidated financial statements because the amounts that originated in each year were quantitatively and qualitatively immaterial. The Company elected, as allowed under SAB 108, to reflect the effect of initially applying this guidance by adjusting the carrying amount of the respective accounts as of the beginning of 2006 and recording an offsetting adjustment to the opening balance of our deficit in 2006. Accordingly, the Company recorded a cumulative adjustment to increase the opening deficit by \$696 for the adoption of SAB 108. Included in this cumulative adjustment is a \$556 decrease in property, plant and equipment relating to amortization of leasehold improvements in the years 2000 to 2005. The remaining amount includes increases in accrued liabilities and inventory of \$251 and \$88, respectively, and decreases in accounts receivable, long-term debt, other assets and capital stock of \$112, \$174, \$125 and \$86, respectively.

(ii) Inventory costs:

Beginning January 2006, the Company adopted SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4 ("SFAS 151"). SFAS 151 requires that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) be recognized as current period

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**2. Significant accounting policies (Continued)**

charges, and that fixed production overheads be allocated to inventory based on normal capacity of production facilities. The adoption of SFAS 151 did not have a material impact on the Company's consolidated financial statements.

(iii) Exchange of non-monetary assets:

Beginning January 2006, the Company adopted SFAS No. 153, Exchange of Non-Monetary Assets, an amendment of Accounting Principles Board ("APB") Opinion 29 ("SFAS 153"). APB Opinion 29 ("APB 29") is based on the principle that exchanges of non-monetary assets generally should be measured based on the fair value of assets exchanged. SFAS 153 amends APB 29 to eliminate the exception from fair value measurement for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. The adoption of SFAS 153 did not have a material impact on the Company's consolidated financial statements.

(iv) Share-based payments:

In January 2006, the Company adopted SFAS 123R which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors based on the grant date fair value of those awards. SFAS 123R also requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Refer to (xiii) "Stock-based compensation" under "Basis of Presentation" within this note for the impact of adoption of SFAS 123R on the Company's consolidated financial statements.

(v) Accounting changes and error corrections:

Also in January 2006, the Company adopted SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 ("APB 20") and SFAS No. 3 ("SFAS 154"). SFAS 154 requires retrospective application for voluntary changes in accounting principles unless it is impracticable to do so. In addition, SFAS 154 requires that a change in depreciation method be accounted for as a change in estimate, not as a change in accounting principle as previously required by APB 20. However, a change in depreciation methods must continue to be justified by its preferability and related disclosures must be provided. The adoption of SFAS 154 did not have a material impact on the Company's consolidated financial statements.

***Recent accounting pronouncements***

(i) Accounting for uncertainty in income taxes:

In June 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes ("FIN 48"). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition and is applicable for the Company beginning January 1, 2007. The Company is currently assessing the impact of its adoption of FIN 48.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**2. Significant accounting policies (Continued)**

(ii) Fair Value Measurements:

In September 2006, the FASB issued SFAS 157, Fair Value Measurements (“SFAS 157”). SFAS 157 establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, however, the application of SFAS 157 may change current practice. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of SFAS 157.

**3. Consolidated financial statement details**

The following consolidated financial statement details are presented as of December 31 for the consolidated balance sheets and for each of the years ended December 31 for the consolidated statements of operations and consolidated statements of cash flows.

***Consolidated statements of operations***

*Interest expense:*

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Long-term debt	\$4,170	\$3,634	\$5,433
Obligations under capital leases	45	213	146
Other	306	742	(184)
Interest expense	<u>\$4,521</u>	<u>\$4,589</u>	<u>\$5,395</u>

***Consolidated balance sheets***

*Accounts receivable—net:*

	<u>2005</u>	<u>2006</u>
Accounts receivable	\$28,092	\$46,063
Less: Allowance for doubtful accounts	(1,193)	(1,015)
Accounts receivable—net	<u>\$26,899</u>	<u>\$45,160</u>

*Inventories:*

	<u>2005</u>	<u>2006</u>
Raw materials	\$19,035	\$28,622
Work in process	8,748	10,212
Finished goods	4,873	3,290
Other	512	727
Inventories	<u>\$33,168</u>	<u>\$42,851</u>

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**3. Consolidated financial statement details (Continued)**

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

	<u>2005</u>	<u>2006</u>
Cost:		
Land	\$ 1,648	\$ 1,648
Buildings	9,449	9,605
Machinery and equipment (a)	26,886	28,809
Office furniture and equipment	2,808	4,291
Computer hardware and software	8,246	8,460
Leasehold improvements	<u>13,525</u>	<u>13,092</u>
	<u>62,562</u>	<u>65,905</u>
Less accumulated depreciation:		
Land	—	—
Buildings	(2,573)	(3,165)
Machinery and equipment (a)	(17,516)	(18,596)
Office furniture and equipment	(2,342)	(4,022)
Computer hardware and software	(8,094)	(8,197)
Leasehold improvements	<u>(6,386)</u>	<u>(7,121)</u>
	<u>(36,911)</u>	<u>(41,101)</u>
Property, plant and equipment—net	<u>\$ 25,651</u>	<u>\$ 24,804</u>

- (a) Included within Machinery and equipment were assets under capital leases with costs of \$5,155 and \$5,814 and associated accumulated depreciation of \$2,048 and \$1,192, as of December 31, 2005 and 2006, respectively. The related depreciation expense for the years ended December 31, 2005 and 2006 were \$659 and \$593, respectively.

**Other assets:**

	<u>2005</u>	<u>2006</u>
Deferred financing costs	\$ 3,476	\$ 3,901
Less: accumulated amortization	<u>(1,499)</u>	<u>(2,591)</u>
	1,977	1,310
Other	<u>33</u>	<u>—</u>
Other assets	<u>\$ 2,010</u>	<u>\$ 1,310</u>

**Accrued liabilities:**

	<u>2005</u>	<u>2006</u>
Customer related	\$ 5,118	\$ 2,016
Interest and financing related	304	594
Payroll	2,368	4,110
Professional services	960	1,134
Restructuring	1,884	353
Vendor related	623	432
Miscellaneous taxes	538	234
Other	<u>2,054</u>	<u>1,380</u>
Accrued liabilities	<u>\$ 13,849</u>	<u>\$ 10,253</u>

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**3. Consolidated financial statement details (Continued)**

*Consolidated statements of cash flows*

*Interest and taxes paid:*

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Cash interest paid	\$3,362	\$2,626	\$ 3,196
Cash taxes (received) paid—net	\$ 373	\$ 685	\$(2,799)

**Non-cash financing and investing activities:**

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Increase in other assets and accrued liabilities	\$ 1,636	\$—	\$ —
Repayment of long-term debt and existing warrants by issuance of warrants (notes 4 and 5)	\$10,000	\$—	\$ —
Acquisition of equipment under capital lease	\$ 3,572	\$—	\$2,216
Settlement of shareholder loan	\$ —	\$537	\$ —

**4. Long-term debt and capital leases**

*Long-term debt*

The following table shows the components of long-term debt as of December 31:

	<u>2005</u>	<u>2006</u>
Senior debt:		
Revolving	\$ 2,020	\$ 7,135
Term	700	11,658
Subordinated debt	24,895	21,893
Other	875	351
	<u>28,490</u>	<u>41,037</u>
Less: Current portion of long-term debt	<u>(4,633)</u>	<u>(21,742)</u>
Long-term debt	<u>\$23,857</u>	<u>\$ 19,295</u>

In connection with the initial public offering completed on July 27, 2000, the Company and certain of its subsidiaries entered into a credit agreement (the "Credit Agreement") that provided for an initial term loan and amounts made available under revolving credit loans, swing-line loans and letters of credit. Between July 27, 2000 and May 31, 2004, the Company and its pre-existing lenders amended the Credit Agreement from time to time.

On June 1, 2004, the Company announced that it completed a recapitalization. The June 1, 2004 recapitalization consisted of three main components:

- (i) a private placement of equity securities,
- (ii) a new secured credit facility and,
- (iii) a transaction with the Company's pre-existing lenders to repay a portion of and restructure a portion of the Company's existing debt obligations under the Credit Agreement.

Prior to closing on June 1, 2004, the Company had total indebtedness outstanding under the Credit Agreement of \$77,500, consisting of a term loan of \$4,200 and amounts outstanding under the revolving credit loan and swing-line loans of \$73,300.

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**4. Long-term debt and capital leases (Continued)**

**Senior debt:**

On June 1, 2004, the Company entered into a 3-year \$40,000 revolving credit facility and a \$1,400 term loan facility (collectively, the "Wachovia Facilities") with Wachovia Capital Finance of Canada and its affiliates ("Wachovia"), which was used in part to repay a portion of the outstanding debt under the Credit Agreement and to fund future working capital needs. The availability under the Wachovia revolving credit facilities is subject to certain borrowing base conditions based on the eligible inventory and accounts receivable of the Company and requires a lock-box arrangement where all customer remittances are swept daily to reduce the borrowings outstanding. The revolving credit facilities bear interest at a rate of 0.5% in excess of the Canadian prime rate for Canadian-denominated loans and 0.5% in excess of the U.S. prime rate for U.S.-denominated loans. The Wachovia Facilities are secured by the present and future assets of the Company, require the Company to be in compliance with a financial covenant based on achieving certain EBITDA (earnings before interest, taxes, depreciation and amortization) targets and contain subjective acceleration clauses which would allow Wachovia to forego additional advances should they determine certain conditions exist, including those involving a material adverse change of the Company's business, assets, operations, prospects or financial condition. The initial term of the revolving credit facility was three years, with a one-year renewal period at the option of the lender, at which time, the facility would become annually renewable. The term loan bears interest at a rate of 1% in excess of the U.S. prime rate.

On November 16, 2004, the Company, together with Wachovia, executed a letter of understanding amending the terms of the Wachovia Facilities. The letter of understanding provided that, at the Company's option, it may elect to use a "springing lock-box" arrangement, whereby remittances from customers are forwarded to the Company's general bank account rather than the lock-box arrangement, as previously required, whereby customer remittances are swept daily to reduce the borrowings under the revolving credit facilities.

If the Company elected to change to the springing lock-box arrangement, as allowed under the letter of understanding, availability under the facility would have been reduced by the elimination of eligible inventory. The Company would have been required to revert back to a required lock-box arrangement if: (i) availability under the revolving credit facility is less than the greater of (a) \$2,500 or (b) 25% of the outstanding borrowings under the credit facility or (ii) the occurrence of an event of default.

In March 2005, the Company and Wachovia signed amendments to the Wachovia Facilities (the "March 2005 Amendments") which formalized the November 16, 2004 letter of understanding on the terms described above and reduced the EBITDA targets for the quarters ended December 31, 2004 through December 31, 2005.

In August 2005, the Company and Wachovia signed a further amendment to the Wachovia Facilities (the "August 2005 Amendments") which removed the elimination of inventory from the availability calculation should the Company elect to change to the springing lock-box arrangement.

In June 2006, the Company and Wachovia signed a further amendment to the Wachovia Facilities which increased the amount of the term loans to \$1,990, repayable over a period of 36 months.

In August 2006, the Company and Wachovia signed a further amendment to the Wachovia Facilities which extends the term of the revolving credit facilities to October 15, 2007.

In September 2006, the Company and Wachovia signed a fourth amending agreement to the Wachovia Facilities which increased the maximum indebtedness from \$40 million to \$45 million and amended the terms to provide greater flexibility to manage working capital requirements. As part of the debt

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**4. Long-term debt and capital leases (Continued)**

restructuring, a Term Loan B was made available to the Company in an amount equal to \$10 million. This portion of the facilities bears a variable interest rate based on the Libor rate plus 5 percent per annum up to a maximum of seven percent depending on senior leverage ratio. The Term Loan B has a quarterly repayment term of \$250, matures on October 15, 2007 and is secured by Mexican based assets.

In March 2007, the Company and Wachovia signed a further amendment to the Wachovia Facilities which extends the term of the revolving credit facilities and original term loan to April 15, 2008.

Management does not foresee being precluded from exercising the option of converting to a springing lock-box based on its expected financing needs over the next 12 months; however, due to the effective cash management aspect of the current lock-box arrangement, the Company has no plans to move to a springing lock-box arrangement.

Management believes that no conditions have occurred that would result in subjective acceleration by the lenders, nor that any such conditions will exist over the next 12 months. Furthermore, Wachovia has not informed the Company that any such condition or event has occurred. Because of the option to use a springing lock-box arrangement and based on management's assessment of the subjective acceleration clauses, the debt is classified as long-term as at December 31, 2005 and December 31, 2006.

The Wachovia Facilities and the Credit Agreement (as amended on June 1, 2004) are jointly and severally guaranteed by and secured by the assets of the Company and the assets and capital stock of each of the Company's subsidiaries (other than certain foreign subsidiaries) and its future subsidiaries. The security interest granted to Wachovia ranks senior to the security interest of the pre-existing lenders.

The portion of this senior debt denominated in Canadian dollars ("CDN") was \$779 and \$2,201 as of December 31, 2005 and 2006, respectively. The Company recorded foreign exchange losses related to this CDN denominated debt of \$1,149, \$265 and \$35 for the years ended December 31, 2004, 2005 and 2006, respectively.

**Subordinated debt:**

On June 1, 2004, the Company completed a transaction with the Company's pre-existing lenders under which the Company satisfied a portion of its indebtedness outstanding under the Credit Agreement. The Company paid consideration with a fair value of \$50,000, comprised of a cash payment of \$40,000 and \$10,000 of common stock of the Company and warrants in exchange for a reduction of debt with a par value of \$50,000 and cancellation of the warrants issued and to be issued to such lenders under the Credit Agreement.

The pre-existing lenders converted the remaining \$27,500 of outstanding indebtedness into a Tranche A term loan in the amount of \$15,000 and a Tranche B term loan in the amount of \$12,500 under the amended Credit Agreement. The Tranche A term loan matures on December 31, 2007 and bears interest at the U.S. base rate plus 2.5%, except for the period from January 1, 2005 to January 1, 2006, during which it bears interest at the U.S. base rate plus 2.75%. The Tranche B term loan matures on December 31, 2008 and bears interest at a rate equal to 8% payment in kind ("PIK") interest plus 4% cash interest, except for the period from January 1, 2005 to January 1, 2006, during which it bears interest at 8% PIK plus 4.25% cash interest, during the period the Tranche A term loan is outstanding and 6% PIK interest plus 6% cash interest thereafter. The Tranche B PIK interest is added to the outstanding principal balance during the term of the loan.

The Company accounted for the transactions with the pre-existing lenders as a modification of debt. The Company allocated the fair value of the \$50,000 consideration to the outstanding debt and cancelled

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**4. Long-term debt and capital leases (Continued)**

warrants using the relative fair value method, resulting in a reduction of debt outstanding of \$48,600 and allocation of \$1,400 to the cancelled warrants. The amount allocated to the cancelled warrants was recorded as long-term debt and is being amortized as a reduction of interest expense over the term of the term loans.

The Company incurred costs in relation to completion of the term loan transactions with the pre-existing lenders of \$1,800, and these costs and the remaining net book value of the previous deferred financing fees of \$180 were recorded as a non-current deferred charge and are being amortized as additional interest expense over the term of the term loans.

On March 10, 2005, the Company executed an amendment to the Credit Agreement, which reduced the EBITDA targets for each of the four quarters in the year ended December 31, 2005.

**Other:**

The Company incurred costs of \$1,400 related to the completion of the Wachovia Facilities. These costs were recorded as a non-current deferred charge and are being amortized as additional interest expense over the term of the credit facility.

**Amendment and commitment fees:**

The Company did not incur any amendment fees in 2004 and 2006. The Company incurred \$250 in amendment fees in 2005.

Commitment fees of \$46 and \$66 were incurred in 2004 and 2005, respectively. There were no commitment fees incurred in 2006. The weighted average interest rate on the long-term debt was 9.7% and 10.1% for 2005 and 2006 respectively.

**Financial covenants:**

The Company is in compliance with the financial covenants included in its lending agreements at December 31, 2006. Continued compliance with the financial covenants for the next twelve months is dependant on the Company achieving certain forecasts. The Company believes the forecasts are based on reasonable assumptions and are achievable; however, the forecasts are dependent on a number of factors, some of which are outside the control of the Company. These include but are not limited to, general economic conditions and specifically the strength of the electronics industry and the related demand for products and services by the Company's customers. In the event of non-compliance, the Company's lenders have the right demand repayment of the amounts outstanding under the lending agreements or pursue other remedies or, if the Company can reach an agreement with its lenders, amend the covenants.

**Obligations under capital leases:**

Minimum lease payments for capital leases consist of the following at December 31:

	<u>2005</u>	<u>2006</u>
Total minimum lease payments	\$ 1,609	\$2,475
Less: Amount representing interest of 7.0% to 12.0%	<u>(67)</u>	<u>(403)</u>
	1,542	2,072
Less: Current portion of capital leases	<u>(1,542)</u>	<u>(541)</u>
Total capital lease obligations	<u>\$ —</u>	<u>\$1,531</u>

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**4. Long-term debt and capital leases (Continued)**

*Debt and capital lease principal repayments*

At December 31, 2006, principal repayments due within each of the next five years on long-term debt and capital leases are as follows:

	<u>Long-term debt (a)</u>	<u>Capital leases</u>
2007	\$ 21,742	\$ 541
2008	19,295	636
2009	—	509
2010	—	213
2011	—	173
Total	<u>\$ 41,037</u>	<u>\$ 2,072</u>

- (a) In addition to the principal repayments in the table above, the Company is obligated to pay \$1,938 of PIK interest over the remaining term of the subordinated debt in connection with the Tranche B term loan.

**5. Capital stock**

*Common shares*

*Authorized share capital:*

The authorized share capital of the Company at December 31, 2005 and 2006 consisted of:

- (i) 26,000,000 shares of common stock, par value \$0.01 per share: Holders are entitled to one vote per share and the right to share in dividends pro rata subject to any preferential dividend rights of any then outstanding preferred stock.
- (ii) 5,000,000 shares of preferred stock, par value \$0.01 per share: From time to time the Company may issue preferred stock in one or more series and will fix the terms of that series at the time it is created.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**5. Capital stock (Continued)**

*Issued and outstanding:*

The outstanding number of capital stock included in shareholders' equity consisted of the following as of December 31:

	2004		2005		2006	
	Number of shares	\$	Number of shares	\$	Number of shares	\$
<b>Common Stock</b>						
<b>Exchangeable shares:</b>						
Balance at beginning of the year	918,762	\$ 55,671	6,659,552	\$ 63,004	1,748,875	\$16,547
Shares issued pursuant to:						
Completion of private placement	6,670,000	18,983	—	—	—	—
Conversion to common stock	(929,210)	(11,650)	(4,910,677)	(46,457)	(521,919)	(4,939)
Balance at end of the year	<u>6,659,552</u>	<u>63,004</u>	<u>1,748,875</u>	<u>16,547</u>	<u>1,226,956</u>	<u>11,608</u>
<b>Common shares</b>						
Balance at beginning of the year	4,819,194	\$ 240	7,981,780	\$ 390	12,892,457	\$ 439
Adoption of SAB 108	—	—	—	—	—	(86)
Shares issued pursuant to:						
Conversion of debt	2,233,389	112	—	—	—	—
Cancellation of warrants	—	—	—	—	—	—
Conversion of exchangeable shares	929,210	38	4,910,677	49	521,919	5
Options exercised	—	—	—	—	5,000	3
Fractional shares redeemed	(13)	—	—	—	—	—
Balance at end of the year	<u>7,981,780</u>	<u>390</u>	<u>12,892,457</u>	<u>439</u>	<u>13,419,376</u>	<u>361</u>
<b>Special voting stock</b>						
Balance at beginning of the year	<u>1</u>	\$ —	<u>1</u>	\$ —	<u>1</u>	\$ —
Balance at end of the year	<u>1</u>	—	<u>1</u>	—	<u>1</u>	—
<b>Total Common stock</b>		<u>\$ 63,394</u>		<u>\$ 16,986</u>		<u>\$11,969</u>
<b>Warrants</b>						
<b>Common share warrants</b>						
Balance at beginning of the year	2,199,804	\$ 1,523	11,166,947	\$ 2,755	11,166,947	\$ 2,755
Warrants issued pursuant to:						
Cancellation of warrants	(2,199,804)	(1,523)	—	—	—	—
Conversion of debt	11,166,947	2,755	—	—	—	—
Balance at end of the year	<u>11,166,947</u>	<u>\$ 2,755</u>	<u>11,166,947</u>	<u>\$ 2,755</u>	<u>11,166,947</u>	<u>\$ 2,755</u>
<b>Exchangeable share warrants</b>						
Balance at beginning of the year	—	\$ —	16,675,000	7,617	16,675,000	7,617
Shares issued pursuant to:						
Completion of private placement	16,675,000	7,617	—	—	—	—
Balance at end of the year	<u>16,675,000</u>	<u>\$ 7,617</u>	<u>16,675,000</u>	<u>\$ 7,617</u>	<u>16,675,000</u>	<u>\$ 7,617</u>
<b>Total Warrants</b>		<u>\$ 10,372</u>		<u>\$ 10,372</u>		<u>\$10,372</u>

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**5. Capital stock (Continued)**

Capital transactions from January 1, 2004 to December 31, 2006:

*Private placement of Special Warrants:*

On March 3, 2004, the Company completed a private placement, fully underwritten by a syndicate of Canadian investment dealers, of 33,350,000 Special Warrants (each a "Special Warrant" and collectively, the "Special Warrants") of SMTC Manufacturing Corporation of Canada ("SMTC Canada"), an indirect subsidiary of the Company. Each Special Warrant was issued at a price of CDN \$1.20 per Special Warrant, resulting in aggregate proceeds of CDN \$40,020. The proceeds, net of underwriters' commissions and certain other expenses, were placed into escrow on March 3, 2004, pending receipt of shareholder approval.

Subject to the satisfaction of applicable legal requirements, each Special Warrant was exercisable for one unit, consisting of one-fifth of an exchangeable share of SMTC Canada, and one-half of a warrant to purchase one-fifth of an exchangeable share of SMTC Canada. Each whole warrant (a "Purchase Warrant") is exercisable for one-fifth of an exchangeable share of SMTC Canada at an exercise price of CDN \$9.25 per share until March 3, 2009. The Special Warrants were exercised into units on June 2, 2004.

Subject to the satisfaction of applicable legal requirements, each exchangeable share of SMTC Canada can be exchanged on a one-for-one basis for one share of the common stock of the Company. Each exchangeable share of SMTC Canada, as nearly as practicable, is intended to be the economic equivalent of a share of common stock of the Company and holders of the exchangeable shares of SMTC Canada are able to exercise essentially the same voting rights with respect to the Company as they would have if they had exchanged their exchangeable shares of SMTC Canada for common stock of the Company. On or after July 27, 2015, subject to certain adjustment and acceleration provisions, SMTC Canada will redeem all of the outstanding exchangeable shares by delivering common shares of the Company on a one-for-one basis.

The proceeds, net of underwriter commissions and other expenses including interest earned while held in escrow, were released from escrow on June 1, 2004, and were used to repay a portion of the debt under the Credit Agreement.

The gross proceeds of CDN \$40,020 (\$29,372 based on the exchange rate at June 1, 2004) were allocated between the exchangeable shares and Purchase Warrants using the relative fair value method.

The gross proceeds were allocated between the exchangeable shares and warrants in the amounts of \$20,962 and \$8,410, respectively.

The Company incurred total costs related to the private placement of \$2,772, resulting in net proceeds of \$26,600. These costs were offset against the exchangeable shares and warrants in proportion to their relative fair values, resulting in net proceeds allocated to these instruments of \$18,983 and \$7,617, respectively.

*Conversion of outstanding debt:*

On June 1, 2004, the pre-existing lenders exchanged \$10,000 of outstanding debt and all warrants previously issued or required to be issued for 2,233,389 shares of common stock and 11,166,947 warrants (the "Conversion Warrants"). Each warrant is exercisable for one-tenth of one share of common stock of the Company at an exercise price of \$6.90 per share of common stock. The warrants may be exercised by the holders at any time on or before March 4, 2009.

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**5. Capital stock (Continued)**

The common stock and the Conversion Warrants issued to the pre-existing lenders were subject to transfer restrictions on trading. The pre-existing lenders agreed to retain:

- all of the shares of common stock, Conversion Warrants and shares of common stock underlying such Conversion Warrants until September 1, 2004;
- at least 2/3 of the shares of common stock, Conversion Warrants and shares of common stock underlying such Conversion Warrants until December 1, 2004; and
- at least 1/6 of the shares of common stock, and Conversion Warrants and shares of common stock underlying such Conversion Warrants until March 1, 2005.

The fair value of the consideration paid upon conversion of \$10,000 of debt was allocated between the common stock and Conversion Warrants using the relative fair value method. The fair value of the consideration paid was allocated between the common stock and Conversion Warrants in the amounts of \$7,137 and \$2,863, respectively.

The Company incurred total costs of \$379 related to the conversion. These costs were offset against the common stock and Conversion Warrants in proportion to their relative fair values, resulting in net proceeds allocated to these instruments of \$6,866 and \$2,755, respectively. The excess of the amount allocated to the common stock over the par value of \$6,754 was recorded as additional paid-in capital.

*Exchangeable shares:*

During 2004, 2005 and 2006, exchangeable shares of 929,210, 4,910,677 and 521,919 with a par value of \$38, \$49 and \$5, respectively, were exchanged for common stock with the difference recorded as additional paid-in capital.

*Reverse stock split:*

On October 4, 2004, the Company completed a reverse stock split of its issued and outstanding common and exchangeable shares, whereby every five shares of common stock were exchanged for one share of common stock and every five exchangeable shares were exchanged for one exchangeable share. All share information relating to shares outstanding and all employee stock options and warrants have been retroactively adjusted to reflect the reverse stock split.

***Warrants***

**2004 transactions:**

Pursuant to the private placement described above SMTC Canada issued 16,675,000 warrants. Each warrant is exercisable for one-fifth of an exchangeable share of SMTC Canada at an exercise price of CDN. \$9.25 per share until March 3, 2009.

Following the exchange by the pre-existing lenders of \$10,000 of outstanding debt and all warrants previously issued or required to be issued, as described above, the Company issued 11,166,947 warrants. Each warrant is exercisable for one-tenth of one share of common stock of the Company at an exercise price of \$6.90 per share of common stock. The warrants may be exercised by the holders at any time on or before March 4, 2009.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**5. Capital stock (Continued)**

**Stock options**

*1998 SMTC Plan:*

In July 1999, the Company replaced a previous option plan adopted in 1998 with an equivalent stock option plan (the “1998 SMTC Plan”), for which two classes of options were authorized to purchase non-voting shares. In July 2000, pursuant to an initial public offering, the options outstanding under the previous option plan were converted to options to purchase common stock of the Company. The options generally vest over a four-year period and expire after 10 years from the original grant date of the 1998 SMTC Plan options.

*2000 Equity Incentive Plan:*

In July 2000, the Company approved a new stock option plan, the SMTC/SMTC Manufacturing Corporation of Canada 2000 Equity Incentive Plan (the “2000 Equity Incentive Plan”), pursuant to which a variety of stock-based incentive awards may be granted. The plan permits the issuance of up to 1,727,052 shares plus an additional number of shares determined by the Board of Directors but not to exceed 1% of the total number of shares outstanding per year. Options generally vest over a four-year period and expire 10 years from their respective date of grant. The Company generally issues treasury shares when options are exercised. A summary of stock option activity of the years ended December 31, 2004, 2005 and 2006 is as follows:

	<u>Outstanding options</u>	<u>Weighted average exercise price</u>
Balance at December 31, 2003	222,778	\$ 34.87
Options granted under the 2000 Equity Incentive Plan	290,000	\$ 1.93
Options cancelled	<u>(120,603)</u>	<u>\$ 42.38</u>
Balance at December 31, 2004	392,175	\$ 8.19
Options granted under the 2000 Equity Incentive Plan	410,000	\$ 1.17
Options cancelled	<u>(105,336)</u>	<u>\$ 9.72</u>
Balance at December 31, 2005	696,839	\$ 3.83
Options granted under the 2000 Equity Incentive Plan	290,000	\$ 2.50
Options exercised	(5,000)	\$ 1.17
Options cancelled	<u>(39,715)</u>	<u>\$ 10.83</u>
Balance at December 31, 2006	<u>942,124</u>	<u>\$ 1.17</u>

The weighted average estimated fair value at the date of the grant for options granted in 2006 was \$1.81. The estimated fair value of options is amortized over the vesting period on a straight line basis determined using the Black-scholes option pricing model using assumptions disclosed in note 2. During 2006, the Company recorded stock-based compensation expense and a corresponding increase in additional paid-in capital of \$187.

During 2004, 2005 and 2006, 116,600, 83,475 and 170,976 options vested, respectively. At December 31, 2006, compensation expense of \$794,454 related to non-vested stock options has not been recognized. This cost is expected to be recognized over a weighted average period of 2.5 years.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**5. Capital stock (Continued)**

The following table summarizes information about stock options outstanding as of December 31, 2006:

<u>Range of exercise price</u>		<u>Outstanding options</u>	<u>Weighted average exercise price</u>	<u>Exercisable options</u>	<u>Weighted average exercise price</u>
<b>1998 SMTC Plan</b>	\$28.90	6,724	\$ 28.90	6,724	\$ 28.90
<b>2000 Equity Incentive Plan</b>					
	\$ 1.17	340,000	\$ 1.17	90,000	\$ 1.17
	\$ 1.55	200,000	\$ 1.55	200,000	\$ 1.55
	\$ 2.75	30,000	\$ 2.75	16,875	\$ 2.75
	\$ 3.75	8,000	\$ 3.75	8,000	\$ 3.75
	\$ 4.00	35,000	\$ 4.00	25,625	\$ 4.00
	\$15.00	9,580	\$ 15.00	9,580	\$ 15.00
	\$25.00	9,580	\$ 25.00	9,580	\$ 25.00
	\$40.00	13,240	\$ 40.00	13,240	\$ 40.00
	\$ 2.50	<u>290,000</u>	<u>\$ 2.50</u>	<u>0</u>	<u>\$ 2.50</u>
		<u>935,400</u>	<u>\$ 2.78</u>	<u>372,900</u>	<u>\$ 4.04</u>

**6. Restructuring and other charges**

During 2001 and 2002, the Company announced restructuring programs aimed at reducing its cost structure and plant capacity (the "2001 Plan" and the "2002 Plan", respectively) and recorded restructuring and other charges consisting of: a write-down of goodwill and other intangible assets; the costs of exiting equipment and facility leases; severance costs; asset impairment charges; inventory exposures and other facility exit costs. During the third quarter of 2004, the Company announced further changes to its manufacturing operations as it continued to execute its transformation plan (the "2004 Plan"). This plan sought to provide greater focus on new customer and new product introduction and technical activities, to improve capacity utilization and to align its cost structure to expected revenue. During the third quarter of 2006, the Company undertook a restructuring program at the management level to better manage operating costs by reducing certain management roles (the "2006 Plan").

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Lease and other contract obligations	\$ —	\$ 14	\$ —
Reversal of previously recorded lease and other contract obligations	(2,000)	(237)	(1,820)
Severance	1,858	685	470
Reversal of previously recorded severance	—	(456)	—
Other facility exit costs	—	93	—
Proceeds from assets previously written down	—	(12)	—
Proceeds from sale of land	—	—	<u>(1,228)</u>
Restructuring and other charges	<u>(142)</u>	<u>87</u>	<u>(2,578)</u>
Inventory recoveries	(1,822)	—	—
Other charges included in cost of sales	622	—	—
Other adjustments included in selling, general and administrative expenses	<u>(287)</u>	<u>(42)</u>	<u>—</u>
Restructuring and other charges (recoveries)	<u>\$(1,629)</u>	<u>\$ 45</u>	<u>\$(2,578)</u>

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**6. Restructuring and other charges (Continued)**

**2004 charges**

*Restructuring charges:*

During 2004, the Company recorded the recovery of a previously recorded inventory charge of \$1,822, the reversal of previously recorded lease and other contract obligations of \$2,000 and severance charges of \$1,858.

The reversal of the previously recorded inventory charge of \$1,822 related to the settlement of a legal claim in favour of the Company for net proceeds of \$1,822. The settlement was the result of a four-year dispute over obsolete inventory with a former customer. As the Company recorded the original charge in cost of sales, the net proceeds have also been recorded as a recovery in cost of sales.

The reversal of previously recorded lease and other contract obligations of \$1,744 were in connection with the 2001 Plan and were associated with the settlement of a legal claim related to the facility lease in Monterrey, Mexico, which resulted in the recovery of \$1,694 to adjust the provision to the amount of the settlement and \$50 related to the costs associated with exiting a Boston facility for less than originally estimated. The reversal of previously recorded lease and other contract obligations of \$256 were in connection with the 2002 Plan and related to settling various equipment leases for less than originally estimated.

Severance charges of \$400 were in connection with the 2002 Plan and related to a change in the estimate of amounts to be paid out. Severance charges of \$1,458 were in connection with the 2004 Plan and related to 99 and 110 employees at the Chihuahua, Mexico and Markham, Ontario facilities, respectively.

*Other charges (recoveries):*

Other charges included in cost of sales of \$622 relate to an inventory charge of \$1,000 associated with a certain customer, offset by a recovery of a previously recorded inventory write down of \$378.

During 2004, the Company received proceeds of \$287 from the sale of an asset previously written off. This amount has been recorded in selling, general and administrative expenses.

**2005 charges (recoveries)**

*Restructuring charges:*

During 2005, the Company recorded lease and other contract obligations of \$14, a reversal of previously recorded lease and other contract obligations of \$237, severance charges of \$685, a reversal of previously recorded severance charges of \$456, other facility exit costs of \$93 and received proceeds from the disposition of assets previously written down of \$12.

Lease and other contract obligations of \$14 in connection with the 2004 Plan related to the closure of an office in Richmond Hill, Ontario. The reversal of previously recorded lease and other contract obligations of \$237 in connection with the 2002 Plan related to the settlement of various equipment leases for less than originally estimated.

Severance charges of \$156 and a reversal of previously recorded severance charges of \$456 in connection with the 2002 Plan related to changes to the estimate of amounts to be paid out. Severance charges of \$529 in connection with the 2004 Plan related to 35, 4 and 5 employees at the Chihuahua, Mexico, Appleton, Wisconsin and Markham, Ontario locations, respectively.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**6. Restructuring and other charges (Continued)**

*Other charges (recoveries):*

Other charges of \$93 in connection with the 2002 Plan related to costs associated with the closure of the Austin, Texas facility.

Proceeds from assets previously written down of \$12 relate to the disposal of assets of the Charlotte facility. The Company recorded an adjustment of \$42 in selling, general and administrative expenses related to the recovery of assets previously written off.

**2006 charges:**

*Restructuring charges:*

During 2006, the Company undertook restructuring at the management level to better manage operating costs by eliminating certain senior management roles and recorded severance charges of \$470 relating to an employee in the United States and 2 employees in Canada. Also during 2006, the Company changed the estimate of future lease payments under the 2002 Plan as a result of new circumstances and recorded an adjustment which reduced the accrual by \$1,820 and recognized a gain on sale of assets previously written down of \$1,228.

*Other charges (recoveries):*

The following table details original charges, additional charges and adjustments, and the related amounts included in accrued liabilities, as at December 31, 2004, 2005 and 2006, relating to the 2001 Plan:

	<u>Inventory write- downs included in cost of sales</u>	<u>Leases and other contractual obligations</u>	<u>Severance</u>	<u>Asset impairment</u>	<u>Intangible asset write- down</u>	<u>Other facility exit costs</u>	<u>Total</u>
<b>2001 Plan</b>							
2001 charges	\$ 25,388	\$ 8,635	\$ 3,556	\$ 5,609	\$ 17,765	\$ 6,278	\$ 67,231
Non-cash charges	(25,388)	—	—	(5,609)	(17,765)	(3,059)	(51,821)
2001, 2002, 2003 cash payments	—	(7,547)	(3,556)	—	—	(3,000)	(14,103)
2002 Reversals	—	(393)	—	—	—	—	(393)
2003 Reversals	—	—	—	—	—	(219)	(219)
2003 Charges	—	2,178	—	—	—	—	2,178
Balance as at December 31, 2003	<u>\$ —</u>	<u>\$ 2,873</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,873</u>
Adjustments	—	(1,744)	—	—	—	—	(1,744)
Cash payments	—	(1,129)	—	—	—	—	(1,129)
Balance as at December 31, 2004	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**6. Restructuring and other charges (Continued)**

The following table details original charges, additional charges and adjustments, and the related amounts included in accrued liabilities, as at December 31, 2004, 2005 and 2006, relating to the 2002 Plan:

	Inventory write- downs included in cost of sales	Leases and other contractual obligations	Severance	Asset impairment	Sale of assets (a)	Other facility exit costs	Total
<b>2002 Plan</b>							
2002 charges	\$ 6,536	\$ 18,656	\$ 2,844	\$ 7,689	\$ —	\$1,568	\$ 37,293
Non-cash charges	(6,536)	—	—	(7,726)	—	—	(14,262)
2002 and 2003 cash payments	—	(8,113)	(4,703)	—	293	(630)	(13,153)
2003 Reversals	—	(4,123)	—	—	—	(701)	(4,824)
2003 Charges	—	326	2,418	37	(293)	96	2,584
Balance as at December 31, 2003	<u>\$ —</u>	<u>\$ 6,746</u>	<u>\$ 559</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 333</u>	<u>\$ 7,638</u>
Charges	—	—	400	—	—	—	400
Reversals	—	(256)	—	—	—	—	(256)
Payments	—	(4,100)	(103)	—	—	(300)	(4,503)
Balance as at December 31, 2004	<u>\$ —</u>	<u>\$ 2,390</u>	<u>\$ 856</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 33</u>	<u>\$ 3,279</u>
Charges	—	—	156	—	(12)	93	\$ 237
Reversals	—	(237)	(456)	—	—	—	(693)
Receipts (payments)	—	(299)	(556)	—	12	(96)	(939)
Balance as at December 31, 2005	<u>\$ —</u>	<u>\$ 1,854</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 30</u>	<u>\$ 1,884</u>
Reversals	—	(1,820)	—	—	—	—	\$ (1,820)
Payments	—	(34)	—	—	—	(30)	(64)
Balance as at December 31, 2006	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

(a) The receipt from sale of assets relates to cash received from the proceeds on sale of a previously written down asset.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**6. Restructuring and other charges (Continued)**

The following table details original charges, additional charges and adjustments, and the related amounts included in accrued liabilities, as at December 31, 2004, 2005 and 2006, relating to the 2004 Plan:

	<u>Leases and other contractual obligations</u>	<u>Severance</u>	<u>Total</u>
<b>2004 Plan</b>			
Balance as at January 1, 2004	\$ —	\$ —	\$ —
Charges	—	1,458	1,458
Payments	—	(722)	(722)
Balance as at December 31, 2004	<u>\$ —</u>	<u>\$ 736</u>	<u>\$ 736</u>
Charges	14	529	543
Payments	(14)	(977)	(991)
Balance as at December 31, 2005	<u>\$ —</u>	<u>\$ 288</u>	<u>\$ 288</u>
Payments	—	(288)	(288)
Balance as at December 31, 2006	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

The following table details original charges, additional charges and adjustments, and the related amounts included in accrued liabilities, as at December 31, 2006, relating to the 2006 Plan:

	<u>Severance</u>
<b>2006 Plan</b>	
Balance as at January 1, 2006	\$ —
Charges	470
Payments	(117)
Balance as at December 31, 2006	<u>\$ 353</u>

The Company expects to pay out the remaining amounts under the 2006 Plan during 2007 through a drawdown on the revolving credit facility.

**7. Income taxes**

The Company recorded the following income tax expense (recovery) for the years ended December 31:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
<b>Current:</b>			
Federal	\$ 534	\$ —	\$(1,249)
Foreign	107	(72)	(774)
	641	(72)	(2,023)
<b>Deferred:</b>			
Federal	—	—	—
Foreign	(135)	(484)	62
	(135)	(484)	62
Income tax expense (recovery)	<u>\$ 506</u>	<u>\$(556)</u>	<u>\$(1,961)</u>

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**7. Income taxes (Continued)**

The overall income tax expense (recovery) as recorded in the consolidated statements of operations varied from the tax expense (recovery) calculated using U.S. federal and state income tax rates as follows for the years ended December 31:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Federal tax (recovery)	\$ 383	\$ (233)	\$ 2,669
State income tax expense (recovery), net of federal tax benefit	180	(20)	229
Change in enacted rates	—	—	93
Income of international subsidiaries taxes at different rates	(38)	(42)	(601)
Change in valuation allowance	(10,249)	1,911	(4,154)
Inter-company dividend	9,078	—	—
Permanent differences and other	1,152	(2,172)	(197)
Income tax expense (recovery)	<u>\$ 506</u>	<u>\$ (556)</u>	<u>\$(1,961)</u>

Earnings (loss) before income taxes and discontinued operations consisted of the following for the years ended December 31:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
U.S.	\$ 4,373	\$(200)	\$5,166
Non U.S.	(4,086)	(468)	2,460
	<u>\$ 287</u>	<u>\$(668)</u>	<u>\$7,626</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's deferred tax liabilities and assets are comprised of the following at December 31:

	<u>2005</u>	<u>2006</u>
Deferred income tax assets:		
Net operating loss carryforwards	\$ 34,441	\$ 31,773
AMT credit carryforwards	534	1,350
Capital and other assets	15,358	13,158
Reserves, allowances and accruals	2,356	2,195
	52,689	48,476
Valuation allowance	(52,070)	(47,919)
Net deferred income tax assets	<u>\$ 619</u>	<u>\$ 557</u>

At December 31, 2006, the Company had total net operating loss ("NOL") carry forwards of \$74,171, of which \$1,259 will expire in 2012, \$3,608 will expire in 2014, \$210 will expire in 2015, \$1,077, will expire in 2018, \$60 will expire in 2019, \$30 will expire in 2020 and the remainder will expire between 2021 and 2026.

Deferred income taxes have not been provided on \$3,679 of undistributed earnings of foreign subsidiaries. These earnings have been indefinitely reinvested and the Company currently does not plan to initiate any action that would precipitate payment of income taxes thereon. The amount of unrealized deferred tax liabilities related to these earnings is \$1,471.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**7. Income taxes (Continued)**

During 2006, the Company reviewed if its tax position related to the Recapitalization Transaction would result in an ownership change for purposes of Section 382 of the Internal Revenue Code (“Section 382”), which imposes a limitation on a corporation’s use of net operating loss (“NOL”) carry forwards following an “ownership change.” The Company has concluded that the recapitalization transactions did not result in an ownership change and as such the use of the NOL carry forwards has not been limited.

Taxes related to discontinued operations were offset by the recognition of tax loss carryforwards.

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, projected future taxable income and tax planning strategies in making this assessment. SFAS No. 109, Accounting for Income Taxes, states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence, such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. In 2003, the Company concluded that given the weakness and uncertainty in the economic environment at that time, it was appropriate to establish a full valuation allowance for the deferred tax assets arising from its operations in the jurisdictions to which the deferred tax assets relate. In 2006, it was determined by management that it was more likely than not that the deferred tax assets associated with the Mexican jurisdiction would be realized in the amount of \$557. The U.S. and Canadian jurisdictions continued to have a full valuation allowance established for the deferred tax asset.

**8. Discontinued operations**

In connection with the Company’s 2001 and 2002 restructuring plans described in further detail in note 6, the Company decided to exit and dispose of the Appleton and Cork operations.

***Appleton:***

During the third quarter of 2003, the Company sold the manufacturing operations of the Appleton facility for cash proceeds of \$3,058. The Appleton facility has historically been included in the results of the United States segment (note 10). The Company recorded a loss on disposal of \$235, which has been included in the loss from discontinued operations.

The following table outlines the statements of operations for the discontinued Appleton operations which are presented for the years ended December 31:

*Statements of operations:*

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Revenues	\$—	\$—	\$—
Net earnings (loss) from discontinued operations—net of tax (a)	\$460	\$—	\$—

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**8. Discontinued operations (Continued)**

- (a) The earnings for 2004 relate to the proceeds from the settlement of a lawsuit of \$243 and an adjustment to the remaining accrual for closing costs of \$217.

**Cork:**

In February 2002, the main customer of the Cork, Ireland facility was placed into administration as part of a financial restructuring. As a result, on March 19, 2002, the Company announced that it was closing the Cork, Ireland facility and that it was taking steps to place the subsidiary that operates that facility in voluntary administration and recorded a charge of \$9,717 related to the closure of the facility.

The following table outlines the statement of operations for the discontinued Cork operations which are presented for the years ended December 31:

*Statements of operations:*

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Revenues	\$—	\$—	\$—
Net earnings (loss) from discontinued operations—net of tax (a)	\$377	\$—	\$874

- (a) The earnings for 2004 and 2006 relate to additional proceeds from liquidation of \$243 and \$874. The recovery in 2006 is anticipated to be the final recovery.

**9. 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 (loss) per common share for the following years:

<u>(Number of common shares)</u>	<u>2004 (a)</u>	<u>2005 (a)</u>	<u>2006</u>
Basic weighted average shares outstanding	10,943,763	14,641,333	14,642,459
Dilutive stock options (b)	—	—	382,588
Diluted weighted average shares outstanding	10,943,763	14,641,333	15,025,047

- (a) As a result of the net loss from continuing operations for the years ended December 31, 2004 and 2005, diluted earnings per share was calculated using the basic weighted average shares outstanding because to do otherwise would have been anti-dilutive.
- (b) Dilutive stock options were determined by using the average common share price for the period. For the year ended December 31, 2006, the average share price used was \$3.17 per share.

During 2004, 2005 and 2006, the calculations of diluted weighted average shares outstanding did not include 392,175, 696,839 and 559,588 options respectively, nor did they include 16,675,000 warrants, each warrant exercisable for one-fifth of an exchangeable share of SMTC Canada, and 11,166,947 warrants, each warrant exercisable for one-tenth of one share of common stock of the Company, as the effect would have been anti-dilutive.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**10. Segmented information**

*General description*

The Company derives its revenue from one dominant industry segment, the electronics manufacturing services industry. The Company is operated and managed geographically and has facilities in the United States, Canada and Mexico. The Company monitors the performance of its geographic operating segments based on EBITA (earnings before interest, taxes and amortization) before restructuring charges (recoveries) and discontinued operations. Discontinued operations relate to the Cork, Ireland facility, which was previously included in the results of the European segment and the Appleton manufacturing operations, previously included in the results of the United States segment (note 8). Intersegment adjustments reflect intersegment sales that are generally recorded at prices that approximate arm's-length transactions. In assessing the performance of the operating segments management attributes revenue to the operating segment which ships the product and invoices the customer. Information about the operating segments is as follows for the years ended December 31:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
<b>Revenues</b>			
US	\$ 69,336	\$111,954	\$102,875
Canada	81,610	36,242	57,890
Mexico	132,380	100,103	117,680
<b>Total</b>	<u>\$283,326</u>	<u>\$248,299</u>	<u>\$278,445</u>
<b>Intersegment revenue</b>			
US	\$ (101)	\$ (450)	\$ (145)
Canada	(10,787)	(4,391)	(7,212)
Mexico	(27,842)	(14,692)	(8,306)
<b>Total</b>	<u>\$(38,730)</u>	<u>\$(19,533)</u>	<u>\$(15,663)</u>
<b>Net external revenue</b>			
US	\$ 69,235	\$111,504	\$102,730
Canada	70,823	31,851	50,678
Mexico	104,538	85,411	109,374
<b>Total</b>	<u>\$244,596</u>	<u>\$228,766</u>	<u>\$262,782</u>
<b>EBITA</b>			
US	\$ 4,694	\$ 5,758	\$ 9,216
Canada	(4,781)	(5,146)	(1,768)
Mexico	5,261	3,396	3,821
<b>Total</b>	<u>\$ 5,174</u>	<u>\$ 4,008</u>	<u>\$ 11,269</u>
Interest	4,521	4,589	5,395
Amortization	2,330	—	—
Restructuring charges (recoveries)	(142)	99	(1,350)
Gain on sale of assets	—	(12)	(1,228)
Other expenses	(1,822)	—	826
<b>Earnings (loss) from continuing operations before income taxes</b>	<u>\$ 287</u>	<u>\$ (668)</u>	<u>\$ 7,626</u>

**SMTC CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
(Expressed in thousands of US dollars, except numbers of shares and per share amounts)

**10. Segmented information (Continued)**

*Capital expenditures*

The following table contains capital expenditures for the years ended December 31:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
US	\$—	\$ 54	\$ 506
Canada	179	117	1,466
Mexico	<u>234</u>	<u>2,314</u>	<u>2,425</u>
Total	<u>\$413</u>	<u>\$2,485</u>	<u>\$4,397</u>

*Geographic revenues*

The following table contains geographic revenues based on the product shipment destination, for the years ended December 31:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
US	\$179,447	\$138,633	\$188,338
Canada	16,855	65,902	33,096
Europe	11,048	3,508	32,160
Asia	9,811	1,799	7,298
Mexico	<u>27,435</u>	<u>18,924</u>	<u>1,890</u>
Total	<u>\$244,596</u>	<u>\$228,766</u>	<u>\$262,782</u>

*Assets*

	<u>2005</u>	<u>2006</u>
<b>Long-lived assets (a)</b>		
US	\$ 8,343	\$ 1,883
Canada	1,671	7,487
Mexico	<u>15,637</u>	<u>15,434</u>
Total	<u>\$ 25,651</u>	<u>\$ 24,804</u>
<b>Total assets</b>		
US	\$ 30,109	\$ 55,222
Canada	15,036	27,367
Mexico	<u>44,900</u>	<u>33,373</u>
Total	<u>\$ 90,045</u>	<u>\$ 115,962</u>

(a) Long-lived assets information is based on the principal location of the asset.

*Significant customers and concentration of credit risk:*

Sales of the Company's products are concentrated among specific customers in the same industry. The Company generally does not require collateral. 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.

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**10. Segmented information (Continued)**

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 largest customers or any product line manufactured for one of its largest customers, it could experience a significant reduction in revenue. Also, the insolvency of one or more of its largest customers or the inability of one or more of its largest 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 business, financial condition and results of operations.

Three customers individually comprised 17%, 16% and 10%; 21%, 18% and 11% and 17%, 14% and 11%, respectively, of total revenue across all geographic segments during 2004, 2005 and 2006, respectively. At December 31, 2005 and 2006 these customers represented 4%, 18% and 2% and 17%, 2% and 17%, respectively, of the Company's accounts receivable.

**11. Commitments and contingencies**

*Operating leases*

The Company leases manufacturing equipment and office space under various non-cancellable operating leases. Minimum future payments under non-cancellable operating lease agreements are as follows:

2007	\$ 1,739
2008	1,343
2009	1,178
2010	1,210
2011	1,194
Thereafter	<u>3,386</u>
<b>Total</b>	<b><u>\$ 10,050</u></b>

Operating lease expense for the years ended December 31, 2004, 2005 and 2006 was \$4,097, \$1,878 and \$2,192 respectively.

Certain of the Company's facility leases include renewal options and normal escalation clauses. Renewal options are included in the lease term if reasonably assured. Escalation clauses are accounted for on a straight-line basis over the lease term. The Company has posted a letter of credit in the amount of \$450 in favour of a facility landlord.

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

**12. Related Party**

A director of the Company is an Operating Partner of Bain Capital, LLC ("Bain Capital"). During 2006, Bain Capital or its affiliates acquired slightly less than 50% of the capital stock of MEI, Inc. ("MEI"), a customer of the Company. All transactions between the Company and MEI in 2006 were in the normal course of operations.

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**13. United States and Canadian accounting policy differences**

The consolidated financial statements of the Company have been prepared in accordance with U.S. GAAP. The significant differences between U.S. GAAP and Canadian GAAP and their effect on the consolidated financial statements of the Company are described below.

The following table reconciles net earnings (loss) under US GAAP as reported in the accompanying consolidated statements to net earnings (loss) under Canadian GAAP, and calculates earnings (loss) per share under Canadian GAAP:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
<b>Net earnings (loss) from continuing operations:</b>			
Under U.S. GAAP	\$ (219)	\$ (112)	\$ 9,587
Stock-based compensation expense (i)	(256)	(231)	—
Share of earnings (loss) attributed to minority interest (ii)	(194)	—	—
Restatement (iii)	122	(291)	—
Under Canadian GAAP	<u>\$ (547)</u>	<u>\$ (634)</u>	<u>\$ 9,587</u>
<b>Net earnings (loss) from discontinued operations</b>	<b>\$ 837</b>	<b>\$ —</b>	<b>\$ 874</b>
<b>Earnings (loss) per share under Canadian GAAP</b>			
Basic earnings (loss) per common share:			
—From continuing operations	\$ (0.09)	\$ (0.07)	\$ 0.73
—From discontinued operations	<u>\$ 0.13</u>	<u>\$ —</u>	<u>\$ 0.07</u>
Diluted earnings (loss) per common share:			
—From continuing operations	\$ (0.09)	\$ (0.07)	\$ 0.64
—From discontinued operations	<u>\$ 0.08</u>	<u>\$ —</u>	<u>\$ 0.06</u>
<b>Weighted average number of shares outstanding under Canadian GAAP</b>			
Basic	6,423,175	9,707,829	13,186,328
Diluted	10,943,763	9,707,829	15,025,047

Net earnings (loss) under Canadian GAAP are comprised of the following:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
Operating earnings	\$ 4,674	\$ 3,399	\$13,021
Interest expense	(4,521)	(4,589)	(5,395)
Earnings (loss) from continuing operations before income taxes and non-controlling interest	153	(1,190)	7,626
Income taxes (expense) recovery	(506)	556	1,961
Non-controlling interest	(194)	—	—
Earnings (loss) from continuing operations	<u>(547)</u>	<u>(634)</u>	<u>9,587</u>
Earnings (loss) from discontinued operations	837	—	874
Net earnings (loss)	<u>290</u>	<u>(634)</u>	<u>10,461</u>

**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**13. United States and Canadian accounting policy differences (Continued)**

The following table reconciles shareholders' equity as reported in the accompanying consolidated financial statements under US GAAP to shareholders' equity under Canadian GAAP:

	<u>2004</u>	<u>2005</u>	<u>2006</u>
<b>Shareholders' Equity</b>			
Under U.S. GAAP	\$14,134	\$14,022	\$23,891
Stock-based compensation expense (i)	(256)	(487)	(487)
Restatement (iii)	(405)	(696)	—
<b>Under Canadian GAAP</b>	<u>\$13,473</u>	<u>\$12,839</u>	<u>\$23,404</u>

The following accounting pronouncements differ in application under US GAAP and Canadian GAAP.

(i) *Stock-based compensation:*

In November 2001, the CICA issued Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments" ("Section 3870"), which was revised in November 2003. Section 3870 establishes standards for the recognition, measurement, and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services and applies to transactions, including non-reciprocal transactions, in which an enterprise grants common shares, stock options or other equity instruments, or incurs liabilities based on the price of common shares or other equity instruments. Section 3870 outlined a fair value based method of accounting required for stock-based transactions, effective January 1, 2002 and applied to awards granted on or after that date and was effective January 1, 2004.

In accordance with transitional rules, the Company adopted this change in accounting policy on a retroactive basis for options granted during the period from January 1, 2002 to December 31, 2003 without restating prior periods. Consequently, the January 1, 2004 opening deficit was increased by \$328 to reflect the cumulative impact of the adoption of CICA 3870 to December 31, 2003, with an offsetting credit to additional paid-in capital. As a result, there was no net effect on shareholders' equity at December 31, 2003. Stock-based compensation expense related to stock option grants of \$256 and \$231 would have been recorded in the years ended December 31, 2004 and 2005, respectively, for Canadian GAAP purposes.

Under US GAAP for the years ended December 31 2004 and 2005, the Company was required to calculate and disclose pro forma information related to the fair value of stock-based compensation, but was not required to record a related stock-based compensation expense. The differences between proforma disclosures in 2004 and 2005 and the expense recorded for Canadian GAAP purposes is a result of the Canadian GAAP expense representing grants from 2002 onwards. For US GAAP pro forma purposes all grants related to outstanding stock options were included in the fair value calculations.

Effective January 1, 2006, the Company adopted SFAS 123R which required the measurement and recognition of compensation expense for all stock-based awards made to employees and directors based on the grant date fair value of those awards using a fair value based method prospectively for all outstanding awards. SFAS 123R also required the company to estimate forfeitures for all outstanding stock options. As a result of the adoption of SFAS 123R, the expense recorded under both Canadian and US GAAP was \$187 for the year ended December 31, 2006.

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**13. United States and Canadian accounting policy differences (Continued)**

*(ii) Exchangeable shares:*

Effective for periods ending on or after June 30, 2005, as a result of the Emerging Issues Committee Abstract No. 151, Exchangeable Securities Issued by Subsidiaries of Income Trusts ("EIC-151"), Canadian GAAP requires companies to present exchangeable securities as liabilities or minority interest rather than within equity.

Based on the characteristics of the Company's exchangeable shares, the Company has classified them as non-controlling interest for Canadian GAAP purposes, in accordance with EIC-151. Consequently, the Company has reduced the loss recorded in 2003 and the income recorded in 2004 by the share of income or loss attributable to the non-controlling interest for Canadian GAAP purposes. As of December 31, 2004, the balance of the non-controlling interest under Canadian GAAP had been reduced to nil as a result of the conversion of exchangeable shares to common stock and the allocation of the non-controlling interest share of losses and deficit in current and prior years. Under Canadian GAAP, if the non-controlling interest balance had not been reduced to nil, it would be presented between liabilities and shareholders' equity on the balance sheet.

As the exchangeable shares are considered non-controlling interest for Canadian GAAP purposes, they are excluded from the basic earnings per share denominator. Diluted earnings per share are calculated as though the exchangeable shares had been converted at the beginning of each period presented.

*(iii) Restatement:*

As disclosed in Note 2, the Company recorded a cumulative adjustment to increase the opening deficit in 2006 related to the correction of misstatements arising in prior years on the adoption of SAB 108 under US GAAP. Under Canadian GAAP, the Company is required to reflect each correction as a restatement in the period to which it relates. The opening deficit in 2004 has been decreased by \$527 to reflect the correction of an error in years prior to 2004 related to the amortization of leasehold improvements. The impact of the correction of the items disclosed in note 2 on the loss from continuing operations in 2004 and 2005 are a decrease of \$122 and an increase of \$291, respectively.

*Recent Canadian Accounting Pronouncements*

*(i) Non-monetary transactions:*

In 2005, the CICA issued Handbook Section 3831, Non-monetary Transactions, ("CICA 3831"), replacing Section 3830, Non-monetary Transactions. CICA 3831 requires that an asset exchanged or transferred in a non-monetary transaction must be measured at its fair value except when (a) the transaction lacks commercial substance; (b) the transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange; (c) neither the fair value of the asset received nor the fair value of the asset given up is reliably measurable; or (d) the transaction is a non-monetary, non-reciprocal transfer to owners that represents a spin-off or other form of restructuring or liquidation.

In these cases, the transaction must be measured at the carrying value. The new requirements were effective for transactions occurring on or after January 1, 2006. This new standard, which is consistent with US GAAP, has not had a material impact on the Company's consolidated financial statements under Canadian GAAP.

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**SMTC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Expressed in thousands of US dollars, except numbers of shares and per share amounts)**

**13. United States and Canadian accounting policy differences (Continued)**

(ii) Accounting changes:

In 2006, the CICA issued Handbook Section 1506, Accounting Changes ("CICA 1506"). CICA 1506 prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors. This new standard, which is consistent with US GAAP, is required to be adopted by the Company on January 1, 2007 and is not expected to have a material impact on the Company's consolidated financial statements.

(iii) Financial instruments:

In 2005, the CICA issued Handbook Section 3855, Financial Instruments—Recognition and Measurement, Handbook Section 1530, Comprehensive Income, Handbook Section 3251, Equity, and Handbook Section 3865, Hedges. The new standards are effective for the Company's financial statements commencing January 1, 2007.

Under these standards, all of the Company's financial assets will be classified as loans and receivables, which, along with all financial liabilities, will be carried at amortized cost using the effective interest method. Upon adoption, the Company has determined that none of its financial assets will be classified as available for sale, held-for-trading or held-to-maturity and none of its financial liabilities will be classified as held-for-trading.

All derivatives, including embedded derivatives that must be separately accounted for, will be measured at fair value, with changes in fair value recorded in the consolidated statements of income unless they are effective cash flow hedging instruments. The Company is currently assessing the impact of the requirement to recognize embedded derivatives and non-financial derivatives at fair value under Canadian GAAP. The Company does not currently enter into hedging activities.

Effective January 1, 2007, under Canadian GAAP, the Company is required to adopt an accounting policy to either expense financing fees as incurred or to add them to the amortized cost of the related financial instruments and amortize them using the effective interest method.

In 2006, the CICA issued Handbook Section 3862, Financial Instruments—Disclosures, and Handbook Section 3863, Financial Instruments—Presentation. These new standards will be effective for the Company beginning January 1, 2008. The Company is currently assessing the impact of adopting these two new standards under Canadian GAAP.

(iv) Capital disclosures:

In 2006, the CICA issued Handbook Section 1535, Capital Disclosures ("CICA 1535"). CICA 1535 requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital including disclosures of any externally imposed capital requirements and the consequences for non-compliance. The new standard will be effective for the Company beginning January 1, 2008. The Company is currently assessing the impact of adopting this new standard under Canadian GAAP.

March 28, 2007

SMTC Manufacturing Corporation of California  
2302 Trade Zone Boulevard  
San Jose, California  
USA  
95131

- and -

SMTC Manufacturing Corporation of Massachusetts  
109 Constitution Blvd.  
Unit 160  
Franklin, Massachusetts  
USA

Attention: Jane Todd

Dear Sirs/Mesdames:

**Re: Wachovia Capital Corporation (Central) and SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc.**

Reference is made to a Loan Agreement dated as of June 1, 2004 as amended March 10, 2005, August 17, 2005, June 12, 2006, August 1, 2006 and September 20, 2006 (the "**Loan Agreement**") between SMTC Manufacturing Corporation of California, SMTC Manufacturing Corporation of Wisconsin, SMTC Manufacturing Corporation of Massachusetts and SMTC Mex Holdings, Inc., as borrowers ("**Borrowers**"), and Congress Financial Corporation (Central), now known as Wachovia Capital Finance Corporation (Central), as lender ("**Lender**"). All capitalized terms used in this notice of extension but not defined herein have the meanings given to such terms in the Loan Agreement.

Borrowers are hereby given notice that Lender has agreed to extend the Renewal Date of the Loan Agreement to April 15, 2008. All other terms and conditions of the Loan Agreement remain in full force and effect, unamended. Borrowers agree to pay to Lender an early termination fee equal to 0.50% of the US Maximum Credit if the Loan Agreement is terminated prior to October 15, 2007.

Yours very truly,

**WACHOVIA CAPITAL FINANCE  
CORPORATION (CENTRAL)**

By: /s/ Darrell Kay

Name: Darrell Kay

Title: Vice President

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The undersigned Borrowers hereby acknowledge receipt of the foregoing notice of extension of the Loan Agreement and agree to same.

Dated this 28<sup>th</sup> day of March, 2007.

**SMTC MANUFACTURING  
CORPORATION OF CALIFORNIA**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC MANUFACTURING  
CORPORATION OF MASSACHUSETTS**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC MANUFACTURING  
CORPORATION OF WISCONSIN**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC MEX HOLDINGS, INC.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

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Echo f the undersigned Obligor hereby:

- (a) acknowledges, confirms and agrees that such Obligor's Financing Agreements (as each of the same may have been amended, modified, supplemented, extended, renewed, restated or replaced) remain in full force and effect as at the date hereof in respect of each of the Borrower's Obligations under the Loan Agreement, as renewed/extended as herein provided; and
- (b) acknowledges and confirms that such Obligor has received a copy of the Loan Agreement and this notice of extension and understands the terms thereof.

Dated this 28<sup>th</sup> day of March, 2007.

**SMTC CORPORATION**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**HTM HOLDINGS, INC.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC DE CHIHUAHUA, S.A. DE C.V.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC MANUFACTURING  
CORPORATION OF NORTH CAROLINA**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**RADIO COMPONENTES DE MEXICO,  
S.A. DE C.V.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

March 28, 2007

SMTC Manufacturing Corporation of Canada  
Societe de Fabrication SMTC du Canada  
635 Hood Road  
Markham, Ontario  
L3R 4N6

Attention: Jane Todd

Dear Sirs/Mesdames:

**Re: Wachovia Capital Finance Corporation (Canada) and SMTC Manufacturing Corporation of Canada/Societe de Fabrication SMTC du Canada**

Reference is made to a Loan Agreement dated as of June 1, 2004 as amended March 10, 2005, August 17, 2005, June 12, 2006, August 1, 2006 and September 20, 2006 (the "**Loan Agreement**") between SMTC Manufacturing Corporation of Canada/Societe de Fabrication SMTC du Canada, as borrower ("**Borrower**"), and Congress Financial Corporation (Canada), now known as Wachovia Capital Finance Corporation (Canada), as lender ("**Lender**"). All capitalized terms used in this notice of extension but not defined herein have the meanings given to such terms in the Loan Agreement.

Borrower is hereby given notice that Lender has agreed to extend the Renewal Date of the Loan Agreement to April 15, 2008. All other terms and conditions of the Loan Agreement remain in full force and effect, unamended. Borrowers agree to pay to Lender an early termination fee equal to 0.50% of the Canadian Maximum Credit if the Loan Agreement is terminated prior to October 15, 2007.

Yours very truly,

**WACHOVIA CAPITAL FINANCE  
CORPORATION (CANADA)**

By: /s/ Darrell Kay

Name: Darrell Kay

Title: Vice President

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The undersigned Borrower hereby acknowledges receipt of the foregoing notice of extension of the Loan Agreement and agree to same.

Dated this 28<sup>th</sup> day of March, 2007.

**SMTC MANUFACTURING  
CORPORATION OF CANADA/SOCIETE  
DE FABRICATION SMTC DU CANADA**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

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Each of the undersigned Obligors hereby:

- (a) acknowledges, confirms and agrees that such Obligor's Financing Agreements (as each of the same may have been amended, modified, supplemented, extended, renewed, restated or replaced) remain in full force and effect as at the date hereof in respect of each of the Borrower's Obligations under the Loan Agreement, as renewed/extended as herein provided; and
- (b) acknowledges and confirms that such Obligor has received a copy of the Loan Agreement and this notice of extension and understands the terms thereof.

Dated this 28<sup>th</sup> day of March, 2007.

**SMTC NOVA SCOTIA COMPANY**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC MANUFACTURING CORPORATION OF WISCONSIN**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC CORPORATION**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**HTM HOLDINGS, INC.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC DE CHIHUAHUA, S.A. DE C.V.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**940862 ONTARIO INC.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC MEX HOLDINGS, INC.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**SMTC MANUFACTURING CORPORATION OF NORTH CAROLINA**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**RADIO COMPONENTES DE MEXICO, S.A. DE C.V.**

By: /s/ Jane Todd  
Name: Jane Todd  
Title: SVP Finance & CFO

**EMPLOYMENT AGREEMENT**

Employment Agreement made as of the 30<sup>th</sup> day of March 2007.

**BETWEEN:**

**SMTC MANUFACTURING CORPORATION OF CANADA,**  
a corporation amalgamated under the laws of Ontario

(hereinafter called the "Corporation")

- and -

**JOHN CALDWELL,**

(hereinafter called the "Executive")

**WHEREAS** the Executive was employed as the President and Chief Executive Officer of the Corporation and certain of its Affiliates (as this term is defined in the *Ontario Business Corporations Act*) on an interim beginning on October 16, 2003.

**WHEREAS** the Corporation and the Executive entered into a written employment agreement that came into effect on February 7, 2005 (the "Effective Date"), setting out the compensation to be paid to the Executive and all other matters relating to his employment with the Corporation and certain of its Affiliates;

**WHEREAS** the Corporation and the Executive have now agreed to new terms of employment;

**NOW THEREFORE** in consideration of the mutual covenants and agreements contained herein, the Corporation and the Executive hereby agree as follows:

**ARTICLE 1 - TERM, POSITION AND DUTIES**

**1.1 Term.** The employment of the Executive shall be continued for an indefinite period.

**1.2 Position.** The Executive shall serve as the President and Chief Executive Officer ("CEO") of the Corporation and certain of its Affiliates. The Executive is currently serving as Chair of the Board of Directors (the "Board") of SMTC Corporation and the Executive shall resign his position as Chair of the Board upon the request of the Board but shall remain as a board member.

**1.3 Duties.** The Executive shall perform such duties as are regularly and customarily performed by a Chief Executive Officer of a corporation, and in particular, shall be responsible for making all day to day general operating decisions within agreed long term strategic and annual business plans and within policy guidelines of the Corporation as established from time to time. The Executive shall report to the Board.

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## ARTICLE 2 - THE EXECUTIVE'S OBLIGATIONS

**2.1 Full Time and Effort.** Throughout his term of employment, the Executive shall devote his full time, effort and attention to the affairs of the Corporation and its Affiliates (the "Business"). The Executive shall not, without the prior approval of the Board accept any other employment, with the sole exception of the directorships which the Executive currently holds and has disclosed to the Board. and further, except in the capacity of an investor of money and so long as such monetary investment does not require any active involvement or otherwise affect the conduct of the Executive's duties and responsibilities of employment as set forth in this Agreement.

**2.2 Non-Competition.** The Executive recognizes and understands that, in performing his duties and obligations as a principal officer of the Corporation and its Affiliates and hereunder, he will occupy a position of high fiduciary trust and confidence, pursuant to which he will develop and acquire wide experience and knowledge with respect to the Business. It is the expressed intent and agreement of the Executive and the Corporation that such knowledge and experience shall be used solely and exclusively in the furtherance of the business interests of the Corporation and its Affiliates and not in any manner that would be detrimental to any of them.

The Executive therefore agrees that so long as he is employed by the Corporation or any of its Affiliates the Executive will not, without the prior written consent of the Board, engage in any undertaking or have any financial interest in any person or entity which competes with the Corporation or any of its Affiliates. If this Agreement is terminated for any reason whatsoever, this obligation shall continue during the Restricted Period.

Notwithstanding the foregoing, nothing shall prevent the Executive from owning an investment in securities listed on a stock exchange in Canada or the U.S.A. so long as those securities do not represent more than 2% of the issued securities of any class of any company which competes with the Corporation or any of its Affiliates.

For the purposes of this Agreement, the "Restricted Period" shall mean the period during which the Executive is employed by the Corporation or any of its Affiliates and for a twenty-four (24) month period commencing immediately after he ceases to be an employee of the Corporation or any of its Affiliates (including without limitation by reason of the termination of this Agreement by the Executive or the resignation of the Executive).

**2.3 Non-Solicitation.** During his employment with the Corporation or any of its Affiliates, and during the Restricted Period, the Executive will not, without the prior written consent of the Board:

- (a) canvass or solicit or endeavour to canvass or solicit whether directly or indirectly, any customer in which the Corporation or any of its Affiliates is selling or providing products or services at the time the Executive ceases to be an employee of the Corporation for the purpose of selling to that customer any products or services which are the same or substantially similar to products or services sold by the Corporation or any of its Affiliates; or

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- (b) entice, solicit or endeavour to entice or solicit any officer, employee, contractor, agent or consultant of the Corporation or any of its Affiliates away from employment with or engagement by the Corporation or any of its Affiliates, whether or not such person would commit a breach of contract by reason of leaving such service.

For the purposes of this Section, “customer” shall mean any person to whom the Corporation or any of its Affiliates sells or provides products or services at the time the Executive ceases to be an employee, or within six (6) months prior thereto, or with whom the Corporation or any of its Affiliates is in negotiation at the time the Executive’s employment is terminated, with a view to selling or providing goods or services to such person.

**2.4 Non-Disclosure of Confidential Information.** The Executive acknowledges that, in the course of performing and fulfilling his duties and obligations he will have access to, and will continue to be entrusted with, confidential information concerning the activities, business operations, customers and clients of the Corporation and its Affiliates which information is not generally known in the industry in which the Corporation and its Affiliates do business (“Confidential Information”) and that the disclosure of any Confidential Information to competitors of the Corporation and any of its Affiliates or to other persons would be highly detrimental to the interests of the Corporation and its Affiliates. Confidential Information does not include information that is and/or becomes generally available to the public other than due to a breach of this Agreement. The Executive further acknowledges and agrees that the right to maintain confidential such Confidential Information is a proprietary right that the Corporation is entitled to protect. Accordingly, the Executive covenants and agrees with the Corporation that (i) he will not during his employment by the Corporation or any of its Affiliates disclose any such Confidential Information to any person, nor shall he use the same, except as required in the normal course of his employment by the Corporation or any of its Affiliates and (ii) after the termination or expiration of his employment by the Corporation or any of its Affiliates, he will not disclose or make any use of Confidential Information without the prior written consent of the Corporation and its Affiliates.

**2.5 Inventions.** The Executive agrees that all right, title and interest in and to any information, trade secrets, inventions, discoveries, improvements, research materials and products made or conceived by the Executive alone or with others during the course of the Executive’s employment or relating to the business or affairs of the Corporation shall belong exclusively to the Corporation. The Executive hereby waives in favour of the Corporation any and all copyright and moral rights, and assigns to the Corporation any and all legal rights, that the Executive may have in respect of any such materials. The Executive agrees to execute any assignments and/or acknowledgements as may be requested by the Corporation from time to time, at the expense of the Corporation including for patent, copyright and industrial design registration, without any further remuneration.

**2.6 Acknowledgement and Agreement.** The Executive acknowledges that the restrictive covenants contained in Sections 2.2, 2.3, 2.4, and 2.5 above have been considered by the Executive and that the restraints and restrictions on his future activities are reasonable in the circumstances. The Executive agrees that, in addition to any other remedies at law which the Corporation may have (which other remedies the Executive acknowledges to be inadequate to protect the Corporation’s legitimate interests), the Corporation shall be entitled to injunctive relief in the event of a breach of Sections 2.2, 2.3, 2.4, and/or 2.5 above.

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**2.7 Scope of Application.** The foregoing restrictions shall apply to any action taken by the Executive, directly or indirectly, alone or in concert or in partnership with others, whether as an agent, representative, principal, shareholder, employee, consultant, director or in any other capacity.

### ARTICLE 3 - COMPENSATION

**3.1 Annual Base Salary.** The Corporation shall pay to the Executive an aggregate base salary (the "Base Salary") effective April, 2007 of CDN\$504,000 per annum, payable in equal instalments every two weeks, subject to such payroll and withholding deductions as may be required by law. The Base Salary may be increased from time to time in the sole discretion of the Board, and upon the recommendation of the Compensation Committee.

**3.2 Short Term Bonus Award.** The Executive shall be entitled to receive a short-term bonus award in the sole discretion of the Board and in accordance with the Corporation's Short Term Bonus Plan, which is to be as established by the Board. No Short Term Bonus shall be payable in the circumstances described in Sections 4.2 and 4.4.

**3.3 Long Term Incentive Award.** The Executive shall participate in the 2000 Equity Plan (or any successor plan) that the Board has adopted on such terms and conditions as the Board shall determine. For greater certainty, in the event of a change of control other than that which is defined in the Plan, any unvested options that were granted prior to the change of control, shall continue to vest in accordance with the vesting period in the Plan and the options shall expire at the earlier of the original expiration date and five years following the date of the change of control.

**3.4 Benefits.** The Corporation (or a U.S. subsidiary) shall provide the Executive with health, dental, and disability benefits and insurance coverage, consistent with the benefits coverage provided to senior executives of the Corporation. In addition, the Corporation shall reimburse the Executive for professional dues, to a maximum of Cdn\$1,500 per year, upon the provision of an appropriate receipt.

**3.5 Reimbursement of Expenses.** The Executive shall be entitled to reimbursement of all reasonable business expenses incurred in good faith upon presentation of appropriate invoices, receipts and other requested documentation, provided that such receipts are submitted within a reasonable period.

**3.6 Automobile Allowance.** The Corporation shall provide the Executive with a reasonable automobile allowance.

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**3.7 Vacation.** The Executive shall be entitled to receive the following vacation entitlements:

- (a) The Executive shall be entitled to receive nineteen (19) paid vacation days that were earned but not taken as of September 29, 2004. The Executive agrees to use best efforts to use some of this vacation entitlement during the 2005 calendar year. For any remaining vacation time accorded, but not taken at December 31, 2005, the Corporation shall pay the Executive the remaining vacation entitlement.
- (b) For the period from September 29, 2004 to December 31, 2004, the Executive was entitled to five days paid vacation time-off. The Executive agreed to use his best efforts to use some of this vacation entitlement during this period and the Executive agreed that any remaining vacation time-off that was not used by the end of the 2004 calendar year was forfeited and that the Corporation paid the Executive any remaining vacation pay on or before December 31, 2005.
- (c) For calendar year 2005 and all future years following calendar year 2005, the Executive shall be entitled to four weeks paid vacation time-off for each calendar year. Such vacation must be taken within the year it is accrued. Any remaining vacation time-off that is not taken in a calendar year will be forfeited and the vacation pay will not be paid out at the end of that year. The Executive agrees and acknowledges that this vacation entitlement constitutes a "greater right or benefit" for the purposes of the *Employment Standards Act, 2000*, and that therefore, this provision is not in breach of the vacation pay provisions as contained in the *Employment Standards Act, 2000*.

#### **ARTICLE 4 - TERMINATION**

**4.1 Termination for Cause.** Notwithstanding the provisions of Section 1.1 hereof, the Corporation may terminate the employment of the Executive hereunder for cause (as defined herein) by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice. If the Corporation exercises its rights under this Section to terminate the Executive's employment hereunder, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder from and after the effective date of termination of this Agreement other than those obligations which have accrued and are payable pursuant to Article 3.

**4.2 Termination Without Cause.** The Corporation may terminate the employment of the Executive without cause in which case the Corporation will provide the Executive a lump sum payment, less applicable statutory deductions, equivalent to two times the aggregate Base Salary plus the target bonus payable under the Short Term Bonus Plan. If the Corporation exercises its rights under this Section 4.2 to terminate the Executive's employment hereunder, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder from and after the date the payment is made except for any entitlement in Deferred Share Units and any vesting of options pursuant to Section 3.3. Following such termination, the Executive shall not be required to be available to work for the Corporation and may have other activities, subject to the restrictions provided in Article 2, but excluding Section 2.1. Further, other work done by the Executive during the Restricted Period that adheres to the requirements of Section 2.2, Section 2.3, and Section 2.4 shall not be considered work during the course of the Executive's employment with the Corporation and, thus, Section 2.5 will not apply.

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**4.3 Termination by the Executive.** The Executive may terminate this Agreement by providing written notice to the Board specifying the effective date of termination (not to be more than three months after the date of the written notice). The Corporation may elect to deem any date prior to the date specified in the notice as the effective date of termination in which event the Executive shall receive payment of all amounts which would have been due during the remainder of the notice period provided by the Executive, to a maximum of three (3) months. The Executive shall not be entitled to receive any further remuneration or payments of any kind or nature from and after the effective date of termination, unless the parties agree otherwise except for any entitlement in Deferred Share Units.

**4.4 Change of Control.** In the event of a Change of Control (as defined below), and if within six months following the Change of Control, the Executive is terminated without cause or is constructively dismissed, the Executive shall be deemed to have been terminated without cause under Section 4.2 of this Agreement, and entitled to receive all payments in accordance with Section 4.2.

For the purposes of this Agreement, Change of Control means immediately after any of the following occurrences:

- (a) the acquisition, directly or indirectly and by any means whatsoever, by any one shareholder, or group of shareholders acting jointly or in concert, of more than 50% of the outstanding voting shares of SMTC Corporation; or
- (b) a sale by the SMTC Corporation (in one or more transactions) of all or substantially all of its assets to an unrelated third party, or other liquidation or dissolution; or
- (c) a merger, consolidation, arrangement or other reorganization of SMTC Corporation which results in the SMTC Corporation's shareholders owning less than 50% of the voting shares of the resulting entity.

**4.5 Disability.** In the event that the Executive is Totally Disabled (as defined below) provided that the Corporation ensures that he is in receipt of long-term disability benefits, the Corporation shall be entitled to terminate the employment of the Executive by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice, provided further that such termination does not affect in any way the Executive's right to receive disability insurance benefits. In the event of a termination of employment under these circumstances, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder from and after the effective date of termination of this Agreement except for (i) any entitlement in Deferred Share Units, and (ii) termination and severance pay in accordance with the *Employment Standards Act, 2000*.

For the purposes of this section, "Totally Disabled" means any physical or mental incapacity, disease or affliction, as determined by a legally qualified medical practitioner mutually agreed to by the Board and the Executive, which prevents the Executive from performing the essential duties of his position for a continuous period of six (6) months or any cumulative period of six months in any 12 consecutive months.

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In the event that the Executive is totally disabled for a period of less than six (6) months, he shall be entitled to receive all remuneration, payments and rights including, without limiting the generality of the foregoing, all benefits provided for under this Agreement, during this period, as if he were regularly and fully employed.

**4.6 Resignation.** If the Executive is a director or officer at the time of the termination of this agreement for any reason whatsoever, the Executive agrees that he shall resign from any position he may hold as an officer or director of the Corporation or any of its Affiliates, unless otherwise agreed to by the Board and the Executive.

**4.7 Inclusive.** The Executive agrees that all payments under this Article 4 are inclusive of any and all payments that may be owed to the Executive upon termination, including termination and severance pay under the *Employment Standards Act, 2000*, and pay in lieu of reasonable notice under the common law.

**4.8 Cause.** For the purposes of section 4.1 of this Agreement, the term “cause” shall mean:

- (a) any “cause” at law; or
- (b) gross negligence, material breach of fiduciary duty, or material breach of any of the non-competition, non-solicitation, confidentiality, or inventions provisions as contained in sections 2.2, 2.3, 2.4, and 2.5 of this Agreement; or
- (c) any conviction of the Executive under any local, provincial or federal statute which makes the performance of his duties hereunder impracticable or impossible; or
- (d) any conviction of an indictable criminal offence which in the Board’s view, may harm the reputation of the Corporation; or
- (e) any misconduct, gross incompetence or conduct incompatible with the Executive’s duties, or prejudicial to the Corporation’s business; or
- (f) any insubordination or willful disobedience to the lawful directions of management of the Corporation; or
- (g) any material breach of this agreement; provided, however, that the Executive shall first be counselled as to the standard of conduct required in the circumstances (as determined in the reasonable discretion of the Board) and the Executive shall be entitled to a 30 day period thereafter (or such longer period of time as the Board in its sole discretion may allow) to remedy the impugned conduct.

**4.9 Privatization.** In the event that SMTC Corporation’s common shares cease to be publicly traded or SMTC Corporation ceases to be an SEC registrant (except by reason of a change of control where the Executive continues as the President and Chief Executive Officer of a successor public company), the Executive may at his option, deem his employment to have been terminated without cause under Section 4.2 of this Agreement, and in which case he will be entitled to receive all payments in accordance with Section 4.2.

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**ARTICLE 5 - MISCELLANEOUS**

**5.1 Binding Agreement.** This Agreement shall be binding on the parties hereto and its successors in interest and assigns.

**5.2 Notices.** Any notice or other communication required or permitted to be given or made hereunder shall be in writing and shall be sufficiently given or made if:

- (a) enclosed in a sealed envelope and delivered in person or by courier to the party hereto to whom it is addressed (or, in the case of the Corporation, to the receptionist or other responsible employee) at the relevant address set forth below; or
- (b) telexed, telegraphed, telecopied or sent by other means of recorded electronic communication;

if to the Corporation, addressed to:

SMTC Manufacturing Corporation of Canada  
625 Hood Road  
Markham, Ontario  
L3R 4N6

Attention: Chair of Board of Directors  
Telecopy: 905-479-1877

with a copy to:

Goodmans, LLP  
250 Yonge Street, Box 24  
Toronto, Ontario  
M5B 2M6

Attention: Celia Rhea  
Telecopy: (416) 979-1234

and if to the Executive, addressed to:

26 York Ridge Road  
Toronto, Ontario  
M2P 1R7

Any notice or other communication so given or made shall be deemed to have been given or made and to have been received on the day of delivery, if delivered in person or by courier, and on the day of sending, if sent by telex, telegraph, telecopy or other means of recorded electronic communication (provided such delivery or sending is during normal business hours on a business day and, if not, then on the first business day thereafter). Any party hereto may change his or its address for notice by notice to the other party hereto given in the manner aforesaid.

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**5.3 Modification and Waivers.** No provision of this Agreement may be modified or amended unless such modification or amendment is agreed to in writing and signed by the Corporation and the Executive. No waiver by either party hereto of any breach by the other party hereto of any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the time or any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the employment of the Executive by the Corporation have been made by any party which are not set forth expressly in this Agreement.

**5.4 Entire Agreement.** This Agreement contains all the terms and conditions of the Executive's employment with the Corporation and supersedes all prior agreements and understandings.

**5.5 Law Governing.** This Agreement shall be subject to and governed by the laws of the Province of Ontario. The Executive agrees that he can only enforce this agreement in the Courts of the Province of Ontario (or the Courts of the location of the Corporation's head office).

**5.6 Submission to Arbitration.** It is hereby agreed that any dispute or controversy in connection with this Agreement, including its interpretation, will be conclusively settled by submission to arbitration (the "Arbitration") in accordance with the rules of arbitration of the *Arbitration Act* (Ontario) as amended from time to time. The Arbitration will be conducted before a single arbitrator mutually agreeable to the parties (the "Arbitrator"). Each party will be responsible for their own legal costs incurred at the Arbitration. The cost of the Arbitrator will be shared subject to SMTC's agreement to reimburse the Executive for share of the Arbitrator's costs in the event the Executive is largely successful at the Arbitration.

**5.7 Severability.** The invalidity, illegality or unenforceability of any provision hereof shall not in any way affect or impair the validity, legality or enforceability of the remaining provisions hereof.

**5.8 Headings.** The headings contained herein are for reference purposes only and shall not in any way affect the construction or interpretation of this Agreement.

**5.9 Independent Advice.** The Executive confirms having had the opportunity to obtain independent legal advice regarding this Agreement and that the Executive is signing this Agreement freely and voluntarily with full understanding of its contents.

**5.10 Successors.** This Agreement and all rights of the Executive hereunder shall enure to the benefit of and be enforceable by the Executive and his personal or legal representatives, heirs, executors, administrators and successors and shall enure to the benefit of and be binding upon the Corporation, its successors and assigns, subject to section 4.4.

**5.11 Taxes.** All payments under this Agreement shall be subject to withholding of such amounts, if any, relating to tax or other payroll deductions as the Corporation may reasonably determine and should withhold pursuant to any applicable law or regulation.

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**5.12 Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed to be an original but all of which together shall constitute one and the same instrument.

*\*\*The remainder of this page is intentionally left blank\*\**

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IN WITNESS WHEREOF the parties have executed this Agreement this 30<sup>th</sup> day of March, 2007, with effect as of March 30, 2007.

**SMTC MANUFACTURING CORPORATION OF CANADA**

Per: /s/ Stephen Adamson  
Authorized Signing Officer

/s/ John Calwell

**JOHN CALDWELL**

Witness

GOODMANS\MORRISOJ5126238.6

**EMPLOYMENT AGREEMENT**

Employment Agreement made as of the 30<sup>th</sup> day of March, 2007.

**BETWEEN :**

**SMTC Manufacturing Corporation**, a corporation incorporated under the laws of Ontario, Canada;

(hereinafter called the “Corporation”)

- and -

**Jane Todd**,

(hereinafter called the “Executive”)

**WHEREAS** the Executive is currently a Senior Vice President Finance, Chief Financial Officer;

**AND WHEREAS** the Corporation and the Executive wish to enter into a written employment agreement with respect to the compensation to be paid to the Executive and other matters relating to her employment with the Corporation;

**NOW THEREFORE** in consideration of the mutual covenants and agreements contained herein, the Corporation and the Executive hereby agree as follows:

**ARTICLE 1 – TERM, POSITION AND DUTIES**

**1.1 Term.** The employment commenced on July 5, 2004.

**1.2 Position.** The Executive shall serve as the Senior Vice President Finance, Chief Financial Officer of the Corporation. The Executive shall be based out of the Corporation’s head offices located in Markham, Ontario.

**1.3 Duties.** The Executive shall perform such duties as are regularly and customarily performed by the chief financial officer of a public corporation and in particular shall be responsible for leadership of the company-wide finance function. The Executive shall report directly to the President and Chief Executive Officer of the Corporation.

**ARTICLE 2 - THE EXECUTIVE’S OBLIGATIONS**

**2.1 Full Time and Effort.** Throughout her term of employment, the Executive shall devote her full time, effort and attention to the affairs of the Corporation and its Affiliates (the “Business”). The Executive shall not, without the prior approval of the President and Chief Executive Officer, accept any other employment or serve as a director, consultant or partner of any

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business or profit making enterprise or entity other than the Corporation and its Affiliates (the term “Affiliate” in this Agreement shall have the meaning ascribed thereto in the Business Corporations Act - Ontario) except in the capacity of an investor of money and so long as such monetary investment does not require any active involvement or otherwise affect the conduct of the Executive’s duties and responsibilities of employment as set forth in this Agreement.

**2.2 Non-Solicitation.** During her employment with the Corporation or any of its Affiliates, and during the eighteen (18) month period immediately following the cessation of the Executive’s employment for any reason whatsoever (with or without cause), the Executive will not, without the prior written consent of the Board:

- (a) canvass or solicit or endeavour to canvass or solicit whether directly or indirectly, any customer or prospective customer in Canada or the United States of America (“U.S.A.”) in which the Corporation or any of its Affiliates is selling or providing products or services at the time the Executive ceases to be an employee of the Corporation for the purpose of selling to that customer any products or services which are the same or substantially similar to products or services sold by the Corporation or any of its Affiliates; or
- (b) Entice, solicit or endeavour to entice or solicit any officer, employee, contractor, agent or consultant of the Corporation or any of its Affiliates away from employment with or engagement by the Corporation or any of its Affiliates, whether or not such person would commit a breach of contract by reason of leaving such service.

For the purposes of this Section, “customer” shall mean any person to whom the Corporation or any of its Affiliates sells or provides products or services at the time the Executive ceases to be an employee, or within six (6) months prior thereto, or with whom the Corporation or any of its Affiliates is in negotiation at the time the Executive’s employment is terminated, with a view to selling or providing goods or services to such person.

**2.3 Non-Disclosure of Confidential Information.** The Executive acknowledges that, in the course of performing and fulfilling her duties and obligations she will have access to, and will continue to be entrusted with, confidential information concerning the activities, business operations, customers and clients of the Corporation and its Affiliates which information is not generally known in the industry in which the Corporation and its Affiliates do business (“Confidential Information”) and that the disclosure of any Confidential Information to competitors of the Corporation and any of its Affiliates or to other persons would be highly detrimental to the interests of the Corporation and its Affiliates. Confidential Information does not include information that is and/or becomes generally available to the public other than due to a breach of this Agreement. The Executive further acknowledges and agrees that the right to maintain confidential such Confidential Information is a proprietary right that the Corporation is entitled to protect. Accordingly, the Executive covenants and agrees with the Corporation that (i) she will not during her employment by the Corporation or any of its Affiliates disclose any such Confidential Information to any person, nor shall she use the same, except as required in the normal course of her employment by the Corporation or any of its Affiliates and (ii) after the termination or expiration of her employment by the Corporation or any of its Affiliates, she will not disclose or make any use of Confidential Information without the consent of the Corporation and its Affiliates.

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**2.4 Acknowledgement and Agreement.** The Executive acknowledges that the restrictive covenants contained in this Article 2 above have been considered by the Executive and that the restraints and restrictions on her future activities are reasonable in the circumstances. The Executive agrees that any breach of these provisions will result in irreparable harm which cannot be quantified or adequately compensated by monetary damages alone. The Executive further agrees that, in addition to any other remedies at law that the Corporation may have (which other remedies the Executive acknowledges to be inadequate to protect the Corporation's legitimate interests), the Corporation shall be entitled to injunctive relief in the event of a breach of this Article 2. The Executive expressly waives all defences to such relief in the event of a breach of the restrictive covenants in this Article 2.

**2.5 Scope of Application.** The foregoing restrictions shall apply to any action taken by the Executive, directly or indirectly, alone or in concert or in partnership with others, whether as an agent, representative, principal, shareholder, lender, employee, consultant, director or in any other capacity.

### ARTICLE 3 - COMPENSATION

**3.1 Annual Base Salary.** The Corporation shall pay to the Executive an annual base salary (the "Base Salary") of CDN \$252,500.00, payable in equal instalments every two weeks, subject to such payroll and withholding deductions as may be required by Canadian law. The Base Salary may be increased from time to time at the sole discretion of the Board upon recommendation of the Compensation Committee.

**3.2 Short Term Incentive Award.** The Executive shall be entitled to receive a short-term bonus award in the sole discretion of the Board and in accordance with the Corporation's short Term Bonus Plan, as established by the Board. The annual target bonus shall be 50% of base salary, based upon achievement on financial performance targets approved by the Board of Directors and individual performance. No Short Term Bonus shall be payable in the circumstances described in Section 4.1 and 4.3.

**3.3 Long Term Incentive Award.** The Executive shall continue to be eligible to participate in the 2000 Equity Plan (or any successor plan) that the Board has adopted on such terms and conditions as the Board shall determine. For greater certainty, in the event of a change of control other than that which is defined in the Plan, any unvested options that were granted prior to the change of control, shall continue to vest in accordance with the vesting period in the Plan and the options shall expire at the earlier of the original expiration date and five years following the date of the change of control.

**3.4 Monthly Car Allowance.** The Executive shall be entitled to a monthly car allowance up to a maximum of Cdn. \$1,200 per month.

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**3.5 Benefits.** The Corporation shall provide the Executive with entitlement to the executive benefit program.

**3.6 Reimbursement of Expenses.** The Executive shall be entitled to reimbursement of all reasonable business expenses incurred in good faith upon presentation of appropriate invoices, receipts and other requested documentation.

**3.7 Vacation.** The Executive shall be entitled to four (4) weeks paid vacation each calendar year, and in accordance with the Corporation's vacation policy.

#### **ARTICLE 4 - TERMINATION**

**4.1 Termination for Cause.** The Corporation may terminate the employment of the Executive hereunder for cause (as such term is understood under applicable law) by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice ("termination date"). If the Corporation exercises its rights under this Section to terminate the Executive's employment hereunder, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder, including any bonus and long term incentive payments pursuant to Section 3.2 and 3.3, from and after the termination date other than those obligations that have accrued pursuant to Article 3.1 and 3.9.

**4.2 Termination Without Cause.** The Corporation may terminate the employment of the Executive with salary continuance of the Executive's then current annual base salary in circumstances which do not constitute cause, in which case the Corporation shall provide the Executive with twelve (12) months plus one (1) month for every completed year of active employment beyond twelve (12) years of service (to a maximum of 18 months), provided that the Executive continues to abide by the non-solicitation, and confidentiality provisions set out in Sections 2.2 and 2.3. If the Corporation exercises its rights under this Section 4.2 to terminate the Executive's employment hereunder, with the exception of the payments aforementioned in this Section 4.2, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder, save and except any vesting of options pursuant to Section 3.3 and any relocation expenses in the event of a relocation to the United States as set out in Section 3.8. In the event that, prior to the end of the notice period, the Executive obtains alternative employment that provides total remuneration that is at least 75% of the Executive's total compensation as provided in Article 3, then the Corporation shall cease to provide the salary continuation but instead, shall provide the Executive with a lump sum payment, less applicable statutory deductions, that is equivalent to 50% of the remaining salary continuation payments that the Executive otherwise would have been entitled to receive.

**4.3 Termination by the Executive.** The Executive may terminate this Agreement by notice in writing specifying the effective date of termination (not to be less than three (3) months after the date of notice). The Corporation may elect to deem any date prior to the date specified in the notice as the effective date of termination in which event the Executive shall receive payment of her bi-weekly salary payments in accordance with Section 3.1 that would have been due during the remainder of the notice period provided by the Executive, to a maximum of 3 months.

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#### 4.4 Disability

- (a) For the purposes of this Section 4.4, "Partially or Totally Disabled" means any physical or mental incapacity, disease or affliction, as determined by a legally qualified medical practitioner, which prevents the Executive from performing the essential duties of her position.
- (b) In the event that the Executive is Partially or Totally Disabled for a period of six (6) months or less, she shall receive all remuneration including bonuses, payments and rights including, without limiting the generality of the foregoing, all benefits provided for under this Agreement, as if she were regularly and fully employed.
- (c) In the event that the Executive is Partially or Totally Disabled for a continuous period of more than six (6) months, the Corporation shall be entitled to terminate the employment of the Executive by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice. In the event of a termination of employment under these circumstances, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder from and after the effective date of termination of this Agreement, save and except termination and severance pay as required pursuant to the *Employment Standards Act, 2000* and continuing coverage under the Corporation's executive benefit program.
- (d) For greater certainty, in the event the Executive is Partially or Totally Disabled and the Corporation terminates her employment without cause before six (6) months have expired from the date she became totally disabled, Section 4.2 hereof shall apply.

**4.5 Resignation.** The Executive agrees that after termination of her employment with the Corporation pursuant to this Article 4, for any reason whatsoever, she will tender her resignation from any position she may hold as an officer or director of the Corporation or any of its Affiliates, unless otherwise agreed to by the Board and the Executive.

#### ARTICLE 5 - MISCELLANEOUS

**5.1 Binding Agreement.** This Agreement shall be binding on the parties hereto and its successors in interest and assigns.

**5.2 Notices.** Any notice or other communication required or permitted to be given or made hereunder shall be in writing and shall be sufficiently given or made if:

- (a) enclosed in a sealed envelope and delivered in person or by courier to the party hereto to whom it is addressed (or, in the case of the Corporation, to the receptionist or other responsible employee) at the relevant address set forth below; or

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(b) telexed, telegraphed, telecopied or sent by other means of recorded electronic communication;

if to the Corporation, addressed to:

SMTC - Headquarters

635 Hood Road

Markham, Ontario L3R 4N6 Canada

Attention: President and Chief Executive Officer

with a copy to:

Goodmans, LLP

250 Yonge Street, Box 24

Toronto, Ontario

M5B 2M6

Attention: Celia Rhea

Telecopy: (416) 979-1234

and if to the Executive, addressed to:

Jane Todd

153 Willis Drive

Aurora, ON

L4G 7M4

Any notice or other communication so given or made shall be deemed to have been given or made and to have been received on the day of delivery, if delivered in person or by courier, and on the day of sending, if sent by telex, telegraph, telecopy or other means of recorded electronic communication (provided such delivery or sending is during normal business hours on a business day and, if not, then on the first business day thereafter). Any party hereto may change her or its address for notice by notice to the other party hereto given in the manner aforesaid.

**5.3 Modification and Waivers.** No provision of this Agreement may be modified or amended unless such modification or amendment is agreed to in writing and signed by the Corporation and the Executive. No waiver by either party hereto of any breach by the other party hereto of any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the time or any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the employment of the Executive by the Corporation have been made by any party which are not set forth expressly in this Agreement.

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**5.4 Entire Agreement.** This Agreement contains all the terms and conditions of the Executive's employment with the Corporation and supersedes all prior agreements and understandings.

**5.5 Law Governing.** This Agreement shall be subject to and governed by the laws of the Province of Ontario. The Executive agrees that she can only enforce this Agreement in the Courts of the Province of Ontario (or the Courts of the location of the Corporation's head office). The Corporation may enforce this Agreement in any jurisdiction in which the Executive lives or carries on business.

**5.6 Severability.** The invalidity, illegality or unenforceability of any provision hereof shall not in any way affect or impair the validity, legality or enforceability of the remaining provisions hereof.

**5.7 Headings.** The headings contained herein are for reference purposes only and shall not in any way affect the construction or interpretation of this Agreement.

**5.8 Independent Advice.** The Executive confirms having had the opportunity to obtain independent legal advice regarding this Agreement and that the Executive is signing this Agreement freely and voluntarily with full understanding of its contents.

**5.9 Successors.** This Agreement and all rights of the Executive hereunder shall enure to the benefit of and be enforceable by the Executive and her personal or legal representatives, heirs, executors, administrators and successors and shall enure to the benefit of and be binding upon the Corporation, its successors and assigns.

**5.10 Taxes.** All payments under this Agreement shall be subject to withholding of such amounts, if any, relating to tax or other payroll deductions as the Corporation may reasonably determine and should withhold pursuant to any applicable law or regulation.

**5.11 Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed to be an original but all of which together shall constitute one and the same instrument.



**SMTC MANUFACTURING CORPORATION OF CANADA  
DEFERRED SHARE UNITS  
AGREEMENT**

In recognition of the important contributions that John Caldwell (the “Executive”) can make to the success of SMTC Corporation and its Affiliates, SMTC Manufacturing Corporation of Canada (the “Corporation”) hereby grants to the Executive the deferred share units award described below.

1. The Deferred Share Unit Award. The Corporation hereby grants to the Executive Thirty-six thousand four hundred twenty five (36,425) Units (the “Award”). A “Unit” is an amount equal to the Fair Market Value (as defined below) of a single share of Common Stock (as defined below) on the Grant Date (as defined below).

a. The Executive is not entitled to any dividends payable on the Common Stock.

b. The Award shall not be interpreted to bestow upon the Executive any equity interest or ownership in the Corporation or any Affiliate.

c. The Executive acknowledges that the Board of Directors of SMTC Corporation shall continue to manage SMTC Corporation as such Board of Directors deems appropriate, and that such Board of Directors is under no obligation to manage SMTC Corporation or take any action so as to maximize the value of the Award or avoid any diminution in value of the Award.

d. The Board of Directors, in its sole discretion, may make additional grants of Units to the Executive from time to time.

2. Definitions. The following definitions will apply for purposes of this Agreement.

a. “Affiliate” of any person means (a) any other person directly or indirectly owning, controlling, or holding with power to vote, five percent or more of the outstanding voting securities of such person, (b) any person five percent or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote, by such person and (c) any other person directly or indirectly controlling, controlled by, or under common control with, such person.

b. “Board of Directors” means the board of directors of SMTC Corporation.

c. “Cause” shall have the meaning as set forth in section 4.8 of the Employment Agreement.

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d. "Common Stock" means a share of common stock, \$0.01 par value per share, of SMTC Corporation.

e. "Employment Agreement" means the employment agreement between the Corporation and the Executive, dated February 7, 2004.

f. "Fair Market Value" means the closing price of the Common Stock for the day immediately preceding the Payment Date; *provided*, that if such day is not a trading day, fair market value shall mean the closing price of the Common Stock for the next preceding day which is a trading day. For this purpose, the "closing price" of the Common Stock on any trading day will be the last sale price with respect to such Common Stock, or, in case no such sale takes place on such day, the average of the high bid and low asked prices in the over-the-counter market with respect to such Common Stock, as reported by the National Association of Securities Dealers, Inc. Automated Quotation System or such other similar system then in use; or, if on any such date such Common Stock is not quoted by any such organization, the average of the closing bid and asked prices with respect to such Common Stock, as furnished by a professional market maker making a market in such Common Stock selected by the Board of Directors of SMTC Corporation in good faith; or, if no such market maker is available, the fair market value of such Common Stock as of such day as determined in good faith by the Board of Directors of SMTC Corporation.

g. "Grant Date" means the date on which this Agreement was executed as indicated on the signature page hereof.

h. "Payment Date" means a date determined by the Board of Directors in its sole discretion that is within sixty (60) days of the occurrence of a Termination Event, subject to adjustment pursuant to Sections 5b and 6 hereof.

i. "Termination Event" means the Executive's termination of employment by reason of death, disability, voluntary resignation with the Corporation and its Affiliates or termination of employment by the Corporation or its Affiliates other than for Cause.

3. Vesting. Subject to Section 5b, the entire Award shall be fully vested on the Grant Date.

4. Adjustments Based on Certain Changes in the Common Stock. In the event of any stock split, reverse stock split, stock dividend, recapitalization or similar change affecting the Common Stock, the Award shall be equitably adjusted.

5. Termination of Employment. On the Payment Date, the Corporation shall pay to the Executive the Fair Market Value of the Award in a single cash lump sum payment.

6. Change of Control. In the event that of a Change of Control (as defined in Section 4.4 of the Employment Agreement), a Termination Event will be deemed to have occurred on the date of the closing of the Change of Control (or series of transactions constituting the Change of Control), and the Payment Date shall be adjusted to be ten (10) days after such closing date.

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7. Determination by the Board of Directors. Any determination by the Board of Directors in its reasonable discretion concerning any provision hereto shall be binding upon the Corporation, SMTC Corporation, and the Executive.

8. Designation of Beneficiary. The Executive may designate or change the designation of a beneficiary or beneficiaries to receive any payment due hereunder upon his death by filing a written designation with the Corporation. The Corporation shall be bound by the last designation filed with it by the Executive. In the absence of such designation of a beneficiary by the Executive, or if no beneficiary so designated shall survive him, the Executive's beneficiary shall be his or her estate. Any amounts due hereunder payable to the beneficiary or beneficiaries shall be made on the same terms and shall be subject to the same conditions as if such amounts were paid to the Executive.

9. Employment Rights. This Deferred Share Units Agreement shall not create any right of the Executive to continued employment with the Corporation or its Affiliates or limit the right of Corporation or its Affiliates to terminate the Executive's employment at any time and shall not create any right of the Executive to employment with the Corporation or any of its Affiliates. Except to the extent required by applicable law that cannot be waived, the loss of the Award shall not constitute an element of damages in the event of termination of the Executive's employment even if the termination is determined to be in violation of an obligation of the Corporation or its Affiliates to the Executive by contract or otherwise.

10. Unfunded Status. The obligations of the Corporation and its Affiliates hereunder shall be contractual only and all such payments shall be made from the general assets of the Corporation or its Affiliates. The Executive shall rely solely on the unsecured promise of the Corporation and nothing herein shall be construed to give the Executive or any other person or persons any right, title, interest or claim in or to any specific asset, fund, reserve, account or property of any kind whatsoever owned by the Corporation or any Affiliate.

11. No Assignment. No right or benefit or payment under the Plan shall be subject to assignment or other transfer nor shall it be liable or subject in any manner to attachment, garnishment or execution.

12. Withholding. The Corporation and its Affiliates shall have the right to withhold from any payment made under this Deferred Share Units Agreement any U.S., Canadian, state, provincial, local or other taxes required by law to be withheld with respect to the payment.

13. Amendment or Termination. This Deferred Share Units Agreement may be amended by mutual written agreement of the parties; provided, however, that the Corporation may in its sole discretion deem a Termination Event to have occurred, terminate this Deferred Share Units Agreement and accelerate the payment of benefits hereunder.

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IN WITNESS WHEREOF, SMTC Manufacturing Corporation of Canada has executed this Deferred Share Units Agreement as of the 30<sup>th</sup> day of March, 2007.

SMTC MANUFACTURING CORPORATION OF  
CANADA

By: /s/ Stephen Adamson  
Title: Chairman of Compensation Committee

Acknowledged and agreed:

/s/ John Caldwell  
John Caldwell

SMTC CORPORATION

By: /s/ Stephen Adamson  
Title: Chairman of Compensation Committee

**EMPLOYMENT AGREEMENT**

Employment Agreement made as of the 30<sup>th</sup> day of March, 2007.

**BETWEEN:**

**SMTC Manufacturing Corporation**, a corporation  
incorporated under the laws of Ontario, Canada;

(hereinafter called the "Corporation")

- and -

**Steve Hoffrogge**,

(hereinafter called the "Executive")

**WHEREAS** the Executive is currently a Senior Vice President Business Development;

**AND WHEREAS** the Corporation and the Executive wish to enter into a written employment agreement with respect to the compensation to be paid to the Executive and other matters relating to his employment with the Corporation;

**NOW THEREFORE** in consideration of the mutual covenants and agreements contained herein, the Corporation and the Executive hereby agree as follows:

**ARTICLE 1 - TERM, POSITION AND DUTIES**

**1.1 Term.** The employment commenced on July 1, 1993.

**1.2 Position.** The Executive shall serve as the Senior Vice President Business Development of the Corporation. The Executive shall be based out of the Corporation's head offices located in Markham, Ontario.

**1.3 Duties.** The Executive shall perform such duties as are regularly and customarily performed by a senior executive of a public corporation and in particular shall be responsible for leadership of company-wide sales and marketing. The Executive shall report directly to the President and Chief Executive Officer of the Corporation.

**ARTICLE 2 - THE EXECUTIVE'S OBLIGATIONS**

**2.1 Full Time and Effort.** Throughout his term of employment, the Executive shall devote his full time, effort and attention to the affairs of the Corporation and its Affiliates (the "Business"). The Executive shall not, without the prior approval of the President and Chief Executive Officer, accept any other employment or serve as a director, consultant or partner of any

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business or profit making enterprise or entity other than the Corporation and its Affiliates (the term “Affiliate” in this Agreement shall have the meaning ascribed thereto in the Business Corporations Act - Ontario) except in the capacity of an investor of money and so long as such monetary investment does not require any active involvement or otherwise affect the conduct of the Executive’s duties and responsibilities of employment as set forth in this Agreement.

**2.2 Non-Solicitation.** During his employment with the Corporation or any of its Affiliates, and during the twelve (12) month period immediately following the cessation of the Executive’s employment for any reason whatsoever (with or without cause), the Executive will not, without the prior written consent of the Board:

- (a) canvass or solicit or endeavour to canvass or solicit whether directly or indirectly, any customer or prospective customer in Canada or the United States of America (“U.S.A.”) in which the Corporation or any of its Affiliates is selling or providing products or services at the time the Executive ceases to be an employee of the Corporation for the purpose of selling to that customer any products or services which are the same or substantially similar to products or services sold by the Corporation or any of its Affiliates; or
- (b) Entice, solicit or endeavour to entice or solicit any officer, employee, contractor, agent or consultant of the Corporation or any of its Affiliates away from employment with or engagement by the Corporation or any of its Affiliates, whether or not such person would commit a breach of contract by reason of leaving such service.

For the purposes of this Section, “customer” shall mean any person to whom the Corporation or any of its Affiliates sells or provides products or services at the time the Executive ceases to be an employee, or within six (6) months prior thereto, or with whom the Corporation or any of its Affiliates is in negotiation at the time the Executive’s employment is terminated, with a view to selling or providing goods or services to such person.

**2.3 Non-Disclosure of Confidential Information.** The Executive acknowledges that, in the course of performing and fulfilling his duties and obligations he will have access to, and will continue to be entrusted with, confidential information concerning the activities, business operations, customers and clients of the Corporation and its Affiliates which information is not generally known in the industry in which the Corporation and its Affiliates do business (“Confidential Information”) and that the disclosure of any Confidential Information to competitors of the Corporation and any of its Affiliates or to other persons would be highly detrimental to the interests of the Corporation and its Affiliates. Confidential Information does not include information that is and/or becomes generally available to the public other than due to a breach of this Agreement. The Executive further acknowledges and agrees that the right to maintain confidential such Confidential Information is a proprietary right that the Corporation is entitled to protect. Accordingly, the Executive covenants and agrees with the Corporation that (i) he will not during his employment by the Corporation or any of its Affiliates disclose any such Confidential Information to any person, nor shall he use the same, except as required in the normal course of his employment by the Corporation or any of its Affiliates and (ii) after the termination or expiration of his employment by the Corporation or any of its Affiliates, he will not disclose or make any use of Confidential Information without the consent of the Corporation and its Affiliates.

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**2.4 Acknowledgement and Agreement.** The Executive acknowledges that the restrictive covenants contained in this Article 2 above have been considered by the Executive and that the restraints and restrictions on his future activities are reasonable in the circumstances. The Executive agrees that any breach of these provisions will result in irreparable harm which cannot be quantified or adequately compensated by monetary damages alone. The Executive further agrees that, in addition to any other remedies at law that the Corporation may have (which other remedies the Executive acknowledges to be inadequate to protect the Corporation's legitimate interests), the Corporation shall be entitled to injunctive relief in the event of a breach of this Article 2. The Executive expressly waives all defences to such relief in the event of a breach of the restrictive covenants in this Article 2.

**2.5 Scope of Application.** The foregoing restrictions shall apply to any action taken by the Executive, directly or indirectly, alone or in concert or in partnership with others, whether as an agent, representative, principal, shareholder, lender, employee, consultant, director or in any other capacity.

### ARTICLE 3 - COMPENSATION

**3.1 Annual Base Salary.** The Corporation shall pay to the Executive an annual base salary (the "Base Salary") of Cdn \$274,500.00, payable in equal instalments every two weeks, subject to such payroll and withholding deductions as may be required by Canadian law, provided however, the amount of the Base Salary for the calendar years 2005, 2006 and 2007 shall be grossed up to provide the equivalent after tax income that the Executive would have earned as a resident of the United States. The Base Salary may be increased from time to time at the sole discretion of the Board upon recommendation of the Compensation Committee.

**3.2 Short Term Incentive Award.** The Executive shall be entitled to receive a short-term bonus award in the sole discretion of the Board and in accordance with the Corporation's Short Term Bonus Plan, which is to be as established by the Board. The annual target bonus shall be 50% of base salary, based upon achievement of budgeted annual financial performance approved by the Board and individual performance. No Short Term Bonus shall be payable in the circumstances described in Section 4.1 and 4.3. The amount of the short term incentive payments received up to December 31, 2007 shall be grossed up to provide the equivalent after tax income that the Executive would have earned as a resident of the United States. For greater certainty, a bonus which may be earned related to company performance in the calendar year 2007 but paid in calendar year 2008 shall not be subject to the tax equalization adjustment.

**3.3 Long Term Incentive Award.** The Executive shall continue to participate in the 2000 Equity Plan (or any successor plan) that the Board has adopted on such terms and conditions as the Board shall determine.

**3.4 Monthly Car Allowance.** The Executive shall be entitled to a monthly car allowance of Cdn. \$1,200 per month.

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**3.5 Benefits.** The Corporation shall provide the Executive with entitlement to the executive benefit program.

**3.6 Reimbursement of Expenses.** The Executive shall be entitled to reimbursement of all reasonable business expenses incurred in good faith upon presentation of appropriate invoices, receipts and other requested documentation.

**3.7 Income Tax Advice.** The Executive shall be entitled to reimbursement for the reasonable costs of income tax advice and filing of income tax returns for 2005, 2006 and 2007 up to a maximum of Cdn \$6,000.00 per year upon provision of receipts by the Executive to the Corporation, such receipts to be provided within 30 days of their receipt by the Executive.

**3.8 Relocation Expenses.** In the event that the Executive is terminated without cause prior to December 31, 2007, the Executive shall also be entitled to reimbursement of reasonable out of pocket expenses incurred in relocating to the United States from Canada provided receipts for such expenses are provided to the Corporation within 30 days of their receipt by the Executive. Such expenses limited to direct moving costs and the realty fees, legal fees, and other expenses associated with the sale of his Canadian residence.

#### **ARTICLE 4 - TERMINATION**

**4.1 Termination for Cause.** The Corporation may terminate the employment of the Executive hereunder for cause (as such term is understood under applicable law) by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice ("termination date"). If the Corporation exercises its rights under this Section to terminate the Executive's employment hereunder, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder, including any bonus and long term incentive payments pursuant to Section 3.2 and 3.3, from and after the termination date other than those obligations that have accrued pursuant to Article 3.1.

**4.2 Termination Without Cause.** The Corporation may terminate the employment of the Executive in circumstances which do not constitute cause, in which case the Corporation shall provide the Executive with salary continuance of the Executive's annual base salary equal to twelve (12) months plus one (1) month for every completed year of active employment after twelve years of service to a maximum of eighteen (18), provided that the Executive continues to abide by the non-solicitation, and confidentiality provisions set out in Sections 2.2 and 2.3. If the Corporation exercises its rights under this Section 4.2 to terminate the Executive's employment hereunder, with the exception of the payments aforementioned in this Section 4.2, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder, save and except any vesting of options pursuant to Section 3.3 and any relocation expenses in the event of a relocation to the United States as set out in Section 3.8. In the event that, prior to the end of the notice period, the Executive obtains alternative employment that provides total remuneration that is at least 75% of the Executive's total compensation as provided in Article 3, then the Corporation shall cease to provide the salary continuation but instead, shall provide the Executive with a lump sum payment, less applicable statutory deductions, that is equivalent to 50% of the remaining salary continuation payments that the Executive would have been entitled to receive.

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**4.3 Termination by the Executive.** The Executive may terminate this Agreement by notice in writing specifying the effective date of termination (not to be less than 3 months after the date of notice). The Corporation may elect to deem any date prior to the date specified in the notice as the effective date of termination in which event the Executive shall receive payment of his bi-weekly salary payments in accordance with Section 3.1 that would have been due during the remainder of the notice period provided by the Executive, to a maximum of 3 months.

**4.4 Disability**

- (a) For the purposes of this Section 4.4, “Partially or Totally Disabled” means any physical or mental incapacity, disease or affliction, as determined by a legally qualified medical practitioner, which prevents the Executive from performing the essential duties of his position.
- (b) In the event that the Executive is Partially or Totally Disabled for a period of six (6) months or less, he shall receive all remuneration including bonuses, payments and rights including, without limiting the generality of the foregoing, all benefits provided for under this Agreement, as if he were regularly and fully employed.
- (c) In the event that the Executive is Partially or Totally Disabled for a continuous period of more than six (6) months, the Corporation shall be entitled to terminate the employment of the Executive by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice. In the event of a termination of employment under these circumstances, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder from and after the effective date of termination of this Agreement, save and except termination and severance pay as required pursuant to the *Employment Standards Act, 2000* and continuing coverage under the Corporation’s executive benefit program.
- (d) For greater certainty, in the event the Executive is Partially or Totally Disabled and the Corporation terminates his employment without cause before six (6) months have expired from the date he became totally disabled, Section 4.2 hereof shall apply.

**4.5 Resignation.** The Executive agrees that after termination of his employment with the Corporation pursuant to this Article 4, for any reason whatsoever, he will tender his resignation from any position he may hold as an officer or director of the Corporation or any of its Affiliates, unless otherwise agreed to by the Board and the Executive.

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**ARTICLE 5 - MISCELLANEOUS**

**5.1 Binding Agreement.** This Agreement shall be binding on the parties hereto and its successors in interest and assigns.

**5.2 Notices.** Any notice or other communication required or permitted to be given or made hereunder shall be in writing and shall be sufficiently given or made if:

(a) enclosed in a sealed envelope and delivered in person or by courier to the party hereto to whom it is addressed (or, in the case of the Corporation, to the receptionist or other responsible employee) at the relevant address set forth below;

or

(b) telexed, telegraphed, telecopied or sent by other means of recorded electronic communication;

if to the Corporation, addressed to:

SMTC - Headquarters

635 Hood Road

Markham, Ontario L3R 4N6 Canada

Attention: President and Chief Executive Officer

Telecopy: 905.479.1877

with a copy to:

Goodmans, LLP

250 Yonge Street, Box 24

Toronto, Ontario

M5B 2M6

Attention: Celia Rhea

Telecopy: (416) 979-1234

and if to the Executive, addressed to:

Steve Hoffrogge 113 Tyler Street

Aurora, ON

L4G 2N4

Any notice or other communication so given or made shall be deemed to have been given or made and to have been received on the day of delivery, if delivered in person or by courier, and on the day of sending, if sent by telex, telegraph, telecopy or other means of recorded electronic communication (provided such delivery or sending is during normal business hours on a business day and, if not, then on the first business day thereafter). Any party hereto may change his or its address for notice by notice to the other party hereto given in the manner aforesaid.

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**5.3 Modification and Waivers.** No provision of this Agreement may be modified or amended unless such modification or amendment is agreed to in writing and signed by the Corporation and the Executive. No waiver by either party hereto of any breach by the other party hereto of any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the time or any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the employment of the Executive by the Corporation have been made by any party which are not set forth expressly in this Agreement.

**5.4 Entire Agreement.** This Agreement contains all the terms and conditions of the Executive's employment with the Corporation and supersedes all prior agreements and understandings.

**5.5 Law Governing.** This Agreement shall be subject to and governed by the laws of the Province of Ontario. The Executive agrees that he can only enforce this Agreement in the Courts of the Province of Ontario (or the Courts of the location of the Corporation's head office). The Corporation may enforce this Agreement in any jurisdiction in which the Executive lives or carries on business.

**5.6 Severability.** The invalidity, illegality or unenforceability of any provision hereof shall not in any way affect or impair the validity, legality or enforceability of the remaining provisions hereof.

**5.7 Headings.** The headings contained herein are for reference purposes only and shall not in any way affect the construction or interpretation of this Agreement.

**5.8 Independent Advice.** The Executive confirms having had the opportunity to obtain independent legal advice regarding this Agreement and that the Executive is signing this Agreement freely and voluntarily with full understanding of its contents.

**5.9 Successors.** This Agreement and all rights of the Executive hereunder shall enure to the benefit of and be enforceable by the Executive and his personal or legal representatives, heirs, executors, administrators and successors and shall enure to the benefit of and be binding upon the Corporation, its successors and assigns.

**5.10 Taxes.** All payments under this Agreement shall be subject to withholding of such amounts, if any, relating to tax or other payroll deductions as the Corporation may reasonably determine and should withhold pursuant to any applicable law or regulation.

**5.11 Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed to be an original but all of which together shall constitute one and the same instrument.



**EMPLOYMENT AGREEMENT**

Employment Agreement made as of the 30<sup>th</sup> day of March, 2007.

**BETWEEN:**

**SMTC Manufacturing Corporation**, a corporation  
incorporated under the laws of Ontario, Canada;

(hereinafter called the "Corporation")

- and -

**Don Simpson**,

(hereinafter called the "Executive")

**WHEREAS** the Executive is currently a Senior Vice President, Manufacturing and Engineering;

**AND WHEREAS** the Corporation and the Executive wish to enter into a written employment agreement with respect to the compensation to be paid to the Executive and other matters relating to his employment with the Corporation;

**NOW THEREFORE** in consideration of the mutual covenants and agreements contained herein, the Corporation and the Executive hereby agree as follows:

**ARTICLE 1 - TERM, POSITION AND DUTIES**

**1.1 Term.** Employment in this position commenced on December 15, 2005.

**1.2 Position.** The Executive shall serve as the Senior Vice President, Manufacturing and Engineering of the Corporation. The Executive shall be based out of the Corporation's head offices located in Markham, Ontario.

**1.3 Duties.** The Executive shall perform such duties as are regularly and customarily performed by a senior executive of a public corporation and in particular shall be responsible for leadership of manufacturing and engineering functions worldwide. The Executive shall report directly to the President and Chief Executive Officer of the Corporation.

**ARTICLE 2 - THE EXECUTIVE'S OBLIGATIONS**

**2.1 Full Time and Effort.** Throughout his term of employment, the Executive shall devote his full time, effort and attention to the affairs of the Corporation and its Affiliates (the "Business"). The Executive shall not, without the prior approval of the President and Chief Executive Officer, accept any other employment or serve as a director, consultant or partner of any business or profit making enterprise or entity other than the Corporation and its Affiliates (the term

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“Affiliate” in this Agreement shall have the meaning ascribed thereto in the Business Corporations Act - Ontario) except in the capacity of an investor of money and so long as such monetary investment does not require any active involvement or otherwise affect the conduct of the Executive’s duties and responsibilities of employment as set forth in this Agreement.

**2.2 Non-Solicitation.** During his employment with the Corporation or any of its Affiliates, and for a period of eighteen (18) months immediately following the cessation of employment for any reason (with or without cause), the Executive will not, without the prior written consent of the Board:

- (a) canvass or solicit or endeavour to canvass or solicit whether directly or indirectly, any customer or prospective customer in Canada or the United States of America (“U.S.A.”) in which the Corporation or any of its Affiliates is selling or providing products or services at the time the Executive ceases to be an employee of the Corporation for the purpose of selling to that customer any products or services which are the same or substantially similar to products or services sold by the Corporation or any of its Affiliates; or
- (b) Entice, solicit or endeavour to entice or solicit any officer, employee, contractor, agent or consultant of the Corporation or any of its Affiliates away from employment with or engagement by the Corporation or any of its Affiliates, whether or not such person would commit a breach of contract by reason of leaving such service.

For the purposes of this Section, “customer” shall mean any person to whom the Corporation or any of its Affiliates sells or provides products or services at the time the Executive ceases to be an employee, or within six (6) months prior thereto, or with whom the Corporation or any of its Affiliates is in negotiation at the time the Executive’s employment is terminated, with a view to selling or providing goods or services to such person.

**2.3 Non-Disclosure of Confidential Information.** The Executive acknowledges that, in the course of performing and fulfilling his duties and obligations he will have access to, and will continue to be entrusted with, confidential information concerning the activities, business operations, customers and clients of the Corporation and its Affiliates which information is not generally known in the industry in which the Corporation and its Affiliates do business (“Confidential Information”) and that the disclosure of any Confidential Information to competitors of the Corporation and any of its Affiliates or to other persons would be highly detrimental to the interests of the Corporation and its Affiliates. Confidential Information does not include information that is and/or becomes generally available to the public other than due to a breach of this Agreement. The Executive further acknowledges and agrees that the right to maintain confidential such Confidential Information is a proprietary right that the Corporation is entitled to protect. Accordingly, the Executive covenants and agrees with the Corporation that (i) he will not during his employment by the Corporation or any of its Affiliates disclose any such Confidential Information to any person, nor shall he use the same, except as required in the normal course of his employment by the Corporation or any of its Affiliates and (ii) after the termination or expiration of his employment by the Corporation or any of its Affiliates, he will not disclose or make any use of Confidential Information without the consent of the Corporation and its Affiliates.

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**2.4 Acknowledgement and Agreement.** The Executive acknowledges that the restrictive covenants contained in this Article 2 above have been considered by the Executive and that the restraints and restrictions on his future activities are reasonable in the circumstances. The Executive agrees that any breach of these provisions will result in irreparable harm which cannot be quantified or adequately compensated by monetary damages alone. The Executive further agrees that, in addition to any other remedies at law that the Corporation may have (which other remedies the Executive acknowledges to be inadequate to protect the Corporation's legitimate interests), the Corporation shall be entitled to injunctive relief in the event of a breach of this Article 2. The Executive expressly waives all defences to such relief in the event of a breach of the restrictive covenants in this Article 2.

**2.5 Scope of Application.** The foregoing restrictions shall apply to any action taken by the Executive, directly or indirectly, alone or in concert or in partnership with others, whether as an agent, representative, principal, shareholder, lender, employee, consultant, director or in any other capacity.

### **ARTICLE 3 - COMPENSATION**

**3.1 Annual Base Salary.** The Corporation shall pay to the Executive an annual base salary (the "Base Salary") of CDN \$230,000.00, payable in equal instalments every two weeks, subject to such payroll and withholding deductions as may be required by Canadian law. The Base Salary may be increased from time to time at the sole discretion of the Board upon recommendation of the Compensation Committee.

**3.2 Annual Incentive Award.** The Executive shall be entitled to receive a short-term bonus award in the sole discretion of the Board and in accordance with the Corporation's short Term Bonus Plan, as established by the Board. The annual target award shall be 50% of base salary, based upon achievement of annual financial performance targets approved by the Board and individual performance. No Short Term Bonus shall be payable in the circumstances described in Section 4.2 and 4.4.

**3.3 Long Term Incentive Award.** The Executive shall be entitled to participate in the 2000 Equity Plan (or any successor plan) that the Board has adopted on such terms and conditions as the Board shall determine. For greater certainty, in the event of a change of control other than that which is defined in the Plan, any unvested options that were granted prior to the change of control, shall continue to vest in accordance with the vesting period in the Plan and the options shall expire at the earlier of the original expiration date and five years following the date of the change of control.

**3.4 Monthly Car Allowance.** The Executive shall be entitled to a monthly car allowance up to a maximum of Cdn. \$1,200 per month.

**3.5 Benefits.** The Corporation shall provide the Executive with entitlement to Corporation's executive benefit program.

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**3.6 Reimbursement of Expenses.** The Executive shall be entitled to reimbursement of all reasonable business expenses incurred in good faith upon presentation of appropriate invoices, receipts and other requested documentation.

**3.7 Vacation.** The Executive shall be entitled to four (4) weeks paid vacation each calendar year, and in accordance with the Corporation's vacation policy.

#### **ARTICLE 4 - TERMINATION**

**4.1 Termination for Cause.** The Corporation may terminate the employment of the Executive hereunder for cause (as such term is understood under applicable law) by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice ("termination date"). If the Corporation exercises its rights under this Section to terminate the Executive's employment hereunder, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder, including any bonus and long term incentive payments pursuant to Section 3.2 and 3.3, from and after the termination date other than those obligations that have accrued pursuant to Article 3.1 and 3.9.

**4.2 Termination Without Cause.** The Corporation may terminate the employment of the Executive in circumstances which do not constitute cause, in which case the Corporation shall provide the Executive with the following payments: (i) if the Corporation terminates the Executive within the first ten (10) years of the Executive's employment with the Corporation, twelve (12) months salary continuance of the Executive's then current annual base salary, (ii) if the Corporation terminates the Executive's employment anytime after the first ten (10) years of employment, twelve (12) months plus one (1) month for every completed year of service after ten (10) years of then current salary continuance of the Executive's base salary. These salary continuance payouts are conditional upon the Executive continuing to abide by the non-solicitation, and confidentiality provisions set out in Sections 2.2 and 2.3. If the Corporation exercises its rights under this Section 4.2 to terminate the Executive's employment hereunder, with the exception of the payments aforementioned in this Section 4.2, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder, save and except any vesting of options pursuant to Section 3.3. In the event that, prior to the end of the notice period, the Executive obtains alternative employment that provides total remuneration that is at least 75% of the Executive's total compensation as provided in Article 3, then the Corporation shall cease to provide the salary continuation but instead, shall provide the Executive with a lump sum payment, less applicable statutory deductions, that is equivalent to 50% of the remaining salary continuation payments that the Executive otherwise would have been entitled to receive.

**4.3 Termination by the Executive.** The Executive may terminate this Agreement by notice in writing specifying the effective date of termination (not to be less than three (3) months after the date of notice). The Corporation may elect to deem any date prior to the date specified in the notice as the effective date of termination in which event the Executive shall receive payment of his bi-weekly salary payments in accordance with Section 3.1 that would have been due during the remainder of the notice period provided by the Executive, to a maximum of 3 months.

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#### 4.4 Disability

- (a) For the purposes of this Section 4.4, "Partially or Totally Disabled" means any physical or mental incapacity, disease or affliction, as determined by a legally qualified medical practitioner, which prevents the Executive from performing the essential duties of his position.
- (b) In the event that the Executive is Partially or Totally Disabled for a period of six (6) months or less, he shall receive all remuneration including bonuses, payments and rights including, without limiting the generality of the foregoing, all benefits provided for under this Agreement, as if he were regularly and fully employed.
- (c) In the event that the Executive is Partially or Totally Disabled for a continuous period of more than six (6) months, the Corporation shall be entitled to terminate the employment of the Executive by giving written notice to the Executive of its intention to terminate this Agreement on the date specified in such notice. In the event of a termination of employment under these circumstances, the Executive shall not be entitled to receive any further remuneration or payments of any kind or nature hereunder from and after the effective date of termination of this Agreement, save and except any termination and severance as required by the *Employment Standards Act, 2000* and continuing coverage under the Corporation's executive benefit program.
- (d) For greater certainty, in the event the Executive is Partially or Totally Disabled and the Corporation terminates his employment without cause before six (6) months have expired from the date he became totally disabled, Section 4.2 hereof shall apply.

**4.5 Resignation.** The Executive agrees that after termination of his employment with the Corporation pursuant to this Article 4, for any reason whatsoever, he will tender his resignation from any position he may hold as an officer or director of the Corporation or any of its Affiliates, unless otherwise agreed to by the Board and the Executive.

#### ARTICLE 5 - MISCELLANEOUS

**5.1 Binding Agreement.** This Agreement shall be binding on the parties hereto and its successors in interest and assigns.

**5.2 Notices.** Any notice or other communication required or permitted to be given or made hereunder shall be in writing and shall be sufficiently given or made if:

- (a) enclosed in a sealed envelope and delivered in person or by courier to the party hereto to whom it is addressed (or, in the case of the Corporation, to the receptionist or other responsible employee) at the relevant address set forth below;
- or

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(b) telexed, telegraphed, telecopied or sent by other means of recorded electronic communication;  
if to the Corporation, addressed to:  
SMTC - Headquarters  
635 Hood Road  
Markham, Ontario L3R 4N6 Canada  
Attention: President and Chief Executive Officer

with a copy to:

Goodmans, LLP  
250 Yonge Street, Box 24  
Toronto, Ontario  
M5B 2M6  
Attention: Celia Rhea  
Telecopy: (416) 979-1234

and if to the Executive, addressed to:

Don Simpson  
12 Harpers Croft  
Markham, ON  
L3R 5S7

Any notice or other communication so given or made shall be deemed to have been given or made and to have been received on the day of delivery, if delivered in person or by courier, and on the day of sending, if sent by telex, telegraph, telecopy or other means of recorded electronic communication (provided such delivery or sending is during normal business hours on a business day and, if not, then on the first business day thereafter). Any party hereto may change his or its address for notice by notice to the other party hereto given in the manner aforesaid.

**5.3 Modification and Waivers.** No provision of this Agreement may be modified or amended unless such modification or amendment is agreed to in writing and signed by the Corporation and the Executive. No waiver by either party hereto of any breach by the other party hereto of any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the time or any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the employment of the Executive by the Corporation have been made by any party which are not set forth expressly in this Agreement.

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**5.4 Entire Agreement.** This Agreement contains all the terms and conditions of the Executive's employment with the Corporation and supersedes all prior agreements and understandings.

**5.5 Law Governing.** This Agreement shall be subject to and governed by the laws of the Province of Ontario. The Executive agrees that he can only enforce this Agreement in the Courts of the Province of Ontario (or the Courts of the location of the Corporation's head office). The Corporation may enforce this Agreement in any jurisdiction in which the Executive lives or carries on business.

**5.6 Severability.** The invalidity, illegality or unenforceability of any provision hereof shall not in any way affect or impair the validity, legality or enforceability of the remaining provisions hereof.

**5.7 Headings.** The headings contained herein are for reference purposes only and shall not in any way affect the construction or interpretation of this Agreement.

**5.8 Independent Advice.** The Executive confirms having had the opportunity to obtain independent legal advice regarding this Agreement and that the Executive is signing this Agreement freely and voluntarily with full understanding of its contents.

**5.9 Successors.** This Agreement and all rights of the Executive hereunder shall enure to the benefit of and be enforceable by the Executive and his personal or legal representatives, heirs, executors, administrators and successors and shall enure to the benefit of and be binding upon the Corporation, its successors and assigns.

**5.10 Taxes.** All payments under this Agreement shall be subject to withholding of such amounts, if any, relating to tax or other payroll deductions as the Corporation may reasonably determine and should withhold pursuant to any applicable law or regulation.

**5.11 Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed to be an original but all of which together shall constitute one and the same instrument.



Consent of Independent Registered Public Accounting Firm

To the Board of Directors of SMTC Corporation:

We consent to the incorporation by reference in the registration statement (No. 333-44250) on Form S-8, the registration statement (No. 333-116986) on Form S-3, the registration statement (No. 333-86802) on Form S-3, and the registration statement (No. 333-115400) on Form S-1 of SMTC Corporation of our report dated April 2, 2007, with respect to the consolidated balance sheets of SMTC Corporation as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in shareholders' equity (deficiency) and cash flows for each of the years in the three-year period ended December 31, 2006, and the related financial statement schedule, which report appears in the December 31, 2006 annual report on Form 10-K of SMTC Corporation.

/s/ KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

April 2, 2007

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

**CERTIFICATIONS**

I, John Caldwell, certify that:

1. I have reviewed this annual report on Form 10-K 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)) 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) 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
  - c) 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 registrant's fourth fiscal 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(s) 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: April 2, 2007

/s/ John Caldwell

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John Caldwell

President and Chief Executive Officer

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

**CERTIFICATIONS**

I, Jane Todd, certify that:

1. I have reviewed this annual report on Form 10-K 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)) 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) 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
  - c) 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 registrant's fourth fiscal 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(s) 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: April 2, 2007

/s/ Jane Todd

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Jane Todd

Chief Financial Officer

**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 executive officer of SMTC Corporation (the "Company"), does hereby certify that to the undersigned's knowledge:

- 1) the Company's annual report on Form 10-K for the year ended December 31, 2006 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 Company's annual report on Form 10-K for the year ended December 31, 2006 fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John Caldwell

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John Caldwell

President and Chief Executive Officer

Date: April 2, 2007

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

**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 principal financial officer of SMTC Corporation (the "Company"), does hereby certify that to the undersigned's knowledge:

- 1) the Company's annual report on Form 10-K for the year ended December 31, 2006 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 Company's annual report on Form 10-K for the year ended December 31, 2006 fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jane Todd

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Jane Todd  
Chief Financial Officer

Date: April 2, 2007

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