



Coretec Inc. 2003 First Quarter Results Conference Call

Paul Langston

Good morning. I'm Paul Langston, Coretec's Chairman, President and Chief Executive Officer. With me today is Mark Thornley, Coretec's Chief Financial Officer.

I'd like to thank you for joining us to discuss Coretec's first quarter results.

But first, I must caution you that this call may include statements about future expectations, plans and prospects that may constitute forward-looking statements. Please be cautioned that any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties. Actual results or developments may vary materially from those projected or implied in the forward-looking statements as a result of any number of factors, including the effects of the slow-down in the general economy and the electronics and printed circuit board industries; customer order levels, product mix and inventory build-up; lower than expected or delayed sales; pricing and other competitive pressures in the industry; our ability to reduce costs; our ability to integrate past and any future acquisitions; and other risks listed in Coretec's filings with Canadian Securities regulators available at www.sedar.com.

Mark will begin our presentation by reviewing the first quarter financial results. Then I'll provide a snapshot of our business highlights in the quarter and describe the outlook for Q2 for our industry and Coretec specifically.

Mark Thornley

Thanks Paul.

The first quarter of 2003 continued in much the same way the year ended – it was a quarter in which we continued make investments in gaining market share, tooling new parts and expanding our customer base to better position ourselves for future recovery and growth. At this point I'd like to take you through our first quarter results.

A net loss of \$2.5 million (\$0.13 per share) was recorded in the first quarter of 2003 compared to a net loss of \$1.7 million (\$0.10 per share) in the 2002 first quarter. Included in the net loss for the first quarter of 2003 is a charge of \$0.5 million or \$0.03 per share, related to the foreign exchange translation of our non-Canadian dollar denominated net assets.



Earning before interest, taxes, depreciation and amortization in the first quarter of 2003 was negative \$0.5 million, compared to EBITDA of negative \$0.2 million in the 2002 first quarter. EBITDA for the first quarter of 2003 is also inclusive of the \$0.5 million foreign exchange translation charge previously mentioned.

Sales for the first quarter of 2003 increased \$2.4 million or 14.7 % to \$18.7 million, compared to \$16.3 million in the first quarter of 2002.

The increase in sales principally relates to increased sales from our Canadian operations. The increase in sales was partially offset by lower sales from our US operations and by the impact of US denominated sales being converted by an approximately 5% lower US dollar exchange rate compared to the prior year period. In the period, 55% of sales were to the US, 30% to Canada and 15% to Europe as compared to 59%, 23% and 18% respectively in the comparative period for 2002. The increase in total sales for the first quarter of 2003 compared to the same period in 2002 is a result of market share gains made by Coretec and greatly increased new customer activity since activity in the PCB industry as a whole declined close to 20% over the 12 month period ended February 2003 compared to the 12 month period ended February 2002. The severe contraction in the PCB and electronics industry, which began impacting our sales in the second quarter of 2001, however, continued to add downward pricing pressure on our products and services in the first quarter of 2003 as it has for the entire PCB industry in North America.

Our sales by segment in the first quarter of 2003 were 33% EMS, 23% aerospace/military, 23% instruments, 20% communications and 1% computers.

Our 10 largest customers accounted for 33% of sales in the first quarter of 2003 compared to 32% in the first quarter of 2002.

Gross profit for the first quarter of 2003 decreased \$0.1 million or 2.3% to \$3.3 million, compared to \$3.4 million in the first quarter 2002. Gross profit as a percentage of sales decreased to 17.8% from 20.9% in the first quarter of 2002. The decline in gross margin as a percentage of sales is largely a result of reduced pricing levels, the reduced converted value of US denominated revenues from our Canadian operations as a result of the decline in the US dollar over the comparable periods and lower gross margins as a percentage of sales from our US operations. These impacts were partially offset by higher capacity utilization in our Canadian facilities in the first quarter of 2003 compared to the same period in 2002. Higher capacity utilization decreases the relative portion of the Company's fixed operating cost component in gross margin as a percentage of sales. Gross margins in the first quarter of 2003 were also negatively affected by the set up costs associated with the increases in first time part production and the increase in smaller production runs and reduced cycle time relative to the comparable prior period.



Loss from operations in the first quarter of 2003 decreased \$0.4 million to a loss of \$1.8 million, compared to a loss from operations of \$2.2 million in the first quarter of 2002.

Selling, General and Administrative (“SG&A”) expenses in the first quarter of 2003 decreased \$0.3 million to \$3.3 million, compared to \$3.6 million in the 2002 prior period. As a percentage of sales, SG&A expenses decreased to 17.9%, compared to 22.3% in 2002. The decrease in SG&A expense was principally due to reductions in sales and sales support personnel during the latter part of 2002 and reduced expenditures in administrative costs for our subsidiaries as a result of centralizing certain administrative functions.

Depreciation and amortization expense decreased \$0.2 million in the first quarter of 2003 to \$1.8 million compared to \$2.0 million in the 2002 prior period. The decrease in depreciation and amortization is principally a result of a reduction in depreciation due to the write down of \$1.8 million of assets in our UK operations in the second quarter of 2002.

Interest and other expenses increased \$0.1 million to \$0.2 million in the first quarter of 2003 compared to \$0.1 million in the 2002 prior period as the Company had higher average net debt balances during the first quarter of 2003 compared to the 2002 prior period.

Foreign exchange loss increased \$0.5 million to \$0.5 million in the first quarter of 2003 compared to approximately nil in the first quarter of 2002. During the quarter, the value of the US dollar declined approximately 7% vis-à-vis the Canadian dollar and the British Pound declined 10% which resulted in foreign exchange translation losses of \$0.4 million related to the book value conversion of our foreign denominated net assets. The change in exchange rates for the US dollar and British Pound in the first quarter of 2002 vis-à-vis the Canadian dollar was not material.

There was no income tax expense or recovery in the first quarter of 2003 due to valuation allowances booked against the entire tax benefited losses for the 2003 first quarter period.

Turning to Capital Additions:

Capital additions for the first quarter of 2003 decreased \$0.3 million to \$0.6 million compared to \$0.9 million in the first quarter of 2002. Capital additions in the first quarter consisted principally of investments in capital equipment for production of \$0.4 million and investment in production and design software and computer equipment of \$0.2 million. In addition to these capital expenditures, the Company



made \$2.0 million in deferred payments related to capital equipment received and recorded in capital assets in prior periods.

Turning to Liquidity and Cash Flows:

At March 31, 2003, our principal source of liquidity included cash of \$0.6 million and trade accounts receivable of \$13.2 million. In addition, the Company has a credit facility with a Canadian chartered bank's asset based lending group to provide a three year credit facility, maturing November 15, 2005, providing an \$8.0 million revolving credit facility collateralized by our accounts receivable and inventory. There were no amounts drawn under this facility as of March 31, 2003. At the end of the first quarter, working capital decreased \$1.4 million to \$7.4 million compared to \$8.8 million at December 31, 2002. The decrease was primarily due to decreased cash balances caused by the loss for the period and the purchase of \$0.6 million in capital additions in the period. Accounts receivable at the end of the quarter represented average days outstanding of 64 days and inventory represented average turns of 13 times.

Cash used by operating activities increased \$2.3 million in the first quarter of 2003 resulting in cash used by operations of \$0.6 million compared to cash provided by operating activities of \$1.7 million in the first quarter of 2002. Cash used in operating activities in the first quarter of 2003 is principally a result of the loss for the period of \$2.4 million offset by \$1.8 million in depreciation and amortization and \$0.5 million in unrealized foreign exchange loss, which both are non-cash operating items, plus an outflow from changes in working capital balances of \$0.4 million. The change in working capital is principally a result of an increase in accounts receivable of \$2.0 million which was offset by a reduction in income taxes receivable of \$0.3 million and an increase in trade accounts payable of \$1.3 million.

Cash used in investing activities in the first quarter of 2003 amounted to \$2.6 million compared to cash used in investing activities of \$2.7 million in the first quarter of 2002. The first quarter of 2003 amount principally relates to \$0.6 million of capital additions of machinery, equipment and computer software/hardware for our Canadian design and manufacturing operations. Also included in capital expenditures for the first quarter of 2003 are \$2.0 million of deferred payments for capital assets acquired in prior periods, which were carried on the balance sheet in accounts payable.

Cash used in financing activities amounted to \$0.4 million in the first quarter of 2003 compared to cash provided of \$7.0 million in the first quarter of 2002. Cash used in the 2003 period principally represents \$0.3 million in principal repayments



on long term debt and the repayment of the operating facility loan for Coretec Limited of \$0.2 million.

Shares outstanding at the end of the first quarter were 18.6 million.

Now I'll turn the call over to Paul.

Paul Langston

Thanks Mark.

Q1 2003 proved to be a very challenging quarter for Coretec from a number of perspectives including exchange rate volatility, a highly unpredictable bookings pattern, ongoing price pressure and a series of unusual factors specific to our Toronto operations. Notwithstanding, Coretec continued to take market share and execute on initiatives that are positioning us to play a leadership role in the industry in the future. In particular, in Q1 2003 we achieved the following :

- the fourth quarter out of the past five that we had sequential revenue gains despite the negative impact of currency exchange on our sales which are predominantly export oriented
- we once again experienced a book to bill ratio greater than 1.0 (1.01 in fact)
- our shipments year over year in Q1 were up 15% versus the industry which was down greater than 20%
- we added roughly 60 new accounts since the end of the year;
- we expanded our US sales coverage to include new sales reps in the Midwest and Texas;
- we achieved a series of new Tier 1 EMS and OEM approvals which we believe will provide significant opportunities within the year;
- we tooled in excess of 1,400 new part numbers thereby expanding our penetration in to new programs and subsequent ramp production opportunities;
- we were able to initiate several programs with our offshore strategic partners and expect to gain further business through this key channel in 2003;
- we made the final payments associated with equipment commitments made in 2001;
- we initiated the installation of our Cimnet ERP software in Denver and will commence the UK integration in Q3 2003;
- we continued to roll out our brand through our Field Application Engineering group and added FAE personnel in Phoenix, Arizona and an additional person in Toronto;



- In Q1 2003 we undertook cost containment and strategic measures at our Denver and UK operations that we believe will return these sites to positive cash performance by Q3;
- And finally in Q1 2003, we continued our R&D efforts particularly as relates to embedded passive components and advanced materials;

We believe that these initiatives will impact both our short term and longer term operational and financial results.

As for the industry, Q1 2003 started off with some promise of a recovery but the buildup to and onset of the war in Iraq seemed to squash any momentum that was in evidence in January. As a result of the uncertain environment, many corporations put capital investments on hold which has again affected the demand for PCBs. As such capacity utilization in North American PCB factories remains stagnant at around 60%, well below the level required to generate profitability.

The current industry downturn is by far the deepest and most prolonged on record. According to industry experts Henderson Ventures, the North American PCB sector is operating at an annualized shipments rate of roughly US\$4 billion and has been stuck in the \$4-\$4.5 billion range for approximately 9 months. This compares to an annualized shipment rate of over US\$11 billion at the peak in late 2000. Current activity levels are similar to those experienced in the late 1980s and early 1990s. As of late, industry analysts are projecting industry shipments will range from a mild contraction to low single digit growth in 2003. As it stands now, the industry is in to its third year of compression.

After a rash of plant closings throughout 2001 and 2002, estimated to represent upwards of 40% of the supply base, there remains excess capacity in the marketplace. It is our estimate that the industry in North America as it exists today has US\$6-7 billion of capacity, resulting in a significant imbalance between supply and demand. Having said this, the relevance of industry capacity is an issue. Advancing technology and a high mix of low volume product requirements now characterize the industry making some of the industry's capacity in North America outdated and redundant.

It is our opinion that further capacity must be permanently squeezed out the North American and European marketplaces in order for the sector to experience a return to health. At present irrational pricing and business practices abound as companies attempt to gain market share or simply protect their existing account bases to survive.

On a more positive note, in Q1 2003, the North American industry posted monthly book to bill ratios above parity for the first time in 10 months. Statistics were 1.02 in January, 1.03 in February and 1.04 in March.

Coretec Inc.

8150 Sheppard Ave E, Toronto, Ontario, Canada M1B 5K2 T 416.208.2100 F 416.208.2196
www.coretec-inc.com



The above parity ratios however are more a reflection of depressed shipments rather than strength in bookings but if the trend is maintained it will ultimately result in improved shipments in upcoming quarters. Early indications from IPC (the industry association) are that April also posted a positive book to bill.

The UK and European markets have proven to be similarly depressed over the past 12 months but Q1 was also showing signs of improvement according to a survey of UK manufacturers.

From a product and service perspective, the North American and European marketplaces continue to experience significant NPI(New Product Introduction) activity and a noticeable absence of conversion to production demand at present. The fact that average leadtime is approximately 15 days in the market, down from 70 days in 2000 and a more normal 20-30 days throughout the late nineties, is allowing customers to move to a Just-In-Time inventory business model and is compressing the number of PCBs per order. This leadtime compression is also impacting the industry's ability to charge premiums for rapid response manufacturing. In fact, in today's environment premiums are only possible on requirements that are well below 10 days.

We believe that the North American and European PCB industry has been permanently realigned whereby high mix, small quantity demand, as well as specialty products will be satisfied by local or domestic fabricators whilst higher volumes, regardless of the technology, will inevitably migrate offshore. Hence, we think that players in the industry who are still awaiting a return to ebullient market conditions, will not be rewarded for their patience. We believe that the key to survival is higher technology smaller lots - fast.

With reference to Coretec specifically, we continue to be encouraged by the fact that our prototype demand continues to be relatively strong particularly with respect to higher technology PCBs and exotic materials. We feel that this is a direct result of our deployment of additional field engineering and sales personnel over the past year combined with our broad range of product expertise, industry leading advanced technology capability, exceptional value added services and compressed lead-times.

We believe that this new part number activity sets the stage for a stronger platform of business for Coretec in the future. However developing new client relationships, as well as investing in new programs at existing accounts is cost intensive. There are significant administrative costs, approvals required, non-recurring engineering investments per part number and intense sales and marketing activities. We are viewing new customer and new part number activities as prudent investments for future growth and prosperity.



Having said this, we are quite satisfied that the investments that we have made in terms of account acquisition over the past 24 months have given us enough exposure and diversity that we can now turn our focus to mining our significant customer base.

In the past month we have undertaken a series of initiatives that we believe are prudent in this uncertain environment. With respect to our Toronto operations, we have consolidated our manufacturing in to our main facility and have installed a 24 hour 7 day capability. This move has unfortunately caused us to reduce our labour force by a further 40. We do believe that this consolidation will improve our financial metrics as well as make us more efficient operationally. The 7 day operation will improve our ability to respond to erratic demand while reducing cycle time - a key differentiator in today's market.

At the end of 2002 we took a write down on our Sheppard site, a 100,000 square foot building on 9 acres of property. This facility was intended to be operational as an advanced fabrication site by the end of 2001 or early 2002 and was ultimately going to be expanded in order to consolidate all of our Toronto operations. It was an implementation that we placed on hold in the fall of 2001, awaiting signs of an industry turnaround that would encourage us to recommence the buildout. While we remain committed to establishing an advanced platform in the future we are exploring other options which include the sale of the site.

Finally, I would like to briefly discuss our thoughts for the balance of the year.

At present we are internally forecasting second quarter revenues in the range of \$16-\$19 million. Unfortunately we are unable to offer eps guidance at this time. We are refining our product costing systems and investigating cost savings initiatives as they relate to processes and product engineering. We will continue to address cost savings opportunities at the supplier level as well as with respect to SG&A. In regards to the latter, we are committed to aggressively automating our administrative and customer service functions and are focussing on removing all non-value added or nonperforming activities or assets.

We do believe that there are some positive signs developing in the marketplace and expect a more stable and healthy environment into 2004. In particular there is life in telecom spending especially as relates to wireless; the defense sector will experience ongoing growth as new program spending takes hold; strong automotive unit sales combined with growth in telematics will spur demand; and electronics for the medical and instrumentation sectors will remain stable. Recent announcements by communications equipment manufacturers suggest that 2004 may mark the start of a wireline telecom equipment



replacement cycle. This is particularly significant to the North American PCB industry as the telecom sector accounts for 30-40% of total demand for PCBs and more importantly higher technology products.

One final issue that requires discussion is that of Severe Acute Respiratory Syndrome of SARS. There have been several recent announcements associated with OEMs pulling work back in to Europe and North America as insurance against supply disruptions in the fareast. If SARS is not soon controlled in China, this may become a significant factor in the North American demand equation for PCBs.

Specifically, as relates to our Toronto operations, we have not experienced any medical issues associated with SARS but we have been impacted by the sensitivity worldwide to Toronto as a SARS epicentre. We have had several customer audits cancelled and have had numerous discussions with customers regarding our SARS policy and contingency plans in the event of a production disruption. We have also seen a softness in demand for our products domestically since mid March and we suspect that the SARS phenomenon is playing a role in business confidence and activity levels locally in particular.

In closing I would like to say that we now believe that the PCB industry in North America and Europe has been permanently recalibrated. Although less than half the size it was in 2000, it is still a significant industry at roughly US\$4-5 billion per annum in North America and roughly US\$2-3 billion in Europe. There are now several hundred fewer competitors and many others have been severely damaged. In fact we believe that the PCB industry has been bisected. There now exists a small cluster of players including Coretec, who have the technological plus financial capability and capacity to serve the industry well while the vast majority of facilities will not be relevant to the marketplace in the future. At Coretec, we are convinced that our core operating pillars; technology, time and value added services, will cause us to be one of the industry's key players.

That wraps up our presentation. We thank you for your interest and attention. I would therefore like to open the discussion up for questions.



Paul Langston (after the Q&A period is finished)

As a reminder, the instant replay of this Conference Call will be available from today at 10:30 a.m. until Wednesday, May 14, 2003 at 11:59 p.m. The phone number for the instant replay is 416-640-1917 or toll free 877-289-8525, the passcode is 250947#.

As well, the text of our remarks will be posted on our website;

www.coretec-inc.com