FINAL TRANSCRIPT

Baylin Technologies Inc.

First Quarter Results Conference Call

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CONFERENCE CALL PARTICIPANTS

Steven Li
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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Baylin Technologies Inc. First Quarter Results Conference Call. At this time, all participants are in a listen-only mode.

After the speakers' presentation, there will be a question-and-answer session. To ask a question during the session, you will need to press *, 1 on your telephone.

Please be advised today's conference is being recorded.

If you require any further assistance, please press *, 0.

I will now turn the call over to Mr. Daniel Kim, Executive Vice President, Corporate Development of Baylin Technologies. Thank you.

Please go ahead, sir.

Daniel Kim — Executive Vice President, Corporate Development, Baylin Technologies Inc.

Hello and welcome, everyone. Thank you for joining us this morning for the first quarter 2020 earnings conference call for Baylin Technologies. Joining me is our President and Chief Executive Officer, Randy Dewey, and our Chief Financial Officer, Michael Wolfe. We will all be available for questions at the end of the presentation.

Before we begin our report, let me make it clear that our comments today will include statements and answers to questions that could imply future events such as our 2020 prospects and our financial performance and could include the use of non-GAAP and non-IFRS measures. Though it is obvious these statements are subject to risks and uncertainties and assumptions, accordingly, actual performance could differ materially from statements made today. So do not place undue reliance upon them.

We also disclaim any obligation to update forward-looking statements except as required by law.

I ask that you read our legal disclaimers and refer you to our risk and assumptions outlined in our public disclosures, in particular, the section entitled Forward-Looking Statements and Risk Factors in our Annual Information Form for the year ended December 31, 2019, and our filings, which are available on SEDAR.

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

I would now like to turn the call over to Randy.

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

Thank you, Daniel. We started 2020 with significant optimism and a lot of important restructuring accomplishments behind us. The year changed very early on with the global pandemic.

We felt the impact of COVID-19 early, January 20th, when our factory in Wuxi raised the warning that the virus in the neighbouring province was likely going to affect their region in China. One week later, the announcement of the Lunar New Year holiday by the Chinese government took place, and the effect and the restart plan in China in early February was far greater than anyone had expected.

Despite the government’s shutdown, the Company and all of its subsidiaries worldwide have remained open for business. Each jurisdiction that Baylin and our subsidiaries operate in deemed as an essential service, and we were allowed to operate in all areas throughout the Company.

The reason we received this distinction is because our product and our product lines are essential communication services and that critical emergency response application as well as vital support to government agencies, military companies, aerospace companies, and public safety networks. In early March, our operations in China returned to full capacity, and substantially all employees had returned to work.

Our operations in Vietnam were not subject to any government restrictions. However, the Vietnam government closed the international airport in Hanoi, which has impacted the timing of the completion of construction of our new massive MIMO factory.

Our operations in North America were not subject to any government restrictions, and we continued throughout this period to operate.

We have taken proactive and precautionary measures to protect the health and safety of our workers, customers, and communities, including work-from-home wherever possible, temporary bans on travel, and self-isolation where required. We have had zero cases of COVID-19 reported by any of our employees worldwide.

Our Asia-Pacific mobile products have been the most impacted by COVID-19 due initially to short supply chain issues in China and then a stark decline in global smartphone sales as a result of the North American and European commercial store closures.

Infrastructure in Embedded Antenna sales were negatively impacted as both of those product lines are manufactured in our China facility and experienced delayed shipments from China during the government-mandated extension of the Lunar New Year holiday and supply chain shortages in China as some businesses did not reopen as quickly as our facility.

Satcom revenues were impacted by lower demand from its commercial customers, which has been somewhat offset by the strength of our emergency services and military customers.

As I mentioned, the massive MIMO unit factory construction in Vietnam was delayed due to travel restrictions. Critical equipment suppliers could not finalize installation and equipment calibrations, and customers' final factory certification audits were postponed. The impact has pushed our expectation for revenue to the fourth quarter of this year, which is contingent on the Vietnam airport reopening on its scheduled July 1st.

Our outlook in things that are apparent from Q2 is that we are seeing an improvement across all of our business lines and expect this to continue during the remainder of the year as governments begin to lift restrictions on commercial activity. All of the Company's business lines have seen an increase in sales orders, and we expect revenue to be higher in each of the remaining quarters this year compared to the first quarter.

Asia Pacific's had much improved forecast due to pent-up demand in its sector during the lockdown and the reopening of cellular stores in North America and Europe.

The wireless infrastructure, Embedded Antenna, and Satcom groups' end markets have seen an increase in demand from the explosive need for increased bandwidth and low latency in the wireless networks due to people working from home and other needs.

We have recently announced several opportunities that have secured including purchase orders and supply agreements totalling 11 million of Satcom products. I am pleased to report that Galtronics recently received the best-quality supplier award for the fourth quarter of 2019 from one of Asia Pacific's major customers in recognition of its innovation and outstanding performance.

While it's been a challenging time, I believe that we've been fortunate relative to other companies in our industry that have been more severely impacted. We expect continued challenges ahead, but I believe we are weathering these turbulent times well and that we have taken necessary actions that will result in improved financial performance in the second half of 2020.

I'd like to thank all of our employees for their commitment, dedication, hard work, and certainly the sacrifices over this very challenging time. Clearly, without them, we would not have been able to continue to operate and supply our customers the products they deliver to these essential components and services to provide for businesses and consumers.

I'd like to now turn the call over to Michael to provide you more details and commentary on our financial results. Michael?

Michael Wolfe — Chief Financial Officer, Baylin Technologies Inc.

Thank you, Randy. Yesterday, we reported that our credit agreement with RBC and HSBC has been amended. Compliance with the financial covenants as at March 31st was waived. The financial covenants for the second and third quarters of 2020 have been amended. And we have the option to defer the term loan principal repayments on June 30th and September 30th.

Both of our banking partners took the time to review our recent financial performance, understand the challenges that we have faced over the past few quarters, analyze the steps we've taken to reduce costs, and get comfortable with our forecast for the balance of the year. The flexibility provided in the amendment demonstrates their confidence in our business and expectations of improved financial performance. We are very appreciative of their continued support.

Revenue for the first quarter of 2020 was $26.9 million compared to 39 million in the first quarter of 2019. In the first quarter of 2019, Asia Pacific was awarded several one-time platforms from a major customer that were not expected to be repeated in the first quarter of 2020. Excluding that portion of the revenue decrease, most of the remaining revenue variance was due to COVID-19. Randy has already discussed the impact across the Company.

Adjusted EBITDA for the first quarter of 2020 was 0.6 million compared to 4.1 million in 2019. The decrease was primarily due to lower revenue combined with sales mix. Asia Pacific's margin was negatively affected by manufacturing mix and the postponement of some new platforms.

Lower gross profit compared to the prior-year quarter was somewhat offset by lower operating costs. Operating costs, excluding depreciation and items that we include in EBITDA adjustments, were $2.6 million lower in Q1 compared to the prior year and were $3.6 million lower than operating costs in Q2 of last year, which was the quarter prior to implementation of the first cost-reduction initiatives.

One-third of the March 2020 annualized cost reductions of 6.5 million were initially expected to be permanent. However, we now expect that the permanent cost reductions will be closer to two-thirds. At March 31st, we had a cash balance of $13.6 million and access to approximately $24 million of revolving credit facilities of which 12.1 million was utilized. We believe we have sufficient liquidity going forward.

Since the credit agreement was completed after the end of the quarter, the full balance of the term loan was recorded as a current liability at March 31st. The portion not due within one year will be reclassified as a long-term liability now that the amendment is in place.

In order to provide financial assistance to companies as a result of COVID-19, the Chinese government reduced corporate social insurance premiums commencing in January. In the first quarter of 2020, our China subsidiaries' premiums were reduced by US$185,000.

Subsequent to the end of the first quarter, we filed for and received government stimulus related to COVID-19 relief in the United States under the Paycheck Protection Program and in Canada under the Canada Emergency Wage Subsidy. The forgivable loans and wage subsidies have allowed us to reduce some of the leaves of absences that were implemented, to rehire certain employees that had been terminated, and prevent additional terminations that may have been required.

As Randy discussed, we expect to see a continuing improvement across all business lines during the remainder of the year. The higher expected quarterly revenue combined with the expense reductions implemented in the third and fourth quarters of last year and the further expense reductions implemented in March are expected to result in improved profitability for the balance of the year.

That concludes our formal remarks. Operator, please open up the call for questions.

Q&A

Operator

Thank you. At this time I would like to remind everyone, in order to ask a question, press *, then the number 1 on your telephone keypad.

The first question comes from Steven Li of Raymond James. Your line is open.

Steven Li — Raymond James

Hi. Thank you. Randy, can you provide some colour how much Satcom and Infrastructure was down year over year in Q1? Thanks.

Randy Dewey

Sure. So obviously, we had some shifting priorities in Q1 with most of the end customers in those markets more towards, obviously, some of the emergency services and essential military contracts. So call it low-double digits settling of some revenue in those areas.

Obviously, as we mentioned earlier that mobile is more directly impacted because of the closure of stores, but we've since seen recovery in all four business lines quarter to date here in Q2.

Steven Li

So both Satcom and Infrastructure saw low-double-digit declines? Or was it just Infrastructure you were talking about?

Randy Dewey

Both. Both.

Steven Li

Okay. Both. Perfect. And on the gross margin side, were there some segments that saw significant compression more than the others?

Randy Dewey

Well, certainly on the mobile side, which is typically lower gross margins.

Steven Li

Yeah.

Randy Dewey

Obviously, without the volume, that got affected a little bit heavier than maybe others. But yeah. That would certainly be the one area that we've certainly seen more margin compression than the others.

Steven Li

Okay. So the others were able to sustain pretty similar gross margins.

Randy Dewey

Typically. Yes.

Steven Li

Okay. And then on the comment regarding the gradual revenue recovery in Q2 and Q3, I heard your prepared remarks. So all of your revenue lines are expected to contribute to that recovery. But I was just wondering, is there one that kind of stands out in terms of contribution to that recovery.

Randy Dewey

Well, mobile obviously with this—

Steven Li

Mobile, yeah.

Randy Dewey

—across North America and Europe now, as we've seen that sequentially, month over month, week over week in this quarter, lines have returned significantly.

Steven Li

Got it. And then last question for me. Maybe for Michael. When you look at the rest of the year, are you expecting to generate positive free cash flow, Michael?

Michael Wolfe

Yes. We are.

Steven Li

And this is even after the 3 million MIMO CapEx, what's left that's going to get incurred in the quarter? So even after that, your free cash flow, you would expect positive through the rest of the year.

Michael Wolfe

Yes. Definitely.

Steven Li

Okay. And so then your net debt should be slightly lower by year-end? Is that fair to assume?

Michael Wolfe

Well, we are going to take on some additional debt in Vietnam to complete that factory. So yes and no. But there will be a repayment on some existing. But we will be taking this incremental debt on.

Steven Li

In Vietnam. Okay. Very helpful. Thanks guys.

Michael Wolfe

No problem.

Operator

Again, if you would like to ask a question, press *, then the number 1 on your telephone keypad.

Your next question comes from David Kwan of PI Financial. Your line is open.

David Kwan — PI Financial

Morning, guys. I guess outside of the 5G Massive MIMO win (phon), I understand that's going to contribute late in the year, but looking at the wireless infrastructure business outside of that, could you see the revenues grow this year?

And maybe can you comment on the status of some of your delayed projects that you'd seen over recent quarters? I guess some of the new product launches, the base station antennas in particular, and just other things that could help see stronger growth than what we've seen over the last year or so.

Randy Dewey

Well, if you recall, last year in September, we had announced that there was a slower two to three, possibly as much as four-quarter delay in some of the small cell deployments. That was expected to carry through to the end of June, which is what we announced last September.

The second half of this year, we are seeing a recovery in a lot of those key areas. So it's too early to necessarily say it's going to be a growth year, but certainly, we're seeing an improvement over some of the volumes over the last I'll call it three quarters.

So to answer your question directly, yes. We do see the volumes returning as long as we don't end up with a second wave of COVID or some other challenges there. But as it sits today, there's a more bullish expectation for the second half of the year in line with what we were expecting when we announced it last September.

David Kwan

Okay. Thanks.

Daniel Kim

David, I'll just add that with regards to the commentary in the MD&A of our expectation for higher sequential revenues for the balance of the year, that applies to all the business units.

David Kwan

That's helpful, guys. I guess in the Asia Pacific market, you talked about a rebound that you're already seeing in Q2. So it sounds like there's some pent-up demand there. Do you expect that for the full year that we could see revenues from similar to what we've seen in prior years outside, I guess, the last year? So in the, call it, 50 million-ish revenue for fiscal '20?

Randy Dewey

Excuse me. So there's no doubt from the first half of the year, with the slowness in the mobile sector, that there was certainly pent-up demand. And we are seeing a number of those programs that were a little slower or, in fact, delayed as a result of the pandemic now starting to ramp up. So we do expect the second half of the year to be more robust than the first half of the year, obviously. We're not certainly giving guidance on a specific 50 million, but we do see the robustness in the second half of the year.

Traditionally, the second half of the year has been certainly stronger than the first half of the year normally, in normal times. This, I think, will certainly just be enhanced, let's call it.

David Kwan

Okay. Can you talk about the impact of the government subsidy programs both in China and then here in North America? How we should see like the OpEx lines once those programs kind of fall off? What would kind of be the run rate that we should be expecting in terms of your expenses?

Michael Wolfe

Yeah. I mean in terms of ongoing or future operating expenses, it's not really a straightforward answer unfortunately. OpEx in predictable times can move quarter to quarter depending on timing of certain expenses, especially in the sales and marketing area. And I'd say Q1 did benefit from some timing and was lower, on the lower side, and we're talking like say a 5 percent variance. But I think that was true for Q1.

Q1 also saw some of the cost reductions. We did announce them at the end of Q1, but some of them were implemented during the quarter, earlier in the quarter. So we did see some cost reductions.

We also saw some additional expenses in Q1 related to COVID. Things like PPE, cleaning, overtime, a whole bunch of other expenses. And as we reported, the cost reduction implemented in Q1, they were a mix of permanent and temporary. So we're going to have to make some decisions going forward, depending on how things unfold in terms of our revenue ramp and the timing of bringing people back and incurring other expenses is really uncertain and will depend on, as I said, the revenue ramp, so.

OpEx will also be impacted probably in the fourth quarter, depending on the ramp of the new facility as that gets underway, and we would likely see an increase. But for the next quarter, we do expect the additional cost reductions that we made at the end, or some at the beginning but mostly at the end of Q2, to impact Q2 operating expenses and then the government assistance as well, offset by the additional costs that we're going to continue to have for the COVID measures we've put in place.

But I would expect that Q2 to go down and then probably some increases as we are expecting revenue to ramp in Q3 and Q4.

So sorry for the convoluted answer, but it's just difficult to predict at this time.

David Kwan

No. I can appreciate that. Thanks. Thanks, Michael.

I guess on the Vietnam facility, in the past, you've talked about I think it was last quarter that you'd mentioned that the customer was supportive of what was going on here and that you wouldn't lose business to a competitor because of the delays. Given that we're seeing that delay pushed out here, is that commentary still valid? And are the other vendors that were selected seeing similar issues? Or could they potentially help supply antennas to the customer until your facility is operational?

Randy Dewey

So there's no doubt, obviously, there was a slowdown let's call it in MMU volumes worldwide over that last, call it, two quarters here. The customer is still very supportive.

Obviously, everybody is anxious to get the airport open and get in there to finalize our factory and get final certifications done and final calibrations and equipment installations completed. So the customer is well aware of it. We meet with them regularly, and they're very supportive. And they're as anxious as we are to get our facility up and running.

So the unfortunate part is it just delays us unfortunately a couple of quarters versus what we were expecting, but we don't expect that to sort of degrade the business case necessarily. It's just, unfortunately, a delay in the business case.

Daniel Kim

David—

David Kwan

Has the overall—

Daniel Kim

David, sorry to interrupt there. If you look at the end market, this technology is only being deployed now in Asia, and you're only starting to see trials in North America. So it's still a very early stage. If I understand your question correctly, the opportunity absolutely is still there, and it's just starting.

David Kwan

Yeah. That's the sense that I got that it's still quite early. So if you are losing some business it's probably not much at this point. But like I say I'm just trying to get a sense of from the economics, some of the stuff that you'd talked about in terms of generating the positive ROI in the first two years of production, is that still the case?

Randy Dewey

Well, we are a couple of quarters behind, unfortunately, as a result of the delay here. We still think the business case is solid and intact. And to Daniel's earlier point, nothing has changed on the need for those products in the world. The unfortunate part with the pandemic is it's caused a lull.

So the business case is still intact, and we're certainly just anxious to get on with the program for sure.

David Kwan

One last question. Thanks, Randy. Because of the delays, has the cost increased? And if so, can you comment on how much? And then the balance, it looked like there was about $3 million that's still left to be spent from a CapEx perspective. Can you confirm that?

Randy Dewey

Yes. I can confirm that. And the operational costs are quite low at the moment other than rent and a few—the engineering team that we have. That would be the extent of the cost impact that we have right now. So a couple quarters delayed.

It certainly did hit a bit of OpEx costs because the facility didn't ramp up as quickly as expected. But it's not burdensome necessarily.

David Kwan

All right. Thanks, guys.

Randy Dewey

Mm-hmm.

Operator

There are no further questions at this time. I will now return the call to our presenters.

Randy Dewey

Well, we appreciate everybody's support, and certainly during these difficult times. Obviously, we're excited about where the future holds, and we felt that we weathered a very important and difficult storm quite well. In fact, we were feeling very blessed the fact that we had been deemed an essential service worldwide, and all of our operations were able to run through this entire period as well as supplying products that actually were essential and helpful for the world's efforts against COVID.

So thank you, again, for all your support, and we look forward to reporting Q2, which is not that far away. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.