



Coretec Inc.
2004 Fourth Quarter and Year Results
Conference Call
March 11, 2005

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 fourth quarter and 2004 full year 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 fourth quarter and full year financial results. Then I'll provide a snapshot of our business highlights in the quarter and describe the outlook for Q1 for our industry and Coretec specifically.

Thanks Paul:

After three successive quarters of profitability in 2004, our continuing operations in the fourth quarter were not profitable, with a loss of \$0.03 per share. Negatively affecting the quarter was a restructuring charge of \$0.05 per share which I will discuss later on. Excluding the restructuring charge, fourth quarter EBITDA was \$2.1 million and free cash flow \$1.1 million, a decline of 16% and 35% respectively from the prior quarter.

In the fourth quarter of 2004, sales increased \$3.3 million or 19% to \$20.8 million compared to sales of \$17.4 million in the fourth quarter of 2003. The increase in sales is mainly the result of the addition of sales from the Cleveland operations (acquired in March of 2004) and increased sales activity from the Toronto operation. Sequentially, sales declined 4% from the third quarter of 2004.

The geographic breakdown of revenue was 67% to the US, 28% to Canada and 5% to Europe. Revenue by end market was 40% EMS, 18% military/aerospace, 18% instruments, 13% Telecom and 11% computer. Our top 10 customers accounted for 31% of sales with the largest customer representing around 4% of sales in the quarter.

Gross profit increased \$0.2 million or 5% to \$4.6 million compared to \$4.4 million in the prior year period. The fourth quarter 2004 gross profit benefited \$0.3 million from the reversal of a product warranty accrual and \$0.3 million from the recording of investment tax credits for research and development expenditures in prior year periods. Gross profit as a percentage of sales decreased to 22.3% of sales compared to 25.4% in the fourth quarter of 2003 and, sequentially, 24.9% in the third quarter of 2004. The decrease in gross profit as a percentage of sales is principally a result of negative gross profit contribution from the Cleveland operations partially offset by the benefit related to warranty and tax credits noted above.

SG&A costs increased by \$0.1 million to \$2.8 million compared to \$2.7 million in the prior year period principally as a result of costs associated with the Cleveland facility, acquired in 2004.

Depreciation and amortization expense was \$1.6 million in the fourth quarter of 2004, a decrease of \$0.1 million from the prior year period.

In the fourth quarter of 2004 the Company restructured both its operations and sales management team, including the replacement of its COO and senior sales executives. As a result, the Company recorded a restructuring charge of \$0.9 million in the quarter as a result of associated severance costs compared to no such cost in the prior year period.

Loss from operations in the fourth quarter of 2004 was \$0.7 million as a result of the above items, compared to essentially break even in the prior year period.

Interest expense in the fourth quarter of 2004 increased \$0.1 million to \$0.3 million compared to \$0.2 million in the prior year period. There was a foreign exchange gain of \$0.3 million in the fourth quarter of 2004 compared to a loss of \$0.1 million in the prior year period.

In the fourth quarter, the Company sold some surplus equipment for less than the carrying value resulting in a book loss of \$0.2 million.

The Company recorded an income tax recovery of \$0.3 million in the quarter related to the valuation of loss carry backs available to the Company as a result of losses in prior periods. Net loss in the fourth quarter of 2004 was \$0.6 million or \$0.03 per share compared to a loss of \$0.2 million or \$0.01 per share in the fourth quarter of 2003.

With respect to our discontinued UK operations, as you may be aware, the Company restructured its UK operations which included the closing of its Biggleswade, Bedfordshire manufacturing site and the appointment of an administrator under the UK Insolvency Act to administer the winding up of our UK operating subsidiary. In the fourth quarter, the UK subsidiary was put into liquidation providing proceeds through the collection of accounts receivable and from the sale of equipment and raw materials less transactions and administration costs. The results of the UK operations have been accounted for as discontinued operations. In the fourth quarter, the Company recorded a recovery from the administration of \$1.7 million representing the proceeds from liquidation due to Coretec Inc. as the principal secured creditor of the UK subsidiary. At year end the Company had a receivable from the administration for the yet undistributed amount of \$1.5 million. We expect to receive the remaining funds within the first half of 2005.

Turning to capital additions, in the fourth quarter the Company made \$1.1 million of capital additions. Of this amount, \$0.6 million represents the purchase of the entire equipment platform

from the administration of the UK facility at liquidation pricing. This equipment has since been delivered to our North American facilities.

In 2003, the Company put its Sheppard facility up for sale and for reporting purposes segregated its \$5.1 million carrying value as a long-lived asset held for sale on the balance sheet. The 93,000 square foot facility, located on approximately 9 acres of land in Toronto, contains the Company's administrative offices, however the remaining 75,000 square feet of manufacturing area has not been completed or fitted out with equipment. In the fourth quarter of 2004 the Company decided to discontinue the proposed sale of the building while it formulates a plan for the potential consolidation of its three Toronto facilities into one facility. Concurrent with this development, in the fourth quarter of 2004 the Company agreed to a \$2.2 million conditional offer to sell the land the Lawrence facility is located on. The original offer has now expired and the Company is currently negotiating revised terms and conditions of sale with the potential purchaser, however, no assurance can be given as to whether the proposed transaction will occur or not.

Turning to liquidity and capital resources:

At December 31, 2004, the Company's principal source of liquidity included cash of \$0.4 million, trade accounts receivable of \$13.9 million, income taxes recoverable of \$0.6 million and a receivable due from the administration of the UK discontinued operations of \$1.5 million. Net working capital was \$6.5 million at December 31, 2004 compared to \$8.0 million at December 31, 2003. The decrease in working capital is principally a result of re-classifying approximately \$3.5 million of the Company's loans under its asset-based bank facility, due November 15, 2005, to current liabilities in the fourth quarter of 2004. We are currently investigating re-financing opportunities with respect to the maturing credit facility.

Cash provided from operating activities in the fourth quarter of 2004 decreased \$1.9 million to approximately nil compared to cash provided of \$1.9 million in the fourth quarter of 2003. The decrease in cash provided is principally as result of the \$0.5 million decrease in cash provided by net income adjusted for non-cash items compared to the prior year period and a \$1.3 million increase in cash used from changes in working capital compared to the prior quarter. Cash used by changes in working capital balances of \$1.1 million is principally a result of an increase in accounts payable in the period of \$0.7 million and an increase in income taxes recoverable of \$0.6 million.

Cash used in investing activities increased \$0.7 million to \$0.8 million compared to \$0.1 million in the prior year period. The increase in cash used is principally the result of an increase in capital expenditures in the fourth quarter of 2004 principally related to the further equipping of the Cleveland operation offset partially by proceeds from the sale of surplus equipment.

Cash provided by financing activities increased \$2.3 million to cash provided of \$0.5 million compared to cash used of \$1.8 million in the prior year period. In the fourth quarter of 2003, the Company increased bank indebtedness by \$0.7 million offset by the repayment of \$0.3 million of long term debt. In the prior year period the company repaid a promissory note in the amount of \$1.9 million and \$0.3 million of long term debt offset by an increase in bank indebtedness of \$0.4 million.

Shares outstanding at the end of the year were 18.6 million. And with that I'll hand it back to Paul.

Paul Langston

Thanks Mark.

The highlights of 2004 are as follows:

- We experienced year-over-year revenue growth of 25% despite the challenges associated with the appreciation of the Canadian dollar versus the US dollar. Approximately 60% of our revenues are denominated in US Dollars;
- Revenues achieved during the year of \$81.9 million are the highest annual revenues realized in the Company's history;
- Continuing operations returned to profitability on a full year basis;
- We achieved our highest EBITDA result since 2000;
- We achieved significant free cash throughout the year;
- We professionalized our executive team during the year with the addition of Mr. Jeff Canavor, Executive Vice President of Sales & Marketing as well as successfully concluded a search for operational expertise able to inject advanced manufacturing methodologies into all of our sites. Mr. Jonathan Schofield was appointed Chief Operating Officer on January 2, 2005;
- During the second half of 2004 we significantly improved our sales and marketing organization through key personnel additions, in particular Mr. Tom Carney formerly a Global Account Manager with Sanmina and Mr. Gary Miller, formerly V.P. sales with Pemstar. We have also executed a series of structural changes within the sales organization, the most important of which is the migration to a direct (versus indirect or rep based) and consultative sales model;
- We successfully progressed our offshore strategy and more than doubled our program management revenues;
- In March 2004 we acquired Ohio based Proto Circuits, a manufacturer of high reliability rigid and rigid flex PCBs. This acquisition has added product and customer diversity to our organization;
- In terms of approvals we had much success in 2004. Our Toronto operations were recertified to ISO14000, making us one of only a handful of companies in the industry in North America so accredited. In fact we were the recipient of Province of Ontario award for environmental governance and excellence. Our Ohio operation was certified to AS9100 in Q3 of 2004 and our Toronto operations successfully achieved the same in Q4 2004;
- During the year we expanded our Banking facility as well as revised the associated conditions whereby covenants have either been greatly relaxed or removed altogether;
- At the end of 2004 we have a very sound financial foundation relative to many other industry participants. Our working capital ratio was 1.4:1 and our long term debt was only 6% of total assets as of December 31, 2004;
- Our Denver operation underwent an organization restructuring to better align it with NPI (New Product Introduction) requirements as relates to technology and cycle time. Additionally the capacity of the operation has been augmented to facilitate the transfer of UK business as well as key account growth;

Specific to Q4 we additionally executed on the following:

- We continued the retooling of our executive suite following the departure of Barry Bristow, with the addition of Jonathan Schofield as Chief Operating Officer. Mr. Schofield has many years experience in the defense/aerospace sector and is a Professional Engineer and has a Masters of Business Administration. His particular expertise is in advanced manufacturing methodologies such as Lean and 5S as well as continuous quality improvement;
- During the quarter we made a series of capital equipment additions aimed at increasing capacity and capability. In Toronto we added several advanced Hitachi drilling machines and finalized the installation of an advanced electroplating platform. In Ohio we made significant investments in electrical test, vacuum lamination, photo plotting, drilling and routing equipment;
- We drastically improved our information systems team with the addition of Mr. Mike Schumacher, a renowned expert in our particular ERP system (Cimnet). Furthermore we launched an intelligent engineering system (Engenix) that will dramatically improve job engineering cycle time and team productivity;
- We purchased from our discontinued UK operation the entire equipment platform at liquidation pricing and subsequently distributed it to our Toronto, Ohio and Denver sites;
- We also redistributed the order book from our discontinued UK operation between our various North American sites;
- Towards the end of Q4 we also finalized the administration process related to the liquidation of the UK business which will result in a \$1.7 million cash recovery;
- Also in Q4 we upgraded the management team at our Ohio operation, which included the addition of Messrs. Herb Snogren and Greg Lucas. The former being one of the Company's top technologists and the latter is an industry renowned process engineering guru;
- We received notification that our Scientific Research and Experimental Development (SRED) filings were accepted as filed for fiscal 2001 representing an unutilized Investment Tax Credit of approximately \$600,000. We anticipate additional tax credits to be granted for filings made with respect to 2002 and intend to make further submissions for fiscal 2003 and 2004. We record ITCs associated with research and development expenditures on an "as cash is received" basis versus on an accrual basis;
- And finally, we harmonized our Customer Service and Engineering organizations in order to drive shared capacity and a common "value added" customer experience regardless of site.

With respect to the marketplace, 2004 proved to be a tale of two halves. Through to the middle of Q2 the industry specific to Rigid PCBs was enjoying a rebound in demand and commensurate production activity that started in Q3 2003. Since that point in time the Book-to-Bill index has been below parity for 6 out of 8 months with the weakest results occurring in Q4 (i.e. November was 0.87 and December was 0.93). December 2004 versus December 2003, Rigid PCB bookings are down 1.3% and shipments are off 6.1%. On the year bookings are up 6.6% versus 2003 and shipments were up 16.0% but the majority of the increase occurred in the first half of the year. Case in point, bookings on a trailing 3-month basis at the end of Q4 2004 are off roughly 20% as compared to the same period in 2003.

Capacity Utilization in Q4 2004 softened to levels not seen since 2002 and early 2003, namely below 70%. It has been suggested that 80% is the level required for the industry in general to

experience financial health. Additionally, Lead Time in Days has been consistently below the key 20-day level since Q1 2004, with additional deterioration in Q4, i.e. below 19 days. As a result of the deterioration in Lead Times and CAPU, pricing has been affected negatively in North America. After enjoying stability and some price appreciation across all layer counts since Q3 2003, the industry since late Q3 2004 has been experiencing a marked decline in pricing. Of concern is the aggressive pricing of prototypes and quick turn production which has been evidenced since summer 04. As Lead Times shrink additional capacity becomes available for rapid response manufacturing. However, not all companies are equal in this regard. In the longer term, companies that are not appropriately structured culturally or are not oriented to high mix low volume manufacturing, from an equipment platform perspective, will restructure and remove capacity.

Indeed the second half 2004 softness has precipitated a new round of restructurings and rationalizations amongst the large industry players. Most notable are 1/ Photocircuits, who announced the closing of their Georgia operations which employed 600 people and had capacity of approximately US\$100-\$150 million; 2/ Viasystems who have scheduled the closure of their remaining North American facilities (in Montreal) which once had revenues of US\$150 million and employed as many as 2000 people (780 recently); 3/ Sanmina who've had a series of layoff announcements at their various PCB facilities; 4/ EIT who have downsized staff measurably in late 2004; 5/ DDi who have reduced staffing by 20% at the California operations and walked away from their UK facilities; 6/ Electropac who have restructured their Canadian operations where combined they once produced US\$20 million in PCBs annually; and 7/ Ambitech who have been forced to sell several divisions as well as equipment in order to deal with liquidity issues.

Small companies have fared much better than large over the past 4 years but recently there are indications that this is about to change. A recent Credit Suisse First Boston research report suggested that 13% of the North American PCB industry capacity will likely be shuttered in 2005 and as others have projected that as many as 25% of the industry's participants will succumb to restructuring or closure in the near term.

What's in store for 2005 and beyond? Forecasts for 2005 growth rates in North America have been significantly reduced over the past six months and are now ranging from slight contraction to minimal growth, i.e. 1 or 2%. The projections beyond 2005 are not much more attractive with one analyst (Prismark) suggesting that PCB growth in the America's will be virtually non-existent through 2008 (eg. 0-1%/annum).

Of particular concern are projections for declining growth rates in the Defense and Aerospace sector which has been a bright light in the North American PCB industry over the past couple of years. A slowdown in defense spending by the US government caused by a gradual reduction in activities in the Middle East are pointing to a reduction in military electronics demand. According to Henderson Ventures, in 2003 the growth in Military Electronics was 13.3% slowing to 11.3% in 2004 and projected to continue to decelerate (6-7% in 2005 and 2006) and ultimately decline by as much as 5% in 2007. In addition, expenditure cuts at NASA have already affected space subcontractors. Additionally, satellite programs, particularly commercial, have been significantly reduced over the past several years resulting in layoffs across the industry. All of these factors are suggesting that a pause in demand is coming to, or is already upon, electronic components providers.

Offsetting the aforementioned dampening factors in the aerospace sector is demand for electronics emanating from the airline industry which is undergoing somewhat of a rebound due

to several key programs – the Airbus A380 and the Boeing 787. It is also worthy to note that on March 5, 2005 the US Air force lifted its ban against Boeing for satellite launch contracts. The missile defense system should also play an uplifting role with respect to satellite builders.

With respect to costs, in 2004 the PCB industry experienced a significant degree of supply inflation. Specialty chemicals rose by as much as 20%, laminate pricing increased by 5-10% and precious metals used in PCBs (silver, gold, palladium), being a function of global demand, increased in cost significantly throughout the first 9 months of the year. The inflationary trend abated by Q4 as industry activity levels declined. It is our expectation that PCB supplies inflation will be very much muted in 2005.

We are however concerned about the health of our supply chain. With the number and magnitude of recent PCB company closures or announcements of closures to come, we believe that suppliers and distributors to the PCB industry will be under tremendous pressure to cut costs and services. Already, meaningful staff downsizing has occurred at the laminate manufacturers as well as the other specialty suppliers to the industry. The Canadian marketplace is particularly worrisome given the size of the supply infrastructure and the historical reliance on Viasystems (formerly Circocraft). Having said this, it is our belief that our size will afford us ongoing attention from the supply base but the available resources will continue to be limited.

Now turning to our strategy.

2005 will be a year of change for Coretec – culturally and infrastructure wise. The executive team that has been assembled we believe is one of the best in the industry. The addition of Mr. Jonathan Schofield was the final key to effectuating our drive to be Worldclass. From field engineering consulting and value added Customer Service to increasingly compressed manufacturing cycle times and tough technology reconciliation we are dedicated to optimizing the customer's experience with Coretec. In every aspect of our business, personnel are being improved, whether it be through ongoing training and education or newly imported talent, and systems are being enhanced to fulfill our **“how far? how fast?”** brand commitment.

Our investment plans in 2005 involve ongoing advanced equipment installations at our Toronto and Denver operations as well as further equipment transfers from Toronto to Ohio. Our \$4 million capital expenditure program for 2005 is focused on technology furtherance in Toronto as well as Denver. Additionally, we are now deep into the planning phase with respect to our consolidation strategy in Toronto at our owned 100,000 sq.ft., 9 acre Sheppard site which we took off of the market in Q4. Phase 1 of the project (facility design/layout, costing and Board approval), will be complete in Q2. Phase 2, involves the construction and installation of a complete lamination and CNC drilling operation within the existing building. The estimated timeframe for Phase 2 is Q2 2006. Phase 3, deals with the expansion of the current building by 40,000 sq.ft. and Phase 4 is the final installation of the outerlayer processing platforms from Ellesmere and Lawrence.

In regards to our Lawrence facility, in November we accepted an offer of purchase and sale for the site from a land developer who has also agreed to buy three adjacent properties. The original offer did not firm up as a result of complications with one of the other properties. We are currently in ongoing negotiations with the land developer and remain hopeful that a revised deal can be reached in the near term.

Additionally, in early January 2005 we exercised an option to purchase the building and land associated with our Denver facility. The purchase price is equivalent to the balance remaining

on the mortgage financing. We expect to close this purchase in early Q2 with the net result being the achievement of annual operating savings.

TIME remains a key operating principle for us. In fact it is our belief that TIME is truly the only market differentiator. As such we are intensifying our efforts to drive revenues with associated time premiums. To facilitate this we are forcing structural and cultural changes into our quotations, customer service, materials management and engineering organizations such that improvements in cycle and response times are aggressively sought. Additionally, we are adopting LEAN methodologies in operations to drive out queue times and drive in cycle time optimization. At the root of these initiatives is the assumption and belief that the demand for PCBs in North America will be increasingly boutique in nature (namely small volume exotics) and rapid response oriented, i.e. required in as short a time as is physically possible.

As fundamental to our strategy as TIME is, we are also committed to providing Worldclass value added services. It is already well known throughout the industry that our field applications engineering team is one of the best if not the best. Our design group is also developing a strong reputation for responsiveness, technology capability and intelligent design.

At the opposite end of the prototype and quick turn manufacturing spectrum is the provision of volume product. In response to the dynamics of the marketplace and specific customer requests we continue to develop our offshore program management offering. In the past 12 months our revenues associated with brokering PCBs built offshore have expanded significantly but more importantly we have established new supply partnerships that we believe will allow us to accelerate our growth within this silo. With the addition of a program manager familiar with the China and Taiwan environments we believe that our offering is significantly more value added than most of those available in the industry today.

With respect to our Ohio facility, we initially projected it to be accretive to earnings in early 2005. Our integration and execution at the site has not proceeded as expeditiously or as effectively as anticipated. We have refined our product focus at the site such that it is virtually dedicated to Rigid Flex PCBs, which has traditionally been an engineering and operational strength. This is a \$120 million PCB sector that is not well served in the industry and capable fabricators are quite sought after by key military and satellite contractors. We are now budgeting the site to be accretive from a free cash perspective by midyear.

Our Denver operation has performed extremely well in terms of On Time Delivery performance and New Product Introductions (NPI) activity. The capacity of the site has been expanded by 25%-30% since Q3 2004 and from a personnel perspective is prepared to assume an even greater variety of high reliability projects. This facility integrated the order book from the UK facility very well in Q4 2004, albeit at a significant cost as relates to non-recurring engineering activities. It is now preparing to integrate some of the Ohio order book, as relates to non-Rigid Flex PCBs.

Finally, I would like to briefly discuss our thoughts for Q1 2005.

The fact that we are just-in-time product builders, makes it difficult for us to offer revenue or eps guidance. Historically we have experienced annual revenue growth in excess of the industry as measured by IPC. We expect that 2005 will be no different in this regard. Furthermore, we are keenly focused upon maintaining meaningful positive free cash throughout 2005.

We now believe that the PCB industry in North America is undergoing a restructuring that will result in significantly less capacity and fewer market participants. As this shift takes place we believe that a significant opportunity exists for companies that are appropriately aligned with the changing market demand dynamics. We are convinced that our core operating pillars;

technology, time and value added services, combined with our customer centric culture will allow us to adapt and optimize and become 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 Friday, March 12, 2004 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 21115479#. As well, the text of our remarks will be posted on our website; www.coretec-inc.com.