

Q2 2013 Earnings Call

Company Participants

- Ricardo Fernandes Pereira, Chief Financial Officer

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Positivo Informatica's 2Q13 Earnings Conference Call. Today, we have with us Helio Bruck Rotenberg, CEO; Ricardo Fernandes Pereira, CFO and Head of Investor Relations; and Lincon Lopes Ferraz, IR manager from Positivo Informatica.

We would like to inform you that you will be in a listen-only mode during the Company's presentation. After Positivo Informatica's remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions) We have a simultaneous webcast that may be accessed through the Company's website www.positivoinformatica.com.br/ir. Slide presentation may be downloaded from this website. Please feel free to flip through the slides during the conference call.

Before proceeding, let me mention that forward looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Positivo Informatica's management and on information currently available to the Company.

They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Positivo Informatica and could cause results to differ materially from those expressed in such forward looking statements.

Now, I will turn the conference over to Mr. Ricardo Fernandes Pereira, Positivo Informatica's CFO. Mr. Ricardo, you may begin the conference.

Ricardo Fernandes Pereira {BIO 17161053 <GO>}

Thank you. Good morning. We are here to present the results for the second quarter of 2013, when we recorded an adjusted EBITDA of R\$28.4 million, up 16.9% in relation to the second quarter of 2012.

On page three, we highlighted the following results for the period. We recorded quarterly sales volume of 800,000 PCs and tablets under Positivo Informatica's brand. A gross

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profit of R\$130.8 million, from our adjusted EBITDA of R\$28.4 million as I said before, a growth of 16.9%. An operating cash flow of R\$72.8 million in the second quarter '13 and R\$164.8 million in the first half, an improvement of 19 days in the cash conversion cycle over the first quarter of '13 and a reduction in the net debt of R\$149 million in the first half of this year.

On the next page, page five. In the second quarter 2013, the Brazilian PC market recorded a moderate sales volume in line with expectations, as well as with the first quarter. Two factors they hampered a larger sell-in volume: a weaker demand from the consumer and excess inventory in the channel at the beginning of the quarter. This effect, however, was partially offset by the significant volume of sales to the government market.

Consequently, the PC market recorded some retraction in relation to the second quarter 2012, but it's important to note that if we add a tablet in the hardware category, sales grew in the second quarter according to the preliminary analysis of the main institutes that monitor the markets.

The 10% appreciation of the U.S. dollar as of late May impacted computer manufacturing costs. Bearing in mind that the costs were read on the press release, which (inaudible) and the moderate appreciation of the U.S. dollar since mid-2012.

So, from the standpoint of manufacturers, they need to increase prices to pass through the higher costs was imminent. However, the lower consumption in the domestic market increased the level of complexity of negotiations between manufacturers and sales channels. As the later sought to keep products in a price points, especially entry level products, which account for the largest share of the volume.

Now looking at the supply chain. We saw an increase in memory card prices in international market. This component's supplied was readjusted after a periods of financial losses in the industry, when production was centralized in the hands of few manufacturers.

Additionally, strong demand for the tablets and smart phones has driven part of the production capacity of the suppliers to manufacturing memory cards for mobile devices.

In view of this scenario, Positivo Informatica focused on fulfilling its commitments with the channels, while seeking to maintain profitability by revising its product portfolio and marketing expenses, which you will be able to see during this presentation. We also focused on cutting fixed costs and the further increase efficiency gains.

On page six, you can see that in the second quarter of 2013, the Company sales volume hit a new record with 816,000 devices, which represent a growth of 37% year-on-year. Of this total, 713,000 units were sold in Brazil and upturn of 27% and 106,000 units were sold in Argentina, a sharp increase of 182%.

The Company expects to have increased its market share in both countries as the sales performance was well above the industry projections for the period.

In terms of retail, we managed to record a slight increase of 0.3% over the same period last year, despite the weaker demand and the holding back of some deliveries in the end of the quarter caused by negotiations with retail chains to mitigate an impact from the dollar appreciation against the real.

In the government segment, we recorded our highest growth which was 223%. We were involved in an intense schedule of deliveries for projects, especially education projects, both in Brazil and Argentina. Due to the entrance of the new projects, we have increased the estimated volumes to be achieved in 2013 to more than 600,000 devices, of which 350,000 in Brazil and the rest in Argentina.

The corporate market continues to contribute with a significant growth in the second quarter 2013 given the recorded of 61% increase year-on-year. This upturn was led by delivery of tablets to private universities in Brazil and the performance of own platform of subsidiary resellers who serve mainly the segment of small and medium components. Our own service platform has more than 5,000 registered resellers.

Moving forward, we selected two very interesting launches in the second quarter of 2013 to share with you today. The first one is our new all-in-one computer line called Positivo Union. We are offering six models in this format with a wide range of configurations. These computers have the advantage of saving space and energy.

We have a version with 18.5 inches wide screen, optional embedded TV with digital and analog tuner and remote control, and a top of line version with capacity 21.5 inches screen, resolution full HD and multi-touch screen with ten simultaneous detection points. Prices for all-in-one computers started from R\$1299.

Another important launch was the Company entry level tablets, Positivo Ypy L700. We are beginning with a suggested sale price of R\$479. This device has a capacity of 7 inches screen, one front camera and one rear camera and black finishing in the front and silver finishing in the back with a Google signature.

Moving to the financial results, on page nine. We can see that in the second quarter of 2013, we've recorded net revenues of R\$632 million, a substantial growth of 25% in relation to the previous year. The government segments played an important role in this result, but let's also bear in mind that the corporate segment recorded an excellent performance and also had a contribution from new business lines, which together with tablets accounts for more than 15% of total revenues, as you can see in the first graph to the left.

In terms of average price, the Company recorded a reduction in relation to the first quarter due to the lower share in the government and the corporate market, which usually drives prices up. We also recorded a high volume of sales of desktops without monitor.

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The average notebook prices fell by 2.7% quarter-on-quarter, mainly due to higher volumes of sales of notebooks for education projects and the average tablet prices declined by 9.8% over the first quarter, mainly reflecting the higher volumes and deliveries for the devices to the government projects developed by the Ministry of Education at prices that are lower than the retail prices.

Moving forward, the cost of goods sold consumed 79% of net revenues in the second quarter of 2013, climbing to 5.0 percent point in relation to the second quarter of 2012 and the first quarter 2013, respectively. This increase was a result of higher prices of raw material and components due to the valid appreciations and higher sales of notebooks that result and tablets for the education projects, whose raw material and component costs account for the larger share of their cost restructures, which one hand and at least one on the other hand was offset by lower expenses with marketing and sales commissions.

Raw material and components represented 75% of net revenue as the average imported input U.S. dollar price achieved R\$2.06 in the second quarter of 2013. The appreciation of the U.S. dollar affects with specifically components with high inventory turnover ratio, such as processors and operating systems. This line was also affected by higher prices of memory cards in the international market and the largest volumes of notebook and tablets for educational projects of the government.

Other costs represents 3.9% of net revenue in the second quarter, virtually flat in relation to the second quarter of 2012 and the first quarter 2013. We manages to offset from the college bargain agreement as of March by following business efficiency gains and we also have benefited from the evaluation of the fixed costs structure. Gross profit totaled R\$130.8 million in the second quarter of 2013.

On page 11, selling expenses amounted to R\$99 million in the second quarter of 2013, corresponding to 15.6% of net revenue, down 2.2 percentage points year-on-year. Reduction was mainly due to the higher share of revenue from government clients, which represents lower selling expenses and also due to adjustments to marketing expenses with retail clients.

The marketing expenses totaled R\$34 million in the second quarter or 5.4% of net revenues. That was the lowest level reached in the past six years.

In addition to the higher share of revenue from the government clients as I mentioned before, there was also an effect from actually co-operated marketing expenses as a result of negotiation of the dollar appreciation to adjust profitability.

The technical assistance expenses reached R\$37 million in the second quarter or 5.4% of net revenues, an improvement of 1.0 percentage point year-on-year, due to efficient gains, lower components and scrapping expenses, and better dilution of the fixed cost structure.

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The G&A expenses totaled R\$27 million in the second quarter plus 9% year-on-year. We recognized a non-recurring amount related to contingencies and consulting services focused in efficient enhancing projects, which if excluded -- which is excluded, sorry year-on-year increase to 4.7%.

On page 12, adjusted EBITDA totaled R\$28.4 million in the second quarter, an increase of 16.9%. In terms of margins, this represents 4.5% down, 0.3 percentage points in relation to the second quarter of 2012. This happened chiefly due to the impact from the dollar's appreciation on components with high inventory turnover ratios, such as processors and operational systems.

It's worth noting that in absolute terms, the adjusted EBITDA is exactly at the same value as the traditional EBITDA under the accounting rules until 2012, thus incorporating the results of our joint-venture in Argentina.

In the second quarter, financial results was a net expense of R\$21 million, reflecting the Company's net debt as well the variation of the exchange rates which recorded a loss of R\$14 million.

In the period, the Company recognized losses from the payments of obligations due to the appreciation of the dollar and also the mark-to-market of outstanding invoices denominated in foreign currencies on June, 30. Consequently, the Company calculated the net loss of R\$8.2 million in the second quarter, which corresponds to a margin of less 1.2%. Year-to-date net income decreased to R\$3.5 million.

Moving forward, we recorded a significant cash generation in the second quarter 2013, totaling R\$17 million, filled by the working capital, about which we are going to talk next.

In the first half of 2013, cash generation amounted to R\$165 million, an increase of 25% over the first half of 2012. We closed the second quarter with a working capital of 500 -- R\$600 million, a reduction of R\$95 [ph] million over the first quarter 2013.

We can see on the first graph to the left that the account receivables decreased to the equivalent to 65 days of revenues, due to the holding back of some deliveries at the end of the quarter. While the Company renegotiated commercial conditions with retail clients due to the same reason, inventory increased quarter-on-quarter, closing the second quarter at 85 days as we ended up with a larger inventory volumes. Trade accounts payable financed 76% of the balance inventories improving 14 days, 14% discounts in relation the first quarter.

Benefiting from this improvement on their working capital, net debt decreased to R\$225 million, R\$65 million lower than the end of the first quarter 2013. In the first half, net debt decreased R\$143 million or 38%. Another piece of good news is that our debt profile improved substantially in the second quarter due to their release of the first tranche of total three tranches of a loan of up to R\$173 million that we contracted from BNDES. This led to the BNDES loans representing 74.0% of our net debt, moving up to 35 percentage points in a relation to the close of the first quarter.

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It is important to bear in mind that in the second half as based on the Company's historical seasonality, net debt is expected to increase due to demand for the working capital deriving from the upturn in retail at the Company.

On the last page about the financial. The investment totaled R\$7.5 million in the second quarter, down to 46.2% over the second quarter 2012. In the first half, investments came to R\$15 million, a reduction of 51% over the same period last year, in line with what we expect for 2013.

If we consider all investments that are not related to R&D, since R&D investments are mandatory, the reduction that the management was able to achieve reached 74.5% in the six-month period and they are estimated at 53% for the year, reflecting the Company's focus on cash generation.

In the period, Company expanded the nominal production capacity in this turn of Manaus, which moved up from 20,000 to 35,000 PCs. Due to the new structure, the Company had to expand the warehousing area as well.

Now we are available for the Q&A session and thank you very much for being here.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) There appears to be no questions, so I would like turn the conference back over to Positivo Informatica for final considerations.

A - Ricardo Fernandes Pereira {BIO 17161053 <GO>}

Thank you. Well, the Company continues focusing on strengthening its financial position as well as the entering in new segments and diversifying its portfolio to hardware devices. Higher costs are to be passed through the PC price due to the dollar appreciation for further quarter. It is very important to mention that.

Volumes can keep at satisfactory levels despite the macroeconomic scenario, due to factors government client[ph] first volume. The second tranches of the loan with BNDES is expected to be released in the second half 2013. The new loan from BNDES amounts to up to R\$173.1 million, and mature in six years.

Effects from adjustments to the fixed costs structure should be better perceived as of the third quarter and an expectation of leverage by smartphone sale volumes was the beginning of manufacturing in Brazil and the new tax structure that stimulates domestic production.

Once again, thank you very much, and see you in the next quarter.

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Operator

Thank you. This concludes today's Positivo Informatica's earnings conference call. You may disconnect your lines at this time. Thank you.

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