

Q2 2014 Earnings Call

Company Participants

- Lincon Lopes Ferraz, Investor Relations Officer

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Positivo Informatica's 2Q14 Earnings Conference Call. Today, we have with us Helio Rotenberg, Chief Executive Officer, and Lincon Ferraz, Investor Relations Officer. We would like to inform you that you will be in 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. The 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 belief 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 call over to Mr. Lincon Ferraz, Positivo Informatica's Investor Relations Officer. Mr. Ferraz, you may begin your conference.

Lincon Lopes Ferraz {BIO 18660463 <GO>}

Thank you. Good morning, everyone. We are here to present the results for the second quarter 2014, when we recorded adjusted EBITDA of BRL43 million.

Moving to page five, we can discuss a little bit about the margin. The Brazilian hardware market was really impacted by the low economic activity in the second quarter. Consumer and industry confidence fell to the lowest levels in five years. So retail sales were below expectations with lower PC volumes and a slowdown in mobile devices, such as tablets and cell phones. As of July, however, we had seen signs of an improvement in demand, which may lead to a retail volume recovery in the third quarter.

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Given this scenario, company sales benefitted from revenue growth in the corporate and government markets, which partially offset the decline in the retail revenue. In the mobile device market, we recorded higher retail revenue from tablets and a one-off decline in mobile phone sales. We decided to anticipate the rich configuration of smartphone production in our plant in Curitiba. It was begun in June and should consume around BRL4 million in investment.

Also we are pursuing more diversification in revenue, with increased revenues in the corporate and also in the government market. We won recently a big bid for around 900,000 tablets which are going to deliver in 2015. And also we are putting a lot of efforts in optimizing working capital. So we expect a rapid decline in the acquisition of raw materials in order to prioritize the use of the inventory already started here in Brazil.

On page six, we can see the sales performance as we can see here, we sell year-on-year to 29% in PCs and tablets, in the first half of the year, the reduction while a little bit lower at 22%, mainly due to the performance in Notebooks that is very representative in the retail segment. As you can see government and corporate sales also fell, but they had a bigger average price, so the revenue in both segments were degrade year-on-year.

Mobile phones were around 100% in the first half of the year when compared to 2013. But in the second quarter, because we had some problems with outsource [ph] of production and also because we were bringing the production to our factory. We had a low reduction of 21%, but it also driven a reduction in terms of revenues.

We can see on page seven, our new product launch is very cost effective smartphone with interesting design, we have 4 inches screen, it can receive dual SIM, also its projects with the new Android KitKat and have front and back camera with 5 megapixel and flash. The projected prices is BRL469 in the retail.

Moving to page nine, we can see the revenues, as I said we have below average prices. So the reduction in net revenue was single digit 8% year-on-year in the second quarter, mainly due to the reduction of 40% in the retail segment. Government and corporate segments grew by two digit percentage. In the half of the year, the revenue is almost flat with one that BRL2 billion and we expect in the second half that the retail recovery its position as the leading segment in our revenue.

Average price, you can see that the trend is positive. In the case of Desktops is the fifth consecutive quarter in which we -- which is an increase. Notebooks had more decline, but it was covered by big project involved in Notebooks, educational laptops sales here in Brazil. Tablets we had more sales in the retail and we have more entry-level products.

And cell phones grew by 28% quarter-on-quarter due to the higher cost situation of smartphones in the sales mix.

Moving forward, analyzing costs and expense, we recovered 3 percentage points in the gross margin. We came to 23% and this resulted from the decline in the dollar price of

components as we couldn't keep the price flat and the dollar price reduced [ph] in the period we could recover 3 percentage points in the gross margin.

In selling expenses, we registered 14%, it's almost flat quarter-on-quarter, it's because we are still selling much of the government and corporate sales, which does not have much expenses with marketing, you can see that marketing is still around 4% in the second quarter. We had a compensation in the technical assistance, which grew to 6%. You can see in the graph in the right but all in all, selling expenses remained at 14% in the second quarter.

G&A expenses registered BRL30 million, we had BRL3 million in extraordinary expenses related to consulting services. We also had BRL3 million in R&D and if we clean up the base by both the consulting and the R&D, we will reach BRL25 million in the second quarter. It should be a growth of 9% which is mainly represented by the collective bargaining agreement that we had as of March.

Page 11, we can see EBITDA and net margins. We've registered 43 million adjusted EBITDA in the period is a growth of 51%, it was very good, it's the same recovery we saw in the gross margin and due to the better relation between the prices in the US dollar here in Brazil. In the first half of the year, adjusted EBITDA totaled BRL80 million with the EBITDA margin of 6.09%.

Net income totaled BRL3 million in the second quarter and in the first half of the year, it is BRL4.5 million, which is a growth of 27% year-on-year. The financial results was negative by BRL22 million, which is due to our higher debt, higher net debt that we carried in the second quarter, which we expect to reverse in the third and fourth quarters, because of the reduction in the working capital.

We had also in the financial results are negative exchange valuation of BRL9 million, which is the result from the hedging instruments with a loss of 30 million and the positive result in the exchange rate on accounts payable which was positive by BRL4 million.

Moving to the cash flow. Operating cash flow was negative by BRL8 million in the second quarter and positive by 4 million in the first half of the year. As we explained in the recent conference call, we expect that the operating cash generation will increase in the second half due to the working capital optimization initiatives and the concentration of government projects in the most preceding the elections that will take place in October.

Page 13, working capital we can see that in the close of the second quarter. Working capital totaled BRL700 million, it was down 21 million in relation to the end of the first quarter. The declining international purchases let a lower volume in the inventory (inaudible). Accounts receivable also fell due to the collection of receivables and lower revenue in the second quarter. Working capital represented 28% of annualized net revenue, cash conversion cycle closes at 126 days, an increase of 36 days in one year, reflecting the decline in revenue between the periods.

We closed June with the net debt of BRL405 million [ph], flat in relation to the end of the first quarter, it showed [ph] growth that is substantial improvement in the company's profile that profile. Thanks to the 100 million raised through the first issue of debentures. This debentures will mature on April, 2016.

Investment on page 14, we began producing smartphone in Curitiba's plant here in Brazil the South end region we could allocate BRL500 million to do so and we try to review the priorities for the year, and make the investment results hiring the total duration budgets for the year. So you can say that we have a new expectation of 27 million for the year 2013, it's a new reduction of 7% year-on-year, the last quarter I presented to you that this year would be a little bit higher than the previous year and now have the good news, we can again reduce the CapEx by 7%.

Well, thank you for your attention. We can now start the Q&A session. Thank you.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) It seems to be no further questions, so I would turn over to Positivo Informatica for final considerations. Please go ahead.

A - Lincon Lopes Ferraz {BIO 18660463 <GO>}

Okay, thank you. Well, we start to growing more positive as we can see that in the second half of the year, we will have certainly more cash generation. Also we expect the retail demand to improve and we are also seeing that happen as of July. The lower purchase from suppliers can lead to more cash generation and we are in fact, realization -- realizing that we don't need to have so big working capital. We can work with new logic skills [ph]. We can work with better payment terms with the suppliers, so we expect to keep the working capital lower in relation to the net revenue in the future.

The trend of recovery in the retail was seen in the month of July, which was a good month, I can't disclose the number, but I can see that we have good recovery also in the PC segment, which was very hurt in the first half of the year. For the government, we also have more than 300,000 PCs deliver between July and December. So it's a big government project to deliver. And in-house smartphone production will help us to reduce costs and we are going to be more competitive. So we are very, very optimistic about the volumes of smartphones in the third and the fourth quarter 2014.

So, thank you for your attention. We will see you in the next conference call. Bye-bye.

Operator

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

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