

Y 2015 Earnings Call

Company Participants

- Lincon Ferraz, Investor Relations Officer

Presentation

Operator

Good morning ladies and gentlemen. At this time, we would like to welcome everyone to Positivo Informatica's 4Q15 Earnings Conference Call. Today, we have with us Lincon Ferraz, Investor Relations Officer. 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) Also, please note today's call is being recorded.

We have a simultaneous webcast that may be accessed through the company's website at 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 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'll turn the conference over to Mr. Lincon Ferraz, Positivo Informatica's Investor Relations Officer. Mr. Lincon, you may begin your conference.

Lincon Ferraz {BIO 18660463 <GO>}

Thank you. Good morning, everyone. We are here to present the results for the full year 2015 and the fourth quarter. In the period, we recorded strong growth of mobile phone sales. We surpassed the 1 million devices, more than twice that we registered in 2014. We started new direct sales fronts.

Now, we have an in-house e-commerce platform to sell smartphones. We launched kiosks in shopping centers and also we are awaiting space in some .com companies here in

Brazil retailers, that we call marketplaces, which is going very well. In the period, we launched the Quantum business unit. The Quantum unit is focused on direct sales of smartphones. It had a great results in the fourth quarter. We are going to discuss this later. Also, we launched VAIO brand here in Brazil. It's a very well-known brand in the country and it focuses in the high premium segment.

We also launched some measures to improve efficiency in terms of cost and cash due to the economic crisis here at Brazil. So we've tried to mitigate this impact. So it started with streamlining of the administrative workforce, so it could reach 14% reduction year-on-year in general and administrative expenses. Even though, the inflation was double digit during the period, also, we launched a program to reduce post-sale expenses. So we achieved a 25% of reduction in unit costs.

The third measure was in the factory, so we closed one unit in the State of Ilheus, in the city of Ilheus, pardon me, and also we moved the PC and tablet production from Curitiba to Manaus. So there, we are going to have better synergy in terms of cost and also we have big benefit in terms of cash flow, I'm going to discuss this later.

So our cash conversion cycle improvement by 26% to 75 days and we executed the tax asset monetization plan. So it involved the change of the production from Curitiba to Manaus. I have a chart in the next few slides that I'm going to discuss it with you.

So we ended with a cash balance of over BRL500 million, it's enough for more than one year of payments in the company, independent of refinancing the debt, so with a very good cash position. And we closed the year with the lowest net debt fees 2011, it closes around BRL260 million. It gives us our net debt over EBITDA -- adjusted EBITDA below three times. So we are in a very good condition in terms of liquidity, it's very safe, the financial condition of the company.

Let's move to page four. We can of course -- we have some color on the landscape. The most important thing that happened in 2015 is that the market dropped 36%. This event was not expected. So we can see that the original forecast from the consulting firms, here we have the information for IDC. They expected the market to be flat year-on-year.

But actually what happened was a big reduction and the size of the reduction was increased quarter over quarter over quarter. So in the fourth quarter, the reduction year-on-year reached 48%. So the market didn't expect that and what happens when the market don't expect the level of the inventory in the segment and the industry goes up.

This happens, because companies -- all their products, computers, tablets, smartphones are produced in Brazil, either -- both Positivo and its competitors. So all the major brands that you know, the sales in Brazil are produced locally due to the regulation. So they have to buy component with six months in advance, because most of the logistic -- some components are and they use maritime [ph] logistics.

So the factor says that a lot of pressure in terms of cash flow, because of the inventory build-out, and also in the margin, because the local currency devaluated a lot in the year

and 90% of the cost of the products are carried in dollar. What we did in the period? We launched more conservative methods for forecasting demand. So we reduced our purchases as of July significantly, also we have promotional sales slow-turnover inventory. You can see that in the graph, in the right side of the page four.

We managed to close the year with the same level of excess inventory that we had a year ago. It happened in the fourth quarter. So we have a good cash flow, but you have the counterpart of losing margin. Okay. Moving to page five, we can see what we are facing in 2016. It's much better. We have good news here, because we expect in the first place, a lower volatility of the currency of the exchange rate. This is going to help the pricing activity of the products between the company, its competitors and also the sales trade of China.

We expect the event of (Technical Difficulty) in the industry being normal. Actually we could see that happening already in December 2015. So that means the contribution margins in the opening months of 2016 are in a good level -- in a normalized level. The third thing is that we don't expect to have BRL23 million in non-recurring expenses. So we have extraordinary expenses linked to recessions.

We had reduction here in the administrative personnel and also when we move the production from Curitiba to Manaus in the new factory, we have to file all the personnel in the factory here in Brazil. The personnel linked to the PC and tablet production. Okay.

Also, we have a surplus in R&D expenses in 2015. We've invested more than the minimum that we've gotten or buy as to do, so the exceeding amount can be used through 2016. The first thing that we expect is to reduce the promotions, the sell-off of the inventory because we already have a normalized level in the company. And five, the efficiencies that we have in 2015 that came along the year. We are going to have it since the first day. So we can see in 2016, an annualization of the efficiency gains in terms of factories, post-sales and also in the fixed costs. Six, we introduced two new brands, VAIO and Quantum in the second half of the year. So, we are going to have this two new business helping us along the full year.

Seven, in the retail, as I mentioned, we already see the return of the contribution margin to a standard level. Eight, we begin the year with a portfolio of deliveries to the government of 500,000 PCs and tablets here, in Brazil, Argentina, Uruguay and Rwanda. So, it's a good delivery portfolio, it means is similar to what we had in 2015 and that we are only in March, so number can improve a lot along the year.

In mobile phones, you are seeing that our sales are growing very fast and we expect substantial volume growth in the first half of the year. We are anxious to disclose the numbers for the first quarter and also the second quarter numbers are big in the mobile phones.

Corporate and direct sales, we are doing a good bet in direct sales because the margin is better. So, though we need to achieve that I mentioned regarding e-commerce and end marketplaces, we are expecting this to grow a lot in 2016. With regard to the inventory

level, we closed the year with BRL135 million in excess of the inventory. We are managing to get this by half or close to zero throughout the year. So this is going to be good cash inflow for the year. And last, the migration of the production to Manaus. So we are going to have a lot of synergy in cost, concentrated in production in one factory and also, we have good monetization of tax credit.

So if you move to Page 6, I can give you more color on these subjects. What are the reasons for us to move the production from Curitiba to Manaus? The first thing is in regard of cash generation. So if you take look at our financial statements, you can see that we have over BRL300 million in recoverable taxes. Why we have such a high amount of recoverable taxes? You can see in the graph that in the past years, we have a kind of inefficiency in tax sales, because we, here in Curitiba and in our Brazil, you pay taxes when you buy the components.

So these taxes are turned into credits and these credits are -- when you sell the finished goods, you compensate these credits with the tax on savings. What happened in the previous years is that we've paid a lot of taxes, when we bought the components, but when we were to sell the finished goods, there were very, very low tax, because we don't have, for example, the state VAT charge of sales.

We -- in the last six years, we have exemption of the Federal VAT that we call here in Brazil PIS/COFINS and we also have a big reduction in the tax on the industrializing products that we call here in Brazil IPI. So when you take a look 2012, 2013, 2014, you can see that every year, we were accumulating recoverable taxes.

What happens in Manaus? In Manaus, it's very different, because there is no payment of taxes, when you buy components. Okay. The payments occur when you sell the finished goods. So you don't have the working capital of recoverable taxes with an operation in the Free Zone of Manaus.

So what is going to happen is that we expect to start accumulating recoverable taxes and all the taxation sales that we have, we are going to be able to pay with the credits that we have today in our balance sheet.

So that's the reason we expect 2016, '17, '18 to have a big cash inflow in the company, a big net debt reduction due to the recoverable taxes. But it's not only cash, there is also the margin, an operation in Manaus is a little bit better, because they have lower tax burden on sales. The difference is around 6 to 8 percentage points in terms of tax on sales. In the case of smartphones, it's a little bit higher. Obviously, you have some losses in Manaus due to the logistics, is more complicated because of the -- it's a remote region of the country. You have to use a lot of logistics with our plan for example. So we lose part of the gain in the tax burden, in logistics. So, the net gain in terms of margin, if we expect to be 4% in PCs and tablets and 7% in the case of smartphones for direct sales. For the indirect sales, which is retail for example, the difference is 1 percentage points for the PCs and tablets and 4 percentage points for -- in the case of smartphones, it is a big difference.

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Moving to Page 7, here we have some business, the main goals for the year. In the case of mobile phones, we are looking to ensure attractive cost benefits for the consumer -- for the Brazilian consumer. We had a very good experience with the Quantum brand. It's a very well configured smartphones with a very competitive price. We have lack of inventory in December, because the sales were better than we expected. We need to maximize the synergy and the scale of the retail sales with the computers.

Also, we are looking to leverage the opportunities with the carriers. To strength the Quantum brand, it's a new consumer that we are acquiring right now and is on needs to talk, configuration. It's not a focus of Positivo brand. So Quantum is a new market for us and really expects to have a significant increase in terms of market share. You can see the market share moving up in the -- from the first quarter to the fourth quarter of 2015.

But what you are going to see in the first and the second quarter of 2016 makes you brighter, because the volumes are very, very strong. In the case of computers, as I said, we want to increase the share of direct sales in our revenue, in the in-house e-commerce platform and also with the marketplace because the margin is better. We also want to defend our market share in the retail chains in the broader market, provided that they are possible. We are not looked for lose money this year.

We will try to be more relevant in the premium market with the VAIO brand. It's very important for us. It's also a new market to us, because Positivo is concentrated in the middle class, this income group here in Brazil and we also are looking to expand the portfolio of major educational products in Africa and Latin America.

We are now discussing our big project in Kenya. We expect to close in the first half of the year and we will bring to you more detail as the contract is signed. So we can move to page nine to take a look at our sales. So we have to hike the volume of 2014 in terms of mobile phones. We did a lot both in the feature phone and smartphone, which was a very good year for us and wait to see for the numbers for 2016.

In the case of PCs and tablets, you can see that the reduction 35% is actually the same or very close to the reduction that we have in the market in Brazil. So the market share for computers was flat year-on-year. The reduction in sales accompanied the reduction in the market.

And when you take a look in the device sales by brands, they're like five of them, on the chart. You can see that Positivo BGH's brand was flat year-on-year and it has a small increase in the fourth quarter. If this is due to the -- we began to sell computers in Rwanda as of July, so we added in the second half of the year over 7,000 educational laptops.

Moving forward, page 10, we can see that the net revenue dropped by 20% in the year, most of the reduction was due to the computers, because of the markets here in Brazil was very, very bad. But we managed to grow over 100% in terms of net revenue in the mobile phone segment.

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The average prices were pressured in the fourth quarter due to the sell-off of the exceeding inventory. This is more with in terms of use in the case of desktops and also tablets, but mobile phones moved up by 10%. This is the effect of the Quantum brand that I mentioned, this is a product priced in around BRL1,000 and is twice the price of the Positivo's smartphone in average.

So we can move on page 11, you can see the costs and selling expenses, both were pressured in the period, because of the prices were also pressured. So you can that see in the first quarter, we've increased the adjusted COGS about -- to 83% and also the selling expenses to 17%. The adjusted COGS is -- we are bringing to the operational result.

The cash effect of the hedging of the inputs that we see in the financial result, because 100% of this result is for input, is operational. We think that it's better to analyze the COGS with this adjust by hedge. So you can see that the fourth quarter reached 80% [ph]. The main factor is the sell-off of the exceeding inventory.

I want to highlight the performance in the G&A expenses in the fourth quarter 2015. We had a big reduction in personnel and also other expenses of over 13%. Even though the inflation here in Brazil in the 20 years was double-digit, so you can conclude that we managed to reduce the G&A expenses over 20% [ph] year-on-year.

We had a lot of non-recurring items. As I mentioned, we have some terminations here in the company on the administrative personnel, also we have a termination in the factory and also in regard to the R&D expenses, there were a little bit higher. We are going to recover that in 2016. Everything we have BRL13 million in non-recurring items in R&D. So we discount this, what is recurring is the BRL21 million that we saw in the fourth quarter.

Moving to page 12, the adjusted EBITDA reached BRL19 million in 2015. We are adjusting the EBITDA by the cash effect of the input hedging. Also, we are adjusting by the extraordinary terminations, the surplus in the R&D and also the traditional adjustment of the joint ventures.

So we finished the year with an adjusted EBITDA margin of 4.9%, it's lower than the year-ago, mostly because of the fourth quarter, the margin decreased to 2% due to the sell-off of an inventory. But also we managed to rebuild the net debt, so the relation between net debt and EBITDA was 2.9 times. It's a very good position, because we had the addition of EBITDA compensating -- was compensated by the reduction in the net debt.

So we move to Page 13, we can take a look at the working capital and debts. The working capital end of the year is 75 days, we could reduce a lot, the inventory days to a level similar to what we had one year ago. We also could manage to postpone payment terms with providers. So we have 65 days average and also we have the government receivables in profit or loss in the second half of the year.

So a lot of things that were not in our cash. We could manage to make a return to cash in the last month of the year. So, net debt came to BRL265 million, 70% is in the long term

and the cash balance in December 31 was over BRL500 million, it's very big, it's a big cash, so we have enough cash to cover all the compromising that we have in one year for example, even though, we don't refinance the shortened debt. So, it's a very comfortable position. So this is the last page.

I will open for the Q&A section and hope to see you again in the next conference call.
Thank you very much.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) There appears to be no questions at this time and thus concludes today's conference call. We thank you very much for attending today's presentation and you may now disconnect. Take care.

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