



Event: SharedValue Ltd - Sitronics Q4 and Full Year 2007 Results Call

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Speaker: Irina Lanina

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OPERATOR: Hello, and welcome to today's Sitronics Q4 and full year 2007 Results Call. Your host for today is Irina Lanina. For the first part of this call, all participants will be in listen only mode, and afterwards there will be a question and answer session. I'll now hand you over to the host of our call, Irina Lanina. Thank you.

IRINA LANINA: Good morning and welcome, ladies and gentlemen. Thank you for dialling into this presentation and discussion of our financial results for the fourth quarter and full year 2007. My name is Irina Lanina, and I am Vice President of Corporate Communication. Joining me on the call today are our President, Sergey Aslanian, and our First Vice President and Chief Financial Officer, Dmitry Ivanov. Also on the call to answer your questions later is our Vice President and Chief of Strategy, Alexander Lutsenko. You can find our results statement on our website at www.sitronics.com. Before we start, I would like to draw your attention to the cautionary statement at the end of our press release. Additionally, some of the information during this call may contain projections or other forward-looking statements regarding future events or the future financial performance of Sitronics. We wish to caution you that these statements are only predictions and that actual events or results may differ materially. We do not intend to update these statements to reflect events and circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events. Many factors could cause the actual results to differ materially from those contained in our projections or forward-looking statements.

Following the statements by our President and CFO, we will be happy to answer your questions. Our contact details are also included at the bottom of today's announcement and on our website, should you have any follow-up questions after this call. I will now hand the call to our President, Sergey Aslanian.

SERGEY ASLANIAN: Thank you, Irina. Good morning and good afternoon, ladies and



gentlemen, and thank you for joining us today. We have delivered the 61% sequential growth in our revenues in the fourth quarter. We also report today positive adjusted OIBDA of US\$15.3 million in the fourth quarter. Our new management team was instrumental in producing these results, which demonstrate a major improvement in our operations. Our results were also positively impacted by the seasonality factor. Through the dedicated efforts of our team and focus on working capital management, Sitronics produced positive operating cash flows and significantly reduced its net debt level at the end of the year.

As you can see from our fourth quarter results, we have not just delivered on our promises made during the last conference call, but have taken significant steps to improve our efficiency level and addressed the changing market conditions. We have completed a comprehensive strategic review of our business, and announced our new "Crystal" strategy in January. Our main strategic goal is to build a vertically integrated high-tech company under a unified Sitronics brand, with a portfolio of highly competitive end-to-end complete solutions based on our own products, as well as partnerships with world-leading high-tech companies.

On the Russian market we intend to actively participate in large public-sector infrastructural projects, in cooperation with the government and large businesses.

Within the framework of our strategy, we have identified four key areas, which will ensure the achievement of our strategic goals. Firstly, optimised project portfolio.

We are optimising our existing product range, with a focus on fast-growing product segments with the highest margin potential. We are focused on the full usage of our extensive R&D base, while expanding our partnerships with leading international technology companies in order to develop and market new products.

Secondly, end-to-end product offering. We are capitalising on our strategic partnerships with industry leaders in order to offer highly competitive complex solutions including both Sitronics and partner products.

Thirdly, efficient operations. We are implementing a Centralised management structure for major business functions, which will enable us to optimise business processes and increase our business efficiency level. We are also looking at ways to reduce our production costs by transferring mass- market production facilities to countries with a lower cost base.

And finally, we intend to capitalise on our unique competitive advantages, such as our portfolio technologies and our business scale to become the partner of choice for the Russian state for the realisation of large infrastructural projects. I am confident that the execution of our new strategy will result in a stronger company with a leading market position in advanced technological solutions, both in the domestic market and abroad.

I see alliances with the world leading technological partners such as Ericsson, Cisco, and ZTE as a key part of our strategy. Let me give you a few examples. We have announced our plans to build manufacturing facilities in China with ZTE. We also plan to offer our consumer product and telecom equipment solutions in the Indian market, in line with Sistema's expansion in the region. Shyam Telelink, as you know, already received mobile frequencies in 12 states, with a population of more than 650 million. We plan to manufacture CDMA and GSM phones for the Indian market at our joint production facilities with ZTE. As you know, ZTE has a strong reputation in the assembly of CDMA phones and is the largest manufacturer globally.

Secondly, we plan to produce telecom equipment in these facilities, which we can export to India. We see tremendous opportunity for this project in India, because there is a huge market in terms of volumes. With them we expect to leverage our position there and extend it to other countries.

Now I would like to say a few words about our product pipeline. We have secured US\$300 million of new business, in addition to the US\$150 million, which we announced on our last conference call. Sitronics has continued to expand its

operations and further diversify its client base in key EEMEA markets during the year. As a result, sales to companies not affiliated with the Sistema group increased to around 82% of total revenues in 2007, compared to 77% in 2006. We have signed new deals with Warid Telecom in Uganda, with Syrian public sector organisations, and MTS-Ukraine. In terms of the geographical breakdown, around 50% of the new contracts in value terms were generated from Russia and the CIS. 30% came from the Middle East, and the remaining 20% were signed in Central and Eastern Europe, North America, and other countries.

I will now focus on what has been achieved in each of our segments during the quarter. Sitronics' underperformance in 2007 was mainly due to lower revenues in the telecommunications solutions segment, while the level of fixed costs has been maintained in line with the 2006 level, reflecting the requirement to service ongoing and new projects, and our continued expansion into the Middle East and Africa. Telecommunications solutions revenue declined by 20% year-on-year for the full year 2007. Sitronics Telecom Solutions has signed over US\$200 million of new contracts since the beginning of the fourth quarter. Following the end of the reporting period, Sitronics started the implementation of the FORIS Next Generation Customer Care and Billing Platform for Warid Telecom in Uganda under the existing US\$23 million contract, and today we announced the €40 million deal with the Syrian Wireless Organisation for the deployment of a backup wireless telecommunication network.

In terms of geographical breakdown, 40% of contracts in value terms were generated from Russia and the CIS, 35% from the Middle East, and the remaining 25% from other countries.

At the end of 2007, we started restructuring the telecommunications solutions segment. We optimised the organisational structure, reduced the headcount by more than 500 employees, and strengthened the management team with a number of highly experienced industry executives. We also realigned the division's product

portfolio to focus on end-to-end solutions and innovative products

created by Sitronics, and we reviewed our strategy with regard to partnership agreements.

Sitronics' full year results were impacted by provisions made by our Consumer Services and Products segment in the amount of US\$47 million as a result of our conservative approach in relation to the realisation of certain assets. The vast majority of this provision was included in our Q3 result. We restructured the segment and merged the EMS and Consumer Electronics into one segment. The new segment manufactures consumer electronics for third party clients, as well as markets consumer electronics under the Sitronics brand, which are sold by retailers throughout Russia.

We have strengthened the management team, introduced a number of cost reduction programmes, and enhanced the quality control systems following the review of supplier relationships and the supply chain. We plan to capitalise on the large estimated capacity we have in this business, which can be used for mass-market production. We see opportunities to develop this segment further in cooperation with ZTE.

In the short-to-medium term, we plan to introduce the following product lines: system boxes, GLONASS, satellite systems, smart phones, and communication devices, portable media players, navigational system using GPS, and portable electronics.

The information technology solutions and the microelectronic solutions segments continues to outperform during the fourth quarter. The information technology solutions segment generates 47% of total revenues for 2007. Its revenues were up 37% year-on-year for the full year 2007, as the business continues to demonstrate strong performance in the fourth quarter, both in the system integration and distribution business. During this period, the segment has successfully delivered IT solutions to the two largest Ukrainian banks, Universal and Ukrsootsbank. We were

the subcontractor for the network installation of the NGM

multi-servers for Comsat network in the Ukraine. We experienced market pressure during the period in the distribution business as a result of increasing competition in the Russian and Ukrainian market. The segment has, however, significantly increased its market share in the CIS and Russian IT markets in 2007.

A few words on our shareholding in Kvazar-Micro. In March 2008, we increased our stake in this company to 87%. The acquisition took us to the next level in the process of consolidating our assets and creating a unified company with higher efficiency levels. Our microelectronic solutions segment generated 13% of total group revenues in 2007. This segment was our best performing business during 2007, with year-on-year revenue growth of 77% in 2007. Strong sales growth was fuelled by robust demands in the Russian microelectronics market, which grew at approximately double the pace of the global market. In addition, the volume of Sitronics contracts for research and development projects with the Russian state has doubled year-on-year. Sitronics continues to cooperate with the Russian government agencies by acting as a dedicated provider of advanced technological solutions. Following the end of the reporting period, we delivered a DSTK platform to MTS Belarus, and won two tenders for the delivery of approximately 16 million SIM cards to MTS Russian and Uzbekistan. The segment generated a 15% year-on-year increase in sales of SIM cards in 2007 in the CIS region.

We also expect continued growth in demand for SIM cards beyond 2008 as Russian and CIS mobile operators begin the transition to 3G. The segment added to its successful RFID ticketing technology project with the Moscow Metro by winning two pilot tenders to provide RFID tickets to Tyumen Transport Company and Mosgortrans.

In December 2007 we successfully launched the 0.18-micron technology at the micron plant in Zelenograd. Presently the group is in the process of constructing new facilities for the production of next generation microchips. Last week we signed

an agreement with STMicroelectronics to licence 0.13-micron technology.

Looking forward, Sitronics expects to outperform anticipated market growth of 15% in 2008, and to generate an OIBDA margin of not less than 5% for the full year 2008. Capital expenditure is expected to be substantially lower in 2008 than in 2007, with investments in organic operations of US\$50 million, and yet to be specified additional investments in the 0.13-micron technology and the joint production facilities with ZTE.

The information technology solutions and microelectronic solutions segments are expected to continue to perform strongly in 2008, while the telecommunications solutions division is expected to continue to show significant improvement throughout 2008. I will now hand the call over to our CFO, Dmitry Ivanov, who will take you through our financial performance in the fourth quarter and full year 2007.

DMITRY IVANOV: Thank you, Sergey. Sitronics revenue increased slightly year-on-year despite a weakness early in this year. Sitronics reported revenue growth of 61% quarter-on-quarter in the fourth quarter of 2007 and a sales increase of 8% compared to the fourth quarter of 2006. We reached positive operating cash flow for the full year. This was achieved by actively working with our debtors to reduce accounts receivable, tightly controlling our inventory turnover, and encouraging our customers to pay advances on new contracts. As a result, we significantly improved our overall cash position. The new management team implemented the strict working capital management policy which resulted in the reduction of Sitronics' net debt to US\$327 million at the end of 2007, compared to US\$409 million at the end of 2006. We reported an OIBDA loss of US\$101 million for the full year 2007, compared with an OIBDA of US\$172 million in 2006.

The results were impacted by the three following factors. Firstly, lower revenues in the telecom solutions segment, while we maintained the level of fixed costs in line

with the 2006 level, following the need to service ongoing and new projects and continued expansion into the Middle East and Africa. Secondly, Sitronics' OIBDA was also impacted by the stock option expense of US\$30 million. Thirdly, we made provision in the consumer services and product segment of US\$47 million due to taking a conservative approach on the evaluation of the assets.

As promised to you on the third quarter conference call, Sitronics delivered an adjusted OIBDA profit of over US\$15 million in the fourth quarter of 2007, compared with an adjusted OIBDA loss of US\$48 million in the third quarter, and a profit of US\$58 million in the fourth quarter of 2006. We reported a net loss of US\$46 million in the fourth quarter, and a US\$234 million loss for the full year 2007, compared to a net loss of US\$108 million in the third quarter, a net profit of US\$24.3 million in the fourth quarter of 2006, and a net profit of US\$61 million in 2006. Net cash provided by operating activities increased by US\$147 million to around US\$2 million, from net cash used by operating activities of US\$145 million in 2006 as a result of this strict working capital management policy introduced by the new team.

The reduction of the accounts receivable and the receipt of advances enabled the company to reach positive operating cash flow and significantly improve its overall cash position. Net cash used in investment activities increased by US\$12 million from US\$207 million in 2006 to US\$219 in 2007, and was primarily used by the microelectronic solutions segment to increase its production capacity for the 0.18-micron technology and transportation cards, as well as investments in software development by the telecom solutions segment, and the purchase of new production lines by the consumer services and products segment.

Net cash provided by financing activities decreased by US\$37 million from US\$346 million in 2006 to US\$310 million in 2007, and included the repayment of US\$200 million of Eurobonds, US\$355 million share issue, US\$125 million loan obtained from Dresdner Bank, and US\$118 million Russian bond issue. Sitronics

total debt, excluding capital leases and derivatives, amounted to US\$512 million at the end of 2007, compared to US\$499 million at the end of 2006. Now, back to you, Irina.

IRINA LANINA: Thank you, Dmitry. We will now be happy to open the floor to any questions you might have. Operator, over to you.

OPERATOR: Thank you very much. We will now begin our question and answer session. If you have a question, please press 01 on your telephone keypad now. You will enter a queue, and after you are announced, you may ask your question. Should you find your question has been answered before it is your turn to speak, you may press 02 to cancel. So, that's 01 to ask a question, or 02 to cancel. Our first question comes from David Ferguson, of Renaissance Capital. Please go ahead.

DAVID FERGUSON: Thank you. Good afternoon, everyone. I've just got a couple of questions, please. Firstly, on the new contracts signed, of US\$450 million. Can you tell us what percentage of that you expect to actually book in 2008 revenue? That's the first question. Secondly, on capital expenditure. In the press release, you talk about the potential for additional investment in the 0.13 technology. Can you just give us some colour on, if you were to make that investment, how much it would be and when that would take place, and what, in terms of the criteria you are using to make that decision? Then, finally, on the revenue outlook, you talked about market growth of 15%. I tend to remember earlier on in the year you were maybe talking about a higher number, around 18%, and outperforming that. So, I just wonder, if that is the case, has anything changed over the last few months? Have you become incrementally more cautious or incrementally more positive, for that matter, on the broader market backdrop? That's it, thank you.

SERGEY ASLANIAN: Thank you, David. This is Sergey. The first question was about the market revenue to be booked in 2008 out of the contracts that were won during the last three months. I would assume that we would book about 80% of that revenue in 2008. Your second question, about capital expenditure, yes, we are seeing that our capital expenditure would be US\$50 million for the organic growth, and we may require additional US\$60 million for the 0.13 and for the ZTE factory and 0.65. We see that our investment in the 0.13 technology will not be significant and will be immaterial if you compare it to the investment in the 0.18 technology, mainly due to the fact that the equipment that has been purchased to implement the 0.18 micron technology is pretty much the same that will be used for the 0.13. As for the revenue outlook, in the last conference call we were saying that the possible blended growth the market would operate would be from 15 to 18%. We are pretty much confirming this statement, saying that there will be the growth in the market, probably a little less than the 18%. We still plan to outperform the market.

DAVID FERGUSSON: Okay, that's great. Thank you, Sergey.

OPERATOR: Our next question comes from Istvan Matetoth of Credit Suisse. Please go ahead.

ISTVAN MATETOTH: Good evening, gentlemen. My question is related to David's. You are saying that you are going to outperform the broader market, which is growing 15%. Which of your business segments do you expect to be one of the best performers, in terms of revenue, so, if you are ranking them, is it telecom solutions business, microelectronics, and so on? Secondly, I have seen that some of these contracts are coming from the Middle East and Africa, and I was just wondering whether you think that this region still has some good opportunities for you, i.e., would you expect that an increasing amount of contracts in the telecom solutions business would come from this region?

SERGEY ASLANIAN: Thank you, Istvan. This is Sergey again. Answering to your first question, we clearly see that the breakdown between our business lines will go pretty much the same in 2008, so clearly the IT business streams will generate close to 45% of our business, so this is the biggest unit we have. For the Middle East and Africa, we have said that the two main regions, which we were going to focus on in 2008, in order for this to serve as fundamental for our next business, would be India and the Middle East. We clearly see the big demand for our services in the Middle East and Africa, and we will be extending our business with our presence and more products to be offered to our clients in this region. Thank you.

ISTIVAN MATEOSH: Thank you.

OPERATOR: Our next question comes from Nadia Golubeva of UniCredit Aton. Please go ahead, Nadia.

NADIA GOLUBEVA: Good afternoon. Several questions, if I may. First of all, I wanted to ask you, on the OIBDA margin in your microelectronic business was down pretty materially year-on-year. So, do you expect that you will sustain the level of margin we saw in 2007, or is there any chance the margin in microelectronics will go up as operating leverage increases? That is the first question. Secondly, I wanted to ask you about the IT business. Could you please break down revenue for the distribution and system integration, and also comment on the margin drop as well, in 2007? So, while initially business under the previous management, as far as I remember, guided the margin increases this year. And also, what do you expect regarding the margin in IT business for 2008? Finally, I wanted to ask you, we really see progress in telecoms and IT, but do you really want to pursue what you call the start-up business, because we see continuing losses in this part? Could you please tell us,

for how long are you ready to suffer these losses, and is it reasonable just to shut down this business at certain stage? Do you have any deadlines for yourself, say, that if in one year you do not break in at the OIBDA level for these start-ups, you will just quit the business? Thank you.

DMITRY IVANOV: Thank you, Nadia. This is Dmitry Ivanov. First, the margin in microelectronic solutions is expected to grow in 2008 due to the following factors: First, we successfully started our production by the project - 0.18 micron, and this is financial production, which will increase our margin. Second, we are adding services and introducing new products in transportation cards, which a little bit deteriorated our margin in 2007. We will sell more R&D in 2008 than in 2007. All these factors will increase our margin in microelectronics in 2008. As for your second question, in IT, systems integration represents approximately one-third of sales. IT margin for 2008 is expected to grow, because in 2007 the main goal for this business was to gain bigger market share, and for 2008 is to increase its profitability. What they will achieve by increasing system integration services value.

SERGEY ASLANIAN: I will take the third question about the Consumer Electronics and EMS business. As you know, we have merged those two businesses into one business division, and we have now clear a strategy on how we will operate further. We understand that one of our strategic pillars is a large public sector infrastructural project, in Russia and the CIS. Having our own manufacturing facility is a must for being qualified for such projects, and the cost structure, as you understand, is also very important to win those projects. So our strategy represents the fact that we will preserve our manufacturing capacity in Russia in combination with the development of our own production facilities in lower cost locations such as China. We believe that implementation of this strategy will be facilitated by the partnership with our technology partner ZTE, which is one of the leaders from China. So, we clearly

believe that this combination will allow us to successfully participate in some other programmes such as GLONASS, and the digitalisation of TV broadcasting public projects, and others. We think that the performance of the business will clearly break even as a result of 2008, and an increasing margin going forward. Thank you.

OPERATOR: Are there any further questions? A reminder that you can press 01 on your telephone keypad to ask a question, or you can press 02 to cancel if your question has already been answered. Okay, we have no further questions. Would you like to make your closing comments?

SERGEY ASLANIAN: Yes, thank you. To summarise, I would like to highlight that firstly we have delivered on the commitment that we have made at the time of the announcement of our Q3 results, by outperforming our revenue guidance by delivering 61% sequential quarterly revenue growth, and an increase in full year revenues over US\$1.6 billion. Outperforming our commitment in OIBDA break-even results in the fourth quarter with an adjusted OIBDA of US\$15.3 million, delivering net cash flow from operations, and applying strict working capital management principles, which enabled us to reduce our net debt at the year end by 20% to under US\$330 million. Secondly, we have a revitalised management team and a clear four-point strategy entitled "Crystal", as in crystal-clear. The focus is on management structure, great communication products, and efficient production, and we are delivering on each of these priorities. Finally, we have set clear goals for 2008. More than 15% growth and OIBDA margin of at least 5%, plus we have secured US\$300 million of new business revenue since our Q3 results. We are looking forward to speaking to you with our first quarter results call in June. Thank you very much.

OPERATOR: This concludes our call. Thank you for attending.