



Conference Transcription

Date of conference : 8 September 2011
**Conference title : Shared Value
Limited –
SITRONICS Second
Quarter 2011
Results
Teleconference**

CONFERENCE DETAILS

Conference Date: 8 September 2011

Conference Time: 13:00 BST

Conference Duration: Approximately 19 minutes

Chairperson: Irina Lanina

Speakers: Irina Lanina, Sergey Aslanian, Evgeny Tarasov

KEY:	
words in bold	Unsure if words heard correctly - please check
??	Words could not be distinguished
<i>(Inaudible -)</i>	Words that are entirely inaudible for the specified reason

ACT Operator

Welcome to the SITRONICS Second Quarter 2011 Result Teleconference on 8 September 2011. Throughout today's recorded presentation all participants will be in a listen-only mode. After the presentation there will be an opportunity to ask questions. If any participant has difficulty hearing the presentation, please press *0 on your telephone for operator assistance.

I will now hand the conference over to Irina Lanina. Please go ahead, madam.

Irina Lanina

Good morning and good afternoon. Thank you for dialling into this presentation and discussion on the SITRONICS' Financial Results for the Second Quarter of 2011. My name is Irina Lanina, Vice President of Corporate Communications. Joining me on the call today are Sergey Aslanian, President and Chief Executive Officer; and Evgeny Tarasov, our acting Chief Financial Officer.

Before we start I would like to draw your attention to the cautionary statements at the end of our press release. Additionally, some of the information provided 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 today's date or to reflect the occurrence of unexpected events. Many factors could cause the actual results to differ materially from those contained in our projections or forward-looking statements.

Following the comments by our President and acting-CFO we will be happy to answer your questions. You can find our contact details 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 over to our President, Sergey Aslanian.

Sergey Aslanian

Thank you, Irina. And good morning and good afternoon to everyone. We have delivered another quarter of strong year-on-year sales growth and we are well on track to meet our full year revenue growth target of 15% to 20%. Our revenues were up 24% year-on-year to \$333 million and each of our business segments generated double digit year-on-year sales growth. Our Telecommunication Solutions business reported an increase in sales for the first time since the first quarter of 2010.

All three business segments reported OIBDA profits in the second quarter. We continued to win new contracts across each of our business segments during the second quarter. \$310 million of new contracts have been secured since we announced our first quarter results at the beginning of June. And our contracted revenue pipeline now amounts to approximately \$650 million for the second half of the year.

We remain on track with the implementation of our three year business development strategy and we made significant further progress during the second quarter. As you

know the first element of the strategy is our partnership and close working relationship with the Russian government. In this context we are a preferred partner and supplier to the Russian government and we are participating in a number of important public sector initiatives. We are now in the first phase of implementing the intelligent transport system for the City of Moscow. Having undertaken a comprehensive analysis of the existing infrastructure, we are currently designing the system according to international best practice. The ITS is a major step in the modernisation of Moscow City and includes the installation of next generation traffic lights, control centres, navigation and traffic monitoring systems.

We are the leading microchip manufacturer in Russia and there is a clear and growing demand for our products. We have recently signed two major agreements in this area. Firstly we will be producing personalised banking cards with digital electronic signatures as part of e-government project with Rostelecom. And secondly we are developing the government's universal electronic identity cards. We have all the necessary capabilities to implement the project and plan to not only be the chipmaker for the project but also the system integrator responsible for the running of the system, the integration of the cards various applications and the development and implementation of payment and billing solutions. This project has considerable potential which is why we have now acquired a 7% equity stake in UEC.

We will be involved in establishing the technology protocols and specifications for the production of the electronic cards and the Russian government has recently approved the production plan. The cards will be issued on demand from January 2012 and will be compulsory in Russia from 2014.

Our Microelectronics division is at the centre of our work for the Russian government. Our joint project with state corporation RUSNANO to establish a full scale 90 nanometre microchip manufacturing capability in Russia is proceeding according to plan. As promised we expect to commence commercial production by the end of this year.

The second element of our strategy is to become a leading ICT company in each of our four core vertical market sectors: telecoms, the public sector, finance and diversified industrials. Our FORIS billing solutions continue to be in high demand in the telecom sector and we are the number one supplier of SIM cards in the Russian market.

In the public sector we recently won a tender to produce an electronic card to store Russian athletes biometric data on a microchip, as well as an automated information analysis system. This system will make medical examinations more efficient and enable detailed monitoring of athletic performance. This project will be completed before the end of this year in time for the Olympic Games in London and Sochi. As part of the Virtual School national education project sponsored by the Sberbank we have also launched our multimedia information education system in schools in Kiev and Russia's Voronezh region.

In the financial sector we have one new contract to produce and deliver magnetic strip and microchip banking cards to Barclays Bank Russia and various banks in the Russian region.

In the diversified industrial sector, we have continued our successful cooperation with Bashneft and its subsidiaries and completed the implementation of a centralised IT service management system which now has more than 12,000 users. We have also won a tender to install commercial and technical power supply metres at Bashneft's production facilities and have hired 120 technical specialists to work at our SITRONICS Bashkortostan subsidiary. More recently, we have signed an agreement with Lukoil and MTS to launch a mobile phone service that will enable MTS subscribers to use their mobiles to make payments at Lukoil gas stations using NFC-enabled SIM cards, antennas

and automated readers. Furthermore, we also won a tender to implement the CRM system for the Medsi Group of medical centres across Russia. This is the first implementation of an industrial CRM system for a healthcare organisation in Russia.

Our third and final strategic focus area is the development and execution of R&D projects in high demand product and service areas. Demand for RFID technology is increasing rapidly in areas such as forestry, farming, retail and postal services. One of our new initiatives in this area is the recently concluded agreement with RUSNANO and the X5 Retail Group to create a so-called retail store of the future. The use of RFID tags will cut distribution cost and improve overall retail logistics. Together with X5 we plan to open the first pilot grocery store of the future in 2013.

SITRONICS lead the Russian market in developing innovative technological solutions and we have further expanded our network of R&D centres in the Russian regions. These have included the opening of a new R&D centre in St Petersburg which specialises in the development of billing solutions. This is our fifth specialised R&D centre and the third in Russia, so we have a widespread presence but all of our centres are managed centrally from Moscow. This strengthening of our R&D capability is all about us developing unique products by utilising domestic resources. In this context, we decided in the second quarter to establish the Institute for Scientific Research of Molecular Electronics which is based around the Mikron operations and is part of our Microelectronics division. The Company's primary objective is to develop products using 180 and 90 nanometre technology as well as to develop new technologies.

Given all of the above we are clearly investing in sales and marketing personnel and R&D in light of the growing contract and customer base and the resurgence in the Russian ITT market. We are also investing in new markets and technologies. We are seeing a higher proportion of lower margin hardware equipment sales this year as customers compensate for lower investment levels during the crisis which is why we have seen lower OIBDA margins in the first half of the year. However, when you include the impact of 90 nanometre technology project we continue to expect to deliver a full year OIBDA margin of approximately 7%. As we previously indicated this implies a stable year-on-year margin when excluding the 90 nanometre project.

We are pleased with the progress we are making in SITRONICS. The strength of our market position reflect our efforts to develop close working relationship with the leading public and private organisations across a wide range of industries and geographies. We are implementing a number of highly innovative projects and have a healthy forward revenue pipeline.

I will now hand the call over to Evgeny for his comments on our financial performance and position.

Evgeny Tarasov

Thank you, Sergey. Good morning and good afternoon, everyone. As Sergey noted, we reported strong sales growth in all of our operating segments in the second quarter. The strengthening in majority of our operating currencies against US dollar reporting currency added 5 percentage points of year-on-year growth of our revenues but also boosted our total operating expenses by 7 percentage points. So currency movement negatively impacted the Group OIBDA margin. Our total OpEx when excluding depreciation and amortisation charges increased by 19% year-on-year in the second quarter and by 11% for the first six months of the year.

Selling, general and administrative expenses were up 21% year-on-year in the second quarter and 13% for the first half of 2011 which was also influenced by increased investments in sales and marketing to build the Company's market position and to

develop our internal resources so we can successfully complete the projects already mentioned by Sergey. Impairment losses and reserves were down 3% year-on-year in the second quarter and 34% for the six months period which affected measures taken to improve the quality of our assets. Research and development expenses were 67% up year-on-year in the quarter and up 15% for the first six months of 2011 which reflects our strategy to invest more in R&D activities and capabilities.

The Group therefore reported OIBDA profits of \$11.1 million in the second quarter and \$16.9 million for the first half of the year with OIBDA margins of 3.3% and 2.8% for the two periods. The decrease was due to lower margin hardware equipment sales, adverse currency movements, increased spends on 90 nanometre project and increased investments in marketing and sales to build our market position.

Our depreciation and amortisation charges were down 22% year-on-year in the second quarter and for the half year which mainly reflected end of the useful life of certain tangible assets recognised during the acquisition of INTRACOM TELECOM. Our weighted average cost of borrowing decreased year-on-year to 7.7%.

Our weighted average cost of borrowing decreased year-on-year to 7.7% at the end of the second quarter and our net interest expenses were reduced by 9% year-on-year to \$16.3 million for the period. This also reflected the capitalisation of interest expenses on borrowings during the quarter to finance the 90 nanometre project. We reported foreign exchange gains of \$1.2 million in second quarter and \$11.2 million for the first six months of the year compared to losses of \$10.8 million and \$0.1 million for the corresponding periods of 2010. The gains and losses mainly reflected the difference in the value of our US dollar denominated borrowing between balance sheet dates. We therefore reported 28% year-on-year reduction in the net loss attributable to SITRONICS in the second quarter and 38% reduction for the year-to-date.

Our net cash used in operating activities amounted to \$132.4 million for the first half of the year compared to \$22.6 million of the cash used during the same period 2010 which mainly reflected the negative change in working capital following cash advances we received in prior periods. Net cash used in investing activities was 58% higher year-on-year and is reflected in a 30% year-on-year increase in capital expenditure following investments in the 90 nanometre project, development of in-house software products.

Net cash provided by financing activities amounted to \$41.3 million for the six months of the year compared to \$69.8 million in the corresponding periods of 2010. This included \$13 million of borrowings from SITRONICS-NANO joint venture, \$14 million borrowed from Bank of Moscow and \$7 million borrowed from MBRD for short-term financing.

We also repaid, refinanced or rescheduled a total of \$32.2 million of loan during the second quarter and total of \$83.1 million since the beginning of the year including \$15 million of credit from HSBC that was extended for one year and the refinancing of \$42 million of INTRACOM debt. We therefore ended the second quarter with \$127 million cash and cash equivalent.

In addition to that we increased our credit line with Bank of Moscow from RUB500 million to RUB700 million in June which will be used later in the year for short-term financing. We have signed a RUB3 billion credit line with Bank of Moscow to finance Intelligent Transportation System project in August and extended \$120 million INTRACOM TELECOM syndicated loan till the end of 2011. We also met our plan to provide financing for the development of the 90 nanometre project in the amount of RUR3.6 billion in 2011 by signing the last portion in the form of a RUR0.7 billion loan with Bank of Moscow in August.

Now back to you, Irina.

Irina Lanina

Thank you, Evgeny. We will now be happy to open this call to any questions you may have. Operator, over to you.

ACT Operator

Thank you. The Q&A sessions will be conducted electronically. If you would like to ask a question, please press *1 in your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach your equipment. We will take questions in the order received and we will take as many as time permits. If you find that your question has been answered, you may remove yourself from the queue by pressing *2. Again, please *1 to ask a question. We will pause for a moment to allow everyone to register for questions.

We will take our first question from Stanislav Yudin from Aton.

Stanislav Yudin – Aton

Yes, good afternoon. Technology and IT is clearly cyclical business and from this perspective, do you see any sign that the expectations of an economic slowdown already has started negatively affecting your growth expectations for second half of this year and probably for the next year? For example, have you started seeing any orders withdrawing or something like that?

The final, are you still comfortable with your 15%, 20% year-on-year growth forecast for this year? Thank you.

Sergey Aslanian

I am touching wood now and we have not seen any affects and implications yet and so, no orders yet have been withdrawn and we are still enjoying the fact that the companies are compensating the fact that they have been under-investing into IT and ITT during the crisis years. Also we are comfortable with the 15%, 20% growth for this year.

Stanislav Yudin – Aton

OK. Thank you very much. And is it possible to share your growth forecast for your IT services segment, if possible of course?

Sergey Aslanian

We don't have the breakdown or we don't share the breakdown but the only thing I can say is that the growth for IT services will be higher than the one for the Group.

Stanislav Yudin – Aton

OK. Thank you very much.

ACT Operator

Again, please press *1 to ask a question. You may remove yourself from the queue by pressing *2.

There appear to be no further questions. This concludes today's question and answer session. I will now hand the call back to the Company for the final remarks.

Sergey Aslanian

Thank you. And to sum up, we continue to execute on our business strategy and have won more than \$310 million of contracts since the announcement of our first quarter results in June. We have approximately \$650 million of revenues contracted for the second half of the year. We generated healthy sales growth during the second quarter and have strengthened our public and private sector customer relationship and market positions across all our key geographies and verticals. We are well on track with our full year revenue target of 15% to 20% growth and we will use our net cash flow from operations to invest in the further operational and financial development of the Group. We look forward to speaking to you and meeting with you over the coming weeks and months and thank you for your time today.

ACT Operator

This concludes today's conference. Thank you for your participation, ladies and gentlemen.

END OF CONFERENCE