SGOCO Group, Ltd.
Second Quarter 2013 Earnings Conference Call
August 21, 2013

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to SGOCO Group Second Quarter 2013 Earnings Conference Call. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session and instructions will be provided at that time.

At this time, I would now like to turn the conference over to Serena Wu, Investor Relations for SGOCO. Please go ahead.

Serena Wu:

Thank you, Operator. Good morning, everyone and thank you for joining us on SGOCO's Second Quarter 2013 Earnings Conference Call. My name is Serena Wu, and I'm the IR Manager of SGOCO Group. Also joining me on today's call are Mr. Johnson Lau, CFO of SGOCO Group, and Mr. Tony Zhong, Finance Manager of SGOCO Group.

Before I get started, I'd like to remind everyone that this conference call may contain forward-looking statements, which are subject to risks and uncertainties. Our earnings release issued on August 20th and our SEC filings, including our most recent Annual Report, contain additional information about factors that could cause actual results to differ from the management expectations. All amounts noted in this conference call are in U.S. Dollars unless otherwise noted. The Company does not assume any obligations to update information discussed in this conference call or in its filing.

Now, I'd like to turn the call over to Mr. Johnson Lau, the CFO of the Company.

Johnson Lau:

Thank you, Serena, and hi everyone.

We are very pleased with our second quarter results as we saw a significant improvement in the various metrics over the quarter, most notably the revenue growth, increasing 39.0% year-over-year, and net earnings, increasing 176.0% year-over-year. Net margin for the second quarter increased 280 basis points from the same period of last year, driven by the continuous sales growth, and the positive results from our efforts to streamline our operational expenditures.

The strategic sale of Honesty Group in November, year 2011 has afforded us the opportunity to build up our company in new and exciting directions. Over the last year we have been focusing on four key paths for growth: firstly, on expanding our brand portfolio; second, to specialize in high-growth industries; and third, to diversify and advance our product lines; and fourth, to continue expanding our distribution channels among the tier three and four cities in China. I am pleased to report that the execution of these growth strategies is progressing well.

First of all, on the brand portfolio, our goal is to leverage on our strong distribution network to sign up more top tier quality brands. We have identified a few target brands and have been in talks with them. We believe that by adding one or two qualified high quality brands into our already strong brand portfolio, we will be able to increase overall brand awareness for SGOCO and our clients to capture additional market share in our target markets. More importantly, our distributors in various provinces will be able to introduce more world-class quality brands to the Chinese consumer.

Secondly, on the industrial vertical focus, we have identified several industries that we believe have a huge growth potential in the coming five to 10 years, for example, just like the budget hotel chains. Driven by the rising demand for domestic leisure travel, the market is estimating top budget hotel brands to open 200/400 hotels a year until year 2015, and we think that the smaller players in tier three or four cities will also benefit from this trend and making their own expansion. We are trying to align with these hotel chains and provide them with the tailor-made display products for their boutique size of the hotel rooms.

This will bring us to our third focus strategy, on advancing our product portfolio. Although the PC monitors remain our primary revenue contributor, we believe that our new focus in producing advanced, smart display products and solutions is starting to pay off. Earlier this year, we had soft-launched the two new products to the market: firstly, the All-In-One PC which is a touch-screen, user-friendly PC that is built-in to a flat screen monitor, and also the Parts-In-One PC which is very similar to the All-In-One, but has additional flexibility for the users to configure and build their own PC system. The market feedback for the products are very good so far; our distributor told us that they like the Parts-In-One PC a lot because it can act as a tool for them to upsell their other PC parts products. We also see the opportunities to sell our All-In-One PC to the budget hotels because of its multi-functionality and its slim design. In view of the great market potential, we anticipate these two products to be one of the key drivers for our revenue growth and the margin expansion in the second half of the year.

Lastly, on our distribution channel — from many established research believe that the middle-class growth will boom in tier three and four cities in China. It is estimated that in year 2022, the proportion of Chinese middle-class households in the smaller cities should reach more than 30%, up from the 15% in year 2002. We believe this growing middle-class will pose a number of opportunities and challenges across the distribution landscape. At SGOCO, we have already laid the foundation for establishing distribution networks in the rural areas. Going forward, not only do we see the ample room to expand the tradition distribution network, we are also looking into emerging channels such as the e-commerce to capture the shift of the consumer behavior in the market. We believe these new channels are key to success for both of SGOCO and our clients.

We are also very excited about our new sales operation that has been opened in Shenzhen to accommodate our sales expansion in China. Shenzhen is one of the most active and demanding cities for innovative electronic device and we have strategically placed some of our top talent in the region to support this high-growth area. Our Shenzhen sales team brings solid high technology and channel experience to SGOCO, and is dedicated to carry out SGOCO's growth strategies to transform our business from a traditional panel-display designer and distributor to a smart value-added display solution provider. We will continue to acquire and develop niche products such as our All-In-One or Parts-In-One PCs, to serve the growing needs of these high-growth industries.

We are also committed to further growing our revenue and profits through the expansion of our distribution channels and our brand portfolio. Our new Shenzhen sales operation and our continuous focus on the four key growth directions will ensure that SGOCO excels in its emerging role and capture enormous business opportunities from a Chinese new rising of the income and shifting urban landscape.

Now I will hand over the call to Serena, who will walk you through the financial results on behalf of the management. Serena?

Serena Wu:

Thank you, Johnson.

For the second quarter of 2013, our total revenue was $59.2 million, up 39.0% from $42.7 million from the second quarter of last year. The increase was mainly due to additional sales orders from a few local distributor clients and increased sales of flat panel monitors in the second quarter. As a revenue breakdown for the quarter,

- $41.3 million or 69.8% of total revenues were generated from SGOCO Brand and Licensed Brands Product sales. This portion was previously known as “SGOCO Brand”;
- $17.1 million or 28.9% of total revenues were generated from Key Accounts sales, which was previously known as “Non-SGOCO Brand and OEM”;
- $0.8 million or 1.3% of total revenues were derived from the sales of Other Application Products.

Gross profit for the second quarter increased 31.5% to $5.2 million from $4.0 million year-over-year. Gross margin for the quarter was 8.8%, as compared to 9.3% for the same quarter of last year. The decrease in gross margin was mainly due to withholding taxes paid to the Chinese authorities for recycling imported monitors, starting in the second half of 2012. The margin decrease was offset by Foreign Exchange Gains that we recognized due to RMB appreciation, as we settle most of our purchases in U.S. dollars.

As a breakdown for our margin profile in the second quarter, SGOCO Brand and Licensed Brands had a gross margin of 9.6%, Key Account sales had a gross margin of 8.2%, and sales of Other Application Products had a gross margin of 10.4%.

Selling expenses increased 140.0% year-over-year to $0.3 million from $0.1 million in the second quarter 2012. The increase was mainly attributable to the increased transportation costs stemmed from increased product sales due to (during) the second quarter, as well as the increased staff costs due to additional employees hired in Shenzhen and Beijing offices to strengthen our sales team.

G&A expenses decreased 52.7% year-over-year to $0.8 million from $1.8 million for the second quarter of last year. The decrease of G&A expenses was due to tightened expenses control and a decrease in the professional fees upon the completion of the investigation in relation to the Company's trading halt and the change of auditors in 2012.

Operating income for Q2 was $4.1 million, up 97.0% year-over-year from $2.1 million. Operating margin was 6.8%, improved from 4.8% in the second quarter of last year, due to the increase of revenue and the reduction of G&A expenses.

Net income for Q2 was $3.4 million, which grew 176.0% from $1.2 million from Q2 of last year. The net income margin was 5.7%, up from 2.9% year-over-year.

We reported earnings per share at $0.20 for the quarter, as compared to $0.07 year-over-year.

Moving to the balance sheet, as of June 30, 2013, the Company held $14.2 million in cash and cash equivalents, as compared to $11.5 million at the end of 2012.

As of June 30, 2013, our inventory increased to $16.4 million from $5.7 million at the end of 2012. The increase is to fulfill upcoming sales orders and expected market demand.

As of June 30, 2013, we have working capital of $83.6 million, with a current ratio of 2.56.

With that, I would like to conclude the management presentation and open the floor for questions and answers. Operator, please?

Operator:

Ladies and gentlemen, we will now conduct a question-and-answer session. If any participant would like to ask a question, please press the star, followed by the one on your telephone. If you wish to cancel this request, please press the star, followed by the two.

Your questions will be polled in the order they're received, and there will be a short pause while participants register for a question.

The first question comes from Savoy Lee from FH. Please go ahead.

Savoy Lee:

First of all, congratulations, the business in Q2 looks pretty good. The growth seems to come from Key Accounts, which was called OEM business before. Can you give me some more color going into second half and on where do you see growth? What have you done and what's your plan going forward to capture these growths?

Johnson Lau:

Thank you. First of all, I would like to spend some time to clarify on our new names of the product lines, because we feel it's more reflective to our current business.

We have now separated our business into three main lines, namely the SGOCO Brand and Licensed Brands, the Key Accounts and also the Other Application Products. SGOCO Brand and Licensed Brands are sales from the SGOCO Brand Products, the Co-Brand Products, and our Licensed Products from the traditional distribution channel and e-commerce channel in the future. On the other hand, the Key Accounts sales are from our old OEM business plus the new sales generated from our relationship with our key clients from industrial end-users such as application, telecom and government industries.

Although it's a seed business, we believe our focus in developing applications-specific products for specific industries will bring us an increase in earnings through these business lines.

Going to the second half of the year, as what I previously mentioned, SGOCO is going to focus on executing our four-point strategies to expand our four highly-correlated yet different directions to drive the growth.

First of all, we are aggressively talking to more top tier brands to expand our brand portfolio. It will help us to sign up more qualified and large distributors to expand our geographical reach.

After that, with the expanded geographical reach, it will help us to get more qualified brands to engage us as their distributor or Co-Brand with SGOCO. It will develop new products for our target customers in high growth-industries.

Thirdly, we are also in talks with several well-known e-commerce platforms in China to expand our distribution capability. It will help us to reach to more brand clients and get more revenues, and also get some online revenues in a new section.

Lastly, we also have two new products, that are what we previously said about, the Parts-In-One and All-In-One PC. These two products will generate a higher margin than what our current monitor is and we believe that the flexibility of the Parts-In-One PC will give the market very good response on it. Our sales and marketing team is working very hard to help to carry the official launch of these products for the targeted markets.

We believe that we are in the right direction, right market and also targeting the right customers and getting the execution of the right strategies to capture the new business opportunities from our upcoming Chinese continually growing economy. We will definitely have the flexibility to adopt and to change and to transform to fit-in the ever-changing consumer and customer trend. Did I answer your question?

Savoy Lee: Yes. Very much, thank you.

Johnson Lau: Okay.

Operator:

Thank you. The next question comes from John Banks from BNG Capital Management. Please go ahead.

John Banks:

Hey Johnson, welcome to the Company and congratulations. Just a couple of questions. I'm kind of new to the Company. I started following it about six months ago. What's the target in margins or, you know, mix of products, or I guess my question is can we move margins higher? That's my first question.

Johnson Lau:

Okay, well, as you see from the industrial basis, if you're getting on the traditional PC monitors, it's pretty hard to move up the market just like other industrial players. That's why we have been having—working very hard to expand our brand portfolio and also the product portfolio. We have newly introduced a product like the AIO the All-In-One and Parts-In-One PC. We expect that will have a much more higher margin, a special gross margin on what we previously had, and it is what we've been working very hard to get achieving.

John Banks:

Okay, great. My second one, I know David took a new position, COO. Can you elaborate what that new position means? Are you guys just focused mainly in China right now or are you looking to expand, you know, to North America or Europe? Thank you.

Johnson Lau:

Okay. As you see, we set up the North American company last year, SGO Corporation. We will continue to commit ourselves to work in China, obviously, and also we will work over on the other markets just like America and perhaps into Europe. But probably we'll need to take some time. We will focus on both of them.

John Banks:

Okay, great. Thanks a lot. Welcome aboard Johnson.

Johnson Lau:

One more question and this is the one. David Xu, who is the current COO on this, he continues working with SGOCO to expand our business. That's what his new role is.

John Banks: Okay, great. Thank you very much.

Operator:

Thank you. The next question comes from Jon Stone from Focus Capital. Please go ahead.

Jon Stone:

Hi guys. Great quarter. You did a dollar over—with $1.02 in earnings in 2011. Do you think you can do like $0.80 in earnings now even with the new model in the next four quarters? And do you think you can do $240 million in revenue over the next four quarters?

So I was just wondering if you guys could see yourselves doing at least $0.80 and $240 million in sales in next 12 months.

Johnson Lau:

First of all, we don't generally give a guidance about our revenue and also our profit on that, but one thing I can mention is back to the year 2011, the business model was quite different from what we are right now.

In year 2011 and before, we have manufacturing plants in South China which is having been very focused on the revenue-making. So at this point of the time, the market differences are quite separate from what we are doing is since we sell off the Honesty manufacturing plant in November, year 2011.

Back from the previous quarter, you can see that we have continued the focus to increase our revenue and also working very hard to increase our net profit from quarter to quarter. We believe that we will continue this effort and make it up for the upcoming. I hope that would not be a dream.

Jon Stone: Okay.

Operator:

Thank you. Once again, if you'd like to ask a question, please press the star, followed by the one on your telephone. If you wish to cancel this request, please press the star, followed by the two.

As a final reminder, if you'd like to ask a question, please press the star, followed by the one on your telephone.

We have no questions at this time.

Serena Wu:

Okay. Well, thank you everyone for joining us on the conference call today. If you have any follow-up questions, please feel free to contact us by e-mail or by the phone number provided through our website at www.sgocogroup.com. We look forward to speaking with you again. Thank you and have a good day.

Operator:

Thank you. Ladies and gentlemen, this does conclude the conference call for today. We thank you for participating and you may now disconnect.