AeroVironment Inc
Form 10-Q
September 09, 2009
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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# FORM 10-Q

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| | |
|---|---|
| þ | **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.** |
| | **For the quarterly period ended August 1, 2009** |
| | **OR** |
| o | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |
| | **For the transition period from_____________ to ____________** |

**Commission File Number: 001-33261**

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# AEROVIRONMENT, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **95-2705790** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **181 W. Huntington Drive, Suite 202**<br>**Monrovia, California** | **91016** |
| (Address of principal executive offices) | (Zip Code) |

**(626) 357-9983**

(Registrant s telephone number, including area code)

**N/A**

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| o Large accelerated filer | þ Accelerated filer | o Non-accelerated filer (Do not check if smaller reporting company) | o Smaller reporting company |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of August 25, 2009, the number of shares outstanding of the registrant s common stock, $0.0001 par value, was 21,509,200.

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## PART I. FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

**AeroVironment, Inc.**

**Consolidated Balance Sheets**

**(In thousands except share and per share data)**

| | August 1, 2009 (Unaudited) | April 30, 2009 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 113,284 | $ 116,501 |
| Short-term investments | 27,513 | 21,523 |
| Accounts receivable, net of allowance for doubtful accounts of $351 at August 1, 2009 and $291 at April 30, 2009 | 17,485 | 42,551 |
| Unbilled receivables and retentions | 14,458 | 20,070 |
| Inventories, net | 19,212 | 11,602 |
| Income tax receivable | 5,536 | 3,415 |
| Deferred income taxes | 4,119 | 3,994 |
| Prepaid expenses and other current assets | 2,066 | 1,718 |
| Total current assets | 203,673 | 221,374 |
| Long-term investments | 6,952 | 7,156 |
| Property and equipment, net | 18,529 | 18,218 |
| Deferred income taxes | 6,263 | 6,313 |
| Other assets | 112 | 120 |
| Total assets | $ 235,529 | $ 253,181 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 12,091 | $ 23,990 |
| Wages and related accruals | 6,740 | 10,231 |
| Other current liabilities | 4,018 | 3,686 |
| Liability for uncertain tax positions | 730 | 730 |
| Total current liabilities | 23,579 | 38,637 |
| Deferred rent | 1,465 | 1,463 |
| Liability for uncertain tax positions | 5,686 | 5,654 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock, $0.0001 par value: | | |
| Authorized shares 10,000,000 | | |
| None issued or outstanding | | |
| Common stock, $0.0001 par value: | | |
| Authorized shares 100,000,000 | | |
| Issued and outstanding shares 21,508,700 at August 1, 2009 and 21,470,481 at April 30, 2009 | 2 | 2 |

| | | | | |
|---|---|---|---|---|
| Additional paid-in capital | | 111,093 | | 110,102 |
| Accumulated other comprehensive loss | | (569) | | (537) |
| Retained earnings | | 94,273 | | 97,860 |
| Total stockholders equity | | 204,799 | | 207,427 |
| Total liabilities and stockholders equity | $ | 235,529 | $ | 253,181 |

See accompanying notes to consolidated financial statements (unaudited).

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**AeroVironment, Inc.**

**Consolidated Statements of Operations (Unaudited)**

**(In thousands except share and per share data)**

| | Three Months Ended August 1, 2009 | Three Months Ended August 2, 2008 |
|---|---|---|
| Revenue: | | |
| Product sales | $ 8,229 | $ 25,327 |
| Contract services | 29,711 | 28,286 |
| | 37,940 | 53,613 |
| Cost of sales: | | |
| Product sales | 5,557 | 14,358 |
| Contract services | 21,668 | 18,672 |
| | 27,225 | 33,030 |
| Gross margin | 10,715 | 20,583 |
| Selling, general and administrative | 10,495 | 8,095 |
| Research and development | 5,673 | 5,260 |
| (Loss) income from operations | (5,453) | 7,228 |
| Other income: | | |
| Interest income | 59 | 541 |
| (Loss) income before income taxes | (5,394) | 7,769 |
| (Benefit) provision for income taxes | (1,807) | 2,960 |
| Net (loss) income | $ (3,587) | $ 4,809 |
| (Loss) earnings per share data: | | |
| Basic | $ (0.17) | $ 0.23 |
| Diluted | $ (0.17) | $ 0.22 |
| Weighted average shares outstanding: | | |
| Basic | 21,316,776 | 20,711,656 |
| Diluted | 21,316,776 | 21,651,032 |

See accompanying notes to consolidated financial statements (unaudited).

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**AeroVironment, Inc.**

**Consolidated Statements of Cash Flows (Unaudited)**

**(In thousands)**

| | Three Months Ended August 1, 2009 | Three Months Ended August 2, 2008 |
|---|---|---|
| **Operating activities** | | |
| Net (loss) income | $ (3,587) | $ 4,809 |
| Adjustments to reconcile net (loss) income to net cash and cash equivalents provided by (used in) operating activities: | | |
| Depreciation and amortization | 1,950 | 1,070 |
| Provision for doubtful accounts | 60 | (24) |
| Deferred income taxes | (53) | (65) |
| Stock-based compensation | 422 | 161 |
| Tax benefit from exercise of stock options | 176 | 6,555 |
| Excess tax benefit from exercise of stock options | (82) | (3) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 25,006 | 457 |
| Unbilled receivables and retentions | 5,612 | (940) |
| Inventories | (7,610) | (4,764) |
| Income tax receivable | (2,039) | (3,530) |
| Other assets | (340) | 73 |
| Accounts payable | (11,899) | (2,429) |
| Other liabilities | (3,125) | (4,372) |
| Net cash and cash equivalents provided by (used in) operating activities | 4,491 | (3,002) |
| **Investing activities** | | |
| Acquisitions of property and equipment | (2,261) | (2,341) |
| Net purchases of held-to-maturity investments | (5,990) | |
| Net sales of available-for-sale investments | 150 | 4,850 |
| Net cash and cash equivalents (used in) provided by investing activities | (8,101) | 2,509 |
| **Financing activities** | | |
| Excess tax benefit from exercise of stock options | 82 | 3 |
| Exercise of stock options | 311 | 257 |
| Net cash and cash equivalents provided by financing activities | 393 | 260 |
| Net decrease in cash and cash equivalents | (3,217) | (233) |
| Cash and cash equivalents at beginning of period | 116,501 | 105,064 |
| Cash and cash equivalents at end of period | $ 113,284 | $ 104,831 |
| | | |
| Supplemental disclosure: | | |
| Unrealized losses on long-term investments recorded in other comprehensive income, net of deferred tax benefit of $22 | $ (32) | $ |

See accompanying notes to consolidated financial statements (unaudited).

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**AeroVironment, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

**1. Organization and Significant Accounting Policies**

***Organization***

AeroVironment, Inc., a Delaware corporation (the Company ), is engaged in the design, development, production and support of unmanned aircraft systems and efficient energy systems for various industries and governmental agencies.

***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three months ended August 1, 2009 are not necessarily indicative of the results for the full year ending April 30, 2010. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended April 30, 2009, included in AeroVironment, Inc. s Annual Report on Form 10-K.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions, including estimates of anticipated contract costs and revenue utilized in the revenue recognition process, that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to the current year presentation.

The Company s consolidated financial statements include the assets, liabilities and operating results of wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

***Segments***

The Company s products are sold and divided among two reportable segments, as defined by Statement of Financial Accounting Standards ( SFAS ) No. 131, *Disclosures about Segments of an Enterprise and Related Information* ( SFAS No. 131 ), to reflect the Company s strategic goals. Operating segments are defined as components of an enterprise from which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker ( CODM ) in deciding how to allocate resources and in assessing performance. The Company s CODM is the Chief Executive Officer, who reviews the revenue and gross margin results for each of these segments in order to make resource allocation decisions, including the focus of research and development, or R&D, activities and assessing performance. The Company s reportable segments are business units that offer different products and services and are managed separately.

***Investments***

The Company s investments are accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, as held-to-maturity and available-for-sale and reported at amortized cost and fair value, respectively.

***Fair Values of Financial Instruments***

Fair values of cash and cash equivalents, accounts receivable, unbilled receivables, retentions and accounts payable approximate cost due to the short period of time to maturity.

***Government Contracts***

Payments to the Company on government cost reimbursable contracts are based on provisional, or estimated indirect rates, which are subject to an annual audit by the Defense Contract Audit Agency ( DCAA ). The cost audits result in the negotiation and determination of the final indirect cost rates that the Company may use for the period(s) audited. The final rates, if different from the provisional rates, may create an additional receivable or liability for the Company.

For example, during the course of its audits, the DCAA may question the Company s incurred project costs, and if the DCAA believes the Company has accounted for such costs in a manner inconsistent with the requirements under Federal Acquisition Regulations, the DCAA auditor may recommend to the Company s administrative contracting officer to disallow such costs. The Company can provide no assurance that the DCAA or other government audits will not result in material disallowances for incurred costs in the future.

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**AeroVironment, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

***(Loss) Earnings Per Share***

Basic (loss) earnings per share is computed using the weighted-average number of common shares outstanding, excluding shares of unvested restricted stock. The dilutive effect of potential common shares outstanding is included in diluted earnings per share and excludes any anti-dilutive effects of options and shares of unvested restricted stock.

The reconciliation of diluted to basic shares is as follows:

| | Three Months Ended | |
|---|---|---|
| | **August 1, 2009** | **August 2, 2008** |
| Denominator for basic (loss) earnings per share: | | |
| Weighted average common shares outstanding, excluding shares of unvested restricted stock | 21,316,776 | 20,711,656 |
| Dilutive effect of employee stock options and shares of unvested restricted stock | | 939,376 |
| Denominator for diluted (loss) earnings per share | 21,316,776 | 21,651,032 |

Due to the net loss for the three months ended August 1, 2009, no shares reserved for issuance upon exercise of stock options or shares of unvested restricted stock were included in the computation of diluted loss per share as their inclusion would have been anti-dilutive. During the three months ended August 2, 2008 certain options and shares of unvested restricted stock were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive. The number of options and shares of unvested restricted stock which met this anti-dilutive criterion was approximately 31,000 for the three months ended August 2, 2008.

***Recently Issued Accounting Standards***

In April 2009, the Financial Accounting Standards Board ( FASB ) issued Staff Position ( FSP ) FAS 107-1 and Accounting Principles Board ( APB ) Opinion No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ( FSP 107-1 and APB 28-1 ). FSP 107-1 and APB 28-1 amend SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 and APB 28-1 also amend APB Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. FSP 107-1 and APB 28-1 are effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 107-1 and APB 28-1 do not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP 107-1 and APB 28-1 require comparative disclosures only for periods ending after initial adoption. The adoption of FSP 107-1 and APB 28-1 did not have a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( FSP 157-4 ). FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements*, ( SFAS No. 157 ) when the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 157-4 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP 157-4 requires comparative disclosures only for periods ending after initial adoption. The adoption of FSP 157-4 did not have a material impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* ( FSP 115-2 and 124-2 ). FSP 115-2 and 124-2 amend the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. FSP 115-2 and 124-2 does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP 115-2 and 124-2 are effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 115-2 and 124-2 do not require disclosures for earlier periods presented for comparative purposes at initial adoption. The adoption of FSP 115-2 and 124-2 did not have a material impact on the Company s consolidated financial statements.

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**AeroVironment, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* ( FSP 141(R)-1 ). FSP 141R-1 amends the provisions in SFAS No. 141(R), *Business Combinations*, for the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. FSP 141(R)-1 eliminates the distinction between contractual and non-contractual contingencies, including the initial recognition and measurement criteria in SFAS No. 141(R) and carries forward most of the provisions in SFAS No. 141 for acquired contingencies. FSP 141(R)-1 is effective for contingent assets and contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of FSP 141(R)-1 did not have a material impact on the Company s consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* ( SFAS No. 165 ). SFAS No. 165 establishes standards for reporting events that occur after the balance sheet date, but before financial statements are issued or are available to be issued and is effective for the Company as of August 1, 2009. In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through September 8, 2009, the date the financial statements were issued.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (the Codification ). This standard replaces SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles, and establishes only two levels of U.S. generally accepted accounting principles ( GAAP ), authoritative and non-authoritative. The Codification will become the source of authoritative, non-governmental GAAP, except for rules and interpretive releases of the Securities and Exchange Commission ( SEC ), which are sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become non-authoritative. This standard is effective for financial statements for interim or annual reporting periods ending after September 15, 2009. The Company will begin to use the new guidelines and numbering system prescribed by the Codification when referring to GAAP in the quarter ending October 31, 2009. As the Codification was not intended to change or alter existing GAAP, it will not have a material impact on the Company s consolidated financial statements.

**2. Investments**

Investments consist of the following:

| | | **August 1,** **(0.2)** | | 1.1 | (0.5) |
|---|---|---|---|---|---|
| Loans and Financing | (198.5) | (345.3) | 362.5 | | |
| Loans Obtained | 23.4 | 1.0 | 587.2 | | |
| Loans Paid | (117.3) | (167.8) | (128.1) | | |
| Interest Paid | (104.6) | (178.4) | (96.5) | | |
| Increases in Shareholders' Equity | (4.7) | (0.0) | - | | |
| Other Financing Flows | (18.2) | (3.4) | 0.2 | | |
| **(=) Cash Flow from Financing Activities** | **(221.6)** | **(347.7)** | **362.2** | | |

| | | | |
|---|---|---|---|
| **CASH FLOW OF THE PERIOD** | **46.5** | **352.5** | **963.8** |

| | | | |
|---|---|---|---|
| Cash and Cash Equivalents - current balance | 1,642.7 | 1,956.7 | 2,920.5 |
| Cash and Cash Equivalents - previous balance | 1,596.2 | 1,604.2 | 1,956.7 |
| **Variation in Cash and Cash Equivalents** | **46.5** | **352.5** | **963.8** |
| **OPERATING CASH FLOW** | **697.6** | **1,006.5** | **752.4** |
| **(-) Investments on Permanent Assets (includes Investment Suppliers)** | (429.5) | (306.4) | (150.7) |
| **(-) Interest Paid** | (104.6) | (178.4) | (96.5) |
| **(=) FREE CASH FLOW** | **163.5** | **521.7** | **505.1** |

**Operating Cash Flow in the 1Q04 was R$752.4 million**

**The operating generation of Brasil Telecom reached R$752.4 million in the 1Q04,** surpassing by 7.9% the amount registered in the 1Q03.

By deducting from the operating activities generation, the flow of investments for the period in the amount of R$150.7 million in the 4Q03, net operating generation of Brasil Telecom reached R$601.7 million in the period, against R$268.1 million in 1Q03.

**Free cash flow in the 1Q04 was R$505.1 million**

**Free cash flow in the 1Q04 of Brasil Telecom was R$505.1 million,** against R$163.5 million in 1Q03.

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## Stock Market

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**Table 16: Stock Performance**

| | Closing Price as of Mar/31/04 | Performance | | |
|---|---|---|---|---|
| | | In 1Q04 | In 12 months | In 24 months |
| Common Shares (BRTP3) (in R$/l,000 shares) | 18.35 | 0.5% | 24.8% | 8.2% |
| Preferred Shares (BRTP4) (in R$/l,000 shares) | 19.82 | -8.3% | 5.7% | 15.0% |
| ADR (BRP) (in US$/ADR) | 34.15 | -8.8% | 22.2% | -14.4% |
| Ibovespa (points) | 22,142 | -0.4% | 96.4% | 67.1% |
| Itel (points) | 894 | 0.7% | 64.7% | 49.9% |
| IGC (points) | 1,815 | -1.6% | 65.8% | 65.5% |
| Dow Jones (points) | 10,358 | -0.6% | 29.6% | -0.4% |

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**Graph 8: Stock Performance in the 1Q04 Bovespa and NYSE**
(Base 100 = December 31, 2003)

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**Table 17: Share in the Theoretical Portfolio**

| | Ibovespa | | Itel | | IGC | |
|---|---|---|---|---|---|---|
| | **Jan/Apr** | **May/Aug** | **Jan/Apr** | **May/Aug** | **Jan/Apr** | **May/Aug** |
| BRT03 | 0.419% | 0.417% | 2.646% | 2.520% | 0.787% | 0.774% |
| BRT04 | 2.010% | 1.838% | 13.697% | 12.202% | 4.075% | 3.747% |

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## Shareholders Structure

**Capital stock increase**

The amortization of 12/60 of the goodwill resulting from the CRT acquisition/merger **in the fiscal year of 2003, consolidated a fiscal benefit of R$71.8 million,** which was capitalized. The preemptive right predicted in article 171 of Law 6,404/76 **was assured with the issuance of 3,337,565,097 preferred shares.** The issuance and subscription price was R$21.50 per 1,000 preferred shares and the term for the preemptive right extend from 3/19/2004 to 4/19/2004.

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**Table 18: Shareholders Structure**

| **Mar 2004*** | **Common Shares** | **%** | **Preferred Shares** | **%** | **Total** | **%** |
|---|---|---|---|---|---|---|
| Solpart Participações S.A. | 71,830,503,826 | 53.6% | 3,491,253,373 | 1.6% | 75,321,757,199 | 21.1% |
| ADR | - | 0.0% | 145,819,965,000 | 65.5% | 145,819,965,000 | 40.9% |
| Treasury | 1,480,800,000 | 1.1% | - | 0.0% | 1,480,800,000 | 0.4% |
| Other | 60,720,384,377 | 45.3% | 76,696,534,607 | 34.4% | 137,416,918,984 | 38.5% |
| **Total** | **134,031,688,203** | **100.0%** | **226,007,752,980** | **100.0%** | **360,039,441,183** | **100.0%** |

* Position after the capital increase.

| **Dec 2003** | **Common Shares** | **%** | **Preferred Shares** | **%** | **Total** | **%** |
|---|---|---|---|---|---|---|
| Solpart Participações S.A. | 71,830,503,826 | 53.6% | 161,687,175 | 0.1% | 71,992,191,001 | 20.2% |
| ADR | - | 0.0% | 140,385,355,000 | 63.0% | 140,385,355,000 | 39.4% |
| Treasury | 1,480,800,000 | 1.1% | - | 0.0% | 1,480,800,000 | 0.4% |
| Other | 60,720,384,377 | 45.3% | 82,123,145,708 | 36.9% | 142,843,530,085 | 40.0% |
| **Total** | **134,031,688,203** | **100.0%** | **222,670,187,883** | **100.0%** | **356,701,876,086** | **100.0%** |

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## Corporate Governance

**2004 Annual Ordinary and Extraordinary General Shareholders Meeting**

**On April 19, 2004, the shareholders of Brasil Telecom Participações S.A. convened in the Ordinary and Extraordinary General Shareholders Meeting,** where they deliberated and approved the following subjects:

- Financial Statements and Management Report referent to 2003;

- Board Proposal related to the allocation of Net Earnings of the period, realization of the Legal Reserve and the Allocation of Dividends and Interest on Shareholders Equity (JSCP), including the charge for Interest on Shareholders Equity on the dividends, referent to 2003, as well as on the reserve of income retention;
- Election of title members and alternates in the Fiscal Council;
- Election of title members and alternates in the Board of Directors in complement of the term of office;
- Establishment of global remuneration of the Directors and Fiscal Council s members;
- New text of article 5 of the Bylaws to reflect the new amount of Capital Stock and the number of shares of the Company, in view of the capital increase approved in 2004.

**Public Offering**

In an official letter issued on October 21, 2003, **the Brazilian Securities and Exchange Commission (CVM) granted concession of a Public Offer for the exchange of common shares for preferred shares, of Brasil Telecom S.A. issuance,** in the condition of Object Company , to be conducted by Brasil Telecom Participações S.A., in the condition of Offering Company .

Presently, **71% of the common shares were exchanged for preferred shares at the request of the shareholders.** Despite the adhesion period of the Public Offer having ended on December 2, 2003, **the acceptance of the OPA may still occur until December 10, 2004,** which is the put period defined in the bid notice. This is a good opportunity for the investors of common shares of Brasil Telecom S.A. to migrate to preferred shares of the Company, which have higher liquidity.

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**2Q04 and 2004 scenario (Guidelines)**

**Disclaimer**

This press release contains forward-looking statements. Such statements are not statements of historical fact, and reflect the beliefs and expectations of the Company's management. The words "anticipates," "believes," "estimates," "expects," "forecasts," "intends," "plans," "predicts," "projects" and "targets" and similar words are intended to identify these statements, which necessarily involve known and unknown risks and uncertainties. Accordingly, the actual results of operations of the Company may be different from the company's current expectations, and the reader should not place undue reliance on these forward-looking statements. Forward-looking statements speak only as of the date they are made, and the Company does not undertake any obligation to update them in light of new information or future developments.

**Lines in Service**

We believe that in 2004, there will be no increase in the demand for fixed lines due to the macro-economic environment, which is not favoring the income growth in C, D and E classes.

Besides that, Brasil Telecom has disconnected the delinquent lines that do not offer prospects for the return of the client to the active base in medium term.

**ADSL**

We expect the ADSL plant to reach around 380 thousand accesses in service by the end of the 2Q04 and 500 thousand at the end of the year.

**Revenue**

We estimate a recovery in local revenue for the 2Q04, as has already been occurring since March.

In addition, we estimate an increase in DLD and ILD revenue due to the increment of the market share during the 2Q04, as a result of the evolution in the usage of CSC 14.

The Company continues to be aimed at the expansion of data communication revenue, which every quarter increases its share in total revenue.

The consolidation of MetroRed will also have a positive impact in Brasil Telecom s revenues in the 2Q04.

**Costs**

The strict policy in the control of expenses continues to be one of the focal points of the management.

The interconnection cost should increase in the 2Q04 in light of the growth of the market share for CSC 14 outside Region II and also as a result of the growth of the mobile network.

**EBITDA Margin**

As in 2004 we will be launching the cellular service, the expectation is that this operation will have a negative impact of between 2% and 3% on the EBITDA margin. We also entered into the DLD and ILD segments which show margins that are lower than other services.

**Bad Debt**

We expect a slight bad debt growth in relation to 2003, due to the economic situation of the country, which in the 1Q04 went against the expectations for rapid growth, which prevailed at the end of last year.

The maintenance of tighter monetary and fiscal policies and the increase of unemployment rate measures have negatively impacted the payment ability of some clients.

In addition, we have noticed an increase in delinquency due to the use of CSC 14 in calls originated from cell phones. The co-billing with mobile carriers results in a delinquency rate above the average for other segments in which the Company operates.

**Capex**

We estimate a Capex for fixed telephony of 12 to 13% of net revenue in 2004. This assumption is based on the expectation of moderate growth in the Brazilian economy and contemplates the maintenance of the strong growth rate seen in the data communication sector, mainly broadband (ADSL) and IP services.

We also predict a Capex of approximately R$850 million for mobile telephony in 2004, considering the possibility to anticipate for 2004 some investments planned for 2005, seeking for a coverage similar to that of Band B at the first year of operation.

The total Capex estimated for 2004 should be between R$1.8 and R$1.9 billion, including fixed and mobile telephony.

**Debt**

Debt management is focused on the lengthening of its profile and on the reduction of its cost, with the objective of maximizing the Company s capital structure. We work to maintain the current debt level, which is comfortable and healthy for our business.

The Management will keep its conservative position in relation to the financial policy, which is based on: low financial leverage and a solid cash position aiming at making Brasil Telecom less dependent on the macro-economic volatility and the cyclical fluctuations of the telecommunications sector.

**Hedge Policy**

Considering that Brasil Telecom has practically all its revenue in Reais, the Company has constantly evaluated hedge exchange variation mechanisms for funding that involve foreign currency.

Brasil Telecom has made hedge contracts of at least 24 months to cover the short-term payments of the debt. On the other hand, the Company has also followed the market, searching for opportunities in relation to liquidity and coverage cost for longer maturity dates, aiming at minimizing the effective cost of its debt.

**Depreciation**

In 2004, the depreciation rates were recalculated to better adapt to the useful life expectation of the assets in light of the significant pickup in the rhythm of technological evolution in the telecommunications sector.

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**Indicators**

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**Table 19: Evolution of the Indicators**

| PLANT | 1Q03 | 2Q03 | 3Q03 | 4Q03 | 1Q04 |
|---|---|---|---|---|---|
| Lines installed (thousand) | 10,608 | 10,656 | 10,678 | 10,686 | 10,701 |
| Additional lines installed (thousand) | 60 | 48 | 22 | 9 | 14 |
| Lines in service - LIS (thousand) | 9,595 | 9,741 | 9,809 | 9,851 | 9,724 |
| Residential (thousand) | 6,979 | 7,107 | 7,168 | 7,166 | 6,988 |
| Non-residential (thousand) | 1,548 | 1,565 | 1,567 | 1,566 | 1,468 |
| Public phones (thousand) | 296 | 297 | 297 | 296 | 296 |
| Pre-paid (thousand) | 215 | 218 | 232 | 266 | 282 |
| Other (including PBX) (thousand) | 557 | 554 | 546 | 557 | 690 |
| Additional lines in service (thousand) | 130 | 146 | 68 | 42 | (127) |
| Average lines in service (thousand) | 9,530 | 9,668 | 9,775 | 9,830 | 9,787 |
| Utilization rate | 90.5% | 91.4% | 91.9% | 92.2% | 90.9% |
| Teledensity (LIS/l00 inhabitants) | 23.2 | 23.5 | 23.5 | 23.4 | 23.1 |
| ADSL Accesses in service (thousand) | 165.1 | 194.8 | 239.4 | 281.9 | 324.9 |

| TRAFFIC | 1Q03 | 2Q03 | 3Q03 | 4Q03 | 1Q04 |
|---|---|---|---|---|---|
| Exceeding local pulses (million) | 2,973 | 2,959 | 3,099 | 2,927 | 2,586 |
| Long distance - LD (million minutes) | 1,611 | 1,744 | 1,709 | 1,559 | 1,534 |
| Fixed-mobile (million minutes) | 1,058 | 1,058 | 979 | 991 | 1,037 |
| VC-l (million minutes) | 939 | 947 | 877 | 909 | 879 |
| VC-2 (million minutes) | 104 | 98 | 85 | 66 | 125 |
| VC-3 (million minutes) | 14 | 13 | 16 | 16 | 34 |

| PRODUCTIVITY | 1Q03 | 2Q03 | 3Q03 | 4Q03 | 1Q04 |
|---|---|---|---|---|---|
| N° of employees - Fixed Operation | 5,548 | 5,316 | 5,217 | 5,194 | 5,211 |
| Average n° of employees -Fixed Operation | 5,560 | 5,432 | 5,267 | 5,206 | 5,203 |
| LIS/employee | 1,729 | 1,832 | 1,880 | 1,897 | 1,866 |
| Net revenue/average n° of employees/month (R$ thousand) | 112.3 | 117.5 | 130.0 | 132.8 | 133.0 |
| EBITDA/average n° of employees/month (R$ thousand) | 52.0 | 55.3 | 60.8 | 37.1 | 57.2 |
| Net earnings/average n° of employees/month (R$ thousand) | 6.1 | 4.2 | 7.4 | (9.1) | 4.8 |
| Exceeding local pulses/average LIS/month | 104.0 | 102.0 | 105.7 | 99.3 | 88.1 |
| DLD minutes/average LIS/month | 56.3 | 60.1 | 58.3 | 52.8 | 52.1 |
| Fixed-mobile minutes/average LIS/month | 73.5 | 72.5 | 66.2 | 66.7 | 69.5 |
| Net revenue/average LIS/month (R$) | 65.5 | 65.9 | 69.9 | 70.3 | 70.7 |
| EBITDA/average LIS/month (R$) | 30.4 | 31.1 | 32.7 | 19.6 | 30.4 |
| Net earnings/average LIS/month (R$) | 3.5 | 2.4 | 4.0 | (4.8) | 2.5 |

| QUALITY | 1Q03 | 2Q03 | 3Q03 | 4Q03 | 1Q04 |
|---|---|---|---|---|---|
| Quality goals achieved | 35/35/35 | 35/35/35 | 35/35/34 | 35/35/35 | 33/35/35 |
| Digitization rate | 99.0% | 99.0% | 99.0% | 99.0% | 99.5% |

| PROFITABILITY | 1Q03 | 2Q03 | 3Q03 | 4Q03 | 1Q04 |
|---|---|---|---|---|---|
| EBITDA margin | 46.3% | 47.1% | 46.7% | 27.9% | 43.0% |
| Net margin | 5.4% | 3.6% | 5.7% | -6.8% | 3.6% |
| Return on equity - ROE | 1.6% | 1.1% | 1.8% | -2.3% | 1.2% |

| CAPITAL STRUCTURE | 1Q03 | 2Q03 | 3Q03 | 4Q03 | 1Q04 |
|---|---|---|---|---|---|

| | | | | | |
|---|---|---|---|---|---|
| Cash and Equivalents (R$ million) | 1,643 | 1,338 | 1,604 | 1,957 | 2,920 |
| Total debt (R$ million) | 4,148 | 3,969 | 3,988 | 3,790 | 4,283 |
| Short term debt | 15.9% | 28.4% | 35.6% | 44.8% | 40.2% |
| Long term debt | 84.1% | 71.6% | 64.4% | 55.2% | 59.8% |
| Net debt (R$ million) | 2,505 | 2,631 | 2,384 | 1,833 | 1,363 |
| Shareholders' equity (R$ million) | 6,200 | 6,269 | 6,381 | 6,137 | 6,137 |
| Net debt/shareholders' equity | 40.4% | 42.0% | 37.4% | 29.9% | 22.2% |

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## Next Events

**Teleconference: 1Q04 Earnings**

**Tel:** (0 800) 770-4544 (Brazil)
(1 786) 924-8430 (Other countries)
**Date:** May 4 (tuesday)
**Time:** 11:00 noon (Eastern time)

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## IR Contacts


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## Media Contact


| | | |
|---|---|---|
| Cesar Borges | Phone: (55 61) 415-1378 | cesarb@brasiltelecom.com.br |

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 5, 2004

**BRASIL TELECOM PARTICIPAÇÕES S.A.**

By: /s/ Paulo Pedrão Rio Branco

Name: Paulo Pedrão Rio Branco
Title: Financial Executive Officer