

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

2498.TW - Q1 2017 HTC Corp Earnings Call

EVENT DATE/TIME: MAY 09, 2017 / 7:00AM GMT



CORPORATE PARTICIPANTS

Chia-Lin Chang *HTC Corporation - President of Smartphone and Connected Device Business*

Maggie Tseng *HTC Corporation - Senior Director of Treasury and IR*

CONFERENCE CALL PARTICIPANTS

David Dai *Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst*

Richard Alan Kramer *Arete Research Services LLP - Senior Analyst*

PRESENTATION

Operator

Welcome, everyone, to HTC's 2017 First Quarter Results Conference Call and Webcast in English. Today with us, we have President of Smartphone and Connected Device business, Mr. Chia-Lin Chang; Chief Financial Officer, Mr. Peter Shen; and Senior Director of Treasury and Investor Relations, Ms. Maggie Tseng. (Operator Instructions)

For your information, this conference call is now being broadcasted live over the Internet. Webcast replay and English transcript will be available within an hour after the conference is finished. And Chinese-translated transcript will be available within a week after the call is finished. Please visit www.htc.com under the Investors section.

Now I would like to introduce Ms. Maggie Tseng. Ms. Tseng, you may begin.

Maggie Tseng - HTC Corporation - Senior Director of Treasury and IR

Thank you. Greetings, and welcome to HTC First Quarter 2017 Earnings Call. With me on the call today are Chia-Lin Chang, our President of Smartphone and Connected Device business; and Peter Shen, our Chief Financial Officer. The event is now being webcast live via HTC's website at www.htc.com. If you are joining us through the dialing lines, your call is now being placed on mute. As this conference is being broadcast by investors around the world, we will conduct this call in English only.

We would like to begin by stating our disclaimer statement on Page 2 of the presentation slides. Please note that this presentation contains forward-looking statements. These statements are based on our current expectations. Actual results may differ materially from our expectations. And the company undertakes no obligation to update these forward-looking statements going forward.

And now I will summarize our operations for first quarter. Afterwards, Chia-Lin and Peter will lead the Q&A session.

Please turn to Page 3. First quarter 2017 financial highlights. Revenue for first quarter was TWD 14.5 billion, with gross margin of 16.3%. Operating loss was TWD 2.4 billion, with operating margin of negative 16.2%. Net loss after tax was TWD 2 billion or loss per share of TWD 2.47.

Business update. HTC's continued program of resource realignment and process streamlining resulted in a 20% operating expenses saving and an increase in gross margin of 16.3% over the quarter.

The HTC U Ultra and U Play premium smartphones were launched in January, boasting unique design, adaptive audio and new HTC Sense Companion AI features.

High demand was seen for the HTC Vive Tracker, which was launched in January and enabled developers to easily add functionality for a whole range of accessories into their VR experiences.



As part of the Dynamical Biomarkers Group, HTC's health research division was awarded first finalist in the prestigious Qualcomm Tricorder XPRIZE to develop a medical diagnostics kit for remote regions.

Page 4 gives an overview of revenue and operating profit. Revenue for first quarter came in at TWD 14.5 billion. Operating loss was TWD 2.4 billion.

Page 5 gives an overview on gross margin and operating margin. Gross margin for first quarter was 16.3%, and operating margin was negative 16.2%.

Page 6 and 7 were financial overview for income statement and balance sheet statement.

This wraps up the content of our presentation. And now I would like to turn the call over to Chia-Lin and Peter. Operator, we can start the Q&A session. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Richard Kramer from Arete Research.

Richard Alan Kramer - Arete Research Services LLP - Senior Analyst

Apologies, but I have not received any email or the slides yet. So while you went through them, there was obviously some detail that I would have missed out. I guess my question for Chia-Lin is, we saw new products at MWC. We've seen now the April sales figure where there's -- doesn't seem to be any uptick in the run rate of sales. Can you talk about where you are in terms of revitalizing or re-ramping sales up for this year? There's still a very much larger consensus estimate for sales for the year than you have certainly in your current run rate. Is it that new product shipments have been delayed? Is it that the older products, the Desire range is burning off? Can you just talk us through what we should expect for the rest of the year since your run rate doesn't seem to reflect any sort of uptick from the new products announcements that you made?

Chia-Lin Chang - HTC Corporation - President of Smartphone and Connected Device Business

Thanks, Richard. I think to some of the information you have received, maybe there's a slight delay or there's some logistic issue. We'll make sure you receive that. Second, just to reiterate what we talked about last time on our strategy when it comes to smartphone, our goal is to make sure that we have continued traction in the flagship and premium part. Without going into detail in terms of where we define the marketplace in terms of retail, price level, et cetera, but the overall goal is to do that, because that tie into the brand more. We need to secure that part before expand, so that has been the ongoing strategy in the last, actually, close to 12 months or so. We're going to continue to do that. I wouldn't look into sort of like month-over-month variation in that, I think, possibly in a longer period of time. Whether the strategy would pay off or be successful, I think that remains to be seen, but I think it will be clearer in the second half. So as you can see, we also have a planned product announcement for coming 16th, i.e. next week. We also pinned a lot of hopes on that as well. So I think the overall sales status will be more clear coming into the second half. But just to be clear that we're getting out a lot of entry-level. In fact, it's not entry-level. In fact, a lot of affordable level we're actually getting out because we want to focus on making sure that the -- a lot of brand-relevant sort of price tier, we're able to secure and grow our deserved position and market share before we're going to expand. So we're going to go through that process first. I'll just end here.

Richard Alan Kramer - Arete Research Services LLP - Senior Analyst

And in terms of -- I know you were reluctant to talk about it last year in terms of sizing the business, but can you talk at all about or give us any detail around the progress of Vive? We certainly don't seem to see any uptick in sales because of it. Clearly, you're still making losses. Can you sort of size the investment for this year? Since it's clearly early days in VR and it's still very much in investment mode. We do see that you're doing a lot



of marketing activities. So I'm just trying to get a sense of, within the P&L, what's the impact of Vive and how do you see that contributing sort of in the near and longer term?

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

I think the -- first of all, HTC will continue to work on the premium smartphone. And if you fast-forward in the next few years, it will be a time that a lot of moving pieces will come in places, including one part of it is the 5G will come. With the coming of 5G, it will trigger quite a lot of different applications. Richard, given that you're in the industry for a long time, you study this a lot. I think you would agree with some of the trends we're talking about.

Richard Alan Kramer - *Arete Research Services LLP - Senior Analyst*

Sorry, Chia-Lin, I was asking about Vive, not 5G. 5G -- okay, yes, okay.

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

Actually, the -- when 5G comes, it will trigger a lot of things in there. And we're seeing a -- you're seeing a gradual increase and hopefully acceleration when 5G comes. And it's our belief the -- it will tie into, not just the smartphone, but different applications, even including the virtual reality or mixed realities in there. So I'm saying this to answer you in 2 ways. One, we are going to realign our internal resources and making sure that the engineering team is aligned and arranged properly for the next 3 or 5 years, the company's strategic goal in there. So that's why you can see that. We're not trying to go with volume play in smartphone. There is a lot of -- the volume -- there is a lot of energy in getting the scale and volume, including the 5G advantage, et cetera, on those. But you can see with quite some names in the different industry participants, volume doesn't necessarily guarantee the stickiness on the high end or necessarily guarantee that the -- it would definitely be possible. So we're trying to realign the resources for that purpose. But we also need to make sure that we continue to be the leader when it comes to the 5G, another reflection point ticking off. Coming to the Vive, it's actually with the same token there. The -- it's going to take some time to have a mass production. As you can see in this industry here, you can say whether it's an innovator stage or the early adopter stage in there. We still need to migrate into the early majority and hopefully the mass market in that. So it's going to take some time, not just by ourselves, by all the industry participants and also by different -- I would say, the underlying technology infrastructure, they all need to be in place. But we want to make sure we're prepared for that. So that's the reason we're doing what we're doing.

Richard Alan Kramer - *Arete Research Services LLP - Senior Analyst*

Okay. And maybe my last question is, since with the focus on really premium flagship models, and that's very clear, but -- and you're currently loss-making. But how do you think about your sales and marketing costs? Since I think, as you know, when you've been in the sales roll, it's critical to have the sort of right Net Promoter Scores and right profile market-by-market and where HTC has historically had market share. How do you think about managing the costs with a business that is obviously currently making losses so that you can make sure you get your message across in a very crowded premium flagship space?

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

I think at the end of the day, that the -- when it comes to sales work, at the end of the day, it's how you're going to clear the organic demand generation from a end-consumer perspective here. And it's very important you work with the channel partners, either with the carrier partner, retail partners in there. But at the end of the day, consumers' acceptance is the key. So how will we rearrange our infrastructure in terms of sales team infrastructure, marketing team infrastructure or the way we focus on the more precise marketing? That's what we've been doing in there. I think we're scaling that operation according to our strategic goal when it comes to our focus as well.



Operator

(Operator Instructions) Your next question is from David Dai from Bernstein Research.

David Dai - *Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst*

I have 2 questions here. The first one is regarding the smartphone business. I think earlier you mentioned that you're cutting the smartphone number of models to about 6 to 7 this year. Could you give us some more details on what that means to your -- apparently, you're cutting the low end, so keeping the high premium end. What does it mean to your gross margin? And on top of that, by cutting the low -- the models by about 1/2 or so, you are reducing a lot of the operating expense as well as sales and marketing. Could you give us some more direction on what that would mean to your operating expense this year?

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

Right. So thank you for the question. I think it's just the -- extending what I talked about earlier there, we are going to focus on the small number model, and it may even further reduce on the current model. And the goal is we believe that in order to be successful in the smartphone in the longer term, in addition to a continued industry evolution or potential disruption when 5G comes, we need to make sure the brand would associate price tier, and our goal is premium tier needs to be there. And if we are not able to get that premium tier to be stickier, you can sell a lot of the affordable entry-level, it would not help the brand. They actually consume your future equity there. Obviously, there is a balance in there because our channel partners, especially our retail channel partners, that they want volume. And so they may be running at a different model in there, so we need to find the right balance to make sure we continue to work well with our different channel partners. But our strategic goal is to make sure we secure growth on that price tier. With that, we're going to reduce our model appropriately to fit that purpose. If we can get success in that, then we'll potentially expand on that. Other than that, I personally believe -- we HTC believe it's difficult. And you can look at all different participants. There are participants out there with a much, much bigger volume here, but still have pretty significant losses in that. So that's the strategy we do. With that, we are consolidating our engineering resources to make sure that in addition to smartphone, we position well for the future strategic goal in the next 3 to 5 years. Because if you look at the -- regardless what you do 5 or 10 years from now, and then Bernstein just published a research before on that and we saw that, it's a similar thing in there. You have to have a communication there underneath it, and then that needs to be there. You need to have the right system software, you need to have the right hardware, you need to have the right application software in there. That same capability apply to many different so-called product or potential product in the next 5 years or beyond. So we are repositioning our internal for that purposes. And in the meantime, the smartphone will continue but according to the model I just described.

David Dai - *Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst*

So if I understand this correctly, does it mean that -- because if I look at the nearer term, like this year, are you saying that when you cut the number of models, obviously you save a bit on the R&D personnel and R&D expense? Are you redirecting those for longer-term research? Or are you saving a little bit from there this year? And what about the marketing expense?

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

I think the -- you would see our marketing or sales expenses actually going to be scaled according to the current status. In terms of engineering and R&D, we're redirecting it for future purposes, either working with potential industry leaders partners. I wouldn't say industry leader partner, it'll more be like platform leaders, I'd call it, and coming out with potential future innovation 3 or 5 years down the road using our internal capability, that's what we're doing right now. And sales and marketing, you see the expense is going to be -- continue to scale hopefully. And R&D, we're going to redirect into -- because you can leverage -- you can put some R&D resources doing a few more entry-level smartphone model. You're not creating more motivation for R&D team because they're not doing anything new. And you may not sort of utilize their capabilities in the right way. So we are redirecting for that purpose. In terms of P&L impact, I know that's what you guys are focusing on here. If competition remains as we are today, hopefully, selling premium model, your margin will be hopefully slightly better. But you can see the competition continue to, as I described internally, that the tide of competition continue to go up. So even in the, as you can see, different vendors announcing their smartphone, where



you can try to understand the market condition there. So competition is already going up across different price tier spectrum. So sitting here today, particularly in the gross margin, probably is not an easy task. But on the OpEx side, we do want to do the streamlining I just described.

David Dai - *Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst*

I think that's very clear. If I may add one follow-up. Could you elaborate a little bit more about what happens when 5G comes? And specifically, what are the directions or whether what you envision HTC -- the role HTC will play or whatever things that you would do when 5G comes? That's the last question I have.

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

It's everybody's guess. We obviously have our view. For competitive reason, we'll probably don't elaborate a lot. But obviously, we work with quite a few key leaders in the space trying to come up with a potential innovation. So hopefully, that will prepare ourselves well. But you guys -- and you guys research it [all]. I think you guys see the same thing in the sense that once it comes, that quite different applications would ensue. That would not just be a smartphone or whatever the devices you will call at that time, and that will have an impact across different domains as well.

Operator

(Operator Instructions) Next follow-up question is from Richard Kramer from Arete Research.

Richard Alan Kramer - *Arete Research Services LLP - Senior Analyst*

Just 2 very quick ones. Chia-Lin, do you think it's wise to propose to the board that you pay a dividend this year? And can you talk at all about the cash disbursement policies that you have in the past and whether they'll be carried forward? That's the first one.

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

The -- well, I'm not the CFO anymore, so Peter is right here. I think the -- I don't want to say on behalf of Peter, but facing Peter would agree with me that, that would not be our sort of staff management team will propose. But obviously, at the end of the day, the board and the CEO will propose, and the board decides. But I think it's safe to say neither of us will propose that.

Richard Alan Kramer - *Arete Research Services LLP - Senior Analyst*

Okay. And one last one. I know HTC went through, probably before your time, many disputes over what you have to pay for IPR. Are any of those disputes now -- or are any of the license agreements that you had in the past coming up to a point of renewal where, because your volumes are so much lower than they were before, that you would see a material reduction in your costs? Or were those deals largely involving upfront payments and relatively low license fees? Is that some -- is that a material source of cost savings if you have some of these license agreements that come up to their typically 5-year anniversary date?

Chia-Lin Chang - *HTC Corporation - President of Smartphone and Connected Device Business*

Richard, I can only say that it shows that you know this industry well. Obviously, everywhere, every area [well pool] addressing it, and this is one of the area we obviously need to address. Some ones are fixed. Some ones are variable. Beyond that, I can't comment, as you know.



Operator

There is currently no question on line. I will pass the call back to Maggie Tseng for closing remarks. Ms. Tseng?

Maggie Tseng - *HTC Corporation - Senior Director of Treasury and IR*

Thanks, everyone, for joining the call today. Have a great day.

Operator

Thank you for your participation in HTC's conference. There will be a webcast replay within an hour. Please visit www.htc.com under the Investors section. You may now disconnect. Good-bye.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2017, Thomson Reuters. All Rights Reserved.