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CORPORATE PARTICIPANTS

Kelly Hsu *HTC Corp - IR Manager*

Chia-Lin Chang *HTC Corp - President of Smartphone and Connected Devices Business*

Peter Shen *HTC Corp - CFO*

CONFERENCE CALL PARTICIPANTS

Richard Kramer *Arete Research - Analyst*

Wei Chen *Goldman Sachs - Analyst*

PRESENTATION

Operator

Welcome everyone to HTC's 2016 fourth quarter results conference call and webcast in English. Today with us we have President of Smartphone and Connected Device Business, Mr. Chia-Lin Chang; CFO, Mr. Peter Shen and Investor Relations, Ms. Kelly Hsu.

All lines have been placed on mute to prevent background noise. After the presentation, there will be a question-and-answer session for investors and analysts. Please follow the instructions given at that time if you would like to ask a question.

For your information, this conference call is now being broadcasted live over the internet. A webcast replay and English transcript will be available within an hour after the conference is finished. And a 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. Kelly Hsu from Investor Relations. Ms. Hsu, you may begin.

Kelly Hsu - *HTC Corp - IR Manager*

Thank You. Good morning, good afternoon and good evening ladies and gentlemen. Welcome to HTC's 2016 fourth quarter analyst call. This is Kelly Hsu, HTC's IR Manager. The event is now being webcast live via HTC's website at www.htc.com. If you're joining through the dial-in lines, your call is now being placed on mute. As the conference is being broadcast by investors around the world, we'll conduct the call in English only.

The format for today's call will be as follows.

First, I'll summarize our operations for the fourth quarter. Afterwards, our President of Smartphone and Connected Device Business, Mr. Chia-Lin Chang, and CFO, Peter Shen will lead the Q&A session.

Before we begin, I would like to draw your attention to the 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.

If there is no question, I'll begin to give the overview for fourth quarter 2016. Please turn to page 3.

Q4 financial highlights. Revenue for Q4 was TWD22.2 billion with gross margin of 10.5%.

Operating loss was TWD3.6 billion and operating margin of negative 16%. Net loss after tax was TWD3.1 billion or loss per share of TWD3.77.



Business overview. HTC saw robust sales performance in Q4 with quarterly revenue improving sequentially over 2016. While OpEx has been aggressively managed through enhanced resource realignment to deliver a 34% cost reduction over the year.

Q4 saw the global launch of the HTC 10 Evo in November. While HTC Desire 10 Pro and lifestyle edition phones also entered select markets and have been well received.

HTC continues to build a VR ecosystem through HTC Vive with several events underlining the growing reach of the Vive platform including opening the first Vive-based arcade in Taipei. First demo days for ViveX Accelerator program in San Francisco, Beijing, and Taipei, and the launch of Vive Studios.

Page 4. Page 4 gives an overview on revenue and operating profit. Revenue for Q4 came in at TWD22.2 billion, operating loss was TWD3.6 billion.

Page 5. Page 5 gives an overview on growth margin and operating margin. Growth margin for Q4 was 10.5% and operating margin was negative 16%.

Pages 6 and 7, our financial overview for income statements and balance sheet.

This wraps up the content of our presentation.

Now I would like to turn the podium to HTC's President of Smartphone and Connected Device business, Mr. Chia-Lin Chang and CFO, Mr. Peter Shen.

Moderator, we can start the Q&A session.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions).

Your first question comes from the line of Richard Kramer from Arete Research. Please ask your question.

Richard Kramer - Arete Research - Analyst

Hi, thanks very much guys. I apologize but we only got the slides literally as the conference call was starting, so I'm just looking through them. Chia-Lin, can you help us understand a little bit better the ODM business or the partner business that you are doing with partners like Google, for example, on the Pixel, they've clearly named HTC as the vendor and I guess what we are struggling to see looking at the margins, if not also the sales, is how this sort of business impacts the HTC P&L?

And then a second question is clearly it doesn't appear that you've had any material VR sales this year. Do you expect there to be or were there any material VR sales this year? Can you tell us what the impact of the VR investments might have been on your operating losses? And looking into 2017 for the full year, do you expect that VR will be able to materially impact HTC sales?

And then I have, maybe I have a follow up after that. Thanks.



Chia-Lin Chang - HTC Corp - President of Smartphone and Connected Devices Business

Yes, thank you, Richard. And let me answer your two questions. First of all, I understand the HTC names has been mentioned, and all I can comment is that HTC has historically a good relationship with Google. We see Google as a partner as you can see in the past history there. But I will not be able to comment on any business dealing with them and all I can say here is the -- obviously for any business HTC take on for the interest of shareholder, we want to do it in a profitable way. So that's what I would comment.

The second question, in terms of VR, I didn't quite get your statement in terms of 2016. All I can say is 2016, we are happy where we were, ending 2016 in terms of VR sales and as I said -- I forgot which conference call -- that we're selling the product with a profit.

In terms of total, the operating line, it depends on how much dial we want to turn on the investment because this is going to take a few years to get to hopefully, a much, much bigger attractive market here so we are going to have to invest for the future.

And so in terms of having the operating line obviously depends on how much investment we are going to put in there. But I can comment here we are happy with the sales we had in 2016, and hopefully, we will continue the momentum into 2017.

Again, on a product level it's a profitable way. In the operating line here, I cannot separate them yet because for the confidentiality reasons in terms of comparative landscape here. But we do build this for the future.

Richard Kramer - Arete Research - Analyst

I guess, just on both those questions, to ask a little bit of clarification. First of all, can you assure us that the any business that is done with partners like Google or any other partners on perhaps an ODM basis, this is part of the revenues and operating profit that you are just reporting now? So that this is part of the P&L and not part of a sort of -- any sort of separate arrangement that HTC might have to make products using its existing facilities?

And then my question on VR, just to be clear, was when you look at the total sales of 2016 and you look at your projections for VR for 2017, will this be a material component of sales and by that, I mean something that if you took it away, we would notice and will contribute in a meaningful way, you know, more than just 1% or 2% to sales for next year.

Chia-Lin Chang - HTC Corp - President of Smartphone and Connected Devices Business

I think I already answered the first question, I can't elaborate more to you. All I can tell you is we are taking on any business we obviously want to do in a profitable way. That is going to be the case.

So that is number one. Number two here as I said, we hope to continue momentum for 2017 for VR business, of course we want it to be a meaningful part of the overall business in terms of the revenue and bottom line performance. But obviously VR is something new and we see a lot of potential and so we are building for the future.

And in terms of operating line, it depends on how -- what much dial we are going to do in terms of investment side here. But we do sell the product in a profitable way.

Richard Kramer - Arete Research - Analyst

Okay, and then maybe one last one. In terms of your outlook for certainly the first part of the year and how you are thinking about your roll out of flagship model. Can you give us a sense of how you expect the year to go on noticing that you are ending the year with a very low inventory position? That would suggest another relatively soft quarter in the first quarter of sales which is typically down sequentially?

I mean, when would you expect to start to see HTC crawl back to a sort of year-on-year growth in sales or when do you have the timing of your major flagship launches this year for us to anticipate in the P&L?

Chia-Lin Chang - HTC Corp - President of Smartphone and Connected Devices Business

I think the -- basically, I would elaborate a little bit on this question here because actually a benefit of the audience here on what we intend to do. I think we want to do something -- there is some slight difference between 2017 and 2016. 2017, we are looking for profitable sales of products, so we are going to get out of the entry level part which I think is ultra competitive and we are not necessarily going to benefit from a profitability perspective here.

So to us, profitability on the smartphone is going to be quite important. What we are doing in 2017 is we are going to continue to reduce our portfolio so the number of key SKU is going to be dramatically reduced from last year. As I said, our intention to do basically [6 to 7] maximum, obviously you still have a legacy product in sales throughout the coming month in there. But the new introduction, that's what we aim for.

We are going to do it in the, probably I would say, very hard to pin down specifically on a price here, I won't elaborate further on that, but I will say probably would be more mid-tier premium and the flagship type of these SKU products.

So that, you will see the difference. So we're not looking for the volume, we are looking for profitable revenue from the sales of the product perspective.

Richard Kramer - Arete Research - Analyst

So just for us to all understand as investors. Your goal for 2017 is to bring the Company back to the black as opposed to go for sales growth, because obviously you are -- you finished another year where you had operating losses literally every quarter and obviously with a very low gross margin, it's very hard to see how you turn that around in the near term. But the goal this year is to make profit, not to go for sales growth.

Chia-Lin Chang - HTC Corp - President of Smartphone and Connected Devices Business

The goal, this year, is going for basically for profitability. And profitability hopefully comes with the sales growth. In fact, the growth of revenues coming at the no profit in there, that is not what we are going for.

For example, in Q1, the spectrum to Q1 gross margin will be higher in Q4 gross margin. And that will be indication in terms of the direction we are going.

Richard Kramer - Arete Research - Analyst

Okay, thanks.

Chia-Lin Chang - HTC Corp - President of Smartphone and Connected Devices Business

Thank you.

Operator

Thank you. (Operator Instructions).

Your next question comes from the line of Wei Chen from Goldman Sachs. Please go ahead.

Wei Chen - *Goldman Sachs - Analyst*

Yes, thank you. So my first question is regarding virtual reality. Recently -- to give some context, recently the press has been indicating that Facebook is closing down a large amount of Oculus VR demo stations at Best Buy due to significant decline in foot traffic. So even though Oculus is your competitor, but it doesn't sound well for the VR industry if consumer interest is falling very sharply. So my question is after a strong VR debut in 2016, do you see consumer interest falling and why that is?

And any key catalysts in 2017 that could get consumers excited again? That is my first question.

Chia-Lin Chang - *HTC Corp - President of Smartphone and Connected Devices Business*

The -- I can tell you the -- we're happy with 2016, I think Q4 last year, we also had a good VR for Q4. We obviously -- this is something very new, we hope we continue the momentum in 2017. Am I going to have the crystal ball to see the entire 2017 in a changing state of things, probably it's difficult, but so far, in the segment we operate, and in terms of the consumer interest, I think we'll continue what we see is continue to be positive. The -- obviously what we need to do is more and more developer leveraging this ecosystem, the interactive part of the VR, to grow the pie. I think that's what we're doing.

I think the product itself is strong if you experience -- hopefully, you will agree, so we're just going to get more people to get more attractive content to get the momentum going. And so far, for all the places I've traveled, there continues to be partners, clients, or even consumers coming to us saying they like the product. So hopefully, we are able to continue momentum. But again, I don't have a crystal ball to look into the entire 2017. We're just going to continue to do hard work to keep it moving.

Wei Chen - *Goldman Sachs - Analyst*

Got it. Yes, so, I mean to be kind of more specific, for -- I'm not trying to have your crystal ball the entire 2017 but is there a specific catalyst or milestone that you could look for in 2017 that could bring more excitement to the Vive product?

Chia-Lin Chang - *HTC Corp - President of Smartphone and Connected Devices Business*

I think the ecosystem, the content is actually quite key. So that's something we work a lot and then that is not going to be done alone by ourselves, that -- regarding so many partners. And you can see the HTC team is working hard on that.

Obviously, we are also working on different sales tactics in there, so hopefully, it could be reachable, accessible to a broader group of potential customers and audience in there, including online and offline. So you can see some of the places that actually, we are going offline already.

So you see the different sales part, the effort we are doing here, but I think the fundamental part here is getting that ecosystem and that content to be more and more attractive content, I think that will be quite key.

Wei Chen - *Goldman Sachs - Analyst*

Got it. Okay, and going back to the core business, the smartphone business, I think last year, we talked about kind of target to break even and it felt like going from the second quarter to the third quarter, losses have narrowed, so at that point in time, I think the investor were more positively looking at fourth quarter thinking that losses could continue to narrow. But however, now, looking back, it seems like the losses are still pretty significant.

And it seems like the strategy of reducing the number of SKUs or models and focus on mid to high end was something that was sort of being implemented in 2016, but yet we haven't seen the result. Can you just kind of go through what are sort of the miss that you saw in your smartphone business that led to pretty significant loss in the fourth quarter rather than mitigating the losses? And what could change in 2017?

Chia-Lin Chang - HTC Corp - President of Smartphone and Connected Devices Business

I think looking, you know, looking back, to be honest, looking back, we have a difficult year for M9, that is 2015. And then we have an incremental better product for M10, which is still on sale in terms of product quality. Due to the M9 issue, we do have some internal inventory issue and material issue, it took us some time to work out. And 2016, we migrated into that direction, but we are not completely in that direction in terms of reducing the numbers SKUs to the level we want.

Because we do have some of (inaudible), we do need to resolve. I think most of those things, hopefully, are, I wouldn't say completely, but basically mostly, actually, hopefully are behind us. As I said here, you start seeing Q1, our -- the margin we expect them to be better than Q4. I don't know the historical comparison in there but I think that something actually slightly different compared to the historical context in there.

I do think this year in terms of new product introduction here, we're very clear what we want to do in terms of number of SKU, every quarter, we have something unique proposition in terms of hero product, not necessarily every hero product is a flagship level price tier here, so our proposition will be more clear.

We are getting a lot of places in terms of the revenue generating, but not necessarily the high profit generating SKU because those SKU tends to be under a lot of uncertainty because the material planning (inaudible) to creating other issues.

So we are heading in that direction. Profitability, obviously is our key, smartphone to us, getting the profitability, it's our daily job and daily reminder internally.

Wei Chen - Goldman Sachs - Analyst

Got it. And is there a timeline or a new goal to sort of get to a breakeven level in 2017 on the smartphone side?

Chia-Lin Chang - HTC Corp - President of Smartphone and Connected Devices Business

I won't be able to comment. I hope I do know here but I do think the -- I do hope we are going to have a better sequential quarter Q2 to -- better than Q1 given that the product portfolio entirely changed here in Taiwan. So we know we are starting with a new design.

And frankly speaking, that new design, it took us some time, because it takes some time, there is some lead time in there. So we're heading in that direction.

I think the industry is going through the restructuring as well, I think probably not just us, there are some other -- the industry participating also having the pain in that except we are more pure-play, some of the other players are actually more broadline business in there, but we want to quickly get into the direction, the state we want to be in. So hopefully, we can see it in there sequentially quarterly.

Wei Chen - Goldman Sachs - Analyst

My last question, I'm not sure if Peter is on the call but on the financial -- I understand you have a net cash position of roughly TWD35 billion, but if you are burning about TWD3 billion on a quarterly basis and doesn't get smaller, how are you thinking about, by maintaining liquidity for working capital et cetera, how are you going to manage to this level of cash burn versus what you have on your book for net cash?

Peter Shen - *HTC Corp - CFO*

Wei, to answer your question in a more simple way, I think as any business do, right, we are very prudent and very diligent in managing our working capital. That's definitely on a day to day, I guess, focus.

So as you can see, I think your numbers there might not be completely correct, we are not burning that much. But going forward, the strategy is very, very simple. We got to be very diligent on working capital management and we are burning -- as Chia-Lin mentioned and going forward, obviously, it always comes back to operating results. So we are -- as we get more focus, and streamline our product offerings, focus on profit growth, we need to obviously try to mitigate our operating losses.

But on the financial side, therefore, we need to try to really focus on our working capital. And if there are any opportunities for [conversion for] nonperforming assets, we always keep a very diligent eye on that as well.

Wei Chen - *Goldman Sachs - Analyst*

Got it. All right. Thank you, guys. That's all my questions.

Peter Shen - *HTC Corp - CFO*

Okay, thanks.

Operator

Thank you. (Operator Instructions).

There are currently no questions in line. I will pass the call back to IR, Kelly Hsu, for closing remarks. Ms. Hsu?

Kelly Hsu - *HTC Corp - IR Manager*

Thanks everyone for joining the call today. Have a good 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 investor section. You may now disconnect. Goodbye.



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