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PRESENTATION

Operator

Welcome everyone to HTC's 2014 second quarter results conference call and webcast in English. Today with us, we have CFO and President of Global Sales, Mr. Chia-Lin Chang; AVP of Finance, Mr. Edward Wang; and Manager of Investor Relations, Ms. Christine Chi and Ms. Sally Kuo.

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 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.

And now, I would like to introduce Ms. Christine Chi, Manager of Investor Relations. Ms. Chi, you may begin.

Christine Chi - *HTC Corporation - Manager, IR*

Okay. Thank you, Jason. Good morning, good afternoon, and good evening, ladies and gentlemen. Welcome to HTC's [2014] (corrected by company after the call) second quarter analyst call. This is Christine Chi, HTC's IR Manager. The event is now being broadcasted live via HTC's website on www.htc.com. If you are joining us through dial-in lines, your call is now being placed on mute. As the conference is being broadcast by investor around our (technical difficulty) this call in English only. The format for today's call will be as follows.

First, I will have to summarize our operations of second quarter of 2014, followed by our guidance for the third quarter. Afterwards, our CFO, President of Global Sales, Chia-Lin Chang; and AVP of Finance, Edward Wang, will lead a 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 expectation, and the Company undertakes no obligations to update these forward-looking statements going forward.



If you have no questions, I may begin the overview for the second quarter of [2014] (corrected by company after the call). Please turn to page 3. Page 3, second quarter financial highlights. Revenue for second quarter was TWD65.1 billion, with gross margin of 22.2% and operating margin of 3.7%. Net profit after tax was TWD2.3 billion, or EPS of TWD2.74 per share.

Business overview. HTC's return to profitability has been driven by sales momentum of its HTC One (M8), HTC One mini 2, and Desire 816 product around the world. In the US, HTC One (M8) continues to impress the market with availability through all four major operators.

While across Europe, the HTC One mini 2 has extended the best-in-class HTC One (M8) experience in a more compact format. The HTC Desire franchise also experienced significant gains, lead by the success of the Desire 816. The HTC One (M8) and Desire 816 continued to dominate in Taiwan. And for the first time, HTC ranked Number One in both unit shares and value shares.

Overall sales momentum was sound in China and India, as a result of well-catered product portfolio to the very fast-growing markets.

Page 4, product innovations. Adding to the HTC One family, HTC One (M8) brings the iconic signature look to a new level, with vertically curved, tapered sides, edge-to-edge display and lightweighted unibody frame, a design enabled ultimate user experience to end users.

HTC One mini further extended the best-in-class HTC One (M8) experience in a more compact format for user experience. HTC Dot View app available on Google Play for future upgrades, wallpaper customizations, and functionality renewals. Award and honors, HTC's superior design and engineering capability continue to impress, with HTC One (M8) and HTC Dot View case once again claiming the Gold Medal in Design and Innovation at the Computex d&i awards in June, organized by the Taiwan External Trade Development Council and iF (International Forum Design).

Page 5. Page 5 gives an overview on revenues and operating profits. Revenue for second quarter came in at TWD65.1 billion, operating profit of TWD2.4 billion. Page 6. Page 6 gives an overview on gross margin and operating margin. Gross margin for second quarter was 22.2% and operating margin for second quarter was 3.7%. Page 7 and 8 were the financial overview for income statement and balance sheet. The guidance for the third quarter [2014] (corrected by company after the call). Revenue is expected to be in the range of TWD42 billion to TWD47 billion. Gross profit margin is expected to be 22.5% to 23%. EPS is expected to be in the range of TWD0.05 to TWD0.65 per share.

This wraps up the content of our presentation. And now, I would like to turn the podium to HTC's CFO and President of Global Sales, Mr. Chia-Lin Chang.

Moderator, please start the Q&A session.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Can you leave the time to investors and analysts. For media, please contact HTC PR team after the call if you have any questions. (Operator Instructions) Arthur Hsieh, UBS.

Arthur Hsieh - UBS - Analyst

Hi, Chia-Lin, Edward, Christine, and Sally, this is Arthur from UBS. I have a couple of questions. Thank you. I have a couple of questions. First is with regard to the gross margin guidance for the third quarter, it seems like the level is relatively healthy compared to last year. Looks like it's even going to have improvement. But I think there is a news report talking about the flagship model of the Company, the volume is coming down. Could you share with us how do you manage to maintain and even improve the gross margin in the coming quarter?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

You want to go through the rest of question or you want to answer one by one.

Arthur Hsieh - UBS - Analyst

I think one by one is good. Thank you.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Okay. I think third quarter gross margin is similar to the second quarter. I wouldn't say is a big improvement, actually it's pretty much similar there. The reason I'm asking you to ask a separate question is that we're going to talk about the -- you can see -- the guidance for third quarter revenue, there is a sequential decline over second quarter. It's primarily coming out of two things, one a similar product after the initial excitement, which is a hype-up demand in there has settled at the lower level but the good thing about it, it's stabilized.

So in order to maintain a good channel environment, we decide to selling in less for that. So I don't think it has anything to do with the gross margin for that specific product. Second thing, we -- on the Desire line products that the -- given the shorter lifecycle. So in the third quarter, we're probably going to have some sort of transition in certain parts of the world. So there's some product transition period at the time, so we're going to slow down some of the parts we are selling and then in preparation for the ramp-up of the other type product. So a combination of those plus some of the uncertainty there, that's what we have the guidance. But on the gross margin side, I don't believe it's because selling less and then the -- has anything to do with the growth margin on that part.

Arthur Hsieh - UBS - Analyst

Thank you. So, would you be more specific about what are the regions that you consider as probably less relevant and you would try to manage through the transition?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

I'm not sure I understand when you say regions less relevant to manage the transition. Could you specify a little bit more?

Arthur Hsieh - UBS - Analyst

Sure. I think you just mentioned for some of the products that probably there was initial hype, but you didn't want to continue to push those models when the demand wasn't that long-lasting. And therefore, for certain regions, if I steer correctly, it sounds to me like you would like to reduce the overall marketing or maybe the push. And therefore, you can still maintain the overall profitability. So, I'm just wondering what will be the regions that are more critical to the overall profitability, and what will be the regions that you would not waste the resources?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

I think that's a separate question and I'll just clarify also the first part of your question. Let me answer the overall question in terms of profitability. Basically, almost all the countries or regions there we have presence, they are key to us. If you think about some of the key regions there, I could just elaborate a little bit more there from the Greater China area that we're in, from the India, we are in South Asia, the rest of Asia there, and also in Australia, southern parts of Southeast Asia. In North America, as you guys know, we have a long history of having the presence, and also the entire EMEA. It's important to me. I can be more specific, yes, in certain area like in LATAM, we probably have less presence compared to other regions there.

In terms of profitability, that's a separate question there. Given the sequential guidance on the revenue decline, we need to adjust our resources hopefully, so maintain a minimum profitability without impacting on the overall [continuity] brand equity investment in there and also the demand generation, but we need to adjust accordingly is a sensible prudent management. So, that's the answer to your second part of question, is overall question. I want to be more clear on what I said in the beginning and why that has nothing to do with the margin. The margin obviously a combination of product mix, they can see still no product, actually the major driver product actually had a similar margin. So, you wouldn't see a really big change in that.

Quarter-over-quarter, there is always a pressure for the cost down for the price, it was always in combination with cost down. So, it's a balance of those. What I want to -- I'll be clear what I say here is, in the second quarter, especially for the new product ramp up, initially -- the initial ramp-up volume, the customers including the operator or channel partners, they draw certain volume. And then, after the initial hype and the activation, the product may settle at a lower, even though I said a stabilized level in our case. So, we'll decide, we need to make sure that the channel inventory is healthy, really going through the third quarter.

And also, in certain products, and I'll just be even more specific in certain Desire product that we are not going to manage transition in certain region, say, in transition to a new product because we think maintaining a strong and competitive Desire line is important to us. So, it's a combination of those leading to the revenue declined our guidance. So I just want to clarify that.

Arthur Hsieh - UBS - Analyst

Thank you. My next question is about China. Could you let us know how big is overall contribution coming from China? And with regard to the market demand there, I think yesterday, there is semiconductor company blaming on their weaker third quarter outlook to the weakening demand in China, and the carriers there obviously they are under pressure from the authorities to cut the subsidies. So, does that have any impact at all to the overall market demand going to the third quarter? That's the second question. Thank you.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Right. I think we are going through transition in China, for people paying close attention to HTC, they probably would agree and notice, we have gone to, I don't think we've finished the kind of transition in China starting from the probably at the beginning of 2013 after initial success in 2012. So we've gone through the kind of transition period. To us, we have experienced there is always a mix of things what we do (inaudible) and then success we have in China. The good thing about it here, we have proven and also we are optimistic in certain product line, we're able to drive by develop, partner, build, the kind of product and also channel process, we're able to drive continued volume.

In terms of your question about China demand, I don't believe we are able to comment on whether we're seeing a slowdown in China demand. Our market share is just not sizable to be able to say, this is what we feel when I comment about HTC's what I comment about industry. So I probably would refrain from commenting on that. But one thing what you said is actually correct that as you see on the news that the carrier subsidy will lead to an environment in which you basically just need to sell your phone, finding a natural way of creating consumer pool without the help of subsidy to creating that. So that actually is a new environment for all the handset vendors participate in China and frankly speaking, probably in the coming year is the trend globally as well.

Arthur Hsieh - UBS - Analyst

Got it. So just a follow-up on that, do you need to make any adjustment to your overall sales marketing strategy on the back of these changes in these carrier subsidy approach going forward?



Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

I think the carrier subsidy, basically we have been adjusting and also on an ongoing basis on the overall strategy in China and also globally as well, since you talk about China, I'll just be more focused on China. In addition, we are doing a very tactical paying month-over-month or on a quarterly basis. We continue to have a very strong in my view carrier relationship in all the major three carriers in China. We also in certain parts, the provinces there, we actually maintain a good relationship, the kind of carrier relationship not just about subsidy.

I think it's about the kind of trust and build enable to push the product and then you are able to pull the consumer into using their networks, which I think is actually important and it eventually will be a win-win situation. As you can see, probably some of the people would notice that our so-called HTC One E8 in China, we call it (inaudible), the fashion addition of HTC One. One of the carriers actually put it in the as a broadcast live online there the world cup may put us up from center on those. So its ability having that kind of trust and helping them create the more subscribers using the network and then the kind of mutual win situation, that will dictate the future in terms of comes to vendor and carrier relationship.

Arthur Hsieh - UBS - Analyst

Thank you. My last question is about the working capital management. Second quarter last year, I think it was net negative three days. At the end of first quarter is about 12 days and at the end of the second quarter is about 14 days if my calculation is correct. Does that mean that lengthening is a trend that could continue and what's driving the changes?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

You're talking about AR, you're talking about overall?

Arthur Hsieh - UBS - Analyst

The overall working capital turnover.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

The overall working capital, I don't notice a material difference in that. Let me look at it. What page you look at it?

Arthur Hsieh - UBS - Analyst

I'm using the number from Page 8 using this AR days, plus the inventory days and subtract the 80 days. So that lead to a negative number for second quarter last year and it was about 12 days for the first quarter and increased a bit to 14 days in the second quarter. So I was wondering whether that's the trend going forward, and what's driving the trend.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

First of all, I would caution in terms of year-over-year. I don't think we have established a pattern trend to say that. I didn't see your number calculation. But from the business perspective here, I haven't experienced a material change in that regard. We always have pressure from customers to have more favorable to them, the credit terms and also the payment terms. We actually always try to balance that. But compare this time of the year compared to the same time last year, I don't experience a big change in that regard, and I don't experience the big change in the way we manage our internal inventory as well as the AP condition. Edward, do you have anything to comment? Yes, so that now will be a comment but offline we can talk about some of your numbers there, but I don't believe there is a big material change.

Arthur Hsieh - UBS - Analyst

Alright. Thank you.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Thanks, Arthur.

Operator

Richard Kramer, Arete Research.

Richard Kramer - Arete Research - Analyst

Thanks very much. I guess first question is it looks like now the net cash is about 45% of your market cap and I'm just wondering in the context of what the comments you've just made about trying to sustain product momentum and making sure you didn't have inventory in the channel, would you try another strategy where you would start to deploy this net cash and try to compete more aggressively in the channel? And I'm just wondering it looks like you've taken the strategy of conserving cash as opposed to going for sales based on your guidance next quarter and why don't you answer that and then I'll come with a follow-up question. Thanks.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Well, I think I wouldn't want to mix sort of [deploying] the existing cash into -- I understand what you're trying to say here is, but to me managing the P&L is actually quite key in addition to managing the volume and the total revenue. So we are doing tactical things to making sure that they will continue to see the incremental momentum in certain product lines. But under the constrain that the managing overall P&L to us is important. So it's not just the cash issue, it's also the overall P&L issue.

We think, we have since as some our leadership including our Chairperson and the CEO. They have said we have gone through some of the transition starting up probably I would say, internally probably around third quarter last year.

That's a big part of it in terms our sales strategy as well the overall product portfolio. We have gone through it. We also learned our lesson along the way. We had some success, we have some lessons learned, we actually feel like the -- in addition to continue to have a flagship product that received the good attention award. We able to expand it and create drives. So overall, we are relative optimistic, but we'll continue to deploy tactically in terms of the incremental sales momentum, but [whether we have to put a large once the cash is to basically in effect basically dropping the price of course sales I think is under the constrain that we're managing a balanced P&L.

Richard Kramer - Arete Research - Analyst

Okay. And then just in the context of that question and thinking about your market share and how crowded the smartphone space is, is there any other approach you could see its taking heading into 2015 with the pipeline and the product portfolio you're undoubtedly planning today that you could see sort of some bumping up your market share, so that you effectively grab more (inaudible) shelf space, because the guidance seems to imply that you loosed a market share in third quarter and then obviously there's some very high profile launches taking a lot of market share in an attention in fourth quarter.

So, is there another approach you have planning would you mentioned the transition this quarter that we should look forward to that would try to reverse this relatively consistent low market share dynamic or is that just not, would you rather remain sort of a high-end premium niche and that's what we should be expecting from HTC?



Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Yes, I think you asked a very good question. First of all, we are not going to be a high-end-only smartphone vendor, we use the high-end to draw the rest of product portfolio and I can tell you that in addition to high end, and I'll give you more specific there, on the Desire line there, we have proven Desire 816 we can drive volume. And then, that volume will continue. And then, we actually lighten up the [year]. In addition, initially, Desire 816 started out in Greater China, and now extended to certain parts of big markets in India, in Middle East, in other parts of the Western Europe as well. So, we're able to drive volume.

So, looking into quarter four and looking into 2015, obviously too far away and this is very dynamic and very uncertain competitive environment. So, we can't comment beyond that. But certainly, our intention, we care very much about market share with a constrain about the P&L, but we really care about market share as well. We think internally, we have found a way to create quote-unquote value without being seen that it's just purely a spec game. In my view, people buy the -- in certain parts of the world, so I couldn't generalize it, in certain parts of developed countries, now people buying a so-called more entry-level phone probably will have some premium pricing.

But, in other developing countries, it's a very competitive spec game. So, we think we have figured out the path, whether has been proven in the market remains to be seen. But we figure out how to create value in certain segment there that hopefully, we can now create volume outside of I'll just say premium seeing, I'll just say flagship because in 2013, as you know, it's basically a pure flagship game for HTC, which is not healthy in our view. We may extend it. So we're encouraged by the (technical difficulty) able to extend a mid-tier in the Desire 816. We're going down the path that we are going to expand the portfolio a little bit. Again, whether that the way it works here, it will be proven in the market that we'll see in quarter four and also going into 2015, especially around the time you're going to see some product transition in a timeframe as well in quarter four.

Richard Kramer - Arete Research - Analyst

Okay. That's great. Thanks very much.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Yes, with that said, I'll comment on it here. We continue to push our M8. In the second half-year, we are going to have new thing making sure that will continue to kick up the momentum for M8.

Richard Kramer - Arete Research - Analyst

Okay, very clear. Thank you.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Thank you.

Operator

(Operator Instructions) [John Lourie, FTJI].



John Lourie - FTJI - Analyst

Yes, thanks. This is John Lourie from FTJI. Thanks for taking the question. Just looking at your guidance, just even if we take the higher end of your guidance on both revenue and gross margin, something has got to happen I think at the operating levels. Could you please talk about what -- with perhaps efforts that you're making on your operating costs, whether it would be reduction in personnel or perhaps cost saving somewhere, in order to be able to achieve the profitability that you're forecasting for Q3? Thanks.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Basically what we do is actually very simple. We maintain roughly the same R&D for long period of time. So, people always question about the R&D. We have very consistent and efficient and very strong R&D. On G&A, mainly with some small saving, we're not doing any cost cutting in terms of human capital, we are not, just want to be clear. In the sales and marketing, some of the sales expenses there, or some of the market expenses, more related to a longer term, we'll probably will streamline a little bit making more tactical. So, as a result, once you make it more tactical, you need to scale that portion with the sales accordingly and that's [how] you're able to manage your P&L. So, it's the logic behind it.

John Lourie - FTJI - Analyst

Okay, and just for the guidance on the revenue side. For me, I am positively surprised in terms of the revenue guidance and I'm thinking that considering, we are all expecting a very big launch from Apple in Q3 of this year, does your guidance imply that you are expecting somewhere to regain market share?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

I don't think we are expecting to regain market share. I think as Richard said in the beginning there, we have as I guided the sequential revenue decline. I don't know the second quarter and third quarter in terms of overall smartphone size. But we are looking for here as I said, the rationale behind the third quarter guidance. And we're looking for this transition in third quarter and into hopefully a sequential growth into quarter four. That's all.

John Lourie - FTJI - Analyst

Okay. Thank you.

Edward Wang - HTC Corporation - AVP of Finance

Thank you.

Operator

Mark Newman, Sanford Bernstein.

Mark Newman - Sanford Bernstein - Analyst

Hi, thanks. A question on kind of high-level strategy. What is the focus of HTC now more on trying to maintain share or even gain share, or is it more on the profitability? It seems like until recently, you have been focused a little bit more on trying to improve your profitability and clearly, you've had some success there. And I think Samsung has been trying to do the same and Apple has been trying to do the same, more focused on trying to maintain margins rather than share and there seems to be huge competition from the Chinese and also LGE as well to some extent coming in. And so I think there is some change of strategy it seems like from Samsung to be little bit more now focused on share rather than margin, based



on that, just based on what happened in the last quarter then fleshing out a little bit of inventory. And I'm wondering what HTC is thinking about that and what is your preference in terms of share versus profitability?

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Right. First of all, Mark, if you start calling HTC, welcome me. To answer your question, I assume you meant because what you said in the beginning is slightly different what you said in the end. You said Samsung is working on improve the profitability or improve the market share. I think I may have misheard.

Edward Wang - *HTC Corporation - AVP of Finance*

I think they have been trying to focus on both. But it seems like until Q2, the emphasis seems to have been more on margin, that's my opinion, but this Q2, it seems like they've changed their strategy and really tried to flush out the inventory in order to get the volume and try to focus more on volume and that seems to be more the focus now like that it seems to be the recent change from them because of the huge competition, particularly mid and low-end.

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Right, right. So I think probably it's not appropriate, I don't know, some are the competitors. So probably not appropriate for me to comment in terms of their strategy. For HTC, start gaining market share, it's important. As I said in answering Richard's questions, we have gone through a transition period in 2013. We want to be seeing that we could gain market share in the top end and then we have just proven we can do the mid-tier, regain the market share in the mid-tier. So now, we want to have more balanced overall portfolio.

I'll comment a little bit about in terms of entry-level affordable end part of it we also participate in, but I think for HTC, probably mid-tier, frankly, it's where we believe we have competitive strength. Obviously, a lot of vendors probably would claim similarly. However, having the market share, the volume drive to us is going to be quite key. And under the constrain that we are not going to drive so materially into the Red app in order to achieve market share, that's probably not something we would do.

We will take a more balanced approach, but that doesn't necessarily mean that we'll just only focus on P&L. We are willing to sacrifice a [bit of margin and know what, it should] gain market share. But overall, in terms of gross profit, volume to us, it's as important. So, are you willing to sacrifice some of the gross margin in order to better gross profit? So with that said, what I mean is a product not going to be able to sell goes through the mental hurdle and that starts selling product at a loss unless I'm cleaning out end-of-life inventory, that's a different story. So, I hope that answers your question.

Mark Newman - *Sanford Bernstein - Analyst*

Yes, that's helpful. Thanks. And then, just a quick follow-up. Considering that and considering some of the huge volume as some of the Chinese players nowadays, would HTC consider some kind of tie-up with another player such as a Chinese player to increase via some kind of joint venture or some kind of tie-up in order for you to gain more kind of scale and therefore cost advantage, all those great things that Samsung has in its advantage?

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Right. I think the answer is, no. So, I want to be clear of that without creating any speculation and I can elaborate a little bit the rationale behind that. I think when you talk about China, even (technical difficulty) very distinct preference unless you go into very sort of like below CNY1,000 and then that's become a bit murky. But, they have a very distinct preference on the brand. And in our view here, having a product to [operate that create] volume, it's actually easier. Under your control, we can do everything right. We're not seeing combining that, we are creating not much

benefit as people may see sort of like intuitively. And cost, we gone through our cost structure, our sales taxes, our product portfolio, et cetera, our design.

I think for us, just talk about for the benefit of people on the call, the HTC strategy is, going into the second half and also into 2015 in light of more still healthy growth but start getting more mature environment of smartphone, what we intend to do is, how do we promote and then communicate better the consumer experience supported by two very important pillars. One is, a very good, competitive spec in terms of hardware parameters, in terms of [spike] performance ratio. The other pillar is good design and that's something is actually important for HTC, to support the option that we think is a good consumer experience. So, that's our overall strategy and I would believe is probably while we control all these factors on a whole. We have a distinct culture in there. So, people are very clear what they are doing, what their goal or the direction. So, having that kind of combination I would say, in my view is not likely.

Mark Newman - *Sanford Bernstein - Analyst*

I see. Thanks very much. Appreciate that.

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Thank you, Mark.

Operator

(Operator Instructions) John Lourie, FTJI.

John Lourie - *FTJI - Analyst*

Yes, hi, it's John Lourie again. Just a question here on the non-HTC smartphone side of the business, what other efforts are you making to try and increase revenue and/or profits and in terms of non-HTC Smartphone? So, perhaps, for example, ODM business, wearables, tablets, or anything else that you are trying to establish in order to try and improve your revenue? Thank you.

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

I don't think we are considering all the end business. We are continuing to promote the brand. We are doing the -- when you say OD and I am assuming you're building products for vendors -- with vendors -- with customers' names. So, in that, I don't think we are doing that. In terms of products outside smartphone, I won't be able to comment on it. That's related to a new product, et cetera. That's a bit sensitive to talk about it.

John Lourie - *FTJI - Analyst*

But, sure you can say whether your strategy is to try and perhaps expand beyond smartphones. The shareholders want to know that kind of thing.

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

The strategy to us is simple. First of all, smart phone is still an entry point of our platform, whatever you call it, a portal for the majority of mobile Internet. So smartphone is also important, whether it eventually will continue to be center of all connected devices, it remains to be seen. It may well. So people probably will have a better concerns in the next few years; beyond that, nobody can judge.



Beyond smartphone, what we're seeing as our Chairperson and our CEO talk about it in various occasion there. We're seeing the world of smart city, smartphone. smart home and smart society would have connected devices there. So with that, what's your vision and how do you design and promote your product along the kind of vision, it's up to everybody's thinking. So I won't be able to comment on that. Longer term, of course, hopefully, you see, there is a new business driver outside of traditional quote-unquote smartphone.

John Lourie - *FTJI - Analyst*

Okay, thank you.

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Thank you.

Operator

(Operator Instructions) Ann Lee, Nomura.

Ann Lee - *Nomura - Analyst*

Hi, Chia-Lin, I just had the one question because I remember last quarter, you mentioned that the second quarter's gross margin range, guidance, included some one-off impact from the inventory of adjustments. So --

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

I don't think we have a second quarter the impairment on the inventory adjustment.

Ann Lee - *Nomura - Analyst*

Because I remember last quarter, I asked one question. I thought the second quarter gross margin because of a higher mix for new products. So theoretically, gross margins should go higher and you gave that guidance because of some one-off issues. So I just want to confirm whether those issues existed?

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Whether that issue existed. We have a traditional way of just say one of the questions being asked -- raised by Richard, he may deploy [taxable] things here to facilitate the sale in the channel. I don't think it's -- if you meant the inventory in-house or things [made], I don't believe it. But if you meant there are some tactical things we may do just to facilitate the channel, so that's probably start becoming more normal course of business. I'm not sure it's specific I think we referred to what you ask. We can go back and look at it and discuss offline.

Ann Lee - *Nomura - Analyst*

Okay, no problem. Thank you.



Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

We can discuss offline there. I think the -- we can talk about it. Then, it's different thing. Okay, thank you.

Operator

Calvin Wong, Daiwa.

Calvin Wong - Daiwa Capital Markets Hong Kong Ltd. - Analyst

Hi, Chia-Lin, I got a question regarding your focusing strategy into second half and beyond. You think so because the revenue scale becomes smaller right now. So I believe, we might have a less resource compared to like year ago. So well, I was wondering in terms of product, do you have specific focus on high-end or mid-to-low end going to second half and beyond and (inaudible) we will have more focus on mature market or emerging market?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

I think I probably would not agree with your comment that we have less resource. If you look at R&D resources related to the creation of a product,

I actually feel like this year, we have put more into the product portfolio. It's not about a number of models, it's more about we want to create a model that drives volumes. So that's different. So we feel more timing to making sure that the model we created could drive volumes. So that's one thing. I think you can see if we have a situation related to revenue, we need to adjust our sales and marketing expenses, just tactically associated with it, as I commented earlier.

The second thing in terms of where are we going to focus in globally, I can comment a little bit on this. I think traditionally, if you look at history of HTC, we started out in US or US, Canada, and North America, and then in Western Europe. We want to make sure that we continue to have a good and competitive presence in the US and Western Europe, primarily in UK and Germany, plus other parts of the Western Europe.

We also in the last two years are seeing the emergence in terms of overall size and also our presence in other parts of [development] countries like some of the things we comment on the Russia, Middle East, Eastern Europe, India and the China is different. China, I wouldn't call it developed country. It's a very high potential, also very competitive environment there which you will continue to adjust, hopefully, we can adapt well. So, these are the markets I will comment on.

Christine Chi - HTC Corporation - Manager, IR

Okay, thank you for your questions.

Calvin Wong - Daiwa Capital Markets Hong Kong Ltd. - Analyst

Thank you.

Operator

Julie Tai, UBS.



Julie Tai - UBS - Analyst

Hi, Chia-Lin. I just got a question from client. Wondering if you could give us some guidance to the operating expenses that will be incurred into Q3, because from the past few quarters, our operating expenses have been quite volatile or quite differently quarter by quarter. So it is a bit difficult for us to gauge. So, could you share a bit of insight to that?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

So, operating expenses, I'll talk about it. On the G&A side, we will probably maintain similarly. There is a drop in that primarily is probably due to legal expenses, not probably I can tell you for certain. The R&D has been pretty stable in the R&D expenses. Then, on the sales and marketing where you see some changes there. As I said earlier that we want to adjust tactically in association with the [correspondings] in revenue, that's how we see that because managing P&L is important for us. With that said, our goal is to drive volume and we hope we are able to drive volume, potentially sacrificing a little bit gross margin, but although we can yield a better overall gross profit in that. But our goal is still under the P&L balance to drive volumes. So I want to be clear on that.

Julie Tai - UBS - Analyst

So is it fair to say that sales and marketing expenses will be somewhere around, let's say, 11% to 13% of the sales?

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

Sales and marketing, 11% to 13%. I won't be able to comment specific on that. I know that's what you comment on the analyst community perspective as well. I look at it slightly different, I look at the -- I think the sales portion probably pushed the (inaudible) probably some of the tactical marketing side. On marketing, basically, we're putting two sides of marketing. Actually, I would say, it's actually three parts of it. Two parts are actually related and one part -- one part is very related to longer term on the brand creation that we're continuing to build. Obviously, that amount could be adjust and vary from quarter to quarter. And then, on the quarter, you are going to have some tactical part of it and also demand generation part of it here. That's very related to the short-term in terms of revenues. So we adjust accordingly. I won't be able to comment there, I'll stick to whatever, 11% to 12% of the sales, that's the one I look at it, but in the end they are related. Managing the overall P&L in the bottom line to me is probably the one thing. So, you can deduct from that. Hopefully, I answered your question.

Julie Tai - UBS - Analyst

Okay, thank you.

Chia-Lin Chang - HTC Corporation - President of Global Sales and CFO

And then, I want to comment on one of your question, I think raised my hand, the question just gave me some of the tax in terms of the second quarter margin in that. I think that basically, you mentioned what I said. In second quarter, we're trying to clean up the 2013 some of the materials. We'll put in probably maybe a bit more in second quarter and depends into the cleaning those, it's part in the channel. So, facilitate a bit of pipeline for that new product sell-in.

Julie Tai - UBS - Analyst

Thank you, Chia-Lin.



Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Right.

Operator

There is currently no question in line. I'll pass the call back to CFO and President of Global Sales, Mr. Chia-Lin Chang for closing remarks.

Christine Chi - *HTC Corporation - Manager, IR*

Okay. Well, thank you very much for joining our call today and we'll end the call now. Thank you.

Chia-Lin Chang - *HTC Corporation - President of Global Sales and CFO*

Thank you.

Operator

Thank you, ladies and gentlemen. 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. Goodbye.

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