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PRESENTATION

Operator

Welcome, everyone, to HTC's 2012 Q1 results conference call and webcast in English. Today with us we have CEO, Mr. Peter Chou; CFO, Mr. Chialin Chang and IR Director, Mr. Joey Cheng. All lines have been placed on mute to prevent the background noise and after the presentation there will be a question and answer session. (Operator Instructions).

For your information, this conference call is now being broadcasted live on the Internet. Webcast replay will be available within an hour after the conference is finished. Please visit www.htc.com under the Investor Relations section.

Now I would like to introduce Mr. Peter Chou, the CEO. Mr. Chou, you may begin.

Peter Chou - *HTC Corp - CEO*

Hello, hi. Good morning, good afternoon, good evening, all of our friends, investors from the whole world. It's a pleasure to talk to you here today.

And I would like to take this opportunity to introduce Chialin Chang, HTC's new CFO. So you may know that Chialin is from Goldman, Goldman Sachs. And actually Chialin has been supporting me for the last 10 years giving me some finance consulting already. So actually Chialin is not completely new to HTC. Actually he has been involved HTC many times, and actually know HTC pretty well.

So we are very happy to get Chialin joining HTC. The goal is to improving HTC's financial strategy and execution and optimizing our corporate development. So Chialin is very excited joining HTC. So let's welcome Chialin. So Chialin, would you like to say hi to friends?

Chialin Chang - *HTC Corp - CFO*

Hi, everyone from the world, here. Looking forward to seeing you in the coming weeks.



Peter Chou - HTC Corp - CEO

Okay, great. So I would like to take this opportunity to share with you HTC's status. Actually we have changed our strategic focus since the first part of last year, mainly to be focused on our strategy execution. We always think HTC is a young brand and young company and when we first do HTC brand, we were actually open-minded to learn. And we said we don't know everything and we have to learn. So we have taken some risk, to do things and do it quick and learn it quick from the process.

So the first part of last year we said, okay, we have gone through pretty good learning process and now we have to move to the next step. And we said we need to be more disciplined. We need to be more integrated and more [insist] of what we are doing and really make sure we are delivering what we want.

So we re-architect our organization and we made the organization communication more efficient and effective. And we corrected some leadership issues and we insist on delivering what we aim to. So this is -- some of the result what you have seen this year is kind of that HTC rebound, if you will, both from product strategy, global sales and marketing execution. And that's why you see the result of HTC One.

HTC One has achieved what HTC wanted to deliver in terms of design, innovation and user experience. More importantly, we are able to communicate those value and when we saw the overall response from the last two months since we launched HTC One in Barcelona, the response both from consumer and media are pretty positive. So we can conclude actually consumer received our message and agreed with us those value we wanted to deliver.

So what people really like HTC One are number one, truly iconic design, the beauty and the style, and color of the material. And people highly praise HTC One's camera. It's really -- they think that this is pretty innovative and they especially like this burst mode and auto focus. And of course the image quality and some of the special effects like HDR are highly appreciated. And taking photos when doing video is also highly appreciated.

And a lot of people also like our overall music and song experience. And this is the first time, the first year HTC we are able to really bring holistic end-to-end experience from living room to mobile experience to car. So this is actually a major achievement for HTC.

And 2012 is also the year that our global sales and marketing integration and execution really get to the place we want it to be. It is the first time we can really do truly global launch and ship the product to all major market segments. So in the past we launched the product but it's not truly global. Sometimes we miss US market and sometimes we miss China market for example.

But this year HTC One is the first time we are -- this product we are launching in the US, European and Asia market, China, etc. So this is also a major step for HTC as well.

So it took us a tremendous effort to integrating our product strategy and execution and marketing and go-to-market and our partner channels all at one time. This is a huge effort and this is the first time we are able to do that.

I would like to take this opportunity to share with you some of the challenges we have the last two quarters. I have to conclude that the challenge was to do that mainly from the US market. And the challenge was mainly came from iPhone 4S. So what happened was three major US operator, they are pushing iPhone 4S last year and they took almost 70% of the market share. So it put us tremendous challenges and of course some of our products are not in US.

For example, so one of our Hero product like Sensation are not in US. So we have challenges in terms of product portfolio in US and from iPhone 4S and that's the result of the last two quarters.

And of course Q1, this quarter is even worse because HTC, our overall planning is try to transit to our new product range and we are not pushing either. We think it would be good to have natural transition to the new product instead of pushing the old product harder. So that's why you are seeing that we have reduced our product margin compared to our normal business course and also because the lower scale make our OpEx ratio higher.



But however, we didn't see our competency impact in EMEA and Asia. In EMEA we think that this year we should still be growing and Asia is definitely very exciting. We see very strong potential in Asia and particularly in China. So I think that this is the first year, of course after two years of enter into China that we are seeing very good potential in China this year. So I think our brand awareness is getting there and our team are becoming very, very complete and strong and all of our channel distribution partners set up are in place.

And of course HTC's strength of working with mobile operator in China are continuing to grow. And we are actually working with -- all three mobile operator are having at least two Hero product, each operator in China. So HTC One X will be China and actually we're shipping this week. And we also have HTC One XT. That's HTC One X of TD-SCDMA version, for China Mobile. And last week we also launched three China kind of customized product we call the new Desire series. So that actually positions us very well in China market.

This year we are also seeing a major breakthrough in Japan. This is after six years -- five, six years of working in Japan, this is the first time we are able to break in and to be able to make a major strategic partnership with KDDI and launch HTC J. So that's the product, leveraging HTC innovation of cameras and song plus adding Japanese localized experience like 1-SEG TV and the e-wallet application like FeliCa.

So we have seen good momentum in some other Asia countries as well, like India, Indonesia. And in Taiwan we're doing very -- we're very good. And in Hong Kong we're doing very, very good as well.

So we are seeing some very encouraging progress right now after HTC One launch. So this is great to see. But we always see room for us to improve and HTC is always a humble company and always ask ourselves what can we do better. So we will continue to work hard and to improve ourselves.

We notice there's a lot of comment and saying, concerning HTC's future. Based on our Q1 performance, I would say that might be the wrong judgment. And we, actually we are very confident of HTC and we think our competency are still there. And when we look at HTC competency, we look at three things.

Number one is our innovation capability, innovation strength and our product capability and our technology leadership. And we think we are still very, very strong in those area.

Number two is customer relationship and we don't see any sign of our customer relationship is weakening. We are actually even seeing stronger our customer relationship. Most of our mobile operator customer actually love to work with HTC and supporting us and they have confidence on HTC's product innovations and quality. I will say this is actually very high value asset of HTC and actually this is not easy for other people to build up.

And third is employees. HTC employees is great asset of HTC. So we have highly committed employee, very experienced, very capable and very stable, very loyal employee are working hard -- working very, very hard.

So we are having these three major asset of the Company, so we have a very strong confidence of HTC.

Now HTC is a Company we always think positive. Even the challenge from the last two quarter we saw that as a positive because it force us to change quicker. It force us to insist on our innovation and our execution quality. So from that point we think that's actually pretty good and we are moving to the next stage actually faster.

Lastly, I would like to thank you for continuing support HTC. And now I would like to hand this to Joey.

Joey Cheng - HTC Corp - Director, IR

Peter, thank you for your opening remarks and the executive summary. Since Peter has already gone through the main part of our earning call presentation, I'll go through 1Q number and 2Q guidance and briefly the rest of the executive summary, leaving more time for Q&A as we have Peter on the call today.



Well, first of all, let me remind everybody on page two, disclaimer statement first. The forward-looking statements in this release reflect the current belief of HTC as of the date of this release. HTC undertakes no obligation to update these forward-looking statements for events or circumstances that occur subsequent to such date.

On page three, executive summary. First of all, 1Q financial highlights. We have 1Q revenue was TWD67.79b and gross margin and operating margin were 25.03% and 7.53% respectively.

Net income was TWD4.47b. The revenue decline was resulted of product transition cycle as Peter highlighted and gross margin impacted by margin of older products and lower scale contributing to lower operating margin.

Just want to briefly go through some awards and honors we have received, our HTC One family since unveiling. Best Smartphone at Mobile World Congress from Laptop Magazine and Best in Show at MWC from Tom's Hardware and Ultimate Smartphone and Best of MWC from Computeractive.

Page four. Again I'd like to share some positive feedback for HTC One family since launch. From Engadget which they quoted, There's absolutely no doubt that the One X is a masterpiece of an Android device.

And from SlashGear, It is certainly one of the fastest cameras we have used.

From ABC News, I particularly like the way the screen curves at the edges and the white matte back, which is made out of polycarbonate and One X felt more solidly built when I held it in my hands.

And from Recombu, HTC One X topped the table on camera performance.

And I think Peter has gone through some highlights on our US and Asian markets. Just a little bit more color. Basically HTC One family and HTC EVO 4G LTE will broadly cover our USA smartphone market from AT&T, T-Mobile and Sprint.

And also like what Peter mentioned HTC One together with new Desire V family will cover carrier as well as retail network. In particular Desire V will cover all the carrier at the same time in China.

And also just recently we together with KDDI launched HTC J which demonstrates our commitment to Japanese market. And it also brings HTC amazing camera, authentic sound to Japanese market. It also customizes certain local features such as FeliCa mobile wallet and 1-SEG mobile TV. And it also extends HTC iconic design on color and material to bring Japanese-style look and feel.

Page five and six are those -- revenue, operating profits and gross and operating margins trends from most recent five quarters. You can have a reference.

And page seven and eight which has briefly our 1Q consolidated P&L and balance sheet.

Page nine, 2Q guidance. We expect -- the revenue is expected to be around TWD105b. And gross margin is expected to be around 27% and operating margin is expected to be around 11%.

Okay, so I'll stop here. Operator, you may start Q&A.

QUESTIONS AND ANSWERS

Operator

We will now begin our question and answer session. (Operator Instructions).



The first question is from Ben Lu from Seligman. Please go ahead.

Ben Lu - Seligman - Analyst

Hi, thank you, guys, and great to hear you on the call, Peter. Definitely you guys have a new phone. I'm actually waiting for that One X myself to come out. So, congrats on launching a very good Hero product. I have a few questions.

One, Peter can you elaborate a little bit more about what you meant earlier by you had to correct some leadership issues? Does that specifically pertain to the persistent CFO changes you've had with HM and then Winston leaving?

Peter Chou - HTC Corp - CEO

Well, I'd rather not go into the details of those.

Ben Lu - Seligman - Analyst

Okay. Can you elaborate a little bit about what you meant by correcting some leadership issues that you mentioned earlier?

Peter Chou - HTC Corp - CEO

Well, I -- there are people, they are not executing well. So I correct those things. They're supposed to be delivering what they have to deliver but they didn't do that. And then we have to correct that, on both organization leadership and the execution leadership.

Ben Lu - Seligman - Analyst

Okay, great. And Peter, you also said earlier that you --

Peter Chou - HTC Corp - CEO

I cannot go to specific person.

Ben Lu - Seligman - Analyst

Sure. No, that's fine. And you said earlier that you see good opportunity for China this year. Obviously in China right now there's been a lot of growth in the sub CNY1,000 market. Can you talk a little bit about your strategy with your new Golf model as well as the CNY1,000 segment? Do you believe that's a segment that you guys will be playing in this year?

Peter Chou - HTC Corp - CEO

You know I can only talk about the product we already launched. So now we are -- we're kind of focusing on this Desire series. This new Desire series customized for China market, that is ranging -- the price is ranging from CNY1,999 to CNY2,129 or CNY2,199, that kind of range. I think that's the mainstream area we are playing. Of course we have HTC One X, HTC One XT and those are high end models.

Ben Lu - *Seligman - Analyst*

So you have no plans for the CNY1,000 segment?

Peter Chou - *HTC Corp - CEO*

Not for the moment.

Ben Lu - *Seligman - Analyst*

Okay. And then my final question, Peter, is there's been a lot of discussions about carrier subsidies, can you give your insight into what you see on carrier subsidies? We've seen Verizon charging \$30 for upgrades in the US, whereas in Europe we're seeing Telefonica and Vodafone eliminating handsets subsidies for a new subscriber. So it seems like a lot of carriers are either trying to make it more expensive for customers to upgrade or they're just eliminating handsets subsidies. So can you talk about what you're seeing on that subsidy environment? Thank you.

Peter Chou - *HTC Corp - CEO*

Well, it's -- I'm not in a position to make specific comments because we deal with almost all the mobile operator around the world. So each operator they may do differently in their own way and in different countries they do differently. So I think our position is just try to see how we can work with them to support their position and it make also our product attractive.

I think the subsidy models are always adjusting from time to time. So I would not be surprised mobile operator continue to optimize their strategy. I think a lot of times they are also reactive [actually as well]. So if mobile operator, their competitor -- for example, in the same country if their competitors are doing something they'll do that as well. So they have to have a comparable offering instead of just doing their own. So I think it's hard to make a specific comment on that topic.

Ben Lu - *Seligman - Analyst*

But you're not seeing subsidies going down from the carriers, right?

Peter Chou - *HTC Corp - CEO*

No, we are not seeing that.

Ben Lu - *Seligman - Analyst*

Thank you, Peter.

Peter Chou - *HTC Corp - CEO*

Thank you.

Operator

The next question is Will Power from Robert Baird. Please go ahead.



Will Power - *Robert Baird & Co - Analyst*

Great, thanks for taking the questions. I guess a couple of questions, the first one around margins. It looks like for Q2 guidance you're expecting margins to improve as HTC One hits the market and you get greater scale. I wonder if you could talk about perhaps some of the longer range goals there. Do you think gross margins can get back to the high 20% level as HTC One becomes a bigger component? And likewise is the goal to get operating margins back to a mid-teen level? Just any thoughts around that would be great. Thanks.

Peter Chou - *HTC Corp - CEO*

Yes, I think that there's an opportunity we can continue to optimize our operation incomes and our margin portfolio. And I think in Q2 we are still having a little bit of old product mix. And also Q2 we are having a little bit exceptional spending because we just launch HTC One family. And this year we really tried to do something different. So because we are [resetting] this kind of new brand -- new product brand experience and also new product, so we really need to go to invest in our marketing to make this much more known and people really excited about our products. So we are little bit overspending on Q2 and we think that we have to do that for this is good for our long-term brand investment.

So I think that don't take the Q2 as the as the normal either. I think we will continue to optimizing our income, our profit margin.

Will Power - *Robert Baird & Co - Analyst*

Okay.

And then, Peter, just strategically as you know Android has been and continues to probably get even more competitive both at the high end and the low end, with Huawei, ZTE and others competing more aggressively there and probably gaining share. Are you as committed an Android as ever? It sounds like the answer is probably yes. Or are you considering maybe looking at Windows more aggressively or some other type of operating system to try to differentiate yourself more?

Peter Chou - *HTC Corp - CEO*

I mean our position is probably the same as two, three years ago. We are committed to both platform, both Android and Windows. And we actually, since the beginning from we decided to support this operating system, we saw clear value of both operating systems. So this view is the same. We actually, even though Windows progress is a little behind, but however, we have a very long strategic relation with Microsoft. HTC has a tremendous asset on Windows platform development.

So our commitment to these platform are the same. But we are open-minded. We have tried to do our best to make the best product for both platform. And ultimately our consumer will decide. But of course, we, with Microsoft Windows 8 opportunity, of course there's a good potential there. So I think our commitment are the same again.

Will Power - *Robert Baird & Co - Analyst*

Okay. And then maybe just a last question. You all have been a little quieter on this front recently but the tablet market, which has obviously been dominated by the iPad, any update as to your all plans playing there, how you think about that opportunity going forward?

Peter Chou - *HTC Corp - CEO*

Yes, we have been closely looking into that opportunity. And we think at this moment we rather focusing on smartphone and continue to look at that space. And when there's a good opportunity then we will certainly think about that.



Will Power - *Robert Baird & Co - Analyst*

Okay, thank you very much.

Peter Chou - *HTC Corp - CEO*

Thank you.

Operator

The next question is Richard Ko from (inaudible) Investments. Please go ahead.

Richard Ko - *Analyst*

Hi, thanks for taking my question. I just wanted to ask on margins again. I think on your last conference call, you were talking about Q1 being a blip and getting margins back in Q2. And it now seems that Q2, the margins aren't quite getting back to the way you wanted them to be. So I'm just wondering what changed versus when you gave guidance before. Is it that you're spending more on the marketing side? Has the competition evolved a little bit or the markets evolved? What changed?

Peter Chou - *HTC Corp - CEO*

Nothing changed. I think maybe -- I think there might be some -- I think it is the same; our margin is getting back. But sometimes I don't know what's people's expectations of that. So we think our margin is definitely getting back and our revenue is also getting back. But of course there's always room for us to continue to optimizing when we improve the product mix.

Richard Ko - *Analyst*

But I think we're talking about TWD105b in sales in Q2. That's higher than the Q4 level. And we're talking about the gross margin being pretty similar. But we're going to end up with an operating margin well below Q4's 12.7%. So there seems to be a bit of an issue there.

And also in terms of what we were talking about on the last conference call, I think you seemed to be a bit more bullish in terms of the margins bouncing back a bit more. Do you feel there has been anything that's changed?

Peter Chou - *HTC Corp - CEO*

No, it's I think that's a day-to-day this kind of things are happening. I think this is just the product mix, as the result of the product mix, because we still have some old product sale going on in Q2.

Richard Ko - *Analyst*

And you don't think that as we roll forward that pricing and margins will just come off for new models faster than we've seen in the past, so you know there'll always be some old model impact in terms of margins.



Peter Chou - *HTC Corp - CEO*

Well, I can't answer this kind of too specific because I think it's better we share with you every quarter what is that quarter because this market is -- it's changing every day. So I don't want to mislead you and giving you any direction. So we will share with you at the beginning of next quarter.

Richard Ko - *Analyst*

But in terms of -- what you said in terms of mix that would imply that as the mix becomes more new model as we go into the second half, hopefully maybe gross margins can get up higher. And then on the operating expense there's obviously some one-off elements in terms of re-launching or launching this One series brand. And will that operating expenses -- as a kind of an absolute amount will that stay pretty similar going into the second half? Or is there a kind of an element of one-off in Q2?

Peter Chou - *HTC Corp - CEO*

Well, again I can't comment on anything about the second half related issue.

Richard Ko - *Analyst*

Okay. And then just a final question, in terms of the One X and some issues that we've been hearing about that seem to be sort of chip related, what have you done to address some of the feedback for that model in terms of some of the glitches?

Peter Chou - *HTC Corp - CEO*

Well, this is day-to-day operation issue. We always have the component supplier issues and so it's just a everyday sort of like working with suppliers and to see how to improve that. And this is the normal course of the day-to-day operations.

Richard Ko - *Analyst*

The fact that was the Nvidia-based one rather than the Qualcomm where you have a bit more constraint in terms of supply, the One X -- was that a big element of your hoped shipments in Q2? And so if there are any glitches and maybe if the sell through is not what you had hoped, is there any potential downside to what would you like to do in Q2?

Peter Chou - *HTC Corp - CEO*

We don't want to specific comment of any supplier at this moment because it's quite sensitive for a lot of people. So I just think for HTC you probably see every year we have this supply issue, that issue. Sometimes it could be earthquake or sometimes it could be flooding. But it's just the day-to-day operation optimization effort. So we will just need to keep working with our partners, our suppliers.

Richard Ko - *Analyst*

Great, thank you.

Operator

(Operator Instructions). The next question is Alban Cousin from Arete Research. Please go ahead.



Alban Cousin - *Arete Research - Analyst*

Hi, thanks for taking my question. I have three actually. I wanted to ask first on the US channel inventory situation and whether everything was sold and you could now ship normally? That will be the first one.

Peter Chou - *HTC Corp - CEO*

Can you repeat your question again?

Alban Cousin - *Arete Research - Analyst*

Yes, sorry I'm in a noisy environment. But I was asking about US channel inventory status and whether we are now back to normal or do you still have some inventory to go through in the channel?

Peter Chou - *HTC Corp - CEO*

I think for US market what we are focusing on is working with AT&T for HTC One X, we'll be shipping next week. With T-Mobile we'll be working with the HTC One S and with Sprint we are working with HTC EVO and we have one product with Verizon. So those are the major focus activities for HTC but of course for the many products then we would just need to keep working to optimize the inventories and the sell-through and those things and I cannot give you very specific of those.

Alban Cousin - *Arete Research - Analyst*

Okay, okay, I understand. My second question was on the sales and marketing level and whether you view that 10% spending as the new normal given competition and the environment and the lack of differentiation in the smartphone space? Or whether you could see that actually coming down going forward?

Peter Chou - *HTC Corp - CEO*

Q2 there's exceptional investment in terms of marketing. We have been focusing on building this brand equity, product brand equity. And of course HTC One is the new product line and new product so we have a lot of activities going on. We have to advertise, we have to do a lot of channels and retail activity. So Q2 is very high investment and we don't expect the same amount of investment as a normal quarter.

Alban Cousin - *Arete Research - Analyst*

Okay. But in Q1 you spent about 10% in sales and marketing and I would just like to understand whether you think there is -- the channel support now and the other market requires a higher level of spending generally and I'm not talking about specific quarters or whether you're launching a product or not but just whether you think there is -- now we live in a world where you -- the vendors need to spend more on sales and marketing generally?

Peter Chou - *HTC Corp - CEO*

Yes, please don't reference the Q1. The Q1 is a completely I have to say unique quarter situation because that's a quarter we didn't push that much plus we want to transit to the new product as well and of course our products are not that competitive situation. So I think don't look at Q1 numbers as seriously. And I think Q2 is coming back but of course still some exceptions and not completely normal yet because we have some product mix



and also we are spending a bit high in terms of marketing expense. I think I would like to suggest you see the way but please don't conclude in any way of what is HTC's future of doing things.

But we will continue to optimize. We do things and I think for us the most important is how we can be competitive in the market. That's the most important. And we have to adjust our activity and we have to adjust our patterns of things that we're doing and we have to be very flexible. That's my suggestion.

Alban Cousin - *Arete Research - Analyst*

Okay. And that leads me to my third and last question which is when we look at your positioning in China I think it's fair to say that you're fighting against people who can match technically your specs but live on very different economics and I was just wondering what you're thinking in terms of innovation and differentiation in the specific context of the Chinese market?

Peter Chou - *HTC Corp - CEO*

Well, I think sometimes people may underestimate HTC's value. Actually China consumer actually appreciates HTC's value so China consumer appreciates the quality of HTC, the craftsmanship of HTC design, HTC Sense, HTC user experience, the detail, the attention to detail, the China consumer understands. So that's why HTC brand is actually growing quite well in China. Actually our sales is growing quite well in China.

I think that sometimes it's easy to say this is Android, this is Android, but I think a consumer -- I think they're wise, they know -- they will figure out which one is better and that's where I think the HTC brand, HTC quality, HTC innovation shines out. For example HTC One X is a super hot model in China and operators really like HTC, operators appreciate HTC's design, qualities and craftsmanship, they especially mention the craftsmanship of HTC designers just unique in China. So we have a lot of brand value in China.

Alban Cousin - *Arete Research - Analyst*

Okay. Thanks and thanks for being on the call, Peter.

Operator

The next question is James Faucette from Pacific Crest Securities. Please go ahead.

James Faucette - *Pacific Crest Securities - Analyst*

Thank you very much for taking my question. Just a couple of questions. Can you talk a little bit about what the geographical distribution of sales were in the first quarter but maybe more importantly how should we think about your geographical growth prospects for the rest of 2012? For example should we expect that you can return to growth at some point in the US during 2012 or would we expect that to continue to be a difficult market with growth coming from Asia, the Asian markets and in Europe?

Peter Chou - *HTC Corp - CEO*

I think US market was the challenging market for us the last two quarters. As I explained it's mainly from iPhone 4S is having 70% market share of AT&T and Verizon and Sprint, etc. So that actually put us in a tough situation but however given we are working with AT&T, T-Mobile, Sprint and Verizon on new products I think that that will be improving a lot. But we don't expect that HTC market share will come back to our 50% market share like previous year we don't expect to come back and we think the growth will be -- the growth potential will be more coming from Asia and



we are optimistic about EMEA market elsewhere. I think the EMEA market will be still growing this year but US market -- I think after all -- I think they were somewhere like 30%, 30%, 30%, something like that. Over time Asia and Europe could be a little bit even higher.

James Faucette - *Pacific Crest Securities - Analyst*

So if I understood your response there, you expect maybe for 2012 that Asia, US and Europe, Middle East and Africa could all be about one-third each of total sales and then that Asia in the long run could be the bigger or biggest geographical market for HTC. Is that correct?

Peter Chou - *HTC Corp - CEO*

Yes, the potential is there.

James Faucette - *Pacific Crest Securities - Analyst*

Great. And then my last question is from a strategic standpoint what do you believe or what's your expectation as to what Google plans to do with Motorola once the acquisition is completed? Do you think they will try to sell that business or keep it for themselves? And I'm just I guess wondering more importantly how you will determine if you will push more towards Windows or continue your focus more on Android going forward?

Peter Chou - *HTC Corp - CEO*

Google has this public statement of what they want to do so their official statement is the reason they acquired Motorola is mainly for patent portfolio. And that is our belief so I'm not in a position to really make any statement of what they might be doing. But as I explained our position of Android and Windows are the same so we are committed to both products and we will continue to put in both products and hope both will be successful. But we don't have any bias or preference or specific push. Our position on two platforms are the same.

James Faucette - *Pacific Crest Securities - Analyst*

That's very useful. Thank you very much.

Peter Chou - *HTC Corp - CEO*

Thank you.

Operator

The next question is (inaudible) from Societe Generale. Please go ahead.

Unidentified Participant

Hi, thank you for taking my questions. (technical difficulty). As I understand that the American market will become less important and Asia more important, in terms of strategy going forward for operator model versus the retail model how is that going to change and what will that do to your margin structure? Thank you.



Peter Chou - *HTC Corp - CEO*

Can you ask again? Can you please ask again?

Unidentified Participant

Sorry, can you not hear me?

Peter Chou - *HTC Corp - CEO*

That's better.

Unidentified Participant

Okay, sorry, I will speak louder into the phone. Okay, so as the American market becomes less important and the Asian market becomes more important what is the strategy going forward in terms of operator versus retail split and how will that affect your structural margin? Thank you.

Peter Chou - *HTC Corp - CEO*

I think I would not say American market is less important, they all are very important. But we think it's actually not a bad thing that Asian market is also getting stronger. But Asia is slightly different, Asia is -- in the past they are more like open channel model, maybe more than 90% are open channel models. But HTC unique business model is we work with mobile operators but at the same time we have to go to develop channels as well. So actually having a strong channel capability also helps mobile operators sell the product.

So I think -- so for HTC we're kind of 50/50 percent it depends on country. Even in China, in China two years ago we were 70% relying on mobile operators but even China now we are moving into 50/50 percent. And of course both are important, mobile operators are very important because that's where HTC's business strategy and business model if you were.

But we have to really develop channel capability as well so that we can support channel, we can help channel sell-throughs and promoting retail and doing the under-the-line marketing activity and stores and retail experience. All these are very, very important even though we are working with mobile operators. So I would not say which one is important, I would just say they all are very important to us.

Unidentified Participant

Okay, thank you. And in terms of the margin structure, between operator and retail, say for China for example, which one delivers better operating margins for HTC?

Peter Chou; Well, that's too specific. I don't think we can disclose that kind of information.

Unidentified Participant

Okay, sure. Thank you. And just a last question if I may. For the Q2 outlook I just want to know please in terms of the operating margin, I understand the gross margin going up to 27%, but from an operating margin point of view to 11% what do you see needing to actually change because my understanding is your sales and marketing is going to be strong in Q2 coinciding with the launch, your administration will probably be strong. So what actually needs to change in order to see the OPM rise to 11%?



Peter Chou - *HTC Corp - CEO*

Well, I can only comment on that. We are actually overspending on marketing expense on Q2 so that is abnormal and we don't expect there'll be always the high in our business normal post.

Unidentified Participant

Okay, thank you very much, thank you.

Operator

The next question is [Dan McComb] from Viking Global Investors. Please go ahead.

Dan McComb - *Viking Global Partners - Analyst*

Hi, yes, I was just wondering, can you just discuss I think maybe in the local call you guys had talked about the dividend, I didn't see it in the presentation and can you just talk about what your plans are for the dividend?

And then along those lines, it looks like your cash balance declined in the quarter. Can you just talk about cash flow, what cash flow from operations was in the quarter?

And then what's your -- with the change in CFO role what your plans are in terms of uses for cash going forward? Thank you.

Chialin Chang - *HTC Corp - CFO*

Yes, let me answer this question here on the dividend. We talked a little bit in the afternoon. You may have seen from the filing and the press release that we are going to issue TWD40 per share cash dividend. And with that TWD40, as we mentioned in the call this afternoon that in terms of the dividend yield it's quite good, in terms of total cash payout to shareholders it's also quite good compared to companies in Taiwan and also compared to comparable companies in the US.

And we also mentioned something very clearly that we are not using payout ratio as the only factor, just one of the factors we consider. As you can see here, the dividend -- the dividend yield, even for the entire 52 weeks compared to the highest share price or the lowest or the median, actually the dividend yield is actually quite good. So we've been quite generous to the shareholders.

So that's a comment on the cash dividend side. On the second question I think you're asking there is some cash outflow during the quarter of 2012. If you look at the -- I don't know if you have had a chance to see the file -- we had some cash outflow from the cash from operations a little bit, there's some CapEx here in the quarter, so there's some payout in there. And then coupled with the cash used for the share repurchase. So the combined resulting to around I think close to TWD70b or TWD80b in that regard.

And on the cash from operations, some of it actually we used up from the -- given that it's a very simple accounting impact here, you have a [share], you have the revenue down here so you're seeing some of the stuff here got impacted but then will be on accrued expenses we have some outflow, we accrued less so we have natural outflow in there. I think on a working capital it balance. So the result of all those things we talk about is I think some cash outflow.

Dan McComb - *Viking Global Partners - Analyst*

Okay.

Chialin Chang - *HTC Corp - CFO*

And turning to your last question, going forward on the cash use in there, I think we're very careful in terms of how we deploy our cash. Basically it's satisfy our strategic and operation need. That's our top priority here. And then with that in mind we retain the flexibility, we continue to be very attentive to shareholders, returning cash to shareholders as we have been doing in the past.

Dan McComb - *Viking Global Partners - Analyst*

Understood. Thank you so much for that detailed answer. So the TWD40 per share, the payout ratio, what you're saying is -- because if I look at that I think it's about 54% of prior year net income. Is that correct?

Chialin Chang - *HTC Corp - CFO*

It's roughly around that number, yes.

Dan McComb - *Viking Global Partners - Analyst*

Okay, right. And so historically the dividend was based on prior year's net income and I think if I look at the last three years it was 75% last year and then 88% the two years prior. So what you're saying is you're looking more now at dividend yield as opposed to payout relative to prior year net income going forward? Is that the right way to think about it?

Chialin Chang - *HTC Corp - CFO*

Okay, I know a lot of people are asking this question and I just want to make it very clear here. We're not looking to one thing over the other; it's a combination of factors in that regard. As you know, Taiwan is a specific context here and in the US if you look at dividend yield actually our yield is quite high but I also look at the payout ratio. We're not looking at one single factor, that's what we're trying to emphasize.

Dan McComb - *Viking Global Partners - Analyst*

Okay, got it. And so --

Peter Chou - *HTC Corp - CEO*

How we would like to continue to optimize this is of course we want to make sure our investors have a pretty good return but how we continue to optimize when we -- our investor. I think please don't look at percentage but the absolute number is pretty high. But we want to make sure we have the flexibility, we optimize our future potential. And we have the flexibility and that we can do what we want and those things. If you look at our competitors they are keeping a lot of cash so I think we will continue to optimize in the kind of thing, please don't take anything as a trend or changing or duration yet.

Dan McComb - *Viking Global Partners - Analyst*

Okay, that's fair enough, I appreciate that. And then the next question, just when you look at the guidance for the second quarter the revenue guidance is up over 50% sequentially. How would you think about that split in terms of ASPs versus units i.e. do you think that will be primarily unit driven does the ASP go up, I would assume it does given the mix of new models in the quarter? How are you thinking about that?

Peter Chou - HTC Corp - CEO

Yes, unfortunately we are not able to share those volume or ASP specific.

Dan McComb - Viking Global Partners - Analyst

Or just high level? It doesn't have to be -- just directionally?

Peter Chou; No, it's -- today's business environment is quite complicated so we have decided not to share those information.

Dan McComb - Viking Global Partners - Analyst

Okay. Okay, and in terms of mix then, how do you think about the mix in the second quarter of your old versus your new products? Is it vast majority new products, like greater than 60%, or how would you think about that mix relative to last quarter? Obviously the mix of the new products is going to be higher but how do you think about it as a percentage of the overall total?

Peter Chou - HTC Corp - CEO

Yes, sorry we cannot provide you with that information.

Dan McComb - Viking Global Partners - Analyst

Okay, all right. I'll try one more question then. Back to the question on the US market, you made a great point about just Apple being 70% to 80% of smartphones sold at some of the top three carriers. If I look at total smartphones sold at both AT&T and Verizon based on the numbers that they've reported, just total smartphones, even including the iPhone, look like they are declining on a year-over-year basis. At AT&T they were flat in the first quarter and at Verizon they were down pretty substantially I think on a year-over-year basis, they were down 4% year over year, that's total including the iPhone. Obviously non-iPhone smartphones were down a lot more both carriers. Do you think that's a trend that's going to reverse i.e. do you think we'll start to see smartphone growth at the US carriers again? Or do you think that we're now entering a phase of smartphone stagnation in the US whereby your growth in the US will come from share gains versus other players and/or share loss?

Peter Chou - HTC Corp - CEO

Well, US there's still a big chunk of non-smartphone users. I think that will stay a pretty good potential to grow. I think it really depends, sometimes based on the models and I think -- I think it's hard for us to just look at the market size. I think there's a lot more details of what's the pie you can get. And also it depends a lot on your model, your product. So I think this kind of growth stagnating information, these are not the most important things to us. I think for us it's really getting our brand image strong and our product really strong and consumers really like our product. I think that kind of things will drive our growth.

Dan McComb - Viking Global Partners - Analyst

Okay, fantastic. Thank you so much, I appreciate it.

Peter Chou; Thank you.

Operator

The next question is Andrew (inaudible) from (inaudible) Securities. Please go ahead.

Unidentified Participant

Hello, thank you for this call. I have two questions please. Firstly, can you comment generally on prospects for LTE phone sales in your various markets? And can you confirm whether or not all your LTE models are dual-mode LTE/FDD and TD/LTE?

And then secondly if my memory serves you correctly after visiting you earlier this year I think that your production capacity -- total production capacity was about 60m phones but you have been building a second factory. Has that factory been finished yet and by how much will that increase your capacity? Thank you.

Peter Chou - HTC Corp - CEO

LTE situation, I think LTE right now is mainly in US. There are some other countries catching up but we don't see a rapid catch-up in Europe. Some smaller Asian markets is having LTE. I think Japan will be the next -- the second-biggest LTE country. I don't see Europe will have a very strong LTE coverage before 2014. I think that's the LTE situation.

And what is your second question of --?

Unidentified Participant

Sorry, just before that, your own LTE models, do they support both TD/LTE and LTE/FDD or are they single-mode only?

Peter Chou - HTC Corp - CEO

Are you asking the LTE, TDD (multiple speakers)?

Unidentified Participant

Yes.

Peter Chou - HTC Corp - CEO

Okay.

Unidentified Participant

Are all your LTE -- are all your current LTE models dual-mode supporting both TD and FDD?

Peter Chou - HTC Corp - CEO

Our current LTE does not support TD.

Unidentified Participant

Right, so in the US and Hong Kong it's FDD only?

Peter Chou - *HTC Corp - CEO*

Right, right.

Unidentified Participant

Thank you.

Peter Chou - *HTC Corp - CEO*

So the TD -- I think it really depends on some of our operator partners, their planning. I think on chip technology readiness we can do whenever they want.

Unidentified Participant

Thank you.

Peter Chou - *HTC Corp - CEO*

So HTC, one of HTC's strengths is that we have a pretty good technology capability. That is more of our partner, our mobile operator partner planning.

Unidentified Participant

Thank you, thank you. And my second question was I believe that the total smartphones production capacity was 60m but you have been building a new factory which was designed to add 40m more units. How is that plan going?

Peter Chou - *HTC Corp - CEO*

Well, I think we have -- we don't have any capacity problem. I think we have pretty good in-house capacity and we can also leverage external capacity. So we have a building but we can add machinery at any time we want. So now we don't have any capacity issue.

Unidentified Participant

Fine, thank you very much. Thank you for your help.

Peter Chou - *HTC Corp - CEO*

Thank you.

Operator

The last question is [Stanley] from (inaudible). Please go ahead.

Unidentified Participant

Thank you, guys, for taking my follow-up questions. Really quickly, I wanted to get a better understanding of the impact on Q2 margins, Peter. I think you said you're going to have some higher marketing expenses and I think you also said that you still have some old Q1 models that need to be cleared out in Q2. So can you give a sense of roughly how much points of a margin drag that is in Q2? You guys have got obviously 11% margins but trying to get a better sense of if you normalized the marketing expenses and maybe if you clear out some of the old models, can you get your -- would your margins be back to 12%, 13%, 14% level?

Chialin Chang - HTC Corp - CFO

Let me just answer your questions here. First of all, you talk about as Peter mentioned the product mix and unfortunately for business and competitor reasons we can't comment deeper on that so we're just going to leave it like that at the 27% gross margin as we guided.

And I think referring to your second question here, what I believe a lot of people are referring to here is in the past if you look at the last few quarters our OpEx as a percentage of sales is around 14% or so plus or minus. Currently if we guided 27% gross margin and 11% operating margin the difference will be 16% and the bulk of it as Peter mentioned here is given this is the quarter as we launched the product, building momentum and brand equity is important so we had to spend a little bit more in that regard as we commented in the past.

Unidentified Participant

Okay, great. And then my last question is I wanted to see if you can provide an update on some of your investments such as S3, OnLive, Saffron, Beats. I notice that Beats stopped bundling their headphones with your new phones so I wanted to see if you guys have done any impairment tests on any of those investments? Thank you.

Operator

There is currently no question. I will pass the call back to CEO, Mr. Peter Chou, for closing remarks. Mr. Chou, please begin.

Peter Chou - HTC Corp - CEO

Can you repeat the question again?

Operator

He got cut off.

Peter Chou - HTC Corp - CEO

He got cut off? Oh, I could not completely understand the question so --

Operator

Mr. [Lu] can you please repeat the question.

Unidentified Participant

I apologize, can you guys hear me?

Chialin Chang - HTC Corp - CFO

Yes, we can hear you now.

Unidentified Participant

Okay, great. I wanted to see if you can give an update on some of the investments in S3, OnLive, Saffron as well as Beats. I wanted to get a sense of if you guys have recently done any asset impairment tests on those investments? Thank you.

Chialin Chang - HTC Corp - CFO

Yes, we have done at year-end the test in that regard as you alluded to here. We have not seen a need to do the provisional impairment there -- impairment to be precise in that regard and we're integrating some of the strategic investments we made in that regard. On S3 specifically, as you see from the financial report filing here we closed at the end of last year. And S3, given the bulk of it is basically the patents so there is the amortization schedule here that you guys -- is embedded in the P&L statement. On the Beats here, our strategic investment and also working relationship with Beats continues to be strong and we see it continue to a very strong collaborate nature going forward as well.

Unidentified Participant

Great, thank you guys.

Operator

There are currently no questions. I will pass the call back to CEO, Mr. Peter Chou for closing remarks. Mr. Chou, please begin.

Peter Chou - HTC Corp - CEO

Yes, I just want to thank you all and keep supporting us and please keep supporting us. Thank you.

Chialin Chang - HTC Corp - CFO

Thank you.

Operator

Thank you for your participation in HTC's conference call. There will be a webcast replay within an hour. Please visit www.htc.com on the Investor Relations section. You may now disconnect. Goodbye.



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