Company Name: HTC
Company Ticker: 2498 TT
Date: 2012-10-26
Event Description: Q3 2012 Earnings Call

Market Cap: 201,084.31
Current PX: 236
YTD Change($): -261
YTD Change(%): -52.515

Bloomberg Estimates - EPS
Current Quarter: 5.545
Current Year: 25.659
Bloomberg Estimates - Sales
Current Quarter: 74630.333
Current Year: 307628.517

Q3 2012 Earnings Call

Company Participants

- Joey Cheng
- Chia Lin Chang
- Chia Lin Chiang

Other Participants

- Arthur Hsieh
- CK Cheng
- Richard Kramer
- Robert Yen
- Jasmine Lu
- Julie Tai

MANAGEMENT DISCUSSION SECTION

Operator

[Foreign Language] (00:04 – 00:36) Welcome, everyone, to HTC's 2012 Q3 Results Conference Call and a Webcast. Today with us we have CFO, Mr. Chia Lin Chang; and IR Director, Mr. Joey Cheng. All lines have been placed on mute to prevent background noise, and after presentation, there will be a question-and-answer session for investor and analysts. Please follow the instruction given at that time if you would like to ask a question.

For your information, this conference call is now being broadcasted live over the Internet. The webcast replay and English transcript will be available within an hour after the conference is finished. Please visit www.htc.com under the Investor section.

Now, I would like to introduce Mr. Joey Cheng, the IR Director. Mr. Cheng, you may begin.

Joey Cheng

Debbie, thank you. Good afternoon, ladies and gentlemen. Welcome again for joining HTC 2012 third quarter earnings call. And the presentation we are going to – we're about going through has been sent out 10, 15 minutes ago. You may also download it from our website or participate through webcast.

And if you do not have the presentation material, please let us know now and your line will be cut off – will be put on mute when we are presenting. And if you are cut off, please dial back in or call Sally Kuo at 8869-6076-1958 for assistance. And also, we will conduct our later Q&A session both English and Mandarin since we are combining previously a separate Mandarin and English conference call into only one call we are doing at the moment.

And before we start, I would like to draw your attention to the disclaimer statement on page 2. Please note that this presentation contains forward-looking statements and these statements are based on our current expectation. Actual result may differ materially from our expectation and the company undertakes no obligation to update these forward-looking statements going forward. And I'll go over our third quarter business review in English but we have both English and Chinese slides which you guys can choose proper version to the one I'm presenting.

Now, please go to page 3 on our presentation. First of all, third quarter financial highlight. During the quarter, our revenue was NT$70.2 billion. And the gross margin and operating margin were 25% and 7%, respectively. Net income was NT$3.9 billion.

A quick business update for the quarter. Number one, China remains a key growth driver, continuing to further increase local brand awareness, retail presence and operator partnerships. Number two, U.S. was pretty much in line with our earlier expectation and the flagship product were well received.

Number three, Japan had an initial success with HTC J. We have also launched HTC J Butterfly to continue the momentum. Number four, EMEA region focused on enhancing brand consideration in both developed and emerging countries. And in the end, South Asia continue its effort to build distribution channel as well as local presence.

Page 4, first, investment recap. During the quarter, we have $35 million strategic investments for a 17% stake in Magnet Systems. It's the creator of a next-generation software platform for mobile enterprise market. And number two, we also recognized a $40 million investment impairment for OnLive.

A recent new product we have launched so far, HTC One X+ that's an enhanced version of HTC One X, operates on the new HTC Sense 4+, with faster speed, longer battery life and expanded internal storage. HTC One SU and ST, that's a well-sculpted dual-core 4.3 inch tailor-made for the Chinese market with a improved camera capability and Beats Audio effect.

Windows Phone 8X and 8S by HTC, those are considered the Windows Phone hero product by Microsoft. It's perfectly sculpted, three-dimensional pure uni-body design and with ultra-wide-angle front-facing camera.

HTC Desire X, that's an affordable smartphone with a dual-core 1 gig processor featuring a 4-inch super LCD, state-of-the-art camera including VideoPic and continuous shooting and authentic sound.

HTC J Butterfly, together introduced with KDDI, that's the first quad-core smartphone with 5-inch full HD super LCD 3 display, having a 440ppi resolution and have been built-in a 9.1-millimeter slim design and with eight eye-catching colors.

Page 5 and 6 give you a quick reference of quarterly trend and our quarterly revenue, operating profit, gross margin and operating margins. Then page 7 and 8 are our simplified consolidate P&L and balance sheet statement for your quick reference. And page 9, 4Q business outlook. For coming quarter, fourth quarter, we expect our revenue to be around NT$60 billion and gross margin is expected to be around 23% with operating margin expected to be around 1%.

This wrap our presentation. Debbie, we can start Q&A now.

Q&A

Operator

[Foreign Language] (06:48 – 07:05) We will now begin the question-and-answer session. I'm going to leave the time to investor and analyst. For media, please contact the HTC PR team after the call if any questions. [Operator Instructions].

The first question is [ph] Annie Chai (07:41) from Credit Suisse. Please go ahead. [ph] Annie (07:49), please begin.

Operator

The next question is Arthur Hsieh from UBS. Please go ahead.

<Q - Arthur Hsieh>: Hi. Can you hear me?

<A - Chia Lin Chang>: Yes.

<Q - Arthur Hsieh>: Thank you for doing the call. I think the guidance is a bit lower than the market situation. Could you give us a bit more color in terms of what changed? Is it because the company is taking more aggressive pricing strategy, or is there any specific reason that both sales and the margins are kind of low? Thank you. That's my first question.

<A - Chia Lin Chang>: Thank you, Arthur. Before I answer your question, let me make a few points here and [indiscernible] (9:08) is going to be answering your question. First of all, welcome, everybody, on the call here especially for those who are dialing from North America or different time zone making it on the call. Appreciate you dialing on the call here.

We're trying to combine both English and Chinese into one session primarily for purposes here. So, everybody only have to do it once without, sort of, missing the other call and missing potential other information. So, we're consolidating the call information in there. As a result, we can find a time so I'm hopeful that most of people can dial in.

And because of that, our format now need to be combined into the English and in Chinese, so we're trying to make it work. We appreciate your feedback on that.

[Foreign Language] (09:49 – 10:27)

Next, I will make two statements and part of it is to answer your question, Arthur. First of all, I will talk about in terms of the trend, our revenue trend. And the second point I'll talk about the overall in the third quarter in terms of different regions there so people can [indiscernible] (10:44) this is probably going to be most commonly asked question.

First of all, I'll talk about the revenue on the third quarter trend. Actually, you can see our third quarter trends from July, August and September. September monthly revenue is, I would say, from a capital market perspective or the investor perspective here, lower than initially anticipated, probably due to two reasons. One, there is some lumpiness in the monthly sales in third quarter. Second, there's some anticipation or expectation in the market in terms of our new product launches.

So, as a result, we're going to see here is September quarter is lower than the July and August months. Based on our guidance here, I can also just give you more granularity in terms of the fourth quarter trend, in terms of monthly sales. What we're seeing here is you're going to see October sales is going to be lower than the September sales. And before coming back up for November sales, we're expecting November sales will be higher than the September sales. And hopefully, it can carry the momentum into the December quarter, based on what you're seeing here today.

The reason for the December quarter, i.e. the fourth quarter to be lower than, you just said, your expectation, primarily is due to the following reasons. Our – almost all the majority – I would say, the vast majority on new product launches – not the launches, the shipment, actually going to come in in November, probably somewhere in the – around the second or mid-November timeframe to be available on the shelf. So, you're going to see the decline in October revenue before picking up in November. And hopefully, we'll carry the momentum into December. So, that's basically the trend we are seeing today.

In terms of margin, basically what we see in the gross margin, around 23%, partly due to mix and partly actually, we make some reserve [ph] if needed, (13:01) to clean some of the channel inventories some are older [indiscernible] (13:03) is needed on that basis. So, when we guide in the market here, it's about 23%.

In terms of the operating margin, about 1%. A lot of the analysts and investors are also asking in terms the where we see on the operating expense, so I'll make it more clear on that. Because the guidance on the revenue side was NT$60 billion, because that scale, some of the [indiscernible] (13:32) makes fixed nature of operating expense resulting in a higher operating-expense ratio as a percentage of sales. However, one thing I need to emphasize here, that we did not decrease our sales and marketing budget and expenses because we think it's important for both, one, in introducing new product launches in December quarter, and also it's important to continue to put more HTC brand.

We all understand this is a market, the combination of product and also the brand is going to be very important. So, we make a very conscious decision to continue to invest because we think this is better for HTC's future. So, on top of that, you will see the – what we've guided the operating margin to be around 1%.

So, hopefully, that answer your first question here. Joey, you want to just say it in Chinese, or I'll say it in Chinese? Why don't I just say it in Chinese here?

[Foreign Language] (14:32 – 17:27)

<**Q - Arthur Hsieh**>: Yeah. [Foreign Language] (17:30 – 18:39)

<**A - Chia Lin Chang**>: Yes. Well, let me answer this question here and I'm just going to do it in English one by one and then your question and then I'll just start in Chinese. Hopefully, we'll try to get this format to work. Arthur, first question basically saying that typically your shipments start in October. Is there any specific reasons for that this year starting. There's a combination of different things here. The channel rating, the partner ratings, the platform ratings, I think the – there's no specific particular reason we saw causing the delay. It's the planning – actually, it's all been planning according to our schedule here. So, there's not a particular reason for that.

Our product gross margin, how do we sort of the product gross margin, how much we'll make reserve here? I probably will not be able to tell you a very specific number because this is guiding some of our tactical decisions here. I'm only here for six months. So, I can't comment on in the past how we do it here. But, you see, we want to make sure our product – overall product gross margin is higher than this, slightly higher than this – I wouldn't say a lot higher than this year, so partly due to mix on that. But we did reserve, yes, to clean some of the inventory in that.

So, the third question, Arthur asking about the – in terms, I think if you look at some of the slides here says the days payable outstanding, 127 days seems to be quite high.

I will make the following statements here. Frankly, I kind of – personally, I do not want to put this number as sometimes maybe a bit misleading here because that's not – first of all, just to clarify, Arthur, this is not the channel inventory, it's inventory in-house. And then the days payable outstanding combined as a mature inventory – mature payable versus other payable. And then you can take our only material payable, actually the day is actually much, much lower than this day here. But just not to complicate things, and we just follow a format, so we need to study this how to make it more sensible.

[Foreign Language] (21:31 – 22:06)

So, I'll just stop here. Any more question?

<**Q - Arthur Hsieh**>: [Foreign Language] (22:10 – 22:39)

<**A - Chia Lin Chang**>: [Foreign Language] (22:40 – 23:38) the marketing, the methods, the marketing execution [Foreign Language] (23:45 -24:11)

So, what I just told to Arthur is – his question is what are the areas we're focusing most of our time there. I told [ph] Arthur (24:19) here is that first of all, yes, we appreciate the market is very competitive. We're also watching the dynamics quite closely and there's quite a few lessons learned in the last nine months here. The one thing we focus quite clearly is continue to promote HTC brand and also having the right sales and marketing, the execution and also the right marketing message.

The smartphone continue to migrate, it has become very quickly a lifestyle product. So, how to promote HTC brand, how to get the right marketing message, how to get the corresponding marketing and execution to us is a key priority. And, Peter, our CEO is also personally driving on this as well. So, this is one area we focus a lot of time on it.

<**Q - Arthur Hsieh**>: [Foreign Language] (25:07 – 25:10)

<**A - Chia Lin Chang**>: [Foreign Language] (25:10 – 25:11)

Operator

The next question is CK Cheng from CLSA. Please go ahead.

<Q - CK Cheng>: [Foreign Language] (25:19 – 25:34)

<A - Chia Lin Chang>: Okay. [Foreign Language] (25:36 – 28:15) I'll quickly summarize in English here. What we're seeing here, China market continued the momentum on new Desire series. There will be a new successor for the new Desire series. And we have a new China product called the One S product in China [indiscernible] (28:31) because our new Desire C is called [indiscernible] (28:34). So, they go walking in there and buying [indiscernible] (28:38). The current momentum, we're very encouraged by the initial momentum.

The U.S. is performing in line with expectation. Some of the flagship product is well received here. What we need to focus on is in the European market here in both markets and also the emerging markets in Europe, which we – with still room to improve. Fundamentally, what we need to focus on is on the [ph] foreign (29:06) preference in consideration. On the awareness side, there's some piece in this and room to improve, but we think it's even more that important or eminent on the consideration and preference side. In Japan market, we have a good success – initial success on HTC J with KDDI and we hope with the new HTC Butterfly will continue that momentum.

Some of the market in Asia Pacific is also not up to what we expected. We understand some of the markets here, especially some emerging market here. We will continue to increase the distribution channel also of the local presence.

I'll pause here.

<Q - CK Cheng>: [Foreign Language] (29:47 – 30:23)

<A - Chia Lin Chang>: [Foreign Language] (30:24 – 31:19) revenue to the gross margin instead of target.

<Q - CK Cheng>: [Foreign Language] (31:26 – 31:29)

<A - Chia Lin Chang>: [Foreign Language] (31:34 – 31:35)

<Q - CK Cheng>: [Foreign Language] (31:36 – 31:45)

<A - Chia Lin Chang>: [Foreign Language] (31:48 – 31:49) Basically, what I just clarified, the question here is that – what I said here is, our quarter-four sales and marketing expense budget allocation will be higher than quarter three, and primarily because of new product, not just because of that. We'll continue to invest because this is important for our future. And in terms of whether this, including the employee bonus, all the number we included is all-in cost in that regard.

Basically, the question about the dividend policy. We'll be more clear around the end of quarter or maybe first quarter earning call. We're trying to migrate toward direction in which people can predict likely would be a certain ratio – certain payout ratio, but that number, we cannot finalize it yet until the first quarter next year. But, yes, we are discussing internally.

Operator

The next question is from Richard Kramer from Arete Research. Please go ahead.

<Q - Richard Kramer>: Thank you very much. A couple of questions. I guess the first one, if we step back and look over the past couple of years, HTC has made efforts in content with watch and listen and beats, and you're investing in enterprise. Just from your perspective over the past six months, do you think HTC has the right management team in place and skill sets to provide services that are not related to the hardware or the DNA of the company as you see it going forward just to continually put out a stream of products and push them from a sales and marketing perspective?

<A - Chia Lin Chang>: I think from our perspective here, and I'll answer your question in a different way here as – what we're focusing on is you can say – we call it service. What we're focusing on more is, at the end of the day, how do we decide what's the best consumer or customer or end-user experience? That experience is important.

And with that – you call it content. You can them service. We call it, overall, the package, overall offering – needs to provide the right experience in that. And that will require not just the, you say, internal management expertise here in providing that. That requires a lot of internal expertise, hardware, software, UI, content or you call it the user experience service all in one package. And sometimes you make alliance with other partners here. Sometimes the partner require investment there, sometimes you don't. So, it's overall package that we're looking at here.

In terms of [ph] management (35:02) here, I don't think this is in conflict in terms of the – our investment strategy here. The enterprise mobility market – I think a lot of people are talking about it as well. It's going to be quite important as people access the information to the mobile platform so – which we think is a good important market. So, we make the investment in the team. We have a track record and also a good cultural fit. Both teams already start working on it and hopefully sometime next year, we have more information to report to everybody.

<Q - Richard Kramer>: Okay. And a couple of quick follow-up questions on the financials. First of all, can you walk us through the decline in overall cash and maybe comment a little bit about the cash flow. And also, what was the NT$1 billion difference between the operating profit and the pre-tax profit? Was it just the write-down of OnLive, or what are other factors in there?

<A - Chia Lin Chang>: The NT$1 billion difference?

<Q - Richard Kramer>: The NT$1 billion difference between operating profit of NT$4.9 billion and pre-tax profit of NT$3.9 billion.

<A - Chia Lin Chang>: Okay. Let me talk about it and I'll just answer your question just for the benefit of other listeners especially some of the retail investor in Taiwan and Chinese. First of all, on the – in terms of cash flow, just roughly speaking and I'll give you a very quick sense here. At the end of second quarter, we had about NT$81 billion cash. And in third quarter, we did a few things. One, we pay out cash dividend which is about NT$33 billion. We actually [indiscernible] (36:42) as reported last time about the NT$6.7 billion or so which is going to be due in one year. We also pay out employee bonus and that actually is in the long-term incentive. So, it's going to be spread out into the coming year by but the whole package is put in the trust. So, it's out of the balance sheet as well in that. And we've made some investment in there.

As a result of that, the cash level will be lower than what we have today. So, the plus item is our income for third quarter. Some of the amortization here is the non-cash item. We added here. And also, we made a very good effort in terms of the AR side here. So, we'll get more cash back here. So, as a result, we had about NT$50 billion. So, more detail is in work within here but basically that's the highlight here.

And answering your second question here on the – between the difference of EPS or net income versus the operating income here, the two primary difference, one due to the online write-off here is about $40 million. That's a minus side. On the plus side is there's some tax benefit that we are going to detail. Basically, we have the deferred tax asset. And as you know, going forward, in Taiwan, the minimum tax is going to be increasing from 10% to12%. So, we evaluate the deferred taxes as we request the account that we need to realize that benefit, the partner benefit in third quarter. So, that's only one time in that. As a combined, that's the result.

<Q - Richard Kramer>: Okay. Thanks. And maybe my final question, just going back to the discussion we had on the last conference call. We asked last call about inventory and you said there was really no issue. And now, you're talking about reserves that you're taking on to clear the channel. Are these reserves on relatively new products? And what does that mean in terms of the clock speed of the company and the shelf life of the products if you're having to take reserves on products that you really would have only shift in the past few months, it really would have been very new, fairly refreshed portfolio?

<A - Chia Lin Chang>: Well, actually, to answer your question, just to clarify here, when we talk about in the second quarter result and also back in early June, the call here, the reserve – the write-off, the impairment at that time is for the product shift in December and fourth quarter last year here. And here, when I provided guidance for the fourth quarter this year is a precautious reserve we want to put aside just in case during the quarter we want to clean up some of the stuff here. So, they're not in conflict. They are not actually related, I would say. You can say clean inventory is the same thing but if there's two different time period products here in that regard.

And for us, we want to just, going forward, to, on that front here, taking a more prudent approach. We'll gradually migrate toward the – in that part here. But I wouldn't say – I would just say this is part of that, I would say, in the normal course of the inventory management in terms of channel what we're planning to do.

<Q - Richard Kramer>: Okay. Thanks.

Operator

The next question is Robert Yen from Goldman Sachs. Please go ahead.

<Q - Robert Yen>: [Foreign Language] (40:21- 40:30) when dealing with the official fee [Foreign Language] (40:34 – 40:40) quarter-on-quarter. Now, in values or [indiscernible] (40:43), this would be a [indiscernible] (40:44) of mix [Foreign Language] (40:45 – 40:47) this 50 shipment in [indiscernible] (40:50) will cover the company [indiscernible] (40:52). The fourth quarter annual guidance was down 15% quarter-on-quarter. And you also mentioned fourth quarter's product mix is actually improving. So, that means the shipment is actually down more than 15% quarter-on-quarter. Can you confirm that?

<A - Chia Lin Chang>: Yes. I wouldn't [Foreign Language] (41:11 – 42:37)

<Q - Robert Yen>: Okay. [Foreign Language] (42:41 – 42:44)

<A - Chia Lin Chang>: [Foreign Language] (42:44 – 42:46)

<Q - Robert Yen>: [Foreign Language] (42:48 – 43:26). Okay. My second question is right now the fourth quarter is, [ph] revenue (43:32) is actually lower than the first quarter's level that means – right now the [indiscernible] (43:36) impact is even worse than what happened in first quarter which was originally a very challenging quarter. And then right now, the new product only has like three miles away life shelf space before supposedly you will launch the new product in Barcelona which was – which will be the – in the [ph] factories (43:52) next year, how do you manage your new product cycles for the next two quarters in order not to confuse the consumers again?

<A - Chia Lin Chang>: [Foreign Language] (44:03 – 45:11) So, I'll just answer your question here. The second part of it was the – Robert, your question here is we believe the product announcement and [indiscernible] (45:19) the new products started in the fourth quarter this year. Hopefully, the momentum will continue into quarter one. And, yes, indeed, every year we will have our flagship sort of the Hero product coming up. We believe from the variety, from the type, and also the price perspective here should be a good smooth transition into next year. So that to answer your first – the second question. What's your first question? I even forgot already.

<Q - Robert Yen>: [Foreign Language] (45:50 – 46:15)

<A - Chia Lin Chang>: [Foreign Language] (46:14 – 47:14)

<Q - Robert Yen>: Yes.

<A - Chia Lin Chang>: So, let me answer your question here in terms of China momentum here. I specifically said to Robert that don't interpret that because the China momentum – so China momentum means the revenue will be higher. That's why the rest of the region in the world will be lower. So, I do not want to be miscommunicated that way. When I say momentum, it's overall momentum. China also going through the product transition here, That said, we have the new Desire series which we're going to have at the – continue that momentum with the new product here. We're also shipping a – the [indiscernible] (47:51) called the One S, specifically tailor made for China product which actually is called 528 in China jargon here, called 52M here.

If I may just add on one more here, in China, we have very good plan and very strong the partnership with China, then also with the operators. We have a good brand awareness and good consideration. We need to go from that basis here. And the overall what we're trying to do here is migrating people from the new Desire series, continue that in Desire series or new- the successive product, the momentum and also migrating people up because that kind of the whole line to us important, not just for the brand, not just for the product, for revenue, also for the brand in China.

<Q - Robert Yen>: Okay. [Foreign Language] (48:45 – 49:32)

<A - Chia Lin Chang>: [Foreign Language] (49:33 – 50:40) sales and marketing, optimal, that's like a resource allocation among region activity, that's something we care.

The second question here is the efficiency in sales and marketing, also we care. And also, the effectiveness in sales and marketing, we care. So, those three things, we care. We recognize this is not an area that we have done the best job here. And we have a lot of room to improve. And that's what we focus on and answer other question early on as well. This is the area where we spend a lot of time internally.

<Q - Robert Yen>: [Foreign Language] (51:14)

<A - Chia Lin Chang>: [Foreign Language] (51:16)

Operator

[Operator Instructions] The next question is Jasmine Lu from Morgan Stanley. Please go ahead.

<Q - Jasmine Lu>: [Foreign Language] (51:31)

<A - Chia Lin Chang>: Jasmine, hi.

<Q - Jasmine Lu>: [Foreign Language] (51:34 – 51:56)

<A - Chia Lin Chang>: [Foreign Language] (51:59 – 52:00)

<Q - Jasmine Lu>: [Foreign Language] (52:03)

<A - Chia Lin Chang>: [Foreign Language] (52:02 – 52:04)

<Q - Jasmine Lu>: Is the balance sheet [Foreign Language] (52:06 – 52:15)

<A - Chia Lin Chang>: [Foreign Language] (52:15 53:41)

So, my question here is just for the transcript – English transcript purpose here is – as I said here, our October revenue will be lower than September and November revenue will be based on what we're seeing today, will be higher than September. And hopefully, we'll carry through the momentum into the December. That's why we've guided the NT$60 billion.

And Jasmine asking in terms the inventory in-house, this is part of the supply chain issue here. We try not to put a lot of materials in-house. Some of them actually is still open order here. So, we wanted to – this is a part of supply chain management perspective here. And maybe possibly that I explained our October revenue here, but that wouldn't sort of the – too much into it for our overall December quarter. So, December quarter number is what we've guided early on.

<Q - Jasmine Lu>: [Foreign Language] (54:32 – 54:56)

<A - Chia Lin Chang>: [Foreign Language] (55:00 – 56:45)

So, I just said a couple of things here is – one, yes, we do see a bit lumpiness in the monthly sales here, and for a kind of revenue scale we have today, that may be more literal in terms of monthly lumpiness.

Second thing here is that the product cycle, due to competition or any other reason here, we do see the product cycle is not longer than we want it to be. And that's why it's very important for us to continue to extend the OnLive product that basically we need to continue investment in brand. Because it's important not just promoting the product, spec, the product feature, it's also the overall HTC brand. We want the consumer to feel like whatever HTC product they buy, they have the kind of sense the coolness which we think is very important.

Going into the provision for the potential channel inventory, I would encourage people not to read too much into it here. We think that it's a prudent way of doing things in terms of making sure that we have – we're more prepared in terms of managing the new product and also product into the channel, we have better management. That's all.

<**Q - Jasmine Lu**>: [Foreign Language] (58:02 – 58:45)

<**A - Chia Lin Chang**>: [Foreign Language] (58:56 01:00:31)

So, my question to Jasmine here is that whether you look at sales and marketing on an overall absolute [indiscernible] (1:00:37) or just looking at its ratio percentage of revenue, you look at both factors here. But it's important in the December quarter not just for new product launches, not just for the competition, also we need to have a continuing brand-building in terms our voice being heard by consumer over the world here, so that will mean to 2013 to us is important, so we'll continue to make that investment because [indiscernible] (01:01:06) equity needs to be accumulated. With that said, yes, given the fluctuation in quarterly sales, do we look at the ratio? Yes, we do look, but we need to make a cautious decision combine those factors here and decide what we need to do, and then that's what we decide for December quarter.

<**Q - Jasmine Lu**>: [Foreign Language] (01:01:27 – 01:01:33) NT$1 billion before the employee bonus?

<**A - Chia Lin Chang**>: [Foreign Language] (01:01:41 – 01:01:42) NT$1 billion in terms of operating expense.

<**Q - Jasmine Lu**>: So, before employee bonus?

<**A - Chia Lin Chang**>: [Foreign Language] (01:01:52 01:02:20)

<**Q - Jasmine Lu**>: [Foreign Language] (01:02:22)

<**A - Chia Lin Chang**>: So, what I just said to Jasmine here is that she said, can we expect the operating expense to between NT$10 billion to NT$14 billion and obviously this a pretty big range in that. And I basically explained to her that we'll continue to invest. It's very important for not just competition, not just a new product here and also continue our [ph] prime (01:02:43) building and momentum into 2013, so we'll make a conscious decision into the – December. For the range NT$10 billion to NT$14 billion operating expense, that's the range, relatively big here, but that's the range. We probably – you can expect in the coming quarters in that.

Operator

Your next question is Julie Tai from UBS. Please go ahead.

<**Q - Julie Tai**>: Hi. Thank you for taking the question. [Foreign Language] (01:03:18 – 01:03:38)

<**A - Chia Lin Chang**>: [Foreign Language] (01:03:40 – 01:04:04) I did not – I also mentioned the U.S. market as well. The U.S. market in third quarter in line with expectation here, we have some new product going to U.S. market as well. We hopefully will continue that momentum.

<**Q - Julie Tai**>: [Foreign Language] (01:04:18 – 01:04:24) the guidance require gross margins [Foreign Language] (01:04:27) part of the reason is due to reserve to clear inventory [Foreign Language] (01:04:34 – 01:04:39) margins higher than Q3 [Foreign Language] (01:04:43 01:04:48)

<**A - Chia Lin Chang**>: We may make the clarification. We'll show you [indiscernible] (1:04:51) due to reserve and also we aren't reading too much into it. This is [Foreign Language] (01:04:55 – 01:04:56). I cannot say what you just said here. I said the guidance is about 23%, just a part of it here. Our product – overall product mix issue, overall product gross margin is higher than 23% and I stopped at that point. Yes, we did have some provision or potential channel inventory and we will continue to take that similar approach in sort of prudent way here, and that's our comment this year.

<Q - Julie Tai>: Oh, I see. And then, how much was that amount of provision be in Q4 if you can share with us?

<A - Chia Lin Chang>: I cannot share with you, unfortunately. I mentioned that. We apologize for that.

<Q - Julie Tai>: Okay. And lastly, this is actually maybe a – hopefully, an answer for me. HTC J Butterfly seems to be a very good product and available only in Japan. I was just wondering when are you going to make it available internationally, including Taiwan.

<A - Chia Lin Chang>: It's our company policy that we would not comment on the potential future product that's not yet announced. And what – I would only say that we care to our Taiwan customers here. And then the HTC always – this is our home market. So, this is a market we care very much.

<Q - Julie Tai>: Thank you.

<A - Chia Lin Chang>: [Foreign Language] (01:06:27 – 01:06:49)

<Q - Julie Tai>: [Foreign Language] (01:06:52)

<A - Chia Lin Chang>: [Foreign Language] (01:06:54)

Operator

The next question is from [ph] Pablo Chan (1:06:57) from Infinity Capital. Please go ahead.

<Q>: [Foreign Language] (01:07:02 – 01:07:04)

<A - Chia Lin Chang>: [Foreign Language] (01:07:05)

<Q>: [Foreign Language] (01:07:05 – 01:08:17)

<A - Chia Lin Chang>: [Foreign Language] (01:08:19 – 01:08:50) the marketing message is also communication execution [Foreign Language] (01:08:55 – 01:09:32).

So, to answer your question here is we recognize that it would probably not proper for us to compare HTC product with competitor's product in the market. What I would say here is the – we've recognized the smartphone has become a lifestyle product here. So, it's very important not just to have a very compelling and competitive product but also carry through with your strong marketing message and marketing execution. The overall package to us is very important. We recognize that we'll continue to optimize our overall infrastructure message and the theme here and also to improve on that.

<Q>: Okay. [Foreign Language] (01:10:12 – 01:10:55)

<A - Chia Lin Chang>: [Foreign Language] (01:10:58 – 01:11:00)

<Q>: [Foreign Language] (01:11:00 – 01:11:06)

<A - Chia Lin Chang>: [Foreign Language] (01:11:10 – 01:13:00)

So, I'll just say that ARPU – yes, in terms of some of the people leaving or departing HTC, I'd just make a few comments. One, I say I would just not make specific comment on the individual person. For the person who has actually left the company here, we respect their career planning and we also thank them for their contribution to HTC.

Second comment I make here is, yes, we're facing challenge. We recognize the challenge. We recognize the competitor dynamics here. But I would not look to much into that and just sort of magnify the individual situation to be – depending at sort of overall situation in the HTC, especially when we're facing the challenge. The people would like to have a different look in this to paint a different picture of HTC.

From my understanding, HTC [indiscernible] (1:13:56). When I stay in the company, during the day here tend to be really long. When I see my peers, my direct staff and the team here, the people were very motivated. And to us, HTC as open entity, we learn. Yes, we have challenge. We made mistake. We learned our lesson here. But we're very motivated and want to go to the challenge and hopefully get into the next level for us.

<**Q**>: Okay. [Foreign Language] (01:14:26)

<**A**>: [Foreign Language] (01:14:27)

Operator

[Operator Instructions] The next question is [ph] Jean-Louis from JI (1:14:37). Please go ahead.

<**Q**>: Thanks for taking my question. Question I want to ask is on the R&D side of things. You've talked about your OpEx wanting to keep that sort of between NT$10 billion to NT$14 billion going forward, so R&D is a portion – as a percentage of your sales, what do you expect that to remain over the course of FY 2013 looking forward?

<**A - Chia Lin Chang**>: R&D level here [indiscernible] (01:15:05) I think – I would say, R&D level you can – I don't expect big changes. There are some changes sometimes due to some pilot – there are some pilot tests here we'll put in part of the R&D. There are some project expenses sometime maybe on and off, depends on a number of projects we do for the upcoming quarters – two quarters. But overall, R&D level I would say, in the coming year will be roughly around similar level, I would say. I wouldn't say specifically a number in that, but I wouldn't say – I wouldn't see really big changes in the R&D.

[indiscernible] (01:15:42) our IR wanted to show me something. What are trying to show me? Well, I wouldn't comment on the percentage. What I'll just comment on is the – on the absolute number. I don't see a big fluctuation in the absolute number. There may be changes due to some project expenses, maybe a [ph] pile (01:16:00) around there a little bit there, but the overall R&D I think is stable, I think.

<**Q**>: Okay. Do you want to translate those? Shall I follow up with the second question?

<**A - Chia Lin Chang**>: [Foreign Language] (01:16:11 – 01:16:28) Okay, go ahead.

<**Q**>: Okay. So, I've listened to what you said about the OpEx cost, I'm looking at your – the trend of you GPM. Here's my question, for next year, I mean, I see that we're going to have a 1% OPM level for Q4, if you're going to keep your OpEx at NT$10 billion to NT$14 billion, that's assuming that your revenue run rates got to remain somewhere above the NT$60 billion, somewhere around that. And looking into next year, Q4 is obviously an uptake because it's a good quarter. So, NT$60 billion for Q4, let's assume that.

Looking forward Q1, Q2, Q3 of next year, if you don't have successful product launches, that revenue could actually drop below that which would mean that you're going to go into a loss-making scenario. So, listening towards you're saying about that fact that HTC is a lifestyle product or smartphones are lifestyle products et cetera and you want to appeal to your customer et cetera and I am one of them. Then what – what are you going to do to make sure that you don't become a loss-making company and that cash pile of NT$50 billion, which you have now, isn't going [ph] to have (01:17:28) again at the same time next year. I apologize for [indiscernible] (01:17:32) question.

<**A - Chia Lin Chang**>: I think – no problem and I apologize, I won't be able to answer any in good – kind of granular manner that you desire here. What I would say here is that obviously, it's probably not proper for me getting to that kind of speculation. But I would say the following here: possibility to us important, okay. But continue to invest for the future is also very important here. Are we going to expect our revenue next year to be something like this and that. That's not obviously what we want in fact, We want to expect that we – into the fourth quarter this year, into the next year, we're pretty confident about our products. What we need to make sure is with the product, do we offer the right marketing message and execution. That to us, we need to get it right here. So, we, obviously – [ph] our current (01:18:24) infrastructure is [ph] the nice (01:18:26) for us to be a higher revenue run rate in that. And either on the overall fixed infrastructure or on the sales and marketing but in that regard. That's how plan for it.

In your scenario here, we will adjust accordingly here. And that scenario possibility to us is important. But I want to emphasize here, obviously, we don't want to get into that scenario. We think with this thing here, we think we should have a better outlook into next year. So, the answer to your question is not directly here but I think the – I touched it on – the main point.

<**Q**>: Yes, I think I understand that effectively what you're saying is that you're implying that next year's revenue must remain at the past Q3, Q4 levels that we're seeing in the second half of this year.

<**A - Chia Lin Chang**>: No, what I'm – yes, to some extent, that's what I say here. I say our infrastructure, either fixed infrastructure or flexible infrastructure, is designed to have a higher revenue run rate here.

<**Q**>: Yes.

<**A - Chia Lin Chang**>: So, it's probably not appropriate for me to get into the kind of scenario as you speculate here. But if the scenario like that happened to us, profitability is important. So, I would just make that and add to your comment.

<**Q**>: Yes. Thanks so much. Let me just say one point then. In those circumstances, could we potentially expect some sort of write-down on the OpEx side? So, for staff or for some sort of write-down in terms of your assets because it could very well be that – is there a possibility that we could expect some sort of write-down that hasn't quite come yet in order to bring your OpEx down?

<**A - Chia Lin Chang**>: You mean the OpEx, meaning write-down of – what does that mean write-down of staff? You mean the cost-cutting?

<**Q**>: Yes, sorry, cost-cutting is what I mean, yes.

<**A - Chia Lin Chang**>: And then write-down because I want to clarify. When you say write-down of asset means impairment or what?

<**Q**>: Talking about impairment of assets, provision for employee, payments you would have to make if you – cost associated with cutting. So, for example, in the U.S. or Europe or even in China, for example.

<**A - Chia Lin Chang**>: Yes. So, let me answer your question here that the...

<**Q**>: Yes.

<**A - Chia Lin Chang**>: And I'll say...

<**Q**>: Sorry, that's my last question.

<**A - Chia Lin Chang**>: the phrase in a different way here.

<**Q**>: Yes.

<**A**>: Phrased in different way here, our operating expense – and a lot of people asking me question, without going into specific detail, I'll just qualitatively say the following. Our operating expense, yes, contains both the flexible infrastructure and also the relatively fixed cost in that regard. The flexible part of it is actually it's a pretty big part of it. It's not like [indiscernible] (1:21:05) operating expenses actually fixed nature. So, we have flexibility in that regard. And again, I do not want – certainly hope we do not get into that scenario you've depict here. But when this scenario happened here, hopefully not, but if it happen, possibility to us and it's important, I'll stop here. But again, our infrastructure and our investment, our continued investment, is actually done in anticipation to a brighter outlook into 2013.

<**Q**>: Okay. Thank you very much. [indiscernible] (01:21:37)

<**A**>: Thank you. [indiscernible] (1:21:39)

Operator

[Operator Instructions] The next question is Richard Kramer from Arete Research. Please go ahead.

<Q - Richard Kramer>: Thank you very much. Just to add one question. Looking out into 2013, HTC has been trying to preserve this mid- or high-20s growth margin for some time and it's clear that there's a very vast low-end smartphone market developing. How do you think about the trade-off between accepting lower gross margins but looking for a larger top line which would support the sales and marketing expense that everyone has asked about already. I know there are some members of the management team that seem philosophically opposed to going down market. There's others that seem to think it's necessary. But what's your view on accepting, for example – to try to get an extra NT$10 billion or NT$20 billion of sales, a 20% or lower percent growth margin on those sort of products? Thanks.

<A - Chia Lin Chang>: Right. I know that – thanks, Richard. I know your question here and I would say the following we hear is – the way we see internally here – obviously, the overall shipment and revenue growth is not in exactly direct conflict with the overall gross margin or the overall gross profit. Obviously, part of it is due to your product mix.

Our current view here is we want to grow this shipment and we want to grow the revenue here, at the same time, hopefully, we'll also grow our overall gross profit and maintain a healthy gross margin in that regard.

When you say the low end, it's always the definition about what exactly is a low end or affordable end in that regard? To us, we have a product line-up from the [indiscernible] (1:24:00) all the way down to our – probably the most affordable product coming out of HTC, we call it the Desire C product in that regard.

To us, there is a overall growth potential issue and then also there is a brand-building issue here. We think it's very important that you, at the different price segment from – coming from the top here and to – one step down and two step down and three step down into the Desire C, that you'll have the market share you should get. And then, from that, we grow from that. Can we expand broader into a broader price [indiscernible] (01:24:41)? Yes, potentially. But it's very important when you think about that that have you actually maximized your potential in each price spend you are currently on?

So, those are the two issue we took – we talked about. We not necessarily got stuck or hang up on, say, we're not going to specific price paying period. We actually asked two questions. Not just the question you asked and also for each price span and have you really maximized our potential on market share we should have. So, those are things we consider here.

In the end, hopefully, what we see here is that you can grow on the revenue and also total shipments here. Your gross margin and the resulting gross profit will not be too far from that.

<Q - Richard Kramer>: Okay. Thanks very much.

Operator

[Foreign Language] (01:25:29 – 01:25:36) I will pass the call back to the CFO, Mr. Chia Lin Chang, for closing remark. Mr. Chang, please begin.

Joey Cheng

[Foreign Language] (01:25:44 – 01:25:46) and I guess we're going to end this analyst call. And thank you for all your – all of your participation, and we look forward to seeing you probably in three months again. Thank you.

Chia Lin Chiang

Thank you, everyone.

Operator

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