

Company Flash

8 June 2009 | 7 pages

HTC Corporation (2498.TW)

Sell: Getting Difficult to Reach Rising Market Expectation

- Getting difficult to reach rising market expectation:** HTC reported May sales of NT\$12.5Bn, up 9.5% M/M and 14% Y/Y. This is roughly in-line with the lowest end of market expectation of 10% M/M growth. We believe market expectation has been getting higher recently with talks of strong demand of HTC Magic. We believe the market is now expecting HTC to at least beat the high end of its 2Q guidance of NT\$38.5Bn. In fact, we believe the current market expectation is for HTC to deliver NT\$38.5-40 Bn of revenue in 2Q. We note that HTC would have to grow its June sales by 13% M/M to reach the midpoint of its guidance, 17% to reach the low end of market expectation and 29% to reach the high end of market expectation.
- Watch out for ASP trend:** Like many market observers, we are also seeing a strong order rate from HTC and better component fulfillment from HTC's suppliers. Hence, we are also a little bit surprised by the lackluster May sales. While it's a bit too early to conclude whether HTC will miss 2Q market expectation, we would like to remind investors to pay extra attention to HTC's 2Q ASP. We estimate that HTC at least will have 25% unit growth Q/Q in 2Q. Given HTC's much higher sales mix of new products (we estimate new models such as Magic, Diamond II and small volume of Touch Pro II and Snap are roughly 50% of sales mix compared to almost zero in 1Q), failing to maintain ASP in 2Q probably means HTC will probably see even bigger ASP erosion in 2H09. Our argument is based on 1) more competition in 2H09 (new iPhone, Palm Pre, new Android phone from Motorola and Samsung and new touch screen smartphone from Nokia) and 2) incremental product mix improvement in 2H09 is unlikely to be as significant as 2Q09.
- Margin environment getting difficult in 2H09:** HTC guided around 1 %point of gross margin expansion from 30% in 1Q to 31% in 2Q09. If HTC only expands its GM by 1 %point in a very favorable margin environment (much better product mix in 2Q compared to 1Q, improving scale and almost no new model launch from its major competitor), its margin could be subject to lots of pressure given significantly higher competition and relatively less product mix improvement in 2H09.

Sell/High Risk	3H
Price (06 Jun 09)	NT\$489.00
Target price	NT\$468.00
Expected share price return	-4.3%
Expected dividend yield	5.5%
Expected total return	1.2%
Market Cap	NT\$364,498M US\$11,159M

Price Performance (RIC: 2498.TW, BB: 2498 TT)



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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 1. Valuation

Year to 31-Dec	Net Profit (NT\$M)	Diluted EPS (NT\$)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	22,427	30.35	10.76	16.1	6.4	45.3	7.0
2008A	28,636	38.3	26.20	12.8	6.0	49.0	5.5
2009E	26,333	35.21	-8.07	13.9	5.2	40.3	5.1
2010E	27,557	36.97	5.00	13.2	4.6	37.0	5.3
2011E	32,295	43.33	17.20	11.3	4.0	37.8	6.2

Source: Datacentral

Figure 2. HTC P&L

NT\$mn	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09E	3Q09E	4Q09E	2007	2008	2009	2010E	2011E
Net sales	32,682	34,967	37,630	47,074	31,408	38,900	45,327	53,478	118,580	152,353	169,113	195,671	233,382
Gross profit	11,642	12,129	13,037	14,183	9,613	12,361	13,862	15,520	40,254	50,991	51,355	55,882	65,807
OPEX	4,477	5,214	5,648	5,307	4,586	5,436	5,908	6,569	9,231	20,645	22,498	25,627	30,450
Operating profit	7,165	6,915	7,389	8,876	5,027	6,925	7,954	8,951	31,023	30,346	28,857	30,255	35,357
Total Non-OP	485	471	339	96	413	179	213	192	913	1,390	996	959	1,157
Pre-tax profit	7,650	7,386	7,728	8,972	5,440	7,104	8,167	9,143	31,935	31,736	29,854	31,214	36,513
Net profit	6,944	6,615	6,986	8,090	4,875	5,892	7,345	8,221	28,642	28,636	26,333	27,557	32,295
Pre EB EPS	11.11	10.55	11.11	12.75	7.64	10.11	11.63	13.02	38.76	45.54	42.36	44.44	51.98
Post EB EPS	9.32	8.88	9.38	10.71	6.45	7.90	9.85	11.03	30.35	38.30	35.21	36.97	43.33
Margins (%)													
Gross profit	35.6	34.7	34.6	30.1	30.6	31.8	30.6	29.0	33.9	33.5	30.4	28.6	28.2
OPEX to Sales Ratio	13.7	14.9	15.0	11.3	14.6	14.0	13.0	12.3	7.8	13.6	13.3	13.1	13.0
Operating profit	21.9	19.8	19.6	18.9	16.0	17.8	17.5	16.7	26.2	19.9	17.1	15.5	15.1
Pre-tax profit	23.4	21.1	20.5	19.1	17.3	18.3	18.0	17.1	26.9	20.8	17.7	16.0	15.6
Net profit	21.2	18.9	18.6	17.2	15.5	15.1	16.2	15.4	24.2	18.8	15.6	14.1	13.8
Y/Y(%)													
Net sales	38.5	30.2	29.3	20.7	(3.9)	11.2	20.5	13.6	13.2	28.5	11.0	15.7	19.3
Gross profit	49.6	34.0	31.5	5.0	(17.4)	1.9	6.3	9.4	18.8	26.7	0.7	8.8	17.8
Operating profit	17.1	(1.6)	(0.6)	(15.0)	(29.8)	0.1	7.7	0.8	16.8	(2.2)	(4.9)	4.8	16.9
Pre-tax profit	25.1	(4.2)	0.6	(14.0)	(28.9)	(3.8)	5.7	1.9	18.5	(0.6)	(5.9)	4.6	17.0
Net profit	15.7	8.6	(8.6)	(9.1)	(29.8)	(10.9)	5.1	1.6	13.4	(0.0)	(8.0)	4.6	17.2
Q/Q(%)													
Net sales	(16.2)	7.0	7.6	25.1	(33.3)	23.9	16.5	18.0					
Gross profit	(13.8)	4.2	7.5	8.8	(32.2)	28.6	12.1	12.0					
Operating profit	(31.4)	(3.5)	6.8	20.1	(43.4)	37.8	14.9	12.5					
Pre-tax profit	(26.6)	(3.5)	4.6	16.1	(39.4)	30.6	15.0	11.9					
Net profit	(22.0)	(4.7)	5.6	15.8	(39.7)	20.9	24.7	11.9					

Source: Citi Investment Research and Analysis

HTC Corporation

Company description

HTC is a leading manufacturer of Windows PDA phones and smartphones, accounting for roughly 70% of global market share. HTC sells Windows converged handhelds under operator brands as well as the "hTc" brand. In 2007, the Americas represented around 42% (including ODM revenue from Palm) of revenues, while Europe, and Asia and ROW accounted for 40% and 18%, respectively. However, as its business model shifts toward the brand business, we expect revenue mix by region to change. We expect Europe, the Americas, and Asia and ROW to account for 50%, 30% and 20%, respectively.

Investment strategy

We have a Sell/High Risk rating on HTC. We do not believe HTC is ready to compete in the mass consumer market given its lack of scale, 3G patents and proprietary operating system. We expect substantial price declines for smartphones in the next 12 months due to aggressive participation of global OEMs and changing client / product mix (from high end corporate / prosumer models to mainstream / mid-low end consumer models).

Valuation

Our DCF-based target price for HTC shares is NT\$468. We use a DCF-based valuation to reflect HTC's capability to generate stable cash inflows. Our DCF assumes revenue will slow from 29%Y/Y in 2008 to -4%Y/Y in 2018E due to slowing shipment growth and continued ASP erosion. We apply a WACC of 10.2%, which assumes a risk-free rate of 1.4%, a market risk premium of 7.2%, and an equity beta of 1.22. Our target price is equivalent to a P/E of 13x FY09E EPS.

Risks

We have a High Risk rating on HTC shares based on our quantitative risk rating system, which tracks 260-day historical share price volatility. Upside risks to our target price include: 1) stronger-than-expected demand for high-end handsets in 2009; 2) HTC's operating margin deteriorating slower than we expect; and 3) significant strategy changes from other smartphone vendors.

Appendix A-1

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HTC Corporation (2498.TW)

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Analyst: Kevin Chang

Covered since May 23 2008

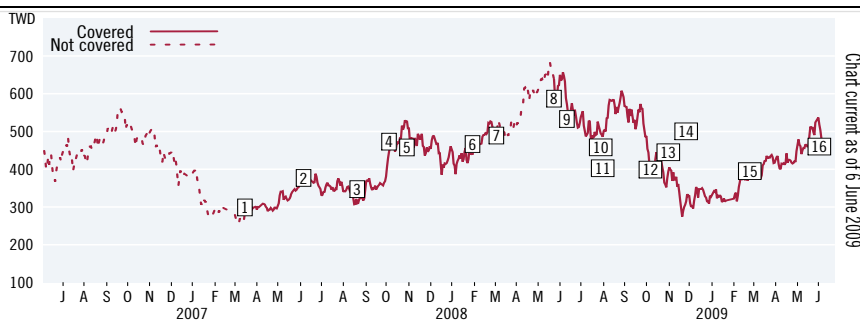


Chart current as of 6 June 2009

Date	Rating	Target Price	Closing Price
1 15-Mar-07	*1H	*384.62	284.91
2 6-Jun-07	*1M	*420.12	360.36
3 21-Aug-07	1M	*420.00	309.23
4 4-Oct-07	1M	*523.08	446.15
5 30-Oct-07	1M	*653.85	528.46
6 30-Jan-08	1M	*576.92	438.46

Date	Rating	Target Price	Closing Price
7 4-Mar-08	Coverage suspended		
8 23-May-08	*3M	576.92	638.46
9 11-Jun-08	3M	*507.69	572.31
10 29-Jul-08	3M	*505.00	495.00
11 31-Jul-08	3M	*446.00	486.00
12 7-Oct-08	*1H	*507.00	415.50

Date	Rating	Target Price	Closing Price
13 31-Oct-08	1H	*520.00	393.50
14 26-Nov-08	1H	*420.00	315.00
15 24-Feb-09	1H	*468.00	375.50
16 2-Jun-09	*3H	468.00	518.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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