

February 18, 2009

Stock Rating  
Equal-weight

Industry View  
Cautious

## HTC Corporation

### Quick Comment: Takeaways from MWC in Barcelona

**Impact on our view:** We see more excitement surrounding HTC's Magic (Android Cupcake) than Diamond/Touch Pro 2 (WM OS 6.1/6.5 ready) introduced at MWC this year. On the hardware side, both lineups have limited upgrades than previous versions (Magic lacks Qwerty keypads from G1 while Diamond/Touch Pro 2 have more enhanced resolutions in displays/cameras) and most of the improvements come in the form of UI and applications. Given increasing competition, we hold our view that HTC needs to differentiate its products with competitive pricing to further widen market share; with long-term pricing/margin downtrend due to likely structural changes in the Smartphone market a key concern. We retain our EW rating on HTC.

**More focus on UI, applications and service this time at MWC:** Not much surprises or innovation on the spec from major Smartphone vendors but highlight more on high resolution of display (WVGA) and cameras (~5-12MP) such as Samsung/LG and SEMC. We are more interested to see the LT focus shift to software service (i.e. Nokia has launched their application store on Ovi, with content including films and games but also user-generated content) while address mid-range Smartphones priced at sub-US\$400 (e.g. E55 on top of 5800/5630 unveiled a while back). HTC appears not to be positioned in these two areas yet.

**When Smartphone moves to M-shaped developments...:** While new entrants remain distant competitors to HTC, it certainly bears watching including 1) NB PC brands like Acer by leveraging existing PC channels, netbook success to cut in operators and to a lesser extent bargaining power over components; 2) equipment makers like ZTE/Huawei's tight relationship with operators and low-priced strategy; and 3) China local brands or white-box players, helped by MTK's support in the long run.

#### Key Ratios and Statistics

Reuters: 2498.TW Bloomberg: 2498 TT

#### Taiwan Hardware Technology

Price target	NT\$350.00
Upside to price target (%)	(6)
Shr price, close (Feb 17, 2009)	NT\$372.50
52-Week Range	NT\$683.08-256.00
Sh out, dil, curr (mn)	745
Mkt cap, curr (mn)	NT\$277,659
EV, curr (mn)	NT\$222,590
Avg daily trading volume (mn)	NT\$4,075

Fiscal Year ending	12/07	12/08e	12/09e	12/10e
ModelWare EPS (NT\$)	42.01	37.92	33.65	35.44
Consensus EPS (NT\$)§	40.93	38.22	35.28	39.46
Revenue, net (NT\$ mn)	118,580	152,561	160,838	173,193
EBITDA (NT\$ mn)	26,822	31,183	28,750	30,372
ModelWare net inc (NT\$ mn)	24,076	28,645	25,083	26,417
P/E	11.0	8.6	11.1	10.5
P/BV	4.7	3.9	4.1	3.7
RNOA (%)	226.1	2,138.4	1,267.0	(29,296.1)
ROE (%)	56.6	51.1	39.5	38.9
EV/EBITDA	7.8	5.9	7.3	6.7
Div yld (%)	5.9	10.4	7.4	7.2
FCF yld ratio (%)	12.2	10.4	9.5	9.8
Leverage (EOP) (%)	(98.2)	(97.5)	(100.1)	(101.6)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.  
e = Morgan Stanley Research estimates

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## **At MWC – we see more surprises from Android (HTC Magic) than WinMo (HTC Diamond/Touch Pro 2)**

HTC at MWC (Mobile World Congress) in Barcelona on February 16 announced updates to two of its high-end touch-screen PDA phones, unveiling the *Touch Diamond 2* and the *Touch Pro 2* - successors to the *HTC Diamond* and *Touch Pro*. On the 2<sup>nd</sup> day, Vodafone at the conference announced to launch the *HTC Magic* – the 2<sup>nd</sup> Android model (in addition to T-Mobile's *G1*) based on Google's latest version of Android platform code named *Cupcake*. The key difference between the *Magic* and the *G1* is the light weight and the absence of Qwerty keyboard. Our first impression is that the UI (user interface) is clearly better than *G1* and the touchscreen has improved with a more iPhone/Palm Pre-like sensitivity to the users' touch. HTC's *Magic* will be exclusive for Vodafone in UK, Germany, France and Spain and on a non-exclusive deal with Italy; and be available this April.

## **New WM-OS models focus on business centric users highlighting higher resolution displays and cameras plus simplified UI although limited differentiation from previous versions:**

Both new WM OS based models are on WM 6.1 OS (yet 6.5 OS ready) with Qualcomm M7200A chips and its existing touch flow user interface. Both devices sport 7.2Mb/s HSDPA 3G connectivity. The difference between the two is that *Diamond 2* carries 5MP camera while *Pro 2*'s is only 3.2MP; and *Pro 2* is equipped with bigger high resolution display at 3.6-inch and Qwerty keyboards. Nonetheless, the upgrade from previous versions is mainly from increased RAM, better battery life and higher resolution in both display and cameras. Beyond hardware, HTC highlights its "push internet" that is designed to alleviate the slow downloading and rendering – the key to increase data ARPU. The *HTC Touch Diamond2* will be available in Europe and in Asia in early Q2 2009, and globally later in the year while *Pro 2* will be available from late 2Q. While we agree that the new *Diamond* and *Touch Pro* improve a lot on UI and applications, it is getting more difficult for them to grab attention as in the past when HTC faced limited competition from other brands that did not have touchscreen models then. However, we have seen several touchscreen models from Samsung and LG, Nokia's mid-range Smartphone 5800, RIMM's *Storm* and upcoming Palm's *Pre* on top of Apple's *iPhone*, it will require a lot more than just spec upgrade and UI improvement to differentiate and widen shares, in our view.

## **2nd Android-platform model HTC Magic targets more consumer segment – so pricing/data plan holds the key:**

Compared with *HTC Diamond 2* and *Touch Pro 2r*, *HTC Magic* has certainly grabbed more attention; as it is a bit disappointing that none of the major brand names (except for Huawei

showcasing its prototype of Android phone) have launched Android phones at MWC. Details on pricing for Vodafone UK are not yet available, but pricing in Spain will be from Euro 99 to 199 or US\$140~283, depending on the contract. We note, however, that the most popular models for Vodafone UK now are Nokia's 5800 and Samsung's *Steel 810*, which are all priced at zero post subsidy, albeit with a monthly fee of US\$35~36 which we consider very attractive. Apparently, the *Magic* aims to address the consumer segment which HTC designs it with lower spec which we expect to carry lower BoM costs that compare with *Diamond/Pro 2*. In our model we have factored in 4m units Android-based models this year, up from low base of 1m units in 08. We maintain our view that HTC's incremental drivers this year should come from its Android based models as we expect shipments of WM OS based models could be just muted or down slightly YoY until we see upgrade to WM OS 7.0 next year. In light of increased competition, we believe that target for a mid-single digit ASP erosion remains pretty challenging unless all other brand names (incl. Samsung, LG, Motorola and Huawei) all delay launches of Android-based models.

## **More new entrants to move in – Early but worth watching**

Besides existing major handset OEMs, we observe a number of new entrants making inroads into the Smartphone market. While we think most of them are either early and/or addressing different segmentations, whether this will lead to the structural change of overall Smartphone market is certainly worth monitoring. This includes:

**1) NB PC brand names – such as Acer** which showcased their new Smartphones on WM OS. While hardware wise, Acer's products lack innovation and are more HTC like, we judge their strength lies in leverage on existing PC channels (plus their penetration into operators backed by success in netbooks) and to a lesser extent bargaining power over components;

**2) Equipment suppliers like Huawei and ZTE:** both names introduced a lineup of Smartphones mainly on WM OS; although Huawei also showcased a prototype of an Android model to be rolled out in 3Q according to the company. Both names should not be considered as technology leaders but we reckon their close relationship with operators (through equipments) and aggressive pricing strategy (bundled with equipments) as evidenced by their strong volume on ultra-low priced phones in the past few years should not be ignored; and

**3) China local brands or white-box players +MTK?** – it is also interesting to see how China local brands or white-box players' strategy in Smartphone market backed by MTK's

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supports (who also showcased their solution at MWC this year). We believe their product proposition should not be considered as really Smartphone focusing on performance but more like Smartphone-light feature phones given lack of support from operators. That said, China local brands or white-box players should not pose direct competition in the long run, but whether Smartphones will be eventually positioned as feature phones with lower pricing certainly bears watching.

#### **Company Description**

HTC is an original design manufacturer (ODM) specializing in designing and manufacturing personal digital assistants (PDAs), PDA phones, and Smartphones. Major customers include leading carriers such as AT&T/Cingular, Verizon, Vodafone, T-Mobile, and O2. HTC also promotes its own brand, hTc, to non-carrier markets.

#### **Taiwan Hardware Technology**

**Industry View: Cautious**

#### **MSCI Country: Taiwan**

Asia Strategist's Recommended Weight: 11.3%

MSCI Asia/Pac All Country Ex Jp Weight: 11.5%



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	Count	% of Total	Count	Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>773</b>	<b>33%</b>	<b>223</b>	<b>37%</b>	<b>29%</b>
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<b>Not-Rated/Hold</b>	<b>33</b>	<b>1.4%</b>	<b>8</b>	<b>1.3%</b>	<b>24.2%</b>
<b>Underweight/Sell</b>	<b>498</b>	<b>21%</b>	<b>101</b>	<b>17%</b>	<b>20%</b>
<b>Total</b>	<b>2,348</b>		<b>598</b>		

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**Industry Coverage: Taiwan Hardware Technology**

Company (Ticker)	Rating (as of)	Price (02/17/2009)
<b>Anya Chang</b>		
Nan Ya PCB (8046.TW)	O (07/28/2008)	NT\$65.6
Tripod Technology (3044.TW)	E (04/30/2008)	NT\$40.8
Unimicron (3037.TW)	E (02/16/2009)	NT\$15.7
<b>Grace Chen</b>		
Acer Inc. (2353.TW)	O (07/11/2007)	NT\$43.9
Asustek Computer Inc. (2357.TW)	U (01/09/2009)	NT\$32.15
Compal Electronics (2324.TW)	U (01/07/2009)	NT\$19
Delta Electronics Inc. (2308.TW)	O (04/30/2007)	NT\$54.1
Foxconn Technology (2354.TW)	O (07/30/2007)	NT\$78.2
Mitac International Corp. (2315.TW)	E (07/30/2007)	NT\$11.65
Paragon Tech. (3518.TW)	O (11/28/2007)	NT\$60.4
Quanta Computer Inc. (2382.TW)	E (04/30/2007)	NT\$36.1
Wistron Corporation (3231.TW)	O (07/21/2008)	NT\$25.85
<b>Jasmine Lu</b>		
HTC Corporation (2498.TW)	E (11/20/2008)	NT\$372.5
Hon Hai Precision (2317.TW)	E (11/20/2008)	NT\$63.9
Largan Precision (3008.TW)	E (01/06/2009)	NT\$230.5
<b>Sharon Shih</b>		
Cheng Uei Precision (2392.TW)	U (02/14/2008)	NT\$37.75
Compal Communications (8078.TW)	U (03/02/2007)	NT\$21.9
D-Link Corporation (2332.TW)	E (09/30/2008)	NT\$19.4
Epistar (2448.TW)	U (09/30/2008)	NT\$41.6
Everlight Electronics Co., Ltd. (2393.TW)	E (09/30/2008)	NT\$49.4
Gemtek Technology (4906.TW)	E (02/17/2009)	NT\$41.8
Merry Electronics (2439.TW)	E (07/24/2008)	NT\$27.8
Silitech Technology (3311.TW)	E (12/22/2008)	NT\$51

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