

**Topic: Acer 2Q FY11 Earnings Conference Call**

Speakers: Mr. JT Wang – CEO and Chairman  
Mr. Jim Wong – Corporate President  
Mr. Che-Min (Jammi) Tu – CFO  
Mr. Kevin Lu – Investor Relations

Host: Kevin Chang – Head of Technology – Hardware

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5:00pm Tokyo Time  
9:00am London Time

**Presentation Session:**

**Kevin Chang:**

Hi, thanks, good afternoon. This is Kevin Chang regional hardware analyst of Citigroup. First of all, we would like to thank Acer for giving us this opportunity to hold the call. Here today we have Mr. JT Wang, Chairman and CEO of Acer, and Jim Wong, President of Acer, and also Jammi Tu, CFO, as well as Kevin Lu, IR manager. I will now pass the call to Jammi for 2Q result. Thanks Jammi.

**Che-Min Tu:**

Good morning and good afternoon. First of all, I would like to provide you the sales closure number Q2 of Acer. For 2Q11, we have revenue NT\$102.09Bn, which represents 32.1% decline year on year and 20.1% decline year on year. For the operating income, in total we have a NT\$7.087Bn loss. For the PAT in total we have NT\$6.789Bn loss, which implies EPS NT\$2.57 loss in Q2.

However, without considering the one off events including the 150M write-off, including the 30M restructuring, and also another one of the severance packages to the senior executives, the revenue of Q2 becomes NT\$106.42Bn, which is 16.7% decline Q/Q and 29.2% decline Y/Y. And for the operating income without any of the one-off events, the loss is NT\$1.24Bn, and for the PAT, because we have some tax credit reverse, the PAT becomes NT\$83M loss. So this is the result without considering any of the one-off events.

Therefore, for the whole 1H Acer generates NT\$229.89Bn, which implies 26% decline Y/Y. And for the PAT for the whole 1H11 is a loss of NT\$5.6Bn. So this is a very brief update for you on our sales closure financial numbers. All the audited number will be approved by KPMG and also by board next week. Thank you. Then right now I will pass to our President Jim for a more detailed update.

**Jim Wong:**

This is Jim Wong speaking. With the status of the worldwide PC industry at this moment in Q2, Acer has underperformed on the overall sales. Looking at the worldwide sales-out numbers we continue to resolve the centric on the EMEA region with the channel and the rest of the world, especially in Asia Pacific and in China. In developing countries like Brazil and India we continue to have relatively good growth, and stable financial performance in Pan America including South America. In some areas like Asia from mobile PCs Acer continues to show 38.8% of growth versus the industry average of 12%, and this is the third highest growth rate compare with Apple first and HP second. So Acer continues to show the proper movement in Asia-Pacific. In North America we have below the industry average growth. Because we are concerned of the inventory as well as the OPP open price product competition we took a more conservative approach there. By looking at the developing countries like China, we outpaced the market growth of mobile PCs continuously, the figures from GSK showing that in June we continue to show strong growth versus industry average of 36% vs. 38% in PC, and 38% vs.80% industry average in mobile PCs. In Brazil we are also showing continuous growth. Although we are already No.4 in the market, we continue to have 35% of growth in Q2 versus the industry this year at 28.8%. In summary, having the EMEA moving forward in the inventory resolution, the rest of the world is showing relatively strong growth compared with industry, especially in Asia Pacific and developing countries, and North America is stabilized.

**JT Wang:**

Okay good afternoon and good morning. This is JT Wang from Acer. Q2 is a correction period, after we announced 150M extra promotion expenditure and 30M US for layoff in EMEA. As the result, the Q2 loss is bigger than what market expected. I think the major reasons are 1) the whole company already defined lower pipeline inventory strategy, therefore the whole company and a lot of countries started to expedite the reduction of the pipeline inventory. Also,

the overall competition reacts the similar way, also the loss is bigger than expected. 2) Several EMEA executive layoffs or resigns. According to the regulations and agreements in specific countries, we have some one-time severance payments. According to the accounting rules, we have to reflect this one-time loss in Q2. So the Q2 loss is bigger than expected a few months ago, when we did our budget for 2H. At that time, I had better confidence and a more optimistic view on 2H. However, the Q2 loss is bigger than expected, so today I have to say the whole year to be breakeven becomes impossible, according to today's situation. I feel sorry that I did indicate in the past that there might be some possibility, but we had reason 1 and 2, and the macro environment including the industry consolidation and revolution is going on and also the macro economics in Europe and America was getting worse. Furthermore, the restructuring and CEO change take more time and more efforts to clean everything. So that is the new judgment for the whole year, under current circumstances it will not be possible to break even. Of course we will try to minimize the loss. Q3 is getting better, but will still have some loss. We try to minimize the loss. Q4 compared to Q3, we have high confidence to improve a lot. But how much profit we can generate becomes difficult to predict under current circumstances. Especially our major competitors also try to clean up their pipeline inventory. We are not the only one, the whole market became a mess and difficult to predict. So that is the current situation. And I would like to report and stop here and answer any question you may have.

**Kevin Chang:**

Operator can we start the Q&A? Thanks.

**QA session:**

**1. Grace Chen from MS Taiwan**

Hi, thank you. Hi JT, Jim, and Jimmi, thank you for taking my questions. I listen to JT's guidance, and looks like Q3 still stats a loss and relatively confidence for Q4. Can you let us know what action plan you have or if channel strategy will change, so that you are more confident that we can see more substantial improvement in Q4? That is my first question, thank you.

**Jim Wong:**

This is Jim Wong. I think the difference between the beginning of Q2 and up to this moment is the resolving of the inventory issues. Whether with the channel

or with our sales we are seeing the improvement by more than 50% up to now. We are seeing by end of Q3 we are going to improve for another 20%, although during this time we are seeing some sell-in. But our control on inventory is very tight. So by the closing Q3 we expect inventory level to be even lower inventory than the regular one we had before. By having much lower inventory we can have 2 things: 1) the organization will be more efficient in doing regular business and 2) with much less inventory efficiency will show on the competitiveness of the products. We are seeing the Q4 unpredictable economic is a challenge, but we try to manage very tightly on PAT. We try to make sure to have a much better inventory level. We like to manage as good as possible, no matter what kind of economic situation we are in.

**JT Wang:**

This is JT Wang. In the restructuring of the organization, according to several countries' regulation, we have to give our employees or managers two months advance notice period. So a lot of restructuring can only be completed by the end of August. And then the new management will start to come on-board and bring everything under control. The inventory level has already gone down to a healthy condition. The shipment from Chongquin through rail road already started. We have a new logistic option to take the rail road route to Europe. We see Netbook NB purchasing is coming back. We see tablet is kind of flat. I think the fever of tablet is going down. The notebook is regaining interest from consumers. We also have new products of Ultrabooks and will start to ship some quantities in September, and continue in 4Q. We see this as a new opportunity and new mainstream trend that is going to be started from 4Q this year. These Ultrabooks are extremely thin, and light, instant on, instant connected with good Dolby sound, with good battery life and attractive selling price. So this is a new trend, which in 20~30 years PC history nobody predicted or nobody could believe in that this time we can create this kind of Ultrabook. We did some marketing studies and we see the acceptance and consumer interest in the Ultrabook. We have some hope. Also the 7" and 10" tablet continue selling, but growth is kind of flat. Thank you

**2. Chitra Gopal CLSA TW**

Thank you for taking my question. Do you see the need to make any further sales allowances to clear the inventory in 3Q or is there any further restructure you need to do in terms of one-off item that might come in 3Q as well?

**JT Wang:**

After the Q2, the operation is getting more stabilized. And we don't have a plan to initiate any further restructuring or sales allowance. Actually, as for the 150M special allowance to help inventory reduction, up to now we only used 50M by July. We already reflected 150M in the book in Q2. However, we will apply this resource to help moving our inventory. We handle them very carefully and we try to optimize and maximize the effect of the sales allowance.

**3. Julie Hsieh UBS TW**

Good afternoon, This is Julie from UBS.

I actually have several questions. First question is that Chairman and CEO did indicate that inventory is healthy at this level. But what is healthy? Could you give me some number or amount in terms of inventory level? Shall I go the other questions or you would like to answer first?

Please do it one by one.

**Jim Wong:**

This is Jim Wong. The amount of regular channel inventory level depends on the region. In EMEA 8 weeks used to be so called the average, the US use to be 8 weeks. But AP used to be less, about 5-6 week. So we said that basically we focus on EMEA, where we had much higher than 8 weeks before. Due to all the operational changes going on it's hard to compare, but we were at the beginning of the year higher than 8 and now below 8 and we are driving even lower.

**Julie Hsieh:**

Thank you. Also, as for the sales breakdown by region, could you give us a better update on 2Q?

**Che-Min Tu:**

I think for the sales breakdown for 2Q, EMEA is 32% (from 47% last year), Pan America 28% (stable), Asia 22% (from 17% last year), Greater China 15% (7% last year), TW 3% (very stable)

Thank you.

**Julie Hsieh:**

Thank you. That was very quick. In addition to that, I am also very interest, and

I think also clients as well are interested to know, what is your strategy going forward? Because as the president has indicates Q3 will still be a loss, but how much will that be? In terms of top line what kind of number Q/Q growth are we looking at in terms of sales? And what kind of GM are we looking at and also OPM? These are always the key numbers we care about in Acer.

**Jim Wong:**

This is Jim Wong. We expect to have similar or slightly higher Q3 over Q2 on topline, and for the Q3 bottom line comparing with Q2 without one-time write-offs and without the inventory resolution or the restructuring, we expect it is going to be better than Q2 on operating result.

**Che-Min Tu:**

As I mentioned earlier, in Q2, without considering the one-offs, the operating loss is about NT\$1.2Bn. So for Q3, what we are targeting now is to try to improve the situation. Therefore, from operating point of view, we expect to be better than the number in Q2.

**Julie Hsieh:**

May I clarify that in Q2 taking out all the one-time or restructuring or severance pay, Q2 operation income was 1.2Bn? Or is it net income?

**Che-Min Tu:**

Operating loss is 1.24Bn

**Julie Hsieh:**

In Q3, we are looking to minimize that loss. But for operating level without the one-time costs it will still be a loss?

**Che-Min Tu:**

Yes

**Julie Hsieh:**

My last question, we just heard that Ultrabook will ship in September and also into Q4. What is the price range and also estimated shipment for 2011/ 2012?

**Jim Wong:**

For the price range for of our Ultrabook, for the first model in Q4, the price

range will be between 799 and 1199 this year because there is only 1 model. It is going to represent less than 3% of total volume of our NB with 3 months of sales. We expect next year Ultrabook will be an industry segment rather than a trend of NB by breaking into the form factor, the performance, and the new user experience. Next year we expect the whole year going to be, depends on how soon the product transition can happen with the new Intel platform and Windows 8 in 2H, we expect the range of 25~35% for next year.

**Kevin Chang:**

Given the very large audience today, can we limit each participates' question to two questions only to let more people ask questions, thanks a lot.

**4. Arthur hsieh USB**

Hi Thank you. In terms of 3Q, I'm still not sure why is it still be a loss? Given there won't be this one-time issues? So could you give us an idea what's the run rate in terms of the operating expense in the administrative cost and R&D per quarter? Do you expect that admin R&D costs to further increase in Q3 and Q4? That is my first question.

**Che-Min Tu:**

I think from the operating expenses point of view, for sure, as I said earlier, we are still only concluding the sales closure financial statement. So we need to have a final confirmation from KPMG before we get into more detail. But for the OPEX I think we are at the range of 8~9%. In the 3Q I think we try to minimize the operating expense and try to see how well we can grow the gross margin there.

However, consider the current market turmoil, we want to be sure what we can deliver exactly and then communicate to the investors. That is I think why in Q3 despite we see relatively improvement in terms of gross margin and possibility to reduce OPEX, we are still a little bit more cautious due to the macroeconomic situation.

**Arthur Hsieh:**

For this 8~9%, is this 2Q number excluding the one-time effects, right?

**Che-Min Tu:**

Yes.

**Arthur Hsieh:**

In terms of dollar amount do you think it will increase further in 2H?

**Che-Min Tu:**

We don't believe the dollar amount in 2H is going to further increase. But it really depends on our scale of revenue in Q3. Because you know in the OPEX are some fixed and variable costs. If you are talking about warranty, if you are going ship more, then for sure the absolute amount of OPEX will increase. So this is subject to also the topline compared to Q2.

**Arthur Hsieh:**

Thank you, Jammi. The second question is about what is the company view on Windows 8? Because apparently in the past, if there is a refresh in the MS operating system, before the refresh usually there is delayed market demand. Even though we have some very nice Ultrabook coming out, is there any potential risk that the market demand could further push out to wait for Windows 8? Any risk we should look out for or for potential improvement on demand? Is it going to be a real driver or not?

**JT Wang:**

To the first one question I will add some comment. Why is Q3 still a loss? We are still in the process of reducing the inventory and now the inventory level is normal. But looking at the future environment the management team has decided to be better make the inventory even lower to deal with the future uncertainty. No matter what industry revolution, windows 8, Europe and America debt situation, a lot of uncertainty is in front of us. We decided to continue to drive down the pipeline inventory, but it takes a longer time and more loss in Q3, but it is in under control. We consider this as a strategic change. The size of the loss is in the normal operation style. Later on I ask Jim whether Windows 8 will stop user demand or not.

**Jim Wong:**

This is Jim Wong speaking. I think Windows 8 effects on purchasing behavior will mainly be falling into the Back-to-school demand next year. Our effort now is to look on Ultrabook. As I mentioned earlier, Ultrabook from our perception is not an industry segment, it is rather an innovation to provide better solution to user to use their mobile computing. Ultrabook is not only about being light, it is

rather about improving user interface with NB mobile computing, so that they can have much better instant on and instant connection, which are today the functions offered by tablets. So this is our thought. Looking from now towards Windows 8, the innovation shall start now, to satisfy customer in mobile computing, rather than waiting for pure OS coming alive. The approach to the back-to-school next year is right before the new OS refreshment. We have to work very hard with MS to assure a tech guarantee for a product newly launched around the November school timing. When they are moving to Windows 8 they have better chances to be upgraded, to avoid users delaying their purchase. And so that is basically the efforts we are doing and also the results to achieve a better sales season next year.

**5. Sherman Wong from Pacific Quest**

Hi, thank you for taking my question. I have 2 questions: 1) What is your guidance now for NB shipment unit in Q3?

**Jim Wong:**

We expect to have Q/Q growth on NB volume, which is contributed by Q3/ Q2 minor growth.

**6. HSBC Taiwan Jenny Lai**

Thanks for taking my question. This is Jenny Lai from HSBC. My first question, in terms of the severance packages, we understand there is a change of CEO, but just wonder if there are any other senior managers leaving? That is my first question.

**JT Wang:**

I just take two examples: the gentleman who handled smart handheld business, the smartphone business, called Aymar, left. Also, the gentleman handling global marketing, Gianpiero Morbello, left, as well as other senior managers. I think they didn't want to stay and we would like to change. So that is the reason we just let them go. We handled this according to the international practice.

**Jim Wong:**

This is Jim Wong. The regional heads, which are more important to the daily business, remain stable with no change. This is our last update.

**Jenny Lai:**

My other question is regarding next year's PC market outlook. We all know it is a very volatile market. Could you share with us your view regarding if you need to plan next year, how would you plan business, including for example the commonly asked question as for the PC market forecast in next year?

**JT Wang:**

I will try, but you know I started to be more conservative. Because in the recent past data did not help the predictions. But for overall, we consider the Netbook + NB + tablet should be able to remain double digit Y/Y growth. However, it depends on the innovation and the new products in each category, and in different countries/ different regions. We still see significant quantities in netbooks in emerging/ developing countries and even in Eastern Europe. Demand for those products is still there. And NB demand depends on new products such as Ultrabook and the new product offerings. Also tablet has to have some innovation. So you know, overall I expect double digit growth Y/Y, but which category grows faster and which category grows slower is still uncertain, it still depends on the innovation and competition. This is what I conclude for next year. Jim, do you want to add something? – No.

**7. Jihsun Taiwan - Alvin Kuo**

Thanks for taking my question. This is Alvin Kuo from Jihsun. I have two questions: 1) regarding Windows 8, from Acer point of view, do you think Windows 8 will bring more potential tablet users back to NB or will it push more NB users to embrace tablet?

**Jim Wong:**

I think we cannot answer this clearly, because working with MS, Windows 8 has still a lot of issue under construction. So we can't talk too much about it. But let me answer it this way: Windows 8 is more considering customer's requirements. It is a good OS, it is good for both touch centric and keyboard centric. So it offers better chances than Windows 7 on touch centric tablet devices. It also offers tremendous chances for a NB which is keyboard centric to be much more user-friendly, no matter on interface or battery life or on instant on. That is what we look for in Windows 8.

**JT Wong**

This is JT Wong. I have a thought I would like to share with you: I believe

Windows 8 will help NB more than tablet.

### **8. Henry King GS**

Hi JT and Jim, thank you for taking my questions. The first question I would like to ask is about iGware. Basically, we got little information about this company. So could you let us know more detail about how would be the synergy between iGware and Acer, and how iGware would bring benefits to Acer? And also is there any senior management from Acer to join iGware to help the consolidation? That is my first question.

### **Jim Wong:**

This is Jim Wong. I think if you pay attention on Acer's Clear.fi since we announced it two years ago, its purpose are two things: 1) to connect devices 2) we mentioned in the mid-term we are going to migrate it to the personal cloud. So to connect devices means for the devices at home. The personal cloud is for users to enjoy this no matter where they are. We would have developed it in-house, but when we had a chance to look into iGware solutions, we found they can help us to speed up and to guarantee us a much bigger proposition of users using our cloud environment. So there was the reason we considered iGware to be part of our Clear.fi vision. And also they have the advantage of having a proven record of servicing multimillion users. We will merge them into Acer operations. However, the independent company is more focused on personal cloud and the personal cloud services are going to be outside services. It's going to be 100% own and its going to be an independent company, and we will have senior executives to join their management, including myself. I will be going to be the president of the company, which will be renamed under Acer's sub-name soon.

### **JT Wang:**

This is JT Wang, I would like to add some comments. Acer cloud is the most important strategy for us in long-term to enhance Acer brand position and Acer brand value. With the proven technology and operation record, we will be able to provide solid services to increase user loyalty to Acer. We believe through these services, Acer NB user would like to buy Acer tablet. Acer tablet user would like to buy Acer smartphone. So the user loyalty will be largely enhanced. And then through this we have all the Acer cloud activities. We can use this infrastructure to engage joined marketing with other public clouds and with other membership clouds. We can proactively participate in the future

cloud society. And we consider this as critical for a hardware centric company like Acer. We see this as a good opportunity to differentiate Acer and show that we can deliver a unique and variable friendly service to open platform device users, which is unique and No.1 in the world. And iGware's expertise is their high level software architecture and high level security software capabilities, such as fighting with hackers and successfully preventing them from interrupting or grabbing data from the end company's web/ cloud. We did not have those kinds of capabilities, but through this kind of special software cloud and security technology we can further enhance Acer design of devices and services in the future.

**Henry King:**

Okay, thank you JT and Jim. My second question is about the HP spin-off. Do you think HP spinning off PSG will help Acer in gaining market share and helping 3Q or 4Q number going up?

**Jim Wong:**

This is Jim. I will take this first question. We still believe the PC industry is still a very sizable and promising market. We continue to focus on this market. With HP's move, we definitely will try our best to make sure we are at good position to satisfy more companies, including HP's existing customers. We are working on that. There is a lot of different information, including that SVP commerce is today rather difficult. So we are going to deal with those uncertainties. However, this doesn't stop Acer from focusing on the IT industry and continue to do innovation and win the customers.

**JT Wang:**

This is JT speaking. I think the most important thing is to reinforce Acer's competitiveness. As soon as possible this is fundamental to increase our competitive advantage, no matter what we can get back on market share and business growth. With the current growth we have high confidence that we will be back. With the HP spin off, I think this is a natural move. The US Wall Street value system does not like low margins or low profit. Their investors will ask the company to do such kind of thing. That is a natural move and this kind of trend will not be changed in Wall Street maybe in the maybe next 10 years. We see this as an opportunity. We talk to all the channels and we will continue to devote our service in PC/ mobile devices/ including Notebook netbook tablet/ and continue to have more innovation and new product offerings. We get some

good feedback from the channels. Thank you.

#### **9. Alliance Bernstein**

Just one quick question about your tablet business: What were your original expectations for unit sales and where are they now? And how do you view the business geographically? And going forward, you mentioned that tablet is not exciting any more, but what is your view on Acer product roll out with the rest of the year and maybe into 2012? Thank you.

#### **Jim Wong:**

Regarding the tablet, we revised last time in Jun and shoot for 2~2.5M and the target remain unchanged. The tablet includes Andorid/ Windows both 7" and 10"

#### **10. Chitra Gopal CLSA**

Thank you, just one follow up from me: Given that you are taking only 50M out of 150M charge, why are you not writing it back? I mean are you having a further inventory provision given that you planning to use it? And then I have a follow up please.

#### **Che-Min Tu:**

I think when we do the provision for 150M we did consider a base on the new business model, which means we will have a lower channel inventory. So from that point we did some simulations to understand exactly what kind of cost we need to provide in order to cut the channel inventory down to the ideal new business model inventory level. That is why we do the provision of 150M. So if you consider from a channel clean up point of view we cannot clean up one shot with total 150M use up. Otherwise, even if we drop the price to the BOM we are not able to move all the channel inventories. Therefore, to answer your question, 150M was based on the new business model channel inventory, which requires this amount to clean up the inventory to the new business level. We hope by the end of the year, the amount can be used up. So up to now in July we only used up 50M.

#### **11. Chitra Gopal CLSA**

Just when I look at Gartner's Acer market share, it seems to suggest that Acer's 2Q market share is about 14%. I know this is all sell-in data. How would you estimate your sell-through data in 2H11?

**Jim Wong:**

I think our market share is sustainable, because the market share statistics they are doing is more based on sell-out. We assume after our low Q2 and Q1 and Q3 to be stable, we will start to supply to the channel in a more healthy way and we are good to sustain at the current level.

**Kevin Chang:**

We would take the last question.

**12. Julie Hsiao UBS**

Thank you, my answer has been answered.

**Jim Wong:**

This is Jim Wong. I need to clarify one point: the last question asked about the market share in the Q2 by Gartner was not 14%. 14% was last year. The Gartner data was showing 11% in Q2. So what I said here is to try to sustain market share here and not further fall.

**Kevin Chang:**

Thanks for everyone to dial in. With this, we conclude our conference.