

China / Hong Kong

Flash Note

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DBS Group Research . Equity

8 Jun 2020

Xiaomi Corp (1810 HK) : BUY

Mkt. Cap: US\$29,459m | **3m Avg. Daily Val:** US\$245.5m

Last Traded Price (5 Jun 2020): HK\$13.02

Price Target 12-mth: HK\$16.00 (22.9% upside)

Analyst

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Company Guide



Summary of our point of view, and highlights the relevant data points, which are actively tracked

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Investor group call takeaways: Stronger position in 5G to drive Internet services growth

- **Smartphones: Stronger position in 5G vs 4G in China, with 14% 5G share in March, higher than its 11% overall share**
- **IOT: Continuous growth driven by product expansion**
- **Internet services: Higher ARPU from growing premium smartphone users, which will structurally drive online games and advertising**
- **Reiterate BUY with TP of HK\$16**

Forecasts and Valuation

FY Dec (RMB m)	2018A	2019A	2020F	2021F
Turnover	174,915	205,839	243,793	311,500
EBITDA	1,945	13,141	12,990	17,023
Pre-tax Profit	13,927	12,163	11,933	15,751
Net Profit	13,478	10,103	9,913	13,084
Net Pft (Pre Ex) (core profit)	8,555	11,532	11,453	15,052
Net Profit Gth (Pre-ex) (%)	(90.5)	948.7	(1.9)	32.0
EPS (RMB)	0.84	0.43	0.42	0.55
EPS (HK\$)	0.92	0.47	0.46	0.60
Core EPS (HK\$)	0.58	0.53	0.53	0.69
Core EPS (RMB)	0.53	0.49	0.48	0.63
EPS Gth (%)	N/A	(49.3)	(1.9)	32.0
Core EPS Gth (%)	(3.1)	(8.8)	(0.7)	31.4
Diluted EPS (HK\$)	0.63	0.45	0.44	0.58
DPS (HK\$)	0.00	0.00	0.00	0.00
BV Per Share (HK\$)	3.30	3.69	4.14	4.73
PE (X)	14.2	28.0	28.5	21.6
Core PE (X)	22.4	24.5	24.7	18.8
P/Cash Flow (X)	28.3	15.8	16.3	11.9
P/Free CF (X)	59.6	18.8	24.3	34.9
EV/EBITDA (X)	83.5	17.9	17.3	12.8
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	3.9	3.5	3.1	2.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	(48.2)	13.2	11.5	13.4

Earnings Rev (%): Nil Nil
Consensus EPS (RMB) 0.48 0.61
Other Broker Recs: B:34 S:0 H:9
Source: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

What's New

We hosted a post 1Q20 results group call for Xiaomi on 5 June 2020. Investors were mostly interested in the outlook for smartphones and Internet services as well as impact from COVID-19. Below are the key takeaways:

Smartphones (32% of 1Q20 gross profit). Investors were concerned that Xiaomi's smartphone market share in China declined from 13% in 1Q19 to 11% in 1Q20. Xiaomi attributed the decline to: (1) Huawei's redirection of its smartphone strategy back to China since 2019, given impact on overseas smartphone shipments from restrictions on Google Mobile Services (GMS); (2) more skew of investment in R&D or marketing towards 5G models instead of 4G since 2H19 given the 4G era is coming to an end. As such, Xiaomi stated that its 5G smartphone market share in China has reached 14% in March 2020, much higher than its overall market share of 11% in China, led by offering 5G smartphones at competitive prices, with its industry-leading operating efficiency.

As for overseas markets, Xiaomi expects Europe to be its next largest smartphone shipment contribution after India. It has gained traction from telecom operators with strategic partnerships since 2019, after establishing leading position in retail channels. Xiaomi is the 4th largest smartphone vendor in Western Europe, and smartphone shipments to that region increased 79% y-o-y in 1Q20, while those of Samsung (005930 KS), Apple (AAPL US) and Huawei, which are the top 3 smartphone vendors in Western Europe, declined 21%, 8%, and 40% y-o-y. Meanwhile, Xiaomi has broken into the underpenetrated high-end market, with the release of Mi 10/10 Pro at an ASP of Rmb3,999+ in February 2020, which helped ASP to increase 7% y-o-y in 1Q20.



Live more, Bank less

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IoT and lifestyle products (23% of 1Q20 gross profit).

Xiaomi is China's largest consumer IoT vendor with 252m connected IoT devices in 1Q20. Smart TV is the largest revenue contributor to the IoT and lifestyle product segment, with shipment ranked #1 in China at 3% y-o-y growth in 1Q20. Xiaomi expects the segment to continue growing driven by product expansion. Other products including wristbands (#1 in global market, +56% y-o-y), scooters (#1 in global market, +41% y-o-y), and TWS headphones (#3 in global market, +620% y-o-y) grew rapidly in 1Q20.

Xiaomi stated that net profit margin (NPM) of hardware (smartphone and IoT and lifestyle products) was less than 1% in FY19. Xiaomi reiterates that its strategy is to cap segmental NPM at 5.0%, as it offers hardware with better specs at lower prices to enable it to garner a large user base (331m monthly active users [MAUs] for its proprietary MIUI operating system [OS]) to cross-sell fast-growing high-margin Internet services.

Internet services (45% of 1Q20 gross profit). Investors are concerned that Xiaomi's mobile game revenue growth may moderate, after lockdown measures are lifted and time spent by users on mobile games normalises after COVID-19 hitting a peak in China in 1Q20. Xiaomi disclosed that its online game revenue increased 81% y-o-y in 1Q20, which outperformed mobile game market's 40%. Xiaomi attributed the outperformance to higher average revenue per user (ARPU), from its growing premium smartphone user base with higher spending power. This is a structural driver that will underpin long term growth even after time spent by users on mobile games normalises.

Online advertising revenue increased 17% y-o-y in 1Q20, despite customers cutting advertising budgets due to COVID-19 in 1Q20. This was mainly attributable to (i) diversifying monetisation methods from pre-installation ads to search ads (i.e. Mi App Store) and newsfeed ads (i.e. Mi Browser); (ii) expanding advertising customer verticals from Internet to SMB and Finance; (iii) improving algorithms; and (iv) increase in monetisation in overseas markets.

COVID-19 impact. Xiaomi stated that smartphone and IoT and lifestyle product revenues still grew 12% and 8% y-o-y in 1Q20, despite COVID-19 hitting a peak in China during the quarter. Overseas markets were heavily impacted by COVID-19 in April and May. However, these markets are recovering with smartphone activations in Europe and India achieving 90% and 60% of January 2020 pre-pandemic levels as of the third week of May.

Due to production suspension in India, Xiaomi redirected smartphones produced from other regions to meet India's demand. However, a 30% tariff will be imposed on those imported smartphones. Xiaomi is applying to obtain approval for production resumption from the Indian government and expects utilisation ramp-up to be similar to China, i.e. around a month to ramp up utilisation rate to pre-pandemic levels.

Reiterate BUY with TP of HK\$16. We expect net profit to decline 1% in FY20, given the slowdown in smartphone demand due to COVID-19, but to stage a strong 34% rebound in FY21F, driven by online ad monetisation revival and smartphone market share gains from Huawei. We reiterate our BUY rating on Xiaomi with TP of HK\$16 based on 25x FY21F PE (1SD above historical average).

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	16-Dec-19	HK\$10.40	HK\$14.40	Buy
2:	15-Apr-20	HK\$10.18	HK\$12.80	Buy
3:	8-May-20	HK\$10.36	HK\$13.30	Buy
4:	21-May-20	HK\$12.80	HK\$16.00	Buy

Source: DBS HK

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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Sources for all charts and tables are DBS HK unless otherwise specified.

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