

Xiaomi Corporation (1810 HK)

Slowing down in Internet revenue growth; recommend HOLD

- Xiaomi's (or "the Company") smartphone shipments are expected to decline in 2H20 as COVID-19 cases rebound in many countries.
- We expect the growth in Xiaomi's smartphone shipment to decrease by 8.0% YoY for 2020E
- Internet revenue growth has been slowing in recent quarters due to reduced smartphone shipment.
- R&D expenses / revenue is expected to rise to 4.6% YoY in 2020E
- Recommend HOLD with TP of HK\$20.00, which implies 29.9x/24.2x FY20E/21E PER

Smartphone shipments are expected to drop by 8.0% YoY for 2020E. According to IDC, Xiaomi 2Q20 smartphone shipments fell 11.8% YoY, which we attribute to COVID-19 spread and stiffened market competition. Going forward, escalating international trade tension and resurgence of COVID-19 in many countries will hamper Xiaomi's smartphone shipment in 2H20. Nonetheless, Xiaomi's smartphone ASP is expected to improve by 11.5% YoY in 2020E on increased mix of higher-end smartphone models.

R&D expenses will surge in 2020E. Xiaomi's R&D expenses are expected to rise because of the development need of 5G smartphone and new product innovations. We expect R&D expenses / revenue to be 4.6% for 2020E.

Declining smartphone shipments will affect internet growth. Since Xiaomi's internet platform users mostly come from its smartphone users, the drop in its smartphone shipments will affect its internet revenue growth. We forecast internet revenue to increase at a CAGR of 24.6% in 2019-22E, vs. the previous estimate at 25.9% CAGR.

Uncertain business environment may affect consumption sentiment; recommend HOLD. The global economy in 2020 is fraught with uncertainties - COVID-19 resurgence as well as escalating trade and geopolitical tension will undermine consumer confidence and reduce consumption. Xiaomi's smartphone shipments will inevitably be affected. Recommend **HOLD** with TP of HK\$20.0, which implies 29.9x/24.2x FY20E/21E PER.

Risk factors: 1) Impacts and aftermath of COVID-19; 2) Fierce market competition may affect profit margin; 3) High R&D expenses drag on net profit growth.

Results and Valuation

FY ended Dec 31	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	174,915	205,839	234,151	278,409	309,854
Chg (% YoY)	52.6	17.7	13.8	18.9	11.3
Shareholders' profit (RMB mn)	13,554	10,044	14,548	17,947	21,042
Chg (% YoY)	(130.9)	(25.9)	44.8	23.4	17.2
EPS (RMB)	0.843	0.423	0.603	0.744	0.872
Chg (% YoY)	(130.9)	(25.9)	44.8	23.4	17.2
BPS (RMB)	4.438	3.425	3.974	4.718	5.590
Chg (% YoY)	(134.0)	(22.8)	16.0	18.7	18.5
P/E (x)	20.9	42.2	29.9	24.3	20.7
P/B (x)	4.0	5.2	4.5	3.8	3.2
ROAE (%)	19.0	12.3	15.2	15.8	15.6
ROAA (%)	9.3	5.5	7.2	8.0	8.4

Source(s): Bloomberg, ABCI Securities estimates

*Exchange rate assumption for FY20E-22E: HKD 1 = RMB 0.900

Company Report
Sep 30, 2020
Rating: HOLD
TP: HK\$ 20.00

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Share price (HK\$)	20.05
Est. share price return	-0.2%
Est. dividend yield	0.0%
Est. total return	-0.2%
Previous Rating & TP	HOLD/HK\$8.8
Previous Report Date	Sept 17, 2019

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L(HK\$)	26.95/8.30
Issued shares (mn)	24,127.2
Class B (listed)	17,632.1
Class A (unlisted)	6,495.1
Class B Market cap (HK\$ mn)	353,523.6
Avg daily turnover (HK\$ mn)	2,501.0
<u>Major shareholder(s) of class B shares:</u>	
Lei Jun	17.5%
Lin Bin	8.9%
Lou Yiting	1.2%

Source(s): Company, ABCI Securities estimates

Share Performance (%)

	Absolute	Relative*
1-mth	13.1	20.1
3-mth	50.2	54.4
6-mth	105.2	107.4

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Smartphone shipments dropped in 2020E

According to IDC, Xiaomi shipped 28.3mn smartphones in 2Q20, down 11.8% YoY; smartphone ASP in 2Q20 grew 11.8% YoY on increased mid-to-high-end smartphone demand. Xiaomi's smartphone shipments in India dropped 49.7% YoY to 5.4mn in 2Q20 on severe COVID-19 spread. According to WHO data as of Sep 27, 2020, India had the world's second highest number of confirmed cases. In many countries, COVID-19 cases are resurging, which we believe will affect consumption and therefore, smartphone shipments.

Xiaomi's business will be affected by the decelerating smartphone shipments in 2020E. The alarming pandemic situation in India and its escalating conflicts with China at the border will hamper the Group's shipment to the country. We expect Xiaomi's overall smartphone shipments to drop by 8.0% YoY in 2020E; nonetheless, we raise its smartphone ASP growth estimates to 11.5%/ 8.0%/ 4.4% for 2020-22E as the global shift to higher-end models continues.

Exhibit 1: Xiaomi's smartphone shipment and ASP estimates with YoY growth

	2018	2019	2020E	2021E	2022E
Smartphone shipments (mn)	118.7	124.6	114.6	123.2	129.4
Growth YoY	29.8%	5.0%	(8.0%)	7.5%	5.0%
Smartphone ASP (RMB)	958.7	979.9	1,092.6	1,180.0	1,231.9
Growth YoY	8.8%	2.2%	11.5%	8.0%	4.4%

Source(s): Company, ABCI Securities estimates

More competition and COVID-19 pandemic may affect IoT & lifestyles business

Many home appliances companies and TV makers in China are offering more discounts and marketing campaigns to boost sales and reduce inventories in 2H20, which will pose challenges to Xiaomi's IoT & lifestyles business. The COVID-19 pandemic may further affect consumption and home appliances replacement needs. We forecast Xiaomi's IoT & lifestyles business revenue growth to slow down, with 30.0% growth in 2020E, compared to 41.7% in 2019.

Exhibit 2: Xiaomi's IoT & lifestyles business revenue and YoY growth:

RMB bn	2019	2020E	2021E	2022E
IoT & lifestyles business revenue	62.1	80.7	97.7	108.4
YoY Growth	41.7%	30.0%	21.0%	11.0%

Source(s): Company, ABCI Securities estimates

Slowing in smartphone shipments will affect internet user growth

Xiaomi's internet revenue has been slowing - 2Q20 growth was 29.0% YoY, lower than 38.6% in 1Q20, attributable to decline in smartphone shipments. Since most of Xiaomi's internet users are generated from its smartphone users, the drop in smartphone shipments will affect internet revenue growth on slower internet platform user growth. We forecast internet revenue to grow at a CAGR of 24.6% in 2019-22E.

Exhibit 3: Xiaomi's quarterly internet revenue and YoY growth:

RMB bn	3Q19	4Q19	1Q20	2Q20
Internet revenue	5.3	5.7	5.9	5.9
YoY Growth	12.3%	41.1%	38.6%	29.0%

Source(s): Company

We revise down 2020E-21E total revenue by 7.8%/7.0% due to adjustments of smartphone ASP, internet revenue and IoT & lifestyles business revenue forecasts. We also revise up 2020E-21E gross margin by 0.1ppt with more high end smartphone shipments and IoT & lifestyles business revenue.

Exhibit 4: Change in our financial estimates

(RMB mn)	OLD			NEW			CHANGE		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	253,859	299,264	N/A	234,151	278,409	309,854	(7.8%)	(7.0%)	N/A
Operating profit	13,982	16,764	N/A	17,917	21,962	25,570	28.1%	31.0%	N/A
Net Profit	11,970	14,269	N/A	14,548	17,947	21,042	21.5%	25.8%	N/A

Source(s): Company, ABCI Securities estimates

Recommend HOLD with TP at HK\$20.00

We apply the SOTP (sum of the total parts) method for valuation since the Group has both the hardware and internet segments. The method derives an EV of RMB 400.0bn to RMB 512.1bn with a fair equity value per share of HK\$ 16.6 to HK\$ 21.2. We recommend Xiaomi with the TP of HK\$ 20.0, which implies 29.9x/24.2x FY20E/21E P/E).

Exhibit 5: Xiaomi's SOTP valuation:

	FY20E net profit (RMB mn)	FY20E P/E multiple	EV (RMB bn)
Smartphone business	2,504.9	8.5x to 10.0x	21.3 to 25.0
IoT & lifestyle products business	4,035.7	13.0x to 20.0x	52.5 to 80.7
Internet services business	8,007.0	37.0x to 47.0x	296.3 to 376.3
Investments			30.0
Total			400.0 to 512.1

Source(s): the Group, ABCI Securities estimates



Exhibit 6: Peer Comparison Table

Ticker	Price*	Currency	P/E				P/B				ROE	ROA	EV/EBITDA	
			19A	20E	21E	22E	19A	20E	21E	22E	20E	20E	20E	
Handset companies														
Apple	AAPL US	112.28	USD	38.6	35.7	30.6	27.5	22.7	32.1	47.2	97.4	124.1	21.3	21.8
Samsung	5930 KS	57,900.00	WON	18.3	15.7	11.3	10.1	1.4	1.4	1.3	1.2	11.9	9.1	3.2
LG	3550 KS	92,900.00	WON	13.5	9.0	9.2	8.6	0.8	0.7	0.7	0.7	7.7	6.5	6.0
Lenovo	992 HK	5.00	HKD	12.8	11.6	10.1	8.9	2.3	2.4	1.8	1.6	20.7	2.5	3.4
Xiaomi	1810 HK	20.05	HKD	41.0	42.0	37.0	20.0	4.7	4.2	3.7	3.2	14.5	6.3	22.6
Simple Average				24.1	21.2	17.4	15.2	6.4	8.2	10.9	20.8	35.8	9.1	11.4
Internet companies														
Tencent	700 HK	503.5	HKD	45.3	35.7	28.7	23.6	10.0	7.8	6.2	4.9	22.5	11.6	20.1
Baidu	BIDU US	123.79	USD	145.3	17.1	14.4	11.7	1.8	1.7	1.5	1.3	9.8	5.6	9.0
Netease	NTES US	472.14	USD	20.1	26.4	22.8	19.6	7.1	5.1	4.3	3.7	19.6	12.8	17.8
Simple Average				65.5	27.7	23.9	19.6	7.0	5.3	4.4	3.6	17.0	9.9	17.7
IoT & lifestyle														
Skyworth Digital	751 HK	2.14	HKD	9.2	8.3	7.2	5.9	0.4	0.4	0.4	0.3	5.4	2.0	3.1
Tcl Electronics	1070 HK	5.40	HKD	5.8	12.8	10.6	8.5	1.2	1.1	1.0	0.9	10.0	3.5	13.0
Haier Electronics	1169 HK	26.50	HKD	9.9	19.7	16.7	15.0	2.5	2.4	2.1	1.9	13.7	9.2	10.4
Hisense Home	921 HK	9.37	HKD	7.3	10.8	8.0	7.0	1.5	1.4	1.3	1.2	15.3	4.1	n.a.
Simple Average				10.6	15.8	13.1	11.4	2.5	2.3	2.0	1.8	15.3	6.4	12.4

*Based on closing price on Sep 29, 2020

Source(s): Bloomberg



Financial Statements

Consolidated income statement (2018A-2022E)

FY Ended Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Smartphone revenue	113,800	122,095	125,246	145,410	159,399
IoT & lifestyle products revenue	43,817	62,088	80,714	97,664	108,408
Internet services revenue	15,956	19,842	25,794	32,243	38,369
Others	1,343	1,814	2,397	3,092	3,679
Total revenue	174,915	205,839	234,151	278,409	309,854
Gross profit	22,192	28,554	33,015	40,091	45,239
S&M expenses	(7,993)	(10,378)	(11,942)	(13,920)	(14,873)
Admin expenses	(12,099)	(3,104)	(3,512)	(4,176)	(4,338)
R&D expenses	(5,777)	(7,493)	(10,771)	(11,693)	(12,394)
Fair value changes on investments measured at fair value through profit or loss	4,430	3,813	5,854	6,403	6,600
Share of losses of investments accounted for using the equity method	(615)	(672)	2,200	2,310	2,426
Others	1,058	1,040	3,073	2,947	2,911
Operating Profits	1,196	11,760	17,917	21,962	25,570
Net finance costs	216	402	(580)	(573)	(493)
Fair value changes of convertible Redeemable preferred shares	12,514	0	0	0	0
Profit before tax	13,927	12,163	17,337	21,389	25,077
Tax	(449)	(2,060)	(2,705)	(3,337)	(3,912)
Profit after tax	13,478	10,103	14,633	18,052	21,165
Minority interests	(76)	59	85	105	123
Shareholders' net profit	13,554	10,044	14,548	17,947	21,042
EPS (RMB)	0.843	0.423	0.603	0.744	0.872
Non-IFRS adjusted net profit*	8,555	11,532	11,358	14,208	17,106

Source(s): the Group, ABCI Securities estimates

*The non-IFRS adjusted net profit exclude items of fair value changes of convertible redeemable preferred shares, share-based compensation, net fair value gains on investments, amortization of intangible assets resulting from acquisitions, changes of value of financial liabilities to fund investors



Consolidated balance sheet (2018A-2022E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
PPE	5,068	6,992	7,888	8,756	9,644
Long-term investments measured at fair value through profit or loss	18,636	20,679	16,003	10,458	4,130
Other non-current assets	15,511	18,418	19,230	20,321	21,676
Total non-current assets	39,215	46,090	43,120	39,534	35,449
Cash & cash equivalents	30,230	25,920	44,617	67,333	93,645
Inventories	29,481	32,585	34,215	35,925	37,722
Trade & loan receivables	15,892	19,672	20,389	21,133	21,905
Restricted cash	1,480	1,538	1,574	1,610	1,647
Others	28,929	57,823	58,170	58,582	59,059
Total current assets	106,013	137,539	158,965	184,583	213,978
Total assets	145,228	183,629	202,085	224,117	249,427
Trade payables	46,287	59,528	61,909	64,385	66,961
Borrowings	3,075	12,837	13,350	13,884	14,439
Others	12,578	19,816	20,618	21,453	22,324
Total current liabilities	61,940	92,181	95,877	99,722	103,724
Borrowings	7,856	4,787	4,978	5,177	5,385
Others	4,182	5,004	4,966	4,934	4,909
Total non-current liabilities	12,038	9,791	9,944	10,112	10,293
Total liabilities	73,978	101,972	105,821	109,834	114,018
Equity attributable to shareholders	71,323	81,331	95,878	113,825	134,867
Non-controlling interests	(73)	327	386	458	542
Total equity	71,250	81,658	96,264	114,283	135,410

Source(s): the Group, ABCI Securities estimates



Consolidated Cash Flow Statement (2018A-2022E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Operating profit before change in working capital	23,842	7,386	30,311	34,100	37,513
Change in working capital	(23,699)	18,019	(8,110)	(8,211)	(8,315)
Tax	(1,558)	(1,594)	(1,631)	(1,668)	(1,706)
Operating cash flow	(1,415)	23,810	20,570	24,220	27,492
CAPEX	(1,096)	(986)	(1,031)	(1,051)	(1,072)
Others	(6,412)	(30,584)	(1,702)	(1,250)	(896)
Investing cash flow	(7,508)	(31,570)	(2,733)	(2,302)	(1,969)
Change in borrowings	129	6,692	705	733	762
Change in restricted cash	1,231	(58)	(35)	(36)	(37)
Others	25,214	(3,513)	(825)	(915)	(952)
Financing cash flow	26,574	3,121	(155)	(218)	(226)
Net increase in cash & cash equivalents	17,652	(4,639)	17,682	21,700	25,297
Cash & cash equivalents at beginning of year	11,563	30,230	25,920	44,617	67,333
Effect of changes in foreign exchange rate	1,015	328	1,015	1,015	1,015
Cash & cash equivalents at end of year	30,230	25,920	44,617	67,333	93,645

Source(s): the Group, ABCI Securities estimates

Financial ratios (2018A-2022E)

As of Dec 31	2018A	2019A	2020E	2021E	2022E
Gross margin (%)	12.7%	13.9%	14.1%	14.4%	14.6%
Operating margin (%)	0.7%	5.7%	7.7%	7.9%	8.3%
Net profit margin (%)	7.7%	4.9%	6.2%	6.4%	6.8%
ROAA (%)	9.3%	5.5%	7.2%	8.0%	8.4%
ROAE (%)	19.0%	12.3%	15.2%	15.8%	15.6%
YoY Growth:					
Revenue	52.6%	17.7%	13.8%	18.9%	11.3%
Operating profit	(90.2%)	882.9%	52.4%	22.6%	16.4%
Net profit	(130.9%)	(25.9%)	44.8%	23.4%	17.2%

Source(s): Company, ABCI Securities estimates

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Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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