

Xiaomi | 1810 HK

Flying higher

Internet services monetization in the fast lane
Smartphones moving to the high-end
Upgrade to Outperform

Internet services monetization in the fast lane. Xiaomi's internet services are still in their early stage of monetization. Average revenue per MIUI user in 3Q18 (ARPU) was RMB21.1, a 29.4% YoY increase but still far below the level of other global internet giants. We look for internet services revenue at Xiaomi to grow 70%/27% in FY18F/19F, underpinned by continuous optimization of the recommendation algorithm, increasing user engagement and higher pre-installation.

Smartphones moving to the high-end. One of Xiaomi's smartphone strategies has been to strengthen its presence in the mid- to high-end market. By promoting high-end models like the Mi 8, Xiaomi's smartphone ASP increased 13% YoY to RMB1.1k in 3Q18. On top of 37%/12% YoY shipment growth in FY18F/19F, we expect ASP to expand 11%/10% YoY in FY18F/ FY19F on the back of product portfolio optimization in mainland China and rapid expansion in Western Europe.

Upgrade to Outperform and raise target price to HK\$19.00. We slightly raise our FY18-20F non-GAAP earnings forecasts 1-4% to reflect our higher sales and margin assumptions. We raise our target price from HK\$15.50 to HK\$19.00, with our new target based on 30x 2019F non-GAAP earnings, up from 25x to reflect strong earnings momentum and better investment sentiment. We like Xiaomi for its leading position in IoT and in the smartphone industry and the considerable monetization potential of internet services.

Forecast and valuation

Year to 31 Dec	2016	2017	2018F	2019F	2020F
Revenue (RMB m)	68,434	114,625	180,479	225,706	264,318
YoY (%)	2.4	67.5	57.5	25.1	17.1
Non-GAAP profit (RMB m)	1,957	5,425	8,859	13,616	18,595
YoY (%)	N/A	177.2	63.3	53.7	36.6
Non-GAAP EPS (RMB)	0.20	0.56	0.39	0.55	0.76
YoY (%)	N/A	175.5	-29.3	40.9	36.6
Non-GAAP P/E (x)	62.3	22.3	30.8	22.5	16.5
P/B (x)	N/A	N/A	4.0	3.4	2.8
ROAE (%)	-0.6	39.9	-40.9	15.4	17.9
Net debt/equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Bloomberg, CCBIS estimates

Outperform (upgrade from Neutral)

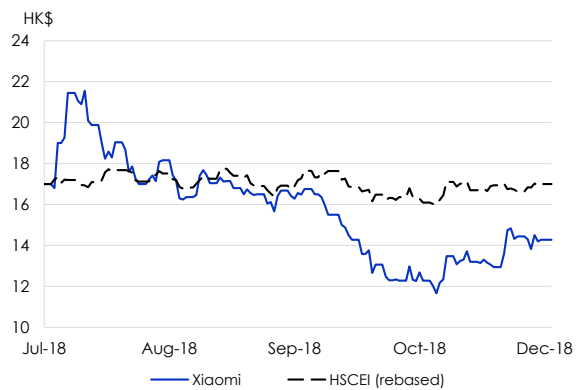
Current price: **HK\$ 14.28** (as at 2 Dec 2018) **►** Target: **HK\$ 19.00** (up from HK\$15.50)

Trading data

52-week range	HK\$11.40-22.20
Market capital (m)	HK\$321,511/US\$41,547
Shares outstanding (m)	22,578
Free float (%)	15
3M average daily T/O (m share)	32
3M average daily T/O (US\$ m)	472
Expected 12-month return (%)	33

Source: Bloomberg, CCBIS estimates

Share price vs HSCEI



Source: Bloomberg, CCBIS

Stock performance

Performance over	1M	3M
Absolute	6	-13
Relative (%) to HSCEI	7	-12

Source: Bloomberg, CCBIS

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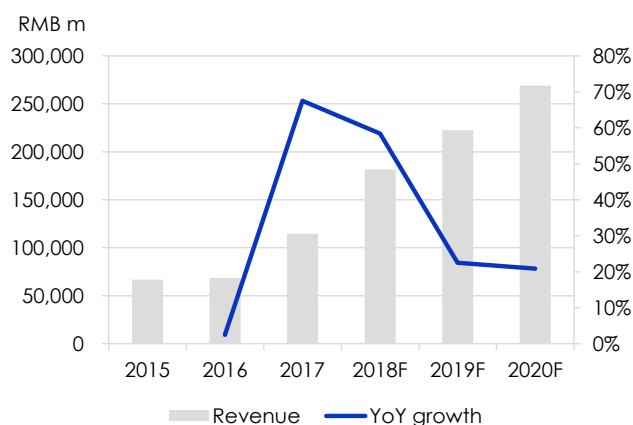
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Xiaomi earnings revisions

P&L (RMB m)	New forecast			Previous forecast			% change		
	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F
Revenue	180,479	225,706	264,318	181,568	223,167	269,665	-0.6	1.1	-2.0
Gross profit	22,889	31,147	38,211	22,878	30,574	37,753	0.1	1.9	1.2
Opex	-25,698	-18,282	-19,824	-25,793	-18,077	-20,225	-0.4	1.1	-2.0
Operating profit	-195	13,415	19,037	-302	13,047	18,178	N/M	2.8	4.7
Non-GAAP profit	8,859	13,616	18,595	8,753	13,304	17,865	1.2	2.4	4.1
Non-GAAP EPS (RMB)	0.39	0.55	0.76	0.39	0.54	0.73	1.2	2.4	4.1
%									
Gross margin	12.7	13.8	14.5	12.6	13.7	14.0	-	-	-
Opex-to-sales	-14.2	-8.1	-7.5	-14.2	-8.1	-7.5	-	-	-
Operation profit margin	-0.1	5.9	7.2	-0.2	5.8	6.7	-	-	-
Net margin	4.9	6.0	7.0	4.8	6.0	6.6	-	-	-

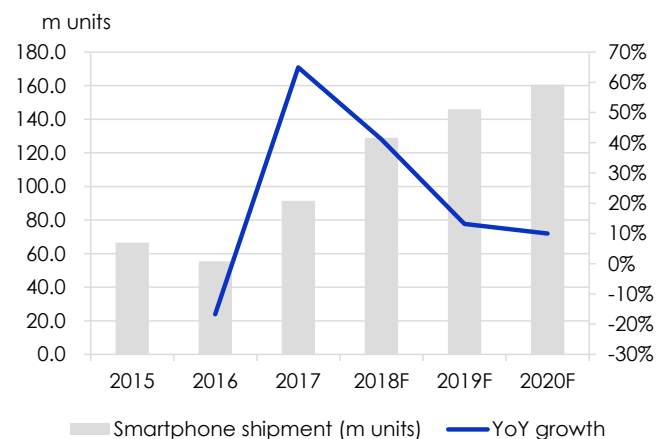
Source: CCBIS estimates

Xiaomi – revenue forecasts



Source: Company, CCBIS estimates

Xiaomi – smartphone shipment forecasts



Source: Company, CCBIS estimates

China technology sector valuation matrix

Company	Stock code	CCBIS rating	Share price* (LC)	Market cap (US\$ m)	EPS growth (%)			P/E (x)		
					CY18F	CY19F	CY20F	CY18F	CY19F	CY20F
Handset brands										
Xiaomi	1810 HK	Outperform	14.28	41,547	N/M	40.9	36.6	30.8	22.5	16.5
ZTE	763 HK	Neutral	15.38	11,389	N/M	N/M	32.9	N/M	12.1	9.1
Lenovo	992 HK	Outperform	5.65	8,748	N/M	42.9	8.6	17.2	12.1	11.1
HTC	2498 TT	Not Rated	46.60	1,240	N/A	N/A	N/A	N/M	N/M	N/M
Average								24.0	15.6	12.2
Handset components										
Largan Precision	3008 TT	Not Rated	3,505.00	15,283	-1.3	19.4	17.5	18.3	15.4	13.1
Mediatek	2454 TT	Not Rated	245.50	12,700	-12.8	11.2	22.8	18.1	16.3	13.3
Sunny Optical	2382 HK	Outperform	75.70	10,700	3.3	36.6	24.7	23.5	17.7	14.2
Luxshare Precision	002475 CH	Not Rated	15.09	8,920	52.8	37.2	27.4	24.2	17.6	13.9
AAC	2018 HK	Neutral	55.45	8,703	-16.7	15.1	14.3	13.0	11.7	10.2
Catcher	2474 TT	Not Rated	275.50	6,899	40.6	-6.6	14.3	6.9	7.4	6.5
O-film Technology	002456 CH	Not Rated	11.48	4,474	91.6	40.4	28.9	15.8	11.2	8.7
Lens Technology	300433 CH	Not Rated	7.90	4,477	15.4	23.2	20.3	13.2	10.7	8.9
Sunway	300136 CH	Not Rated	25.00	3,504	43.9	37.7	25.2	19.1	13.9	11.1
GoerTek	002241 CH	Not Rated	7.19	3,352	-28.4	17.9	16.7	14.8	12.5	10.7
Foxconn Technology	2354 TT	Not Rated	62.70	2,883	-5.4	4.4	3.4	9.4	9.0	8.7
FIT Hon Teng	6088 HK	Outperform	3.35	2,911	17.5	26.8	14.2	13.1	10.3	9.0
Lite-On Technology	2301 TT	Not Rated	41.15	3,129	186.0	11.1	4.2	12.7	11.5	11.0
BYD Electronics	285 HK	Outperform	10.98	3,188	-7.0	9.8	9.3	8.9	8.2	7.5
Everwin Precision	300115 CH	Not Rated	8.28	1,082	-46.0	57.1	31.6	24.4	15.5	11.8
Merry Electronics	2439 TT	Not Rated	133.50	867	-46.2	23.1	11.8	13.1	10.6	9.5
FIH	2038 HK	Not Rated	0.94	995	N/A	N/A	N/A	N/M	N/M	N/M
Tongda Group	698 HK	Outperform	0.88	714	1.3	19.6	10.6	5.4	4.5	4.1
Casetek	5264 TT	Not Rated	43.95	601	N/A	N/A	115.2	N/M	18.4	8.5
TPK	3673 TT	Not Rated	54.10	715	-77.1	57.3	43.5	35.7	22.7	15.8
Q Technology	1478 HK	Neutral	4.55	664	-57.4	83.1	25.4	23.3	12.9	10.3
Truly	732 HK	Not Rated	1.18	500	N/M	66.4	8.0	8.3	5.0	4.6
Average								16.1	12.5	10.1
Average (excl. A shares)								15.0	12.1	9.8

* Price as at 2 Dec 2018

Source: Bloomberg, CCBIS estimates

Xiaomi – income statement

FYE 31 Dec (RMB m)	2016	2017	2018F	2019F	2020F	1Q18	2Q18	3Q18	4Q18F
Revenue	68,434	114,625	180,479	225,706	264,318	34,412	45,236	50,846	49,985
Smartphones	48,764	80,564	122,500	150,500	170,500	23,239	30,501	34,982	33,777
IoT and lifestyle products	12,415	23,448	39,814	52,292	66,419	7,697	10,379	10,805	10,934
Internet services	6,538	9,896	16,803	21,280	25,600	3,231	3,958	4,729	4,884
Other	717	717	1,362	1,635	1,798	245	397	330	390
Cost of revenue	(61,185)	(99,471)	(157,590)	(194,559)	(226,106)	(30,111)	(39,584)	(44,269)	(43,626)
Gross profit	7,249	15,154	22,889	31,147	38,211	4,301	5,652	6,578	6,358
Gross profit margin (%)	10.6	13.2	12.7	13.8	14.5	12.5	12.5	12.9	12.7
Selling and distribution expenses	(3,022)	(5,232)	(8,158)	(9,705)	(10,837)	(1,403)	(2,076)	(2,187)	(2,492)
Administrative expenses	(927)	(1,216)	(12,126)	(2,370)	(2,379)	(465)	(10,457)	(583)	(620)
R&D expenses	(2,104)	(3,151)	(5,414)	(6,207)	(6,608)	(1,104)	(1,364)	(1,534)	(1,413)
Opex	(6,053)	(9,599)	(25,698)	(18,282)	(19,824)	(2,972)	(13,896)	(4,305)	(4,525)
Opex to sales ratio (%)	(8.8)	(8.4)	(14.2)	(8.1)	(7.5)	(8.6)	(30.7)	(8.5)	(9.1)
Fair value changes on investments measured at fair value through profit or loss	2,727	6,371	2,355	0	0	1,763	527	65	(0)
Share of losses of investments accounted for using the equity method	(150)	(231)	(484)	(250)	(150)	16	(129)	(184)	(187)
Other income and gains	12	521	742	800	800	256	254	57	176
Operating profit	3,785	12,215	(195)	13,415	19,037	3,365	(7,592)	2,211	1,821
Operating margin (%)	5.5	10.7	(0.1)	5.9	7.2	9.8	(16.8)	4.3	3.6
Adjusted operating margin	1.7	4.8	3.9	5.7	7.0	3.9	3.7	4.5	3.7
Net finance cost	(86)	27	150	150	150	18	(32)	100	64
Fair value changes of convertible redeemable preferred shares	(2,523)	(54,072)	12,514	0	0	(10,071)	22,533	53	0
Profit before tax	1,176	(41,829)	12,469	13,565	19,187	(6,689)	14,908	2,364	1,886
Tax expense	-684	-2,060	-550	-2,035	-2,878	-338	-276	117	-53
Minority interests	62	63	80	80	80	22	19	18	21
Profit to shareholders	553	(43,826)	11,999	11,610	16,389	(7,005)	14,651	2,499	1,854
Net profit margin (%)	0.8	(38.2)	6.6	5.1	6.2	(20.4)	32.4	4.9	3.7
Non-GAAP net profit	1,957	5,425	8,859	13,616	18,595	1,722	2,135	2,904	2,099
Non-GAAP net margin	2.9	4.7	4.9	6.0	7.0	5.0	4.7	5.7	4.2
Diluted non-GAAP EPS (RMB)	0.20	0.56	0.39	0.55	0.76	0.08	0.10	0.12	0.09
Diluted non-GAAP EPS (HK\$)	0.23	0.65	0.46	0.63	0.87	0.10	0.12	0.14	0.10
Revenue growth	2.4	67.5	57.5	25.1	17.1	85.7	68.3	49.1	42.3
Non-GAAP EPS growth (%)	N/M	175.5	-29.3	40.9	36.6	21.5	(41.3)	(52.8)	42.8
Gross profit margin (%)	10.6	13.2	12.7	13.8	14.5	12.5	12.5	12.9	12.7
Operating profit margin (%)	5.5	10.7	-0.1	5.9	7.2	3.9	3.7	4.5	3.7
Net profit margin (%)	0.8	(38.2)	6.6	5.1	6.2	5.0	4.7	5.7	4.2
Return on equity (%)	(0.6)	34.5	17.5	14.1	16.3	-	-	-	-
Net gearing (%)									
	Net cash	Net cash	Net cash	Net cash	Net cash				

Source: Bloomberg, CCBIS estimates

Xiaomi | 1810 HK – financial summary

Profit and loss

FYE 31 Dec (RMB m)	2016	2017	2018F	2019F	2020F
Revenue	68,434	114,625	180,479	225,706	264,318
COGS	(61,185)	(99,471)	(157,590)	(194,559)	(226,106)
Gross profit	7,249	15,154	22,889	31,147	38,211
Other income	–	–	–	–	–
Operating expenses	(6,053)	(9,599)	(25,698)	(18,282)	(19,824)
EBIT	1,196	5,555	(2,809)	12,865	18,387
Net financial inc(exp)	(86)	27	150	150	150
JV & associate	(150)	(231)	(484)	(250)	(150)
Other	216	(47,180)	15,612	800	800
Forex	–	–	–	–	–
Profit before tax	1,176	(41,829)	12,469	13,565	19,187
Tax	(684)	(2,060)	(550)	(2,035)	(2,878)
Total profit	492	(43,889)	11,919	11,530	16,309
Minority interest	62	63	80	80	80
Net profit attrib to shareholder	553	(43,826)	11,999	11,610	16,389
Non-GAAP net profit	1,957	5,425	8,859	13,616	18,595
Reported EPS (RMB)	0.06	(4.49)	0.53	0.47	0.67
Diluted EPS (RMB)	0.06	(4.49)	0.53	0.47	0.67
Non-GAAP EPS (RMB)	0.20	0.56	0.39	0.55	0.76

Cash flow

FYE 31 Dec (RMB m)	2016	2017	2018F	2019F	2020F
Profit before tax	1,176	(41,829)	12,469	13,565	19,187
Amort. & depr.	240	361	659	859	1,059
Net financial charge adj.	86	(27)	(150)	(150)	(150)
Non-cash items adj.	1,478	49,306	(1,073)	2,000	2,200
Change in working capital	1,735	(7,283)	(1,074)	(1,570)	(2,069)
Tax paid	(183)	(1,523)	(550)	(2,035)	(2,878)
Other	0	(0)	(0)	(0)	(0)
Operating cash flow	4,531	(996)	10,281	12,670	17,350
Disposal of fixed assets	50	2	–	–	–
Capex	(1,862)	(1,218)	(2,000)	(2,000)	(2,000)
Investment	(2,134)	(1,869)	–	–	–
Net interest rec.(paid)	107	266	150	150	150
Other	104	142	484	250	150
Investment cash flow	(3,735)	(2,678)	(1,366)	(1,600)	(1,700)
Change in borrowings	1,602	13,287	(6,102)	–	–
Equity issues	–	68	23,525	–	–
Other	(1,674)	(7,140)	3,081	50	50
Financing cash flow	(72)	6,215	20,504	50	50
Change in cash flow	724	2,542	29,420	11,120	15,700
Cash & equivalents, begin	8,394	9,230	11,563	40,983	52,103
Forex	112	(209)	–	–	–
Cash & equivalents, ending	9,230	11,563	40,983	52,103	67,802
Free cash flow	2,669	(2,213)	8,281	10,670	15,350

Source: Company, CCBIS estimates

Balance sheet

FYE 31 Dec (RMB m)	2016	2017	2018F	2019F	2020F
Cash & equivalents	9,230	11,563	40,983	52,103	67,802
Pledge dep., restricted cash	634	2,711	2,711	2,711	2,711
Receivables	8,436	25,008	36,611	46,238	55,210
Inventory	8,378	16,343	25,905	31,982	37,168
Other current assets	3,958	5,513	5,513	5,513	5,513
Total current assets	30,636	61,138	111,724	138,548	168,405
Property, plant & equip.	848	1,731	2,959	4,038	4,967
Intangible assets	1,120	2,274	2,464	2,605	2,695
JV & associate	–	–	–	–	–
Other non-current assets	18,161	24,726	24,164	23,836	23,608
Total non-current assets	20,129	28,731	29,588	30,479	31,269
Total assets	50,766	89,870	141,312	169,026	199,674
Short-term borrowings	3,769	3,551	500	500	500
Trade & bill payable	21,290	41,618	61,709	75,843	87,932
Other current liabilities	1,005	1,964	1,964	1,964	1,964
Total current liabilities	26,063	47,133	64,173	78,307	90,396
Long-term borrowings	390	7,251	7,251	7,251	7,251
Other non-current liabilities	116,370	162,696	1,245	1,245	1,245
Total non-current liabilities	116,760	169,948	8,497	8,497	8,497
Total liabilities	142,823	217,080	72,670	86,804	98,892
Reserves and retained profits	(92,192)	(127,273)	68,630	82,241	100,830
Shareholders' equity	(92,192)	(127,272)	68,630	82,241	100,830
Minority interest	134	62	12	(18)	(48)
Total equity	(92,058)	(127,211)	68,642	82,222	100,782
Total equity and liabilities	50,766	89,870	141,312	169,026	199,674

Ratios

FYE 31 Dec	2016	2017	2018F	2019F	2020F
Growth (%)					
Revenue	2.4	67.5	57.5	25.1	17.1
EBITDA	N/A	312.0	N/A	N/A	41.7
EBIT	N/A	364.5	N/A	N/A	42.9
Net profit	N/A	N/A	N/A	(3.2)	41.2
Non-GAAP net profit	N/A	177.2	63.3	53.7	36.6
Profitability (%)					
Gross margin	10.6	13.2	12.7	13.8	14.5
EBITDA margin	2.1	5.2	(1.2)	6.1	7.4
EBIT margin	1.7	4.8	(1.6)	5.7	7.0
Net margin	0.8	(38.2)	6.6	5.1	6.2
Non-GAAP net margin	2.9	4.7	4.9	6.0	7.0
Tax rate	58.2	(4.9)	4.4	15.0	15.0
Efficiency (days)					
Inventory turnover days	51	45	49	54	56
Trade receivables days	9	12	14	15	16
Trade payable days	95	95	99	109	112
Returns & leverage (%)					
ROAA	1.2	(62.3)	10.4	7.5	8.9
ROAE	(0.6)	39.9	(40.9)	15.4	17.9
Net debt (cash)/equity	Net cash	Net cash	Net cash	Net cash	Net cash
Liquidity (x)					
Current ratio	1.2	1.3	1.7	1.8	1.9
Quick ratio	0.9	1.0	1.3	1.4	1.5

Rating definitions:**Outperform (O) – expected return > 10% over the next twelve months****Neutral (N) – expected return between -10% and 10% over the next twelve months****Underperform (U) – expected return < -10% over the next twelve months****Analyst certification:**

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