

# Xiaomi Corporation

## 3Q18: Upbeat results supported by strong growth momentum

### Reiterate Buy rating; upbeat revenue growth and profitability despite challenging market condition

Xiaomi reported a stronger-than-expected set of results. 3Q18 revenue was Rmb 50.8bn, vs consensus of 50.4bn, +49% yoy and +12% qoq. Non-IFRS net profit was Rmb 2.9bn vs consensus of Rmb 2.0bn, +17% yoy with non-IFRS net margin expanding to 5.7% from 4.8% in 1H18. Xiaomi's global smartphone market share further expanded to 9.7% from 9.4% in 2Q18, according to IDC. Revenue across all business lines were strong with Smartphone revenue +36% yoy, IoT revenue +90% yoy and Internet service +85% yoy. Overall gross margin expanded to 12.9% from 12.5% in 2Q18 despite unfavorable FX movement, as contribution from high-margin advertising business increases. Revenue contribution outside of China increased further to 44% from 36% in 1H18.

### Smartphone: Successful product optimization leads to higher ASP; overseas sales maintained strong growth momentum

In 3Q18, Xiaomi smartphone shipment reached 33.3m (+20% yoy) and YTD (till Oct 26) crossed the 100m hurdle. Xiaomi smartphone maintained its No.1 position in India and is fast growing in Europe. This was achieved in a backdrop of global smartphone shipment decline by 6% yoy in 3Q18, according to IDC. Overall smartphone ASP reached Rmb 1,052 +13% yoy and +10% qoq as Mi 8 series and Mix series received strong market response. The ASP expansion was driven by the ASP increase in mainland China (+16% yoy, +4% qoq) and the increasing contribution from Western European market. IoT and lifestyle product revenue grew by 90% yoy, driven by strong sales of smart TV (+198.5% yoy). By Sep-18, there were 1.98 million users that own more than 5 IoT products from Xiaomi, +16% yoy.

### Internet service's share in revenue was boosted to 9.3% from 8.8% in 2Q18; FinTech potential to be explored

As of Sep-2018, Xiaomi had approximately 224 million MAUs on its MIUI. As Xiaomi gradually moves to middle/high-end segment, its monetization potential can be further explored. Within internet service, revenue from FinTech and Youpin outgrew gaming revenue. Overseas market contributed for 4.4% of internet service revenue, showing further monetization potential. Xiaomi's data accumulation enables it to develop credit assessment and risk management model and provide innovative internet finance product including consumer finance and supply chain finance. Loans provided to its internet finance subsidiaries reached Rmb 8.2bn. We expect this to continue to grow at a relatively fast rate in the next 3 years.

### Operating efficiency remain at high level; offline distribution was further strengthened through fast expansion of authorized stores

Operating expense as % of revenue was maintained a very low level of 8.5%. Mi Home reached 499 while authorized stores targeting lower tier cities expanded to 1,100 from 360 in 2Q18. This would further increase hardware sales from offline channels.

### Price target: HK\$22.0 (49% upside)

We derive our Dec-19 price target of HK\$22.0 per share using a discounted cash flow model, assuming 13.4% cost of equity, 3% long-term growth rate.

Stock code: 1810.HK

Rating: Buy

Price target (HK\$)	22.0
Current price (HK\$, 20 Nov 2018)	14.7
Upside/downside %	49%
Market cap (HK\$ m)	332,794
Market cap (US\$ m)	42,490
Avg daily turnover (HK\$ m)	1,100

Source: Bloomberg, AMTD Research

### Key forecasts

(Rmb m)	2017	2018e	2019e
Non-IFRS net profit	5,362	8,311	11,351
yoy %	183%	55%	37%
Revenue	114,625	180,605	231,291
yoy %	67%	58%	28%
Smartphone shipment (m)	91	130	155
yoy %	65%	42%	20%
Gross margin	13.2%	12.4%	13.4%
Non-IFRS net margin	4.7%	4.6%	4.9%
EPS	5.49	0.37	0.51

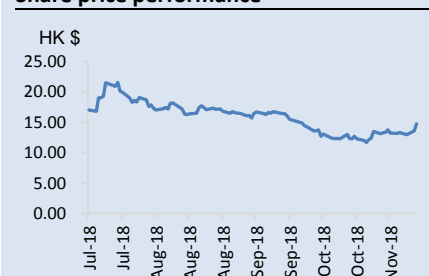
Source: Company data, AMTD Research

### Valuation

	2017	2018e	2019e
P/E (adjusted)	55.2	35.6	26.1
P/S	2.6	1.6	1.3
ROE	na	na	18.2%
ROA	na	7.7%	8.2%

Source: Bloomberg, AMTD Research

### Share price performance



Source: Bloomberg

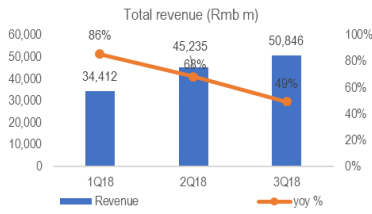
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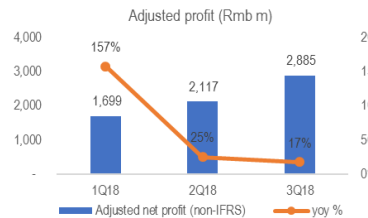
## Focus charts

**Figure 1: Xiaomi revenue growth maintained a strong momentum in 3Q18**



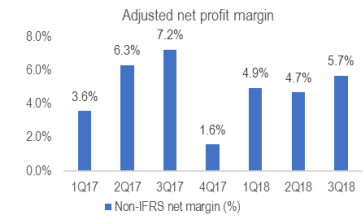
Source: Company data

**Figure 2: Xiaomi non-IFRS net profit beat market expectation**



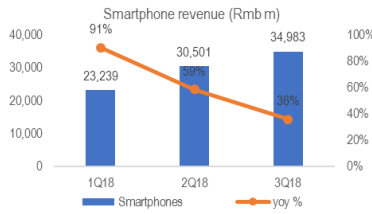
Source: Company data

**Figure 3: Xiaomi non-IFRS net margin expanded strongly**



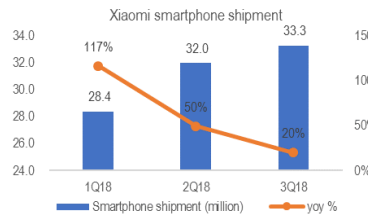
Source: Company data

**Figure 4: Smartphone revenue continued fast growth despite challenging environment**



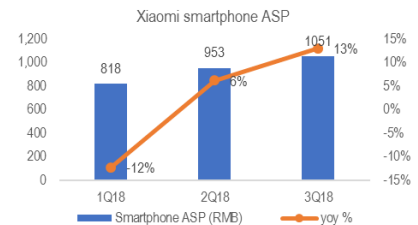
Source: Company data

**Figure 5: Xiaomi smartphone shipment forecast**



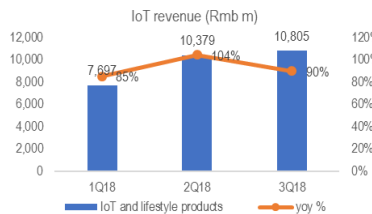
Source: Company data

**Figure 6: Xiaomi smartphone ASP grew by 13% yoy**



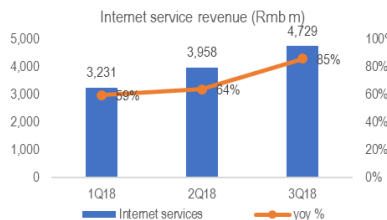
Source: Company data

**Figure 7: IoT and life style revenue is fast growing**



Source: Company data

**Figure 8: Internet service revenue supported by strong ad business, FinTech and Youpin**



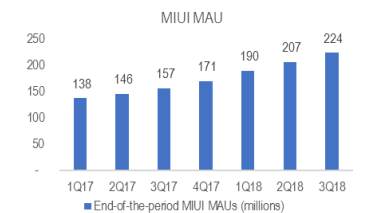
Source: Company data

**Figure 9: Overall hardware gross margin held up well despite unfavorable FX movement**



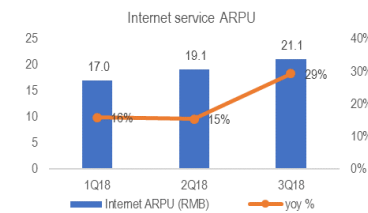
Source: Company data

**Figure 10: MIUI MAU continued to expand, paving the way for further monetization**



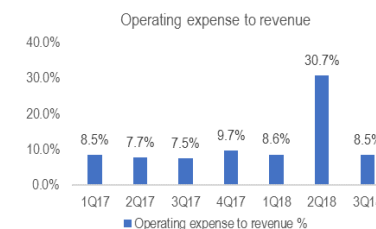
Source: Company data

**Figure 11: Xiaomi internet service ARPU forecast**



Source: Company data

**Figure 12: Operating efficiency was maintained at high level**



Source: Company data

Figure 13: Xiaomi's quarterly P&amp;L

Rmb m	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18
<b>Profit &amp; loss</b>							
<b>Revenue</b>	<b>18,532</b>	<b>26,879</b>	<b>34,100</b>	<b>35,114</b>	<b>34,412</b>	<b>45,235</b>	<b>50,846</b>
Smartphones	12,194	19,219	25,711	23,440	23,239	30,501	34,983
IoT and lifestyle products	4,161	5,081	5,692	8,514	7,697	10,379	10,805
Internet services	2,030	2,420	2,550	2,898	3,231	3,958	4,729
Advertising	1,008	1,474	1,525	1,607	1,874	2,500	3,200
IVAS	1,021	946	1,024	1,291	1,357	1,458	1,529
Others	148	160	147	262	245	397	330
<b>Cost of sales</b>	<b>(16,068)</b>	<b>(23,031)</b>	<b>(28,898)</b>	<b>(31,474)</b>	<b>(30,111)</b>	<b>(39,584)</b>	<b>(44,269)</b>
<b>Gross profit</b>	<b>2,464</b>	<b>3,848</b>	<b>5,202</b>	<b>3,640</b>	<b>4,301</b>	<b>5,652</b>	<b>6,578</b>
<b>Gross margin</b>	<b>13.3%</b>	<b>14.3%</b>	<b>15.3%</b>	<b>10.4%</b>	<b>12.5%</b>	<b>12.5%</b>	<b>12.9%</b>
<b>Operating expenses</b>	<b>(1,572)</b>	<b>(2,080)</b>	<b>(2,548)</b>	<b>(3,399)</b>	<b>(2,972)</b>	<b>(13,896)</b>	<b>(4,305)</b>
Selling and marketing expenses	(727)	(1,144)	(1,447)	(1,914)	(1,403)	(2,076)	(2,187)
Administrative expenses	(240)	(229)	(297)	(450)	(465)	(10,457)	(583)
R&D expenses	(605)	(707)	(805)	(1,035)	(1,104)	(1,364)	(1,534)
<b>EBIT</b>	<b>892</b>	<b>1,768</b>	<b>2,654</b>	<b>241</b>	<b>1,330</b>	<b>(8,244)</b>	<b>2,273</b>
Fair value changes on investments	1,180	1,738		3,453	1,763	527	65
Share of losses of investments	(66)	(85)	(67)	(14)	16	(129)	(184)
Other income	24	173	106	146	158	207	259
Other (losses)/gains, net	(75)	65	222	(140)	98	47	(202)
<b>PBT</b>	<b>(7,522)</b>	<b>(11,340)</b>	<b>(10,264)</b>	<b>(12,703)</b>	<b>(6,689)</b>	<b>14,908</b>	<b>2,364</b>
Income tax expenses	(345)	(626)	(729)	(360)	(338)	(276)	117
<b>(Loss)/profit for the year</b>	<b>(7,867)</b>	<b>(11,967)</b>	<b>(10,993)</b>	<b>(13,063)</b>	<b>(7,027)</b>	<b>14,633</b>	<b>2,481</b>
Minority interest	(21)	(6)	(3)	(33)	(22)	(19)	(18)
<b>Attributable profit</b>	<b>(7,846)</b>	<b>(11,961)</b>	<b>(10,990)</b>	<b>(13,030)</b>	<b>(7,005)</b>	<b>14,651</b>	<b>2,499</b>
Adjustment	8,528	13,658	13,452	13,613	8,727	(12,516)	405
<b>Adjusted net profit (non-IFRS)</b>	<b>661</b>	<b>1,691</b>	<b>2,459</b>	<b>550</b>	<b>1,699</b>	<b>2,117</b>	<b>2,885</b>
<b>Yoy growth %</b>							
<b>Total revenue</b>					<b>86%</b>	<b>68%</b>	<b>49%</b>
Smartphones					91%	59%	36%
IoT and lifestyle products					85%	104%	90%
Internet services					59%	64%	85%
Advertising					86%	70%	110%
IVAS					33%	54%	49%
Others					66%	149%	125%
<b>Gross profit</b>					<b>75%</b>	<b>47%</b>	<b>26%</b>
<b>(Loss)/profit for the year (reported)</b>					na	na	na
<b>Adjusted net profit (non-IFRS)</b>					<b>157%</b>	<b>25%</b>	<b>17%</b>

Source: Company data; AMTD estimates

Figure 14: Xiaomi's quarterly operating matrix

Operating matrix	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18
<b>Revenue mix</b>							
Smartphones	65.8%	71.5%	75.4%	66.8%	67.5%	67.4%	68.8%
IoT and lifestyle products	22.5%	18.9%	16.7%	24.2%	22.4%	22.9%	21.2%
Internet services	11.0%	9.0%	7.5%	8.3%	9.4%	8.8%	9.3%
Advertising	5.4%	5.5%	4.5%	4.6%	5.4%	5.5%	6.3%
IVAS	5.5%	3.5%	3.0%	3.7%	3.9%	3.2%	3.0%
Others	0.8%	0.6%	0.4%	0.7%	0.7%	0.9%	0.6%
Smartphone shipment (million)	13.1	21.4	27.7	29.3	28.4	32.0	33.3
yoy %					117%	50%	20%
Smartphone ASP (RMB)	932	898	930	801	818	953	1051
yoy %					-12%	6%	13%
IoT and lifestyle product sales per smartphone	318	237	206	291	271	324	324
yoy %					-15%	37%	58%
IoT and lifestyle product sales per MIUI MAU	30	35	36	50	41	50	48
yoy %					35%	44%	32%
End-of-the-period MIUI MAUs (millions)	138	146	157	171	190	207	224
yoy %					37%	42%	43%
Internet ARPU (RMB)	14.7	16.6	16.3	17.0	17.0	19.1	21.1
yoy %					16%	15%	29%
Gross margin for hardware (%)	7.30%	9.4%	11.4%	6.3%	7%	7.4%	7.1%
Gross margin for internet services segment (%)	60.40%	62%	61%	57%	62.30%	63%	68%
Advertising	83.70%	0%	0%	0%	82.30%	0%	0%
IVAS	37.30%	0%	0%	0%	34.70%	0%	0%
Non-IFRS net margin (%)	3.6%	6.3%	7.2%	1.6%	4.9%	4.7%	5.7%
Operating margin (reported)	10.5%	13.6%	10.5%	8.6%	9.8%	-16.8%	4.3%
Operating expense to revenue %	8.5%	7.7%	7.5%	9.7%	8.6%	30.7%	8.5%
Effective tax rate	17.6%	17.1%	20.3%	11.9%	10.1%	-3.6%	-5.3%
<b>Revenue mix by geography</b>							
China	76.8%	75.7%	69.3%	69.3%	63.8%	63.7%	56.1%
Rest of the world	23.2%	24.3%	30.7%	30.7%	36.2%	36.3%	43.9%

Source: Company data, AMTD estimates

Figure 15: Xiaomi's P&amp;L forecast

Rmb m	2015	2016	2017	2018E	2019E
<b>Profit &amp; loss</b>					
<b>Revenue</b>	<b>66,811</b>	<b>68,434</b>	<b>114,625</b>	<b>180,605</b>	<b>231,291</b>
Smartphones	53,715	48,764	80,564	122,887	148,183
IoT and lifestyle products	8,691	12,415	23,448	39,903	57,329
Internet services	3,239	6,538	9,896	16,596	24,438
Advertising	1,821	3,838	5,614	10,667	16,534
IVAS	1,419	2,699	4,282	5,928	7,904
Others	1,166	717	717	1,219	1,341
<b>Cost of sales</b>	<b>(64,111)</b>	<b>(61,185)</b>	<b>(99,471)</b>	<b>(158,150)</b>	<b>(200,217)</b>
<b>Gross profit</b>	<b>2,700</b>	<b>7,249</b>	<b>15,154</b>	<b>22,454</b>	<b>31,074</b>
<b>Gross margin</b>	<b>4.0%</b>	<b>10.6%</b>	<b>13.2%</b>	<b>12.4%</b>	<b>13.4%</b>
<b>Operating expenses</b>	<b>(4,191)</b>	<b>(6,053)</b>	<b>(9,599)</b>	<b>(26,368)</b>	<b>(21,510)</b>
Selling and marketing expenses	(1,913)	(3,022)	(5,232)	(8,308)	(11,102)
Administrative expenses	(766)	(927)	(1,216)	(12,281)	(2,775)
R&D expenses	(1,512)	(2,104)	(3,151)	(5,779)	(7,633)
<b>EBIT</b>	<b>(1,491)</b>	<b>1,196</b>	<b>5,555</b>	<b>(3,914)</b>	<b>9,564</b>
Fair value changes on investments	2,813	2,727	6,371	2,200	1,000
Share of losses of investments	(93)	(150)	(231)	(450)	(200)
Other income	522	540	449	300	300
Other (losses)/gains, net	(379)	(528)	72	(58)	-
<b>PBT</b>	<b>(7,473)</b>	<b>1,176</b>	<b>(41,829)</b>	<b>10,703</b>	<b>10,925</b>
Income tax expenses	(155)	(684)	(2,060)	327	(1,813)
<b>(Loss)/profit for the year</b>	<b>(7,627)</b>	<b>492</b>	<b>(43,889)</b>	<b>11,030</b>	<b>9,113</b>
Minority interest	(46)	(62)	(63)	(69)	(76)
<b>Attributable profit</b>	<b>(7,581)</b>	<b>553</b>	<b>(43,826)</b>	<b>10,960</b>	<b>9,036</b>
Adjustment	7,323	1,404	49,251	(2,719)	2,238
<b>Adjusted net profit (non-IFRS)</b>	<b>(304)</b>	<b>1,896</b>	<b>5,362</b>	<b>8,311</b>	<b>11,351</b>
<b>Yoy growth %</b>					
<b>Total revenue</b>		<b>2%</b>	<b>67%</b>	<b>58%</b>	<b>28%</b>
Smartphones		-9%	65%	53%	21%
IoT and lifestyle products		43%	89%	70%	44%
Internet services		102%	51%	68%	47%
Advertising		111%	46%	90%	55%
IVAS		90%	59%	38%	33%
Others		-39%	0%	70%	10%
<b>Gross profit</b>		<b>169%</b>	<b>109%</b>	<b>48%</b>	<b>38%</b>
<b>(Loss)/profit for the year (reported)</b>		na	na	na	na
<b>Adjusted net profit (non-IFRS)</b>		na	183%	55%	37%

Source: Company data; AMTD estimates

Figure 16: Xiaomi key operating matrix

Operating matrix	2015	2016	2017	2018E	2019E
<b>Revenue mix</b>					
Smartphones	80.4%	71.3%	70.3%	68.0%	64.1%
IoT and lifestyle products	13.0%	18.1%	20.5%	22.1%	24.8%
Internet services	4.8%	9.6%	8.6%	9.2%	10.6%
Advertising	2.7%	5.6%	4.9%	5.9%	7.1%
IVAS	2.1%	3.9%	3.7%	3.3%	3.4%
Others	1.7%	1.0%	0.6%	0.7%	0.6%
Smartphone shipment (million)	67	55	91	130	155
yoy %		-17%	65%	42%	20%
Smartphone ASP (RMB)	807	880	881	948	955
yoy %		9.0%	0.2%	7.6%	0.7%
IoT and lifestyle product sales per smartphone	131	224	257	308	369
yoy %		71.5%	14.5%	20.0%	20.0%
IoT and lifestyle product sales per MIUI MAU	77	92	137	174	187
yoy %		18.9%	49.1%	27%	7%
End-of-the-period MIUI MAUs (millions)	112	135	171	229	307
yoy %		20%	27%	34%	34%
Internet ARPU (RMB)	29	49	58	72	80
yoy %		68%	19%	25%	10%
Gross margin for hardware (%)	-0.20%	4.40%	8.70%	7.1%	7.4%
Gross margin for internet services segment (%)	64%	64%	60%	63%	64%
Advertising	91%	86%	82%	82%	80%
IVAS	30%	34%	32%	30%	30%
Non-IFRS net margin (%)	-0.5%	2.8%	4.7%	4.6%	4.9%
Operating margin (reported)	2.1%	5.5%	10.7%	-1.1%	4.6%
Operating expense to revenue %	6.3%	8.8%	8.4%	14.6%	9.3%
Cash conversion cycle (days)	-20	-35	-38	-35	-35
Net cash/ (net debt)	8,373	9,663	8,986	23,527	25,684

Source: Company data; AMTD estimates

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## IMPORTANT DISCLOSURES

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### AMTD Investment Ratings

Industry Rating	
<b>Overweight</b>	Industry sector expected to outperform the market over the next 12 months
<b>Neutral</b>	Industry sector expected to perform in-line with the market over the next 12 months
<b>Underweight</b>	Industry sector expected to underperform the market over the next 12 months
Stock Rating	
<b>Buy</b>	Stock with potential return of over 20% over the next 12 months
<b>Hold</b>	Stock with potential return of -20% to +20% over the next 12 months
<b>Sell</b>	Stock with potential loss of over 20% over the next 12 months

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AMTD Global Markets Limited has an investment banking relationship with Xiaomi Corporation and/or its affiliate(s) within the past 12 months.

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