

Huami Corporation (HMI) Third Quarter 2020 Earnings Call

Transcript November 23, 2020, 8:30 AM ET

Company Participants

Brad Samson	VP, Investor Relations
Grace Zhang	Investor Relations East
Wang Huang	Chairman and CEO
Leon Deng	CFO
Mike Yeung	COO

Operator

Hello ladies and gentlemen. Thank you for standing by for Huami Corporation's third quarter 2020 earnings conference call. At this time, all participants are in listen-only mode. Today's conference call is being recorded. I will now turn the call over to your host, Ms. Grace Zhang, Director of Investor Relations for the Company. Please go ahead, Grace.

Grace Zhang

Hello everyone and welcome to Huami Corporation's third quarter 2020 earnings conference call. The Company's financial and operating results were issued in a press release via newswire services earlier today and are posted online. You can also view the earnings press release and the slides to which we will refer on this call by visiting the IR section of the Company's website at: www.huami.com/investor.

Participating in today's call are Mr. Wang Huang, our Chairman of the Board of Directors and Chief Executive Officer and Mr. Leon Cheng Deng, our Chief Financial Officer. The Company's management will begin with prepared remarks and the call will conclude with a Q&A session. Mr. Mike Yeung, our Chief Operating Officer, will join us for the Q&A session.

Before we continue, please note that today's discussion will contain forward looking statements made under the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the Company's actual results may be materially different from the views expressed today. Further information regarding these and other risks and uncertainties is included in the Company's annual report on Form 20-F for the fiscal year ended December 31, 2019 and other filings as filed with the U.S. Securities and Exchange Commission. The Company does not assume any obligation to update any forward-looking statements except as required under applicable law.

Please also note that Huami's earnings press release and this conference call include discussions of unaudited GAAP financial information as well as unaudited non-GAAP financial measures. Huami's press release contains a reconciliation of the unaudited non-GAAP measures to the unaudited most directly comparable GAAP measures.

I will now turn the call over to our CEO, Mr. Wang Huang. Please go ahead.

Wang Huang:

Hello everyone. Thank you for joining our earnings conference call today.

We are pleased to report another quarter of solid financial results, highlighted by revenue growth of 20% year-over-year that exceeded our expectations, despite supply issues that partially dampened results due to the Covid-19. Our topline results were complemented by bottom-line profitability. Together these testify to the resonance of our portfolio of smart health products and services, as well as our efficient products development capability.

We've launched 5 new smart watch products, including the popular GTR and GTS series in the third quarter. I'm pleased with our development pace. Through agile management our teams' executed according to plan, and our product portfolio was well positioned and fully prepared for the global holiday seasons.

Innovation has always been the core of our DNA. It drives our R&D development, and supports our comprehensive health and fitness ecosystem.

Reflecting this, we recorded a number of new product upgrades and launches in the third quarter. In September, we upgraded our most popular product line, the GTS and GTR smart watches, with numerous technology-enriched functionalities. Now the upgraded versions are fully equipped with features that support blood oxygen monitoring. Among other important applications, blood oxygen saturation data is an essential metric used to monitor breathing quality.

Our classic and sports variants of the Amazfit GTR 2, as well as other select smart wearables, are also upgraded with our newly launched BioTracker-2 PPG 24/7 heart rate sensor. This sensor supports five biological data engines and is the most versatile and precise biosensor we've ever developed.

We also launched our new upmarket Zepp brand as previously announced in August. The Zepp line brings a more comprehensive and professional health and fitness management experience to users, leveraging our expertise of smart wearable technology.

These are just a few of our products and services rollouts and upgrades

In the third quarter, we also extended our cooperation agreement with our strategic partner, Xiaomi. The mi-band product line is an important product line to us, and we will continue to work with Xiaomi on that product line. In the year of 2019, we shipped more than 30 million mi-band products to the global market, and we anticipate the fitness band market will become a more stabilized market in the future.

Now, Turning to our global expansion efforts.

Our Amazfit products achieved strong market position in many of the international markets we serve. According to the IDC report, we have been positioned as number one market share in Spain and Indonesia for several quarters. In IDC's second quarter report, we experienced a 323.7% growth in the India market, and 241.6% in the Western Europe market, these all contributed by our growing brand recognition, strengthening sales and market strategy as well as distribution channels. Our international shipments as a percentage of total 49.1 % in the third quarter, with even our largest market like Europe and SEA are still under the impact of Covid-19.

Starting in September, two of our most popular smart watch lines, the Amazfit Bip S and the Amazfit GTS, became available for purchase in America at over 2,500 Walmart retail stores. This is the first time that consumers can buy them at Walmart stores. We believe there is a strong fit between these value-priced lines and Walmarts' target shoppers. We are pleased to have expanded our retail channel distribution with this large partner and will keep exploring the opportunities with other global large channels.

It's worth remembering that the global megatrend of personal health awareness was well in place before the pandemic. And the last 10 months have brought awareness to compelling levels. We also note that without exception, leading industry forecasts are unified in their forecasts for continued strong demand for smart wearables well into the future, regardless of consumer purchasing methods.

We are confident international shipment volumes will recover once things get normalized and will exceed pre-pandemic levels in the longer term. Coupled with the explosion in our channel development and consumers' ready acceptance, we see our international distribution reach has the likely potential to expand beyond the 70+ countries we currently

serve.

These new products and services development as well as geographic expansion are all part of our continuous execution on our 'Connect Health with Technology' strategy. In addition, we are now doing academic research projects cooperated with more than 20 different hospitals, research institutes, and pharmaceutical companies in both China and overseas, to help monitor users' health condition by using our smart wearable devices.

To name a few, we are now working with the The First Affiliate Hospital of Guangzhou Medical College and Dr. Zhong Nan Shan's team on a Children Asthma early warning project. We are also longing to have deeper understanding of our users' sleep quality data and are working with Klinik Barmelweid in Switzerland, which was recently announced, and the Stanford Sleep Medicine Center in the U.S. to collect more comprehensive analysis.

We believe that we are in the leading position of the industry, and throughout those academic research projects, we will be able to offer our users more dimensions of healthcare services including pre disease warning and more comprehensive health condition analysis in the future, leveraging our cut-edge smart wearable technology. I'd now like to turn the call over to our new CFO, Leon Cheng Deng, to provide highlights and color on our third quarter financial results.

Leon comes to Huami from Royal Philips, where he was most recently Global Head of Finance for Philips Domestic Appliances Division. He brings to us 17 years of extensive experience in accounting, financial management, and manufacturing, perspective on Europe and many other key international markets, and strategic transaction experience that I believe will help Huami accelerate in our next phase of growth.

Leon, welcome to your first Huami earnings call. We are glad to have you as part of the team and look forward to your contributions as we continue to execute and grow the business. The floor is yours.

Leon Deng:

Thank you, Wang.

I am excited to join the Huami family. I believe that with my global consumer health experience, I can help the company focus and manage its sustainable growth. Huami has grown very fast and has many opportunities in both the health and fitness sector and industrial side of healthcare.

Building off my 17 years of strategic operational financial and accounting management

experience at Philips, I will be focusing on continuing to improve management processes, planning and financial controls.

I anticipate looking at areas such as working capital management, cash flow and return on invested capital. I also look forward to leveraging my experience to help manage the company's global expansion in the future.

Let's begin talking about third quarter results with sales. The COVID-19 virus continued to challenge companies and their business planning around the world. It both helped and hurt Huami in the third quarter.

During the summer quarter, COVID cases abated in many regions and allowed local economies to open up more. People got outside to exercise and to live their lives. That was good for the industry, and Huami shipped 15.9 million units in the quarter, up 16.1% from the year ago third quarter and driving a revenue increase of 20%.

The largest portion of that increase was driven by the Xiaomi Mi-Band 5 and we also began shipping a number of our own branded new products, as Wang just described. Where the virus hurt us was in some supply chain challenges, which left us a short of new Huami product inventory in a number of locations and forced the delay of some of our new product launches from the beginning to the end of the third quarter.

I will have more to say on the impact of the virus when I talk about the look forward and guidance. But first, I want to focus on just a few key numbers including gross margin and operating expenses that I think are the most important for understanding what happened in the quarter and that shape our outlook.

Gross margin can be affected by product mix, product launch timing and product life cycles including model upgrades. The 460 basis point decrease in gross margin from a year ago quarter was predominantly driven by those effects. In our specific case, gross margin can be impacted by the proportional split between products which we make and sell to Xiaomi and also the products we bring to market under our own brands.

The split of products between Xiaomi and Huami was the same as in the year ago quarter, reflecting nearly identical patterns of old models winding down and new model quantity shipments for Xiaomi. In this year's quarter that was the new Xiaomi Mi-Band 5.

Gross margin on Xiaomi products in 2020 third quarter was 400 basis points lower than the year ago quarter. This much larger volume of Xiaomi products versus our own branded products in the quarter was the primary driver of the overall lower gross margin.

Let me next highlight operating expenses. As has been true all the year Sales and Marketing, R&D and G&A expenses have been up year-over-year quite significantly in some areas. As you saw in today's press release, R&D was up 38.8% year-over-year and comprised 7.7% of the revenue compared to 6.7% a year ago.

Sales and marketing expenses was up 104.2% year-over-year and comprised 5.2% of revenue compared to 3% a year ago. G&A increased 30.8% year-over-year comprising 4.1% of the revenue compared to 3.7% a year ago. R&D has achieved a scale which we believe can continue to drive strong new product development going forward.

Sales and marketing expenses vary with seasonality. And, obviously, it is important to support key selling seasons such as the year-end holidays and as we expand geographically. But we expect to apply some additional process to prioritize Sales and Marketing investments with the highest sales impact and return on investment through the fourth quarter and into the next year.

Total operating expense in the third quarter 2020 was up 51.3% year-over-year, comprising 17% of revenue, compared to 13.5% in the year ago quarter. Given the uncertainties of the pandemic for the foreseeable future, we are going to manage operating expenses to a percentage of sales target at about where they are now in order to maintain profitability.

The company's cash position continued to be strong, finishing the third quarter with cash and cash equivalents of RMB 2,556 million, up 42% from December 31st, 2019.

As I said, the new resurgence of cases in our key markets of Europe and Russia, as well as the U.S. caused us to temper our outlook for fourth quarter sales. How the impact of the virus will play out through the holidays is very uncertain. Retailers in several key geographies after reopening during the summer are facing new lockdowns according to many recent media reports.

Our guidance reflects this uncertainty. For fourth quarter 2020, management currently expects net revenues to be between RMB1.95 billion and RMB2.15 billion. That outlook is based on the current market conditions, and reflects management's current and preliminary estimates of market and operating conditions and customer demand, which are all subject to change.

This concludes our prepared remarks. We will now open the call to questions. Operator, please go ahead.