Huami Corporation (HMI) Fourth Quarter 2020 Earnings Call Transcript

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Company Participants

Brad Samson	VP Investor Relations, West
Grace Zhang	Director 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 the fourth quarter and full year 2020 earnings conference call for Zepp Health Corporation (formerly named Huami Corporation). 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 Zepp Health Corporation's fourth quarter and full year 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 Zepp's earnings press release and this conference call include discussions of unaudited GAAP financial information as well as unaudited non-GAAP financial information. Zepp'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.

Huang Wang

Hello everyone. Thank you for joining our call.

2020 was a remarkable year for all of us. Yet with all the severe disruptions brought by the global pandemic, I am pleased to report we recorded full-year revenue growth on a year-over-year basis of 10.7% and total shipment volume rose 8% for the year, reached 45.6 million units, especially our self-branded products, which rose 20%, reached 4.5 million units.

These results are despite a fourth quarter tempered by COVID's impact in several of the international markets we serve. Specifically, in Q4, our revenue dipped by 6.6% and total shipment volume fell 9.5%, both on a year-over-year basis. We should highlight, however, against the challenges, our own brands achieved 37.5% shipment growth in the fourth quarter, and continuously strengthened market leadership in countries and regions such as Indonesia and Spain, which we still ranked market number one in terms of smart watch shipment. As vaccinations worldwide have begun rolling out in mass, we are confident that our business will rise again soon in both revenue and shipment volume in 2021, especially our own-branded watches which will become the main engine for the business to grow.

Our solid full-year results bear evidence to the soundness of our strategy of connecting health with technology, the broad appeal of our smart health products and services, and our adept ability to execute in a rapidly changing environment.

In 2020 we made significant strides in building out our strategy of connecting health with technology. Notably, we identified three pillars that will function and be developed as the framework for our business. These are: consumer health technology, data analytics, and industrial health. I'd like to take a few minutes to explain these now.

Consumer health technology is the backbone of our business. Our products and services in this portfolio showcase many attributes that have made us a global leader in the smart wearables space, namely, commitment to innovation, cutting edge technology and speed to market.

In 2020 we introduced a record 20-plus new products or upgrade versions. We also branched into new product categories including ear buds, scales and home fitness equipment, such as treadmills. Many of these new products were present at the Consumer Electronics Show (CES) in January and several of our Amazfit and Zepp-branded products received “best-in-show” distinction and accolades from reviewers in leading publications including Wearable, Tech Radar, Digital Trends and Gadgets and Wearables.

A key element of our strategy in this segment is to continue to rapidly innovate and bring increased functionality and features to our products at all price points. This has been the bedrock of our success in the wearable space and you can expect more the same from us going forward.

Supporting this effort is our ongoing commitment to R&D, which is core to our DNA. Our proprietary designed and built AI smart chip, the Huangshan, is a shining example of our prowess in technology that distinguishes us from competitors. Now in its second generation, the Huangshan-2, introduced in 2020, is the most powerful and fastest AI smart chip for wearables of its kind, and we’ve already begun rolling it out in our products. In the meantime, we are also in the process of developing the new Huangshan-3, and we believe we are in the leading position on the AI smart chip industry for wearables.
Data analytics is the second pillar in our framework and is an integral part in expanding our smart health ecosystem. Primarily targeting insurers, care providers, and employers, this segment works to utilize our data analytics from more than 30 million active users in partnership with industry to empower better wellness decisions.

In this regard, in late 2020, U.S. based re-insurance company Gen Re cited study results using analytics from our Pai Health unit as providing unique value beyond traditional tools in the underwriting process. Just last week, Gen Re had another announcement of a study documenting Pai’s effectiveness at improving employee health and longevity. We see these as harbingers of growing recognition for the value wearable data analytics can bring to the industry. While the pandemic largely consumed the attention of the insurance industry in 2020, we are hopeful 2021 will afford more opportunities for insurers to integrate wearable-device data analytics into their business.

Industrial healthcare is the third area we are developing as part of our framework. This is a long-term development effort. I believe the industrial health technology space represents a tremendous opportunity for us to apply our engineering expertise in precision sensors, biometrics, AI chips and engineering capabilities focused on miniaturization and health data analytics. I believe this space is also ripe for disruption.

Most recently, you've seen the announcement of a partnership agreement and investment with Promaxo, a provider of miniaturized MRI technology targeted initially at urology applications. Just two weeks ago, they received their FDA 510-K clearance, which was a very exciting critical step. You also should have noted two different announcements about our partnership with Rouumetch, a first-mover leader in portable X-Ray technology. We are working towards private labelling all of their miniaturized X-ray systems for sale in China.

In the industrial healthcare segment, in the near term, we will derive incremental revenue from helping sell products in China. In the longer-term, we plan to engage in select joint research and harness ways to integrate imaging data or imaging devices into our health technology ecosystem.

To better reflect our strategic positioning connecting health with technology, our expanding product portfolio and our growth in the global industrial healthcare technology market, on February 25th we announced our name change to Zepp Health Corporation. This name is easy to remember, transcends languages and cultures.

Last but not least, in October we extended our strategic cooperation agreement with Xiaomi Corporation for an additional three years. As part of the extended agreement, we will continue to receive the most-preferred-partner status to develop Xiaomi wearable products and enjoy most-preferred strategic partnership status for research and development of AI-chips and algorithms for wearable devices. We are currently working on Mi Band 6 and expect to launch in the near future.

In closing, while no one could have predicted the enormous impact COVID had on the world in 2020, our results for the year serve as solid proof points for the resilience of our business, the soundness of our strategy and the broad-based appeal of our products. Even though, we can still foresee that the Covid still restrains our smart wearable business in the short-term especially in a few European countries which are our key markets, I'm confident that as we continue to execute on our strategy of connecting health with technology, we are well positioned to capture new and exciting opportunities and deliver long-term shareholder value.

I will now turn the call over to Leon to go over highlights of our fourth quarter and full-year results.

Leon Deng

Thank you, Wang.

I am going to drill down from Wang's full-year view to talk specifically about the fourth quarter. As I did last quarter, I want to provide some specific color commentary on just a few key metrics.

Starting with sales, from my perspective, the company had a good quarter, despite renewed impact of the Covid virus re-instituting lockdowns in some of our key European markets for the important holiday period. Our unit sales were up in most of these markets, but they weren't up as much as we believe they would have been otherwise. In addition, a second Covid-related impact on the quarter was product deliveries delays in China with some of our new products in the quarter. As a result, Q4 revenue from our own Zepp Health Amazfit and Zepp-branded products was up 25% year-over-year, which we believe would have been even stronger.

The third, and largest factor pushing our numbers to the lower end of our guidance range, was that sales of Xiaomi products were not as robust as we had hoped, resulting in a 21% decrease in revenue in the quarter compared to 2019. We believe consumer anticipation of Xiaomi's new model may have factored into this affect.

These affects translated into Q4 revenue of RMB1.973 billion, compared to our guidance range of RMB1.95 billion toRMB2.15 billion.

One of the important takeaways of the quarter, is that we saw strong product sales performance across our pricing spectrum, from the higher end to the value priced. For example, of our own-branded smart watch and band products, the more fashion-oriented GT series, in which the newest models sell for $180 U.S., comprised 41% of smart watch and band unit shipments in the quarter. Sales of our basic smart watch series Bip, in which the newest models sell for $60 to $70, comprised 9% of our fourth quarter's smart watch and band unit shipments. We think it's important to highlight that our products appeal across a broad spectrum of price points, feature sets and consumer expectations. Revenue from our self branded products grew mid-teens to mid thirty percentages each quarter in 2020, and we expect that trend to continue.

Now moving to Gross Margin. Gross Margin can be affected by product mix, product launch timing and product lifecycles, including model upgrades. The 480 basis point decrease in Gross Margin from the year-ago fourth quarter was predominantly driven by lower margins on products produced for Xiaomi, and to a lesser extent on our own branded products, from discounting to run-out older products, and holiday promotional discounting.

Next, I want to provide additional color on Operating Expenses. Total operating expenses trended up through the three first quarters of 2020, but in the fourth quarter, decreased sequentially in both absolute dollars, as well as a percentage of sales. This was a result of the cost control measures we discussed on last quarter's call to prioritize the highest-return activities in all expense areas.

While reduced sequentially, total fourth quarter operating expenses were up 9%, year-over-year, reflecting Sales and Marketing investments in additional headcount as well as marketing, and support for global expansion of our self branded products. I am sure you noted in our release the three-fold increase in the number of countries in which we had 100,000 or more device activations in this year's fourth quarter compared to 2019.

The increase in Sales and Marketing expenses year-over-year was offset by reductions in R&D and G&A expenses. We believe R&D is mostly scaled to continue driving new product development in 2021, which we know is a key to our success.

Given the uncertainties of the pandemic for the foreseeable future, we are going to continue to manage operating expenses to percent of sales targets at about where they are now, in order to drive profitability.

Reported Net income, as a percent of sales, was 5.8% for the fourth quarter, compared to 9.8% in the year-ago fourth quarter.

Q4 net income benefitted from a net year-over-year increase of RMB 62 million in investment income, due to RMB 18 million of realized gain and RMB 44 million of unrealized fair value valuation increase in a 2017 partnership with an electric toothbrush company in China.

The company's cash position continues to be strong, finishing the fourth quarter with cash and cash equivalents of RMB 2,273 million, up 26% from December 31, 2019, but down from September 30, 2020 of RMB 2,556. The sequential decline was driven mainly by working capital swings and investments in industrial health companies such as Hyperfine and Promaxo.

Looking forward to guidance, there remains much uncertainty globally about the pandemic. While vaccination rates are rising, risks from different strains are being discussed, and there are concerns with loosening restrictions and resuming travel. Europe is currently looking like it will stay largely closed for the near term. In the U.S., a number of states have dropped mask mandates and college spring break seems to be back in swing, which risks driving new surges.

Our guidance reflects this continuing uncertainty, as well as first-quarter seasonality. For the first quarter 2021, management currently expects net revenues to be between RMB 1.0 billion and RMB 1.15 billion.

That outlook is based on the current market conditions and reflects the Company 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.