

China/Hong Kong Company Update

Xiaomi Corp

Bloomberg: 1810 HK Equity | Reuters: 1810.HK

Refer to important disclosures at the end of this report.

DBS Group Research . Equity

17 Jan 2022

BUY

Last Traded Price (14 Jan 2022): HK\$18.64 (HSI : 24,383)
Price Target 12-mth: HK\$23.70 (27% upside)

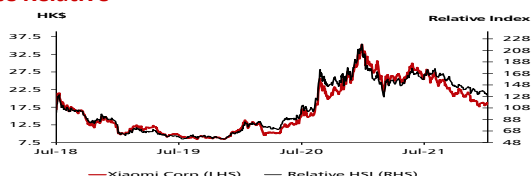
Analyst

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What's New

- Anticipate very healthy growth in 2022 shipment, more optimistic than the market consensus
- Margin in 2022 to be slightly down from the high level of 2021, maintain double digits in the long run
- An aggressive EV production plan and sales target coming this year
- Reiterate BUY for its margin expansion and EPS FY20-23 CAGR of 20.7%

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021F	2022F	2023F
Turnover	245,866	320,933	391,437	452,646
EBITDA	25,743	32,683	38,315	48,123
Pre-tax Profit	21,633	28,336	33,523	42,482
Net Profit	20,356	23,989	29,378	37,174
Net Pft (Pre Ex) (core profit)	20,356	23,989	29,378	37,174
Net Profit Gth (Pre-ex) (%)	102.7	17.8	22.5	26.5
EPS (RMB)	0.85	0.93	1.14	1.45
EPS (HK\$)	1.04	1.14	1.40	1.77
EPS Gth (%)	100.6	9.9	22.5	26.5
Diluted EPS (HK\$)	1.01	1.14	1.40	1.77
DPS (HK\$)	N/A	N/A	N/A	N/A
BV Per Share (HK\$)	6.32	7.45	9.04	10.66
PE (X)	17.9	16.3	13.3	10.5
P/Cash Flow (X)	22.4	20.3	14.2	8.8
P/Free CF (X)	32.6	37.9	19.9	11.0
EV/EBITDA (X)	11.2	9.2	7.5	5.4
Net Div Yield (%)	N/A	N/A	N/A	N/A
P/Book Value (X)	2.9	2.5	2.1	1.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	19.9	17.4	17.5	18.2
Earnings Rev (%)		Nil	Nil	Nil
Consensus EPS (RMB)		0.86	0.99	1.18
Other Broker Recs:		B: 47	S: 2	H: 5

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Stepwise proceed to premium market & Internet service

Investment Thesis

Strong penetration in the Europe market and taking market share of Huawei overseas together fuel a market-beating smartphone shipment growth, an FY20-23 CAGR of 17.0%. A more diversified revenue distribution worldwide also minimises its geopolitical risk under the technology embargo of China.

Promising internet service growth imposes a strong pull on the overall margin. We expect the overall gross margin to increase from 14.9% FY20 to 20.8% in FY23, with internet service's gross profit contribution to expand to 41.1% in FY23.

Growing premium smartphone market share supported by advancing smartphone hardware technology, pulling an overall ASP growth at an FY21-23 CAGR of 5.4%.

Valuation:

Our TP of HK\$23.70 is based on 16.5x FY22F PE, which is based on a mean reversion to its historical average since IPO, justified by smartphone market share gains and the margin pull from Internet services.

Where we differ:

Our smartphone segment's ASP is 2.2%/ 6.3% higher and gross margin is 1.6/2.5 ppts higher than the market in FY22/23F, as we expect better penetration in premium smartphone market to resulting in a 2.2/3.5ppts higher margin together with the internet's margin pull.

Key Risks to Our View:

Delay or cancellation of smartphone shipment caused by persisted chips shortage or lockdown owing to new variant of pandemic.

At A Glance

Issued Capital (m shrs)	25,183
Mkt Cap (HK\$/US\$m)	469,411 / 60,298
Major Shareholders (%)	
ARK Trust (Hong Kong) Ltd.	17.2
Lin (Bin)	9.2
Free Float (%)	73.6
3m Avg. Daily Val. (US\$m)	208.19
GICS Industry: Information Technology / Technology Hardware & Equipmen	



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WHAT'S NEW

Optimistic about 2022 shipment and margin maintains in double digits

We hosted a post-results roadshow with Xiaomi on 13 Jan 2021. Founded in 2010 and listed in 2018, Xiaomi is the world's fourth-largest smartphone vendor, with an 11% market share in 2020. It expanded into IoT & lifestyle products in 2013. Investors were mostly interested in the company's latest innovations, shipment outlook, and market dynamics. Below are the key takeaways.

Innovations

What is the rationale of Xiaomi's self-develop chips like power management IC and ISP chips?

- to further improve the competitiveness, the way to differentiate Xiaomi from its peers.
- Imaging and charging have been the most important differentiator for a smartphone, developing their power management chips can help establish their leadership position in the above directions.
- try to maintain their capabilities by keeping this advanced technology in-house.
- Too early to announce if they are going to develop their own SoC.

Can you have some sharing on the Metaverse potential?

- the first to cooperate with Oculus, launched their first AR glasses in 2021.
- The vast majority of suppliers of AR/VR equipment are incumbent on Xiaomi's suppliers.
- Waiting for the right timing to step in, expected taking some time for the whole ecosystem to mature and to see a very practical use case.

Smartphone Outlook

Can we have some highlights on the competition of Foldable phone and its shipment forecast?

- Taken the earliest moment to launch a foldable smartphone.
- Expected it as one of the very distinctive features that all smartphone players are going to compete for.
- Very high probability that Xiaomi will continue to iterate its foldable phones.

What are the revenue or shipment growth targets and margin outlook in 2022?

- Anticipate very healthy growth in 2022. Internal view is more optimistic than the current market consensus.

- Expect the chips shortage to start to ease and to regain the same growth momentum in the 1H21 in all regions.
- Expect Xiaomi to maintain a y-o-y growth in shipment of 2022.

- Expected the margin in 2022 to be slightly down from the high level of 2021 due to lacking some contribution last year (reduction in promotional expense and discount)
- Structural change in their smartphone composition and a higher proportion of high-end smartphones lead to higher margin growth in the long run and maintain at a double-digit level.

EV development

What is the amount of CAPEX already spent on the construction of the EV plants and the total CAPEX plan for the EV production?

- Not a very large amount of CAPEX on the EV plants as the construction process just started
- A larger amount of CAPEX and investment in the R&D of EV expected in 2022.
- CAPEX for the EV-related expense including CAPEX c.RMB 10bn before the launch of 1st EV in 1H2024.
- c.RMB 100bn on the CAPEX and other expenses in the EV business in 10 years.
- An aggressive production plan and sales target coming this year.

Will the large EV R&D expense drag down the company's profit level in short term given no revenue before 2024.

- Will drag down the profit.
- Have to take account of the benefits, evaluation, and intrinsic value associate with the EV business given that a very aggressive production and sales target for EV business will come out shortly.
- Getting a lot of government subsidies advantage offering and interest from local government in EV plant construction despite their significant spending.

What is the price range of Xiaomi's EV?

- Maintain their good value for money principle.
- a mid- to high-price product, the most competitive, or best value product in its price range.

Internet Service

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Will there be more tactics and strategies in the monetisation of users in 2022?

-Expected a very fast expanding user base in the overseas market on the back of the growth in new market such as Latin America, Eastern Europe, some African countries, and the Middle East.

-Stronger bargaining power with advertising platforms as long as the high-end smartphone proportion in shipment to overseas increases.

-Expect the growth trend to continue in the short to medium term especially in 2022.

-Premiumisation strategy as the main factor to drive up APRU in the short to medium term in Mainland China.

-Higher spending on gaming in high-end smartphone and advertisers are more willing to bid on those users.

-Differences between spending in gaming of premium smartphones user and entry-level smartphones users up to 10 folds.

-Overseas business expected to have a faster growth rate than mainland China.

Economy and Industrial factors

Will the China macro slow down affect smartphone shipment, internet service, or advertising growth in the near term?

-Demand for shipment is inelastic in comparison with other elective consumption products.

-Demand rebounded quickly after the first Covid-19 outbreak, same applies to the economic downturn.

-Expected the shipment in China or overseas to remain relatively stable.

Is there any potential in components related to the US technology ban?

-Currently no ban or restricted list imposed by the US government or any government, on import or export on for Xiaomi products.

-Have a comprehensive, internal audit of all kinds of operations and practices, very cautious in terms of regulatory impact.

How does Xiaomi do in protecting users' data privacy?

-Overseas operations in full compliance with the GDPR "General Data Protection Regulation", the privacy law in Europe and one of the most stringent privacy laws in the world.

-Mainland China operation fully in compliance with PIPL "Personal information Protection law".

-Established data centre overseas for the overseas user's data such as in Singapore and other place around the world to ensure no transmit data across the borders.

-Published white paper and transparency reports on personal data usage to disclose all the data requests that they received from all kinds of government agencies and if they decided to disclose any kind of data.

How do you see other competitors?

-Vivo and OPPO are competitive players, as they have 200,000 offline stores in China covering third- to sixth-tier cities and even smaller counties, giving them a high barrier than Honor.

-Honor use the same kind of suppliers as other smartphone players. The market share ramped up quickly in 2Q21, as it carried some Hua Wei retail channels.

Conclusion

We see great investor interest in the stock. The outlook remains positive based on the expected rebounded of 2022 smartphone shipment, their premiumisation of smartphones, and monetisation of their growing user base. We expect the company's EPS to grow in a FY20-23 CAGR of 20.1%. Reiterate BUY with the TP unchanged at HK\$23.7. Our TP is based on a 16.5x FY22F PE, which is based on a mean reversion to its historical average since the IPO.

Company Background

Founded in 2010 and listed in 2018, Xiaomi is the world's fourth largest smartphone vendor, with an 11% market share in 2020. It expanded into IoT & lifestyle products in 2013. Its proprietary MIUI operating system garnered 396m monthly active users (MAUs) in 2020, which are monetised through Internet services. Smartphones, IoT and lifestyle products, Internet services, and others accounted for 62%, 27%, 10% and 1% of FY20 revenue respectively. Jun Lei, Xiaomi's Chairman and CEO, is the founder of the company. He is the largest shareholder of the company with a 13% stake.

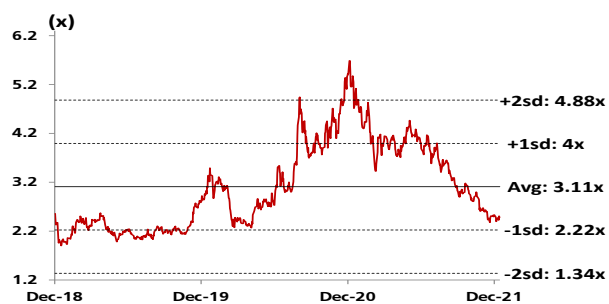
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Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021F	2022F	2023F
Smartphones Revenue	122,094.9	152,190.9	206,727.4	248,951.2	285,157.9
Gross Margin (%)	7.2	8.7	12.5	13.0	13.5
Internet services Revenue	19,841.6	23,755.3	31,274.7	40,383.2	51,930.1
Gross Margin (%)	64.7	61.6	73.5	73.5	74.5

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenues (RMB m)					
Smartphones	122,095	152,191	206,727	248,951	285,158
IoT and lifestyle products	62,088	67,410	79,914	98,493	111,371
Internet services	19,842	23,755	31,275	40,383	51,930
Others	1,814	2,509	3,018	3,611	4,187
Total	205,839	245,866	320,933	391,437	452,646

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenue	205,839	245,866	320,933	391,437	452,646
Cost of Goods Sold	(177,285)	(209,114)	(260,455)	(315,331)	(358,436)
Gross Profit	28,554	36,752	60,479	76,107	94,210
Other Opng (Exp)/Inc	(20,975)	(27,542)	(37,870)	(45,306)	(54,275)
Operating Profit	7,580	9,210	22,609	30,800	39,935
Other Non Opg (Exp)/Inc	4,853	13,444	7,553	5,680	5,767
Associates & JV Inc	(672)	1,381	28	(1,158)	(1,190)
Net Interest (Exp)/Inc	402	(2,401)	(1,853)	(1,799)	(2,030)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	12,163	21,633	28,336	33,523	42,482
Tax	(2,060)	(1,321)	(4,362)	(4,149)	(5,313)
Minority Interest	(59)	43	15	4	5
Preference Dividend	0	0	0	0	0
Net Profit	10,044	20,356	23,989	29,378	37,174
Net Profit before Except.	10,044	20,356	23,989	29,378	37,174
EBITDA	13,141	25,743	32,683	38,315	48,123

Growth

Revenue Gth (%)	17.7	19.4	30.5	22.0	15.6
EBITDA Gth (%)	549.6	95.9	27.0	17.2	25.6
Opg Profit Gth (%)	(306.1)	21.5	145.5	36.2	29.7
Net Profit Gth (%)	(25.9)	102.7	17.8	22.5	26.5

Margins & Ratio

Gross Margins (%)	13.9	14.9	18.8	19.4	20.8
Opg Profit Margin (%)	3.7	3.7	7.0	7.9	8.8
Net Profit Margin (%)	4.9	8.3	7.5	7.5	8.2
ROAE (%)	13.2	19.9	17.4	17.5	18.2
ROA (%)	6.1	9.3	8.4	8.4	8.9
ROCE (%)	6.6	6.7	10.9	12.5	13.5
Div Payout Ratio (%)	0.0	0.0	0.0	0.0	0.0
Net Interest Cover (x)	NM	3.8	12.2	17.1	19.7

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Net Fixed Assets	6,992	6,306	9,903	14,246	18,987
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	39,098	71,091	88,696	103,832	124,018
Cash & ST Invt	63,906	95,525	117,528	133,263	160,395
Inventory	32,585	41,671	53,097	64,761	74,888
Debtors	39,509	35,462	46,429	61,180	69,168
Other Current Assets	1,538	3,625	2,564	6,292	8,062
Total Assets	183,629	253,680	318,216	383,574	455,519
ST Debt	12,837	6,962	7,882	7,882	7,882
Creditors	76,866	97,818	116,617	142,592	166,371
Other Current Liab	2,478	3,147	4,426	5,823	7,524
LT Debt	4,787	10,635	20,267	20,267	20,267
Other LT Liabilities	5,004	11,105	17,045	22,772	28,530
Shareholder's Equity	81,331	123,692	151,672	183,934	224,647
Minority Interests	327	322	307	303	299
Total Cap. & Liab.	183,629	253,680	318,216	383,574	455,519
Non-Cash Wkg. Capital	(5,711)	(20,207)	(18,954)	(16,182)	(21,776)
Net Cash/(Debt)	46,283	77,928	89,379	105,114	132,246
Debtors Turn (avg days)	67.7	55.6	46.6	50.2	52.6
Creditors Turn (avg days)	139.0	153.7	151.7	151.5	158.9
Inventory Turn (avg days)	64.4	65.3	67.0	68.9	71.8
Asset Turnover (x)	1.3	1.1	1.1	1.1	1.1
Current Ratio (x)	1.5	1.6	1.7	1.7	1.7
Quick Ratio (x)	1.1	1.2	1.3	1.2	1.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	26.1	29.0	31.7	27.9	32.2
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Pre-Tax Profit	12,163	21,633	28,336	33,523	42,482
Dep. & Amort.	1,381	1,708	2,493	2,993	3,611
Tax Paid	(2,060)	(1,321)	(4,362)	(4,149)	(5,313)
Assoc. & JV Inc/(loss)	672	(1,381)	(28)	1,158	1,190
(Pft)/ Loss on disposal of FAs	(3,813)	(13,173)	(6,595)	(4,871)	(4,871)
Chg in Wkg.Cap.	14,614	14,496	(1,253)	(2,772)	5,594
Other Operating CF	(4,404)	(5,670)	657	1,617	1,791
Net Operating CF	18,553	16,293	19,248	27,499	44,484
Capital Exp.(net)	(4,597)	(5,110)	(8,936)	(7,867)	(9,063)
Other Invt.(net)	(33,266)	(30,055)	(11,879)	(14,737)	(19,643)
Invt in Assoc. & JV	(672)	1,381	28	(1,158)	(1,190)
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	8,272	26,709	13,751	10,551	10,638
Net Investing CF	(30,263)	(7,076)	(7,036)	(13,210)	(19,258)
Div Paid	0	0	0	0	0
Chg in Gross Debt	6,692	(27)	10,552	0	0
Capital Issues	(695)	24,194	2,455	2,995	3,463
Other Financing CF	1,402	(4,552)	(317)	(1,910)	(1,953)
Net Financing CF	7,399	19,615	12,691	1,085	1,510
Currency Adjustments	0	0	0	0	0
Chg in Cash	(4,310)	28,833	24,903	15,374	26,735
Opg CFPS (RMB)	0.17	0.07	0.80	1.18	1.51
Free CFPS (RMB)	0.59	0.47	0.40	0.76	1.38

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	16-Dec-21	HK\$18.00	HK\$23.70	Buy

Source: DBS HK

Analyst: Jim Au

Tsz-Wang TAM, CFA

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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