

COMPANY RESULTS

**Xiaomi Corp (1810 HK)**

2Q23: Solid Beat On Robust Margin Expansion

**Xiaomi reported a strong beat in its 2Q23 results with adjusted net profit 28% above our and consensus estimates on the back of better-than-expected margin expansion across all businesses. Going forward, we expect a gradual recovery in its smartphone business, while margins may remain elevated thanks to the premiumisation strategy, and a more stable forex impact. Upgrade to BUY. Raise target price to HK\$15.30.**

RESULTS

2Q23 RESULTS

Year to 31 Dec	2Q22	1Q23	2Q23	yoy%	qoq %	1H22	1H23	yoy%
Revenue	70,171	59,477	67,355	(4.0)	13.2	143,522	126,832	(11.6)
Smartphones	42,268	34,985	36,596	(13.4)	4.6	88,031	71,580	(18.7)
IoT & Lifestyle products	19,812	16,834	22,254	12.3	32.2	39,289	39,088	(0.5)
Internet services	6,971	7,028	7,444	6.8	5.9	14,084	14,472	2.8
Other	1,120	631	1,061	(5.2)	68.3	2,119	1,692	(20.2)
Gross Profit	11,768	11,592	14,161	20.3	22.2	24,478	25,753	5.2
Adjusted Net Profit	2,081	3,233	5,140	147.0	59.0	4,940	8,374	69.5
GPM (%)	16.8	19.5	21.0	25.4	7.9	17.1	20.3	3.2
Smartphones	8.7	11.2	13.3	4.7	2.1	9.3	12.3	3.0
IoT & Lifestyle products	14.3	15.7	17.6	3.3	1.8	14.9	16.8	1.8
Internet services	73.0	72.3	74.1	1.1	1.8	71.9	73.2	1.3

Source: Xiaomi, UOB Kay Hian

• **2Q23 results were a strong beat.** Xiaomi Corp's (Xiaomi) 2Q23 revenue was slightly better than expected, primarily driven by the stronger-than-expected IoT & lifestyle business which registered a strong 12% yoy and 32% qoq growth, beating our estimates by 6.5%. The smartphone and internet service businesses were largely in line at Rmb36.6b (-13.4% yoy and +4.6% qoq) and Rmb7.4b (+6.8% yoy and -5.9% qoq). Margins were a strong beat across the board, with smartphones, IoT, and internet services margins arriving at 13.3%/17.6%/74.1%, which is 1.3ppt/1.6ppt/1.1ppt above our estimates. This is partially offset by a slightly higher-than-expected opex, and operating profit and adjusted net profit ended up 15%/29% above our estimates at Rmb4.2b/Rmb5.1b respectively.

STOCK IMPACT

• **Smartphone shipment continued to pick up sequentially in 2Q23 to Aug 23.** While the smartphone end-demand remained sluggish in 2Q23, management remained optimistic regarding the 8.3% sequential recovery in shipment during the quarter, and stated that Xiaomi's inventory at all regions and channels have returned to a relatively healthy level. On the contrary, due to Xiaomi's stringent inventory controls, some of its best-selling products such as the Mi 13 series, Mi Pad and Mi Band are in supply shortages. With the gradual ramp-up in end-demand and a healthy inventory level, management sees further sequential improvement in smartphone demand in 3Q23.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2021	2022	2023F	2024F	2025F
Net turnover	328,309	280,044	268,290	309,390	335,747
EBITDA	23,263	9,955	17,051	21,549	22,865
Operating profit	20,201	6,247	13,194	17,423	18,455
Net profit (rep./act.)	19,339	2,474	13,557	15,045	15,870
Net profit (adj.)	22,040	8,518	15,032	15,045	15,870
EPS (Fen)	88.4	34.3	60.1	60.2	63.5
PE (x)	11.7	33.4	17.2	18.0	17.1
P/B (x)	3.0	2.2	1.9	1.9	1.7
EV/EBITDA (x)	9.5	22.2	12.9	10.2	9.7
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Net margin (%)	5.9	0.9	5.1	4.9	4.7
Net debt/(cash) to equity (%)	(20.6)	(23.6)	(45.4)	(42.9)	(36.4)
Interest cover (x)	12.5	(5.6)	(9.6)	(7.0)	(7.3)
ROE (%)	16.9	6.1	10.0	9.1	8.8
Consensus adjusted net profit	-	-	11,438	12,546	14,167
UOBKH/Consensus (x)	-	-	1.31	1.20	1.12

Source: Xiaomi, Bloomberg, UOB Kay Hian

BUY

(Upgraded)

Share Price	HK\$12.38
Target Price	HK\$15.30
Upside	23.6%
(Previous TP)	HK\$13.60

COMPANY DESCRIPTION

Xiaomi Corporation manufactures communication equipment and parts. The company produces and sells mobile phones, smart phone software, set-top boxes and related accessories. Xiaomi markets its products worldwide.

STOCK DATA

GICS sector	Communications Equipment
Bloomberg ticker:	1810 HK
Shares issued (m):	25,001
Market cap (HK\$m):	309,512
Market cap (US\$m):	45,517
3-mth avg daily t'over (US\$m):	92.0

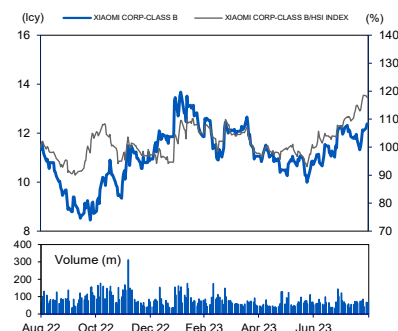
Price Performance (%)

52-week high/low	HK\$14.10/HK\$8.30			
1mth	3mth	6mth	1yr	YTD
1.6	18.1	4.4	8.6	13.2

Major Shareholders

Lin Bin	8.78
FY23 NAV/Share (RMB)	7.18
FY23 Net Cash/Share (RMB)	3.23

PRICE CHART



Source: Bloomberg

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- **Outlook for IoT and internet services businesses is improving as well.** For the IoT business, management highlighted that apart from the white goods and large home appliances which registered a 70% yoy revenue growth in 2Q23, Xiaomi's Tablet product performed strongly as well, with its market share rising to no.3 in China. Growth in the overseas market should start to pick up from 2H23 as the inventory adjustment is completed.
- For the internet business, we are more optimistic on its 2H performance, thanks to the recovery in China's advertising business, as well as Xiaomi's premiumisation strategy which is driving ARPU expansion. Management also stated that more overseas companies are approaching Xiaomi's advertising platform given its expanding scale, which can lead to an acceleration in its overseas ARPU growth.
- **Margins may slightly normalise, but should remain elevated going forward.** Management stated that the significant expansion in margins was due to: a) lower material costs for smartphones, b) the ongoing premiumisation trend as ASP in China grew by 24% yoy, c) strong sales of high-margin white goods products such as air conditioners and fridges in 2Q23, d) recovery of the high-margin advertising business and the expanding ARPU with growing contribution from high-value premium phones, e) less impact from forex, and f) the ongoing optimisation of Xiaomi's internal management system.
- Given that prices of components are unlikely to further deteriorate and prices of several components such as memory start to pick up, we believe further upside in margins will be limited. However, with a more moderate forex impact, Xiaomi's ongoing premiumisation efforts, and less inventory impairment, we expect Xiaomi's margins to remain elevated going forward.
- **SG&A will remain well under control in 2H23.** 2Q23 saw SG&A declining by 16% yoy to Rmb5.6b, primarily thanks to more stringent cost controls. We expect Xiaomi to maintain its focus on cost optimisation measures in 2H23-25 in order to facilitate the extra expenditure into the development of new initiatives such as its EV business.
- **Development of AI is still underway.** The development of XiaoAI based large language model (LLM) and AI applications is still an ongoing process and received >180,000 application requests to partake in the testing/training since its announcement in mid-August. Xiaomi has also invested in six companies involved in the development of AI, through a US\$150m fund it set up along with Shungwei and Kingsoft.
- **Southeast Asia (SEA) and Latin America (LATAM) remain key overseas focus.** Xiaomi's share in Middle East and LATAM reached 17% and 15%, and is targeting to reach 25% and 20% share for the two markets respectively. Xiaomi is also expanding into Western and Eastern Africa, after recently entering Kenya and Nigeria. We believe this is a welcoming development, as we believe emerging markets such as Africa will be the next big growth driver for smartphones in the coming cycle.

### EARNING REVISION/RISK

- **We revise down our shipment assumptions to 134m/152m/159m units** (from 139m/153m/165m units) as we further revise down our global smartphone shipment estimates to 1,146m/1,212m/1,262m in 2023-25 respectively (from 1,160m/1,217m/1,267m) due to the lengthening replacement cycle and weak recovery.
- **Raise our 2023-25 operating profit estimates by 8.7%/0.5%/1.9% respectively to Rmb13.6b/15.0b/15.9b respectively**, as we factor in 1H23 earnings for 2023. For 2024-25, our lower revenue estimates are more than offset by a higher margin assumption.

### VALUATION/RECOMMENDATION

- **Upgrade to BUY and raise target price to HK\$15.30.** We roll over to our 2024 earnings estimate, and our target price is based on 23.5x 2024F PE, on par with historical forward mean valuation.

### PROFIT & LOSS

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
<b>Net turnover</b>	<b>280,044</b>	<b>268,290</b>	<b>309,390</b>	<b>335,747</b>
EBITDA	9,955	17,051	21,549	22,865
Deprec. & amort.	(3,707)	(3,857)	(4,126)	(4,410)
<b>EBIT</b>	<b>6,247</b>	<b>13,194</b>	<b>17,423</b>	<b>18,455</b>
Total other non-operating income	(3,431)	3,366	-	-
Associate contributions	(400)	74	-	-
Net interest income/(expense)	1,117	1,369	2,473	2,532
<b>Pre-tax profit</b>	<b>3,934</b>	<b>17,928</b>	<b>19,896</b>	<b>20,987</b>
Tax	(1,431)	(4,303)	(4,775)	(5,037)
Minorities	(29)	(68)	(76)	(80)
<b>Net profit</b>	<b>2,474</b>	<b>13,557</b>	<b>15,045</b>	<b>15,870</b>
Net profit (adj.)	8,518	15,032	15,045	15,870

### CASH FLOW

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
<b>Operating</b>	<b>(4,390)</b>	<b>44,167</b>	<b>8,134</b>	<b>28,296</b>
Pre-tax profit	3,934	17,928	19,896	20,987
Tax	(3,420)	(4,303)	(4,775)	(5,037)
Deprec. & amort.	3,707	3,857	4,126	4,410
Associates	400	(74)	-	-
Working capital changes	(21,255)	28,053	(8,640)	10,468
Non-cash items	12,244	(1,295)	(2,473)	(2,532)
Other operating cashflows	-	-	-	-
<b>Investing</b>	<b>15,549</b>	<b>(8,000)</b>	<b>(8,000)</b>	<b>(6,500)</b>
Capex (growth)	(5,800)	(8,000)	(8,000)	(6,500)
Investments	(80,563)	-	-	-
Proceeds from sale of assets	98,068	-	-	-
Others	3,843	-	-	-
<b>Financing</b>	<b>(7,855)</b>	<b>1,511</b>	<b>2,473</b>	<b>2,532</b>
Dividend payments	-	-	-	-
Issue of shares	84	-	-	-
Proceeds from borrowings	19,858	20,000	20,000	20,000
Loan repayment	(22,649)	(19,858)	(20,000)	(20,000)
Others/interest paid	(5,147)	1,369	2,473	2,532
<b>Net cash inflow (outflow)</b>	<b>3,304</b>	<b>37,678</b>	<b>2,607</b>	<b>24,328</b>
Beginning cash & cash equivalent	23,512	27,607	65,285	67,891
Changes due to forex impact	791	-	-	-
<b>Ending cash &amp; cash equivalent</b>	<b>27,607</b>	<b>65,285</b>	<b>67,891</b>	<b>92,220</b>

### BALANCE SHEET

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
<b>Fixed assets</b>	<b>9,138</b>	<b>14,828</b>	<b>20,326</b>	<b>24,115</b>
Other LT assets	103,954	102,407	100,784	99,084
Cash/ST investment	27,607	65,285	67,891	92,220
Other current assets	132,808	113,967	136,804	128,505
<b>Total assets</b>	<b>273,507</b>	<b>296,487</b>	<b>325,805</b>	<b>343,924</b>
ST debt	2,151	2,293	2,293	2,293
Other current liabilities	87,477	96,689	110,886	113,055
LT debt	21,493	21,493	21,493	21,493
Other LT liabilities	18,463	18,463	18,463	18,463
Shareholders' equity	143,658	157,216	172,261	188,131
Minority interest	265	333	408	488
<b>Total liabilities &amp; equity</b>	<b>273,507</b>	<b>296,487</b>	<b>325,805</b>	<b>343,924</b>

### KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
<b>Profitability</b>				
Gross margin	17.0	20.3	20.3	19.7
Pre-tax margin	1.9	6.6	6.4	6.3
Net margin	0.9	5.1	4.9	4.7
ROA	3.0	5.3	4.8	4.7
ROE	6.1	10.0	9.1	8.8
<b>Growth</b>				
Turnover	(14.7)	(4.2)	15.3	8.5
EBITDA	(18.3)	14.6	15.1	5.4
Pre-tax profit	(83.9)	355.7	11.0	5.5
Net profit	(87.2)	448.0	11.0	5.5
Net profit (adj.)	(61.4)	76.5	0.1	5.5
EPS	(61.2)	75.3	0.1	5.5
<b>Leverage</b>				
Debt to total capital	8.6	8.0	7.3	6.9
Debt to equity	16.5	15.1	13.8	12.6
Net debt/(cash) to equity	(23.6)	(45.4)	(42.9)	(36.4)
Interest cover (x)	(5.6)	(9.6)	(7.0)	(7.3)

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