Fixed Income
Credit Commentary

11 May 2023

CMBI Credit Commentary

Chinese TMT: Buy XIAOMI 0'27 (CB), XIAOMI 30-31s, MEITUA 0'27 (CB) and PDD 0'25 (CB)

Glenn Ko, CFA 高志和
(852) 3657 6235
glennko@cmbi.com.hk

Cyrena Ng, CPA 吴蒨瑩
(852) 3900 0801
cyrenang@cmbi.com.hk

Jerry Wang 王世超
(852) 3761 8919
jerrywang@cmbi.com.hk

Executive Summary

- **Strong liquidity profile and a moderating regulatory environment:** Chinese TMT issuers are cash-rich with solid liquidity profiles. Most of them are in net cash positions and/or have strong coverage ratios for their rating levels. See Table 2. Despite the noise on sanction risk and recent weakness in their equities. Their credit stories remain solid. We take additional comfort that the restrictive regulatory environment is moderating.

- **XIAOMIs are our top picks with favourable risk-return profile: XIAOMI 3 3/8 04/29/30** and **XIAOMI 2 7/8 07/14/31** are trading at higher YTM than JD/WB/MEITUA at similar credit rating. XIAOMI'30 is trading at 80.9 while XIAOMI'31 is trading at 75.9, both with YTM of c7%. See Table 1.

- **Shorter-dated carry plays in CB space.** We consider **XIAOMI 0 12/17/27 (CB)**, puttable in Dec'25 with a YTP of 6.8%, a good shorter-dated play within the XIAOMI curve. On MEITUAs, we prefer **MEITUA 0 04/27/27 (CB)** which offers yield pick-up of c140bps over MEITUA 2.125 10/28/25. Additionally, the cash price of the CB is c4pts lower and the tenor is effectively 6 months shorter. We also like **PDD 0 12/01/25 (CB)**, puttable in Dec'23, as a good short-dated carry play with a cash price of 95.8 and YTP of 8.4%. Xiaomi, Meituan and PDD all have large net cash positions and CB redemptions should be well manageable.

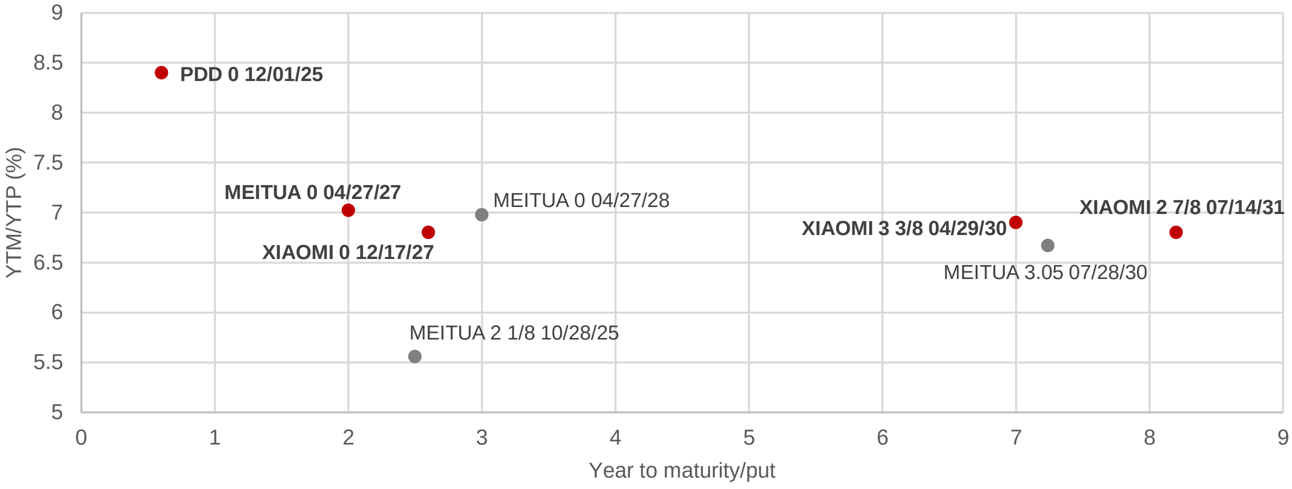
Table 1: Summary of our picks

Bond	Px	YTM/YTP	Outstanding (USD mn)	Maturity/put date	Year to maturity/put
MEITUA 0 04/27/27	87.8	7.0%	1,480	04/27/25	2.0
PDD 0 12/01/25	95.8	8.4%	2,000	12/01/23	0.6
XIAOMI 0 12/17/27	84.1	6.8%	855	12/17/25	2.6
XIAOMI 3 3/8 04/29/30	80.9	6.9%	600	04/29/30	7.0
XIAOMI 2 7/8 07/14/31	75.9	6.8%	800	07/14/31	8.2

Source: Bloomberg.

CMBI Fixed Income
fis@cmbi.com.hk

Chart 1: YTM/YTP of MEITUAs, PDD and XIAOMIs



Source: Bloomberg.

Chinese TMT: Buy XIAOMI 0’27, XIAOMI 30-31s, MEITUA 0’27, PDD 0‘25

Buy XIAOMI CB and 30-31s for better risk-adjusted return

We like Xiaomi’s solid credit story and liquidity profile with a large cash position. As at Dec’22, Xiaomi has RMB67.8bn unrestricted cash (including short-term investment and deposits), compared with total debts of RMB23.6bn. It has been in net cash position over the past 5 years. We believe it will be able to repay the bond in the absence of refinancing.

Recommend buy on **XIAOMI 3 3/8 04/29/30** and **XIAOMI 2 7/8 07/14/31** for more favourable risk-return profiles compared with those of JD, WB and MEITUA at similar credit ratings. XIAOMI’30 is trading at 80.9 while XIAOMI’31 is trading at 75.9, both with YTM of c7%. We also see **XIAOMI 0 12/17/27 (CB)** have YTP of 6.8% while were puttable 4.4 years earlier.

Xiaomi’s large net cash position supports its strong credit profile

In FY22, Xiaomi’s revenue dropped c15% to RMB280.4bn, dragged by the weak global consumer electronics market. Revenue from smartphone segment decreased by 20% yoy to RMB167.bn. IoT and lifestyle products revenue experienced a 6% drop to RMB79.8bn. The revenue drop, partly offset by an increase in revenue from smart large home appliances, was mainly due to price cut of smart TVs and laptops. The fall in gross profits together with higher research and development expenses led to 61% decline in EBITDA to RMB8.8bn. Market volatility also caused RMB1.7bn financial investment loss in FY22, mainly from equity investments. Nonetheless, our equity research expects Xiaomi’s operating performance to recover given the improving channel inventory and margin improvement resulting from declining component costs and efficiency enhancement.

Xiaomi announced in Mar’21 that it would enter the smart electric vehicle business and target to have the mass production by 1H24. The initial investments is RMB10bn (cUSD1.5bn), it is investing another USD10bn over the next 10 years. With the recovery of consumption demand post COVID especially in China, cash flow from the smartphone operations shall improve and this should strengthen Xiaomi’s financial flexibility to fund the EV capex and to preserve the net cash position, in our view. As at Dec’22, it had a net cash position of RMB44.1bn. It maintained a net cash position averaged RMB51.1bn over the past five years.

Prefer MEITUA 0’27 (CB) within MEITUA curve

For MEITUAs, we see **MEITUA 0 04/27/27 (CB)** the best opportunity within the curve. The CB, puttable at 100.37 on 27 Apr’25, is trading at 87.8 with a YTP of 7%. Compared with MEITUA 2 1/8 10/28/25, the CB offer a yield pick-up of 141bps, and the tenor is effectively 6 months shorter. The CB is trading at 87.8, c4pts lower than the cash price of MEITUA 2 1.8’25 of 92.2. As of Dec’22, Meituan had unrestricted cash in hand and short-term investments of RMB112bn while its annual cash burnt (including capex) was RMB25.9bn. Meituan is able to redeem the outstanding CB of USD1.48bn in 2025 with internal resources.

Meituan to recover from the pandemic with ample liquidity

In FY22, Meituan’s revenue increased by 22.8% to RMB220bn. Its revenue in FY22 was 92% higher than that of 2019. Its gross margin rebounded 4pct pts to 28% in FY22 from 24% in FY21, is on track to recover to 30% in FY19. We expect its revenue and EBITDA continue to recover post removal of COVID restriction and resumption of domestic travel within China. Meituan has been active in expansion. That said, we take comfort from its financial policies discipline. As at Dec'22, Meituan had unrestricted cash and short-term treasury investments of RMB112bn and a net cash position (debt minus unrestricted cash and ST treasury investments) of RMB53.9bn. These should be sufficient to cover its ST debts of RMB19.7bn and capex. Over the past 5 years, its net cash position averaged RMB52.5bn. We take additional comfort that Moody's/S&P/Fitch affirmed Meituan's Baa3/BBB-/BBB- rating and revised its rating outlook to stable from negative on 30 Mar/6 Apr/13 Apr respectively**.**

PDD 0'25 (CB)

At 95.8, **PDD 0 12/01/25** (CB, o/s USD2bn) is trading at a YTP of 8.4% and a parity of 32.2. We consider PDD 0 12/01/25, puttable at 100 on 1 Dec'23, a good short-dated carry play. With unrestricted cash on hand of RMB34.3bn and ST investments of RMB115.1bn as at Dec'22, PDD was in net cash position of RMB132.5bn. It has an ample liquidity to redeem the CBs of USD2bn (cRMB13.6bn) in Dec'23.

Simple capital structure and asset light model favorable for ongoing cash generation

As of Dec'22, Pinduoduo only has two CBs outstanding. It does not have any straight bonds or bank borrowings outstanding. The finance cost is therefore minimal as CBs are zero-coupon. On the other hand, the company operates a shopping platform with a "team purchase" model. The capex requirements will be limited as it only operates an online platform, generating revenue from marketing services and transaction fee. Its EBITDA turned to positive since 2021 and reached RMB33.1bn in FY22.

Table 2: Summary of FY22 financials of major China TMT players

FY22	BABA RMB mn	Tencent RMB mn	Baidu RMB mn	JD RMB mn	Xiaomi RMB mn	Weibo USD mn	Meituan RMB mn	PDD RMB mn
Issuer Ratings (M/S/F)	A1/A+/A+	A1/A+/A+	A3/-/A	Baa1/A-/-	Baa2/BBB-/BBB	Baa2/BBB/-	Baa3/BBB-/BBB-	Not rated
Rating Outlook	Stable	Stable	Stable	Stable	Stable	Neg/Sta/-	Stable	Not rated
Revenue	853,062	554,552	123,675	1,046,236	280,044	1,836	219,955	130,558
EBITDA	154,491	164,037	22,855	25,580	8,819	545	1,227	33,137
Interest expenses	4,909	9,352	2,913	2,106	549	72	1,629	52
Unrestricted cash	189,898	156,739	53,156	78,861	27,607	2,691	20,158	34,326
Short-term investments/deposits	256,514	132,739	120,839	141,095	40,170	480	91,873	115,112
Short-term debts	8,841	28,380	23,361	19,834	2,151	10	19,728	14,488
Long-term debts	132,503	330,761	67,993	45,211	21,493	2,422	38,360	2,446
Total debts	141,344	359,141	91,354	65,045	23,644	2,432	58,088	16,934
Net debt/(net cash)	(305,068)	69,663	(82,641)	(154,911)	(44,133)	(739)	(53,943)	(132,504)
EBITDA margin	18.1%	29.6%	18.5%	2.4%	3.1%	29.7%	0.6%	25.4%
EBITDA/int	31.5x	17.5x	7.8x	12.1x	16.1x	7.6x	0.8x	641.5
Debt/EBITDA	0.9x	2.2x	4.0x	2.5x	2.7x	4.5x	47.4x	0.5x

Note: Net debt is calculated as total debts minus unrestricted cash and short-term investment/deposits.
Sources: Companies' filling, CMBI Research.

Concerns on regulatory uncertainties mitigated

One of the major concerns facing Chinese TMT sector is regulatory uncertainty, as demonstrated by various "anti-monopoly" measures against the major players, especially the platform-economy companies over the past three years. In 2021, Alibaba and Meituan were accused of abusing its dominant market positions, led to an unfair competition. Alibaba and Meituan were fined RMB18bn and RMB3.4bn, respectively in 2021. The regulatory environment had subsequently moderated. During the Politburo Meeting in Jul'22, the policy objectives regarding platform economy were "toned down" to "sustainable development and to normalize the regulation". See table 3.

During the Two Sessions in Mar'23, Li Qiang, the new Prime Minister, emphasised that the government support towards the private sector that is one of the most important pillars in supporting the economic growth of China. In the meantime, Alibaba's founder Jack Ma, an iconic entrepreneur of China, returned to China. Shortly after his return, Alibaba announced the plan to split into six units; five of them may explore IPO while Taobao Tmall will remain wholly owned by Alibaba. We believe that the return of Ma, the proposed split and exploration of separate listing are signs of more supportive regulatory environment for platform-economy companies and their access to financing channels. Furthermore, we see the Chinese government's clear support to the TMT sector under current geopolitical backdrop. During the Two Sessions in 2023, the central authority set up the Central Science and Technology Commission to formulate strategies and leverage resources to boost science and technology innovation.

Table 3: Key events related to anti-monopoly in China

Date	Key events	Details
Dec'20	Politburo Meeting	Reinforced anti-monopoly rules and prevent capital expansion disorderly
Feb'21	Guidelines for Anti-monopoly in the Field of Platform Economy	Defined monopolistic conduct in platform economy
Apr'21	Alibaba penalty	Alibaba was fined RMB18bn for anti-monopoly violation
Jul'21	"Double Reduction"	Banned private tutorial schools from IPO
Oct'21	Meituan penalty	Meituan was fined RMB3.4bn for anti-monopoly violation
Jan'22	Measures for Cybersecurity Review	Government to review offshore IPO of company with more than 1mn users
Mar'22	National market regulatory of anti-monopoly meeting	Announced anti-monopoly work obtained significant results in 2021
Jul'22	Politburo Meeting	Promoted platform economy to develop sustainably and regulation will be normalized
Apr'23	Politburo Meeting	Promoted platform company to develop orderly and encourage leading companies innovation

Source: Xinhua News, CMBI Research.

Sanction risk largely priced in

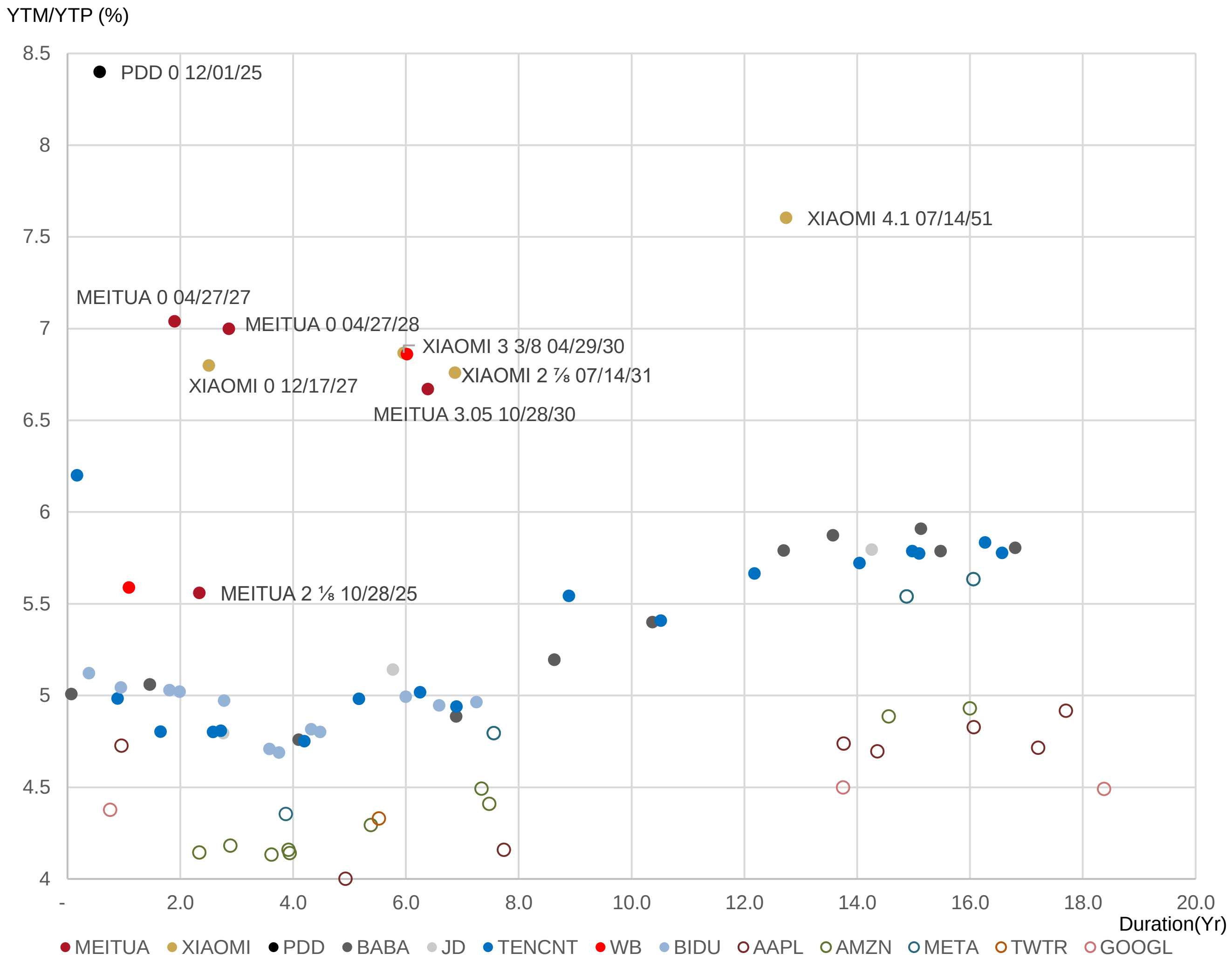
Since China-US trade dispute in 2018, the US government imposed numerous sanctions on Chinese TMT companies. These include export bans, restrictions on investment, removal of the listing status in the US, etc.

Semi-conductor, communication or military-related companies are more impacted by the U.S. sanctions. Xiaomi, as a manufacturer of mobile devices, was blacklisted by the Department of Defense of the U.S. in Jan'21, it was removed from the list after having a lawsuit with the U.S. government. We view the likelihood that the U.S. government to impose additional sanctions on Xiaomi is lower. Recently, there are noises in the U.S. pushing for a new sanction on Chinese cloud computing companies, including Alibaba and Tencent. Nonetheless, we believe that the impact to Alibaba or Tencent is relatively limited, as cloud computing is not their major revenue source, represented 8.7% and 6.0% of their revenue in FY22, respectively.

Regarding the threat of delisting in the U.S., listing in Hong Kong offers a backup for the U.S.-listed Chinese corporates. According to the listing rules of Hong Kong, overseas companies without weighted voting rights can apply for a secondary listing if their market capitalisation exceed HKD3bn and listed for 5 years with good compliance record. For example, Alibaba was listed in Hong Kong in 2019 via secondary listing after listed on NYSE in 2014, it is in the progress of applying to convert into dual primary listing; JD/Weibo was listed in Hong Kong via secondary listing in 2020/2021 after listed on Nasdaq in 2014.

Furthermore, we consider the valuation of Chinese TMT bonds have more or less priced in the sanction risk. The bonds of Chinese TMT companies are in general trading at premium of 30-100bps over those of similarly rated U.S. peers. For example, TENCNT (A1/A+/A+) are trading at c35bps over META (A1/AA-/-) and BABA (A1/A+/A+) are 50-100bps higher over AMZN (A1/AA/AA-).

Chart 2: YTM/YTP of major Chinese and U.S. TMT players



Source: Bloomberg, CMBI Research.

CMB International Global Markets Limited
Fixed Income Department
Tel: 852 3761 8867/ 852 3657 6291
fis@cmbi.com.hk

CMB International Global Markets Limited ("CMBGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Author Certification

The author who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the author covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that author in this report.
Besides, the author confirms that neither the author nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

Important Disclosures

CMBIGM or its affiliate(s) have investment banking relationship with the issuers covered in this report in preceding 12 months.

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.
This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM and/or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.
The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.
CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.
Additional information on recommended securities is available upon request.

Disclaimer:

For recipients of this document in the United Kingdom
This report has been provided only to persons (I)falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time)("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.,) of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.
For recipients of this document in the United States
CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.
For recipients of this document in Singapore
This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.