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Hikvision (002415 CH)

Short term margin pain amid business transformation

Hikvision top-line remained strong but GPM erosion was a negative surprise in FY21 & FY1Q22, due to 1) more implementation work of large-scale smart city projects, 2) increasing innovative business contribution and 3) additional costs due to supply chain disruption. However, we are encouraged to see reducing reliance on public security projects. Margin decline is a temporary yet inevitable short term pain amid business transformation, in our view. Maintain BUY.

- **FY1Q21 top-line beat but margin miss.** Hikvision reported in-line FY21 with revenue of RMB81.42bn (+28% YoY) and net profit of RMB16.80bn (+26% YoY). However, GPM missed (-2.2 ppts YoY to 44.3%) as more low-margin implementation work was performed in FY4Q21 (FY4Q21 GPM: 40.0%, -4.2 pct pts YoY). FY1Q22 revenue growth remained strong at +18% YoY to RMB16.52bn but net profit missed (merely +5% YoY to RMB2.28bn), largely due to unexpected GPM erosion (-3.1 pct pts YoY to 43.7%).
- **Innovative business revenue doubled YoY in FY21.** With continuous R&D effort (R&D expense was up 29% YoY to RMB8.25bn in FY21), Hikvision has expanded its camera applications with AI/ sensors technology. Innovative businesses (Smart Home/ Robotics/ Thermal/ HikAuto/ Storage, etc.) revenue doubled YoY to RMB12.27bn, accounting for 15% of FY21 revenue (vs. 10% in FY20). Core surveillance business also recorded strong recovery from COVID-19 (+20.6% YoY to RMB69.15bn in FY21). Meanwhile, we are encouraged to see lower reliance on public security projects as PBG China revenue contribution continued to decline (32% in FY21 vs. 35% in FY20).
- **Targets stable FY22E GPM despite mix change.** Hikvision FY21 & FY1Q22 GPM erosion was a negative surprise. The decline was attributable to 1) local government specifically appointing Hikvision to be the system integrator of large-scale Smart City projects (Construction GPM was low at 23.0% vs. Core products of 46.4%), 2) increasing innovative business contribution (GPM improved to 40.5% in FY21 from 37.3% in FY20, but still below blended GPM) and 3) additional raw materials/ logistics cost caused by supply chain disruption. Hikvision will continue its high-inventory strategy and targets to maintain a stable GPM in FY22E despite revenue mix change.
- **Maintain BUY.** We cut FY21-23E net profit by 6-7% to reflect lower gross margin. Maintain BUY with new target price of RMB57.10 (prior RMB62.06). Key downside risks include city-lockdowns and softening macro.

Earnings Summary

(YE 31 Dec)	FY20	FY21	FY22E	FY23E	FY24E
Revenue (RMB mn)	63,503	81,420	93,872	109,644	126,871
YoY growth (%)	10	28	15	17	16
Net profit (RMB mn)	13,386	16,800	18,574	21,982	24,218
EPS (RMB)	1.43	1.80	1.97	2.33	2.57
YoY growth (%)	8	26	9	18	10
Consensus EPS (RMB)	1.43	1.77	2.13	2.57	N/A
PE (x)	27.9	22.2	20.3	17.1	15.6
PB (x)	6.9	5.9	5.1	4.4	3.8
Dividend Yield (%)	0.02	0.02	0.02	0.02	0.03
ROE (%)	27	29	27	27	26
Net debt to equity	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	**RMB57.10**
(Previous TP	RMB62.06)
Up/Downside	**+43.0%**
Current Price	**RMB39.93**

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Stock Data

Mkt Cap (RMB mn)	376,668
Avg 3 mths t/o (RMB mn)	1,093.32
52w High/Low (RMB)	70.44/ 36.39
Total Issued Shares (mn)	9,433

Source: Bloomberg

Shareholding Structure

CETC	36.5%
Kung Hong Ka - Chairman	10.3%

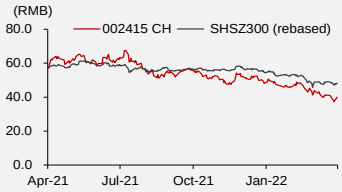
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-3.2%	-7.9%
3-mth	-17.3%	-6.7%
6-mth	-28.6%	-15.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

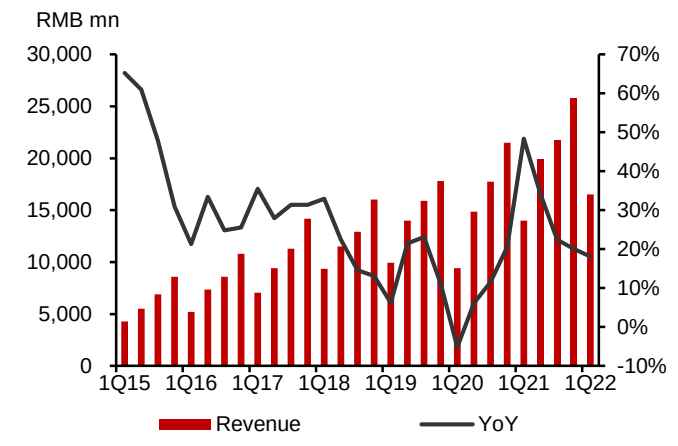
Auditor: Deloitte

Related Reports

1. China AI "AI leaders taking different expansion paths" – 10 Feb 2022 (link)
2. Hikvision (002415 CH) "High inventory buffer" – 25 Oct 2021 (link)

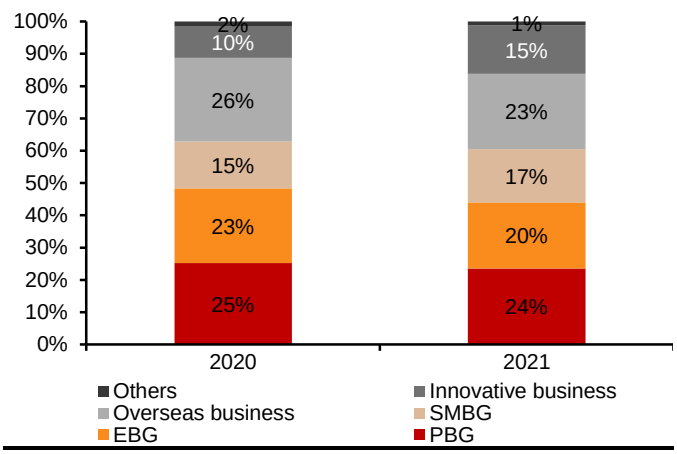
Focus Charts

Figure 1: Quarterly revenue and YoY growth



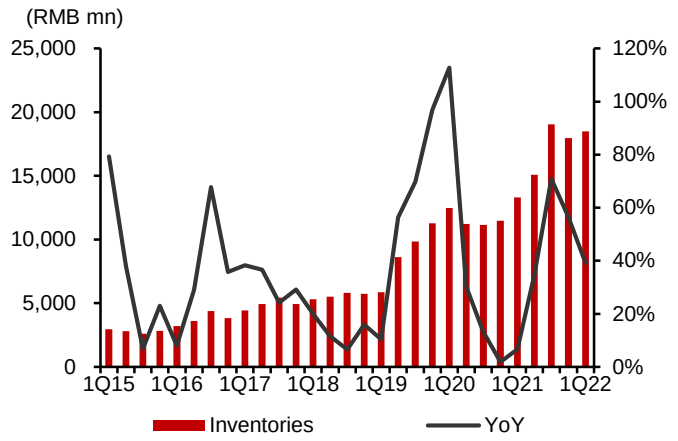
Source: Company data, CMBIGM estimates

Figure 2: Revenue breakdown



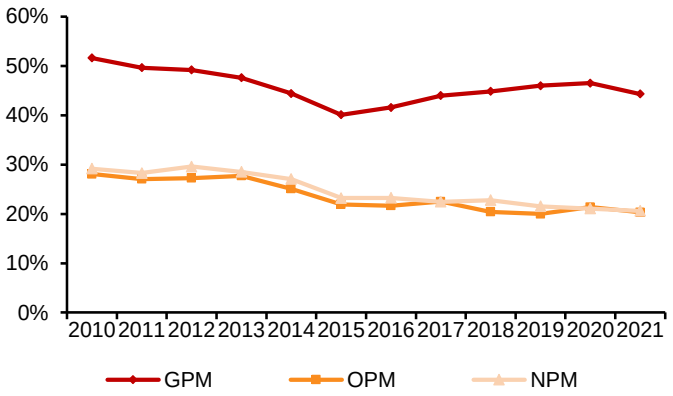
Source: Company data, CMBIGM estimates

Figure 3: Quarterly inventory and YoY growth



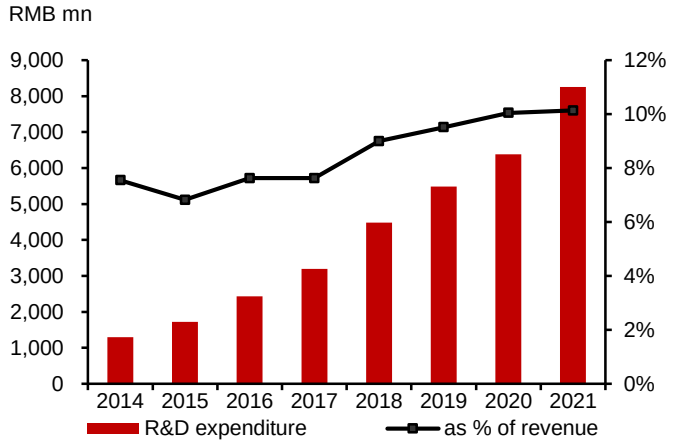
Source: Company data, CMBIGM estimates

Figure 4: Margin trend



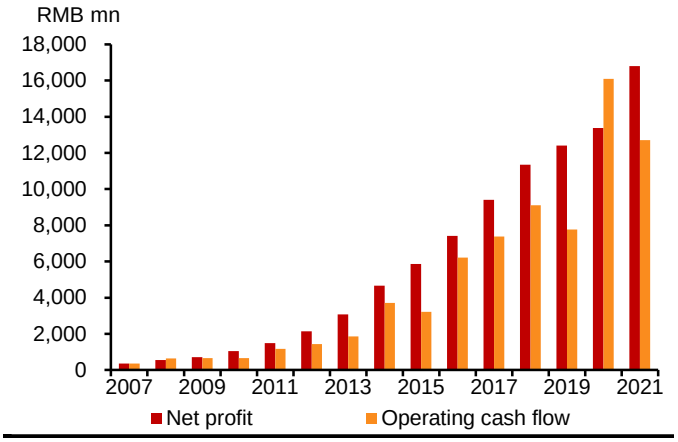
Source: Company data, CMBIGM estimates

Figure 5: R&D



Source: Company data

Figure 6: Net profit vs. operating cash flow



Source: Company data

FY21 results review

- **Revenue** was at RMB81,420mn (+28% YoY), in-line with our and consensus estimates.
  - **PBG:** RMB19,161mn (+19.9% YoY)
  - **EBG:** RMB16,629mn (+12.9% YoY) – part of thermal camera business is reclassified from EBG in 2020 to HikImaging in 2021. Adj. EBG grew at +24% YoY in FY21
  - **SMBG:** RMB13,490mn (+46.5% YoY)
  - **Overseas:** RMB18,926mn (+15.1% YoY)
  - **Innovative business:** RMB12,271mn (+98.9% YoY)
  - **Constructions:** RMB4,004mn (+148.0% YoY)
- **Gross profit** was at RMB36,091mn (+22 YoY), below our estimate by 3% and consensus by 2%.
- **Gross margin** was at 44.3%, (-2.2 pct pts YoY), below both our estimate by 1.9 pct pts and consensus by 1.7 pct pts.
  - **Core products and services:** 46.4% (-2.1 pct pts YoY)
  - **Constructions:** 23.0% (+6.8 pct pts YoY)
  - **Innovative business:** 40.5% (+3.2 pct pts YoY)
- **Operating profit** was at RMB16,559mn (+22% YoY), below our estimate by 4% and consensus by 10%.
- **Operating margin** was at 20.3% (-1.1 pct pts YoY), below our estimate by 0.9 pct pts and consensus by 2.7 pct pts.
- **Net profit** was at RMB16,800mn (+26% YoY), in-line with our and consensus estimates.
- **EPS** was at RMB1.80 (+26% YoY).

Figure 7: FY21 results review

RMB mn	FY2020 actual	FY2021 actual	YoY	FY2021 CMBI	versus CMBI	FY2020 consensus	versus consensus
Revenue	63,503	81,420	28%	80,796	1%	79,716	2%
Gross profit	29,546	36,091	22%	37,354	-3%	36,690	-2%
Gross margin	46.5%	44.3%	-2.2 pct pts	46.2%	-1.9 pct pts	46.0%	-1.7 pct pts
Operating profit (adjusted)	13,583	16,559	22%	17,185	-4%	18,334	-10%
Operating margin (adjusted)	21.4%	20.3%	-1.1 pct pts	21.3%	-0.9 pct pts	23.0%	-2.7 pct pts
Net non-op	1,690	1,909		2,034		717	
PBT	15,273	18,468	21%	19,219	-4%	19,051	-3%
Tax	-1,595	-957		-1,834		-2,421	
Minorities	-293	-710		-617			
Net income	13,386	16,800	26%	16,768	0%	16,630	1%
EPS RMB	1.43	1.80	26%	1.80	0%	1.78	1%

Source: Company data, CMBIGM

FY1Q22 results review

- **Revenue** was at RMB16,522mn (+18% YoY, -36% QoQ), beat our estimate by 3% and but below consensus by 7%.
- **Gross profit** was at RMB7,224mn (+10% YoY, -30% QoQ), below our estimate by 5% and consensus by 12%.
- **Gross margin** was at 43.7%, (-3.1 pct pts YoY, +3.7 pct pts QoQ), below our estimate by 3.7 pct pts and consensus by -2.1 pct pts.
- **Operating profit** was at RMB2,548mn (-1% YoY, -52% QoQ), below our estimate by 14%.
- **Operating margin** was at 15.4% (-2.9 pct pts YoY, -5 pct pts QoQ), below our estimate by 3.1 pct pts and consensus by 0.2 pct pts.
- **Net profit** was at RMB2,284mn (+5% YoY, -61% QoQ), below our estimates by 20% and consensus by 22%
- **EPS** was at RMB0.24 (+5% YoY, -61% QoQ), below our estimate by 20% and consensus by 17%.

Figure 8: FY1Q22 results review

	Mar-21 1Q21	Dec-21 4Q21	Mar-22 1Q22			Mar-22 1Q22	versus	Mar-22 1Q22	versus
RMB mn	**actual**	**actual**	**actual**	**YoY**	**QoQ**	**CMBI**	**CMBI**	**consensus**	**consensus**
Revenue	13,988	25,791	16,522	18%	-36%	16,064	3%	17,829	-7%
Gross profit	6,549	10,316	7,224	10%	-30%	7,625	-5%	8,169	-12%
Gross margin	46.8%	40.0%	43.7%	-3.1 pct pts	3.7 pct pts	47.5%	-3.7 pct pts	45.8%	-2.1 pct pts
Operating profit (adjusted)	2,569	5,266	2,548	-1%	-52%	2,968	-14%	2,779	-8%
Operating margin (adjusted)	18.4%	20.4%	15.4%	-2.9 pct pts	-5 pct pts	18.5%	-3.1 pct pts	15.6%	-0.2 pct pts
Net non-op	341	490	318			427		831	
PBT	2,910	5,756	2,866	-2%	-50%	3,394	-16%	3,609	-21%
Tax	-476	258	-450			-322		-692	
Minorities	-265	-179	-132			-227			
Net income	2,169	5,835	2,284	5%	-61%	2,845	-20%	2,917	-22%
EPS RMB	0.23	0.62	0.24	5%	-61%	0.30	-20%	0.30	-17%

Source: Company data, CMBIGM

Earnings revision

Figure 9: Hikvision earnings revision

RMB mn	2022E New	2022E Old	2022E Diff	2023E New	2023E Old	2023E Diff
Sales	93,872	94,686	-1%	109,644	108,649	1%
Gross profit	41,724	43,861	-5%	49,008	50,844	-4%
Operating profit	19,363	20,693	-6%	23,325	24,705	-6%
Profit before tax	21,404	22,791	-6%	25,459	26,854	-5%
Net profit	18,574	19,977	-7%	21,982	23,268	-6%
EPS	1.97	2.14	-8%	2.33	2.49	-7%
Margins						
GM	44.4%	46.3%	-187 bps	44.7%	46.8%	-210 bps
OPM	20.6%	21.9%	-123 bps	21.3%	22.7%	-147 bps
PBT margin	22.8%	24.1%	-127 bps	23.2%	24.7%	-150 bps
NPM	19.8%	21.1%	-131 bps	20.0%	21.4%	-137 bps

Source: Company data, CMBIGM estimates

Figure 10: Hikvision CMBI estimates vs. consensus

RMB mn	2022E CMBI	2022E Street	2022E Diff	2023E CMBI	2023E Street	2023E Diff
Sales	93,872	94,905	-1%	109,644	113,578	-3%
Gross profit	41,724	43,779	-5%	49,008	52,404	-6%
Operating profit	19,363	22,504	-14%	23,325	27,096	-14%
Profit before tax	21,404	23,084	-7%	25,459	27,709	-8%
Net profit	18,574	20,331	-9%	21,982	24,448	-10%
EPS	1.97	2.13	-8%	2.33	2.55	-9%
Margins						
GM	44.4%	46.1%	-168 bps	44.7%	46.1%	-144 bps
OPM	20.6%	23.7%	-308 bps	21.3%	23.9%	-258 bps
PBT margin	22.8%	24.3%	-152 bps	23.2%	24.4%	-118 bps
NPM	19.8%	21.4%	-164 bps	20.0%	21.5%	-148 bps

Source: Company data, CMBIGM estimates

Operating model

Figure 11: Operating model

RMB mn	2020	2021	2022E	2023E	2024E
Revenues	63,503	81,420	93,872	109,644	126,871
Cost of sales	(33,958)	(45,329)	(52,148)	(60,636)	(69,731)
Gross Profit	29,546	36,091	41,724	49,008	57,140
Gross margin	46.5%	44.3%	44.4%	44.7%	45.0%
R&D	(6,379)	(8,252)	(9,528)	(11,070)	(12,848)
SG&A	(9,168)	(10,719)	(12,209)	(13,881)	(15,769)
Operating Income	13,583	16,559	19,363	23,325	27,684
Operating margin	*21.4%*	*20.3%*	*20.6%*	*21.3%*	*21.8%*
Non-Operating Income	1,690	1,909	2,041	2,135	321
Profit Before Tax	15,273	18,468	21,404	25,459	28,005
Income tax (expense) gain	(1,595)	(957)	(2,211)	(2,546)	(2,801)
Minorities	(293)	(710)	(619)	(931)	(986)
Net Income to Shareholders	13,386	16,800	18,574	21,982	24,218
Net margin	21.1%	20.6%	19.8%	20.0%	19.1%
EPS (RMB)	1.43	1.80	1.97	2.33	2.57
DPS (RMB)	0.70	0.80	0.90	0.99	1.18
Revenue breakdown					
Core camera solution	55,721	65,146	72,069	80,717	90,403
Construction	1,614	4,004	4,603	5,096	5,606
Innovative business	6,168	12,271	17,200	23,831	30,862
PBG	15,987	19,161			
EBG	14,724	16,629			
SMBG	9,209	13,490			
Domestic	45,807	59,435			
Export	17,697	21,985			
Gross margin breakdown					
Core camera solution	48.4%	46.4%	46.2%	46.3%	46.2%
Construction	16.2%	23.0%	23.5%	24.4%	24.0%
Innovative business	37.3%	40.5%	42.7%	43.7%	45.3%
Domestic	44.9%	44.5%			
Export	50.7%	44.0%			
Growth YoY					
Revenues	10%	28%	15%	17%	16%
Gross profit	11%	22%	16%	17%	17%
Operating Income	18%	22%	17%	20%	19%
EPS	8%	26%	9%	18%	10%

Source: Company data, CMBIGM

Figure 12: Quarterly operating model

RMB mn	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22E	3Q22E	4Q22E
Revenues	21,482	13,988	19,914	21,727	25,791	16,522	22,093	24,767	30,491
Gross Profit	9,495	6,549	9,148	10,078	10,316	7,224	10,029	10,959	13,513
Operating profit	5,126	2,569	3,899	4,826	5,266	2,548	3,928	5,286	7,601
Net profit (loss)	4,947	2,169	4,312	4,484	5,835	2,284	3,937	5,173	7,174
EPS (RMB)	0.53	0.23	0.46	0.48	0.62	0.24	0.42	0.55	0.76
Margins									
Gross margin	44.2%	46.8%	45.9%	46.4%	40.0%	43.7%	45.4%	44.2%	44.3%
Operating margin	23.9%	18.4%	19.6%	22.2%	20.4%	15.4%	17.8%	21.3%	24.9%
Net margin	23.0%	15.5%	21.7%	20.6%	22.6%	13.8%	17.8%	20.9%	23.5%
Growth (QoQ)									
Revenues	21%	-35%	42%	9%	19%	-36%	34%	12%	23%
Gross Profit	19%	-31%	40%	10%	2%	-30%	39%	9%	23%
Operating profit	32%	-50%	52%	24%	9%	-52%	54%	35%	44%
Net profit (loss)	30%	-56%	99%	4%	30%	-61%	72%	31%	39%
Growth (YoY)									
Revenues	21%	48%	34%	22%	20%	18%	11%	14%	18%
Gross Profit	18%	47%	20%	26%	9%	10%	10%	9%	31%
Operating profit	41%	74%	26%	24%	3%	-1%	1%	10%	44%
Net profit (loss)	13%	45%	38%	18%	18%	5%	-10%	14%	22%

Source: Company data, CMBIGM

Valuation

Hikvision (002415 CH, BUY, TP RMB57.10)

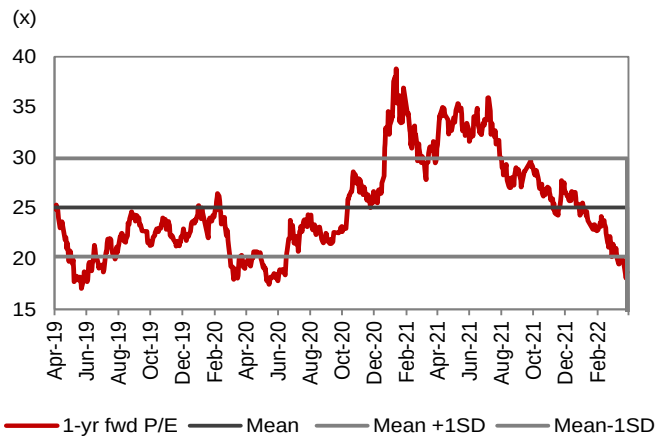
We raised our target price to RMB57.10 (prior RMB62.06), based on unchanged 29x FY22 P/E, 1-SD above its three-year mean. We believe Hikvision deserves a re-rating as supply chain risk is mitigated and new growth drivers (innovative businesses) are emerging. Also, Hikvision announced plan to spin off its smart home and robotics businesses on STAR board. We believe the spin-off could provide new financing channel to support IoT/ AI R&D.

Figure 13: Peers' valuation

Company	Ticker	Rating	Mkt Cap (US$ mn)	Price (LC)	TP (LC)	P/E FY22E	EV/sales FY22E	ROE FY21E	ROE FY22E	Sales CAGR FY20-23E	EPS CAGR FY20-23E
Hikvision	002415 CH	BUY	59,118	39.93	57.10	20.3	3.7	28.7	27.1	20%	18%
Dahua	002236 CH	HOLD	7,388	15.72	20.89	14.1	1.3	17.1	16.2	18%	9%
SenseTime	20 HK	BUY	22,468	5.26	7.84	N/A	26.7	N/A	N/A	33%	N/A
Cambricon Tech	688256 CH	NR	3,539	56.26	N/A	N/A	19.9	N/A	N/A	31%	N/A
China Transinfo	002373 CH	NR	2,471	9.96	N/A	15.3	1.1	8.2	7.8	12%	5%
iFlytek	002230 CH	NR	15,168	41.58	N/A	40.8	4.1	11.8	14.1	34%	34%
					Mean	**22.6**	**9.5**	**16.5**	**16.3**	**25%**	**17%**
					Median	**17.8**	**3.9**	**14.5**	**15.2**	**26%**	**14%**

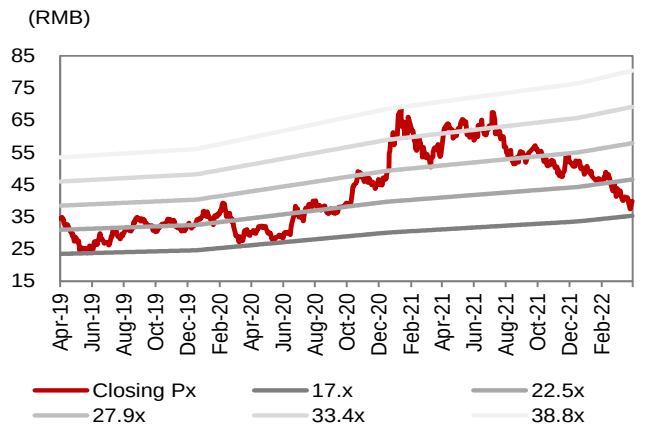
Source: Bloomberg, CMBIGM

Figure 14: Hikvision 12M forward P/E chart



Source: Bloomberg, CMBIGM

Figure 15: Hikvision 12M forward P/E band



Source: Bloomberg, CMBIGM

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20	FY21	FY22E	FY23E	FY24E
Revenue	**63,503**	**81,420**	**93,872**	**109,644**	**126,871**
Cost of sales	(33,958)	(45,329)	(52,148)	(60,636)	(69,731)
Gross profit	**29,546**	**36,091**	**41,724**	**49,008**	**57,140**
Selling exp	(7,378)	(8,586)	(9,757)	(11,013)	(12,452)
Admin exp	(1,790)	(2,132)	(2,453)	(2,868)	(3,317)
R&D exp	(6,379)	(8,252)	(9,528)	(11,070)	(12,848)
Other operating exp.	(416)	(561)	(624)	(733)	(838)
Operating profit	**13,583**	**16,559**	**19,363**	**23,325**	**27,684**
Finance costs	(396)	133	91	289	369
Other non-oper exp.	2,086	1,776	1,950	1,846	(47)
Pre-tax profit	**15,273**	**18,468**	**21,404**	**25,459**	**28,005**
Income tax expense	(1,595)	(957)	(2,211)	(2,546)	(2,801)
Minority interests	(293)	(710)	(619)	(931)	(986)
Net profit to S/H	**13,386**	**16,800**	**18,574**	**21,982**	**24,218**

Cash flow summary

YE 31 Dec (RMB mn)	FY20	FY21	FY22E	FY23E	FY24E
Net profit	**13,386**	**16,800**	**18,569**	**21,982**	**24,218**
Depreciation/amortization	845	892	1,690	1,900	2,081
Change in working capital	597	(7,081)	(4,974)	12,642	(3,246)
Others	1,260	2,097	810	931	986
Net cash from operating	**16,088**	**12,709**	**16,095**	**37,455**	**24,040**
Capex	(2,004)	(3,098)	(2,976)	(3,114)	(3,014)
Other	(551)	(58)	116	0	0
Net cash from investing	**(2,555)**	**(3,156)**	**(2,860)**	**(3,114)**	**(3,014)**
Net borrowings	2,049	(1,842)	1,151	(1,587)	459
Dividend paid	(6,542)	(7,475)	(8,490)	(9,384)	(11,108
Other	(189)	(791)	2,273	(931)	(986)
Net cash from financing	**(4,681)**	**(10,108**	**(5,066)**	**(11,902**	**(11,635**
Net change in cash	**8,852**	**(556)**	**8,169**	**22,440**	**9,390**
Cash at beginning of the year	27,072	35,460	34,722	42,856	65,296
Exchange difference	(464)	(182)	(35)	0	0
Cash at the end of the year	**35,460**	**34,722**	**42,856**	**65,296**	**74,686**

Balance sheet

YE 31 Dec (RMB mn)	FY20	FY21	FY22E	FY23E	FY24E
Current assets	**74,763**	**86,019**	**102,598**	**133,778**	**155,100**
Cash & equivalents	35,460	34,722	42,856	65,296	74,686
Account receivables	24,098	28,563	36,132	40,497	46,916
Inventory	11,478	17,974	18,671	21,982	26,650
Other current assets	3,727	4,760	4,939	6,003	6,848
Non-current assets	**13,939**	**17,845**	**19,197**	**20,411**	**21,344**
PPE	7,301	9,019	10,427	11,641	12,575
Intangible assets	1,634	1,665	1,658	1,658	1,658
Other non-current assets	5,003	7,162	7,112	7,112	7,112
Total assets					
Current liabilities	**31,225**	**33,292**	**37,934**	**58,392**	**67,399**
ST borrowings	7,507	4,672	5,849	4,925	5,246
Account payables	14,631	17,230	19,044	37,934	44,126
Accrued expense	6,173	7,888	8,802	10,019	12,181
Other current liabilities	2,914	3,502	4,238	5,514	5,847
Non-current liabilities	**2,997**	**5,178**	**8,036**	**7,374**	**7,512**
LT borrowings	1,961	3,284	3,225	2,563	2,701
Other non-current liabilities	1,036	1,894	4,811	4,811	4,811
Total liabilities	**34,222**	**38,470**	**45,970**	**65,766**	**74,911**
Share capital	9,343	9,336	9,433	9,433	9,433
Capital surplus	5,179	5,404	8,411	8,411	8,411
Retained earnings	40,479	49,821	59,901	72,499	85,609
Other reserves	(1,207)	(1,100)	(4,014)	(4,014)	(4,014)
Minority interest	**685**	**1,934**	**2,094**	**2,094**	**2,094**
Total equity	**53,794**	**63,461**	**73,731**	**86,329**	**99,439**
Total liabilities and	**88,016**	**101,931**	**119,701**	**152,095**	**174,350**

Key ratios

YE 31 Dec	FY20	FY21	FY22E	FY23E	FY24E
Revenue mix					
Core camera solution	88%	80%	77%	74%	71%
Construction	3%	5%	5%	5%	4%
Innovative business	10%	15%	18%	22%	24%
Growth (%)					
Revenue	10%	28%	15%	17%	16%
Operating profit	18%	22%	17%	20%	19%
Net profit	8%	26%	11%	18%	10%
EPS	8%	26%	9%	18%	10%
Margin (%)					
Gross margin	46.5%	44.3%	44.4%	44.7%	45.0%
Operating margin	21.4%	20.3%	20.6%	21.3%	21.8%
Net profit margin	21.1%	20.6%	19.8%	20.0%	19.1%
Balance sheet ratio					
Current ratio (x)	2.39	2.58	2.70	2.29	2.30
Receivable turnover days	136	118	126	128	126
Inventory turnover days	65	66	71	68	70
Payable turnover days	157	139	133	126	127
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Profitability (%)					
ROE	27.1%	28.7%	27.1%	27.5%	26.1%
ROIC	42.7%	44.9%	39.8%	51.1%	66.5%
Per share data (RMB)					
EPS (RMB)	1.43	1.80	1.97	2.33	2.57
DPS (RMB)	0.70	0.80	0.90	0.99	1.18
BVPS (RMB)	5.76	6.80	7.82	9.15	10.54

Source: Company data, CMBIGM estimates

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