

## FINANCIAL INFORMATION

*You should read the following discussion and analysis with our audited consolidated financial information, including the notes thereto, included in the Accountant’s Report in Appendix I to this [REDACTED]. Our consolidated financial information has been prepared in accordance with IFRS.*

*The following discussion and analysis contain forward-looking statements that reflect our current views with respect to future events and financial performance. These statements are based on our assumptions and analysis in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate under the circumstances. However, whether actual outcomes and developments will meet our expectations and predictions depends on a number of risks and uncertainties. In evaluating our business, you should carefully consider the information provided in this [REDACTED], including the sections headed “Risk Factors” and “Business.”*

*For the purpose of this section, unless the context otherwise requires, references to 2015, 2016 and 2017 refer to our financial years ended December 31 of such years. Unless the context otherwise requires, financial information described in this section is described on a consolidated basis.*

## OVERVIEW

Xiaomi is an internet company with smartphones and smart hardware connected by an IoT platform at its core. Under the leadership of Lei Jun, Xiaomi was founded in 2010 by a group of accomplished engineers and designers, who believed that high quality and well-designed technology products and services should be accessible to the world. To achieve this, we are unwavering in our pursuit of advances in innovation, quality, design, user experience and efficiency in an effort to provide the best technology products and services that are accessibly priced to our users.

Our unique and powerful “triathlon” business model comprises three synergistic pillars of growth—(i) innovative, high quality and well-designed hardware focused on exceptional user experience, (ii) highly efficient new retail allowing for our products to be priced accessibly and (iii) engaging internet services.

We offer a broad range of hardware products developed in-house or in collaboration with our ecosystem partners. Innovation, quality, design and user experience are ingrained in all of our products regardless of whether they are developed in-house or in collaboration with our partners. We strive to offer our products at price points that are accessible to the widest user base to enjoy broad adoption and high retention. For our core in-house products, we focus on designing and developing a range of cutting-edge hardware products including smartphones, laptops, smart TVs, AI speakers and smart routers. We curate a wide range of additional products by investing in and managing an ecosystem of over 210 companies, among which more than 90 companies were focused on the development of smart hardware and lifestyle products as of March 31, 2018. This has enabled us to build the largest consumer IoT platform globally as of December 2017, excluding smartphones and laptops, according to iResearch. We had over 100 million connected devices, excluding smartphones and laptops, as of March 31, 2018. This active and integrated suite of connected technology products enhances the lives of our users and constitutes a proprietary delivery platform for our internet services. We also curate a range of lifestyle products to further drive brand awareness and traffic to our sales points.

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Our highly efficient omni-channel new retail distribution platform is a core component of our growth strategy, allowing us to operate efficiently while simultaneously extending our user reach and enhancing our users’ experience. Since inception, we have focused on direct online sales of our products to maximize efficiency and build a direct digital relationship with users. We were number one in terms of smartphone unit shipments online in both mainland China and India in the fourth quarter of 2017, according to IDC. In particular, Mi Store was the third-largest 3C and home appliances direct sales online retail platform in mainland China by GMV in 2017, according to iResearch. We were also the third-largest direct sales online retail platform by GMV in India in 2017, according to the same source. Since 2015, we have also significantly expanded our direct offline retail network, for example, through our self-operated Mi Home stores. Our direct offline retail capability allows us to broaden our reach and provide a richer user experience, while maintaining similar efficiency and the same product prices as our online channels. In 2017, our self-operated Mi Home stores generated the second highest average sales per square meter amongst retail store chains globally, according to iResearch. Our efficient omni-channel sales strategy enables us to provide our products at accessible price points to the largest user base.

We provide internet services to give our users a complete mobile internet experience. In March 2018, we had approximately 190 million MAUs on MIUI, our proprietary operating system built on the Android kernel. MIUI fully embraces the Android ecosystem, including all mobile apps. It functions as an open platform for us to deliver our wide range of internet services, such as content, entertainment, financial services and productivity tools. The connectivity between our devices and the seamless integration between hardware and internet services enable us to provide our users with better user experience. Furthermore, we have a proven track record of developing killer apps. In March 2018, we had 38 apps with more than 10 million MAUs and 18 apps with more than 50 million MAUs, including our Mi App Store, Mi Browser, Mi Music and Mi Video apps. Our users spent an average of approximately 4.5 hours per day on our smartphones in March 2018. Compared to other internet platforms that acquire new users at high costs, we leverage the sale of our hardware to acquire users at a profit.

During our Track Record Period, our total revenues increased from RMB66.8 billion in 2015 to RMB68.4 billion in 2016, and further increased to RMB114.6 billion in 2017. We had an operating profit of RMB1,372.7 million, RMB3,785.1 million and RMB12,215.5 million in 2015, 2016 and 2017, respectively. Excluding the impacts of (i) fair value changes of convertible redeemable preferred shares, (ii) share-based compensation expenses, (iii) net fair value gains on investments, and (iv) amortization of intangible assets resulting from acquisitions, we had adjusted non-IFRS loss of RMB303.9 million in 2015 and adjusted non-IFRS profit of RMB1,895.7 million and RMB5,361.9 million in 2016 and 2017, respectively. See “—Consolidated Income Statements” and “—Non-IFRS Measure: Adjusted (Loss)/Profit” for details. We had a loss of RMB7,627.0 million in 2015, a profit of RMB491.6 million in 2016 and a loss of RMB43,889.1 million in 2017.

## BASIS OF PRESENTATION

The historical financial information of our Group has been prepared in accordance with applicable International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board. The historical financial information has been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities which are carried at fair value.

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The preparation of historical financial information in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our Group’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the historical financial information are disclosed in Note 4 to the Accountant’s Report included in Appendix I to this [REDACTED].

All effective standards, amendments to standards and interpretations are consistently applied to our Group for the Track Record Period.

### MAJOR FACTORS AFFECTING OUR RESULTS OF OPERATIONS

Our results of operations have been, and are expected to continue to be, materially affected by a number of factors, many of which are outside of our control, including the following:

#### General Factors

Our business and operating results are affected by general factors affecting the broader internet industry and the consumer electronics industry in mainland China and in the international markets where we focus. These factors include:

- overall economic growth and level of per capita disposable income;
- growth of mobile internet usage and penetration rate;
- growth and competition of the smartphone, IoT and lifestyle product markets;
- growth and competition of the internet service markets; and
- new and substantially more superior technology products and services.

Unfavorable changes in any of these general industry conditions could negatively affect demand for our products and services and materially adversely affect our results of operations.

#### Specific Factors

Our results of operations are also affected by specific factors affecting our results of operations, including the following major factors:

#### *Popularity of Our Products*

A substantial majority of our revenues is derived from sales of products, in particular smartphones, as well as the IoT and lifestyle products. Revenue growth in our smartphones segment and our IoT and lifestyle products segment in recent years was primarily driven by increased sales of existing products, including new models, and the category expansion of our product offerings. To maintain our growth momentum, we must continue to innovate and develop high-quality, well-designed and user-centric products to increase sales. Furthermore, revenues from our smartphones and our IoT and lifestyle products segments are affected by the selling price of our products, which is in turn affected by changes in the cost of components and raw materials, the anticipated demand for new models, the income levels of target users, changes in the mix of sales channels, the historical sales volume of previous models, and the prices of comparable products. In particular, the average selling price for smartphones typically declines during its life cycle. The effect of such declining average selling prices of our existing smartphone models has been offset by our continuous introduction of new and enhanced models and our expanded product category offerings.

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### *Growth of Internet Services Revenues*

Our internet services segment has achieved high gross profit margin during the Track Record Period, which plays a significant role in our overall profitability.

The growth of our internet services revenues ultimately depends on the breadth of our internet service offerings, the size of our user base and the level of user engagement and spending. We derive our internet services revenue primarily from advertising and internet value-added services, which mainly include online games. Advertisers are drawn to our platform because of the size of our user base, the level of our user engagement and the attractive demographics of our user base. Our value-added services depend on the overall size of our user base, in particular the number of paying users, as well as the level of user engagement. Our ability to maintain and expand our user base, as well as maintaining and enhancing user engagement and spending, depends on, among other things, our ability to continuously offer popular services, recommend personalized services and content through technological innovation and provide a superior user experience. We will continue to leverage our big data analytic capabilities and the resulting nuanced understanding of user interests to stay abreast of evolving user demand and preferences and introduce more popular and personalized products and services.

### *Expansion and Penetration in International Markets*

As of March 31, 2018, we sell our products in 74 countries and regions across five continents. We have experienced significant growth in international operations during the Track Record Period, particularly in India. In 2015, 2016 and 2017, 6.1%, 13.4% and 28.0%, respectively, of our total revenues were derived from sales outside of mainland China. We believe our global opportunity is significant, and we will continue to enhance our sales and marketing efforts, expand our distribution channels, and invest in infrastructure and personnel to support our international expansion. We intend to leverage our strong execution abilities to localize our unique business model internationally. We believe our leading position in India’s smartphone market lays a strong foundation for us to further expand our user base and internet services offerings to enhance user experience and further increase user monetization in India. Outside of mainland China and India, we will focus on expanding operations in additional markets, such as Southeast Asia, Europe, Russia and other regions. We may have to adapt our business model to the local markets due to various legal requirements and market conditions. Fluctuation in currency exchange rates between our main transaction currencies and foreign currencies used in international markets may impact our financial condition and operating results.

### *Strategic Investments*

During the Track Record Period, we invested in a large number of companies both in mainland China and in the rest of the world. These investee companies can mainly help us efficiently expand our product and service offerings, provide proprietary technologies complementary to ours, or help us expand our international footprint. Our strategic investments can provide us with an additional stream of recurring income. We plan to continue to invest in businesses that are complementary to our business and growth strategies. Such investments may impact our results of operations and financial condition, depending on the amount involved and the performance of the companies in which we invest. In 2015, 2016 and 2017, our realized investment income was RMB533.5 million, RMB29.5

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million and RMB283.4 million, respectively. In 2015, 2016 and 2017, our fair value gains on long-term investments measured at fair value through profit or loss were RMB2.8 billion, RMB2.7 billion and RMB6.4 billion, respectively.

### *Management of Supply-related Costs*

For our smartphones segment and IoT and lifestyle products segment, raw materials, component and assembly costs of our in-house products, as well as the cost of procuring ecosystem products from our partners, have historically accounted for the largest portion of our cost of sales. Since the early stage of our development, we have adopted a contract-based outsourcing model for the assembly of our in-house products under which we strictly control the procurement, production and quality assurance processes. Our ability to effectively control our supply and other production-related costs has affected and will continue to affect our profitability. For products not developed in-house, we rely on our ecosystem partners to supply finished products. Cost of sales for the sale of such ecosystem products comprises primarily the production cost of such products and revenue-sharing with our partners. We proactively manage the cost of the ecosystem products supplied by our partners, and we believe maintaining a mutually beneficial relationship with our ecosystem partners is critical to our business and growth prospects. We provide ecosystem partners with significant business demand, allowing them to commercially launch their products and ramp up their business rapidly. Our ecosystem partners, on the other hand, leverage their research and development capabilities and help us quickly enter into new market segments, enabling us to expand our product portfolio.

To a lesser extent, our cost of sales had been impacted by fluctuations in foreign currency exchange rates as a result of our global operations. We are exposed to foreign exchange risks from trade receivables and trade payables when we receive foreign currencies from, or pay foreign currencies to overseas business partners.

For our internet services segment, revenue-sharing with game developers and other content providers accounted for a large portion of our cost of sales. Our ability to maintain a mutually beneficial relationship with our internet service partners in order to assure and improve the high quality and attractiveness of our internet services to users will significantly affect our results of operations.

### *Investment in People, Technology and Infrastructure*

We are a technology company operating in intensely competitive markets. We have made, and will continue to make, significant investments in people, technology and infrastructure, to solidify our market leadership and to provide great user experience. As our organization expands, and as we invest more in R&D, expand our product and service offerings and broaden our retail channels, talent attraction and retention are critical for our business, operations and growth prospects. We will continue to invest in our people, particularly engineers, designers and product management personnel. As of March 31, 2018, over 5,500 of our employees held share-based awards.

In addition, we have dedicated and will continue to dedicate significant resources to research and development. Our patent portfolio, especially global patent portfolio, has grown rapidly in recent years as a result of our continued investments. We expect our future investments will include designing and developing new products and services with enhanced functionalities and features, as well as continued building of our patent reserve around the world. We will also continue to upgrade and expand our technology infrastructure to keep pace with the growth of our business. We have invested significant resources in the development of our cloud, big data and AI capabilities in recent years, and we expect to continue to do so in the near future.



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### *Marketing and Brand Promotion*

One of our growth strategies is to attract new users through enhancing our brand recognition. Instead of incurring a large amount of selling and marketing expenses for a company of our size, we rely on word-of-mouth marketing through continuous offering of popular products and services. Since 2016, we broadened our user base beyond the tech-savvy crowd through a variety of selected sales and marketing initiatives, as well as effective brand promotion campaigns which resulted in an increase in our selling and marketing expenses both in absolute amount and also as a percentage of our total revenues. Such efforts include expanding the large network of Mi Home stores, conducting online, TV and other offline advertising campaigns, as well as engaging popular celebrities for the promotion of our brands. As we continue to increase our domestic and global footprints, our marketing and brand promotion expenses may continue to increase in the near future.

### *Management of Working Capital*

Our ability to effectively control our working capital has affected and will continue to affect our cash flow from operations. We actively manage our trade receivables for sales of goods and provision of services, and our trade payables for goods and services from our suppliers. We leverage our scale to negotiate attractive contractual terms with our customers and suppliers. In addition, we intend to maintain appropriate inventory levels to meet the market demand for our products.

### *Capital Expenditures on Land Use Rights and Office Buildings*

To accommodate our growth in staff headcount, as well as our expanding domestic and global footprint in the most cost-effective manner, we have acquired and will continue to acquire land use rights and dedicate resources towards the construction of office buildings in favorable locations, such as Beijing, Wuhan, Chengdu, Nanjing and Shenzhen. As we expand our footprint into more countries and regions, our capital expenditures may influence our overall liquidity.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Some of our accounting policies require us to apply estimates and assumptions as well as complex judgments related to accounting items. The estimates and assumptions we use and the judgments we make in applying our accounting policies have a significant impact on our financial position and operating results. Our management continually evaluates such estimates, assumptions and judgments based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. There has not been any material deviation from our management’s estimates or assumptions and actual results, and we have not made any material changes to these estimates or assumptions during the Track Record Period.

We make estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal to the related actual results. We set forth below those accounting policies that we believe may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Our significant accounting policies, estimates, assumptions and judgments, which are important for understanding our financial condition and results of operations, are set forth in detail in Notes 2 and 4 to the Accountant’s Report in Appendix I to this [REDACTED].

### **Revenue Recognition**

We principally derive revenue from sales of products and provision of internet services.

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Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods sold or services performed, stated net of discounts, returns and value-added taxes. We recognize revenue when the specific criteria have been met for each of our activities, as described below.

### *Sales of Products*

Revenue from the sale of products, which mainly includes smartphones, IoT and lifestyle products, directly to our customers is recognized when the control of the goods has been transferred upon the acceptance of products by our customers. Customers have full discretion over the products, and there is no unfulfilled obligation that could affect customers’ acceptance of the products.

We collect cash from our customers before or upon deliveries of products mainly through banks or third-party online payment platforms. Cash collected from our customers before the acceptance of products is recognized as advance from customers. In mainland China, we generally allow customers to return our products purchased online for any reason within seven days from the date of purchase except for certain limited products that we allow return only if the packages of the products are unpacked, and we generally allow customers to exchange any defective products within 15 days from the date of purchase. We base our estimates of sales return on historical results, taking into consideration the type of customers, the type of transactions and the specifics of each arrangement.

### *Internet Services*

Internet services primarily comprise advertising services and internet value-added services.

#### *Advertising Services*

We generate advertising revenues primarily from display-based and performance-based advertisements.

Revenue from display-based advertisements to our users of smartphones and other devices are recognized on a straight-line basis over the contract period.

Revenue from performance-based advertisements is recognized based on actual performance measurement. We recognize revenue from the delivery of advertisements, typically based on (i) per-click when the users click on the content, (ii) per-impression when the advertising contents are displayed to users, or (iii) per-download when the third-party apps are downloaded by users.

#### *Internet Value-Added Services*

We recognize revenues from internet valued-added services, including online games, on a gross or net basis depending on whether we are acting as a principal or an agent in the transaction. For online games, we defer related revenues, over the estimated user relationship periods, when there is an explicit or implicit obligation for us to maintain the relevant applications and allow users to have access to them.

We determine whether our revenue should be reported gross or net based on a continuing assessment of various factors. When determining whether we are acting as the principal or agent in offering services to a customer, we need to first identify who control the specified goods or services

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before the goods are sold or services are provided to the customer. We are a principal in a transaction if we obtain control of the goods or services before they are sold or provided to the customer. We are deemed to have control if we own: (i) a product or another asset from another party before the control is transferred to customers; (ii) a right to a service to be performed by another party, which provides us with the ability to direct such party to provide the service to customers on our behalf; or (iii) a product or service from another party before being combined with other products or services and provided to customers. If the control is unclear, we consider the following factors: (i) who is the primary obligor in the arrangement; (ii) who has latitude in establishing the selling price; and (iii) who has inventory risks. Therefore, we have adopted different revenue recognition methods based on our specific roles and responsibilities in different services offerings.

We do not expect to have any contracts under which the period between the transfer of the subject products or services to end customers and the payment by the customers exceeds one year. As a result, we do not adjust any of the transaction prices for the time value of money.

### Foreign Currency Translation

#### *Functional and Presentation Currency*

Items included in the financial information of each of our entities are measured using the currency of the primary economic environment in which the entity operates (the “**functional currency**”). The functional currency of our Company is United States dollar. Our primary subsidiaries were incorporated in mainland China and these subsidiaries considered RMB as their functional currency. We determined to present our historical financial information in RMB (unless otherwise stated).

#### *Transactions and Balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation when items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated income statements.

Foreign exchange gains and losses are presented as “other (losses)/gains, net” in our consolidated income statements.

Translation differences on non-monetary financial assets and liabilities, such as instruments held at fair value through profit or loss, are recognized in profit or loss as part of the fair value changes.

#### *Group Companies*

The results and financial position of all of our entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of rates



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prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and

- all resulting currency translation differences are recognized in other comprehensive income (“OCI”).

Goodwill and fair value adjustments arising from the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated using the exchange rate on the closing date of the transaction. Currency translation differences are recognized in other comprehensive income.

### *Disposal of Foreign Operation and Partial Disposal*

On the disposal of a foreign operation (that is, a disposal of our entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, a disposal involving loss of joint control over a joint venture that includes a foreign operation, or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the currency translation differences accumulated in equity in respect of that operation attributable to the owners of our Company are reclassified to profit or loss.

In the case of a partial disposal that does not result in us losing control over a subsidiary that includes a foreign operation, the proportionate share of accumulated currency translation differences are re-attributed to non-controlling interests and are not recognized in profit or loss. For all other partial disposals (that is, reductions in our ownership interest in associates or joint ventures that do not result in us losing significant influence or joint control), the proportionate share of the accumulated exchange difference is reclassified to profit or loss.

## **Financial assets**

### *Classification*

We classify our financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through other comprehensive income, or through profit or loss), and
- those to be measured at amortized cost.

The classification depends on our business model for managing the financial assets and the contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in debt instruments, this will depend on the business model in which the investment is held. For investments in equity instruments that are not held for trading, this will depend on whether we have made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income.

See Note 19 to the Accountant’s Report in Appendix I to this [REDACTED] for details of each type of financial asset.

We reclassify debt investments when and only when its business model for managing those assets changes.

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### *Measurement*

At initial recognition, we measure a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are recorded in profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

### *Debt Instruments*

Subsequent measurement of debt instruments depends on our business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which we classify our debt instruments:

- *Amortized cost.* Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortized cost. A gain or loss on a debt investment that is subsequently measured at amortized cost and is not part of a hedging relationship is recognized in profit or loss when the asset is derecognized or impaired. Interest income from these financial assets is included in finance income using the effective interest rate method.
- *Fair value through other comprehensive income (“FVOCI”).* Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets’ cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss and recognized in other losses/gains, net. Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other losses/gains, net and impairment expenses in other losses/gains, net.
- *Fair value through profit or loss.* Assets that do not meet the criteria for amortized cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and presented net in the statement of profit or loss within other losses/gains, net in the period in which it arises.

### *Equity Instruments*

We subsequently measure all equity investments at fair value. There is no investment with fair value gains or losses present in other comprehensive income during the Track Record Period. Dividends from such investments continue to be recognized in profit or loss as other income when our right to receive payments is established.

Changes in the fair value of financial assets at fair value through profit or loss are recognized in the consolidated income statements. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value.

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### *Impairment*

We have the following types of financial assets subject to IFRS 9’s expected credit loss model:

- loans receivables from micro loans business;
- trade receivables for sales of goods or provision of services; and
- other receivables.

We assess the expected credit losses associated with its debt instruments carried at amortized cost on a forward-looking basis, and with the exposure arising from financial guarantee contracts. The impairment methodology applied depends on whether there has been a significant increase in credit risk. See Note 3.1(b) to the Accountant’s Report in Appendix I to this [REDACTED] for details on how we determine whether there has been a significant increase in credit risk.

For trade receivables, we apply the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognized from initial recognition of the receivables.

Impairment on other receivables is measured as either 12-month expected credit losses or lifetime expected credit loss, depending on whether there has been a significant increase in credit risk since the initial recognition. If a significant increase in credit risk of a receivable has occurred since the initial recognition, then impairment is measured as lifetime expected credit losses.

### *Derecognition*

#### *Financial assets*

We derecognize a financial asset, if the part being considered for derecognition meets one of the following conditions: (i) the contractual rights to receive the cash flows from the financial asset expire; or (ii) the contractual rights to receive the cash flows from the financial asset have been transferred and we transfer substantially all the risks and rewards of ownership of such financial asset; or (iii) we retain the contractual rights to receive the cash flows of the financial asset, but assume a contractual obligation to pay the cash flows to the eventual recipient in an agreement that meets all the conditions of derecognition of transfer of cash flows (“pass through” requirement), and we transfer substantially all the risks and rewards of ownership of such financial asset.

Where a transfer of a financial asset in its entirety meets the criteria for derecognition, the difference between the two amounts below is recognized as profit or loss:

- the carrying amount of the financial asset transferred; and
- the sum of the consideration received from the transfer and any cumulative gains or losses that have been recognized directly in equity.

If we neither transfer nor retain substantially all the risks and rewards of ownership and continue to control the transferred asset, we continue to recognize the asset to the extent of its continuing involvement, and we recognize such asset as an associated liability.

#### *Asset-backed securities*

As part of our operations, we securitize financial assets related to internet finance business, generally through the sale of these assets to special purpose vehicles which issue securities to investors.

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### *Other financial liabilities*

A financial liability is derecognized when the obligation under the liability is discharged, canceled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognized in profit or loss.

### **Intangible Assets**

#### ***Goodwill***

Goodwill arises from the acquisition of subsidiaries and represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identified net assets acquired.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash-generating units (“CGUs”), or groups of CGUs, that is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes. Goodwill is monitored at the operating segment level.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of the CGU containing the goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs of disposal. Any impairment is recognized immediately as an expense and is not subsequently reversed.

#### ***Licenses***

Licenses include third-party payment license and other licenses. Third-party payment license represents the license issued by Chinese government authorities that enable us to operate third-party payment business. Other licenses primarily include licenses to use certain intellectual properties purchased from third parties. These acquired licenses are shown at historical cost. Licenses that have an indefinite useful life are tested annually for impairment and carried at cost less accumulated impairment losses. Others are amortized over their estimated useful lives using the straight-line method which reflects the pattern in which future economic benefits of the intangible assets are expected to be consumed.

#### ***Trademarks, Patents and Domain Names***

Separately acquired trademarks, patents and domain names are shown at historical cost. Trademarks, patents and domain names acquired in a business combination are recognized at fair value at the acquisition date. Trademarks, patents and domain names have a finite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of trademarks, patents and domain names over their estimated useful lives of one to 16 years.

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### *Other Intangible Assets*

Other intangible assets mainly include computer software. They are initially recognized and measured at costs incurred to acquire and bring them to use. Other intangible assets are amortized on a straight-line basis over their estimated useful lives, and recorded in amortization within operating expenses in the consolidated income statements.

### *Research and Development Expenditures*

Research expenditure is recognized as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are capitalized as intangible assets when recognition criteria are fulfilled. These criteria include:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognized as an expense as incurred.

### **Convertible Redeemable Preferred Shares (“Preferred Shares”)**

Preferred shares issued by us are redeemable at the option of the holders at any time commencing on the redemption start date of December 23, 2019. This instrument can be converted into our Class B ordinary shares of par value US\$0.000025 each at the option of a holder after July 3, 2015, or automatically converted into our Class B ordinary shares of par value US\$0.000025 each upon occurrence of (i) the closing of a [REDACTED] or (ii) with written consent of holders of more than fifty percent of the issued and outstanding Series A Preferred Shares, or written consent of holders of more than two thirds of the issued and outstanding Preferred Shares (other than the Series A Preferred Shares), as detailed in Note 35 to the Accountant’s Report in Appendix I to this [REDACTED].

We designated the Preferred Shares as financial liabilities at fair value through profit or loss. They are initially recognized at fair value. Any directly attributable transaction costs are recognized as finance costs in the consolidated income statements.

Subsequent to initial recognition, the Preferred Shares are carried at fair value with changes in fair value recognized in the consolidated income statements.

The Preferred Shares are classified as non-current liabilities because the Preferred Shares holders cannot demand us to redeem the Preferred Shares for at least 12 months after the end of the reporting period.



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### Share-based Compensation

We operate share-based compensation plans, under which we receive services from employees as consideration for our equity instruments. The fair value of the employee services received in exchange for the grant of equity instruments (options and restricted shares units (“RSUs”)) is recognized as an expense with a corresponding increase in equity. The total amount to be expensed is determined by reference to the fair value of the equity instruments (options and RSUs) granted:

- including any market performance conditions (for example, an entity’s share price);
- excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining as an employee of the entity over a specified time period); and
- including the impact of any non-vesting conditions (for example, the requirement for employees to save or hold shares for a specific period of time).

Non-market performance and service conditions are included in assumptions about the number of options and RSUs that are expected to vest. The total expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied.

At the end of each reporting period, we revise our estimates of the number of RSUs and options that are expected to vest based on the non-marketing performance and service conditions. We recognize the impact of the revision to original estimates, if any, in our consolidated income statements, with a corresponding adjustment to equity.

In some circumstances employees may provide services in advance of the grant date, and therefore, the fair value on the grant date is estimated for the purposes of recognizing the expense during the period between service commencement date and grant date.

### Inventories

Inventories, consisting principally of raw materials, work in progress, finished goods and spare parts, are stated at the lower of cost, using the weighted average method, and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs to completion, applicable variable selling expense and related tax.

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### CONSOLIDATED INCOME STATEMENTS

The following table sets forth a summary of our consolidated income statements with line items in absolute amounts and as percentages of our revenues for the periods indicated.

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
	(in thousands, except percentages)					
<b>Revenue</b> .....	66,811,258	100.0	68,434,161	100.0	114,624,742	100.0
Cost of sales .....	(64,111,325)	(96.0)	(61,184,806)	(89.4)	(99,470,537)	(86.8)
<b>Gross profit</b> .....	2,699,933	4.0	7,249,355	10.6	15,154,205	13.2
Selling and marketing expenses .....	(1,912,765)	(2.9)	(3,022,313)	(4.4)	(5,231,540)	(4.6)
Administrative expenses .....	(766,252)	(1.1)	(926,833)	(1.4)	(1,216,110)	(1.1)
Research and development expenses .....	(1,511,815)	(2.3)	(2,104,226)	(3.1)	(3,151,401)	(2.7)
Fair value changes on investments measured at fair value through profit or loss .....	2,813,353	4.2	2,727,283	4.0	6,371,098	5.6
Share of losses of investments accounted for using the equity method .....	(92,781)	(0.1)	(150,445)	(0.2)	(231,496)	(0.2)
Other income .....	522,436	0.8	540,493	0.8	448,671	0.4
Other (losses)/gains, net .....	(379,439)	(0.6)	(528,250)	(0.8)	72,040	0.1
<b>Operating profit</b> .....	1,372,670	2.0	3,785,064	5.5	12,215,467	10.7
Finance (expense)/income, net .....	(85,867)	(0.1)	(86,246)	(0.1)	26,784	0.0
Fair value changes of convertible redeemable preferred shares .....	(8,759,314)	(13.1)	(2,523,309)	(3.7)	(54,071,603)	(47.2)
<b>(Loss)/profit before income tax</b> .....	(7,472,511)	(11.2)	1,175,509	1.7	(41,829,352)	(36.5)
Income tax expenses .....	(154,519)	(0.2)	(683,903)	(1.0)	(2,059,763)	(1.8)
<b>(Loss)/profit for the year</b> .....	(7,627,030)	(11.4)	491,606	0.7	(43,889,115)	(38.3)
<b>Non-IFRS Measure:</b>						
<b>Adjusted (loss)/profit (unaudited)<sup>(1)</sup></b> .....	(303,887)	(0.5)	1,895,657	2.8	5,361,876	4.7

Note:

(1) We define ‘adjusted (loss)/profit’ as loss or profit for the year by adding back (i) fair value changes of convertible redeemable preferred shares, (ii) share-based compensation, (iii) net fair value gains on investments, and (iv) amortization of intangible assets resulting from acquisitions. Adjusted (loss)/profit is not a measure required by, or presented in accordance with IFRS. The use of adjusted (loss)/profit has limitation as an analytical tool, and you should not consider it in isolation from, or as a substitute for analysis of, our results of operations or financial condition as reported under IFRS. See “—Non-IFRS Measure: Adjusted (Loss)/Profit” for details.

### DESCRIPTION OF MAJOR COMPONENTS OF OUR RESULTS OF OPERATIONS

#### Our Company

Our business activities are regularly reviewed and evaluated by the chief operating decision-maker, who is responsible for allocating resources and assessing performance of our operating segment. Our chief operating decision-maker has been identified as our Chief Executive Officer, who makes strategic decisions and considers that our operations are operated and managed as four segments.

#### Revenue

During the Track Record Period, we generated revenues from four business segments: smartphones, IoT and lifestyle products, internet services and others. Our revenues from smartphones

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segment are derived from the sale of smartphones. Our revenues from the IoT and lifestyle products segment comprise revenues from sales of (i) our other in-house products, including smart TVs, laptops, AI speakers and smart routers, and (ii) our ecosystem products, including certain IoT and other smart hardware products, as well as certain lifestyle products. Our revenues from internet services segment are derived from advertising services and internet value-added services. Revenues from other segment are primarily derived from repair services for our hardware products.

The following table sets forth segment revenue both as an absolute amount and as a percentage of total revenues for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
	(in thousands, except percentages)					
Smartphones	53,715,410	80.4	48,764,139	71.3	80,563,594	70.3
IoT and lifestyle products	8,690,563	13.0	12,415,438	18.1	23,447,823	20.5
Internet services	3,239,454	4.9	6,537,769	9.6	9,896,389	8.6
Others	1,165,831	1.7	716,815	1.0	716,936	0.6
<b>Total</b>	<b>66,811,258</b>	<b>100.0</b>	<b>68,434,161</b>	<b>100.0</b>	<b>114,624,742</b>	<b>100.0</b>

Geographically, we generated 93.9%, 86.6% and 72.0% of our revenues in mainland China in 2015, 2016 and 2017, respectively. The following table sets forth revenues from mainland China and the rest of the world both as an absolute amount and as a percentage of total revenues for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
	(in thousands, except percentages)					
Mainland China	62,755,575	93.9	59,279,381	86.6	82,543,462	72.0
Rest of the world	4,055,683	6.1	9,154,780	13.4	32,081,280	28.0
<b>Total</b>	<b>66,811,258</b>	<b>100.0</b>	<b>68,434,161</b>	<b>100.0</b>	<b>114,624,742</b>	<b>100.0</b>

### Smartphones

We sell our smartphones through our new retail channels directly to end users and through our online and offline distribution partners. We strive to offer our smartphones at price points that are accessible to the widest user base. The following table sets forth the average selling prices, the number of smartphones sold, and the total revenue from smartphone sales for the periods indicated.

	For the year ended December 31,		
	2015	2016	2017
Average selling price (RMB) <sup>(1)</sup>	807.2	879.9	881.3
Number of smartphones sold (thousands)	66,546	55,419	91,410
Total revenues from smartphones segment (RMB thousands)	53,715,410	48,764,139	80,563,594

Note:

(1) Averaging selling price equals our total revenue from smartphones segment divided by the total number of smartphones sold.

The average selling price of our smartphones fluctuated over the years due to various factors such as sales volume of differently priced models and the mix of sales channels. Revenues from the smartphone segment increased by 65.2% from 2016 to 2017, compared to a decrease of 9.2% from 2015 to 2016.

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### *IoT and Lifestyle Products*

We have significantly expanded our product categories during the Track Record Period and systematically introduced a series of popular products. In addition to our in-house products, we collaborate with our ecosystem partners to design and develop a wide range of smart home, health and fitness, travel, audio, kids and other IoT products, as well as certain lifestyle products, the sales of which has driven the growth of our user base.

### *Internet Services*

The growth of our internet services revenues ultimately depends on the size of our user base and the level of user engagement and spending. MAUs of our MIUI operating system increased by 20.1% from 112.2 million in December 2015 to 134.8 million in December 2016, and further by 26.7% to 170.8 million in December 2017. Average internet services revenues per user, calculated as the ratio of internet services revenues for the year divided by the MAUs in December for such year, increased from RMB28.9 in 2015 to RMB48.5 in 2016, and further to RMB57.9 in 2017. We derive our internet services revenues from advertising and internet value-added services, which mainly include online games. The following table sets forth internet services revenues from advertising and internet value-added services, both as an absolute amount and as a percentage of total internet services revenues for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
	(in thousands, except percentages)					
Advertising services . . . . .	1,820,637	56.2	3,838,420	58.7	5,614,389	56.7
Internet value-added services . . . . .	1,418,817	43.8	2,699,349	41.3	4,282,000	43.3
<b>Total</b> . . . . .	<u>3,239,454</u>	<u>100.0</u>	<u>6,537,769</u>	<u>100.0</u>	<u>9,896,389</u>	<u>100.0</u>

We generate advertising revenue primarily by offering advertisements through our online distribution channels, which include our mobile apps and smart TVs. We offer diverse types of advertising formats, such as display and performance-based advertising, to our advertising customers to suit their particular business needs and marketing goals. Revenue from display-based advertisements to the users of online, mobile platforms and other devices operated by us are recognized on a straight-line basis over the contract period. Revenue from performance-based advertisements is recognized based on actual performance measurement. We recognize the revenue from the delivery of such advertisements typically based on a per-click basis when the users click on the content, on a per-impression basis when the advertising content is displayed to users, or on a per-download basis, when the third-party apps is downloaded by users.

For online games operations, we primarily generate revenue from sales of virtual currency for purchase of virtual items that can be used in the games we operate, which is subject to the revenue-sharing arrangements with third-party game developers. Revenues from online games operations amounted to RMB1,334.5 million, RMB2,135.0 million and RMB2,546.1 million in 2015, 2016 and 2017, respectively.

Our other sources of internet value-added service revenues are mainly from paid subscription by users of premium entertainment content (such as online videos, literature and music), as well as live streaming and internet financial services.

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### Others

Revenues from other segment are primarily derived from repair services for our hardware products.

### Cost of Sales

Our cost of sales for smartphones segment and IoT and lifestyle products segment primarily consist of (i) procurement cost of raw materials and components for our in-house products, (ii) assembly cost charged by our outsourcing partners for our in-house products, (iii) royalty fees for certain technologies embedded in our in-house products, (iv) costs, in the forms of production costs and profit-sharing, paid to our partners for procuring ecosystem products, (v) warranty expenses, and (vi) provision for impairment of inventories. Our cost of sales for internet services segment primarily consist of (i) content fees to game developers, and (ii) bandwidth, server custody and cloud service related costs. Cost of sales for others segment primarily consists of hardware repair costs.

The following table sets forth our cost of sales by segment and as a percentage of total revenues for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
(in thousands, except percentages)						
Smartphones	53,886,309	80.7	47,082,377	68.8	73,462,255	64.1
IoT and lifestyle products	8,655,686	13.0	11,402,565	16.7	21,496,958	18.8
Internet services	1,160,777	1.7	2,329,294	3.4	3,935,638	3.4
Others	408,553	0.6	370,570	0.5	575,686	0.5
<b>Total</b>	<b>64,111,325</b>	<b>96.0</b>	<b>61,184,806</b>	<b>89.4</b>	<b>99,470,537</b>	<b>86.8</b>

### Gross Profit

The following table sets forth our gross profit in absolute amounts and as a percentage of revenues, or gross margins, for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
(in thousands, except percentages)						
Gross profit	2,699,933	4.0	7,249,355	10.6	15,154,205	13.2

The following table sets forth our gross (loss)/profit and gross margin by segment for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
(in thousands, except percentages)						
Smartphones	(170,899)	(0.3)	1,681,762	3.4	7,101,339	8.8
IoT and lifestyle products	34,877	0.4	1,012,873	8.2	1,950,865	8.3
Internet services	2,078,677	64.2	4,208,475	64.4	5,960,751	60.2
Others	757,278	65.0	346,245	48.3	141,250	19.7
<b>Total</b>	<b>2,699,933</b>	<b>4.0</b>	<b>7,249,355</b>	<b>10.6</b>	<b>15,154,205</b>	<b>13.2</b>



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### Selling and Marketing Expenses

Our selling and marketing expenses primarily consist of (i) offline promotional and advertising expenses, (ii) online promotional and advertising expenses, and (iii) salaries and benefits (including employee benefit expenses and share-based compensation) relating to selling and marketing personnel. Offline promotional and advertising activities primarily include the placement of physical advertisements in mass transit stations, on billboards and in residential and commercial buildings. Online promotional and advertising activities primarily include advertising in films and TV series, on internet video platforms, in popular mobile apps and through search engines, as well as celebrity endorsements.

Selling and marketing expenses increased significantly during the Track Record Period primarily due to (i) an expanded sales and marketing team dedicated to promoting our brand, products and services along with the rapid growth of Mi Home network, and (ii) the increased promotional activities in mainland China and the rest of the world.

### Administrative Expenses

Our administrative expenses primarily consist of (i) salaries and benefits (including employee benefit expenses and share-based compensation) relating to administrative personnel, (ii) certain third-party consulting and professional service fees, (iii) depreciation and amortization expenses allocated to administrative expenses, and (iv) rent, utility and other office expenses allocated to administrative expenses.

During the Track Record Period, administrative expenses increased steadily primarily due to increased headcount in line with our expanding business operations and, to a lesser extent, increased professional fees.

### Research and Development Expenses

Our research and development expenses primarily comprise (i) salaries and benefits (including employee benefit expenses and share-based compensation) relating to research and development personnel, (ii) sample testing and certification expenses, (iii) licensing fees paid to third parties for certain intellectual property used, (iv) depreciation and amortization expenses allocated to research and development expenses and (v) rent, utility and other office expenses allocated to research and development expenses.

The increase in research and development expenses during the Track Record Period was primarily due to an increase in the number of research and development personnel.

### Share-based Compensation

In May 2011, our Directors approved the Xiaomi Corporation 2011 Employee Stock Option Plan, which was further superseded in its entirety as the Pre-[REDACTED] ESOP to attract, motivate, retain and reward certain employees and directors. We are authorized to grant share options and RSUs to our employees and directors under the Pre-[REDACTED] ESOP. Share-based compensation expenses constitute a portion of salaries and benefits, which will be reflected in our selling and marketing expenses, administrative expenses and research and development expenses.

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In terms of the share options we have awarded to our employees, we used the discounted cash flow method to determine the underlying equity fair value of our Company and adopted equity allocation model to determine the fair value of the underlying ordinary shares. Key assumptions, such as discount rate and projections of future performance, are determined by us with best estimate. Based on fair value of the underlying ordinary shares, we have used binomial option-pricing model to determine the fair value of the share option as at the grant date. We established a development fund in August 2014 and invited certain of our employees to participate in the fund (the “**Employee Fund**”). See Note 29 to the Accountant’s Report included in Appendix I to this [REDACTED] for details regarding the Employee Fund.

The total expenses recognized in the expenses lines of our consolidated income statements for the Pre-[REDACTED] ESOP granted to our employees were RMB621.6 million, RMB813.9 million and RMB807.9 million for the years ended December 31, 2015, 2016 and 2017, respectively. We will continue to incur expenses in connection with any further grants under the Post-[REDACTED] ESOP and the Employee Fund, and will incur additional expenses to the extent that additional share options and RSUs are granted in the future.

### Fair Value Changes on Investments Measured at Fair Value through Profit or Loss

We recognize the fair value changes on the following types of investments in profits or losses: (i) short-term investments measured at fair value through profit or loss, which are RMB-denominated wealth management products whose returns are not guaranteed, (ii) equity investments other than those accounted for using the equity method, and (iii) investments in convertible redeemable preferred shares or ordinary shares with preferential rights.

The following table sets forth a breakdown of our fair value changes on investments measured at fair value through profit or loss by asset class for the periods indicated:

	For the year ended December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Fair value changes on short-term investments measured at fair value through profit or loss	11,943	4,537	21,076
Fair value changes on long-term investments measured at fair value through profit or loss <sup>(1)</sup>	2,801,410	2,722,746	6,350,022
<b>Total</b>	<u>2,813,353</u>	<u>2,727,283</u>	<u>6,371,098</u>

Notes:

(1) Represents (i) fair value changes on equity investments and (ii) fair value changes on preferred shares investments.

### Share of Losses of Investments Accounted for Using the Equity Method

We recorded share of losses from investments primarily because we had accounted for several investee companies that had losses using the equity method during the Track Record Period.

### Other Income

Our other income primarily includes (i) government grants, (ii) value-added tax and other tax refunds, (iii) dividend income and (iv) income from wealth management products.

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The following table sets forth a breakdown of our other income by amount and as a percentage of our total revenues for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
	(in thousands, except percentages)					
Government grants . . . . .	87,698	0.1	217,046	0.3	121,151	0.1
Value-added tax and other tax refunds . . . . .	38,017	0.1	121,939	0.2	3,738	0.0
Dividend income . . . . .	3,652	0.0	96,328	0.1	106,291	0.1
Income from wealth management products <sup>(1)</sup> . . . . .	393,069	0.6	105,180	0.2	217,491	0.2
<b>Total</b> . . . . .	<u>522,436</u>	<u>0.8</u>	<u>540,493</u>	<u>0.8</u>	<u>448,671</u>	<u>0.4</u>

Note:

- (1) Represents (i) investment income from short-term investments measured at fair value through profit or loss and (ii) interest income from short-term investments measured at amortized cost.

### Other (Losses)/Gains, Net

Our other (losses)/gains, net primarily include (i) gains on disposal of investments, (ii) remeasurement of loss of significant influence in an associate, (iii) foreign exchanges losses, net, and (iv) impairment on investments accounted for using the equity method. Gains on disposal of investments primarily arise from disposal of our equity investments in our investee companies. Foreign exchanges losses, net are incurred primarily due to fluctuations in exchange rates between RMB and U.S. dollars.

The following table sets forth a breakdown of our other (losses)/gains, net, by amount and as a percentage of our total revenues for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
	(in thousands, except percentages)					
Gains on disposal of investments <sup>(1)</sup> . . . . .	533,516	0.8	29,490	0.0	283,437	0.3
Remeasurement and impairment on investments <sup>(2)</sup> . . . . .	(421,717)	(0.6)	(511,532)	(0.7)	—	—
Foreign exchanges losses, net . . . . .	(506,528)	(0.8)	(54,291)	(0.1)	(144,265)	(0.1)
Others . . . . .	15,290	0.0	8,083	0.0	(67,132)	(0.1)
<b>Total</b> . . . . .	<u>(379,439)</u>	<u>(0.6)</u>	<u>(528,250)</u>	<u>(0.8)</u>	<u>72,040</u>	<u>0.1</u>

Note:

- (1) Represents (i) net gains on disposal of long-term investments measured at fair value through profit or loss and (ii) net gain on disposal of investments accounted for using the equity method.  
(2) Represents (i) remeasurement of loss of significant influence in an associate and (ii) impairment on investments accounted for using the equity method.

### Operating Profit

The following table sets forth our operating profit in absolute amounts and as a percentage of our revenues, or operating margin, for the periods indicated:

	For the year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
	(in thousands, except percentages)					
Operating profit . . . . .	1,372,670	2.0	3,785,064	5.5	12,215,467	10.7

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### Finance (Expense)/Income, Net

Finance (expense)/income, net represents finance income net against finance costs. Finance income consists of interest income from bank deposits, including bank balance and term deposits, whereas finance cost consists of interest expenses.

### Fair Value Changes of Convertible Redeemable Preferred Shares

Fair value changes of convertible redeemable preferred shares represent changes in fair value of the Preferred Shares issued by us. For the years ended December 31, 2015, 2016 and 2017, our fair value changes of convertible redeemable preferred shares were RMB8.8 billion, RMB2.5 billion and RMB54.1 billion, respectively. Prior to the [REDACTED], the Preferred Shares are not traded in an active market and the fair value at respective reporting dates is determined using valuation techniques. Please refer to Note 35 to the Accountant’s Report included in Appendix I to this [REDACTED] for details of the key assumptions in the valuations. Upon the completion of the [REDACTED], all of our Preferred Shares will be automatically converted to our Class B ordinary shares of US\$0.000025 each. The fair value of each of Preferred Share will then be equivalent to the fair value of each of our ordinary shares on the conversion date, which is the [REDACTED] in the [REDACTED].

We designate Preferred Shares as financial liabilities at fair value. Any changes in the fair value of the Preferred Shares are recorded as “fair value changes of convertible redeemable preferred shares” in the consolidated income statements.

### Taxation

Income tax expense was RMB154.5 million, RMB683.9 million and RMB2.1 billion for 2015, 2016 and 2017, respectively. As of the Latest Practicable Date, we did not have any dispute with any tax authority. We are subject to various rates of income tax under different jurisdictions. The following summarizes the major factors affecting our applicable tax rates in the Cayman Islands, the BVI, Hong Kong, mainland China and India.

#### *Cayman Islands and the British Virgin Islands*

We are incorporated under the laws of the Cayman Islands as an exempted company with limited liability under the Cayman Companies Law. The Cayman Islands currently levy no taxes on individuals or corporations based upon profits, income, gains or appreciations and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to the Company levied by the Government of the Cayman Islands save certain stamp duties which may be applicable, from time to time, on certain instruments executed in or brought within the jurisdiction of the Cayman Islands. The Cayman Islands are not party to any double tax treaties that are applicable to any payments made by or to the Company. Our BVI companies limited by shares incorporated or registered with limited liability under the BVI Business Companies Act (as amended) are currently exempt from income and corporate tax. In addition, BVI does not levy capital gains tax on companies incorporated or registered under the BVI Business Companies Act (as amended).

#### *Hong Kong*

Hong Kong profits tax rate was 16.5% on the assessable profits for the years ended December 31, 2015, 2016 and 2017, based on the existing legislation, interpretation and practices in respect thereof.

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### *Mainland China*

Our income tax provision in respect of our operations in mainland China was calculated at tax rate of 25% on the assessable profits during the Track Record Period, based on the existing legislation, interpretations and practices in respect thereof.

Certain of our subsidiaries were entitled to preferential tax rates ranging from 9% to 15%. Beijing Xiaomi Mobile Software Co., Ltd. was accredited as a software enterprise under the relevant Chinese laws and regulations in 2012. Accordingly, Beijing Xiaomi Mobile Software Co., Ltd. was exempt from income tax for two years, between 2012 and 2013, followed by a 50% reduction in the statutory income tax rate of 25% for the next three years, between 2014 and 2016. Beijing Xiaomi Mobile Software Co., Ltd. also qualifies as a “high and new technology enterprise,” and it enjoys a preferential income tax rate of 15% commencing from 2017. Tibet Zimi Communications Co., Ltd., established in the Tibet Autonomous Region of the mainland China, is entitled to a preferential rate of 9% for 2015, 2016 and 2017.

According to the relevant laws and regulations promulgated by the State Tax Bureau of mainland China that were effective from 2008 onwards, enterprises engaging in research and development activities are entitled to claim 150% of their research and development expenses so incurred a tax deductible expenses when determining their assessable profits for that year (“**Super Deduction**”). We have made our best estimate for the Super Deduction to be claimed for our entities in ascertaining their assessable profits during the Track Record Period.

### *India*

The income tax provision for our entity in India was calculated at effective tax rates of 30% to 35% on the assessable profits during the Track Record Period, based on the existing legislation, interpretations and practices in respect thereof.

### **Profit/(Loss)**

The following table sets forth our profit/(loss) in absolute amounts and as a percentage of our revenues, or net margin, for the periods indicated:

	Year ended December 31,					
	2015		2016		2017	
	RMB	%	RMB	%	RMB	%
(in thousands, except percentages)						
Profit/(loss) .....	(7,627,030)	(11.4)	491,606	0.7	(43,889,115)	(38.3)

Our Board has resolved that for the year ending December 31, 2018 and each year thereafter, we will limit the net margin after tax for our entire hardware business (including smartphone, IoT and lifestyle products) (the “**Margin**”), to a maximum of 5%. The Margin is calculated based on the following formula (the “**Formula**”):

- the Margin = the net profits after tax relating to the sales of our entire hardware business based on our management accounts for a financial year (the “**Net Profit**”) / the revenue of the entire hardware business for the same financial year; and
- the Net Profit = (revenue from the entire hardware business – cost of goods sold relating to the entire hardware business – the selling and marketing expenses, research and development expenses and administrative expenses relating to the sales of the entire hardware business) X (1 – the Group’s effective tax rate for the preceding financial year).



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The expenses cited in the Formula exclude any expenses related to share based compensation. If the actual Margin achieved for any financial year exceeds 5% calculated based on the Formula, we will distribute the amount of net profit earned exceeding 5% to our customers in general by way of reasonable means as our Board may determine from time to time.

### NON-IFRS MEASURE: ADJUSTED (LOSS)/PROFIT

To supplement our consolidated results which are prepared and presented in accordance with IFRS, we also use adjusted (loss)/profit as an additional financial measure, which is not required by, or presented in accordance with IFRS. We believe that this non-IFRS measure facilitates comparisons of operating performance from period to period and company to company by eliminating potential impacts of items that our management does not consider to be indicative of our operating performance such as certain non-cash items and certain impact of investment transactions. The use of this non-IFRS measure has limitations as an analytical tool, and you should not consider it in isolation from, or as a substitute for analysis of, our results of operations or financial conditions as reported under IFRS. In addition, this non-IFRS financial measure may be defined differently from similar terms used by other companies.

The following tables set forth the reconciliations of our non-IFRS financial measure for the years ended December 31, 2017, 2016 and 2015 to the nearest measures prepared in accordance with IFRS:

Year Ended December 31, 2017						
Adjustments						
		Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments <sup>(1)</sup>	Amortization of intangible assets <sup>(2)</sup>	Non-IFRS
	As reported	(RMB in thousand, unless specified)				
(Loss)/profit for the year	(43,889,115)	54,071,603	909,155	(5,732,151)	2,384	5,361,876
Net margin	(38.3)%					4.7%
Year Ended December 31, 2016						
Adjustments						
		Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments <sup>(1)</sup>	Amortization of intangible assets resulting from acquisitions <sup>(2)</sup>	Non-IFRS
	As reported	(RMB in thousand, unless specified)				
(Loss)/profit for the year	491,606	2,523,309	871,230	(1,992,999)	2,511	1,895,657
Net margin	0.7%					2.8%
Year Ended December 31, 2015						
Adjustments						
		Fair value changes of convertible redeemable preferred shares	Share-based compensation	Net fair value gains on investments <sup>(1)</sup>	Amortization of intangible assets resulting from acquisitions <sup>(2)</sup>	Non-IFRS
	As reported	(RMB in thousand, unless specified)				
(Loss)/profit for the year	(7,627,030)	8,759,314	690,742	(2,130,169)	3,256	(303,887)
Net margin	(11.4)%					(0.5)%

*Notes:*

- (1) Includes fair value gains on equity investments and preferred shares investments, impairment provision for investments and remeasurement of loss of significant influence in an associate, net of tax.
- (2) Represents amortization of intangible assets resulting from acquisitions, net of tax.

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### PERIOD-TO-PERIOD COMPARISON OF RESULTS OF OPERATIONS

#### Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

##### *Revenues*

Our total revenues increased by 67.5% from RMB68.4 billion in 2016 to RMB114.6 billion in 2017. Our revenues in mainland China increased by 39.2% from RMB59.3 billion in 2016 to RMB82.5 billion in 2017, and our overseas revenues significantly increased by 250.4% from RMB9.1 billion in 2016 to RMB32.1 billion in 2017.

##### *Smartphones*

Our revenues from the smartphones segment increased by 65.2% from RMB48.8 billion in 2016 to RMB80.6 billion in 2017, primarily due to a significant increase in the number of smartphones sold. We sold approximately 91.4 million units of smartphones in 2017, compared to approximately 55.4 million units sold in 2016. The average selling price of our smartphones was RMB881.3 per unit in 2017, compared with RMB879.9 per unit in 2016.

##### *IoT and lifestyle products*

Our revenues from the IoT and lifestyle products segment increased by 88.9% from RMB12.4 billion in 2016 to RMB23.5 billion in 2017, primarily due to a significant expansion of our IoT and lifestyle product offerings, and a continued increase in the popularity of existing products among consumers, such as smart TVs and laptops. Revenues from the sales of our key IoT products, including smart TVs and laptops, increased by 146.5% from RMB3,372.2 million in 2016 to RMB8,312.4 million in 2017.

##### *Internet services*

Our revenues from internet services segment increased by 51.4% from RMB6.5 billion in 2016 to RMB9.9 billion in 2017, primarily due to an increase in revenues from advertising and game operations. MIUI MAUs increased by 26.7% from 134.8 million in December 2016 to 170.8 million in December 2017. Average internet services revenues per user, calculated as the ratio of internet services revenues for a year divided by the MAUs in December for such year, increased from RMB48.5 in 2016 to RMB57.9 in 2017.

##### *Others*

Our revenues from others segment remained stable from RMB716.8 million in 2016 to RMB716.9 million in 2017.

##### *Cost of sales*

Our cost of sales increased by 62.6% from RMB61.2 billion in 2016 to RMB99.5 billion in 2017.

##### *Smartphones*

Cost of sales related to the smartphones segment increased by 56.0% from RMB47.1 billion in 2016 to RMB73.5 billion in 2017, primarily due to increased cost associated with the increased sales of

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our smartphones. The cost of inventories recognized as expense and included in cost of sales of smartphones segment increased by 26.7% from RMB40.9 billion in 2016 to RMB51.8 billion in 2017. Royalty fees paid to third-party intellectual property holders increased by 78.9% from RMB1.9 billion in 2016 to RMB3.4 billion in 2017. Warranty expenses increased by 77.8% from RMB0.9 billion in 2016 to RMB1.6 billion in 2017, and provision for impairment of inventories increased by 178.6% from RMB203.0 million in 2016 to RMB565.6 million in 2017.

### *IoT and lifestyle products*

Cost of sales in the IoT and lifestyle products segment increased by 88.5% from RMB11.4 billion in 2016 to RMB21.5 billion in 2017, which was generally consistent with the increase in IoT and lifestyle product revenues.

### *Internet services*

Cost of sales related to the internet services segment increased by 69.0% from RMB2.3 billion in 2016 to RMB3.9 billion in 2017, primarily due to increased amount of revenues shared with game developers as well as our increased infrastructure spending resulting from higher user traffic and engagement. Revenues shared with game developers increased by 20.0% from RMB1.0 billion in 2016 to RMB1.2 billion in 2017. Cloud service, bandwidth and server custody fees increased by 54.6% from RMB601.5 million in 2016 to RMB929.9 million in 2017.

### *Others*

Cost of sales in our others segment increased by 55.4% from RMB370.6 million in 2016 to RMB575.7 million in 2017, primarily due to the increased hardware repair costs.

### ***Gross profit and gross margin***

As a result of the foregoing, our gross profit significantly increased by 109.0% from RMB7.2 billion in 2016 to RMB15.2 billion in 2017. The gross profit margin from our smartphones segment increased significantly from 3.4% in 2016 to 8.8% in 2017 primarily due to changes in product mix. The gross profit margin from our IoT and lifestyle products segment remained relatively stable, at 8.2% in 2016 and 8.3% in 2017. The gross profit margin from our internet services segment decreased from 64.4% in 2016 to 60.2% in 2017, as we significantly improved the quality of our internet services, which resulted in faster growth in our cloud service, bandwidth and server custody fees over our segment revenues. Furthermore, internet financial services, which has a relatively lower gross margin compared to other internet value-added services, contributed a larger portion to our internet services segment revenues. As a result of the foregoing, our gross margin increased from 10.6% in 2016 to 13.2% in 2017.

### ***Selling and marketing expenses***

Our selling and marketing expenses increased by 73.1% from RMB3.0 billion in 2016 to RMB5.2 billion in 2017, primarily due to increases in promotional and advertising expenses, as well as salaries and benefits for selling and marketing personnel. Promotional and advertising expenses increased significantly by 99.5% from RMB963.4 million in 2016 to RMB1.9 billion in 2017, primarily due to our enhanced promotion and advertising activities for our newly launched products and our brand in general. Salaries and benefits (including employee benefit expenses and share-based

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compensation) relating to selling and marketing personnel increased primarily due to increased headcount.

### *Administrative expenses*

Our administrative expenses increased by 31.2% from RMB0.9 billion in 2016 to RMB1.2 billion in 2017, primarily due to the increase in salaries and benefits (including employee benefit expenses and share-based compensation) as a result of the increased headcount of administrative personnel.

### *Research and development expenses*

Our research and development expenses increased by 49.8% from RMB2.1 billion in 2016 to RMB3.2 billion in 2017, primarily due to an increase in the total compensation relating to research and development personnel as a result of the increased headcount as well as an increase in sample testing and certification expenses. Salaries and benefits (including employee benefit expenses and share-based compensation) relating to research and development personnel increased primarily due to increased headcount. Our research and development personnel headcount increased by 52.5% from 3,441 as of December 31, 2016 to 5,247 as of December 31, 2017.

### *Fair value changes on investments measured at fair value through profit or loss*

Our fair value changes on investments measured at fair value through profit or loss significantly increased by 133.6% from RMB2.7 billion in 2016 to RMB6.4 billion in 2017, primarily due to significant fair value gains in several of our investee companies.

### *Share of losses of investments accounted for using the equity method*

Our share of losses of investments accounted for using the equity method increased by 53.9% from RMB150.4 million in 2016 to RMB231.5 million in 2017 due to increased losses incurred by certain of these investments.

### *Other income*

Our other income decreased by 17.0% from RMB540.5 million in 2016 to RMB448.7 million in 2017, primarily due to decreases in government grants and value added tax and other tax refunds, partially offset by an increase in interest income from short-term investments.

### *Other (losses)/gains, net*

Our other (losses)/gains, net changed from a net loss of RMB528.3 million in 2016 to a net gain of RMB72.0 million in 2017, primarily due to increased gains on disposal of long-term investments, and no impairment on investments accounted for using the equity method occurred, partially offset by an increase in foreign exchange losses resulting from the devaluation of the U.S. dollars in our current deposit accounts and our trade and other receivables.

### *Operating profit*

As a result of the foregoing, we had operating profits of RMB3.8 billion and RMB12.2 billion in 2016 and 2017, respectively.

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### *Finance (expense)/income, net*

We had a net finance expense of RMB86.2 million in 2016 and a net finance income of RMB26.8 million in 2017, primarily due to higher interests from more bank deposits, partially offset by higher interest expenses. Our interest expenses increased primarily due to an increase in bank borrowings and an increase in average interest rates on these bank borrowings partially offset by a higher amount of interest expenses being capitalized.

### *Fair value changes of convertible redeemable preferred shares*

Changes in the fair value of convertible redeemable preferred shares were recorded as “fair value changes of convertible redeemable preferred shares.” Fair value changes of convertible redeemable preferred shares increased from a loss of RMB2.5 billion in 2016 to a loss of RMB54.1 billion in 2017, resulting from changes in the valuation of our Company. See Note 35 to the Accountant’s Report included in Appendix I to this [REDACTED] for details regarding the change in fair value of convertible redeemable preferred shares.

### *(Loss)/profit before income tax*

As a result of the foregoing, we had a loss before income tax of RMB41.8 billion in 2017, compared with a profit before income tax of RMB1.2 billion in 2016.

### *Income tax expenses*

Our income tax expenses increased from RMB683.9 million in 2016 to RMB2.1 billion in 2017, primarily due to our significantly higher operating profits in 2017.

### *(Loss)/profit for the year*

As a result of the foregoing, we had a loss of RMB43.9 billion in 2017, compared with a profit of RMB491.6 million in 2016.

## **Year Ended December 31, 2016 Compared to Year Ended December 31, 2015**

### *Revenues*

Our total revenues increased by 2.4% from RMB66.8 billion in 2015 to RMB68.4 billion in 2016. Globally, our revenues in mainland China decreased by 5.5% from RMB62.8 billion in 2015 to RMB59.3 billion in 2016, and our overseas revenues increased by 125.7% from RMB4.0 billion in 2015 to RMB9.1 billion in 2016.

### *Smartphones*

Our revenues from the smartphones segment decreased by 9.2% from RMB53.7 billion in 2015 to RMB48.8 billion in 2016, primarily due to a decrease in the number of smartphones sold, partially offset by the increase in the average selling price of our smartphones. We sold approximately 55.4 million units of smartphones in 2016, compared to approximately 66.5 million units sold in 2015. The average selling price of our smartphones was RMB879.9 per unit in 2016, compared with RMB807.2 per unit in 2015.



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### *IoT and lifestyle products*

Our revenues from the IoT and lifestyle products segment increased by 42.9% from RMB8.7 billion in 2015 to RMB12.4 billion in 2016, primarily due to the significant expansion in our IoT and lifestyle products portfolio and an increase in the popularity of such products among consumers. Revenues from sales of our key IoT products, including smart TVs and laptops, increased by 29.1% from RMB2,612.0 million in 2015 to RMB3,372.2 million in 2016.

### *Internet services*

Our revenues from internet services segment increased significantly by 101.8% from RMB3.2 billion in 2015 to RMB6.5 billion in 2016, primarily due to the growth of our advertising and internet value-added services revenues driven by an increase in our user base and deepening of user engagement. MAUs of our MIUI operating system increased by 20.1% from 112.2 million in December 2015 to 134.8 million in December 2016. Average internet services revenues per user, calculated as the ratio of internet services revenues for a year divided by the MAUs in December for such year, increased from RMB28.9 in 2015 to RMB48.5 in 2016.

### *Others*

Our revenues from others segment decreased by 38.5% from RMB1.2 billion in 2015 to RMB0.7 billion in 2016, primarily due to the decrease of revenue-sharing from cellular network carriers in mainland China for the cellular service plans purchased by users of our smartphones.

### ***Cost of sales***

Our cost of sales decreased by 4.6% from RMB64.1 billion in 2015 to RMB61.2 billion in 2016.

### *Smartphones*

Cost of sales in the smartphones segment decreased by 12.6% from RMB53.9 billion in 2015 to RMB47.1 billion in 2016, primarily due to a decrease in the number of smartphones sold. The cost of inventories recognized as expense and included in cost of sales of smartphones segment decreased by 18.5% from RMB50.2 billion in 2015 to RMB40.9 billion in 2016. Royalty fees paid to third-party intellectual property holders increased by 18.8% from RMB1.6 billion in 2015 to RMB1.9 billion in 2016. Warranty expenses decreased by 18.2% from RMB1.1 billion in 2015 to RMB0.9 billion in 2016, and provision for impairment of inventories decreased by 73.5% from RMB764.8 million in 2015 to RMB203.0 million in 2016.

### *IoT and lifestyle products*

Cost of sales from the IoT and lifestyle products segment increased by 31.7% from RMB8.7 billion in 2015 to RMB11.4 billion in 2016, primarily due to the increase in our IoT and lifestyle product revenues.

### *Internet services*

Cost of sales in the internet services segment significantly increased by 100.7% from RMB1.1 billion in 2015 to RMB2.3 billion in 2016, primarily due to increased amount of revenues

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shared with game developers as well as our increased infrastructure service spending resulting from higher user traffic and engagement. Revenues shared with game developers and video providers increased by 45.3% from RMB737.6 million in 2015 to RMB1.1 billion in 2016. Cloud service, bandwidth and server custody fees increased by 91.8% from RMB313.6 million in 2015 to RMB601.5 million in 2016.

### *Others*

Cost of sales in our others segment decreased by 9.3% from RMB408.6 million in 2015 to RMB370.6 million in 2016, primarily due to the decrease of repairing fees.

### *Gross profit and gross margin*

As a result of the foregoing, our gross profit significantly increased by 168.5% from RMB2.7 billion in 2015 to RMB7.2 billion in 2016. We had a gross loss margin of 0.3% from our smartphones segment in 2015, compared to a gross profit margin of 3.4% in 2016, primarily due to changes in product mix among which relatively more products in 2016 had higher gross profit margin. The gross profit margin from our IoT and lifestyle products segment increased significantly from 0.4% in 2015 to 8.2% in 2016, primarily due to the introduction of new and enhanced models, our expanded product category offerings, as well as the rapid growth of our sales volume, resulting in significant economies of scale. The gross profit margin from our internet services segment increased from 64.2% in 2015 to 64.4% in 2016. In 2016, we also generated a significantly higher percentage of our total revenues from our IoT and lifestyle products segment and internet services segment, which have higher gross margins than our smartphones segment. Our gross margin increased from 4.0% in 2015 to 10.6% in 2016.

### *Selling and marketing expenses*

Our selling and marketing expenses increased by 58.0% from RMB1.9 billion in 2015 to RMB3.0 billion in 2016, primarily due to a significant increase in our promotion and advertising efforts to promote our products, services and brand, which are complementary to our word-of-mouth marketing approach through the sales of our products. Promotion and advertising expenses increased significantly from RMB152.9 million in 2015 to RMB963.4 million in 2016, primarily due to more promotion and advertising activities we conducted related to the launch of our new products and the enhancement of our overall brand recognition.

### *Administrative expenses*

Our administrative expenses increased by 21.0% from RMB0.8 billion in 2015 to RMB0.9 billion in 2016, primarily due to an increase in salaries and benefits (including employee benefit expenses and share-based compensation) relating to administrative personnel to support our growing business operations.

### *Research and development expenses*

As we dedicated more resources towards our people, technology and infrastructure, our research and development expenses increased by 39.2% from RMB1.5 billion in 2015 to RMB2.1 billion in 2016, primarily due to an increase in the total compensation relating to research and development personnel as a result of the increased headcount as well as the increase in research and

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development expenditures. Compensation relating to research and development personnel consisting of salaries and benefits (including employee benefit expenses and share-based compensation) increased primarily due to increased headcount. Our research and development personnel headcount increased by 50.1% from 2,292 as of December 31, 2015 to 3,441 as of December 31, 2016.

### ***Fair value changes on investments measured at fair value through profit or loss***

Our fair value changes on investments measured at fair value through profit or loss remained relatively stable at RMB2.8 billion in 2015 and RMB2.7 billion in 2016.

### ***Share of losses of investments accounted for using the equity method***

Our share of losses of investments accounted for using the equity method increased by 62.2% from RMB92.8 million in 2015 to RMB150.4 million in 2016 due to increased losses incurred by certain investments accounted for using the equity method.

### ***Other income***

Our other income increased by 3.5% from RMB522.4 million in 2015 to RMB540.5 million in 2016, primarily due to the new governments’ grants, higher dividend income and higher value-added tax and other tax refund, partially offset by a decrease in investment income from short-term investments.

### ***Other losses/gains, net***

Our net other losses, net increased by 39.2% from RMB379.4 million in 2015 to RMB528.3 million in 2016, primarily due to a decrease in gains on disposal of long-term investments, partially offset by a decrease in foreign exchanges losses resulting from our increased U.S. dollar asset holdings.

### ***Operating profit***

As a result of the foregoing, we had operating profits of RMB1.4 billion and RMB3.8 billion in 2015 and 2016, respectively.

### ***Finance (expense)/income, net***

As a result of the foregoing, we had finance expenses of RMB85.9 million and RMB86.2 million in 2015 and 2016, respectively.

### ***Fair value changes of convertible redeemable preferred shares***

Fair value changes of convertible redeemable preferred shares was a loss of RMB8.8 billion in 2015, compared to a loss of RMB2.5 billion in 2016, resulting from changes in the valuation of our Company. See Note 35 to the Accountant’s Report included in Appendix I to this [REDACTED] for details regarding the change in fair value of convertible redeemable preferred shares.

### ***(Loss)/profit before income tax***

As a result of the foregoing, we had a profit before income tax of RMB1.2 billion in 2016, compared with a loss before income tax of RMB7.5 billion in 2015.

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### *Income tax expenses*

Our income tax expenses increased from RMB154.5 million in 2015 to RMB683.9 million in 2016, primarily due to the fact that profit for entities subject to income tax increase.

### *(Loss)/profit for the year*

As a result of the foregoing, we had a profit of RMB491.6 million in 2016, compared with a loss of RMB7.6 billion in 2015.

## DISCUSSION OF CERTAIN KEY CONSOLIDATED BALANCE SHEET ITEMS

The table below sets forth selected information from our consolidated statements of financial position as of the dates indicated, which have been extracted from our audited consolidated financial statements included in the Accountant’s Report in Appendix I to this [REDACTED].

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Total non-current assets . . . . .	14,184,010	20,129,283	28,731,300
Total current assets . . . . .	24,952,527	30,636,318	61,138,461
<b>Total assets . . . . .</b>	<b>39,136,537</b>	<b>50,765,601</b>	<b>89,869,761</b>
Total non-current liabilities . . . . .	109,310,565	116,760,214	169,947,781
Total current liabilities . . . . .	16,464,280	26,063,262	47,132,671
<b>Total liabilities . . . . .</b>	<b>125,774,845</b>	<b>142,823,476</b>	<b>217,080,452</b>
<b>Net liabilities . . . . .</b>	<b>(86,638,308)</b>	<b>(92,057,875)</b>	<b>(127,210,691)</b>
Share capital . . . . .	150	150	150
Reserves . . . . .	(86,714,628)	(91,191,820)	(127,272,511)
Non-controlling interests . . . . .	76,170	133,795	61,670
<b>Total equity . . . . .</b>	<b>(86,638,308)</b>	<b>(92,057,875)</b>	<b>(127,210,691)</b>
<b>Total equity and liabilities . . . . .</b>	<b>39,136,537</b>	<b>50,765,601</b>	<b>89,869,761</b>

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The following table sets forth our current assets and current liabilities as of the dates indicated:

	As of December 31,			As of
	2015	2016	2017	March 31,
	(in thousands of RMB)			2018
				(unaudited)
<b>Current assets</b>				
Inventories	8,643,183	8,378,342	16,342,928	[15,237,493]
Trade receivables	1,470,155	2,089,518	5,469,507	[5,689,848]
Loan receivables	100,980	1,598,063	8,144,493	[8,185,244]
Prepayments and other receivables	3,118,768	4,748,418	11,393,910	[11,260,984]
Short-term investments measured at amortized cost	1,629,000	80,000	800,000	[1,000,000]
Short-term investments measured at fair value through profit or loss	789,943	3,437,537	4,488,076	[2,644,754]
Short-term bank deposits	739,360	440,156	225,146	[28,198]
Restricted cash	67,060	633,964	2,711,119	[1,678,153]
Cash and cash equivalents	8,394,078	9,230,320	11,563,282	[14,220,213]
<b>Total current assets</b>	<b>24,952,527</b>	<b>30,636,318</b>	<b>61,138,461</b>	<b>[59,944,887]</b>
<b>Current liabilities</b>				
Trade payables	14,225,540	17,577,702	34,003,331	[29,464,513]
Other payables and accruals	1,275,068	1,876,267	4,223,979	[1,409,363]
Advance from customers	530,675	1,836,174	3,390,650	[4,648,044]
Borrowings	—	3,768,500	3,550,801	[5,806,972]
Income tax liabilities	101,345	257,558	421,113	[507,727]
Warranty provision	331,652	747,061	1,542,797	[1,798,361]
<b>Total current liabilities</b>	<b>16,464,280</b>	<b>26,063,262</b>	<b>47,132,671</b>	<b>[43,634,980]</b>
<b>Net current assets</b>	<b>8,488,247</b>	<b>4,573,056</b>	<b>14,005,790</b>	<b>[16,309,907]</b>

### Inventories

Our inventories consist of raw materials, finished goods, work in progress and spare parts and others. The following table sets forth a breakdown of our inventories as of the dates indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Raw materials	1,052,131	2,958,699	5,117,285
Work in progress	1,735,739	988,561	1,352,886
Finished goods	5,622,542	3,326,181	8,461,798
Spare parts	772,070	906,155	1,569,040
Others <sup>(1)</sup>	261,929	481,905	510,061
	9,444,411	8,661,501	17,011,070
Less: Provision for impairment <sup>(2)</sup>	(801,228)	(283,159)	(668,142)
<b>Total</b>	<b>8,643,183</b>	<b>8,378,342</b>	<b>16,342,928</b>

#### Notes:

(1) Others primarily comprise in-transit inventories.

(2) Provision for impairment was recognized for the amount by which the carrying amount of the inventories exceeds its net realizable value, and was recorded in “cost of sales” in the consolidated income statements. The provision for impairment expenses of inventory amounted to RMB777.0 million, RMB280.0 million and RMB652.6 million for the years ended December 31, 2015, 2016 and 2017, respectively.

Our inventories decreased by 3.1% from RMB8.6 billion as of December 31, 2015 to RMB8.4 billion as of December 31, 2016, primarily due to a decrease in finished goods of

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RMB2.3 billion and a decrease in work in progress of RMB0.7 billion, partially offset by an increase in raw materials of RMB1.9 billion. Our finished goods decreased primarily due to improved sales as we launched new models of smartphones such as Mi MIX and Mi Note 2 in the second half of 2016. Our raw materials increased primarily due to increased procurement for production in anticipation of new product launches.

Our inventories significantly increased by 95.1% from RMB8.4 billion as of December 31, 2016 to RMB16.3 billion as of December 31, 2017, primarily due to an increase in raw materials of RMB2.2 billion and an increase in finished goods of RMB5.1 billion. Our raw materials increased primarily as we purchased an increased amount of raw materials for the production of Redmi Note 5 and Mi MIX 2S, the two new models of our smartphones launched in the first quarter of 2018. Our finished goods increased primarily due to the introduction of our Mi MIX 2 and Mi 6 in the second half of 2017 and the anticipated demand of their popularity.

The following table sets forth the number of our inventory turnover days for the periods indicated:

	For the year ended December 31,		
	2015	2016	2017
Inventory turnover days <sup>(1)</sup> .....	49	51	45

*Note:*

(1) Inventory turnover days for a period equals the average of the opening and closing inventory balances of the indicated period divided by the cost of sales for such period and multiplied by the number of days in such period, being 365 days for a full-year period.

Our inventory turnover days increased from 49 days for the year ended December 31, 2015 to 51 days for the year ended December 31, 2016. Our inventory turnover days decreased from 51 days for the year ended December 31, 2016 to 45 days for the year ended December 31, 2017 primarily due to faster sales cycle of our products.

RMB[7,955.5] million, or [94.0]%, of our finished goods as of December 31, 2017 had been sold as of March 31, 2018.

### Trade Receivables

Trade receivables represent outstanding amount due from our customers or agents for the purchase of services we performed or inventories we sold in the ordinary course of business. Trade receivables are classified as current assets if they are expected to be collected in one year or less (or more than one year but within the normal operating cycle of the applicable business). Otherwise, they are presented as non-current assets. Trade receivables from third parties have credit periods within 180 days.

The following table sets forth our trade receivables as of the date indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Third parties .....	1,487,537	1,981,250	5,337,711
Related parties .....	13,177	148,316	188,616
	1,500,714	2,129,566	5,526,327
Less: allowance for impairment .....	(30,559)	(40,048)	(56,820)
<b>Total</b> .....	<u>1,470,155</u>	<u>2,089,518</u>	<u>5,469,507</u>



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Our trade receivables increased by 42.1% from RMB1.5 billion as of December 31, 2015 to RMB2.1 billion as of December 31, 2016, primarily due to significant growth in our internet services and our increased sales overseas, especially in certain overseas markets with longer receivable days.

Our trade receivables significantly increased by 161.8% from RMB2.1 billion as of December 31, 2016 to RMB5.5 billion as of December 31, 2017, primarily due to the overall growth of our product sales, an increase in trade receivables associated with distributors in overseas markets and the development of our internet services.

The following table sets forth an aging analysis of our trade receivables as of the dates indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
<b>Trade receivables</b>			
Up to 3 months	1,319,371	1,943,643	5,099,590
3 to 6 months	115,680	115,885	302,354
6 months to 1 year	62,083	38,097	39,028
1 to 2 years	3,580	30,840	53,613
Over 2 years	—	1,101	31,742
<b>Total</b>	<u>1,500,714</u>	<u>2,129,566</u>	<u>5,526,327</u>

The following table sets forth the number of turnover days for our trade receivables for the periods indicated:

	For the year ended December 31,		
	2015	2016	2017
Trade receivables turnover days <sup>(1)</sup>	7	9	12

Note:

(1) Trade receivables turnover days for a period equals the average of the opening and closing trade receivables divided by revenue for the same period and multiplied by 365 days for a full-year period.

There were no significant fluctuations in the trade receivables turnover days for the years ended December 31, 2015, 2016 and 2017.

RMB[5.0] billion, or [90.7]%, of our trade receivables as of December 31, 2017 had been settled as of March 31, 2018. Approximately RMB[149.3] million of our trade receivables due from related parties as of December 31, 2017 had been settled as of March 31, 2018.

### Loan Receivables

Our loan receivables primarily comprise loans from our subsidiaries that engage in internet finance business to its customers.

Our loan receivables increased significantly from RMB101.0 million as of December 31, 2015 to RMB1.6 billion as of December 31, 2016, and further to RMB8.1 billion as of December 31, 2017, primarily due to a growth of our internet finance business.

RMB[4,541.4] million, or [53.9]%, of our loan receivables as of December 31, 2017 had been repaid as of March 31, 2018.

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### *Prepayments and Other Receivables*

Prepayments and other receivables primarily comprise receivables from outsourcing partners for outsourcing of raw materials, recoverable value-added tax and other taxes, receivables from import and export agents, prepayments to suppliers, loans to related parties, prepaid fees for establishing loan facilities and other prepaid expenses, receivables from market development fund, receivables from disposal of investments, deposits to suppliers, receivables from employees related to the Employee Fund and interest receivables.

The following table sets forth our prepayments and other receivables as of the dates indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Receivables from outsourcing partners for supply of raw materials . . . . .	347,639	1,929,600	5,663,419
Recoverable value-added tax and other taxes . . . . .	1,657,857	1,173,704	3,387,401
Receivables from import and export agents . . . . .	—	132,493	644,766
Prepayments to suppliers . . . . .	350,516	114,770	304,286
Loans to related parties . . . . .	76,463	74,329	62,143
Prepaid fees for establishing loan facilities and other prepaid expenses . . .	143,731	183,248	195,592
Receivables from market development fund . . . . .	—	105,654	199,751
Receivables from disposal of investments . . . . .	203,831	164,281	108,056
Deposits to suppliers . . . . .	28,795	563,688	96,913
Receivables from employees related to the Employee Fund . . . . .	156,200	142,200	114,850
Interest receivables . . . . .	21,826	21,401	104,521
Others . . . . .	131,910	143,050	512,212
<b>Total</b> . . . . .	<u>3,118,768</u>	<u>4,748,418</u>	<u>11,393,910</u>

For our hardware product sales in India, we deliver raw materials to our outsourcing partners in India, who then assemble such raw materials into finished goods that are sold to our local operating subsidiary. The increase in receivables from outsourcing partners for supply of raw materials between 2015 and 2017 is generally a result of the rapid growth of our product sales in India.

### *Short-term Investments Measured at Amortized Cost*

Our short-term investments measured at amortized cost comprise bank wealth management products issued by major and reputable commercial banks with guaranteed returns. As of December 31, 2015, 2016 and 2017, none of these investments are past due.

Our short-term investments measured at amortized cost decreased from RMB1.6 billion as of December 31, 2015 to RMB80.0 million as of December 31, 2016, primarily due to the reduction of the purchase of wealth management products with low guaranteed returns in order to seek for better returns in products with floating rate. As a result, the purchase of short-term investments measured at amortized cost is only RMB1.2 billion compared to a RMB2.7 billion in maturity in the year of 2016. Our short-term investments measured at amortized cost significantly increased from RMB80.0 million as of December 31, 2016 to RMB0.8 billion in 2017, primarily due to higher amount of cash generated from operating activities and increased purchase of wealth management products from banks with guaranteed returns.

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### *Short-term Investments Measured at Fair Value through Profit or Loss*

Our short-term investments measured at fair value through profit or loss comprise wealth management products issued by major and reputable commercial banks without guaranteed returns. As of December 31, 2015, 2016 and 2017, none of these investments are past due.

Our short-term investments measured at fair value through profit or loss increased from RMB0.8 billion as of December 31, 2015 to RMB3.4 billion as of December 31, 2016, and further by 30.6% to RMB4.5 billion in 2017, primarily due to increased purchase of wealth management products from banks.

### *Long-term Investments Measured at Fair Value through Profit or Loss*

The following table sets forth our long-term investments measured at fair value through profit or loss as of the dates indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
<b>Long-term investments measured at fair value through profit or loss</b>			
Equity investments			
Listed .....	3,026,959	3,302,689	5,764,532
Unlisted .....	851,682	1,201,237	1,683,719
Preferred shares investments .....	4,512,153	7,845,272	11,408,710
<b>Total</b> .....	8,390,794	12,349,198	18,856,961

The investees of our preferred shares investments are principally engaged in the business related to IoT and lifestyle products, media and entertainment, mobile internet, internet finance and artificial intelligence. These investments are typically convertible redeemable preferred shares or ordinary shares with preferential rights. We have the right to require and demand the investees to redeem all of the shares held by us at guaranteed predetermined fixed amount at the redemption events, which are out of the control of the issuers. Hence, these investments are accounted for as debt instrument investments and are measured at financial assets at fair value through profit or loss.

Our long-term investments measured at fair value through profit or loss increased by 47.2% from RMB8.4 billion as of December 31, 2015 to RMB12.3 billion as of December 31, 2016, and further by 52.7% to RMB18.9 billion as of December 31, 2017, reflecting the overall increase in our investment activities and the valuation of our investee companies.

Our long-term investments in publicly traded securities remained relatively stable from RMB3,027.0 million as of December 31, 2015 to RMB3,302.7 million as of December 31, 2016 and increased by 74.5% to RMB5,764.6 million as of December 31, 2017, reflecting the overall increase of the market value of our public investee companies.

### *Land Use Rights and Prepayment for Land Use Rights*

Land use rights represent prepayments for the land use rights in mainland China, which are stated at cost initially and expensed on a straight-line basis over the periods of the leases. These land use rights are acquired primarily in order to construct our office complex. The authorized periods of the land use rights were 40 to 50 years.

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Our prepayment to land use rights was RMB2.6 billion, nil and nil as of December 31, 2015, 2016 and 2017, respectively. Our land use rights were nil, RMB3.5 billion and RMB3.4 billion as of December 31, 2015, 2016 and 2017, respectively. In 2015, we made a payment for the acquisition of certain land use rights for new office buildings for which we obtained the related certificates in 2016. Such payment was recorded in 2015 as prepayment and then recognized as land use rights in 2016. We paid an aggregate of RMB3.6 billion for the acquisition of land use rights for new office buildings, pursuant to the agreements entered into with the local governmental authorities or local governments in 2015 and 2016.

### *Intangible Assets*

The following table sets forth a breakdown of our intangible assets as of the dates indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Trademarks, patents and domain names .....	271,409	474,814	723,205
Licenses .....	637	371,579	1,279,951
Goodwill .....	248,167	248,167	248,167
Others .....	33,546	25,573	23,029
<b>Total</b> .....	<u>553,759</u>	<u>1,120,133</u>	<u>2,274,352</u>

Our intangible assets increased significantly by 102.3% from RMB553.8 million as of December 31, 2015 to RMB1.1 billion as of December 31, 2016, primarily due to an increase in license of RMB371.2 million as a result of our acquisition of a third-party payment license holder and the increase in trademarks, patents and domain names of RMB203.4 million, mainly as a result of our acquisition of certain patents.

Our intangible assets increased significantly by 103.0% from RMB1.1 billion as of December 31, 2016 to RMB2.3 billion as of December 31, 2017, primarily due to an increase in licensed rights to use intellectual property.

### *Trade Payables*

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method. Trade payables primarily include payables for inventories and royalty fee.

Our trade payables increased by 23.6% from RMB14.2 billion as of December 31, 2015 to RMB17.6 billion as of December 31, 2016, and further increased by 93.4% to RMB34.0 billion as of December 31, 2017, primarily due to an increase in payables for inventories and royalty fee as a result of our increased inventory balances in anticipation of strong demand in light of the increasing popularity of certain models of our smartphones.

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The following table sets forth an aging analysis of our trade payables, based on the invoice date, as of the dates indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Up to 3 months	12,586,016	15,590,971	32,859,302
3 to 6 months	469,059	690,100	936,690
6 months to 1 year	786,894	606,043	180,060
1 to 2 years	383,292	687,632	22,525
Over 2 years	279	2,956	4,754
<b>Total</b>	<b>14,225,540</b>	<b>17,577,702</b>	<b>34,003,331</b>

The following table sets forth the number of turnover days for our trade payables for the periods indicated:

	For the year ended December 31,		
	2015	2016	2017
Trade payables turnover days <sup>(1)</sup>	76	95	95

Note:

(1) Trade payables turnover days for a period equals the average of the opening and closing trade payables balance divided by cost of sales for the same period and multiplied by 365 days for a full-year period or the period generating the revenue.

Our trade payables turnover days increased from 76 for the year ended December 31, 2015 to 95 for the year ended December 31, 2016 primarily due to the increased use of post-payment in the settlement with suppliers instead of prepayment.

Our trade payables turnover days remained unchanged from the year ended December 31, 2016 to the year ended December 31, 2017 primarily due to the consistent practice of our supply-chain management.

RMB[31.8] billion, or [93.5]%, of our trade payables as of December 31, 2017 had been settled as of March 31, 2018.

### Other Payables and Accruals

The following table sets forth our other payables and accruals as of the dates indicated:

	For the year ended December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Amounts collected for third parties	6,304	115,740	1,056,228
Payroll and welfare payables	264,387	403,872	694,887
Deposits payable	160,225	259,206	678,472
Employee fund	381,360	409,771	469,930
Accrual expenses	111,064	159,284	373,034
Payables for construction cost	—	142,520	241,881
Loans from related parties	31,184	50,873	51,336
Payables for investments	120,216	106,737	151,712
Other taxes payable	29,838	41,870	59,431
Others	170,490	186,394	447,068
<b>Total</b>	<b>1,275,068</b>	<b>1,876,267</b>	<b>4,223,979</b>

Our other payables and accruals increased from RMB1.3 billion as of December 31, 2015 to RMB1.9 billion as of December 31, 2016, primarily due to an increase in payables for construction

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cost of RMB142.5 million, an increase in payroll and welfare payables of RMB139.5 million, an increase in deposits payable of RMB99.0 million and an increase in amounts collected for third party vendors on our online sales channels of RMB109.4 million.

Our other payables and accruals increased from RMB1.9 billion as of December 31, 2016 to RMB4.2 billion as of December 31, 2017, primarily due to an increase in amounts collected for third party vendors on our online sales channels of RMB0.9 billion, an increase in deposits payable of RMB419.3 million and an increase in payroll and welfare payables of RMB291.0 million.

RMB[3.0] billion, or [70.8]%, of our other payables and accruals as of December 31, 2017 had been settled as of March 31, 2018.

### *Advance from Customers*

Advance from customers represents cash collected from our customers before their acceptance of products or our performance of services.

Our advance from customers increased from RMB530.7 million as of December 31, 2015 to RMB1.8 billion as of December 31, 2016 and further increased to RMB3.4 billion as of December 31, 2017, primarily due to the overall growth in our business operations and the increasing popularity of our products and services.

RMB[3.2] billion, or [93.4]%, of our advance from customers as of December 31, 2017 had been settled as of March 31, 2018.

## KEY RATIOS/METRICS

In addition to the measures presented in our consolidated financial statements, we use the following key ratios/metrics to evaluate our business, measure our performance, develop financial forecasts, and make strategic decisions.

The following table sets forth our key ratios/metrics for the periods indicated:

	For the Year Ended December 31,		
	2015	2016	2017
Total revenue growth (%)	N/A	2.4	67.5
Revenue growth for smartphones segment (%)	N/A	(9.2)	65.2
Number of smartphones sold (thousands)	66,546	55,419	91,410
Smartphone average selling price (RMB)	807.2	879.9	881.3
Revenue growth for IoT and lifestyle products segment (%)	N/A	42.9	88.9
Revenue of IoT and lifestyle products segment per smartphone sold (RMB)	130.6	224.0	256.5
Revenue growth for internet services segment (%)	N/A	101.8	51.4
End-of-the-period MIUI MAUs (millions)	112.2	134.8	170.8
Average internet services revenue per user <sup>(1)</sup> (RMB)	28.9	48.5	57.9
Gross margin for hardware <sup>(2)</sup> (%)	(0.2)	4.4	8.7
Gross margin for internet services segment (%)	64.2	64.4	60.2
Non-IFRS adjusted (loss)/profit <sup>(3)</sup> (RMB in thousands)	(303,887)	1,895,657	5,361,876
Non-IFRS net margin <sup>(4)</sup> (%)	(0.5)	2.8	4.7
Cash conversion cycle <sup>(5)</sup> (days)	(20)	(35)	(38)

Notes:

(1) Calculated as revenue for the internet services segment divided by end-of-the-period MIUI MAUs.



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- (2) Gross margin for hardware equals the sum of the gross profit for the smartphone segment and the IoT and lifestyle products segment divided by the total revenue from these two segments for the period indicated and multiplied by 100%.
- (3) We define non-IFRS adjusted (loss)/profit as loss or profit for the period, as adjusted by adding back (i) fair value changes of convertible redeemable preferred shares, (ii) share-based compensation, (iii) net fair value gains on investments, and (iv) amortization of intangible assets resulting from acquisitions.
- (4) Represents non-IFRS adjusted (loss)/profit divided by the total revenue for the period indicated.
- (5) Cash conversion cycle equals inventory turnover days, plus trade receivables turnover days, minus trade payables turnover days.

See “—Period-to-Period Comparison of Results of Operations—Year Ended December 31, 2017 Compared to Year Ended December 31, 2016” and “—Period-to-Period Comparison of Results of Operations—Year Ended December 31, 2016 Compared to Year Ended December 31, 2015” above for a discussion of the factors affecting our revenue growth, gross margin, during the respective periods. See “—Discussion of Certain Key Balance Sheets Items” above for a discussion of the inventory turnover days.

## LIQUIDITY AND CAPITAL RESOURCES

During the Track Record Period and up to the Latest Practicable Date, we had historically funded our cash requirements principally from cash generated from our operations and bank borrowings. We had cash and cash equivalents of RMB8.4 billion, RMB9.2 billion and RMB11.6 billion as of December 31, 2015, 2016 and 2017, respectively.

Going forward, we believe that our liquidity requirements will be satisfied by using a combination of cash generated from operating activities, other funds raised from the capital markets from time to time and the [REDACTED] received from the [REDACTED]. We currently do not have any plans for material additional external financing, except as described in this document.

The following table sets forth our cash flows for the periods indicated:

	For the year ended December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Net cash (used in)/generated from operating activities	(2,601,311)	4,531,264	(995,669)
Net cash generated from/(used in) investing activities	873,395	(3,735,267)	(2,677,714)
Net cash generated from/(used in) financing activities	568,383	(72,141)	6,214,930
Net (decrease)/increase in cash and cash equivalents	(1,159,533)	723,856	2,541,547
Cash and cash equivalents at beginning of the year	9,264,955	8,394,078	9,230,320
Effects of exchange rate changes on cash and cash equivalents	288,656	112,386	(208,585)
Cash and cash equivalents at end of the year	8,394,078	9,230,320	11,563,282

### *Net Cash (Used in)/Generated from Operations*

Net cash (used in)/generated from operations represents cash (used in)/generated from operations minus income tax paid. Cash (used in)/generated from operations primarily comprise our loss or profit for the period adjusted by non-cash items and changes in working capital.

For 2017, net cash used in operations amounted to RMB1.0 billion, representing cash generated from operations of RMB0.5 billion minus income tax paid of RMB1.5 billion. Cash used in operations was primarily due to our loss before income tax of RMB41.8 billion, as adjusted by (i) the add-back of non-cash items, primarily comprising fair value changes of convertible redeemable preferred shares of RMB54.1 billion, partially offset by fair value gains on long-term investments measured at fair value through profit or loss of RMB6.4 billion, and (ii) changes in working capital, which primarily comprised an increase in inventories of RMB8.6 billion, an increase in loan and interest receivables of

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RMB6.9 billion related to our internet finance business, an increase in prepayments and other receivables of RMB6.6 billion and an increase in trade payables of RMB15.5 billion.

For 2016, net cash generated from operations amounted to RMB4.5 billion, representing cash generated from operations of RMB4.7 billion minus income tax paid of RMB0.2 billion. Cash generated from operations was primarily attributable to our profit before income tax of RMB1.2 billion, as adjusted by (i) the add-back of non-cash items, primarily comprising fair value changes of convertible redeemable preferred shares of RMB2.5 billion, partially offset by fair value gains on long-term investments measured at fair value through profit or loss of RMB2.7 billion, and (ii) changes in working capital, which primarily comprised an increase in trade payables of RMB3.4 billion.

For 2015, net cash used in operations amounted to RMB2.6 billion for the year ended December 31, 2015, representing cash used in operations of RMB2.3 billion minus income tax paid of RMB0.3 billion. Cash used in operations was primarily due to our loss of RMB7.5 billion, as adjusted by (i) the add-back of non-cash items, primarily comprising fair value changes of convertible redeemable preferred shares of RMB8.8 billion, partially offset by fair value gains on long-term investments measured at fair value through profit or loss of RMB2.8 billion, and (ii) changes in working capital, which primarily comprised an increase in trade payables of RMB1.6 billion, and a decrease in other payables and accruals of RMB2.4 billion.

### ***Net Cash Generated from/(Used in) Investing Activities***

For 2017, our net cash used in investing activities was RMB2.7 billion, which was mainly attributable to the net cash used in purchase and settlement of wealth management products (including short-term investments measured at fair value through profit or loss and short-term investments measured at amortized cost) of RMB1.7 billion, and capital expenditures of RMB1.2 billion.

For 2016, our net cash used in investing activities was RMB3.7 billion, which was mainly attributable to the net cash used in purchase and settlement of wealth management products of RMB1.1 billion, capital expenditures of RMB1.8 billion, and placement of long-term investments (including long-term investments measured at fair value through profit or loss and investments accounted for using the equity method) of RMB1.7 billion.

For 2015, our net cash generated from investing activities was RMB0.9 billion, which was mainly attributable to the net cash generated from purchase and settlement of wealth management products of RMB5.6 billion, partially offset by capital expenditures of RMB2.5 billion and placement of investments of RMB3.5 billion.

### ***Net Cash Generated from/(Used in) Financing Activities***

For 2017, our net cash generated from financing activities was RMB6.2 billion, which was mainly attributable to proceeds from borrowings of RMB11.2 billion mainly used to finance our internet finance business, partially offset by repayment of borrowings of RMB4.5 billion.

For 2016, our net cash used in financing activities was RMB72.1 million, which was mainly attributable to placement of restricted cash of RMB624.3 million and interest paid of RMB137.8 million, partially offset by proceeds from borrowings of RMB740.0 million.

For 2015, our net cash generated from financing activities was RMB568.4 million, which was mainly attributable to proceeds from borrowings of RMB3.2 billion and proceeds from issuance of

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convertible redeemable preferred shares of RMB1.4 billion, partially offset by repayment of borrowings of RMB4.0 billion.

### INDEBTEDNESS

#### *Borrowings*

As of December 31, 2015, 2016 and 2017, and March 31, 2018, we had total borrowings of RMB3.2 billion, RMB4.2 billion, RMB10.8 billion and RMB[14.1] billion, respectively.

Borrowings are classified as current liabilities unless we have an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period. Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost.

The following table sets forth our borrowings included in non-current liabilities and current liabilities as of the dates indicated:

	For the year ended December 31,			As of March 31,
	2015	2016	2017	2018
	(in thousands of RMB)			(unaudited)
<b>Included in non-current liabilities:</b>				
Asset-backed securities . . . . .	—	390,000	2,400,105	[920,969]
Fund raised through trusts . . . . .	—	—	400,000	[400,000]
Secured borrowings . . . . .	—	—	714,107	[809,619]
Unsecured borrowings . . . . .	3,246,800	—	3,737,100	[6,119,290]
<b>Included in current liabilities:</b>				
Pledged borrowings . . . . .	—	300,000	729,404	[715,114]
Asset-backed securities . . . . .	—	—	1,491,147	[2,587,998]
Fund raised through trusts . . . . .	—	—	1,170,250	[2,343,860]
Unsecured borrowings . . . . .	—	3,468,500	160,000	[160,000]

We entered into a three-year bank loan agreement on November 1, 2014. We drew down US\$0.5 billion in term loan on July 13, 2015. The borrowings were unsecured and principally used for our business operations.

In 2016, we had short-term borrowings from the Bank of Ningbo that amounted to RMB350.0 million to finance our internet finance business. As of December 31, 2016, RMB50.0 million had been repaid, and the remaining borrowings were collateralized by a pledge of bank deposits of US\$90.0 million, which was recorded as “restricted cash” in the consolidated balance sheets.

We completed several rounds of issuance of our asset-backed securities (“ABS”) during the Track Record Period to finance our internet finance business. In 2016, we issued RMB500.0 million ABS, of which RMB390.0 billion represented senior tranche while RMB110.0 million represented subordinate tranches which were fully acquired by us.

During 2017, long-term borrowings of RMB714.1 million for our office building constructions were secured by construction in progress and land use rights amounted to approximately RMB3.6 billion.

We repaid the remaining borrowings from the Bank of Ningbo in 2017 and obtained new short-term borrowings that amounted to RMB350.0 million to finance our internet finance business.

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We repaid the three-year term loan date November 1, 2014 on August 2, 2017 and entered into another three-year facility bank loan agreement on July 26, 2017. We drew down a US\$0.5 billion term loan on August 2, 2017.

In 2017, we also issued ABS amounting to RMB4.8 billion of which RMB3.9 billion represented senior tranche while RMB856.0 million represented subordinate tranches which were fully acquired by the Group and RMB166.4 million was repaid by the Group. We also raised several rounds of funds amounting to RMB1.2 billion through third party trusts. These financing activities were undertaken to finance our internet finance business.

As of December 31, 2015, 2016 and 2017, the annual interest rate of the interest-bearing liabilities ranges from 2.56% to 2.61%, 2.95% to 4.79%, and 2.22% to 9.00%, respectively.

During the Track Record Period and up to the Latest Practicable Date, we had not been in violation of any of the covenants pursuant to the applicable agreement we entered with each of the lenders mentioned above. Our Directors confirm that we are not subject to other material covenants under any agreements with respect to any bank loans or other borrowings. Our Directors also confirm that there was no delay or default in the repayment of borrowings during the Track Record Period. Taking into consideration our financial position, our Directors are of the opinion that we are able to abide by these covenants amid current market conditions and that our capital raising abilities were not materially affected as of December 31, 2017.

## CONTINGENT LIABILITIES

As of December 31, 2015, 2016 and 2017, we did not have any material contingent liabilities.

## CAPITAL EXPENDITURES AND LONG-TERM INVESTMENTS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

The following table sets forth our capital expenditures and placement for long-term investments for the periods indicated:

	For the year ended December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Capital expenditures .....	2,524,356	1,826,245	1,217,806
Placement for long-term investments <sup>(1)</sup> .....	2,891,017	809,882	813,175
<b>Total</b> .....	<u>5,415,373</u>	<u>2,636,127</u>	<u>2,030,981</u>

Note:

(1) Placement for long-term investments during our Track Record Period represents equity investments and preferred share investments.

Our historical capital expenditures primarily were on property and equipment resulting from the construction of and improvements made to our office complex, as well as intangible assets. We funded our capital expenditure requirements and placement for long-term investments during the Track Record Period mainly from cash generated from our operating activities and bank borrowings. Our capital expenditures and placement for long-term investments amounted to RMB5.4 billion, RMB2.6 billion and RMB2.0 billion for 2015, 2016 and 2017, respectively.

We plan to fund our planned capital expenditures and long-term investments measured at fair value through profit or loss using cash flows generated from our operations and the [REDACTED]

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received from the [REDACTED]. See “Future Plans and Use of [REDACTED]” in this [REDACTED] for more details. We may reallocate the fund to be utilized on capital expenditure and long-term investments measured at fair value through profit or loss based on our ongoing business needs.

See “Business—Risk Management and Internal Control—Investment Risk Management” in this [REDACTED] for a discussion of our investment policy and investment risk management.

### CONTRACTUAL OBLIGATIONS

Our commitments primarily comprise capital expenditure contracted for but not yet incurred during the periods, operating lease commitments and other commitments.

#### *Capital Commitments*

The table below sets forth our capital commitments as of the dates indicated:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Property and equipment .....	75,351	273,789	1,486,029
Intangible assets .....	239,866	159,280	112,888
Investments .....	349,027	305,281	198,788
<b>Total</b> .....	<u>664,244</u>	<u>738,350</u>	<u>1,797,705</u>

#### *Operating Lease Commitments*

We lease office under non-cancellable operating lease agreements. The lease terms are between 1 to 5 years, and majority of lease agreements are renewable at the end of the lease at market rate.

The table below sets forth our future aggregate minimum lease payments under non-cancellable operating leases:

	As of December 31,		
	2015	2016	2017
	(in thousands of RMB)		
Not later than 1 year .....	72,409	273,145	258,230
Later than 1 year and not later than 5 years .....	93,747	411,999	280,613
<b>Total</b> .....	<u>166,156</u>	<u>685,144</u>	<u>538,843</u>

### OFF-BALANCE SHEET COMMITMENTS AND ARRANGEMENTS

As of the Latest Practicable Date, except for the financial guarantee contracts, we had not entered into any off-balance sheet arrangements.

### MATERIAL RELATED PARTY TRANSACTIONS

We enter into transactions with our related parties from time to time. During the Track Record Period, we entered into a number of transactions with related parties in relation to the sales and purchases of goods and services with our associates or associates of Lei Jun. In 2015, 2016 and 2017, (i) sales of goods and services to related parties amounted to RMB83.3 million, RMB614.9 million and

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RMB765.9 million, respectively; and (ii) purchases of goods and services from related parties amounted to RMB4.4 billion, RMB7.1 billion and RMB13.3 billion, respectively. As of December 31, 2015, 2016 and 2017, (i) trade receivables from related parties amounted to RMB13.2 million, RMB148.3 million and RMB188.6 million, respectively; (ii) trade payables to related parties amounted to RMB0.8 billion, RMB2.1 billion and RMB3.2 billion, respectively, (iii) other receivables from related parties amounted to RMB110.1 million, RMB145.4 million and RMB181.8 million, respectively, (iv) other payables to related parties amounted to RMB18.7 million, RMB112.1 million and RMB424.6 million, respectively, (v) prepayments to related parties amounted to RMB9.6 million, RMB40.6 million and RMB67.3 million, respectively, (vi) loans to related parties amounted to RMB76.5 million, RMB74.3 million and RMB62.1 million, respectively, and (vii) loans from related parties amounted to RMB31.2 million, RMB50.9 million and RMB51.3 million, respectively. For more details about our related party transactions, see Note 39 to the Accountant’s Report included in Appendix I to this [REDACTED].

Our Directors believe that our transactions with related parties during the Track Record Period were conducted on an arm’s length basis, and they did not distort our results of operations or make our historical results not reflective of our future performance.

### FINANCIAL RISK DISCLOSURE

Our activities expose us to a variety of financial risks: market risk (including foreign exchange risk, interest rate risk and price risk), credit risk and liquidity risk. Our overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on our financial performance. Risk management is carried out by our senior management.

#### Market Risk

##### *Foreign Exchange Risk*

Our transactions are denominated and settled in our functional currency, U.S. dollars. Our subsidiaries primarily operate in mainland China and are exposed to foreign exchange risk arising from various currency exposures, primarily with respect to U.S. dollars. Therefore, foreign exchange risk primarily arose from recognized assets and liabilities in our subsidiaries in mainland China when receiving or to receive foreign currencies from, or paying or to pay foreign currencies to overseas business partners.

For our subsidiaries whose functional currency is the RMB, if RMB had strengthened or weakened by 5% against the U.S. dollars with all other variables held constant, the profit before income tax for the year ended December 31, 2015 would have been approximately RMB36.0 million higher or lower as a result of net foreign exchange gains on translation of net monetary liabilities denominated in U.S. dollars, and the profit before income tax for the years ended 2016 and 2017 would have been approximately RMB147.3 million higher or lower and RMB124.4 million higher or lower, respectively, as a result of net foreign exchange losses on translation of net monetary assets denominated in U.S. dollars.

##### *Interest Rate Risk*

Our interest rate risk primarily arose from borrowings with floating and fixed rates (details of which have been disclosed in Note 3.1(a) to the Accountant’s Report in Appendix I to this [REDACTED]),



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short-term investments measured at amortized cost, loan receivables, short-term bank deposits and cash and cash equivalents. Those carried at floating rates expose us to cash flow interest rate risk whereas those carried at fixed rates expose us to fair value interest rate risk.

If the interest rate of borrowings with floating rate had been 50 basis points higher or lower, the profit before income tax for the years ended December 31, 2015, 2016 and 2017, would have been approximately RMB16.2 million lower or higher, approximately RMB18.8 million lower or higher, and RMB16.3 million lower or higher, respectively. This analysis does not include the effect of interest capitalized.

If the interest rate of cash and cash equivalents had been 50 basis points higher or lower, the profit before income tax for the years ended December 31, 2015, 2016 and 2017, would have been RMB42.0 million higher or lower, RMB46.2 million higher or lower, and RMB57.8 million higher or lower, respectively.

We regularly monitor our interest rate risk to ensure there is no undue exposure to significant interest rate movements.

### ***Price Risk***

We are exposed to price risk in respect of our long-term investments and short-term investments measured at fair value through profit or loss held by us. We are not exposed to commodity price risk. To manage our price risk arising from the investments, we diversify our portfolio. Each investment is managed by senior management on a case-by-case basis. The sensitivity analysis is performed by our management. See Note 3.3 to the Accountant’s Report included in Appendix I to this [REDACTED] for details.

### **Credit Risk**

We are exposed to credit risk in relation to our cash and cash equivalents, short-term bank deposits, restricted cash, short-term investments measured at amortized cost, loan receivables, trade receivables, other receivables and financial guarantee contracts. The carrying amounts of each class of the above financial assets represent our maximum exposure to credit risk in relation to financial assets.

To manage risk arising from cash and cash equivalents, short-term bank deposits, restricted cash and short-term investments, we only transact with state-owned or reputable financial institutions in mainland China and reputable international financial institutions outside of mainland China. There has been no recent history of default in relation to these financial institutions.

To manage risk arising from trade receivables, we have policies in place to ensure that credit terms are made to counterparties with an appropriate credit history and our management performs ongoing credit evaluations of our counterparties. The credit period granted to our customers is usually no more than 180 days and the credit quality of these customers are assessed, which takes into account their financial position, past experience and other factors. In view of the sound collection history of receivables due from them, our management believes that the credit risk inherent in our outstanding trade receivable balances due from them is not significant.

For other receivables, our management makes periodic collective assessments as well as individual assessment on the recoverability of other receivables based on historical settlement records

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and past experiences. In view of the history of cooperation with debtors and the sound collection history of receivables due from them, our management believes that the credit risk inherent in our outstanding other receivable balances due from them is not significant.

For financial guarantee contracts, we have taken measures to manage credit risk, including credit examination, fraud examination and risk monitoring alert. The maximum credit risk from financial guarantee contracts is approximately RMB2.2 billion, the majority of which is not credit-impaired on initial recognition or does not result in significant increase in credit risk subsequently. We have recognized loss allowance for such losses at each of the reporting date.

To manage risk arising from loan receivables, we perform standardized credit management procedures. For pre-approval investigation, we use our platform and systems using big data technology to optimize the review process, aspects including credit analysis, assessment of collectability of borrowers, and possibility of misconduct and fraudulent activities. In terms of credit examining management, we have established specific policies and procedures to assess loans offering. For subsequent monitoring, we implemented credit examination on each borrower every three months. For unqualified borrowers, credit facilities granted previously could be terminated immediately. Once the loan was issued, all borrowers would be assessed by fraud examination model to prevent fraudulent behaviors. In post-loan supervision, we have established risk monitoring alert system through periodical monitoring, system alert, and corresponding solutions to identify impaired loans. The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. We measure credit risk using Probability of Default (“PD”), Exposure at Default (“EAD”) and Loss Given Default (“LGD”). This is similar to the approach used for the purposes of measuring Expected Credit Loss (“ECL”) under IFRS 9.

### Liquidity Risk

We aim to maintain sufficient cash and cash equivalents. Due to the dynamic nature of the underlying business, our policy is to regularly monitor our liquidity risk and to maintain adequate cash and cash equivalents or adjusted financing arrangements to meet our liquidity requirements.

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For the analysis of our non-derivative financial liabilities that will be settled on a net basis into relevant maturity grouping based on the remaining period at each balance sheet date to the contractual maturity date, please see Note 3.1(c) to the Accountant’s Report included in Appendix I to this [REDACTED].

	Less than 1 year	Between 1 year and 2 years	Between 2 years and 5 years	Over 5 years	Total
	(in thousands of RMB)				
<b>At December 31, 2015</b>					
Borrowings . . . . .	—	3,246,800	—	—	3,246,800
Trade payables . . . . .	14,225,540	—	—	—	14,225,540
Other payables . . . . .	938,463	71,581	—	—	1,010,044
<b>At December 31, 2016</b>					
Borrowings . . . . .	3,768,500	390,000	—	—	4,158,500
Trade payables . . . . .	17,577,702	—	—	—	17,577,702
Other payables . . . . .	1,347,907	1,081	—	—	1,348,988
<b>At December 31, 2017</b>					
Borrowings . . . . .	3,550,801	2,820,105	3,717,184	714,023	10,802,113
Trade payables . . . . .	34,003,331	—	—	—	34,003,331
Other payables . . . . .	3,568,286	206,935	216,496	143,953	4,135,670
Off-balance sheet guarantee liabilities . . . . .	2,152,169	—	—	—	2,152,169

## FUTURE DIVIDENDS

We are a holding company incorporated under the laws of the Cayman Islands. As a result, the payment and amount of any future dividend will also depend on the availability of dividends received from our subsidiaries. Chinese laws require that dividends be paid only out of the profit for the year calculated according to Chinese accounting principles, which differ in many aspects from the generally accepted accounting principles in other jurisdictions, including IFRS. Chinese laws also require foreign-invested enterprises to set aside at least 10% of its after-tax profits as the statutory common reserve fund until the cumulative amount of the statutory common reserve fund reaches 50% or more of such enterprises’ registered capital, if any, to fund its statutory common reserves, which are not available for distribution as cash dividends.

Dividend distribution to our shareholders is recognized as a liability in the period in which the dividends are approved by our shareholders or Directors, where appropriate. During the Track Record Period, no dividends have been paid or declared by us.

## WORKING CAPITAL

Taking into account the financial resources available to us including our cash and cash equivalents on hand, the available banking facilities and the estimated [REDACTED] from the [REDACTED], our Directors are of the view that we have sufficient working capital to meet our present requirements and for the next 12 months from the date of this [REDACTED].

## DISTRIBUTABLE RESERVES

As of December 31, 2017, we did not have any distributable reserves.

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[REDACTED]

### NO MATERIAL ADVERSE CHANGE

After performing sufficient due diligence work which our Directors consider appropriate and after due and careful consideration, the Directors confirm that, up to the date of this [REDACTED], there has been no material adverse change in our financial or trading position or prospects since December 31, 2017, being the end date of the periods reported on in the Accountant’s Report in Appendix I to this [REDACTED], and there is no event since December 31, 2017 that would materially affect the information as set out in the Accountant’s Report in Appendix I to this [REDACTED], except as described below.

On April 2, 2018, we issued 63,959,619 Class B Shares (or [REDACTED] Class B Shares following the Share Subdivision) at par value to Smart Mobile Holdings Limited, an entity controlled by Lei Jun, to reward Lei Jun for his contributions to our Company.

### DISCLOSURE UNDER RULES 13.13 TO 13.19 OF THE LISTING RULES

Our Directors confirm that, except as otherwise disclosed in this [REDACTED], as of the Latest Practicable Date, there was no circumstance that would give rise to a disclosure requirement under Rules 13.13 to 13.19 of the Listing Rules.