

ZTE (763 HK)

Solid 1H results with strong OCF

ZTE released 1H21 results, with revenue/NP growth of 12.4%/119.6% YoY and GPM continued to improve to 36.1% (vs. FY20: 31.6%). 1H21 revenue/NP accounted for 49%/57% of our FY21E estimates. We remain positive on ZTE as we believe the Company will be the major beneficiary of global 5G deployment. We revised up FY21-23E EPS by 9-19% mainly for better margins, and raised TP to HK\$33.06 based on 15x FY22E P/E.

- Despite 5G deployment delay in 1H21, Chinese telcos' full-year plan remains unchanged.** Based on telcos' 1H21 results, 46%/32%/31% of CM/CU/CT FY21 capex budget has been completed. Despite the delay, telcos have not changed their FY21 plan. We believe that telcos' 5G deployment will accelerate in 2H21E. In the previous 2.1G 5G BTS tender, we believe ZTE will win over 35% of the total bid. We expect ZTE to be the key beneficiary of China 5G deployment given telcos' continued investment in network infrastructure and potential share gain.
- Continued improvement in GPM driven by self-developed chips and operating efficiency.** GPM improved to 36.8% in 2Q21 (vs. 28.5%/35.4% in 2Q20/1Q21), mainly due to adoption of self-developed chips and better operating efficiency. ZTE stated that the size of its BTS is reduced by 30%, power consumption is reduced by 30%, performance is improved by 30%, and cost is optimized by 20-30%. We think GPM recovery will sustain and raised our GPM forecast to 35.8%/36.0% in FY22/23E (vs. previous 34.2%/34.5%).
- Stronger cash position with 244% growth YoY.** Meanwhile, 1H21 operating cash flow remained strong and positive, which reached RMB70.3bn in 1H21, exceeding NP of RMB40.8 during the same period. We expect ZTE will continue to strengthen its cash position and the quality of cash flow.
- Maintain BUY with TP of HK\$33.06.** We raised our FY21-23E EPS by 9-19% and lifted our TP to HK\$33.06 based on 15.0x FY22E P/E, lowered from previous 17.4x due to recent sector valuation compression. Trading at 11.8x FY21E P/E, the stock is attractive. We are positive on its 2H21E outlook given that 5G deployment has accelerated. We believe ZTE will enjoy share gain in China 3rd batch 5G BTS tender. Risks include US-China disputes, component restriction and 5G deployment delays.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	90,737	101,451	116,995	129,879	143,959
YoY growth (%)	6.1	11.8	15.3	11.0	10.8
Gross profit margin (%)	37.2	31.6	35.7	35.8	36.0
Net profit (RMB mn)	5,148	4,260	7,206	8,472	9,788
EPS (RMB)	1.22	0.92	1.55	1.83	2.11
YoY growth (%)	NA	-24.8	69.0	17.6	15.5
Consensus EPS (RMB)	NA	0.65	1.47	1.72	2.02
PE (x)	17.6	23.5	13.9	11.8	10.2
PB (x)	2.6	2.3	2.0	1.8	1.6
Yield (%)	0.6	0.6	1.1	1.3	1.5
ROE (%)	19.9	11.8	15.5	16.1	16.4
Net debt/total equity (%)	50.0	43.8	48.4	45.9	42.4

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$ 33.06
(Previous TP)	HK\$28.1)
Up/Downside	+27.2%
Current Price	HK\$ 26.0

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Stock Data

Mkt. Cap. (HK\$ mn)	172,944
Avg. 3mths t/o (HK\$ mn)	292
52W High/Low (HK\$)	31.75/16.50
Total Issued Shares (mn)	755.5

Source: Bloomberg

Shareholding Structure

BlackRock	7.05%
Capital Group	5.08%
Schroders	4.93%

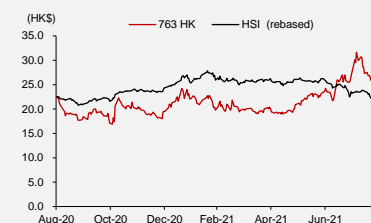
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	0.4%	4.0%
3-mth	28.6%	47.5%
6-mth	36.2%	55.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

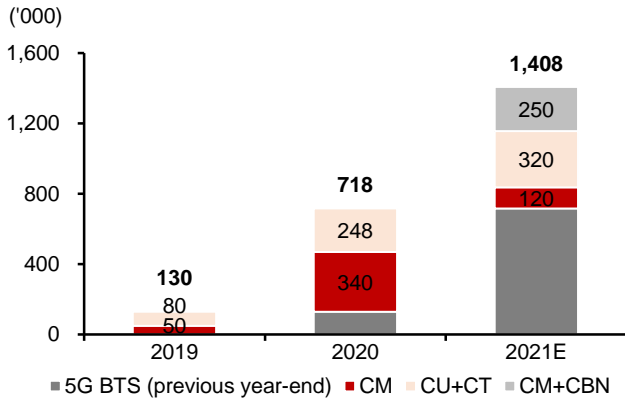
Auditor: Ernst & Young

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- ZTE (763HK) - CMBI Tech Corporate Day takeaways – 17 Jun 2021
- ZTE (763HK) - 1Q21 confirmed GPM recovery on track; Reiterate BUY – 29 Apr 2021

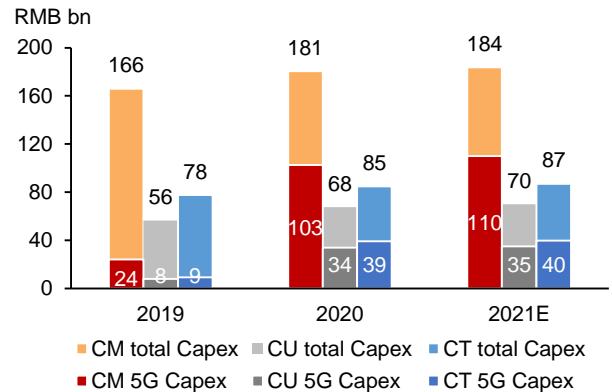
Focus Charts

Figure 1: 5G deployment status: 2020/21E 5G BTS new-add are 588k/690k (including 400k 700MHz)



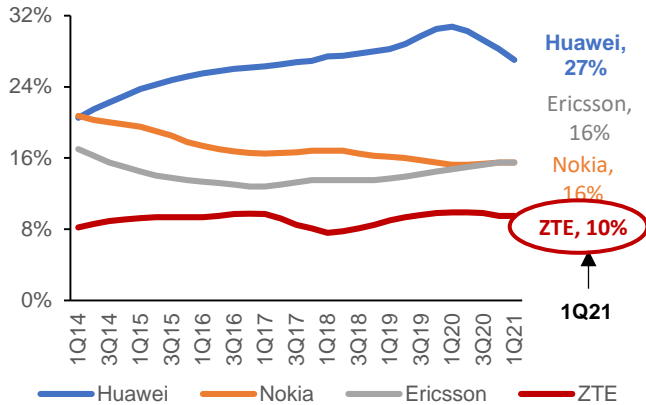
Source: Company filings, CMBIS estimates

Figure 2: 2021E Telco's Capex budget is similar to 2020 (China Mobile/China Unicom/China telecom)



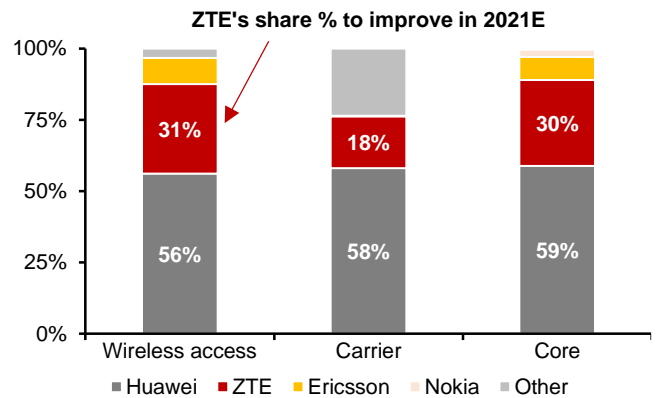
Source: Company filings, CMBIS estimates

Figure 3: Telecom equipment vendor market share (1Q14-1Q21): ZTE ranked as No. 4 globally



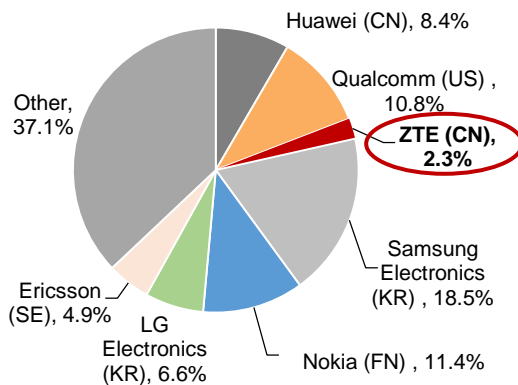
Source: Dell'Oro, CMBIS estimates

Figure 4: ZTE ranked as No.2 with 31% market share of China 5G BTS tender in 2020



Source: China mobile, China Unicom, China telecom, xinhuanet, C114, CMBIS estimates

Figure 5: 5G EP or US granted and active families multiplied by essentiality rate of 1,000 expert mapped patents



Source: Iplytics, CMBIS estimates

Figure 6: Huawei revealed licensing fees for its 5G standard-essential patents (SEPs)

Company	Announced date	Royalties Fee schedule
Huawei	2021/03	\$2.50 cap for smartphone makers
Nokia	2018	3 euro (\$3.58) cap per device
Ericsson	2018	\$2.50 to \$5 per device
Qualcomm	2017	2.275%/3.25% for 5G SEPs and 4%/5% for entire portfolio of patents for single-mode/multi-mode devices. Later the rate was cut from \$16.25 per phone to \$13.

Source: Bloomberg, CMBIS estimates

1H21 Results Review/ Earnings Revision

Figure 7: 1H21 results review

RMBmn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	QoQ	YoY
Revenue	21,484	25,715	26,930	27,321	26,242	26,829	2.2%	4.3%
Gross Profit	8,451	7,330	8,043	8,247	9,299	9,879	6.2%	34.8%
Operating Profit	1,051	1,790	1,098	1,532	2,563	2,983	16.4%	66.6%
Net profit	780	1,077	855	1,548	2,182	1,897	-13.0%	76.1%
EPS (RMB)	0.18	0.23	0.19	0.34	0.47	0.41	-12.9%	76.4%
Gross Margin	39.3%	28.5%	29.9%	30.2%	35.4%	36.8%	1.4 ppt	8.3 ppt
Operating Margin	4.9%	7.0%	4.1%	5.6%	9.8%	11.1%	1.3 ppt	4.2 ppt
Net Margin	3.6%	4.2%	3.2%	5.7%	8.3%	7.1%	-1.2 ppt	2.9 ppt

Source: Bloomberg, CMBIS estimates

Figure 8: CMBIS earnings revisions

RMBmn	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	116,995	129,879	143,959	116,995	129,070	140,524	0%	1%	2%
Gross Profit	41,770	46,547	51,792	39,647	44,084	48,423	5%	6%	7%
Operating Profit	9,684	11,230	12,968	8,671	9,915	12,267	12%	13%	6%
Net profit	7,206	8,472	9,788	6,181	7,097	8,903	17%	19%	10%
EPS (RMB)	1.55	1.83	2.11	1.34	1.54	1.93	16%	19%	9%
Gross Margin	35.7%	35.8%	36.0%	33.9%	34.2%	34.5%	1.8 ppt	1.7 ppt	1.5 ppt
Operating Margin	8.3%	8.6%	9.0%	7.4%	7.7%	8.7%	0.9 ppt	1 ppt	0.3 ppt
Net Margin	6.2%	6.5%	6.8%	5.3%	5.5%	6.3%	0.9 ppt	1 ppt	0.5 ppt

Source: Company data, CMBIS estimates

Figure 9: CMBIS estimates vs consensus

RMBmn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	116,995	129,879	143,959	117,636	131,474	143,567	-1%	-1%	0%
Gross Profit	41,770	46,547	51,792	39,895	45,537	50,290	5%	2%	3%
EBITDA	9,684	11,230	12,968	8,240	9,976	11,869	18%	13%	9%
Net profit	7,206	8,472	9,788	6,332	7,534	8,686	14%	12%	13%
EPS (RMB)	1.55	1.83	2.11	1.47	1.72	2.02	6%	6%	5%
Gross Margin	35.7%	35.8%	36.0%	33.9%	34.6%	35.0%	1.8 ppt	1.2 ppt	0.9 ppt
EBITDA Margin	8.3%	8.6%	9.0%	7.0%	7.6%	8.3%	1.3 ppt	1.1 ppt	0.7 ppt
Net Margin	6.2%	6.5%	6.8%	5.4%	5.7%	6.1%	0.8 ppt	0.8 ppt	0.7 ppt

Source: Bloomberg, CMBIS estimates

Assumptions

Figure 10: P&L forecast

RMB mn	FY19A	FY20A	1H21	2H21E	FY21E	FY22E	FY23E
Revenue	90,737	101,451	53,071	63,924	116,995	129,879	143,959
...YoY	6.1%	11.8%	12.4%	17.8%	15.3%	11.0%	10.8%
Cost of sales	(57,008)	(69,379)	(33,893)	(41,332)	(75,225)	(83,331)	(92,166)
Gross profit	33,728	32,071	19,178	22,592	41,770	46,547	51,792
GPM (%)	37.2%	31.6%	36.1%	35.3%	35.7%	35.8%	36.0%
...YoY	19.8%	-4.9%	21.5%	38.7%	30.2%	11.4%	11.3%
SG&A	(12,642)	(12,574)	(6,713)	(8,253)	(14,966)	(16,079)	(17,707)
...% of rev	-13.9%	-12.4%	-12.6%	-12.9%	-12.8%	-12.4%	-12.3%
R&D	(12,548)	(14,797)	(8,861)	(10,664)	(19,526)	(21,430)	(23,753)
...% of rev	-13.8%	-14.6%	-16.7%	-16.7%	-16.7%	-16.5%	-16.5%
Operating profit	7,552	5,471	5,546	4,138	9,684	11,230	12,968
OPM (%)	8.3%	5.4%	10.4%	6.5%	8.3%	8.6%	9.0%
...YoY	-1334.1%	-27.6%	95.2%	57.3%	77.0%	16.0%	15.5%
Net profit	5,148	4,260	4,079	3,128	7,206	8,472	9,788
NPM (%)	5.7%	4.2%	7.7%	4.9%	6.2%	6.5%	6.8%
...YoY	-173.7%	-17.3%	119.6%	30.2%	69.2%	17.6%	15.5%

Source: Company data, CMBIS estimates

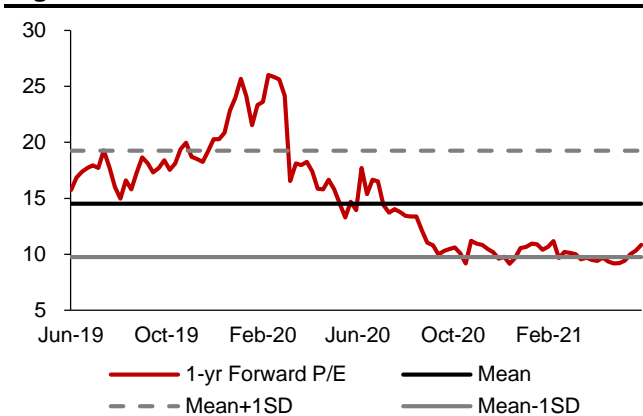
Valuation

Maintain BUY and revised TP to HK\$33.06 (27.2% upside)

We revised our TP to HK\$33.06 based on 15.0x FY22E P/E (prior 17.4x) due to recent valuation compression. Trading at 11.8x FY21E P/E, the stock is attractive. We are positive on its 2H21E outlook given that 5G deployment has accelerated and ZTE is believed to enjoy share gain in China 3rd batch 5G BTS tender. Looking forward, we think telcos will continue a healthy capex deployment similar to FY21's plan.

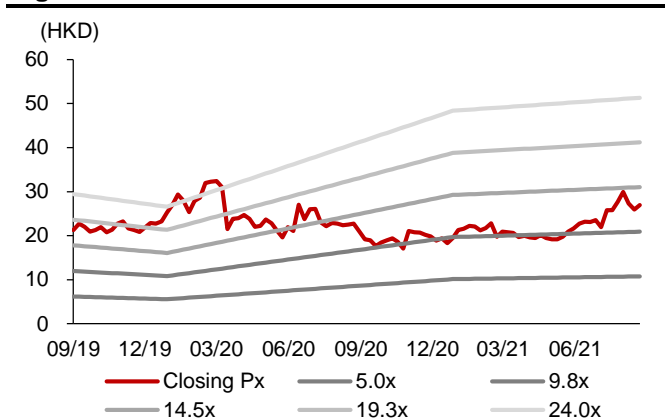
Risks include US-China disputes, component restriction and 5G deployment delays.

Figure 11: 12M forward P/E chart



Source: Company data, CMBIS estimates

Figure 12: 12M forward P/E band



Source: Company data, CMBIS estimates

Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	90,737	101,451	116,995	129,879	143,959	Net profit	5,777	4,722	7,206	8,472	9,788
Cost of sales	(57,008)	(69,379)	(75,225)	(83,331)	(92,166)	Depreciation/amortization	3,062	3,565	4,597	5,293	5,847
Gross profit	33,728	32,071	41,770	46,547	51,792	Change in working capital	(4,177)	(1,965)	(4,195)	(920)	2,429
Selling exp	(7,869)	(7,579)	(9,360)	(10,105)	(11,229)	Others	2,785	3,911	54	(2,582)	(3,165)
Admin exp	(4,773)	(4,995)	(5,607)	(5,974)	(6,478)	Net cash from operating	7,447	10,233	7,662	10,263	14,898
R&D exp	(12,548)	(14,797)	(19,526)	(21,430)	(23,753)	Capex	6,551	6,472	7,021	7,788	8,201
Finance costs	(966)	(421)	(541)	(501)	(240)	Other	(12,574)	(13,554)	(9,374)	(11,649)	(12,474)
Other operating exp.	1,696	1,573	2,340	2,598	2,879	Net cash from investing	(6,023)	(7,082)	(2,353)	(3,861)	(4,273)
Operating profit	7,552	5,471	9,684	11,230	12,968	Net borrowings	9,019	(1,294)	13,514	783	(924)
Other non-oper exp.	(391)	(407)	(121)	(135)	(149)	Dividend paid	2,640	2,951	2,133	3,430	3,563
Pre-tax profit	7,162	5,064	9,563	11,095	12,819	Other	(5,938)	(1,947)	(3,789)	(6,859)	(7,126)
Income tax expense	(1,385)	(342)	(1,626)	(1,886)	(2,179)	Net cash from financing	5,722	(290)	11,859	(2,646)	(4,486)
Minority interests	(280)	(446)	(731)	(737)	(851)	Net change in cash	7,372	2,898	17,185	3,756	6,139
Perpetual capital instrument	(349)	(16)	-	-	-	Cash at beginning of the year	21,134	28,506	35,660	52,845	56,601
Net profit to shareholders	5,148	4,260	7,206	8,472	9,788	Exchange difference	227	37	17	-	-
						Cash at the end of the year	28,506	31,403	52,845	56,601	62,740

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Current assets	102,567	106,977	130,675	136,276	146,989	Revenue mix					
Cash & equivalents	33,309	35,660	52,845	56,601	62,740	Carrier business	66,584	74,018	85,824	94,907	104,903
Account receivables	19,778	15,891	15,517	16,161	17,318	Consumer business	14,997	16,160	17,166	18,431	19,935
Inventory	27,689	33,689	36,159	37,013	39,765	Gov. and enterprise	9,155	11,272	14,006	16,541	19,120
Prepayment	1,023	1,152	1,030	1,030	1,030	Growth (%)					
Other current assets	20,768	20,585	25,124	25,472	26,136	Revenue	6.1	11.8	15.3	11.0	10.8
Non-current assets	38,635	43,658	44,831	45,877	47,837	Gross profit	19.8	(4.9)	30.2	11.4	11.3
PPE	9,383	11,914	13,260	14,237	14,988	Operating profit	(1,334.1)	(27.6)	77.0	16.0	15.5
Intangible assets	7,719	9,367	7,908	7,877	7,878	Net profit	(173.7)	(17.3)	69.2	17.6	15.5
Other non-current assets	21,533	22,376	23,663	23,763	24,971	Profit & loss ratio (%)					
Total assets	141,202	150,635	175,506	182,154	194,827	Gross margin	37.2	31.6	35.7	35.8	36.0
Current liabilities	86,371	74,395	83,921	83,458	89,088	Operating margin	8.3	5.4	8.3	8.6	9.0
ST borrowings	27,258	12,664	17,515	17,796	17,465	Net profit margin	5.7	4.2	6.2	6.5	6.8
Account payables	18,356	17,152	22,440	21,418	27,090	Balance sheet ratio					
Tax payable	889	878	746	746	746	Gearing ratio (%)	50	44	48	46	42
Other current liabilities	39,868	43,701	43,219	43,498	43,787	Current ratio (x)	1.2	1.4	1.6	1.6	1.6
Non-current liabilities	16,877	30,117	38,954	39,456	38,864	Receivable turnover days	83	64	49	45	42
LT borrowings	10,045	22,614	31,277	31,779	31,187	Inventory turnover days	106	110	109	103	97
Deferred income	645	718	638	638	638	Payable turnover days	121	93	96	96	96
Other non-current liabilities	6,187	6,785	7,039	7,039	7,039	Profitability (%)					
Total liabilities	103,248	104,512	122,875	122,914	127,952	ROE	19.9	11.8	15.5	16.1	16.4
Shareholders' equity						ROA	3.6	2.8	4.1	4.7	5.0
Share capital	4,228	4,613	4,613	4,613	4,613	Per share data (RMB)					
Reserve	12,144	23,276	23,754	23,754	23,754	EPS (RMB)	1.22	0.92	1.55	1.83	2.11
Minority interest	2,875	2,826	3,218	3,218	3,218	DPS (RMB)	0.20	0.20	0.34	0.40	0.46
Total equity	37,954	46,123	52,631	59,240	66,874	BVPS (RMB)	8.30	9.39	10.66	12.09	13.73
Total liabilities and equity	141,202	150,635	175,506	182,154	194,827						

Source: Company data, CMBIS estimates

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