

ZTE (763 HK)

Overhang removed; Focus on core business development

ZTE announced that U.S. Court agreed to end probation and declined to impose and penalties upon ZTE. Given the pessimistic market sentiment and previous concerns on further restrictions, this is a positive that removes the overhang on ZTE and helps to stabilize share price as it was previously under pressure. We are positive on ZTE's business development and operation improvement. Maintain BUY, with unchanged TP of HK\$29.65.

- Positive as probation ends but should not over-read.** ZTE announced that the Company received an order from the United States District Court for Northern District Texas (the "Court") declining to revoke probation or impose any penalties upon ZTE, and confirming that the term of probation and the term of the Monitor will end as scheduled on 22 March 2022.

We think this is a positive that removes the overhang on ZTE as 1) the market sentiment was pessimistic as China ADRs may face potential de-list from the U.S. stock exchange, 2) geopolitical pressures and 3) Sino-China tension persists. ZTE's share price was depressed given 8.0x 1-yr forward P/E (vs. 2-yr avg. of 13.0x).

However, we recommend investors not to over-read this announcement. Neither does it mean that the U.S. will loosen its measures against Chinese 5G names (i.e., Huawei, ZTE, etc.), nor the U.S. will take immediate further restrictive actions. This event is a normal legal process. The ruling came on the final day of the probation (completion of 5 years).

- FY21 results in line; focus more on operation and biz. deployment in 2022.** ZTE's FY21 revenue was RMB114.5bn, 12.9% YoY, in line with our previous forecast of RMB115.1bn. FY21 Net profit was RMB6.8bn, +59.9% YoY. Operating CF grew positively for three consecutive years. New 5G BTS planned for 2022 should be at a similar level, but ZTE is expected to have share gain in telco's deployment.
- Reiterate BUY with TP unchanged at HK\$29.65.** Potential risks include Sino-U.S. trade tension, component restriction, and 5G deployment delays.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Turnover (RMB mn)	101,451	114,522	129,338	145,948	162,938
YoY growth (%)	11.8%	12.9%	12.9%	12.8%	11.6%
Gross margin (%)	31.6%	35.2%	35.1%	35.0%	35.0%
Net profit (RMB mn)	4,260	6,813	7,862	9,157	10,585
YoY growth (%)	-17.3%	59.9%	15.4%	16.5%	15.6%
Diluted EPS (RMB)	0.92	1.47	1.66	1.94	2.24
YoY growth (%)	-24.8%	59.8%	13.1%	16.5%	15.6%
Consensus EPS (RMB)	NA	NA	1.71	1.97	2.17
PE (x)	17.0	10.6	9.4	8.1	7.0
Yield (%)	0.8%	0.8%	0.8%	0.8%	0.8%
ROE (%)	9.8%	13.2%	13.5%	13.7%	13.9%
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$29.65
(Previous TP)	HK\$29.65)
Up/Downside	+54.7%
Current Price	HK\$19.16

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Stock Data

Mkt. Cap. (HK\$ mn)	141,363
Avg. 3mths t/o (HK\$ mn)	102
52W High/Low (HK\$)	31.75/12.7
Total Issued Shares (mn)	755.5

Source: Bloomberg

Shareholding Structure

BlackRock	9.15%
Capital Group	5.08%
Schroders	4.93%

Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-22.6%	-16.8%
3-mth	-27.1%	-23.1%
6-mth	-40.3%	-33.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Related Reports

- ZTE (763HK) – ZTE finished 2021 with good results; Positive potentials could materialize ahead – 31 Jan 2022
- ZTE (763 HK) – Expect future share gain under similar 5G capex plan – 16 Oct 2021

Figure 1: Earnings revision

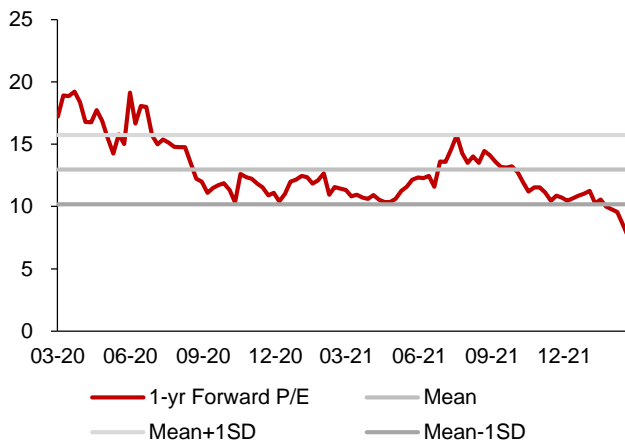
US\$ mn	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	129,338	145,948	162,938	129,803	146,400	na	0%	0%	na
Gross Profit	45,379	51,076	56,995	45,693	51,515	na	-1%	-1%	na
Operating Profit	9,760	11,360	13,121	10,192	11,713	na	-4%	-3%	na
Net profit	7,862	9,157	10,585	7,806	8,975	na	1%	2%	na
EPS (US\$ cents)	1.66	1.94	2.24	1.64	1.85	na	1%	5%	na
Gross Margin	35.1%	35.0%	35.0%	35.2%	35.2%	na	-0.1 ppt	-0.2 ppt	na
Operating Margin	7.5%	7.8%	8.1%	7.9%	8.0%	na	-0.3 ppt	-0.2 ppt	na
Net Margin	6.1%	6.3%	6.5%	6.0%	6.1%	na	0.1 ppt	0.1 ppt	na

Source: Company data, CMBIGM estimates

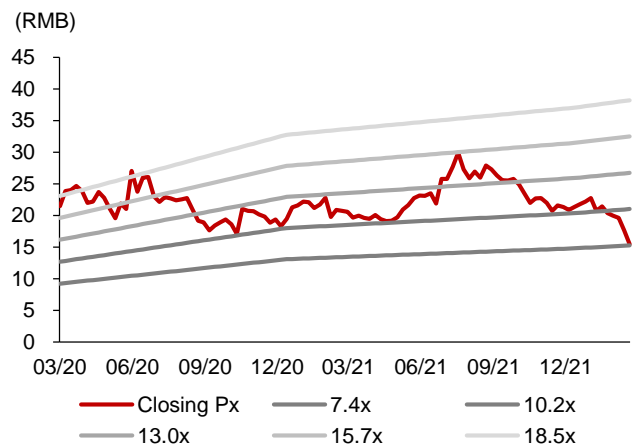
Figure 2: CMBIGM estimates vs consensus

US\$ mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	129,338	145,948	162,938	130,366	144,399	157,198	-1%	1%	4%
Gross Profit	45,379	51,076	56,995	45,977	50,703	55,746	-1%	1%	2%
Operating Profit	9,760	11,360	13,121	9,619	11,044	11,548	1%	3%	14%
Net profit	7,862	9,157	10,585	8,040	9,242	10,160	-2%	-1%	4%
EPS (US\$ cents)	1.66	1.94	2.24	1.71	1.97	2.17	-3%	-2%	3%
Gross Margin	35.1%	35.0%	35.0%	35.3%	35.1%	35.5%	-0.2 ppt	-0.1 ppt	-0.5 ppt
Operating Margin	7.5%	7.8%	8.1%	7.4%	7.6%	7.3%	0.2 ppt	0.1 ppt	0.7 ppt
Net Margin	6.1%	6.3%	6.5%	6.2%	6.4%	6.5%	-0.1 ppt	-0.1 ppt	0 ppt

Source: Company data, CMBIGM estimates

Figure 3: 12M forward P/E chart

Source: Company data, CMBIGM estimates

Figure 4: 12M forward P/E band

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	101,451	114,522	129,338	145,948	162,938
Cost of sales	(69,379)	(74,160)	(83,958)	(94,872)	(105,94)
Gross profit	32,071	40,362	45,379	51,076	56,995
Selling exp	(7,579)	(8,733)	(9,700)	(10,800)	(12,057)
Admin exp	(4,995)	(5,445)	(6,079)	(6,568)	(7,332)
R&D exp	(14,797)	(18,804)	(20,694)	(23,352)	(26,070)
Finance costs	(421)	(963)	219	524	872
Other operating exp.	1,191	2,259	635	479	714
Operating profit	5,471	8,676	9,760	11,360	13,121
Other non-oper exp.	(407)	(177)	(225)	(253)	(283)
Pre-tax profit	5,064	8,499	9,536	11,106	12,838
Income tax expense	(342)	(1,463)	(1,430)	(1,666)	(1,926)
Minority interests	(446)	(223)	(243)	(283)	(327)
Net profit to shareholders	4,260	6,813	7,862	9,157	10,585

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net profit	4,722	7,036	8,105	9,440	10,912
Depreciation/amortization	1,465	1,671	1,688	1,726	1,783
Change in working capital	(1,965)	2,615	(2,676)	(6,403)	(3,734)
Others	6,011	4,401	6,611	7,489	8,186
Net cash from operating	10,233	15,724	13,728	12,252	17,148
Capex	(6,472)	(5,686)	(4,016)	(4,499)	(4,970)
Other	(610)	(4,906)	1,200	1,061	1,121
Net cash from investing	(7,082)	(10,592)	(2,817)	(3,438)	(3,850)
Share issuance	14,167	538	0	0	0
Dividend paid	(2,951)	(2,618)	(2,581)	(2,792)	(3,081)
Other	(11,505)	4,859	2,743	6,542	7,511
Net cash from financing	(290)	2,779	161	3,750	4,431
Net change in cash	2,861	7,910	11,073	12,564	17,729
Cash at beginning of the year	28,506	31,403	39,071	50,144	62,708
Exchange difference	37	(242)	0	0	0
Cash at the end of the year	31,403	39,071	50,144	62,708	80,436

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Current assets	106,977	127,871	141,675	163,038	182,880
Cash & equivalents	35,660	50,713	61,786	74,350	92,079
Account receivables	15,891	17,509	17,926	20,460	20,609
Inventory	33,689	36,317	37,291	40,686	40,585
Prepayment	322	607	493	574	631
Other current assets	21,415	22,725	24,179	26,967	28,976
Non-current assets	43,658	40,892	39,930	39,643	39,772
PPE	11,914	11,437	11,124	11,041	11,147
Deferred tax assets	3,437	3,195	3,438	3,837	4,215
Other non-current assets	28,307	26,261	25,368	24,765	24,410
Total assets	150,635	168,763	181,605	202,681	222,653
Current liabilities	74,395	78,685	80,893	87,450	90,712
ST borrowings	10,559	8,947	8,757	10,135	11,716
Account payables	14,998	16,102	17,327	19,338	21,243
Tax payable	0	0	0	0	0
Other current liabilities	48,838	53,637	54,808	57,978	57,753
Non-current liabilities	30,117	36,791	40,246	46,270	53,015
LT borrowings	22,614	29,908	32,841	38,005	43,935
Deferred tax liability	134	150	162	181	198
Other non-current liabilities	7,369	6,732	7,244	8,085	8,881
Total liabilities	104,512	115,476	121,139	133,721	143,727
Share capital	4,613	4,731	4,731	4,731	4,731
Reserve	23,276	25,360	25,360	25,360	25,360
Retained earnings	14,824	20,651	27,519	35,651	45,198
Other	583	740	808	887	978
Minority interest	2,826	1,806	2,049	2,332	2,659
Total equity	46,123	53,288	60,466	68,960	78,926
Total liabilities and equity	150,635	168,763	181,605	202,681	222,653

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue mix					
Carrier business	74,018	75,712	79,042	83,783	88,555
Consumer business	16,160	25,731	32,536	40,038	48,046
Gov. and enterprise	11,272	13,079	17,759	22,126	26,338
Growth (%)					
Revenue	11.8%	12.9%	12.9%	12.8%	11.6%
Gross profit	-4.9%	25.8%	12.4%	12.6%	11.6%
Operating profit	-27.6%	58.6%	12.5%	16.4%	15.5%
Net profit	-17.3%	59.9%	15.4%	16.5%	15.6%
Profit & loss ratio (%)					
Gross margin	31.6%	35.2%	35.1%	35.0%	35.0%
Operating margin	5.4%	7.6%	7.5%	7.8%	8.1%
Net profit margin	4.2%	5.9%	6.1%	6.3%	6.5%
Balance sheet ratio					
Net debt/total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	1.4	1.6	1.8	1.9	2.0
Receivable turnover days	64	53	50	48	46
Inventory turnover days	(161)	(172)	(160)	(150)	(140)
Payable turnover days	(93)	(96)	(90)	(75)	(60)
Profitability (%)					
ROE	9.8%	13.2%	13.5%	13.7%	13.9%
ROA	2.8%	4.0%	4.3%	4.5%	4.8%
Per share data (RMB)					
EPS	0.92	1.47	1.66	1.94	2.24
DPS	0.20	0.20	0.20	0.20	0.20
BPS	9.35	10.88	12.35	14.08	16.12

Source: Company data, CMBIGM estimates

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