

ZTE (000063 CH)

Mixed 1H24 results

ZTE's announced 1H24 results. Revenue increased by 2.9% YoY to RMB62.5bn, while net profit grew by 4.8% YoY to RMB5.7bn in 1H24. Despite the headwinds from declining capex of domestic telcos for ZTE's carrier business, non-carrier businesses managed to grow double-digits (14.3% and 56.1% YoY growth in consumer and gov't/enterprise segments). On a quarterly basis, Q2 revenue increased by 1.1% YoY / 4.4% QoQ, while net profit increased by 5.7% YoY / 9.1% QoQ. GPM declined sequentially to 39%, mainly due to unfavorable product mix (i.e., lower contribution from high-margin carrier segment). NPM improved sequentially to 9.4% (vs. 9% / 7.5% in 1Q24/FY23) in 2Q24 on operating cost optimization. Looking forward, we think non-carrier segments will maintain double-digit growth, offsetting the weakness in carrier business. **The stock is currently trading at 11.9x 2024E P/E. Maintain BUY, with adjusted TP at RMB32.86.**

- The carrier segment faced headwinds as domestic telecom companies become disciplined in capital expenditures, as the built-out of the 5G network in China has already achieved significant milestone. The aggregate capex of China telcos is projected to be RMB334bn in 2024 (down 5% YoY), with the investment focus shifting to computing power/industrial digitalization/cloud markets, in line with our previous expectations ([report](#)). Given RAN business accounted for more than half of ZTE's carrier business sales, the Company's carrier revenue fell by 8.6% YoY to RMB37.3bn in 1H24. Carrier's GPM remained strong at 54.3% in 1H24 (vs. 54.4%/44.2% in 1H/2H23). Overall, the Company's GPM was stable at 40.5% in 1H24 (vs. 41.5% in 2023).
- Consumer and gov't/enterprise saw significant growth (14.3%/56% YoY), offsetting the weakness in carrier business. Consumer sales grew on robust demand on FTTR market and recovering consumer electronics demand. Gov't/enterprise revenue growth was driven by a surge in server and memory storage sales, however, these relatively low-margin products put pressure on the segment's GPM (21.8% in 1H24 vs. 34.9% in 2023). Looking forward, we expect these segments will maintain decent growth, as the spending of consumer and enterprises may continue to recover.
- **Maintain BUY on ZTE. TP adjusted to RMB32.86, based on 15x FY24E P/E, which equals to its 3-year historical avg.** We revised down our revenue forecasts by 3%/2% for FY24/25E, given continuous headwinds from domestic telecom market (lower spending in RAN). We trimmed net profit forecasts by 3%/7% on lower GPM but partially offsetting by better operating efficiency. Potential downside risks include 1) Sino-US trade tensions, 2) softer capex of domestic telcos and overseas 5G deployment delays, 3) weaker-than-expected consumer/enterprises' spending.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	114,522	122,954	124,251	130,034	140,200
YoY growth (%)	12.9	7.4	1.1	4.7	7.8
Gross margin (%)	35.2	37.2	41.5	39.8	39.0
Net profit (RMB mn)	6,812.9	8,080.3	9,325.8	10,477.7	11,403.6
YoY growth (%)	31.4	18.6	15.4	12.4	8.8
EPS (Reported) (RMB)	1.47	1.71	1.96	2.19	2.38
P/E (x)	17.7	15.2	13.3	11.9	10.9

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **RMB32.86**
 (Previous TP RMB34.20)
Up/Downside **26.2%**
Current Price **RMB26.04**

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Stock Data

Mkt Cap (RMB mn)	19,673.2
Avg 3 mths t/o (RMB mn)	1,792.2
52w High/Low (RMB)	36.33/21.70
Total Issued Shares (mn)	755.5

Source: FactSet

Shareholding Structure

BlackRock	6.7%
Vanguard Group	4.1%

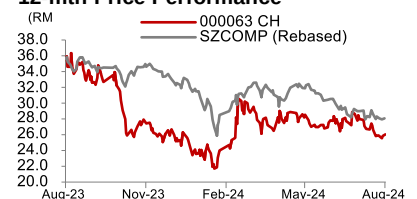
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-8.4%	-5.0%
3-mth	-8.7%	3.7%
6-mth	8.5%	12.0%

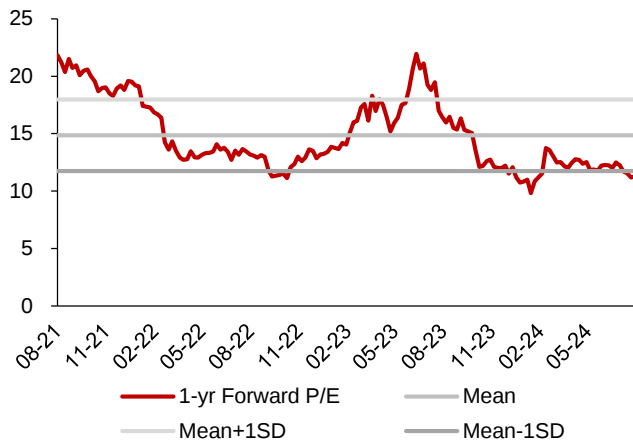
Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: 1-yr forward PE band



Source: Company data, Bloomberg

Figure 2: PE chart



Source: Company data, Bloomberg

Figure 3: Earnings revisions

US\$m	New			Old			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	130,034	140,200	153,503	129,749	136,085	142,119	0%	3%	8%
Gross profit	51,695	54,727	59,263	53,734	56,387	58,751	-4%	-3%	1%
Net profit	10,478	11,404	14,419	9,865	10,726	11,308	6%	6%	28%
EPS (RMB)	2.19	2.38	3.01	2.09	2.22	2.34	5%	7%	29%
Gross margin	39.8%	39.0%	38.6%	41.4%	41.4%	41.3%	-1.7 ppt	-2.4 ppt	-2.7 ppt
Net margin	8.1%	8.1%	9.4%	7.6%	7.9%	8.0%	0.5 ppt	0.3 ppt	1.4 ppt

Source: Company data, CMBIGM estimates

Figure 4: CMBIGM estimates vs. Bloomberg consensus

US\$m	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	130,034	140,200	153,503	133,717	142,644	NA	-3%	-2%	NA
Gross profit	51,695	54,727	59,263	55,973	59,858	NA	-8%	-9%	NA
Net profit	10,478	11,404	14,419	10,842	12,200	NA	-3%	-7%	NA
EPS (RMB)	2.19	2.38	3.01	2.27	2.55	NA	-3%	-7%	NA
Gross margin	39.8%	39.0%	38.6%	41.9%	41.5%	NA	-2.1 ppt	-2.5 ppt	NA
Net margin	8.1%	8.1%	9.4%	8.1%	8.6%	NA	-0.1 ppt	-0.4 ppt	NA

Source: Company data, CMBIGM estimates, Bloomberg consensus

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	101,451	114,522	122,954	124,251	130,034	140,200
Cost of goods sold	(69,379)	(74,160)	(77,228)	(72,650)	(78,339)	(85,473)
Gross profit	32,071	40,362	45,727	51,601	51,695	54,727
Operating expenses	(26,483)	(31,828)	(35,166)	(40,623)	(38,324)	(40,309)
Selling expense	(7,579)	(8,733)	(9,173)	(10,172)	(9,363)	(9,604)
Admin expense	(4,995)	(5,445)	(5,333)	(5,632)	(5,113)	(5,233)
SG&A expense	(685)	(787)	(951)	(1,336)	(1,227)	(1,322)
R&D expense	(14,797)	(18,804)	(21,602)	(25,289)	(26,365)	(27,936)
Others	1,573	1,941	1,893	1,806	3,744	3,785
Operating profit	5,589	8,534	10,561	10,978	13,371	14,417
Other income	238	250	196	173	72	78
Other expense	(644)	(427)	(239)	(228)	(74)	(80)
Gain/loss on financial assets at FVTPL	39	1,099	(1,142)	(702)	(417)	0
Investment gain/loss	906	1,564	1,087	(205)	(179)	0
Other gains/(losses)	(643)	(1,558)	(1,548)	(914)	(552)	(1,536)
EBIT	5,485	9,462	8,915	9,102	12,222	12,880
Net Interest income/(expense)	(421)	(963)	(163)	1,101	62	489
Other income/expense	(164)	(979)	(657)	158	(245)	0
Pre-tax profit	5,064	8,499	8,752	10,203	12,284	13,369
Income tax	(342)	(1,463)	(960)	(962)	(1,843)	(2,005)
After tax profit	4,722	7,036	7,792	9,241	10,441	11,364
Minority interest	446	223	(289)	(85)	(37)	(40)
Others	16	0	0	0	0	0
Net profit	5,184	6,813	8,080	9,326	10,478	11,404

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	106,977	127,871	137,874	158,505	152,838	164,547
Cash & equivalents	31,403	39,071	47,072	51,013	48,458	59,249
Restricted cash	4,256	11,642	9,274	27,530	23,211	23,211
Account receivables	17,043	18,863	19,098	21,968	22,564	23,145
Inventories	33,689	36,317	45,235	41,131	40,857	40,635
Prepayment	322	607	279	242	282	299
Financial assets at FVTPL	1,037	1,361	514	153	3,056	3,235
Other current assets	19,226	20,011	16,402	16,466	14,409	14,773
Non-current assets	43,658	40,892	43,080	42,454	53,791	54,188
PP&E	12,954	12,810	13,877	14,360	14,264	14,119
Right-of-use assets	1,047	815	1,080	1,557	1,473	1,348
Deferred income tax	3,437	3,195	3,719	4,146	4,200	4,446
Investment in JVs & assos	3,749	3,699	3,765	3,631	3,483	3,561
Intangibles	11,440	10,548	9,926	8,999	8,463	7,879
Goodwill	186	0	0	0	0	0
Financial assets at FVTPL	1,537	1,175	1,028	832	842	842
Other non-current assets	9,307	8,650	9,685	8,928	21,065	21,992
Total assets	150,635	168,763	180,954	200,958	206,629	218,734
Current liabilities	78,685	74,395	78,424	83,030	76,050	80,228
Short-term borrowings	8,947	10,559	9,962	7,560	3,935	5,429
Account payables	36,780	32,869	32,595	32,219	36,693	37,447
Tax payable	1,216	878	1,447	1,413	1,077	1,141
Other current liabilities	3,949	4,545	3,498	10,771	6,048	6,256
Contract liabilities	27,793	25,544	30,922	31,067	28,297	29,955
Non-current liabilities	30,117	36,791	42,987	49,596	55,152	55,386
Long-term borrowings	22,614	29,908	35,126	42,576	47,685	47,482
Bond payables	0	0	0	0	0	0
Obligations under finance leases	718	532	789	960	1,009	1,068
Deferred income	134	150	87	78	76	80
Other non-current liabilities	6,651	6,200	6,985	5,982	6,382	6,756
Total liabilities	108,803	111,185	121,410	132,627	131,201	135,614
Share capital	4,613	4,731	4,736	4,783	4,783	4,783
Capital surplus	(115)	0	0	0	0	0
Retained earnings	14,824	20,651	27,309	34,715	41,926	49,659
Other reserves	23,974	26,100	26,596	28,510	28,432	28,432

Total shareholders equity	43,297	51,482	58,641	68,008	75,141	82,874
Minority interest	2,826	1,806	902	323	287	247
Total equity and liabilities	154,925	164,473	180,954	200,958	206,629	218,734

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,722	7,036	7,792	9,241	10,441	11,364
Depreciation & amortization	3,971	4,588	4,386	4,926	5,089	5,520
Tax paid	(963)	258	(587)	(437)	(56)	(242)
Change in working capital	(1,001)	2,357	(8,471)	(324)	3,780	(1,160)
Others	3,504	1,484	4,458	3,999	(11,714)	7,009
Net cash from operations	10,233	15,724	7,578	17,406	7,539	22,490
Investing						
Capital expenditure	(6,472)	(5,686)	(4,952)	(4,005)	(4,551)	(4,864)
Acquisition of subsidiaries/ investments	(620)	(5,127)	3,636	(17,001)	(3,360)	(257)
Net proceeds from disposal of short-term investments	9	221	24	104	167	180
Others	(10,218)	(450)	(471)	(633)	4,318	0
Net cash from investing	(17,300)	(11,042)	(1,762)	(21,534)	(3,426)	(4,941)
Financing						
Dividend paid	(2,951)	(2,618)	(3,688)	(4,836)	(7,557)	(8,051)
Net borrowings	(1,294)	5,309	5,442	11,164	967	1,292
Proceeds from share issues	14,167	538	171	1,676	(78)	0
Others	(10,211)	(450)	(471)	(633)	0	0
Net cash from financing	(290)	2,779	1,455	7,372	(6,669)	(6,759)
Net change in cash						
Cash at the beginning of the year	28,506	31,403	39,071	47,072	51,013	48,458
Exchange difference	37	(242)	260	66	0	0
Others	2,861	7,910	7,741	3,876	(2,555)	10,790
Cash at the end of the year	31,403	39,071	47,072	51,013	48,458	59,249

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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