

ZTE (763 HK)

1Q21 beat on solid revenue and better margin; Reiterate BUY

ZTE reported in-line FY20 results and a strong 1Q21 earnings guidance of 130-208% YoY. 1Q21 NP mid-point of RMB2.1bn is 34%/36% of our/consensus 2021 NP estimates. Excluding one-off gain of RMB774mn, 1Q net profit would grow 70% YoY, mainly driven by solid telco revenue and GPM recovery. Following discussion with mgmt., we continue to like ZTE for global share gain and margin recovery, given Huawei uncertainties and Nokia's continued share loss. Reiterate BUY with TP HK\$28.1 (17.5x FY21E P/E). Upcoming catalysts include 3rd batch of 5G BTS tenders and overseas share gain.

- FY20 in-line; Expect 15% revenue growth with GPM recovery in FY21E.** Despite challenges from COVID-19 and macro uncertainties, ZTE delivered solid revenue growth of 11.8% YoY in FY20 and a strong 1Q21 earnings guidance of 130-208% YoY. For 2021, we believe ZTE will continue to benefit from share gain/5G rollout in China, 4G upgrade in Asia and optical network upgrade in Europe. We expect 5G BTS ASP is likely to remain stable for 3.5GHz/2.6GHz BTS but will be slightly lower for CM/CBN's 700MHz network. We expect revenue to grow at 15% YoY in FY21E, mainly driven by domestic carrier business (+16%) and gov./enterprise business (+24%). We also expect GPM to improve to 33.9% vs. 31.6% in FY20, thanks to improving cost structure and self-developed chips from Sanechip.
- Major beneficiary of global 5G deployment.** We expect next batch of 5G BTS tender to kick off in late March/April, and we estimate China telco capex in 2021 will grow at mid-to-low single digit. Total 5G BTS net-add will reach 700k-800k in 2021 (vs. 600k in 2020), as CU/CT announced 320k net-add and CM/CBN will add 400k unit for 700MHz network. We think ZTE's 5G market share in China will expand to 35% in 2021/22 (vs 31% in 2020), given ZTE's stronger product positioning and cost advantage for 5G network rollout in 2nd/3rd tier cities in 2021.
- Reiterate BUY with TP of HK\$28.1.** We maintain our target price at HK\$28.1 based on 17.4x FY21E P/E, in line with 2-year historical forward P/E. The stock is now trading at 13.5x FY21E P/E (1-sd below 2-year avg.). We think the stock is attractive, compared to 20% EPS FY21-23E CAGR. Near-term catalysts are 3rd batch of 5G BTS tenders in China. 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	129,070	140,524
YoY growth (%)	6.1	11.8	15.3	10.3	8.9
Net profit (RMB mn)	5,148	4,260	6,181	7,097	8,903
EPS (RMB)	1.22	0.92	1.34	1.54	1.93
YoY growth (%)	NA	-24.8	45.6	14.8	25.4
Consensus EPS (RMB)	NA	0.99	1.29	1.54	1.78
PE (x)	14.8	19.7	13.5	11.8	9.4
PB (x)	2.2	1.9	1.7	1.6	1.4
Yield (%)	0.8	0.8	1.1	1.3	1.6
ROE (%)	19.9	11.8	13.5	13.9	15.6
Net debt/total equity (%)	50.0	43.8	50.1	50.5	41.8

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$ 28.1
(Previous TP)	HK\$28.1)
Up/Downside	+28.8%
Current Price	HK\$ 21.8

China Technology Sector

Alex Ng
(852) 3900 0881
alexng@cmbi.com.hk

Lily Yang
(852) 3916 3716
lilyyang@cmbi.com.hk

Stock Data

Mkt. Cap. (HK\$ mn)	157,140
Avg. 3mths t/o (HK\$ mn)	293
52W High/Low (HK\$)	29.95/16.5
Total Issued Shares (mn)	755.5
Source: Bloomberg	

Shareholding Structure

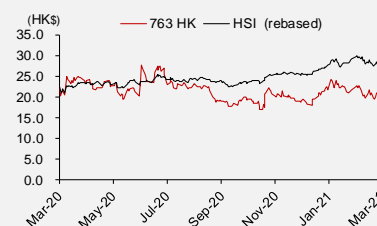
BlackRock	6.21%
Capital Group	5.08%
Schroders	4.93%
Source: Bloomberg	

Share Performance

	Absolute	Relative
1-mth	-9.4%	-4.0%
3-mth	6.8%	-2.6%
6-mth	6.4%	-9.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

FY20 Results Review

Figure 1: FY20 results review

RMB mn	FY18	FY19	FY20	YoY	CMBIS estimates		Consensus	
					FY20E	Diff%	FY20E	Diff %
Revenue	85,513	90,737	101,451	12%	101,379	0%	101,373	0%
Gross Profit	28,146	33,728	32,071	-5%	32,742	-2%	32,828	-2%
Operating Profit	(612)	7,552	5,471	-28%	5,537	-1%	5,739	-5%
Net profit	(6,984)	5,148	4,260	-17%	4,367	-2%	4,499	-5%
EPS (RMB)	(1.67)	1.22	0.92	-25%	0.95	-3%	0.99	-7%
Gross Margin	32.9%	37.2%	31.6%	5.6 ppt	32.3%	-0.7 ppt	32.4%	-0.8 ppt
Operating Margin	-0.7%	8.3%	5.4%	2.9 ppt	5.5%	-0.1 ppt	5.7%	-0.3 ppt
Net Margin	-8.2%	5.7%	4.2%	1.5 ppt	4.3%	-0.1 ppt	4.4%	-0.2 ppt

Source: Bloomberg, CMBIS estimates

Figure 2: 4Q20 results review

RMB mn	4Q19	1Q20	2Q20	3Q20	4Q20	QoQ	YoY
Revenue	26,496	21,484	25,715	26,930	27,321	1.5%	3.1%
Gross Profit	9,081	8,451	7,330	8,043	8,247	2.5%	-9.2%
Operating Profit	1,669	1,051	1,790	1,098	1,532	39.5%	-8.2%
Net profit	1,020	780	1,077	855	1,548	81.1%	51.7%
EPS (RMB)	0.24	0.18	0.23	0.19	0.34	76.6%	39.0%
Gross Margin	34.3%	39.3%	28.5%	29.9%	30.2%	0.3 ppt	-4.1 ppt
Operating Margin	6.3%	4.9%	7.0%	4.1%	5.6%	1.5 ppt	-0.7 ppt
Net Margin	3.8%	3.6%	4.2%	3.2%	5.7%	2.5 ppt	1.8 ppt

Source: Bloomberg, CMBIS estimates

Earnings Revision

Figure 3: CMBIS earnings revisions

RMB mn	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	116,995	129,070	140,524	114,048	129,118	NA	3%	0%	NA
Gross Profit	39,647	44,084	48,423	38,279	43,913	NA	4%	0%	NA
Operating Profit	8,671	9,915	12,267	8,537	9,970	NA	2%	-1%	NA
Net profit	6,181	7,097	8,903	6,176	7,239	NA	0%	-2%	NA
EPS (RMB)	1.34	1.54	1.93	1.34	1.57	NA	0%	-2%	NA
Gross Margin	33.9%	34.2%	34.5%	33.6%	34.0%	NA	0.3 ppt	0.1 ppt	NA
Operating Margin	7.4%	7.7%	8.7%	7.5%	7.7%	NA	-0.1 ppt	0 ppt	NA
Net Margin	5.3%	5.5%	6.3%	5.4%	5.6%	NA	-0.1 ppt	-0.1 ppt	NA

Source: Company data, CMBIS estimates

Figure 4: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	116,995	129,070	140,524	114,464	126,678	134,691	2%	2%	4%
Gross Profit	39,647	44,084	48,423	38,092	42,842	45,898	4%	3%	6%
Operating Profit	8,671	9,915	12,267	8,025	9,724	11,613	8%	2%	6%
Net profit	6,181	7,097	8,903	5,811	7,025	8,195	6%	1%	9%
EPS (RMB)	1.34	1.54	1.93	1.29	1.54	1.78	4%	0%	9%
Gross Margin	33.9%	34.2%	34.5%	33.3%	33.8%	34.1%	0.6 ppt	0.3 ppt	0.4 ppt
Operating Margin	7.4%	7.7%	8.7%	7.0%	7.7%	8.6%	0.4 ppt	0 ppt	0.1 ppt
Net Margin	5.3%	5.5%	6.3%	5.1%	5.5%	6.1%	0.2 ppt	0 ppt	0.3 ppt

Source: Bloomberg, CMBIS estimates

Figure 5: P&L forecast

RMB mn	FY19	1Q20	2Q20	3Q20	4Q20	FY20	FY21E	FY22E	FY23E
Revenue	90,737	21,484	25,715	26,930	27,321	101,451	116,995	129,070	140,524
...YoY	6.1%	-3.2%	14.8%	37.2%	3.1%	11.8%	15.3%	10.3%	8.9%
Cost of sales	(57,008)	(13,033)	(18,385)	(18,887)	(19,074)	(69,379)	(77,348)	(84,986)	(92,101)
Gross profit	33,728	8,451	7,330	8,043	8,247	32,071	39,647	44,084	48,423
GPM (%)	37.2%	39.3%	28.5%	29.9%	30.2%	31.6%	33.9%	34.2%	34.5%
...YoY	19.8%	-4.8%	-14.9%	12.4%	-9.2%	-4.9%	23.6%	11.2%	9.8%
SG&A	(12,642)	(2,740)	(3,465)	(3,124)	(3,244)	(12,574)	(14,507)	(16,134)	(17,706)
...% of rev	-13.9%	-12.8%	-13.5%	-11.6%	-11.9%	-12.4%	-12.4%	-12.5%	-12.6%
R&D	(12,548)	(3,241)	(3,397)	(4,154)	(4,006)	(14,797)	(17,081)	(18,457)	(19,673)
...% of rev	-13.8%	-15.1%	-13.2%	-15.4%	-14.7%	-14.6%	-14.6%	-14.3%	-14.0%
Operating profit	7,552	1,051	1,790	1,098	1,532	5,471	8,671	9,915	12,267
OPM (%)	8.3%	4.9%	7.0%	4.1%	5.6%	5.4%	7.4%	7.7%	8.7%
...YoY	-1334.1%	-28.2%	103.6%	-69.0%	-8.2%	-27.6%	58.5%	14.3%	23.7%
Net profit	5,148	780	1,077	855	1,548	4,260	6,181	7,097	8,903
NPM (%)	5.7%	3.6%	4.2%	3.2%	5.7%	4.2%	5.3%	5.5%	6.3%
...YoY	-173.7%	-9.6%	77.2%	-67.8%	51.7%	-17.3%	45.1%	14.8%	25.4%

Source: Company data, CMBIS

Figure 6: Revenue breakdown

RMB mn	FY18	FY19	1H20	2H20	FY20	FY21E	FY22E
Carriers' network	57,076	66,584	34,970	39,049	74,018	85,824	94,098
...YoY	-11%	17%	8%	15%	11%	16%	10%
China	41,121	47,260	26,428	25,623	52,051	61,606	65,999
...YoY		15%	22%	0%	10%	18%	7%
Overseas	15,955	19,324	8,535	13,432	21,967	24,217	28,099
...YoY		21%	-21%	58%	14%	10%	16%
Consumer business	19,210	14,997	7,413	8,747	16,160	17,166	18,431
...YoY	-45%	-22%	0%	15%	8%	6%	7%
Gov. and corp. business	9,228	9,155	4,817	6,456	11,272	14,006	16,541
...YoY	-6%	-1%	2%	45%	23%	24%	18%
Total	85,513	90,737	47,199	54,251	101,451	116,995	129,070
...YoY	-21.4%	6.1%	5.8%	17.6%	11.8%	15.3%	10.3%
Gross Margin							
Carriers' network	40.4%	42.6%	36.3%	31.5%	33.8%	36.5%	36.8%
Consumer business	12.5%	17.9%	23.1%	24.0%	23.6%	24.0%	24.2%
Gov. and corp. business	29.2%	29.2%	28.3%	29.2%	28.8%	30.0%	30.2%
Blended GPM	32.9%	37.2%	33.4%	30.0%	31.6%	33.9%	34.2%

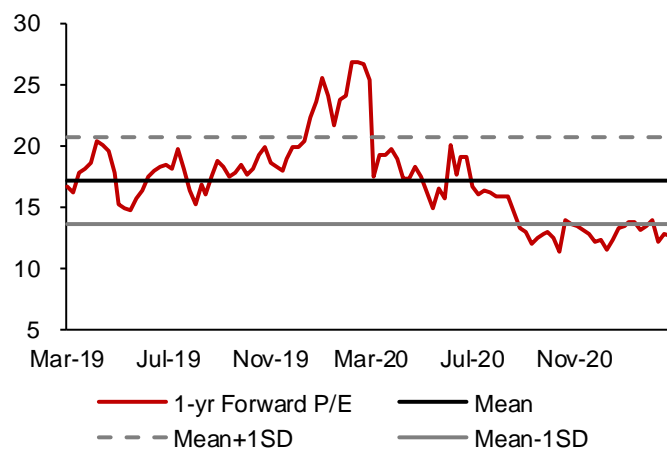
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Valuation

Maintain BUY and maintain TP at HK\$28.1 (29% upside)

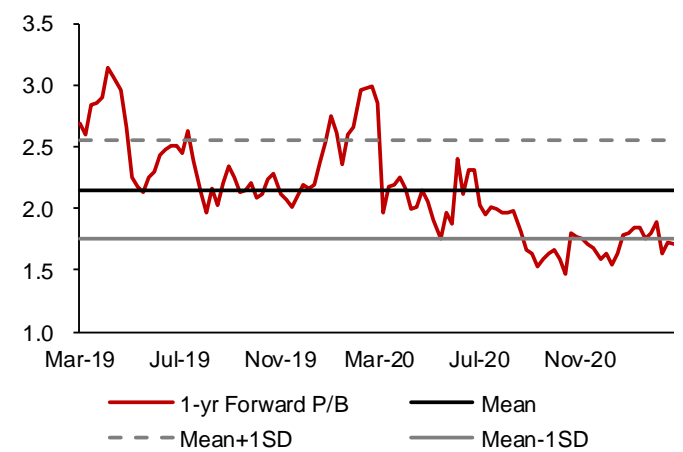
We maintain our TP at HK\$ 28.1 based on 17.4x FY21E P/E, in line with 2-year historical forward P/E. We estimate 20% EPS FY21-23E CAGR, backed by 10% revenue CAGR backed by 1) reaccelerated 5G deployment in China and resumed network construction overseas; 2) strong growth in gov. and enterprises segment and 3) improving gross margin due to cost management and self-developed chips from Sanecchip. Trading at 13.5x FY21E P/E (1-sd below 2-year avg.), we think the stock is attractive. Risks include US-China disputes, component restriction and overseas 5G deployment delays.

Figure 7: 12M forward P/E band



Source: Company data, CMBIS estimates

Figure 8: 12M forward P/B 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	129,070	140,524	Net profit	5,777	4,722	6,181	7,097	8,903
Cost of sales	(57,008)	(69,379)	(77,348)	(84,986)	(92,101)	Depreciation/amortization	3,062	3,565	4,258	4,844	5,428
Gross profit	33,728	32,071	39,647	44,084	48,423	Change in working capital	(4,177)	(1,965)	(589)	199	(1,290)
Selling exp	(7,869)	(7,579)	(8,658)	(9,422)	(10,118)	Others	2,785	3,911	(3,887)	(80)	(914)
Admin exp	(4,773)	(4,995)	(5,850)	(6,712)	(7,588)	Net cash from operating	7,447	10,233	5,962	12,060	12,127
R&D exp	(12,548)	(14,797)	(17,081)	(18,457)	(19,673)	Capex	6,551	6,472	8,146	8,282	8,530
Finance costs	(966)	(421)	(723)	(610)	99	Other	(12,574)	(13,554)	(14,293)	(15,064)	(15,560)
Other operating exp.	1,696	1,573	1,755	1,936	2,108	Net cash from investing	(6,023)	(7,082)	(6,146)	(6,782)	(7,030)
Operating profit	7,552	5,471	8,671	9,915	12,267	Net borrowings	9,019	9,019	15,147	6,443	(12,092)
Other non-oper exp.	(391)	(407)	(936)	(1,033)	(1,124)	Dividend paid	2,640	2,640	2,640	3,506	3,260
Pre-tax profit	7,162	5,064	7,736	8,883	11,143	Other	(5,938)	(5,938)	(5,280)	(7,011)	(6,521)
Income tax expense	(1,385)	(342)	(1,160)	(1,332)	(1,671)	Net cash from financing	5,722	5,722	12,506	2,938	(15,353)
Minority interests	(280)	(446)	(395)	(453)	(568)	Net change in cash	7,372	9,099	12,322	8,216	(10,255)
Perpetual capital instrument	(349)	(16)	-	-	-	Cash at beginning of the year	21,134	21,134	35,660	47,982	56,198
Net profit to shareholders	5,148	4,260	6,181	7,097	8,903	Exchange difference	227	227	-	-	-
						Cash at the end of the year	28,506	30,233	47,982	56,198	45,943
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	130,980	138,414	136,959	Revenue mix					
Cash & equivalents	33,309	35,660	47,982	56,198	45,943	Carrier business	66,584	74,018	85,824	94,098	101,469
Account receivables	19,778	15,891	23,937	19,086	26,987	Consumer business	14,997	16,160	17,166	18,431	19,935
Inventory	27,689	33,689	35,131	38,623	39,446	Gov. and enterprise	9,155	11,272	14,006	16,541	19,120
Prepayment	1,023	1,152	1,152	1,152	1,152	Growth (%)					
Other current assets	20,768	20,585	22,777	23,355	23,430	Revenue	6.1	11.8	15.3	10.3	8.9
Non-current assets	38,635	43,658	46,462	48,823	51,659	Gross profit	19.8	(4.9)	23.6	11.2	9.8
PPE	9,383	11,914	13,757	15,128	16,214	Operating profit	(1,334.1)	(27.6)	58.5	14.3	23.7
Intangible assets	7,719	9,367	10,802	11,936	12,849	Net profit	(173.7)	(17.3)	45.1	14.8	25.4
Other non-current assets	21,533	22,376	21,903	21,759	22,596	Profit & loss ratio (%)					
Total assets	141,202	150,635	177,442	187,237	188,617	Gross margin	37.2	31.6	33.9	34.2	34.5
Current liabilities	86,371	74,395	86,672	86,801	88,988	Operating margin	8.3	5.4	7.4	7.7	8.7
ST borrowings	27,258	12,664	18,101	20,414	16,073	Net profit margin	5.7	4.2	5.3	5.5	6.3
Account payables	18,356	17,152	23,558	21,172	27,302	Balance sheet ratio					
Tax payable	889	878	878	878	878	Gearing ratio (%)	50	44	50	50	42
Other current liabilities	39,868	43,701	44,135	44,337	44,734	Current ratio (x)	1.2	1.4	1.5	1.6	1.5
Non-current liabilities	16,877	30,117	39,827	43,957	36,206	Receivable turnover days	83	64	62	61	60
LT borrowings	10,045	22,614	32,324	36,454	28,703	Inventory turnover days	106	110	107	104	101
Deferred income	645	718	718	718	718	Payable turnover days	121	93	96	96	96
Other non-current liabilities	6,187	6,785	6,785	6,785	6,785	Profitability (%)					
Total liabilities	103,248	104,512	126,499	130,758	125,193	ROE	19.9	11.8	13.5	13.9	15.6
Shareholders' equity						ROA	3.6	2.8	3.5	3.8	4.7
Share capital	4,228	4,613	4,613	4,613	4,613	Per share data (RMB)					
Reserve	12,144	23,276	23,276	23,276	23,276	EPS (RMB)	1.22	0.92	1.34	1.54	1.93
Minority interest	2,875	2,826	2,826	2,826	2,826	DPS (RMB)	0.20	0.20	0.29	0.34	0.42
Total equity	37,954	46,123	50,944	56,479	63,424	BVPS (RMB)	8.30	9.39	10.43	11.63	13.14
Total liabilities and equity	141,202	150,635	177,442	187,237	188,617						

Source: Company data, CMBIS estimates

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OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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