

# ZTE (763 HK)

## Solid 4Q20 recovery with improving margin; Raise TP to HK\$28.1

ZTE announced FY20 preliminary results with revenue/net profit growth of +11.7%/-15.3% YoY, largely in-line with our/consensus estimates, thanks to solid growth across all segments, share gain in China and improving profitability overseas. By 4Q20, revenue/net profit grew 3%/62% YoY to RMB27.3bn/1.66bn. In a mixed backdrop of global 5G deployment and macro uncertainties, we believe ZTE is well positioned to seize the opportunities from "New Infrastructure" initiative and 5G network upgrade amid Huawei uncertainties. We adjusted our estimates and raised TP to HK\$28.1 to reflect better operating leverage and FX assumptions. Catalysts include 5G BTS tenders and 2021 operator capex budget.

- **FY20 largely in-line; Solid growth across all segments.** Despite challenges from COVID-19 and macro uncertainties, ZTE achieved sales growth of 11.7% YoY in FY20E, driven by solid growth from both domestic and overseas markets and all three business segments (carrier's network, consumer business and government/corporate business). Net profit declined 15.3% YoY in FY20, mainly due to one-time asset disposal gain in 3Q19.
- **Improving operating and financial metrics.** ZTE reported record-high operating cashflow of RMB10.23bn in FY20E, up 37.4% YoY, while gearing ratio improved to 69.5% from 73.1% in FY19. We believe ZTE will continue to improve its working capital and optimize balance sheet structure.
- **Major beneficiary of global 5G deployment.** As we believe Chinese operators will kick off next 5G BTS tender in 1Q21E, we expect 5G BTS net-adds to reach 800k/1mn (including CBN) in FY21E/22E and ZTE's 5G market share in China will gradually ramp to 35% (vs 30% in FY20). Thanks to global economic recovery and resumption of 5G BTS rollout post COVID-19, we expect domestic/overseas revenue from carrier's network to grow at 9%/18% CAGR during FY21-23E.
- **Reiterate BUY; Raise TP to HK\$28.1.** We adjusted our forecasts to reflect better operating leverage and new FX assumptions. We lifted our target price to HK\$28.1 based on same 17.5x FY21E P/E, in line with 2-year historical forward P/E. Trading at 14.9x FY21E P/E (1-sd below 2-year avg.), we think the stock is attractive, compared to 26% EPS FY21-23E CAGR. Risks include US-China disputes, component restriction and 5G deployment delays.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20A	FY21E	FY22E
Turnover (RMB mn)	85,513	90,737	101,379	114,048	129,118
YoY growth (%)	(21.4)	6.1	11.7	12.5	13.2
Net profit (RMB mn)	(6,984)	5,148	4,367	6,176	7,239
EPS (RMB)	(1.67)	1.22	0.95	1.34	1.57
YoY growth (%)	NA	NA	(22.4)	40.7	17.2
Consensus EPS (RMB)	NA	NA	0.95	1.26	1.56
PE (x)	(11.9)	16.3	21.0	14.9	12.7
PB (x)	2.9	2.4	2.1	1.9	1.7
Yield (%)	0.0	0.7	0.5	0.8	0.9
ROE (%)	(26)	20	12	14	14
Net debt/total equity (%)	45	50	43	50	46

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$ 28.1
(Previous TP)	HK\$26.3)
Up/Downside	+17.2%
Current Price	HK\$ 24.0

### China Technology Sector

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#### Stock Data

Mkt. Cap. (HK\$ mn)	183,450
Avg. 3mths t/o (HK\$ mn)	313
52W High/Low (HK\$)	36.7/16.5
Total Issued Shares (mn)	755.5

Source: Bloomberg

#### Shareholding Structure

BlackRock	5.93%
Capital Group	5.08%
Schroders	4.93%

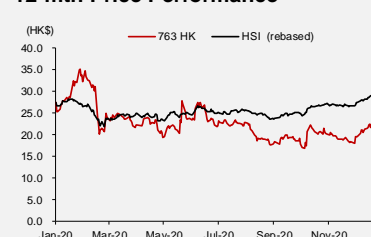
Source: Bloomberg

#### Share Performance

	Absolute	Relative
1-mth	21.3%	8.7%
3-mth	19.4%	1.0%
6-mth	0.2%	-15.9%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: Ernst & Young

## FY20 Results Review

Figure 1: FY20 results review

RMB mn	FY18	FY19	FY20	CMBIS estimate		Consensus	
				FY20E	Diff%	FY20E	Diff %
Revenue	85,513	90,737	101,379	103,273	-2%	102,180	-1%
Operating Profit	-612	7,552	5,537	6,073	-9%	5,843	-5%
Net profit	(6,984)	5,148	4,367	4,422	-1%	4,349	0%
EPS (RMB)	-1.67	1.22	0.95	0.94	1%	0.95	0%
Operating Margin	-0.7%	8.3%	5.5%	5.9%	-0.4 ppt	5.7%	-0.3 ppt
Net Margin	-8.2%	5.7%	4.3%	4.3%	0 ppt	4.3%	0.1 ppt

Source: Bloomberg, CMBIS estimates

Figure 2: 4Q20 results review

RMB mn	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	QoQ	YoY
Revenue	19,631	26,496	21,484	25,715	26,930	27,250	1.2%	2.8%
Operating Profit	3,540	1,669	1,051	1,790	1,098	1,598	45.5%	-4.2%
Net profit	2,657	1,020	780	1,077	855	1,655	93.6%	62.2%
EPS (RMB)	0.63	0.24	0.18	0.23	0.19	0.35	83.1%	43.5%
Operating Margin	18.0%	6.3%	4.9%	7.0%	4.1%	5.9%	1.8 ppt	-0.4 ppt
Net Margin	13.5%	3.8%	3.6%	4.2%	3.2%	6.1%	2.9 ppt	2.2 ppt

## Earnings Revision

Figure 3: CMBIS earnings revisions

RMB mn	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	101,379	114,048	129,118	103,273	117,384	132,909	-2%	-3%	-3%
Gross Profit	32,742	38,279	43,913	33,666	39,954	45,918	-3%	-4%	-4%
Operating Profit	5,537	8,537	9,970	6,073	8,606	10,847	-9%	-1%	-8%
Net profit	4,367	6,176	7,239	4,422	6,210	7,386	-1%	-1%	-2%
EPS (RMB)	0.95	1.34	1.57	0.94	1.32	1.57	1%	1%	0%
Gross Margin	32.3%	33.6%	34.0%	32.6%	34.0%	34.5%	-0.3 ppt	-0.5 ppt	-0.5 ppt
Operating Margin	5.5%	7.5%	7.7%	5.9%	7.3%	8.2%	-0.4 ppt	0.2 ppt	-0.4 ppt
Net Margin	4.3%	5.4%	5.6%	4.3%	5.3%	5.6%	0 ppt	0.1 ppt	0 ppt

Source: Company data, CMBIS estimates

Figure 4: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	101,379	114,048	129,118	102,180	114,382	126,441	-1%	0%	2%
Gross Profit	32,742	38,279	43,913	33,337	38,451	43,503	-2%	0%	1%
Operating Profit	5,537	8,537	9,970	5,843	8,487	10,878	-5%	1%	-8%
Net profit	4,367	6,176	7,239	4,349	5,865	7,255	0%	5%	0%
EPS (RMB)	0.95	1.34	1.57	0.95	1.26	1.56	0%	6%	0%
Gross Margin	32.3%	33.6%	34.0%	32.6%	33.6%	34.4%	-0.3 ppt	-0.1 ppt	-0.4 ppt
Operating Margin	5.5%	7.5%	7.7%	5.7%	7.4%	8.6%	-0.3 ppt	0.1 ppt	-0.9 ppt
Net Margin	4.3%	5.4%	5.6%	4.3%	5.1%	5.7%	0.1 ppt	0.3 ppt	-0.1 ppt

Source: Bloomberg, CMBIS estimates

**Figure 5: P&L forecast**

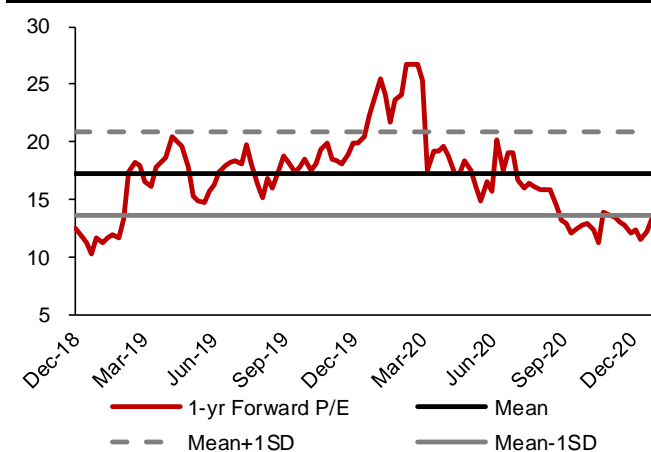
RMB mn	FY18	FY19	1Q20	2Q20	3Q20	4Q20E	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>85,513</b>	<b>90,737</b>	<b>21,484</b>	<b>25,715</b>	<b>26,930</b>	<b>27,250</b>	<b>101,379</b>	<b>114,048</b>	<b>129,118</b>
...YoY	-21.4%	6.1%	-3.2%	14.8%	37.2%	2.8%	11.7%	12.5%	13.2%
Cost of sales	(57,368)	(57,008)	(13,033)	(18,385)	(18,887)	(18,332)	(68,637)	(75,769)	(85,204)
<b>Gross profit</b>	<b>28,146</b>	<b>33,728</b>	<b>8,451</b>	<b>7,330</b>	<b>8,043</b>	<b>8,918</b>	<b>32,742</b>	<b>38,279</b>	<b>43,913</b>
GPM (%)	32.9%	37.2%	39.3%	28.5%	29.9%	32.7%	32.3%	33.6%	34.0%
...YoY	-16.8%	19.8%	-4.8%	-14.9%	12.4%	-1.8%	-2.9%	16.9%	14.7%
SG&A	(12,736)	(12,642)	(2,740)	(3,465)	(3,124)	(3,140)	(12,470)	(14,028)	(15,881)
...% of rev	-14.9%	-13.9%	-12.8%	-13.5%	-11.6%	-11.5%	-12.3%	-12.3%	-12.3%
R&D	(10,906)	(12,548)	(3,241)	(3,397)	(4,154)	(4,213)	(15,004)	(17,107)	(19,368)
...% of rev	-12.8%	-13.8%	-15.1%	-13.2%	-15.4%	-15.5%	-14.8%	-15.0%	-15.0%
<b>Operating profit</b>	<b>(612)</b>	<b>7,552</b>	<b>1,051</b>	<b>1,790</b>	<b>1,098</b>	<b>1,598</b>	<b>5,537</b>	<b>8,537</b>	<b>9,970</b>
OPM (%)	-0.7%	8.3%	4.9%	7.0%	4.1%	5.9%	5.5%	7.5%	7.7%
...YoY	-109.0%	-1334.1%	-28.2%	103.6%	-69.0%	-4.2%	-26.7%	54.2%	16.8%
<b>Net profit</b>	<b>(6,984)</b>	<b>5,148</b>	<b>780</b>	<b>1,077</b>	<b>855</b>	<b>1,655</b>	<b>4,367</b>	<b>6,176</b>	<b>7,239</b>
NPM (%)	-8.2%	5.7%	3.6%	4.2%	3.2%	6.1%	4.3%	5.4%	5.6%
...YoY	-252.9%	-173.7%	-9.6%	77.2%	-67.8%	62.2%	-15.2%	41.4%	17.2%

Source: Company data, CMBIS

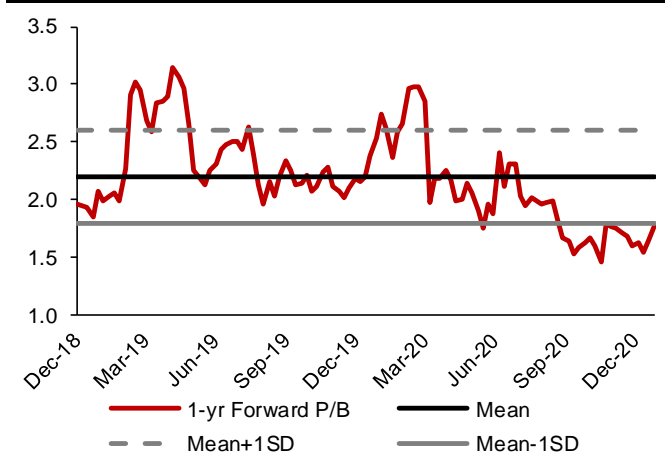
## Valuation

### Maintain BUY and raised TP to HK\$28.1 (17% upside)

We derived our new TP of HK\$ 28.1 based on same 17.5x FY21E P/E, in line with 2-year historical forward P/E. We believe this is justified as the stock has been mostly trading on 18-20x EPS, except the period during negative earnings in 2012, 2016 and 2018. We estimate 26% EPS FY21-23E CAGR, backed by 11% revenue CAGR and improving GPM as 5G scales up. Trading at 14.9x 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 6: 12M forward P/E band**

Source: Company data, CMBIS estimates

**Figure 7: 12M forward P/B band**

Source: Company data, CMBIS estimates

## Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>90,737</b>	<b>101,379</b>	<b>114,048</b>	<b>129,118</b>	<b>140,656</b>	<b>Net profit</b>	5,777	4,367	6,176	7,239	9,775
Cost of sales	(57,008)	(68,637)	(75,769)	(85,204)	(92,594)	Depreciation/amortization	3,062	4,815	5,555	6,403	7,351
<b>Gross profit</b>	<b>33,728</b>	<b>32,742</b>	<b>38,279</b>	<b>43,913</b>	<b>48,063</b>	Change in working capital	(4,177)	4,058	(7,875)	(438)	(7,249)
						Others	2,785	(2,907)	(714)	708	722
Selling exp	(7,869)	(7,401)	(8,211)	(9,296)	(10,127)	<b>Net cash from operating</b>	<b>7,447</b>	<b>10,333</b>	<b>3,142</b>	<b>13,912</b>	<b>10,599</b>
Admin exp	(4,773)	(5,069)	(5,816)	(6,585)	(7,173)	Capex	6,551	6,243	6,633	7,624	8,230
R&D exp	(12,548)	(15,004)	(17,107)	(19,368)	(21,098)	Other	(12,574)	(10,063)	(11,266)	(13,747)	(14,961)
Finance costs	(966)	(637)	(576)	(244)	1,842	<b>Net cash from investing</b>	<b>(6,023)</b>	<b>(3,821)</b>	<b>(4,633)</b>	<b>(6,124)</b>	<b>(6,730)</b>
Other operating exp.	1,696	1,506	2,053	2,324	2,532	Net borrowings	9,019	(4,467)	15,985	(650)	(11,230)
<b>Operating profit</b>	<b>7,552</b>	<b>5,537</b>	<b>8,537</b>	<b>9,970</b>	<b>13,194</b>	Dividend paid	2,640	3,475	2,354	2,959	1,194
						Other	(5,938)	(1,777)	(4,707)	(5,918)	(2,389)
Other non-oper exp.	(391)	(403)	(912)	(1,033)	(1,125)	<b>Net cash from financing</b>	<b>5,722</b>	<b>(2,769)</b>	<b>13,632</b>	<b>(3,609)</b>	<b>(12,425)</b>
<b>Pre-tax profit</b>	<b>7,162</b>	<b>5,134</b>	<b>7,625</b>	<b>8,937</b>	<b>12,068</b>	<b>Net change in cash</b>	<b>7,372</b>	<b>3,007</b>	<b>12,141</b>	<b>4,179</b>	<b>(8,556)</b>
Income tax expense	(1,385)	(975)	(1,449)	(1,698)	(2,293)	Cash at beginning of the year	21,134	33,309	36,316	48,457	52,636
Minority interests	(280)	225	-	-	-	Exchange difference	227	(736)	-	-	-
Perpetual capital instrument	(349)	(16)	-	-	-	<b>Cash at the end of the year</b>	<b>28,506</b>	<b>36,316</b>	<b>48,457</b>	<b>52,636</b>	<b>44,080</b>
<b>Net profit to shareholders</b>	<b>5,148</b>	<b>4,367</b>	<b>6,176</b>	<b>7,239</b>	<b>9,775</b>						
Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Current assets</b>	<b>102,567</b>	<b>109,170</b>	<b>137,541</b>	<b>142,217</b>	<b>144,969</b>	<b>Revenue mix</b>					
Cash & equivalents	33,309	36,316	48,457	52,636	44,080	Carrier business	66,584	74,358	85,268	97,584	106,004
Account receivables	19,778	17,087	22,240	20,799	26,086	Consumer business	14,997	15,873	16,986	17,992	19,063
Inventory	27,689	32,477	43,555	45,492	51,512	Gov. and enterprise	9,155	11,148	11,794	13,542	15,590
Prepayment	1,023	1,031	1,031	1,031	1,031	<b>Growth (%)</b>					
Other current assets	20,768	22,258	22,258	22,258	22,258	Revenue	6.1	11.7	12.5	13.2	8.9
<b>Non-current assets</b>	<b>38,635</b>	<b>38,357</b>	<b>38,356</b>	<b>38,309</b>	<b>37,738</b>	Gross profit	19.8	(2.9)	16.9	14.7	9.4
PPE	9,383	10,170	10,857	11,350	11,674	Operating profit	(1,334.1)	(26.7)	54.2	16.8	32.3
Intangible assets	7,719	7,864	7,624	7,315	6,771	Net profit	(173.7)	(15.2)	41.4	17.2	35.0
Other non-current assets	21,533	20,322	19,876	19,644	19,294	<b>Profit &amp; loss ratio (%)</b>					
<b>Total assets</b>	<b>141,202</b>	<b>147,527</b>	<b>175,897</b>	<b>180,526</b>	<b>182,707</b>	Gross margin	37.2	32.3	33.6	34.0	34.2
<b>Current liabilities</b>	<b>86,371</b>	<b>74,467</b>	<b>87,232</b>	<b>86,241</b>	<b>87,600</b>	Operating margin	8.3	5.5	7.5	7.7	9.4
ST borrowings	27,258	11,373	16,909	16,684	12,795	Net profit margin	5.7	4.3	5.4	5.6	6.9
Account payables	18,356	15,963	22,893	21,952	26,782	<b>Balance sheet ratio</b>					
Tax payable	889	789	789	789	789	Gearing ratio (%)	50	43	50	46	37
Other current liabilities	39,868	46,342	46,640	46,816	47,234	Current ratio (x)	1.2	1.5	1.6	1.6	1.7
<b>Non-current liabilities</b>	<b>16,877</b>	<b>28,172</b>	<b>38,621</b>	<b>38,196</b>	<b>30,855</b>	Receivable turnover days	83	66	63	61	61
LT borrowings	10,045	21,464	31,913	31,488	24,148	Inventory turnover days	106	108	122	126	126
Deferred income	645	561	561	561	561	Payable turnover days	121	91	94	96	96
Other non-current liabilities	6,187	6,147	6,147	6,147	6,147	<b>Profitability (%)</b>					
<b>Total liabilities</b>	<b>103,248</b>	<b>102,639</b>	<b>125,853</b>	<b>124,437</b>	<b>118,456</b>	ROE	19.9	12.1	13.5	14.1	16.7
<b>Shareholders' equity</b>						ROA	3.6	3.0	3.5	4.0	5.4
Share capital	4,228	4,613	4,613	4,613	4,613	<b>Per share data (RMB)</b>					
Reserve	12,144	23,298	23,298	23,298	23,298	EPS (RMB)	1.22	0.95	1.34	1.57	2.12
Minority interest	2,875	1,726	1,726	1,726	1,726	DPS (RMB)	0.20	0.16	0.22	0.26	0.35
<b>Total equity</b>	<b>37,954</b>	<b>44,888</b>	<b>50,044</b>	<b>56,089</b>	<b>64,251</b>	BVPS (RMB)	6.85	9.34	10.46	11.77	13.54
<b>Total liabilities and equity</b>	<b>141,202</b>	<b>147,527</b>	<b>175,897</b>	<b>180,526</b>	<b>182,707</b>						

Source: Company data, CMBIS estimates

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<b>HOLD</b>	: Stock with potential return of +15% to -10% over next 12 months
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<b>OUTPERFORM</b>	: Industry expected to outperform the relevant broad market benchmark over next 12 months
<b>MARKET-PERFORM</b>	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
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