

ZTE (763 HK)

1H23 earnings lifted by improved gross margin

ZTE released 1H23 results, posting revenue/NP (Rmb60.7bn)/NP (Rmb5.4bn), growth of 1.5%/19.9% YoY. The top-line growth was muted, mainly due to the slowdown in overseas capex spending and macro pressures. Geographically, domestic sales grew 6.2% YoY, while overseas sales declined by 8.5% YoY. The bottom-line growth was strong, driven by improving GPM (6.18ppts higher than 1H22), a result of favourable segment mix and cost optimization. We **maintain BUY rating and increase TP to HK\$29.4**, considering potential further share gain on domestic carrier business and higher gross margin.

■ The growth of domestic carrier sales will outpace overseas. 1)

Domestic market: According to China Mobile and China Unicom's recent tender announcements in the past months, they will procure c.500k and 690k 5G BTS, which was greater-than-expected as the telcos guided only 560k to be added earlier this year. ZTE will continue to be the key beneficiary in domestic telecom markets, with potential share gain, partially offsetting the negative impact from declining 5G-related spending (China telco's total capex to grow 2% in 2023 with investment focus shifting to computing power areas). We still expect ZTE's non-RAN business, especially the new server/memory/switch products, to drive double-digit growth. **2) Overseas market:** We think overseas telecom capex has peaked in 2022, reaching all-time high of US\$300bn, driven by resumed 5G buildouts. Looking forward, we are cautious about overseas telecom capex growth, considering plateaued 5G revenue growth and macro pressures.

■ GPM is expected to remain at current 40%+ level. The Company's GPM improved to 43.2% in 1H23 from 37.0%/37.3% in 1H/2H22, mainly due to a significant increase in margin in the Carrier segment (54.2% in 1H23 vs. 45.3%/47.1% in 1H/2H22). We expect the mgmt. team will continue to improve organizational efficiency and strengthen the Company's financial performance.

■ TP was raised to HK\$29.4, based on 11.4x (unchanged, close to 3-year avg.) rollover FY24E P/E. We expect ZTE's revenue to grow 7.6%/8.9% YoY in 2023/24E. We revised down our top-line forecasts by 9%/12%, due to cautious outlook for global telecom spending and soft consumer/corporates spending. We revised up our bottom-line forecasts by 5%/10%, reflecting higher GPM. We raised TP to HK\$29.4. We think the stronger growth in earnings justify the 11.4x P/E multiple. Potential risks include China-US trade tensions, additional component restriction/technology ban, and 5G deployment delays.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	101,451	114,522	122,954	132,278	144,074
YoY growth (%)	11.8	12.9	7.4	7.6	8.9
Gross margin (%)	31.6	35.2	37.2	41.2	41.0
Operating profit (RMB mn)	5,589	8,534	10,561	11,839	12,765
YoY growth (%)	(39.9)	52.7	23.7	12.1	7.8
Net profit (RMB mn)	4,260	6,813	8,080	9,886	11,653
YoY growth (%)	(17.3)	59.9	18.6	22.4	17.9
EPS	0.92	1.47	1.71	2.05	2.4
P/E (x)	22.4	12.9	13.5	11.2	9.6
ROE (%)	11.8	14.4	14.3	15.5	15.7

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$29.4
(Previous TP	HK\$25.0)
Up/Downside	18.8%
Current Price	HK\$24.75

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Stock Data

Mkt Cap (HK\$ mn)	18,698.6
Avg 3 mths t/o (HK\$ mn)	229.2
52w High/Low (HK\$)	31.95/13.72
Total Issued Shares (mn)	755.5
Source: FactSet	

Shareholding Structure

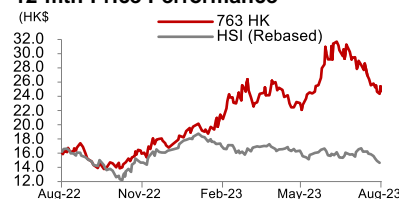
BlackRock	7.1%
Vanguard Group	4.2%
Source: Bloomberg	

Share Performance

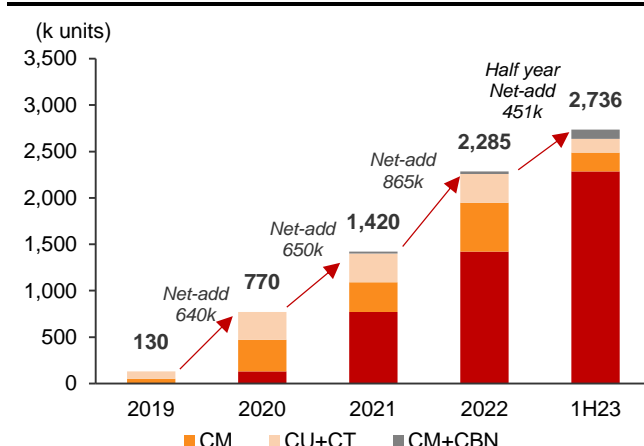
	Absolute	Relative
1-mth	-16.0%	-10.2%
3-mth	9.3%	19.0%
6-mth	19.0%	35.7%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: China major telcos have collectively added ~451k 5G BTS in 1H23


Source: Company data, CMBIGM estimates

Figure 2: 5G BTS tender announcements

Month	Telco	Announcement
2020/03	China Mobile	230k 5G BTS
2020/03	China Unicom, China Telecom	250k 5G BTS
2021/06	China Mobile	480k 5G BTS (700MHz)
2021/07	China Unicom, China Telecom	242k 5G BTS (2.1GHz)
2022/08	China Mobile	200k 5G BTS (2.6GHz/4.9GHz)
2023/05	China Mobile	86.9k 5G BTS (63.8k 2.6GHz/4.9GHz & 23.1k 700MHz)
2023/05	China Mobile	412.7k 5G BTS (251.7k 2.6GHz/4.9GHz & 161k 700MHz)
2023/08	China Unicom	690k 5G BTS

Source: C114, CMBIGM estimates

Figure 3: CMBIGM estimates vs. consensus

RMB mn	CMBI estimates			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	132,278	144,074	156,765	137,529	152,803	167,208	-4%	-6%	-6%
Gross Profit	54,554	59,074	63,811	51,703	57,549	63,404	6%	3%	1%
Operating Profit	11,839	12,765	13,659	11,518	13,165	15,079	-3%	-3%	-9%
Net profit	9,886	11,653	13,312	9,838	11,155	12,656	0%	4%	5%
EPS (RMB)	2.05	2.40	2.74	2.09	2.40	2.70	-2%	0%	1%
Gross Margin	41.2%	41.0%	40.7%	37.6%	37.7%	37.9%	3.6 ppt	3.3 ppt	2.8 ppt
Operating Margin	9.0%	8.9%	8.7%	8.4%	8.6%	9.0%	0.6 ppt	0.3 ppt	-0.3 ppt
Net Margin	7.5%	8.1%	8.5%	7.2%	7.3%	7.6%	0.3 ppt	0.8 ppt	0.9 ppt

Source: Company data, CMBIGM estimates

Figure 4: Earnings revision

RMB mn	New		Old		Diff (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	132,278	144,074	144,923	163,260	-9%	-12%
Gross Profit	54,554	59,074	50,883	56,736	7%	4%
Operating Profit	11,839	12,765	11,024	12,413	7%	3%
Net profit	9,886	11,653	9,396	10,580	5%	10%
EPS (RMB)	2.05	2.40	1.97	2.18	4%	10%
Gross Margin	41.2%	41.0%	35.1%	34.8%	6.1 ppt	6.3 ppt
Operating Margin	9.0%	8.9%	7.6%	7.6%	1.4 ppt	1.3 ppt
Net Margin	7.5%	8.1%	6.5%	6.5%	1 ppt	1.6 ppt

Source: Company data, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Revenue	90,737	101,451	114,522	122,954	132,278	144,074
Cost of goods sold	(57,008)	(69,379)	(74,160)	(77,228)	(77,724)	(85,000)
Gross profit	33,728	32,071	40,362	45,727	54,554	59,074
Operating expenses	(24,424)	(26,483)	(31,828)	(35,166)	(42,715)	(46,308)
Selling expense	(7,869)	(7,579)	(8,733)	(9,173)	(10,052)	(10,804)
Admin expense	(4,773)	(4,995)	(5,445)	(5,333)	(5,501)	(5,920)
Sales tax	(931)	(685)	(787)	(951)	(1,497)	(1,631)
R&D expense	(12,548)	(14,797)	(18,804)	(21,602)	(27,836)	(30,318)
Others	1,696	1,573	1,941	1,893	2,171	2,365
Operating profit	9,304	5,589	8,534	10,561	11,839	12,765
Other income/(expense)	(1360)	(104)	928	(1646)	(1840)	(1513)
EBIT	8,128	5,485	9,462	8,915	9,999	11,253
Other income/expense	(180)	(164)	(979)	(657)	0	0
Pre-tax profit	7,162	5,064	8,499	8,752	11,264	13,280
Income tax	(1,385)	(342)	(1,463)	(960)	(1,230)	(1,454)
After tax profit	5,777	4,722	7,036	7,792	10,034	11,827
Minority interest	(280)	(446)	(223)	289	(148)	(174)
Others	(349)	(16)	0	0	0	0
Net profit	5,148	4,260	6,813	8,080	9,886	11,653

BALANCE SHEET	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Current assets	102,567	106,977	127,871	137,874	146,851	162,909
Cash & equivalents	28,506	31,403	39,071	47,072	56,006	69,553
Restricted cash	4,804	4,256	11,642	9,274	8,387	8,387
Account receivables	19,778	15,891	17,509	17,751	17,039	18,091
Inventories	27,689	33,689	36,317	45,235	44,201	44,292
Other current assets	21,790	21,738	23,332	18,542	21,218	22,586
Non-current assets	38,635	43,658	40,892	43,080	42,190	43,718
PP&E	9,384	11,914	11,437	12,913	13,768	14,587
Right-of-use assets	1,064	1,047	815	1,080	1,031	1,008
Deferred income tax	2,511	3,437	3,195	3,719	3,773	4,124
Intangibles	7,719	9,367	8,905	7,342	8,143	7,891
Goodwill	186	186	0	0	0	0
Other non-current assets	17,771	17,707	16,540	18,026	15,475	16,108
Total assets	141,202	150,635	168,763	180,954	189,041	206,626
Current liabilities	86,371	74,395	78,685	78,424	72,759	80,938
Short-term borrowings	26,646	10,559	8,947	9,962	6,005	7,446
Account payables	18,356	17,152	21,717	19,075	19,576	21,397
Other current liabilities	41,369	46,684	48,021	49,387	47,178	52,095
Non-current liabilities	16,877	30,117	36,791	42,987	46,595	45,063
Long-term borrowings	10,045	22,614	29,908	35,126	38,334	36,033
Other non-current liabilities	6,832	7,503	6,883	7,861	8,261	9,030
Total liabilities	103,248	104,512	115,476	121,410	119,354	126,002
Share capital	4,228	4,613	4,731	4,736	4,827	4,865
Retained earnings	11,680	14,824	20,651	27,309	35,351	46,035
Other	12,919	23,860	26,100	26,596	28,459	28,501
Total shareholders equity	28,827	43,297	51,482	58,641	68,637	79,401
Minority interest	2,875	2,826	1,806	902	1,050	1,223
Other	6,252	0	0	0	0	0
Total equity and liabilities	141,202	150,635	168,763	180,954	189,041	206,626

CASH FLOW	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	5,777	4,722	7,036	7,792	10,034	11,827
Depreciation & amortization	3,587	3,971	4,588	4,386	4,783	5,289
Change in working capital	(4,177)	(1,965)	2,616	(9,058)	1,870	(454)
Others	2,260	3,505	1,484	4,458	3	6,481
Net cash from operations	7,447	10,233	15,724	7,578	16,690	23,143
Investing						
Capital expenditure	(6,551)	(6,472)	(5,686)	(4,952)	(5,678)	(6,195)
Others	528	-610	-4,906	3,661	635	375
Net cash from investing	(6,023)	(7,082)	(10,592)	(1,291)	(5,043)	(5,820)
Financing						
Dividend paid	(2,640)	(2,951)	(2,618)	(3,688)	(3,904)	(2,992)
Net borrowings	9,019	(1,294)	5,309	5,442	(749)	(860)
Others	(657)	3,955	88	(299)	1,941	76
Net cash from financing	5,722	(290)	2,779	1,455	(2,712)	(3,776)
Net change in cash						
Cash at the beginning of the year	21,134	28,506	31,403	39,071	47,072	56,006
Exchange difference	227	37	(242)	260	0	0
Cash at the end of the year	28,506	31,403	39,071	47,072	56,006	69,553

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