

ZTE (763 HK)

Expect future share gain under similar 5G capex plan

ZTE released 3Q21 results, with revenue/NP growth of 14.2%/107.6% YoY and GPM continued to improve to 38.0% (vs. FY20: 31.6%). 9M21 revenue/NP accounted for 71.6%/74.3% of our FY21E estimates. We remain positive on ZTE as we believe the Company will be the major beneficiary of global 5G deployment. We maintain BUY rating, with TP at HK\$33.06 based on 15x FY22E P/E.

- **We raised the gross margin estimates for 2021E-23E.** We raised 2021E GPM by 1.1ppt/0.7ppt to reflect continued gross margin improvement. GPM was up to 38.0% in 3Q21 (vs. 29.9%/36.8% in 3Q20/2Q21). We slightly adjust our GPM estimates for FY22E-23E as we believe GPM will remain at 35%+ due to the adoption of self-developed chips and better operating efficiency. Operating cash flow continued to be strong (189% YoY for 9M2021).
- **Similar 5G capex plan in 2022E but ZTE will outperform with share gain.** China has built 993k 5G BTS as of 3Q21, according to recent announcement made by MIIT. We estimate 5G BTS net-add will reach 692k in 2021 (200k 700MHz 5G BTS to be completed within 2021), compared to 588k in 2020. As for 5G BTS tender in 2021, we saw lower frequency spectrum equipment accounted for the majority of 5G BTS tender (2021: 700MHz/2.1GHz, vs. 2020: 2.6GHz/3.5GHz). Following the de-spec trend, we expect 5G Capex plan to maintain at a similar level in 2022E, but ZTE will continue to outperform with additional share gain in China (31% in 2020, 33% in 2021E, and 35% in 2022E).
- **Maintain BUY with unchanged TP of HK\$33.06.** We maintain our TP at HK\$33.06 based on 15.0x FY22E P/E. Trading at 11.4x FY22E P/E, the stock is attractive in our view. We are positive on ZTE as we believe the company will enjoy share gain in telcos' 5G-related deployment in the following years. Looking forward, we expect telcos will continue a healthy Capex deployment in FY22E similar to FY21 plan. 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	129,879	143,959
YoY growth (%)	6.1	11.8	15.3	11.0	10.8
Gross profit margin (%)	37.2	31.6	36.8	36.6	36.7
Net profit (RMB mn)	5,148	4,260	7,878	8,513	9,822
EPS (RMB)	1.22	0.92	1.70	1.84	2.12
YoY growth (%)	NA	-25%	85%	8%	15%
Consensus EPS (RMB)	NA	0.65	1.54	1.75	2.02
PE (x)	17.1	22.8	12.3	11.4	9.9
PB (x)	2.5	2.2	1.9	1.7	1.5
Yield (%)	0.7	0.7	1.2	1.3	1.5
ROE (%)	19.9	11.8	16.7	15.7	16.0
Net debt/total equity (%)	50.0	43.8	47.5	45.4	42.0

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$ 33.06**
 (Previous TP **HK\$33.06**)
 Up/Downside **+31.2%**
 Current Price **HK\$ 25.2**

China Technology Sector

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Stock Data

Mkt. Cap. (HK\$ mn) 179,608
 Avg. 3mths t/o (HK\$ mn) 230
 52W High/Low (HK\$) 31.75/16.50
 Total Issued Shares (mn) 755.5

Source: Bloomberg

Shareholding Structure

BlackRock 7.09%
 Capital Group 5.08%
 Schroders 4.93%

Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-5.3%	-12.3%
3-mth	-3.3%	1.1%
6-mth	24.1%	38.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Related Report

1. ZTE (763HK) - Solid 1H results with strong OCF – 31 Aug 2021
2. ZTE (763HK) - CMBI Tech Corporate Day takeaways – 17 Jun 2021
3. ZTE (763HK) - 1Q21 confirmed GPM recovery on track; Reiterate BUY – 29 Apr 2021

3Q21 Results Review/ Earnings Revision

Figure 1: 3Q21 results review

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	QoQ	YoY
Revenue	21,484	25,715	26,930	27,321	26,242	26,829	30,754	14.6%	14.2%
Gross Profit	8,451	7,330	8,043	8,247	9,299	9,879	11,687	18.3%	45.3%
Operating Profit	1,051	1,790	1,098	1,532	2,563	2,983	2,157	-27.7%	96.4%
Net profit	780	1,077	855	1,548	2,182	1,897	1,774	-6.5%	107.6%
EPS (RMB)	0.18	0.23	0.19	0.34	0.47	0.41	0.38	-7.2%	100.0%
Gross Margin	39.3%	28.5%	29.9%	30.2%	35.4%	36.8%	38.0%	1.2 ppt	8.1 ppt
Operating Margin	4.9%	7.0%	4.1%	5.6%	9.8%	11.1%	7.0%	-4.1 ppt	2.9 ppt
Net Margin	3.6%	4.2%	3.2%	5.7%	8.3%	7.1%	5.8%	-1.3 ppt	2.6 ppt

Source: Company data, CMBIS estimates

Figure 2: CMBIS earnings revisions

RMB mn	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	116,995	129,879	143,959	116,995	129,879	143,959	0%	0%	0%
Gross Profit	43,057	47,496	52,841	41,770	46,547	51,792	3%	2%	2%
Operating Profit	9,974	11,313	13,045	9,684	11,230	12,968	3%	1%	1%
Net profit	7,878	8,513	9,822	7,206	8,472	9,788	9%	0%	0%
EPS (RMB)	1.70	1.84	2.12	1.55	1.83	2.11	9%	0%	0%
Gross Margin	36.8%	36.6%	36.7%	35.7%	35.8%	36.0%	1.1 ppt	0.7 ppt	0.7 ppt
Operating Margin	8.5%	8.7%	9.1%	8.3%	8.6%	9.0%	0.2 ppt	0.1 ppt	0.1 ppt
Net Margin	6.7%	6.6%	6.8%	6.2%	6.5%	6.8%	0.6 ppt	0 ppt	0 ppt

Source: Company data, CMBIS estimates

Figure 3: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	116,995	129,879	143,959	117,816	131,652	143,708	-1%	-1%	0%
Gross Profit	43,057	47,496	52,841	41,286	46,581	51,117	4%	2%	3%
Operating Profit	9,974	11,313	13,045	8,449	10,216	12,012	18%	11%	9%
Net profit	7,878	8,513	9,822	6,947	7,937	9,062	13%	7%	8%
EPS (RMB)	1.70	1.84	2.12	1.54	1.75	2.02	11%	5%	5%
Gross Margin	36.8%	36.6%	36.7%	35.0%	35.4%	35.6%	1.8 ppt	1.2 ppt	1.1 ppt
Operating Margin	8.5%	8.7%	9.1%	7.2%	7.8%	8.4%	1.4 ppt	1 ppt	0.7 ppt
Net Margin	6.7%	6.6%	6.8%	5.9%	6.0%	6.3%	0.8 ppt	0.5 ppt	0.5 ppt

Source: Company data, CMBIS estimates

Domestic 5G capex to remain at a similar level while ZTE's share will continue to increase

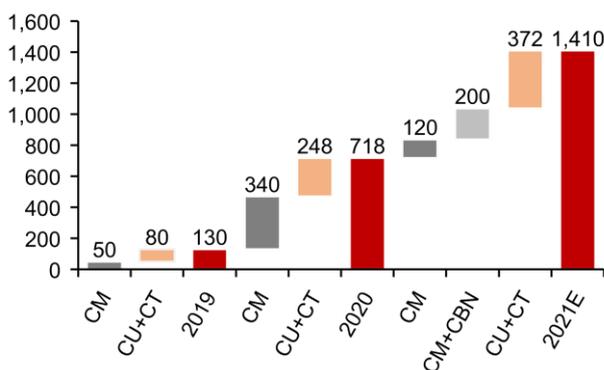
China has built 993k 5G BTS as of 3Q21, according to a recent announcement made by MIIT. We estimate new-add 5G BTS will reach 692k in 2021 (200k 700MHz 5G BTS to be completed in 2021), compared to 588k in 2020.

Chinese telcos' 2021 plan:

- China Mobile ("CM") will build 120k 2.6GHz 5G BTS.
- CM and China Broadcast Network ("CBN") will build 480k 700MHz 5G BTS, among which 200k will be completed by 2021.
- China Unicom ("CU") and China Telecom ("CT") will build 242k 2.1G BTS and 130k 3.5G BTS.

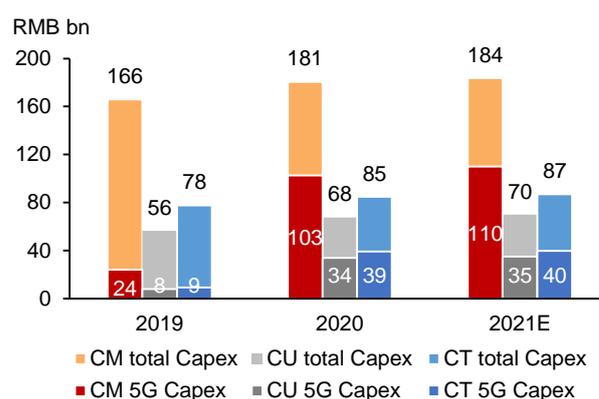
Chinese telcos had added 700MHz and 2.1GHz 5G BTS as the main equipment procurement for 5G deployment this year. The lower frequency spectrum can effectively improve network coverage and reduce cost. The ASP reduced to RMB79k/83k (700MHz/2.1GHz) in 2021 vs. RMB160k/129k (2.6GHz/3.5GHz) in 2020, due to de-spec of 5G BTS. We expect FY21E telco's Capex will still grow at a modest 5% YoY.

Figure 4: 588k/692k new-add 5G BTS in 2020/21E (480k 700MHz 5G BTS to be completed in 2021/22E)



Source: Company filings, C114 and CMBIS estimates

Figure 5: 2021E Telco's Capex budget is similar to 2020 with 5% YoY (CM/CU/CT)



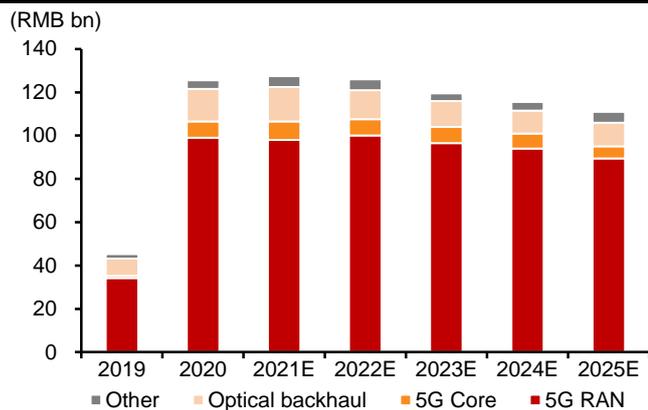
Source: Company filings, CMBIS estimates

Looking forward, we believe the telcos' CAPEX will remain at a similar level next year for continued investment in network and infrastructure. We are positive about ZTE's future performance as we expect the company to be the key beneficiary of China's 5G deployment with potential share gain (31% in 2020, 33% in 2021E, and 35% in 2022E).

A summary of ZTE's share allocation in 2021 5G BTS tender announcements is as follows:

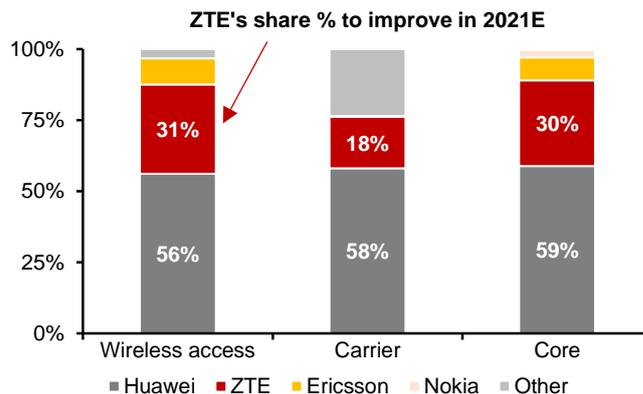
- 700MHz 5G BTS (480k): ZTE won a 31% share of the total bid.
- 2.1GHz 5G BTS (242k): ZTE won a 31.9% base share. There is a floating share of 7.44% for the top 2 winners (Huawei and ZTE) in addition to the base share. The allocation of the additional shares has not been disclosed, but we believe ZTE obtained a more significant portion.
- 3.5GHz 5G BTS: Winner were Huawei, ZTE, Ericsson and DTmobile. There is no disclosure of share allocation, but we believe ZTE's share was similar to last year (30%+).

Figure 6: China telcos' capex forecast for 5G RAN/ 5G Core/ 5G optical backhaul (2021E-25E)



Source: IDC, CMBIS estimates

Figure 7: ZTE ranked as No.2 with 31% market share of China 5G BTS tender in 2020



Source: China mobile, China Unicom, China telecom, xinhuanet, C114, CMBIS estimates

Assumptions

Figure 8: P&L forecast

RMB mn	FY19	FY20	1Q21	2Q21	3Q21	4Q21E	FY21E	FY22E	FY23E
Revenue	90,737	101,451	26,241.6	26,829.3	30,754.2	33,170.0	116,995	129,879	143,959
...YoY	6.1%	11.8%	22.1%	4.3%	14.2%	0.0%	15.3%	11.0%	10.8%
Cost of sales	(57,008)	(69,379)	(16,943)	(16,950)	(19,067)	(20,978)	(73,938)	(82,382)	(91,117)
Gross profit	33,728	32,071	9,298.7	9,879.4	11,687.0	12,192.2	43,057	47,496	52,841
GPM (%)	37.2%	31.6%	35.4%	36.8%	38.0%	36.8%	36.8%	36.6%	36.7%
...YoY	19.8%	-4.9%	10.0%	34.8%	45.3%	47.8%	34.3%	10.3%	11.3%
SG&A	(12,642)	(12,574)	(3,415)	(3,298)	(3,798)	(4,174)	(14,686)	(16,235)	(17,707)
...% of rev	-13.9%	-12.4%	-13.0%	-12.3%	-12.3%	-12.6%	-12.6%	-12.5%	-12.3%
R&D	(12,548)	(14,797)	(4,192)	(4,669)	(5,310)	(5,718)	(19,889)	(21,430)	(23,753)
...% of rev	-13.8%	-14.6%	-16.0%	-17.4%	-17.3%	-17.2%	-17.0%	-16.5%	-16.5%
Operating profit	7,552	5,471	2,563	2,983	2,157	2,271	9,974	11,313	13,045
OPM (%)	8.3%	5.4%	9.8%	11.1%	7.0%	6.8%	8.5%	8.7%	9.1%
...YoY	-1334.1%	-27.6%	144.0%	66.6%	96.4%	48.2%	82.3%	13.4%	15.3%
Net profit	5,148	4,260	2,182	1,897	1,774	2,025	7,878	8,513	9,822
NPM (%)	5.7%	4.2%	8.3%	7.1%	5.8%	6.1%	6.7%	6.6%	6.8%
...YoY	-173.7%	-17.3%	179.7%	76.1%	107.6%	30.8%	84.9%	8.1%	15.4%

Source: Company data, CMBIS estimates

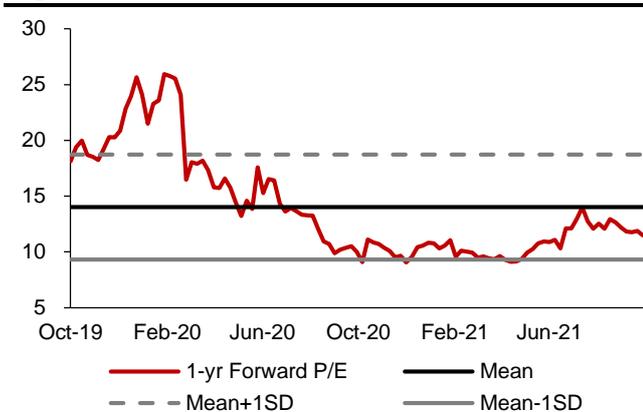
Valuation

Maintain BUY and maintain TP to HK\$33.06 (31.2% upside)

We maintain our TP to HK\$33.06 based on the same 15.0x FY22E P/E. Trading at 11.4x FY22E P/E, the stock is attractive. We are positive on ZTE as we believe the company will enjoy share gain in telcos' 5G related capex in the following years. Looking forward, we think telcos will continue a healthy capex deployment similar to FY21's plan.

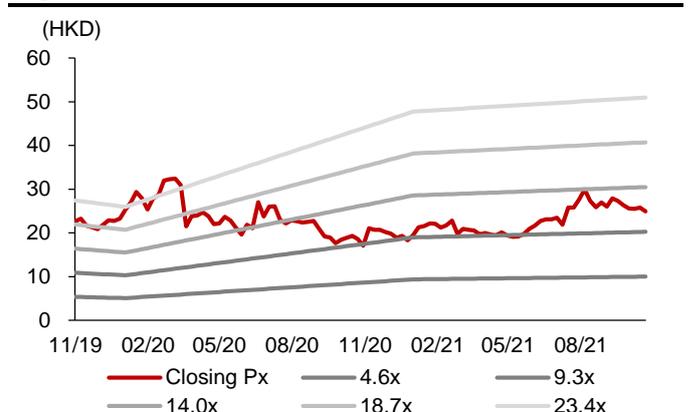
Risks include US-China disputes, component restriction and 5G deployment delays.

Figure 9: 12M forward P/E chart



Source: Company data, CMBIS estimates

Figure 10: 12M forward P/E 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	129,879	143,959	Net profit	5,777	4,722	7,878	8,513	9,822
Cost of sales	(57,008)	(69,379)	(73,938)	(82,382)	(91,117)	Depreciation/amortization	3,062	3,565	4,598	5,304	5,855
Gross profit	33,728	32,071	43,057	47,496	52,841	Change in working capital	(4,177)	(1,965)	573	(4,203)	3,797
Selling exp	(7,869)	(7,579)	(9,000)	(10,131)	(11,229)	Others	2,785	3,911	(4,332)	(5,315)	(6,117)
Admin exp	(4,773)	(4,995)	(5,686)	(6,104)	(6,478)	Net cash from operating	7,447	10,233	8,717	4,300	13,358
R&D exp	(12,548)	(14,797)	(19,889)	(21,430)	(23,753)	Capex	6,551	6,472	7,069	7,788	8,201
Finance costs	(966)	(421)	(1,153)	(786)	(787)	Other	(12,574)	(13,554)	(6,563)	(8,614)	(9,439)
Other operating exp.	1,696	1,573	2,223	2,598	2,879	Net cash from investing	(6,023)	(7,082)	506	(826)	(1,238)
Operating profit	7,552	5,471	9,974	11,313	13,045	Net borrowings	9,019	(1,294)	12,964	1,608	(987)
Other non-oper exp.	(391)	(407)	(148)	(164)	(182)	Dividend paid	2,640	2,951	2,317	3,577	3,572
Pre-tax profit	7,162	5,064	9,826	11,149	12,863	Other	(5,938)	(1,947)	(3,456)	(7,154)	(7,144)
Income tax expense	(1,385)	(342)	(1,670)	(1,895)	(2,187)	Net cash from financing	5,722	(290)	11,826	(1,969)	(4,559)
Minority interests	(280)	(446)	(278)	(740)	(854)	Net change in cash	7,372	2,898	21,264	1,505	7,560
Perpetual capital instrument	(349)	(16)	-	-	-	Cash at beginning of the year	21,134	28,506	35,660	56,924	58,429
Net profit to shareholders	5,148	4,260	7,878	8,513	9,822	Exchange difference	227	37	216	-	-
						Cash at the end of the year	28,506	31,403	56,924	58,429	65,989

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	133,699	140,987	150,623	Revenue mix					
Cash & equivalents	33,309	35,660	56,924	58,429	65,989	Carrier business	66,584	74,018	85,824	94,907	104,903
Account receivables	19,778	15,891	14,108	17,570	16,303	Consumer business	14,997	16,160	17,166	18,431	19,935
Inventory	27,689	33,689	35,131	37,023	39,754	Gov. and enterprise	9,155	11,272	14,006	16,541	19,120
Prepayment	1,023	1,152	1,296	1,296	1,296	Growth (%)					
Other current assets	20,768	20,585	26,240	26,668	27,281	Revenue	6.1	11.8	15.3	11.0	10.8
Non-current assets	38,635	43,658	44,906	45,840	47,930	Gross profit	19.8	(4.9)	34.3	10.3	11.3
PPE	9,383	11,914	13,260	14,237	14,988	Operating profit	(1,334.1)	(27.6)	82.3	13.4	15.3
Intangible assets	7,719	9,367	7,913	7,889	7,893	Net profit	(173.7)	(17.3)	84.9	8.1	15.4
Other non-current assets	21,533	22,376	23,733	23,714	25,049	Profit & loss ratio (%)					
Total assets	141,202	150,635	178,605	186,827	198,553	Gross margin	37.2	31.6	36.8	36.6	36.7
Current liabilities	86,371	74,395	86,546	87,096	91,794	Operating margin	8.3	5.4	8.5	8.7	9.1
ST borrowings	27,258	12,664	17,318	17,895	17,541	Net profit margin	5.7	4.2	6.7	6.6	6.8
Account payables	18,356	17,152	21,763	21,596	26,360	Balance sheet ratio					
Tax payable	889	878	794	794	794	Gearing ratio (%)	50	44	48	45	42
Other current liabilities	39,868	43,701	46,672	46,812	47,099	Current ratio (x)	1.2	1.4	1.5	1.6	1.6
Non-current liabilities	16,877	30,117	38,189	39,220	38,587	Receivable turnover days	83	64	47	45	43
LT borrowings	10,045	22,614	30,925	31,956	31,323	Inventory turnover days	106	110	107	101	97
Deferred income	645	718	564	564	564	Payable turnover days	121	93	96	96	96
Other non-current liabilities	6,187	6,785	6,700	6,700	6,700	Profitability (%)					
Total liabilities	103,248	104,512	124,735	126,316	130,381	ROE	19.9	11.8	16.7	15.7	16.0
Shareholders' equity						ROA	3.6	2.8	4.4	4.6	4.9
Share capital	4,228	4,613	4,642	4,642	4,642	Per share data (RMB)					
Reserve	12,144	23,276	24,425	24,425	24,425	EPS (RMB)	1.22	0.92	1.70	1.84	2.12
Minority interest	2,875	2,826	3,035	3,035	3,035	DPS (RMB)	0.20	0.20	0.37	0.40	0.47
Total equity	37,954	46,123	53,870	60,511	68,172	BVPS (RMB)	8.30	9.39	10.97	12.40	14.05
Total liabilities and equity	141,202	150,635	178,605	186,827	198,553						

Source: Company data, CMBIS estimates

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