

# ZTE (763 HK)

## 1Q21 confirmed GPM recovery on track; Reiterate BUY

ZTE reported 1Q21 results with revenue of RMB26.2bn (22% YoY) and net profit of RMB2.2bn (180% YoY), largely in-line with our/consensus estimates. Excluding one-time gain from sale of asset, net profit grew at 80% YoY, which accounted for 22.8%/23.9% of our/consensus estimates. GPM improved 5.2ppt QoQ to 35.4% in 1Q21 (vs 30.2% in 4Q20), driven by better product mix and improving cost structure. We remain positive on ZTE's outlook with global share gain and GPM recovery, and reiterate BUY with TP of HK\$28.1 (17.4x FY21E P/E). Upcoming catalysts include 3rd batch of 5G BTS tenders, stabilized ASP and share gain.

- **Positive 1Q21 backed by healthy telco's capex outlook.** ZTE delivered 22% YoY revenue growth, driven by solid Carrier business and strong Consumer and Gov./Enterprises business. We believe ZTE will remain the major beneficiary of global 5G deployment in China, and deliver 15% YoY revenue growth in FY21E, backed by ~10% YoY growth in China telco's FY21E capex for 44k traditional 5G BTS and 400k 700MHz 5G BTS (2-year plan by CM/CBN).
- **Expect further share gain and GPM recovery in FY21E.** As China 5G deployment focuses on 2nd/3rd tier cities this year, we expect ZTE to enjoy share gain in upcoming 3rd batch of 5G BTS tender (3.5GHz/2.6GHz BTS), given ZTE's stronger presence in these markets. We think ZTE's China market share will expand to 33%/35% in FY21/22E. GPM recovered to 35.4% (vs. 31.6% FY20), thanks to higher utilization of self-developed chips. We expected FY21E revenue to grow 15% YoY and GPM will reach 34% in FY21E. We expect ASP pressure will ease this year, which will be slightly offset by increasing material costs from suppliers.
- **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. Trading at 12x FY21E P/E (1-sd below 2-year avg.), the stock is extremely attractive, in our view, 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	+37.7%
Current Price	HK\$ 20.4

### China Technology Sector

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### Stock Data

Mkt. Cap. (HK\$ mn)	152,050
Avg. 3mths t/o (HK\$ mn)	205
52W High/Low (HK\$)	29.95/16.5
Total Issued Shares (mn)	755.5

Source: Bloomberg

### Shareholding Structure

BlackRock	6.34%
Capital Group	5.08%
Schroders	4.93%

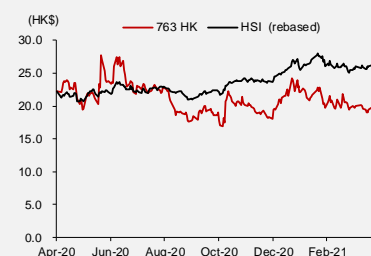
Source: Bloomberg

### Share Performance

	Absolute	Relative
1-mth	3.6%	0.9%
3-mth	-7.7%	-9.3%
6-mth	6.9%	-9.1%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: Ernst & Young**

## 1Q21 Results Review

Figure 1: 1Q21 results review

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	QoQ	YoY
Revenue	21,484	25,715	26,930	27,321	26,242	-4.0%	22.1%
Gross Profit	8,451	7,330	8,043	8,247	9,299	12.7%	10.0%
Operating Profit	1,051	1,790	1,098	1,532	2,563	67.3%	144.0%
Net profit	780	1,077	855	1,548	2,182	41.0%	179.7%
EPS (RMB)	0.18	0.23	0.19	0.34	0.47	40.1%	161.1%
Gross Margin	39.3%	28.5%	29.9%	30.2%	35.4%	5.2 ppt	-3.9 ppt
Operating Margin	4.9%	7.0%	4.1%	5.6%	9.8%	4.2 ppt	4.9 ppt
Net Margin	3.6%	4.2%	3.2%	5.7%	8.3%	2.6 ppt	4.7 ppt

Source: Bloomberg, CMBIS estimates

## Earnings Revision

Figure 2: 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	115,171	128,259	137,864	2%	1%	2%
Gross Profit	39,647	44,084	48,423	38,494	43,779	47,744	3%	1%	1%
Operating Profit	8,671	9,915	12,267	8,232	9,738	11,622	5%	2%	6%
Net profit	6,181	7,097	8,903	5,879	7,123	8,325	5%	0%	7%
EPS (RMB)	1.34	1.54	1.93	1.28	1.55	1.79	4%	-1%	8%
Gross Margin	33.9%	34.2%	34.5%	33.4%	34.1%	34.6%	0.5 ppt	0 ppt	-0.2 ppt
Operating Margin	7.4%	7.7%	8.7%	7.1%	7.6%	8.4%	0.3 ppt	0.1 ppt	0.3 ppt
Net Margin	5.3%	5.5%	6.3%	5.1%	5.6%	6.0%	0.2 ppt	-0.1 ppt	0.3 ppt

Source: Bloomberg, CMBIS estimates

Figure 3: P&L forecast

RMB mn	FY19	FY20	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>90,737</b>	<b>101,451</b>	<b>116,995</b>	<b>129,070</b>	<b>140,524</b>
...YoY	6.1%	11.8%	15.3%	10.3%	8.9%
Cost of sales	(57,008)	(69,379)	(77,348)	(84,986)	(92,101)
<b>Gross profit</b>	<b>33,728</b>	<b>32,071</b>	<b>39,647</b>	<b>44,084</b>	<b>48,423</b>
GPM (%)	37.2%	31.6%	33.9%	34.2%	34.5%
...YoY	19.8%	-4.9%	23.6%	11.2%	9.8%
SG&A	(12,642)	(12,574)	(14,507)	(16,134)	(17,706)
...% of rev	-13.9%	-12.4%	-12.4%	-12.5%	-12.6%
R&D	(12,548)	(14,797)	(17,081)	(18,457)	(19,673)
...% of rev	-13.8%	-14.6%	-14.6%	-14.3%	-14.0%
<b>Operating profit</b>	<b>7,552</b>	<b>5,471</b>	<b>8,671</b>	<b>9,915</b>	<b>12,267</b>
OPM (%)	8.3%	5.4%	7.4%	7.7%	8.7%
...YoY	-1334.1%	-27.6%	58.5%	14.3%	23.7%
<b>Net profit</b>	<b>5,148</b>	<b>4,260</b>	<b>6,181</b>	<b>7,097</b>	<b>8,903</b>
NPM (%)	5.7%	4.2%	5.3%	5.5%	6.3%
...YoY	-173.7%	-17.3%	45.1%	14.8%	25.4%

Source: Company data, CMBIS estimates

Figure 4: Revenue breakdown

RMB mn	FY19	FY20	FY21E	FY22E	FY23E
Carriers' network	66,584	74,018	85,824	94,098	101,469
...YoY	17%	11%	16%	10%	8%
China	47,260	52,051	61,606	65,999	68,299
...YoY	15%	10%	18%	7%	3%
Overseas	19,324	21,967	24,217	28,099	33,170
...YoY	21%	14%	10%	16%	18%
Consumer business	14,997	16,160	17,166	18,431	19,935
...YoY	-22%	8%	6%	7%	8%
Gov. and corp. business	9,155	11,272	14,006	16,541	19,120
...YoY	-1%	23%	24%	18%	16%
<b>Total</b>	<b>90,737</b>	<b>101,451</b>	<b>116,995</b>	<b>129,070</b>	<b>140,524</b>
<b>...YoY</b>	<b>6.1%</b>	<b>11.8%</b>	<b>15.3%</b>	<b>10.3%</b>	<b>8.9%</b>

<b>Gross Margin</b>					
Carriers' network	42.6%	33.8%	36.5%	36.8%	37.2%
Consumer business	17.9%	23.6%	24.0%	24.2%	24.4%
Gov. and corp. business	29.2%	28.8%	30.0%	30.2%	30.4%
<b>Blended GPM</b>	<b>37.2%</b>	<b>31.6%</b>	<b>33.9%</b>	<b>34.2%</b>	<b>34.5%</b>

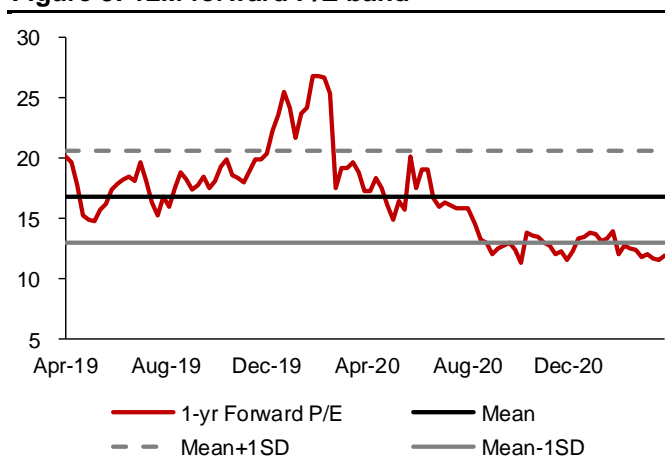
Source: Company data, CMBIS estimates

## Valuation

### Maintain BUY and maintain TP at HK\$28.1 (37.7% upside)

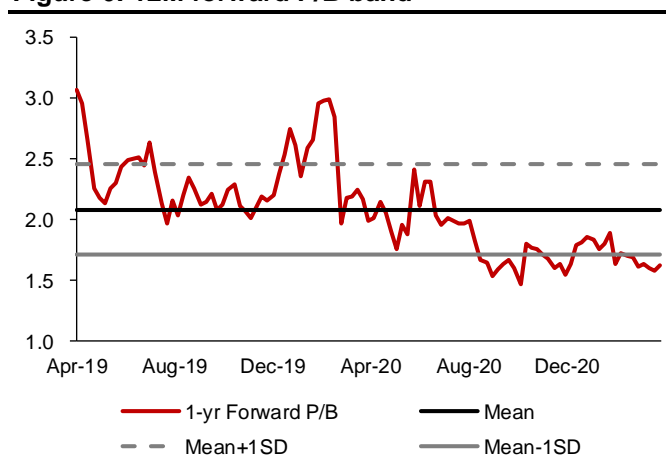
We maintain our TP at HK\$ 28.1 based on 17.4x FY21E P/E, in line with 2-year historical forward P/E. We estimate 20% EPS FY21-23E CAGR, backed by 10% revenue CAGR backed by 1) healthy capex growth of China telco; 2) reaccelerated 5G deployment in China and resumption of network construction overseas and 3) improving gross margin due to cost management and self-developed chips from Sanechip. Trading at 12x 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 5: 12M forward P/E band



Source: Company data, CMBIS estimates

Figure 6: 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
<b>Revenue</b>	<b>90,737</b>	<b>101,451</b>	<b>116,995</b>	<b>129,070</b>	<b>140,524</b>	<b>Net profit</b>	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
<b>Gross profit</b>	<b>33,728</b>	<b>32,071</b>	<b>39,647</b>	<b>44,084</b>	<b>48,423</b>	Change in working capital	(4,177)	(1,965)	(589)	199	(1,290)
						Others	2,785	3,911	(3,887)	(80)	(914)
Selling exp	(7,869)	(7,579)	(8,658)	(9,422)	(10,118)	<b>Net cash from operating</b>	<b>7,447</b>	<b>10,233</b>	<b>5,962</b>	<b>12,060</b>	<b>12,127</b>
Admin exp	(4,773)	(4,995)	(5,850)	(6,712)	(7,588)	Capex	6,551	6,472	8,146	8,282	8,530
R&D exp	(12,548)	(14,797)	(17,081)	(18,457)	(19,673)	Other	(12,574)	(13,554)	(14,293)	(15,064)	(15,560)
Finance costs	(966)	(421)	(723)	(610)	99	<b>Net cash from investing</b>	<b>(6,023)</b>	<b>(7,082)</b>	<b>(6,146)</b>	<b>(6,782)</b>	<b>(7,030)</b>
Other operating exp.	1,696	1,573	1,755	1,936	2,108	Net borrowings	9,019	9,019	15,147	6,443	(12,092)
<b>Operating profit</b>	<b>7,552</b>	<b>5,471</b>	<b>8,671</b>	<b>9,915</b>	<b>12,267</b>	Dividend paid	2,640	2,640	2,640	3,506	3,260
						Other	(5,938)	(5,938)	(5,280)	(7,011)	(6,521)
Other non-oper exp.	(391)	(407)	(936)	(1,033)	(1,124)	<b>Net cash from financing</b>	<b>5,722</b>	<b>5,722</b>	<b>12,506</b>	<b>2,938</b>	<b>(15,353)</b>
<b>Pre-tax profit</b>	<b>7,162</b>	<b>5,064</b>	<b>7,736</b>	<b>8,883</b>	<b>11,143</b>	<b>Net change in cash</b>	<b>7,372</b>	<b>9,099</b>	<b>12,322</b>	<b>8,216</b>	<b>(10,255)</b>
						Cash at beginning of the year	21,134	21,134	35,660	47,982	56,198
Income tax expense	(1,385)	(342)	(1,160)	(1,332)	(1,671)	Exchange difference	227	227	-	-	-
Minority interests	(280)	(446)	(395)	(453)	(568)	<b>Cash at the end of the year</b>	<b>28,506</b>	<b>30,233</b>	<b>47,982</b>	<b>56,198</b>	<b>45,943</b>
Perpetual capital instrument	(349)	(16)	-	-	-						
<b>Net profit to shareholders</b>	<b>5,148</b>	<b>4,260</b>	<b>6,181</b>	<b>7,097</b>	<b>8,903</b>						
Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Current assets</b>	<b>102,567</b>	<b>106,977</b>	<b>130,980</b>	<b>138,414</b>	<b>136,959</b>	<b>Revenue mix</b>					
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	<b>Growth (%)</b>					
Other current assets	20,768	20,585	22,777	23,355	23,430	Revenue	6.1	11.8	15.3	10.3	8.9
<b>Non-current assets</b>	<b>38,635</b>	<b>43,658</b>	<b>46,462</b>	<b>48,823</b>	<b>51,659</b>	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	<b>Profit &amp; loss ratio (%)</b>					
<b>Total assets</b>	<b>141,202</b>	<b>150,635</b>	<b>177,442</b>	<b>187,237</b>	<b>188,617</b>	Gross margin	37.2	31.6	33.9	34.2	34.5
<b>Current liabilities</b>	<b>86,371</b>	<b>74,395</b>	<b>86,672</b>	<b>86,801</b>	<b>88,988</b>	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	<b>Balance sheet ratio</b>					
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
<b>Non-current liabilities</b>	<b>16,877</b>	<b>30,117</b>	<b>39,827</b>	<b>43,957</b>	<b>36,206</b>	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	<b>Profitability (%)</b>					
<b>Total liabilities</b>	<b>103,248</b>	<b>104,512</b>	<b>126,499</b>	<b>130,758</b>	<b>125,193</b>	ROE	19.9	11.8	13.5	13.9	15.6
<b>Shareholders' equity</b>						ROA	3.6	2.8	3.5	3.8	4.7
Share capital	4,228	4,613	4,613	4,613	4,613	<b>Per share data (RMB)</b>					
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
<b>Total equity</b>	<b>37,954</b>	<b>46,123</b>	<b>50,944</b>	<b>56,479</b>	<b>63,424</b>	BVPS (RMB)	8.30	9.39	10.43	11.63	13.14
<b>Total liabilities and equity</b>	<b>141,202</b>	<b>150,635</b>	<b>177,442</b>	<b>187,237</b>	<b>188,617</b>						

Source: Company data, CMBIS estimates

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**NOT RATED** : Stock is not rated by CMBIS

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