

ZTE (000063 CH)

Mixed 3Q results

ZTE released its 3Q23 results. Quarterly revenue of RMB28.7bn (-12.4% YoY and -9.1% QoQ) was below market expectation, largely due to lower-than-expected telecom revenue. 3Q net profit was RMB2.4bn, with 5.1% YoY and -16.3% QoQ. GPM was resilient at 44.6% in 3Q23 (vs. 38.1%/42.0% in 3Q22/2Q23), showing Company's competitiveness in the telecom market. We revised down our EPS forecast for 2023-25E by 5%/7%/9%, reflecting a slowdown in growth in 3Q23. **Maintain BUY with adjusted TP of RMB36.9.**

■ **3Q revenue missed market expectations**, mainly due to 1) server revenue missed expectations, 2) lower-than-expected telecom sales as a result of delayed 5G tender, 3) ongoing pressure on consumer and enterprise/government segments under macro headwinds. We think the 5G tender delay was a temporary impact on seasonality. However, we trimmed our revenue forecasts by 9%/13%/14% for 2023, 2024 and 2025, respectively, reflecting greater-than-expected headwinds on non-carrier revenue and slower-than-expected server business ramp-up.

■ **Resilient GPM continued to be the spotlight.** Despite the decline in revenue, GPM remained at 44.6% for 3Q23. We expect full-year GPM to be 42.8%. Looking forward, considering the Company's competitiveness in the telecom market, we believe the Company's margin will remain stable at the current level.

■ **Maintain BUY, with revised TP to RMB36.9, based on the 16.5x (3-year avg.) FY24E P/E.** We trim our net profit forecasts by 5%/7%/9% for 2023E/24E/25E, due to cautious outlook for global telecom spending and soft consumer/ corporates spending. Potential downside risks include Sino-US trade tensions, additional component restriction/technology ban, and 5G deployment delays.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	114,522	122,954	120,067	126,542	134,289
YoY growth (%)	12.9	7.4	(2.3)	5.4	6.1
Gross margin (%)	35.2	37.2	42.4	41.9	41.5
Net profit (RMB mn)	6,813	8,080	9,371	10,872	12,078
YoY growth (%)	59.9	18.6	16.0	16.0	11.1
P/E (x)	17.8	15.3	13.5	11.7	10.6
ROE (%)	13.2	13.8	13.8	14.2	14.0
Diluted EPS (RMB)	1.47	1.71	1.94	2.23	2.48
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	RMB36.9
(Previous TP	RMB39.5)
Up/Downside	+42.4%
Current Price	RMB25.9

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Stock Data

Mkt Cap (RMB mn)	120,420.6
Avg 3 mths t/o (RMB mn)	2,303.1
52w High/Low (HK\$)	45.54/21.36
Total Issued Shares (mn)	4,027.7
Source: FactSet	

Shareholding Structure

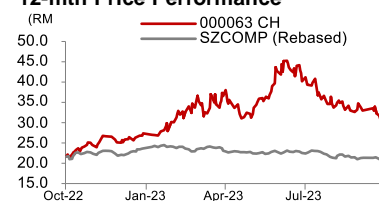
ZTE Holdings	23.86%
National Social Security Fund	1.82%
Source: Bloomberg	

Share Performance

	Absolute	Relative
1-mth	-19.5%	-13.3%
3-mth	-30.4%	-21.1%
6-mth	-23.5%	-11.0%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Earnings revision

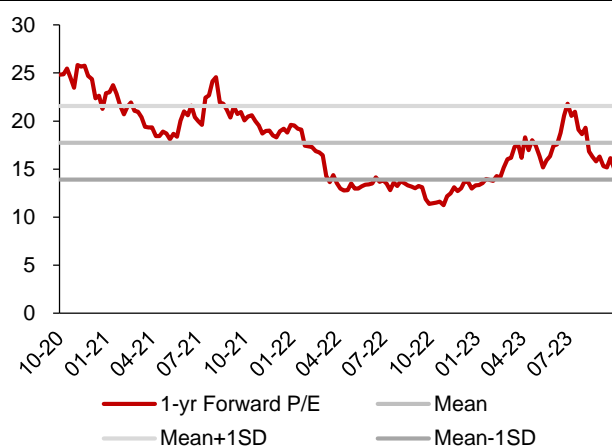
RMB mn	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	120,067	126,542	134,289	132,278	144,704	156,765	-9%	-13%	-14%
Gross Profit	51,338	53,287	56,050	54,554	59,074	63,811	-6%	-10%	-12%
Net profit	9,371	10,872	12,078	9,886	11,653	13,312	-5%	-7%	-9%
EPS (RMB)	1.94	2.23	2.48	2.05	2.40	2.74	-5%	-7%	-9%
Gross Margin	42.8%	42.1%	41.7%	41.2%	40.8%	40.7%	1.5 ppt	1.3 ppt	1 ppt
Operating Margin	8.7%	9.6%	10.1%	9.0%	8.8%	8.7%	-0.2 ppt	0.8 ppt	1.3 ppt
Net Margin	7.8%	8.6%	9.0%	7.5%	8.1%	8.5%	0.3 ppt	0.5 ppt	0.5 ppt

Source: Company data, CMBIGM estimates

Figure 2: CMBIGM estimates vs. consensus

RMB mn	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	120,067	126,542	134,289	125,343	133,893	142,526	-4%	-5%	-6%
Gross Profit	51,338	53,287	56,050	52,070	55,493	59,084	-1%	-4%	-5%
Net profit	9,371	10,872	12,078	9,893	10,808	11,835	-5%	1%	2%
EPS (RMB)	1.94	2.23	2.48	2.09	2.29	2.43	-7%	-2%	2%
Gross Margin	42.8%	42.1%	41.7%	41.5%	41.4%	41.5%	1.2 ppt	0.7 ppt	0.3 ppt
Operating Margin	8.7%	9.6%	10.1%	9.1%	9.5%	9.8%	-0.4 ppt	0.1 ppt	0.3 ppt
Net Margin	7.8%	8.6%	9.0%	7.9%	8.1%	8.3%	-0.1 ppt	0.5 ppt	0.7 ppt

Source: Company data, CMBIGM estimates

Figure 2: 12M forward P/E band

Source: Bloomberg, CMBIGM estimates

Figure 3: 12M forward P/E chart

Source: Bloomberg, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	101,451	114,522	122,954	120,067	126,542	134,289
Cost of goods sold	(69,379)	(74,160)	(77,228)	(68,728)	(73,255)	(78,239)
Gross profit	32,071	40,362	45,727	51,338	53,287	56,050
Operating expenses	(26,483)	(31,828)	(35,166)	(39,346)	(40,810)	(42,610)
SG&A expense	(12,574)	(14,178)	(14,506)	(14,401)	(14,798)	(15,301)
R&D expense	(14,797)	(18,804)	(21,602)	(25,591)	(26,718)	(28,085)
Others	888	1,154	942	645	705	775
Operating profit	5,589	8,534	10,561	11,992	12,477	13,440
Other gains/(losses)	(268)	(51)	(2,303)	(2,065)	(1,170)	(1,140)
Interest income	1,239	1,497	2,440	3,851	3,968	3,777
Interest expense	(1,496)	(1,481)	(1,946)	(3,362)	(3,189)	(2,651)
Pre-tax profit	5,064	8,499	8,752	10,417	12,085	13,426
Income tax	(342)	(1,463)	(960)	(1,143)	(1,326)	(1,473)
After tax profit	4,722	7,036	7,792	9,274	10,759	11,953
Minority interest	(446)	(223)	289	97	112	125
Others	(16)	0	0	0	0	0
Net profit	4,260	6,813	8,080	9,371	10,872	12,078

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	106,977	127,871	137,874	149,117	145,957	155,361
Cash & equivalents	35,660	50,713	56,346	66,086	63,529	68,474
Account receivables	15,891	17,509	17,751	18,104	17,258	18,797
Inventories	33,689	36,317	45,235	45,147	45,167	47,005
Other current assets	12,811	16,747	13,690	15,213	15,442	16,218
Contract assets	8,926	6,585	4,851	4,566	4,561	4,867
Non-current assets	43,658	40,892	43,080	45,570	48,510	52,164
PP&E	11,914	11,437	12,913	14,262	15,507	16,784
Right-of-use assets	1,047	815	1,080	1,141	1,189	1,243
Deferred income tax	3,437	3,195	3,719	3,861	3,857	4,116
Intangibles	9,367	8,095	7,342	7,685	8,205	8,836
Goodwill	186	0	0	0	0	0
Other non-current assets	17,706	17,351	18,026	18,620	19,752	21,184
Total assets	150,635	168,763	180,954	194,687	194,468	207,524
Current liabilities	74,395	78,685	78,424	75,032	72,827	76,681
Short-term borrowings	10,559	8,947	9,962	9,017	6,046	6,737
Account payables	17,152	21,717	19,075	16,702	17,417	17,737
Tax payable	878	1,216	1,447	1,441	1,440	1,536
Other current liabilities	20,262	19,012	17,017	19,739	19,823	20,684
Contract liabilities	14,998	16,102	17,700	15,198	15,181	16,200
Accrued expenses	10,545	11,691	13,222	12,935	12,920	13,788
Non-current liabilities	30,117	36,791	42,987	50,785	44,126	43,918
Long-term borrowings	22,614	29,908	35,126	42,165	35,516	34,730
Deferred income	2,228	1,873	2,322	3,087	3,083	3,290
Other non-current liabilities	5,275	5,010	5,539	5,533	5,527	5,898
Total liabilities	104,512	115,476	121,410	125,816	116,953	120,599
Share capital	4,613	4,731	4,736	4,827	4,865	4,865
Capital surplus	23,276	25,360	25,893	27,752	27,790	27,790
Retained earnings	14,824	20,651	27,309	34,789	43,469	53,003
Other reserves	583	740	704	697	697	697
Total shareholders equity	43,297	51,482	58,641	68,066	76,822	86,356
Minority interest	2,826	1,806	902	805	693	568
Total equity and liabilities	150,635	168,763	180,954	194,687	194,468	207,524

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,722	7,036	7,792	9,274	10,759	11,953
Depreciation & amortization	3,971	4,588	4,386	4,813	5,325	5,901
Change in working capital	(1,965)	2,615	(9,058)	(2,675)	595	(3,645)
Others	3,504	1,484	4,458	3,787	4,162	5,172
Net cash from operations	10,233	15,724	7,578	15,199	20,841	19,381
Investing						
Capital expenditure	(6,472)	(5,686)	(4,952)	(8,872)	(9,145)	(9,727)
Acquisition of subsidiaries/ investments	(7,364)	(17,062)	(11,010)	0	0	0
Net proceeds from disposal of short-term investments	6,510	10,274	13,450	0	0	0
Others	243	1,882	1,221	(1,782)	671	606
Net cash from investing	(7,082)	(10,592)	(1,291)	(10,654)	(8,474)	(9,122)
Financing						
Dividend paid	(2,951)	(2,618)	(3,688)	(5,252)	(5,381)	(5,194)
Net borrowings	(1,294)	5,309	5,442	7,378	(9,621)	(94)
Others	3,955	88	(300)	1,666	77	0
Net cash from financing	(290)	2,779	1,455	3,791	(14,925)	(5,289)
Net change in cash						
Cash at the beginning of the year	28,506	31,403	39,071	47,072	55,628	53,071
Exchange difference	37	(242)	260	268	0	0
Cash at the end of the year	31,403	39,071	47,072	55,628	53,071	58,016

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