

ZTE (000063 CH)

Solid 4Q20 recovery with improving margin; Lift TP to RMB41.7

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 slightly revised our forecasts and raised our TP to RMB41.7 based on same 31.2x FY21E P/E. 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; Lift TP to RMB41.7.** We adjusted our forecasts to reflect better operating leverage and new FX assumptions. We slightly raised our target price to RMB41.7 based on same 31.2x FY21E P/E, in line with 2-year historical forward P/E. Trading at 25.5x FY21E P/E (1-sd below 2-year avg.), we think the stock is attractive, vs 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)	(20.4)	27.8	35.8	25.5	21.7
PB (x)	4.9	4.1	3.6	3.3	2.9
Yield (%)	0.0	0.6	0.5	0.6	0.8
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	RMB 41.7
(Previous TP)	RMB 41.2)
Up/Downside	+22.5%
Current Price	RMB 34.03

China Technology Sector

Alex Ng
 (852) 3900 0881
 alexng@cmbi.com.hk

Lily Yang
 (852) 3916 3716
 lilyyang@cmbi.com.hk

Stock Data

Mkt. Cap. (HK\$ mn)	145,737
Avg. 3mths t/o (HK\$ mn)	2,678
52W High/Low (HK\$)	56.7/30.16
Total Issued Shares (mn)	3,857.9

Source: Bloomberg

Shareholding Structure

ZTE Holdings	26.12%
China Asset Mgmt Co.	1.92%
HKSCC	1.87%

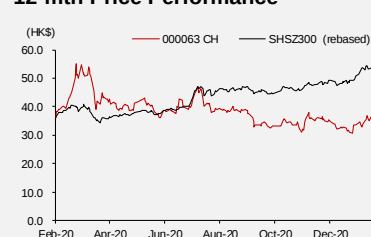
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	15.0%	3.1%
3-mth	6.8%	-10.4%
6-mth	-5.9%	-24.6%

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
Revenue	85,513	90,737	21,484	25,715	26,930	27,250	101,379	114,048	129,118
...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)
Gross profit	28,146	33,728	8,451	7,330	8,043	8,918	32,742	38,279	43,913
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%
Operating profit	(612)	7,552	1,051	1,790	1,098	1,598	5,537	8,537	9,970
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%
Net profit	(6,984)	5,148	780	1,077	855	1,655	4,367	6,176	7,239
NPM (%)	-8.2%	5.7%	3.6%	4.2%	3.2%	6.1%	4.3%	5.4%	5.6%
...YoY	Na	na	-9.6%	77.2%	-67.8%	62.2%	-15.2%	41.4%	17.2%

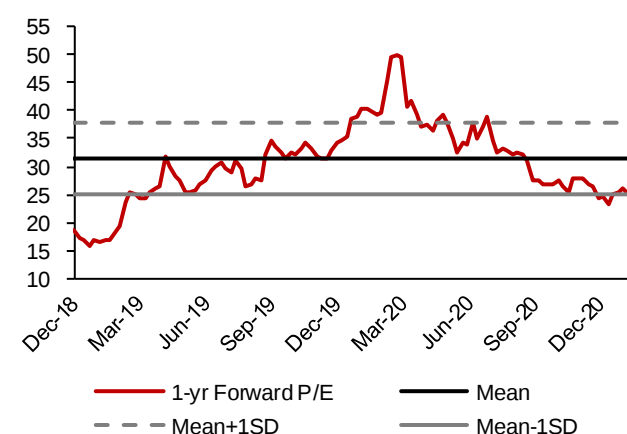
Source: Company data, CMBIS

Valuation

Maintain BUY and raised TP to RMB 41.7 (22.5% upside)

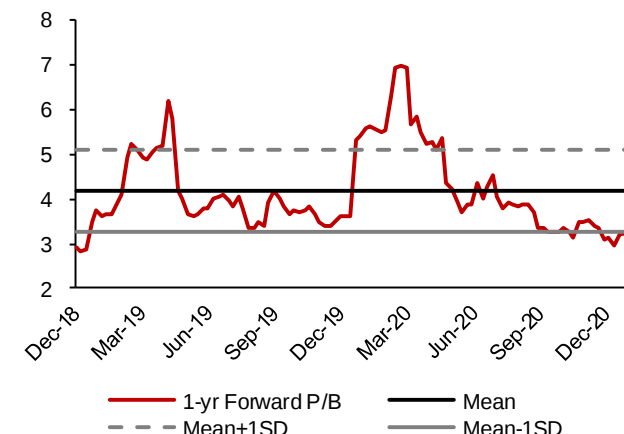
We slightly raised our TP to RMB41.7 based on 31.2x FY21E P/E, in line with 2-year historical forward P/E. We believe this is justified as the stock has been mostly trading on 25-37x EPS, except the period during negative earnings in 2012, 2016 and 2018. We estimate 26% EPS FY21-23E CAGR, backed by 11% revenue CAGR and improving GPM as 5G scales up. Trading at 25.5x 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
Revenue	90,737	101,379	114,048	129,118	140,656	Net profit	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
Gross profit	33,728	32,742	38,279	43,913	48,063	Change in working capital	(4,177)	4,058	(7,875)	(438)	(7,249)
Selling exp	(7,869)	(7,401)	(8,211)	(9,296)	(10,127)	Others	2,785	(2,907)	(714)	708	722
Admin exp	(4,773)	(5,069)	(5,816)	(6,585)	(7,173)	Net cash from operating	7,447	10,333	3,142	13,912	10,599
R&D exp	(12,548)	(15,004)	(17,107)	(19,368)	(21,098)	Capex	6,551	6,243	6,633	7,624	8,230
Finance costs	(966)	(637)	(576)	(244)	1,842	Other	(12,574)	(10,063)	(11,266)	(13,747)	(14,961)
Other operating exp.	1,696	1,506	2,053	2,324	2,532	Net cash from investing	(6,023)	(3,821)	(4,633)	(6,124)	(6,730)
Operating profit	7,552	5,537	8,537	9,970	13,194	Net borrowings	9,019	(4,467)	15,985	(650)	(11,230)
Other non-oper exp.	(391)	(403)	(912)	(1,033)	(1,125)	Dividend paid	2,640	3,475	2,354	2,959	1,194
Pre-tax profit	7,162	5,134	7,625	8,937	12,068	Other	(5,938)	(1,777)	(4,707)	(5,918)	(2,389)
Income tax expense	(1,385)	(975)	(1,449)	(1,698)	(2,293)	Net cash from financing	5,722	(2,769)	13,632	(3,609)	(12,425)
Minority interests	(280)	225	-	-	-	Net change in cash	7,372	3,007	12,141	4,179	(8,556)
Perpetual capital instrument	(349)	(16)	-	-	-	Cash at beginning of the year	21,134	33,309	36,316	48,457	52,636
Net profit to shareholders	5,148	4,367	6,176	7,239	9,775	Exchange difference	227	(736)	-	-	-
						Cash at the end of the year	28,506	36,316	48,457	52,636	44,080

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Current assets	102,567	109,170	137,541	142,217	144,969	Revenue mix					
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	Growth (%)					
Other current assets	20,768	22,258	22,258	22,258	22,258	Revenue	6.1	11.7	12.5	13.2	8.9
Non-current assets	38,635	38,357	38,356	38,309	37,738	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	Profit & loss ratio (%)					
Total assets	141,202	147,527	175,897	180,526	182,707	Gross margin	37.2	32.3	33.6	34.0	34.2
Current liabilities	86,371	74,467	87,232	86,241	87,600	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	Balance sheet ratio					
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
Non-current liabilities	16,877	28,172	38,621	38,196	30,855	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	Profitability (%)					
Total liabilities	103,248	102,639	125,853	124,437	118,456	ROE	19.9	12.1	13.5	14.1	16.7
Shareholders' equity						ROA	3.6	3.0	3.5	4.0	5.4
Share capital	4,228	4,613	4,613	4,613	4,613	Per share data (RMB)					
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
Total equity	37,954	44,888	50,044	56,089	64,251	BVPS (RMB)	6.85	9.34	10.46	11.77	13.54
Total liabilities and equity	141,202	147,527	175,897	180,526	182,707						

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIS Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIS

OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

CMBIS is not a registered broker-dealer in the United States. As a result, CMBIS is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.