

ZTE (763 HK)

Mixed 1H24 results

ZTE announced 1H24 results. Revenue increased by 2.9% YoY to RMB62.5bn, while net profit grew by 4.8% YoY to RMB5.7bn in 1H24. Despite the headwinds from declining capex of domestic telcos for ZTE's carrier business, non-carrier businesses managed to grow double-digits (14.3% and 56.1% YoY growth in consumer and govt/enterprise segments). On a quarterly basis, 2Q24 revenue increased by 1.1% YoY / 4.4% QoQ, while net profit increased by 5.7% YoY / 9.1% QoQ. GPM declined sequentially to 39%, mainly due to unfavorable product mix (i.e., lower contribution from high-margin carrier segment). NPM improved sequentially to 9.4% (vs. 9% / 7.5% in 1Q24/FY23) in 2Q24 on operating cost optimization. Looking forward, we think non-carrier segments will maintain double-digit growth, offsetting the weakness in carrier business. The stock is currently trading at 7x 2024E P/E, 1-SD below its 3-year historical avg. **Maintain BUY rating with adjusted TP at HK\$22.17.**

- **The carrier segment faced headwinds as domestic telecom companies become disciplined in capex, as the built-out of the 5G network in China has already achieved significant milestone.** The aggregate capex of China telcos is projected to be RMB334bn in 2024 (down 5% YoY), with the investment focus shifting to computing power/industrial digitalization/cloud markets, in line with our previous expectations ([report](#)). Given RAN business accounted for more than half of ZTE's carrier business sales, the company's carrier revenue fell by 8.6% YoY to RMB37.3bn in 1H24. Carrier's GPM remained strong at 54.3% in 1H24 (vs. 54.4%/44.2% in 1H/2H23). Overall, the company's GPM was stable at 40.5% in 1H24 (vs. 41.5% in 2023).
- **Consumer and govt/enterprise saw significant growth (14.3%/56% YoY), offsetting the weakness in carrier business.** Consumer sales grew on robust demand on FTTR market and recovering consumer electronics demand. Govt/enterprise revenue growth was driven by a surge in server and memory storage sales; however, these relatively low-margin products put pressure on the segment's GPM (21.8% in 1H24 vs. 34.9% in 2023). Looking forward, we expect these segments will maintain decent growth, as the spending of consumer and enterprises may continue to recover.
- **Maintain BUY on ZTE. TP adjusted to HK\$22.17, based on 9.3x FY24E P/E, which equals to 3-year historical avg.** We revised down our revenue forecasts by 3%/2% for FY24/25E, given continuous headwinds from domestic telecom market (lower spending in RAN). We trimmed net profit forecasts by 3%/7% on lower GPM but partially offsetting by better operating efficiency. Potential downside risks include 1) Sino-US trade tensions, 2) softer capex of domestic telcos and overseas 5G deployment delays, 3) weaker-than-expected consumer/enterprises' spending.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	122,954	124,251	130,034	140,200	153,503
YoY growth (%)	7.4	1.1	4.7	7.8	9.5
Gross margin (%)	37.2	41.5	39.8	39.0	38.6
Operating profit (RMB mn)	10,560.7	10,978.1	13,371.1	14,417.2	16,049.8
YoY growth (%)	23.7	4.0	21.8	7.8	11.3
Net profit (RMB mn)	8,080.3	9,325.8	10,477.7	11,403.6	14,419.5
YoY growth (%)	18.6	15.4	12.4	8.8	26.4
P/E (x)	9.0	7.9	7.0	6.5	5.1

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$22.17**
 (Previous TP) HK\$27.4)
Up/Downside **32.3%**
Current Price **HK\$16.76**

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Stock Data

Mkt Cap (HK\$ mn)	12,662.2
Avg 3 mths t/o (HK\$ mn)	151.6
52w High/Low (HK\$)	25.55/13.58
Total Issued Shares (mn)	755.5

Source: FactSet

Shareholding Structure

BlackRock	6.7%
Vanguard Group	4.1%

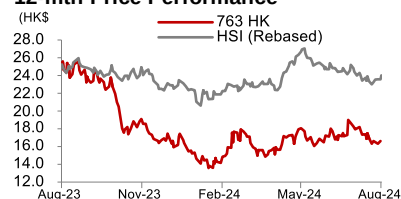
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-9.3%	-7.8%
3-mth	-7.2%	3.2%
6-mth	12.8%	4.5%

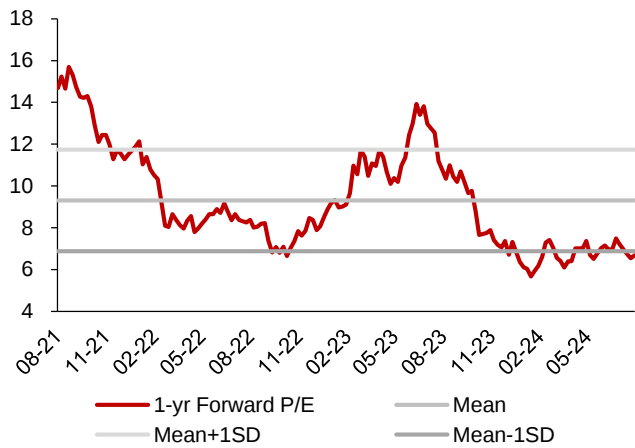
Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: 1-yr forward PE band



Source: Company data, Bloomberg

Figure 2: PE chart



Source: Company data, Bloomberg

Figure 3: Earnings revisions

US\$m	New			Old			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	130,034	140,200	153,503	129,749	136,085	142,119	0%	3%	8%
Gross profit	51,695	54,727	59,263	53,734	56,387	58,751	-4%	-3%	1%
Net profit	10,478	11,404	14,419	9,865	10,726	11,308	6%	6%	28%
EPS (RMB)	2.19	2.38	3.01	2.09	2.22	2.34	5%	7%	29%
Gross margin	39.8%	39.0%	38.6%	41.4%	41.4%	41.3%	-1.7 ppt	-2.4 ppt	-2.7 ppt
Net margin	8.1%	8.1%	9.4%	7.6%	7.9%	8.0%	0.5 ppt	0.3 ppt	1.4 ppt

Source: Company data, CMBIGM estimates

Figure 4: CMBIGM estimates vs. Bloomberg consensus

US\$m	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	130,034	140,200	153,503	133,717	142,644	NA	-3%	-2%	NA
Gross profit	51,695	54,727	59,263	55,973	59,858	NA	-8%	-9%	NA
Net profit	10,478	11,404	14,419	10,842	12,200	NA	-3%	-7%	NA
EPS (RMB)	2.19	2.38	3.01	2.27	2.55	NA	-3%	-7%	NA
Gross margin	39.8%	39.0%	38.6%	41.9%	41.5%	NA	-2.1 ppt	-2.5 ppt	NA
Net margin	8.1%	8.1%	9.4%	8.1%	8.6%	NA	-0.1 ppt	-0.4 ppt	NA

Source: Company data, CMBIGM estimates, Bloomberg consensus

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	114,522	122,954	124,251	130,034	140,200	153,503
Cost of goods sold	(74,160)	(77,228)	(72,650)	(78,339)	(85,473)	(94,240)
Gross profit	40,362	45,727	51,601	51,695	54,727	59,263
Operating expenses	(31,828)	(35,166)	(40,623)	(38,324)	(40,309)	(43,213)
Selling expense	(8,733)	(9,173)	(10,172)	(9,363)	(9,604)	(10,208)
Admin expense	(5,445)	(5,333)	(5,632)	(5,113)	(5,233)	(5,576)
SG&A expense	(787)	(951)	(1,336)	(1,227)	(1,322)	(1,448)
R&D expense	(18,804)	(21,602)	(25,289)	(26,365)	(27,936)	(29,819)
Others	1,941	1,893	1,806	3,744	3,785	3,838
Operating profit	8,534	10,561	10,978	13,371	14,417	16,050
Other income	250	196	173	72	78	85
Other expense	(427)	(239)	(228)	(74)	(80)	(87)
Gain/loss on financial assets at FVTPL	1,099	(1,142)	(702)	(417)	0	0
Investment gain/loss	1,564	1,087	(205)	(179)	0	0
Other gains/(losses)	(1,558)	(1,548)	(914)	(552)	(1,536)	(508)
EBIT	9,462	8,915	9,102	12,222	12,880	15,540
Net Interest income/(expense)	(963)	(163)	1,101	62	489	1,364
Other income/expense	(979)	(657)	158	(245)	0	0
Pre-tax profit	8,499	8,752	10,203	12,284	13,369	16,905
Income tax	(1,463)	(960)	(962)	(1,843)	(2,005)	(2,536)
After tax profit	7,036	7,792	9,241	10,441	11,364	14,369
Minority interest	223	(289)	(85)	(37)	(40)	(50)
Others	0	0	0	0	0	0
Net profit	6,813	8,080	9,326	10,478	11,404	14,419

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	127,871	137,874	158,505	152,838	164,547	178,431
Cash & equivalents	39,071	47,072	51,013	48,458	59,249	72,149
Restricted cash	11,642	9,274	27,530	23,211	23,211	23,211
Account receivables	17,509	17,751	20,822	21,217	21,803	21,935
Inventories	36,317	45,235	41,131	40,857	40,635	40,953
Prepayment	607	279	242	282	299	330
Other current assets	16,140	13,411	12,921	13,577	13,807	13,949
Contract assets	6,585	4,851	4,845	5,235	5,542	5,904
Non-current assets	40,892	43,080	42,454	53,791	54,188	54,611
PP&E	11,437	12,913	13,372	13,737	13,761	13,663
Right-of-use assets	815	1,080	1,557	1,473	1,348	1,190
Deferred income tax	3,195	3,719	4,146	4,200	4,446	4,737
Intangibles	8,095	7,342	7,697	7,427	6,901	6,288
Goodwill	0	0	0	0	0	0
Other non-current assets	17,351	18,026	15,681	26,953	27,732	28,733
Total assets	168,763	180,954	200,958	206,629	218,734	233,042
Current liabilities	78,685	78,424	83,030	76,050	80,228	85,237
Short-term borrowings	8,947	9,962	7,560	3,935	5,429	7,349
Account payables	21,717	19,075	18,931	19,702	19,874	19,888
Tax payable	1,216	1,447	1,413	1,077	1,141	1,215
Other current liabilities	30,703	30,239	40,236	38,008	39,676	41,754
Contract liabilities	16,102	17,700	14,890	13,328	14,108	15,031
Non-current liabilities	36,791	42,987	49,596	55,152	55,386	54,310
Long-term borrowings	29,908	35,126	42,576	47,685	47,482	45,889
Bond payables	0	0	0	0	0	0
Obligations under finance leases	532	789	960	1,009	1,068	1,138
Deferred income	150	87	78	76	80	86
Other non-current liabilities	6,200	6,985	5,982	6,382	6,756	7,197
Total liabilities	115,476	121,410	132,627	131,201	135,614	139,548
Share capital	4,731	4,736	4,783	4,783	4,783	4,783
Capital surplus	25,360	25,893	27,603	27,468	27,468	27,468
Retained earnings	20,651	27,309	34,715	41,926	49,659	60,083
Other reserves	740	704	907	964	964	964
Total shareholders equity	51,482	58,641	68,008	75,141	82,874	93,298
Minority interest	1,806	902	323	287	247	196

Total equity and liabilities	168,763	180,954	200,958	206,629	218,734	233,042
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CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	7,036	7,792	9,241	10,441	11,364	14,369
Depreciation & amortization	1,671	1,673	2,023	2,206	2,378	2,531
Change in working capital	2,615	(9,058)	(760)	3,724	(1,402)	(352)
Others	4,401	7,171	6,902	(8,831)	10,151	9,834
Net cash from operations	15,724	7,578	17,406	7,539	22,490	26,383
Investing						
Capital expenditure	(5,686)	(4,952)	(4,005)	(4,551)	(4,864)	(5,258)
Acquisition of subsidiaries/ investments	0	0	0	0	0	0
Others	(4,906)	3,661	(16,897)	1,125	(77)	(111)
Net cash from investing	(10,592)	(1,291)	(20,901)	(3,426)	(4,941)	(5,369)
Financing						
Dividend paid	(2,618)	(3,688)	(4,836)	(7,557)	(8,051)	(8,440)
Net borrowings	5,309	5,442	11,164	967	1,292	327
Proceeds from share issues	538	171	1,676	(78)	0	0
Others	(450)	(471)	(633)	0	0	0
Net cash from financing	2,779	1,455	7,372	(6,669)	(6,759)	(8,113)
Net change in cash						
Cash at the beginning of the year	31,403	39,071	47,072	51,013	48,458	59,249
Exchange difference	(242)	260	66	0	0	0
Others	7,910	7,741	3,876	(2,555)	10,790	12,900
Cash at the end of the year	39,071	47,072	51,013	48,458	59,249	72,149

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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