

Hong Kong

ADD (no change)

Consensus ratings*: Buy 22 Hold 0 Sell 1

Current price:	HK\$15.98
Target price:	HK\$30.27
Previous target:	HK\$34.51
Up/downside:	89.4%
CGI / Consensus:	-1.3%
Reuters:	0763.HK
Bloomberg:	763 HK
Market cap:	US\$17,517m HK\$137,004m
Average daily turnover:	US\$12.48m HK\$97.39m
Current shares o/s:	4,612m
Free float:	78.7%

*Source: Bloomberg

Key changes in this note



Price performance	1M	3M	12M
Absolute (%)	-23.7	-26	-20.5
Relative (%)	-7.5	-13	7.2

Major shareholders	% held
Zhongxingxin	21.3
HKEX	18.2

Analyst(s)

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ZTE

Outlook remains positive; clarity after upcoming probation hearing a catalyst

- ZTE is expected to deliver solid top- and bottom-line growth, given the acceleration of the carrier network business.
- Telecom operators' CAPEX is expected to remain stable in 2022, and ZTE's growth will be driven by market share gains and gross profit margin improvement.
- The market is expected to wait for clarity after a probation hearing on 14 Mar 2022; at this stage, no corporate member has been charged.
- We maintain our net profit forecasts for 2022 and 2023 and introduce forecasts for 2024. We reiterate our ADD rating, with a lower target price of HK\$30.27 (based on 15x 2022F P/E). The downward revision in the target price is due mainly to the adoption of a lower P/E multiple (from 19x to 15x).

Stable environment

Telecom operators' CAPEX is expected to remain stable in 2022 (low single-digit yoy growth), and ZTE is expected to benefit from the continuous 5G network roll-out. We still expect ZTE to deliver decent revenue growth in 2022F (faster than telecom operations' CAPEX growth), given the change in the competitive landscape and the Company's growing market share. We expect ZTE to continue to report a decent gross profit margin because of enhanced supply chain efficiency and cost control through design improvement and lower component costs. The carrier network business is expected to achieve a gross margin of more than 40% in 2022. In addition to telecommunications equipment, ZTE will benefit from gaining market share in ICT products. ZTE is expected to expand its consumer and enterprise segments, which will be growth drivers for the Company.

Awaiting clarity after upcoming US probation hearing

The recent share price weakness is due partly to concerns about a potential US lawsuit. The Company received a US court order to participate in a probation hearing on 14 Mar. The case is related to a visa fraud case, dated 18 Mar 2021, charged against a former employee of ZTE; so far, no corporate member of the Company has been charged. At this stage, we believe that it is less likely that ZTE will be included in the US Entity List again if the court finds that ZTE made some mistakes regarding its former employee's visa. The market is awaiting clarity after the hearing. This may be a near-term catalyst for ZTE.

2021 results recap

ZTE reported its 2021 results earlier. Its operating revenue was Rmb114,522m, up 13% yoy, and net profit was Rmb6,813m, up 60% yoy. The Company's 2021 net profit was in line with mid-point of previous guidance. Its gross profit margin increased by 3.6ppt yoy to 35.2% in 2021. R&D expenditure increased 27.1% yoy to Rmb18,804m in 2021, accounting for 16.4% of total operating revenue, indicating that the Company continued to invest in new business opportunities, especially applications based on 5G technology.

Reiterate ADD with a lower target price

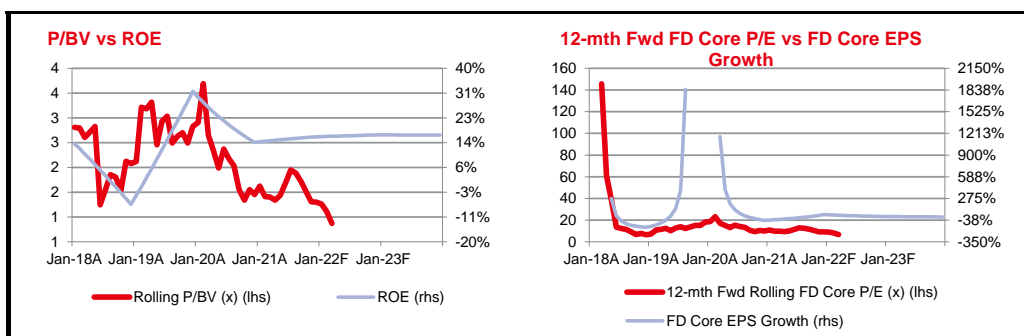
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Financial Summary

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue (Rmbm)	101,451	114,522	130,586	150,348	174,471
Operating EBITDA (Rmbm)	5,481	8,263	9,935	11,001	12,310
Net Profit (Rmbm)	4,260	6,813	8,000	9,155	10,087
Core EPS (Rmb)	1.17	1.66	1.89	2.05	2.25
Core EPS Growth	(40.5%)	41.3%	14.1%	8.6%	9.6%
FD Core P/E (x)	11.02	7.80	6.84	6.29	5.74
DPS (Rmb)	0.20	0.30	0.37	0.43	0.47
Dividend Yield	1.55%	2.32%	2.88%	3.30%	3.63%
EV/EBITDA (x)	10.41	6.05	5.21	4.39	3.64
P/FCFE (x)	NA	5.77	5.29	6.85	6.31
Net Gearing	(5.4%)	(22.3%)	(19.9%)	(23.4%)	(25.9%)
P/BV (x)	1.38	1.19	1.14	1.00	0.88
ROE	14.4%	16.3%	17.0%	16.9%	16.3%
% Change In Core EPS Estimates			3.83%	(0.89%)	
CGI/consensus EPS (x)			0.96	0.94	0.72

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS



Profit & Loss

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Total Net Revenues	101,451	114,522	130,586	150,348	174,471
Gross Profit	32,852	41,245	47,216	53,433	60,971
Operating EBITDA	5,481	8,263	9,935	11,001	12,310
Depreciation And Amortisation	(1,465)	(1,671)	(1,819)	(1,990)	(2,186)
Operating EBIT	4,016	6,593	8,116	9,011	10,124
Financial Income/(Expense)	(257)	16	(27)	69	162
Pretax Income/(Loss) from Assoc.	(421)	66	70	75	81
Non-Operating Income/(Expense)	2,710	2,936	2,938	2,916	2,866
Profit Before Tax (pre-EI)	6,049	9,610	11,097	12,071	13,232
Exceptional Items	(984)	(1,111)	(1,133)	(666)	(666)
Pre-tax Profit	5,064	8,499	9,964	11,405	12,566
Taxation	(342)	(1,463)	(1,703)	(1,950)	(2,149)
Exceptional Income - post-tax					
Profit After Tax	4,722	7,036	8,261	9,455	10,416
Minority Interests	(462)	(223)	(261)	(299)	(330)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	4,260	6,813	8,000	9,155	10,087
Recurring Net Profit	5,178	7,733	8,939	9,708	10,639
Fully Diluted Recurring Net Profit	5,178	7,733	8,939	9,708	10,639

Cash Flow

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
EBITDA	5,481	8,263	9,935	11,001	12,310
Cash Flow from Inv. & Assoc.					
Change In Working Capital	1,465	1,671	1,819	1,990	2,186
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	3,287	5,790	3,378	3,207	2,986
Net Interest (Paid)/Received	(257)	16	(27)	69	162
Tax Paid					
Cashflow From Operations	9,976	15,739	15,105	16,267	17,643
Capex	(3,567)	(1,935)	(2,225)	(2,559)	(2,943)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(3,516)	(8,657)	(2,621)	(6,368)	(6,957)
Cash Flow From Investing	(7,082)	(10,592)	(4,847)	(8,927)	(9,900)
Debt Raised/(repaid)	(7,294)	5,309	1,290	1,587	1,937
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(1,326)	(1,403)	(1,900)	(2,241)	(2,495)
Preferred Dividends					
Other Financing Cashflow	7,348	(2,640)	(2,731)	(3,064)	(3,373)
Cash Flow From Financing	(1,272)	1,266	(3,341)	(3,718)	(3,931)
Total Cash Generated	1,622	6,413	6,918	3,622	3,812
Free Cashflow To Equity	(4,400)	10,456	11,549	8,927	9,680
Free Cashflow To Firm	4,389	6,628	11,799	8,940	9,417

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS... cont'd

Balance Sheet

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Total Cash And Equivalents	35,660	50,713	51,252	56,544	62,192
Total Debtors	24,817	24,094	27,474	31,632	36,707
Inventories	33,689	36,317	41,411	47,678	55,328
Total Other Current Assets	12,811	16,747	18,847	21,432	24,586
Total Current Assets	106,977	127,871	138,985	157,285	178,812
Fixed Assets	11,943	11,466	11,872	12,441	13,199
Total Investments	348	244	256	269	282
Intangible Assets	0	0	0	0	0
Total Other Non-Current Assets	31,396	29,212	30,613	32,095	33,664
Total Non-current Assets	43,686	40,921	42,741	44,805	47,145
Short-term Debt	10,559	8,947	10,202	11,746	13,630
Current Portion of Long-Term Debt					
Total Creditors	54,059	61,068	69,634	80,172	93,035
Other Current Liabilities	9,776	8,671	8,792	8,926	9,146
Total Current Liabilities	74,395	78,685	88,628	100,844	115,812
Total Long-term Debt	22,614	29,908	29,908	29,908	29,908
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	7,503	6,882	7,298	7,752	8,249
Total Non-current Liabilities	30,117	36,791	37,206	37,661	38,158
Total Provisions	0	0	0	0	0
Total Liabilities	104,512	115,476	125,835	138,505	153,969
Shareholders' Equity	43,297	51,482	53,824	61,220	69,292
Minority Interests	2,826	1,806	2,067	2,366	2,696
Total Equity	46,123	53,288	55,891	63,586	71,988

Key Ratios

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue Growth	11.8%	12.9%	14.0%	15.1%	16.0%
Operating EBITDA Growth	(38.2%)	50.8%	20.2%	10.7%	11.9%
Operating EBITDA Margin	5.40%	7.22%	7.61%	7.32%	7.06%
Net Cash Per Share (Rmb)	0.54	2.51	2.35	3.15	3.94
BVPS (Rmb)	9.39	10.88	11.38	12.94	14.64
Gross Interest Cover	2.69	4.45	5.27	5.63	6.05
Effective Tax Rate	6.8%	17.2%	17.1%	17.1%	17.1%
Net Dividend Payout Ratio	17.6%	17.9%	19.3%	20.5%	20.6%
Accounts Receivables Days	97.65	77.95	72.07	71.75	71.68
Inventory Days	163.7	174.4	170.1	167.8	166.1
Accounts Payables Days	281.8	286.7	286.1	282.1	279.3
ROIC (%)	8.4%	13.0%	16.9%	17.4%	18.0%
ROCE (%)	6.8%	9.4%	10.2%	10.6%	10.8%
Return On Average Assets	4.09%	5.09%	5.38%	5.24%	5.10%

Key Drivers

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Wireless system yoy (%)	14.1%	3.7%	8.8%	9.4%	9.4%
Wired system yoy (%)	9.2%	-0.7%	6.1%	6.1%	6.2%
Other products and services yoy (%)	6.2%	1.0%	12.8%	12.8%	12.9%
Handset yoy (%)	7.8%	59.2%	19.7%	21.4%	22.9%
Software and data yoy (%)	23.1%	16.0%	30.0%	30.0%	30.0%

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Description:	Excellent	Very Good	Good	N/A	N/A

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Distribution of stock ratings and investment banking clients for quarter ended on 31 Dec 2021		
619 companies under coverage for quarter ended on 31 Dec 2021		
	Rating Distribution (%)	Investment Banking clients (%)
Add	71.1%	1.5%
Hold	21.8%	0.0%
Reduce	7.1%	0.0%

Spitzer Chart for stock being researched (2 year data)

ZTE (763 HK)

— Price Close



RECOMMENDATION FRAMEWORK

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Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
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Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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