

COMPANY RESULTS

ZTE Corporation (763 HK)

4Q21: Net Profit In Line With Guidance

ZTE's 4Q21 net profit declined 38% yoy to Rmb960m, at the mid-point of the profit alert. The qoq decline is due to delayed revenue recognition and a change in product mix as contribution from the lower margin business surged. Margins for all three major segments declined in 2H21 due to high base and rising component costs. For 2022, management remains confident in its carrier network and enterprise business, maintaining their Rmb130b revenue guidance. Maintain BUY. Target price: HK\$26.20.

4Q21 RESULTS

Year to 31 Dec (Rmbm)	4Q20	3Q21	4Q21	yoy %chg	qoq %chg	2020	2021	yoy %chg
Revenue	27,321	30,754	30,696	12.4	(0.2)	101,451	114,522	12.9
Gross profit	8,247	11,687	9,497	15.1	(18.7)	32,071	40,362	25.8
EBIT	785	2,425	950	21.0	(60.8)	4,016	6,593	64.2
Report NP	1,548	1,774	960	(38.0)	(45.9)	4,260	6,813	59.9
GPM (%)	30.2	38.0	30.9	0.8	(7.1)	31.6	35.2	3.6
OPM (%)	2.9	7.9	3.1	0.2	(4.8)	4.0	5.8	1.8
NPM (%)	5.7	5.8	3.1	(2.5)	(2.6)	4.2	5.9	1.8

Source: ZTE, UOB Kay Hian

RESULTS

- **Full-year revenue grew 12.9% to Rmb114.5b**, slightly below our expectations of Rmb115.1b. This was not entirely unexpected, as we were expecting the carrier network (+2.3% yoy to Rmb75.7b) to register lower-than-expected growth given the delayed tenders in 2021. Government and corporate business (+16.0% yoy to Rmb13.1b) was slightly above our expectations, while the robust consumer business (+59.2% yoy to Rmb25.7b) largely managed to offset the underperforming carrier network business.
- **2021 blended gross margin worse at expected at 35.2% (+3.6ppt yoy)**, while 4Q21 gross margins plunged 7.1ppt qoq to 30.9%. This was mainly due to higher contribution from the lower margin consumer business. ZTE's core business, the carrier network segment, actually delivered stronger-than-expected margins of 42.5% in 2021. That said, all three segments' margins contracted in 2H21, with enterprise/consumer business' margins declining 1.8ppt and 5.0ppt hoh respectively, due to a normalising ASP for the consumer business and surge in component costs.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2020	2021	2022F	2023F	2024F
Net turnover	101,451	114,522	128,743	142,089	157,589
EBITDA	7,129	6,991	9,166	10,503	11,637
Operating profit	4,016	6,593	8,469	9,857	10,967
Net profit (rep./act.)	4,260	6,813	7,729	8,821	9,713
Net profit (adj.)	3,943	5,719	7,729	8,821	9,713
EPS (Fen)	85.5	123.1	166.4	189.9	209.1
PE (x)	14.4	10	7.4	6.5	5.9
P/B (x)	1.3	1.1	0.8	0.8	0.8
EV/EBITDA (x)	16.1	16.5	12.6	11	9.9
Dividend yield (%)	1.6	2.4	2.6	3.1	3.3
Net margin (%)	4.2	5.9	6	6.2	6.2
Net debt/(cash) to equity (%)	4.1	-0.4	2.3	4.4	4
Interest cover (x)	17	7.3	32.9	30.9	31.9
Consensus net profit	-	-	7,920	9,148	12,802
UOBKH/Consensus (x)	-	-	0.98	0.96	0.76

Source: ZTE, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$15.28
Target Price	HK\$26.20
Upside	+71.5%
(Previous TP)	HK\$33.80

COMPANY DESCRIPTION

ZTE Corporation develops and markets switches, access servers, videoconferencing systems, mobile communication systems, data communication devices, and optical communication devices.

STOCK DATA

GICS sector	Information Technology
Bloomberg ticker:	763 HK
Shares issued (m):	755.5
Market cap (HK\$m):	137,851.6
Market cap (US\$m):	17,629.7
3-mth avg daily t'over (US\$m):	13.2

Price Performance (%)

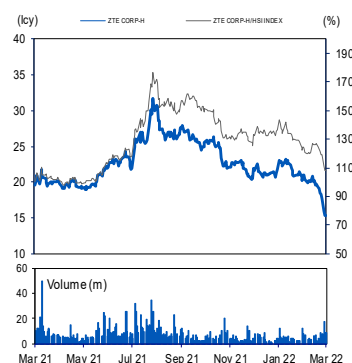
52-week high/low	HK\$31.65/HK\$15.28				
1mth	3mth	6mth	1yr	YTD	
(24.4)	(25.3)	(44.5)	(22.5)	(28.4)	

Major Shareholders

	%
Zhongxingxin	35.1
-	-
-	-

FY22 NTAV/Share (Rmb)	15.22
FY22 Net Cash/Share (Rmb)	0.34

PRICE CHART



Source: Bloomberg

ANALYST(S)

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- **2021 operating expenses grew 20.4% yoy to Rmb33.8b**, primarily due to surge in R&D expenses (due to increased R&D in carrier network/corporate business) and selling expenses (due to increased freight costs). However, the increased operating scale and gross margin expansion has more than offset the cost hikes. As a result, operating profit grew 64.2% yoy to Rmb6.6b, with operating margin expanding by 1.8ppt yoy.
- **4Q21 net profit came in at Rmb960m, declining 38.0% yoy and 45.9% qoq.** The underperformance is mainly attributable to less favourable product mix and an inventory impairment loss of Rmb818m (vs Rmb112m in 2020). Full-year net profit grew 59.9% yoy to Rmb6.8b, roughly at the mid-point of its profit alert.

STOCK IMPACT

- **Management maintained an unchanged 2022 revenue guidance of Rmb130b**, indicating strong confidence in its carrier network and corporate business in 2022.
- **Carrier network business: Delayed order booking to boost 2022 growth.** As mentioned above, the revenue recognition was shifted to 2022 due to the late telco tenders in 2021. As a result, this will boost the segment's growth in 2022. On top of that, we believe ZTE has been gaining market share in various wireline products such as switches, routers, optical transport network and servers, as Huawei continues to face supply constraints. As such, we now expect the segment to register high-teens growth in 2022 with stable margins at 42.5%.
- **Enterprise business: Accelerating growth from domestic market.** The segment's overseas business was affected by the pandemic and registered a yoy decline in 2021, although this is more than offset by the >40% yoy growth in the domestic business. Going forward, we expect the domestic business to continue delivering robust growth on the back of China's initiative to digitalise its economy, while the overseas business will remain stagnant as the company has shifted its focus and resources away from the overseas enterprise business. Overall margins should remain largely stable at 27-28% in 2022-24, compared to 27.1% in 2021 and 26.3% in 2H21.
- **Consumer electronics business to moderate from a high base.** The segment's robust growth in 2021 was mainly thanks to: a) market share gains from Huawei in consumer routers, and b) pandemic-driven demand from overseas. Given that countries have been opening their economies in 2022, we are expecting a yoy decline in 2022 from a high base. Gross margin should also normalise to pre-pandemic levels, at 17/18/18% for 2022-24 respectively.

EARNINGS REVISION/RISK

- **We cut our net profit estimates for 2022-23 by 4.9/3.9% respectively** to Rmb7,730m and Rmb8,821, mainly to factor in elevated R&D expenses, as well as a lower margin assumption for the enterprise and consumer business. This is partially offset by the stronger-than-expected margins for the carrier network business. We introduce our 2024 net profit estimate at Rmb9,714m, implying a 10.1% yoy growth.

VALUATION/RECOMMENDATION

- **Maintain BUY but cut target price to HK\$26.20**, based on lower PE multiple of 13.1x, now pegged to 1SD below mean. While we believe ZTE will remain a key beneficiary of the digitalisation era, we are seeing mounting geopolitical risks amid the worsening US-China relations. The recent US court case regarding ZTE's ex-employee will also be a major risk and overhang in the near future.

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
Net turnover	114,522	128,743	142,089	157,589
EBITDA	6,991	9,166	10,503	11,637
Deprec. & amort.	398	697	646	670
EBIT	6,593	8,469	9,857	10,967
Total other non-operating income	1,941	1,200	1,200	1,200
Associate contributions	66	66	66	66
Net interest income/(expense)	(963)	(278)	(340)	(365)
Pre-tax profit	8,731	9,457	10,783	11,867
Tax	(1,463)	(1,409)	(1,608)	(1,770)
Minorities	(223)	(253)	(289)	(318)
Preferred dividends	-	-	-	-
Net profit	6,813	7,730	8,821	9,713

CASH FLOW

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
Operating	15,724	10,286	10,758	12,897
Pre-tax profit	8,499	9,391	10,717	11,801
Tax	(6,717)	(6,717)	(6,717)	(6,717)
Deprec. & amort.	398	697	646	670
Associates	(66)	(66)	(66)	(66)
Working capital changes	2,616	(866)	(2,228)	(2,582)
Non-cash items	10,994	7,846	8,405	9,790
Investing	(10,592)	(10,664)	(10,756)	(10,871)
Capex (maintenance)	(5,686)	(5,573)	(5,461)	(5,352)
Investments	(3,056)	(3,056)	(3,056)	(3,056)
Others	(1,851)	(2,036)	(2,239)	(2,463)
Financing	2,779	(1,465)	(1,573)	(1,864)
Dividend payments	(2,619)	(1,500)	(1,608)	(1,899)
Issue of shares	-	-	-	-
Proceeds from borrowings	5,309	-	-	-
Others/interest paid	88	35	35	35
Net cash inflow (outflow)	7,910	(1,843)	(1,571)	163
Beginning cash & cash equivalent	31,403	39,071	37,228	35,657
Changes due to forex impact	(242)	-	-	-
Ending cash & cash equivalent	39,071	37,228	35,657	35,820

BALANCE SHEET

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
Fixed assets	11,437	26,546	27,909	28,916
Other LT assets	29,455	37,415	40,968	44,799
Cash/ST investment	39,071	37,228	35,657	35,820
Other current assets	88,801	94,257	101,238	109,243
Total assets	168,763	195,445	205,773	218,777
ST debt	8,947	8,947	8,947	8,947
Other current liabilities	69,738	77,518	85,265	94,166
LT debt	29,908	29,908	29,908	29,908
Other LT liabilities	6,882	6,875	6,875	6,875
Shareholders' equity	51,482	70,138	72,430	76,216
Minority interest	1,806	2,059	2,347	2,665
Total liabilities & equity	168,763	195,445	205,773	218,777

KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
Profitability				
EBITDA margin	6.1	7.1	7.4	7.4
Pre-tax margin	7.6	7.3	7.6	7.5
Net margin	5.9	6.0	6.2	6.2
Growth				
Turnover	12.9	12.4	10.4	10.9
EBITDA	(1.9)	31.1	14.6	10.8
Pre-tax profit	72.4	8.3	14.0	10.1
Net profit	59.9	13.5	14.1	10.1
EPS	44.0	35.2	14.1	10.1
Leverage				
Debt to total capital	42.2	35.0	34.2	33.0
Debt to equity	75.5	55.4	53.6	51.0
Net debt/(cash) to equity	(0.4)	2.3	4.4	4.0
Interest cover (x)	7.3	32.9	30.9	31.9

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