



## ZTE (00763 HK/000063 CH)

### Carriers' network equipment continues to drive GPM

- We forecast revenue to grow 13.4% in 2022E on demand from telecom operators in 5G network expansion, cloud computing, and home entertainment.
- Overall gross margin in 2022E would grow 0.2ppt YoY, thanks to carriers' network equipment business
- Net profit margin to go up 0.4ppt YoY to 6.3% for 2022E
- Recommend BUY with TP of HK\$ 31.0 for ZTE-H (763 HK), which implies 14.8x/ 12.6x FY22E/ FY23E P/E, and BUY for ZTE-A (000063 CH) with TP of RMB 42.0, equivalent to 24.5x/ 20.9x FY22E/ FY23E P/E

**We forecast ZTE's revenue to grow by 13.4% YoY in 2022E.** In 2022, ZTE will benefit from 5G network expansion, rising home electronics and network demand, cloud computing, and smart cities development. Telecom operators are expected to add 600,000 5G base stations in 2022E to improve network coverage. Home electronics and network demand are again rising due to the surge in COVID-19 variants.

**GPM to improve 0.2ppt YoY to 35.4% in 2022E on higher profitability in carriers' network equipment business.** GPM of carriers' network business is projected to increase 1.6ppt YoY in 2022E on higher demand for 5G network products.

**Net profit to grow at a CAGR of 16.7% in 2021-24E.** Due to improving revenue growth and higher margins, we estimate net profit to grow 19.2% YoY for 2022E.

**Valuation.** We recommend (1) **BUY** on **ZTE-H (763 HK)** with TP of HK\$ 31.0, which implies 14.8x/ 12.6x FY22E/ FY23E P/E; (2) **BUY** on **ZTE-A (000063 CH)** with TP of RMB 42.0, equivalent to 24.5x/ 20.9x FY22E/ FY23E P/E.

#### Results and Valuation

FY ended Dec 31	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	101,451	114,522	129,877	145,667	160,884
Chg (% YoY)	11.8	12.9	13.4	12.2	10.4
Net profit (RMB mn)	4,260	6,813	8,124	9,510	10,827
Chg (% YoY)	(61.1)	59.9	19.2	17.1	13.9
EPS (RMB)	0.919	1.467	1.717	2.010	2.288
Chg (% YoY)	(64.5)	59.6	17.0	17.1	13.9
BPS (RMB)	9.385	10.882	12.600	14.610	16.898
Chg (% YoY)	50.2	16.0	15.8	16.0	15.7
P/E (x) –H shr	14.4	8.9	7.6	6.5	5.7
P/E (x) –A shr	27.6	17.3	14.8	12.6	11.1
P/B (x) –H shr	1.4	1.2	1.0	0.9	0.8
P/B (x) –A shr	2.7	2.3	2.0	1.7	1.5
ROAE (%)	10.1	13.7	14.1	14.2	13.9
ROAA (%)	2.9	4.3	3.7	3.5	3.9

\*Exchange rate assumption for FY22E-24E: HKD 1 = RMB 0.82

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Rating (H): BUY

Rating (A): BUY

TP(H): HK\$ 31.0

TP(A): RMB 42.0

Analyst : Ricky Lai

Tel: (852) 2147 8895

rickylai@abci.com.hk

Price (H/A shr)	15.98/ 25.40
Est. price return (H/A shr)	94.0%/ 65.4%
Est. dividend yield (H/A shr)	0.0%/ 0.0%
Est. total return (H/A shr)	94.0%/ 65.4%
Last Rating & TP (H/A shr)	BUY, HK\$29.0 BUY, RMB40.0
Previous Report Date	May 7, 2020

Source(s): Bloomberg, ABCI Securities estimates

#### Key Data:

52Wk H/L (HK\$) (H shr)	31.75/ 15.10
52Wk H/L (RMB) (A shr)	41.68/ 25.00
Total issued shares (mn)	4,731.7
Issued H shr (mn)	755.5
Issued A shr (mn)	3,976.2
H-shr market cap (HK\$ mn)	12,073
A-shr market cap (RMB mn)	100,995

#### Major shareholder(s):

Zhongxingxin	21.30%
Central Huijin Asset Management	0.89%
Hunan Nantian	0.88%

Source(s): Company, ABCI Securities



## ZTE's revenue to grow 13.4% YoY in 2022E

ZTE's FY21 revenue grew 12.9%, driven by 2.3% growth in carriers' network business, 16.0% growth in government & corporate business, and 59.2% growth in consumer business. In 2022, ZTE will benefit from expansion of 5G network. Telecom operators are expected to add 600,000 5G base stations in 2022E to improve network coverage; also, the government is developing cloud computing, internet of things, and smart cities in China, which will support income in its government & corporate business. Consumer business is growing on the back of robust home entertainment and home office demand. For 2022E, we forecast ZTE's revenues from carriers' network business/ government & corporate business/ consumer business to grow by 7.5%/ 13.0% / 31.0%, respectively.

### Exhibit 1: ZTE's revenue forecasts by segment

Revenue (RMB bn)	2020A	2021A	2022E	2023E	2024E
Carriers' network equipment	74.0	75.7	81.4	85.9	90.2
YoY chg	11.2%	2.3%	7.5%	5.6%	4.9%
Government and corporate business	11.3	13.1	14.8	16.4	17.9
YoY chg	23.1%	16.0%	13.0%	11.0%	9.0%
Consumer business	16.2	25.7	33.7	43.3	52.8
YoY chg	7.8%	59.2%	31.0%	28.5%	22.0%
<b>Total revenue</b>	101.5	114.5	129.9	145.7	160.9
YoY chg	11.8%	12.9%	13.4%	12.2%	10.4%

Source(s): Company, ABCI Securities estimates

## Net profit to grow at a CAGR of 16.7% in 2021-24E

FY21 GPM rose 3.6ppt YoY to 35.2%, thanks to increased contributions from carriers' network business, whose GPM jumped 8.7ppt to 42.5% due to increased demand for 5G products. The R&D expenses-to-revenue ratio rose 1.8ppt YoY to 16.4% in FY21 due to new product innovations and development. NPM went up 1.8ppt YoY to 5.9% on higher GPM and economies of scale despite the higher R&D expenses. For 2022E, we forecast GPM to edge up 0.2ppt YoY to 35.4% in 2022E. ZTE's NPM to reach 6.3%.

### Exhibit 2: ZTE's gross margin analysis

	2020	2021	2022E	2023E	2024E
Carriers' network equipment	33.8%	42.5%	44.1%	45.7%	47.0%
Government and corporate business	28.8%	27.1%	27.0%	27.4%	28.0%
Consumer business	23.6%	18.2%	18.0%	19.0%	19.7%
<b>Overall GPM</b>	<b>31.6%</b>	<b>35.2%</b>	<b>35.4%</b>	<b>35.7%</b>	<b>35.9%</b>

Source(s): Company, ABCI Securities estimates



Exhibit 3: Changes in our financial estimates

	OLD			NEW			CHG		
(RMB mn)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	124,207	N/A	N/A	129,877	145,667	160,884	4.6%	N/A	N/A
Net profit	7,887	N/A	N/A	8,124	9,510	10,827	3.0%	N/A	N/A
EPS (RMB)	1.667	N/A	N/A	1.717	2.010	2.288	3.0%	N/A	N/A

Source(s): Company, ABCI Securities estimates

Recommend BUY for ZTE-A /H (763 HK/000063 CH)

Our valuations for ZTE-H/A (763 HK/000063 CH) are based on the DCF model (WACC: 12.9%/12.1%; perpetuity growth rate: 2%/2%). We recommend **BUY** for both A/H shr with TP of HK\$ 31.0/ RMB 42.0. H-shr TP implies 14.8x/12.6x FY22E/ FY23E P/E for the H-shr, while A-shr TP represents 24.5x/ 20.9x FY22E/ FY23E P/E.

Exhibit 4: Peer Comparison

			P/E				P/B				ROE	ROA
	Ticker	Price*	20A	21A	22E	23E	20A	21A	22E	23E	22E	22E
<u>H-share market</u>												
ZTE	763 HK	15.98	26.5	13.5	11.9	10.5	2.4	2.0	1.8	1.5	14.5	4.0
COMBA	2342 HK	1.40	30.0	25.9	19.0	15.2	1.3	1.2	1.2	1.1	2.2	0.9
Xiaomi	1810 HK	13.58	22.5	20.1	17.0	13.5	3.8	3.0	2.5	2.5	16.0	8.2
Average			26.3	19.8	16.0	13.1	2.5	2.1	1.8	1.7	10.9	4.4
<u>A-share market</u>												
ZTE	000063 CH	25.40	36.5	22.5	18.5	16.9	2.9	2.6	2.5	2.3	12.5	4.0
Hengtong Optic-Electric	600487 CH	13.15	23.0	18.5	14.2	12.3	1.5	1.4	1.3	1.1	7.0	2.5
Accelink Technologies Co	002281 CH	19.36	30.5	27.0	20.5	21.0	2.5	2.2	2.0	2.2	10.0	3.5
Hubei Kaile Science & Tech	600260 CH	2.57	20.0	18.5	13.0	11.5	0.8	0.5	0.5	1.0	3.0	1.5
Average			27.5	21.6	16.6	15.4	1.9	1.7	1.6	1.7	8.1	2.9

\*Based on closing price on Mar 10, 2022

Source(s): Bloomberg



**農銀國際**

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

ZTE (00763 HK, BUY/ 000063 CH, BUY)

China Telecom Sector

Mar 11, 2022

## **Risk factors**

### **Slowdown in China's 5G development**

Any delays or slowdown in 5G network development in China would negatively impact ZTE's revenue.

### **Concentration risk**

Over 73.0%/ 66.1% of total revenue in 2020/21 were contributed by carriers' network business. Any adverse changes in this business will have adverse impacts to ZTE's revenue growth.

### **Our forecasts may deviate from actual results**

Our forecasts rely on a number of assumptions. The actual results may deviate from our estimates.

### **Influence of the COVID-19 variant**

ZTE's production may be affected from the spread of COVID-19 variant , which would impact the Company's production capacity.

**農銀國際**

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

ZTE (00763 HK, BUY/ 000063 CH, BUY)

China Telecom Sector

Mar 11, 2022

## Financial Statements

### Consolidated income statement (2020A-2024E)

FY Ended Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Carriers' networks	74,018	75,712	81,390	85,948	90,159
Government & Corporate business	11,272	13,079	14,780	16,405	17,882
Consumer business	16,160	25,731	33,707	43,314	52,843
<b>Total revenue</b>	<b>101,451</b>	<b>114,522</b>	<b>129,877</b>	<b>145,667</b>	<b>160,884</b>
Gross profit	32,069	40,361	45,951	52,003	57,792
R&D costs	(14,797)	(18,804)	(21,560)	(24,618)	(27,511)
Selling and distribution expenses	(7,579)	(8,733)	(9,904)	(11,108)	(12,269)
Administrative expenses	(4,995)	(5,445)	(5,880)	(6,351)	(6,859)
Finance cost	(421)	(963)	(837)	(728)	(633)
Others	787	2,083	2,364	2,665	2,986
<b>Profit before tax</b>	<b>5,064</b>	<b>8,499</b>	<b>10,134</b>	<b>11,863</b>	<b>13,507</b>
Tax	(342)	(1,463)	(1,745)	(2,042)	(2,325)
<b>Profit after tax</b>	<b>4,722</b>	<b>7,036</b>	<b>8,390</b>	<b>9,821</b>	<b>11,182</b>
Minority interests	(446)	(223)	(266)	(311)	(354)
Perpetual capital instruments	(16)	0	0	0	0
<b>Net profit</b>	<b>4,260</b>	<b>6,813</b>	<b>8,124</b>	<b>9,510</b>	<b>10,827</b>
<b>EPS (RMB)</b>	<b>0.919</b>	<b>1.467</b>	<b>1.717</b>	<b>2.010</b>	<b>2.288</b>

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2020A-2024E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
PPE	11,914	11,437	4,895	4,292	3,851
Intangible assets	9,367	8,095	13,401	14,805	16,241
Others	22,376	21,361	21,893	22,342	22,898
<b>Total non-current assets</b>	<b>43,658</b>	<b>40,892</b>	<b>40,188</b>	<b>41,439</b>	<b>42,990</b>
Cash & cash equivalents	35,660	50,713	32,502	28,004	25,258
Inventories	33,689	36,317	38,133	40,039	42,041
Receivables	16,213	18,116	19,209	20,368	21,597
Others	21,415	22,725	142,789	147,052	151,367
<b>Total current assets</b>	<b>106,977</b>	<b>127,871</b>	<b>232,632</b>	<b>235,463</b>	<b>240,263</b>
<b>Total assets</b>	<b>150,635</b>	<b>168,763</b>	<b>272,820</b>	<b>276,902</b>	<b>283,253</b>
Bank borrowings	10,559	8,947	8,052	7,247	6,522
Payables	18,030	22,934	21,896	20,915	19,988
Others	45,806	46,805	147,814	147,131	146,693
<b>Total current liabilities</b>	<b>74,395</b>	<b>78,685</b>	<b>177,762</b>	<b>175,294</b>	<b>173,204</b>
Bank borrowings	22,614	29,908	25,721	22,120	19,023
Others	7,503	6,882	7,166	7,474	7,806
<b>Total non-current liabilities</b>	<b>30,117</b>	<b>36,791</b>	<b>32,887</b>	<b>29,595</b>	<b>26,829</b>
<b>Total liabilities</b>	<b>104,512</b>	<b>115,476</b>	<b>210,650</b>	<b>204,888</b>	<b>200,033</b>
Shareholders' equity	43,297	51,482	59,606	69,116	79,943
Non-controlling interests	2,826	1,806	2,564	2,898	3,278
<b>Total equity</b>	<b>46,123</b>	<b>53,288</b>	<b>62,170</b>	<b>72,014</b>	<b>83,221</b>

Source(s): Company, ABCI Securities estimates



### Consolidated Cash Flow Statement (2020A-2024E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Operating profit before change in working capital	9,225	11,910	13,699	14,852	15,821
Change in working capital	(1,803)	4,437	(5,371)	(5,310)	(5,276)
Others	2,810	(624)	1,408	1,465	1,523
<b>Operating cash flow</b>	<b>10,233</b>	<b>15,724</b>	<b>9,737</b>	<b>11,006</b>	<b>12,068</b>
CAPEX	(347)	(347)	(378)	(412)	(449)
Others	(6,735)	(10,246)	(6,976)	(6,838)	(6,710)
<b>Investing cash flow</b>	<b>(7,082)</b>	<b>(10,592)</b>	<b>(7,354)</b>	<b>(7,250)</b>	<b>(7,159)</b>
Bank loans	(115)	5,682	(5,082)	(4,406)	(3,822)
Others	(175)	(2,903)	(3,676)	(3,693)	(3,710)
<b>Financing cash flow</b>	<b>(290)</b>	<b>2,779</b>	<b>(8,758)</b>	<b>(8,099)</b>	<b>(7,531)</b>
<b>Net increase in cash and cash equivalents</b>	<b>2,861</b>	<b>7,910</b>	<b>(6,375)</b>	<b>(4,342)</b>	<b>(2,622)</b>
Cash and cash equivalents at beginning of year	28,506	31,403	39,071	32,502	28,004
Others	37	(242)	(194)	(155)	(124)
<b>Cash and cash equivalents at end of year</b>	<b>31,403</b>	<b>39,071</b>	<b>32,502</b>	<b>28,004</b>	<b>25,258</b>

Source(s): Company, ABCI Securities estimates

### Financial Ratios (2020A-2024E)

As of Dec 31	2020A	2021A	2022E	2023E	2024E
Gross profit margin	31.6%	35.2%	35.4%	35.7%	35.9%
Operating profit margin	5.4%	7.6%	7.9%	8.2%	8.4%
Net profit margin	4.2%	5.9%	6.3%	6.5%	6.7%
ROAA	2.9%	4.3%	3.7%	3.5%	3.9%
ROAE	10.1%	13.7%	14.1%	14.2%	13.9%
<b>% of revenue</b>					
R&D costs	14.6%	16.4%	16.6%	16.9%	17.1%
Selling and distribution expenses	7.5%	7.6%	7.6%	7.6%	7.6%
Administrative expenses	4.9%	4.8%	4.8%	4.8%	4.8%
<b>YoY Growth:</b>					
Revenue	11.8%	12.9%	13.4%	12.2%	10.4%
Net profit	(61.1%)	59.9%	19.2%	17.1%	13.9%

Source(s): Company, ABCI Securities estimates



## Disclosures

### Analyst Certification

The analyst, LAI Pak Kin, primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company(ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

### Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

### Definition of equity rating

Rating	Definition
Buy	Stock return rate $\geq$ Market return rate (10%)
Hold	- Market return rate (-10%) $\leq$ Stock return rate $<$ Market return rate (+10%)
Sell	Stock return $<$ - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2009 (For reference: Simple average of HSI total return index in 2009-21 is 9.2%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

### Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Copyright 2022 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.

Tel: (852) 2868 2183