

ZTE (000063 CH)

Improved margins in 2023

ZTE released its FY23 results. Revenue grew by 1.1% YoY to RMB124bn, in line with consensus and 3% higher than our forecast. Net profit increased by 15.4% YoY to RMB9.3bn, 5% lower than consensus and in line with our forecasts. Gross margin for 2023 was 41.5%, representing a 434bps increase from FY22. NPM showed a similar trend, reaching 7.5% in FY23 from 4.2%/5.9%/6.6% in FY20-22. ZTE's profitability improved steadily as a result of the company's continued efforts in operation optimization and cost reduction (i.e., self-developed components).

- For 4Q23, the company's revenue grew by 14.7% YoY and 21.5% QoQ, while its net profit grew by 17.8% YoY and fell by 37.3% QoQ, respectively. The sequential decline was mainly due to 1) a lower GPM (36.0% in Q4 vs. 44.6% in Q3) on a less favorable revenue mix, which was partially offset by cost optimization with in-house designed components in Consumer/Government and Enterprise segments, 2) a 42.5% increase in SG&A in Q4 on higher employee benefits and marketing.
- By segment, 1) revenue from Carrier segment increased by 3.4% YoY on domestic market share gains in RAN and non-RAN businesses and overseas progress. 2) Consumer segment sales declined by 1.3% YoY on overseas inventory digestion and intensified competition, partially offset by domestic growth in family network business. 3) Enterprise & gov't segment sales declined by 7.1% YoY in 2023 due to a slowdown in investment.
- Looking ahead to 2024, we believe ZTE is poised to capitalize on emerging trends in the telecom industry, focusing on the evolution towards 5.5G/6G and AI compute power. Maintain BUY on ZTE (000063 CH) with adjusted TP at RMB34.2, based on 15x 2024E P/E, which is close to its 3-year avg. (vs. previous 16.5x, considering potential downside risk from continued industry headwinds and slower-than-expected development in AI). Next catalyst may be telecom operators' capex outlook.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23A	FY24E	FY25E
Revenue (RMB mn)	114,522	122,954	124,251	133,717	142,644
YoY growth (%)	12.9	7.4	1.1	7.6	6.7
Gross margin (%)	35.2	37.2	41.5	41.9	42.0
Net profit (RMB mn)	6,813	8,080	9,326	10,842	12,200
YoY growth (%)	31.4	18.6	15.4	16.3	12.5
EPS (Reported) (RMB)	1.47	1.71	1.96	2.27	2.55
P/E (x)	20.5	17.6	15.4	13.3	11.8
ROE (%)	13.2%	13.8%	13.7%	14.3%	14.5%

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	RMB34.20
(Previous TP)	RMB36.90)
Up/Downside	13.3%
Current Price	RMB30.18

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Stock Data

Mkt Cap (RMB mn)	22,801.0
Avg 3 mths t/o (RMB mn)	3,142.2
52w High/Low (RMB)	45.54/21.70
Total Issued Shares (mn)	755.5

Source: FactSet

Shareholding Structure

BlackRock	7.1%
Vanguard Group	4.2%

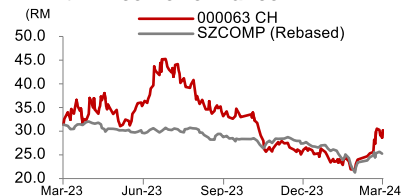
Source: HKEX

Share Performance

	Absolute	Relative
1-mth	25.8%	15.3%
3-mth	15.6%	24.2%
6-mth	-8.1%	3.4%

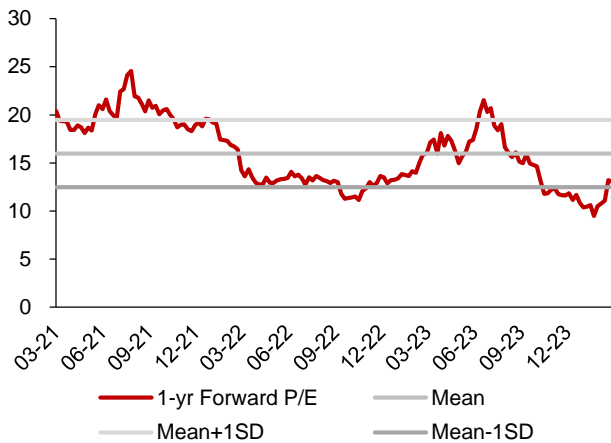
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12-mth Price Performance



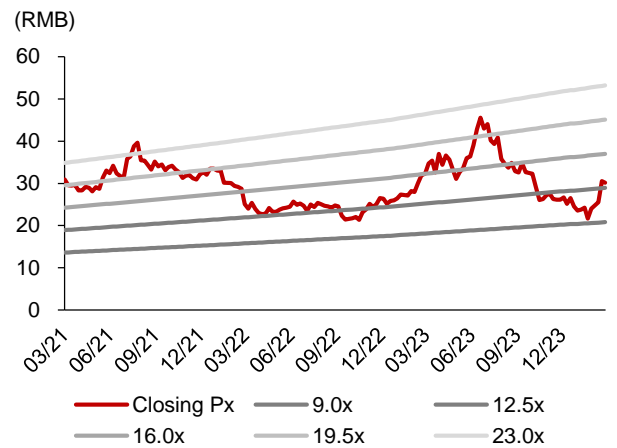
Source: FactSet

Figure 1: 12M forward P/E band



Source: Company data, Bloomberg, CMBIGM

Figure 2: 12M forward P/E chart



Source: Company data, Bloomberg, CMBIGM

Figure 3: CMBI estimates vs. consensus

RMB mn	CMBI estimates		Consensus		Diff	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue	133,717	142,644	152,803	167,208	-12%	-15%
Gross profit	55,973	59,858	57,549	63,404	-3%	-6%
Operating profit	12,023	13,468	13,165	15,079	-9%	-11%
Net profit	10,842	12,200	11,155	12,656	-3%	-4%
EPS (RMB)	2.27	2.55	2.40	2.70	-6%	-6%
Gross margin	41.9%	42.0%	37.7%	37.9%	4.2 ppt	4 ppt
Operating margin	9.0%	9.4%	8.6%	9.0%	0.4 ppt	0.4 ppt
Net margin	8.1%	8.6%	7.3%	7.6%	0.8 ppt	1 ppt

Source: Bloomberg, CMBIGM estimates

Figure 4: CMBI new estimates vs. old

RMB mn	New		Old		Diff	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue	133,717	142,644	126,542	134,289	6%	6%
Gross profit	55,973	59,858	53,021	55,730	6%	7%
Net profit	10,842	12,200	10,872	12,078	0%	1%
EPS (RMB)	2.27	2.55	2.23	2.48	2%	3%
Gross margin	41.9%	42.0%	41.9%	41.5%	0 ppt	0.5 ppt
Net margin	8.1%	8.6%	8.6%	9.0%	-0.5 ppt	-0.4 ppt

Source: CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023A	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	101,451	114,522	122,954	124,251	133,717	142,644
Cost of goods sold	(69,379)	(74,160)	(77,228)	(72,650)	(77,744)	(82,786)
Gross profit	32,071	40,362	45,727	51,601	55,973	59,858
Operating expenses	(26,483)	(31,828)	(35,166)	(40,623)	(43,784)	(46,921)
Selling expense	(7,579)	(8,733)	(9,173)	(10,172)	(11,147)	(12,106)
Admin expense	(4,995)	(5,445)	(5,333)	(5,632)	(5,927)	(6,323)
SG&A expense	(685)	(787)	(951)	(1,336)	(1,437)	(1,533)
R&D expense	(14,797)	(18,804)	(21,602)	(25,289)	(27,216)	(29,033)
Others	1,573	1,941	1,893	1,806	1,944	2,073
Operating profit	5,589	8,534	10,561	10,978	12,189	12,937
Other income	238	250	196	173	186	199
Other expense	(644)	(427)	(239)	(228)	(246)	(262)
Gain/loss on financial assets at FVTPL	39	1,099	(1,142)	(702)	(702)	(702)
Investment gain/loss	906	1,564	1,087	(205)	0	0
Other gains/(losses)	(643)	(1,558)	(1,548)	(914)	(957)	(770)
EBIT	5,485	9,462	8,915	9,102	10,470	11,402
Net Interest income/(expense)	(421)	(963)	(163)	1,101	1,494	2,003
Other income/expense	(164)	(979)	(657)	158	158	158
Pre-tax profit	5,064	8,499	8,752	10,203	11,964	13,405
Income tax	(342)	(1,463)	(960)	(962)	(1,220)	(1,316)
After tax profit	4,722	7,036	7,792	9,241	10,743	12,089
Minority interest	446	223	(289)	(85)	(99)	(111)
Others	16	0	0	0	0	0
Net profit	5,184	6,813	8,080	9,326	10,842	12,200
BALANCE SHEET						
YE 31 Dec (RMB mn)						
Current assets	106,977	127,871	137,874	158,505	157,526	172,726
Cash & equivalents	31,403	39,071	47,072	51,013	61,729	62,746
Restricted cash	4,256	11,642	9,274	27,530	27,530	27,530
Account receivables	17,043	18,863	19,098	21,968	16,865	21,434
Inventories	33,689	36,317	45,235	41,131	35,548	43,835
Prepayment	322	607	279	242	381	353
Financial assets at FVTPL	1,037	1,361	514	153	148	158
Other current assets	19,226	20,011	16,402	16,466	15,324	16,671
Non-current assets	43,658	40,892	43,080	42,454	37,118	33,778
PP&E	12,954	12,810	13,877	14,360	14,282	14,221
Right-of-use assets	1,047	815	1,080	1,557	1,383	1,133
Deferred income tax	3,437	3,195	3,719	4,146	4,016	4,260
Investment in JVs & assos	3,749	3,699	3,765	3,631	3,585	3,672
Intangibles	11,440	10,548	9,926	8,999	4,673	296
Goodwill	186	0	0	0	0	0
Financial assets at FVTPL	1,537	1,175	1,028	832	832	832
Other non-current assets	9,307	8,650	9,685	8,928	8,347	9,363
Total assets	150,635	168,763	180,954	200,958	194,643	206,504
Current liabilities	78,685	74,395	78,424	83,030	76,746	81,824
Short-term borrowings	8,947	10,559	9,962	7,560	4,938	5,340
Account payables	36,780	32,869	32,595	32,219	29,821	32,122
Tax payable	1,216	878	1,447	1,413	1,369	1,452
Other current liabilities	3,949	4,545	3,498	10,771	10,527	10,986
Contract liabilities	27,793	25,544	30,922	31,067	30,090	31,924
Non-current liabilities	30,117	36,791	42,987	49,596	42,089	40,581
Long-term borrowings	22,614	29,908	35,126	42,576	35,289	33,367
Bond payables	0	0	0	0	0	0
Obligations under finance leases	718	532	789	960	930	987
Deferred income	134	150	87	78	75	80
Other non-current liabilities	6,651	6,200	6,985	5,982	5,794	6,147
Total liabilities	108,803	111,185	121,410	132,627	118,835	122,405
Share capital	4,613	4,731	4,736	4,783	4,783	4,783
Capital surplus	(115)	0	0	0	0	0
Retained earnings	14,824	20,651	27,309	34,715	42,290	50,692
Other reserves	23,974	26,100	26,596	28,510	28,510	28,510

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Total shareholders equity	43,297	51,482	58,641	68,008	75,584	83,985
Minority interest	2,826	1,806	902	323	224	113
Total equity and liabilities	154,925	164,473	180,954	200,958	194,643	206,504

CASH FLOW	2020A	2021A	2022A	2023A	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,722	7,036	7,792	9,241	10,743	12,089
Depreciation & amortization	3,971	4,588	4,386	4,926	5,634	5,812
Tax paid	(963)	258	(587)	(437)	128	(240)
Change in working capital	(1,001)	2,357	(8,471)	(324)	7,743	(11,906)
Others	3,504	1,484	4,458	3,999	5,035	5,877
Net cash from operations	10,233	15,724	7,578	17,406	29,283	11,632
Investing						
Capital expenditure	(6,472)	(5,686)	(4,952)	(4,005)	(2,099)	(2,226)
Acquisition of subsidiaries/ investments	(620)	(5,127)	3,636	(17,001)	(651)	(798)
Net proceeds from disposal of short-term investments	9	221	24	104	421	425
Others	(10,218)	(450)	(471)	(633)	0	0
Net cash from investing	(17,300)	(11,042)	(1,762)	(21,534)	(2,329)	(2,599)
Financing						
Dividend paid	(2,951)	(2,618)	(3,688)	(4,836)	(6,328)	(6,497)
Net borrowings	(1,294)	5,309	5,442	11,164	(9,909)	(1,520)
Proceeds from share issues	14,167	538	171	1,676	0	0
Others	(10,211)	(450)	(471)	(633)	0	0
Net cash from financing	(290)	2,779	1,455	7,372	(16,237)	(8,017)
Net change in cash						
Cash at the beginning of the year	28,506	31,403	39,071	47,072	51,013	61,729
Exchange difference	37	(242)	260	66	0	0
Others	2,861	7,910	7,741	3,876	10,716	1,016
Cash at the end of the year	31,403	39,071	47,072	51,013	61,729	62,746

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

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