

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 gov't/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 gov't/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. Gov't/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 |

China Semiconductors

Lily YANG, Ph.D
 (852) 3916 3716
 lilyyang@cmbi.com.hk

Kevin ZHANG
 (852) 3761 8727
 kevinzhang@cmbi.com.hk

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% |

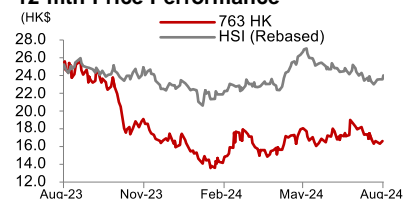
Source: Bloomberg

Share Performance

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

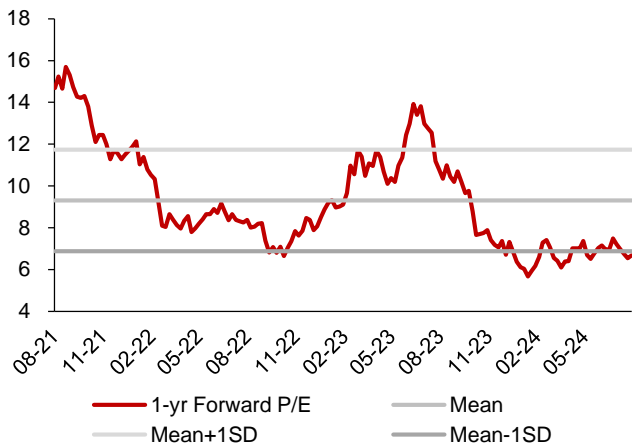
Source: FactSet

12-month 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 | | | | | | |
| 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 |

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| | | | | | | |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Total equity and liabilities | 168,763 | 180,954 | 200,958 | 206,629 | 218,734 | 233,042 |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|

| 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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NOT RATED : Stock is not rated by CMBIGM

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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