

COMPANY NEWS

ZTE Corporation [763.HK; HK\$17.30 Not Rated] - Key takeaway from 2014 results presentation

H-Market Cap: US\$1,421m; Free Float: 100%; 3-months Average Daily Turnover: US\$8.1m
Analyst: Mark Po

The Company. ZTE Corporation (ZTE) develops and markets switches, access servers, videoconferencing systems, mobile communication devices and optical communications devices.

No significant downside for mobile CAPEX in near term. During the results presentation, ZTE's management highlights that the mobile CAPEX by Chinese telcos is unlikely to see significant decline in near future given significant increase in mobile data usage. Telcos have to invest for expanding mobile data capacity which creates replacement demand. Also management sees growth potential from overseas markets which should partly offset the impact of potential decline in mobile CAPEX by Chinese telcos. European telcos just came out of 3-year frame 4G contracts with other vendors, and now starting to deploy 4G more aggressively. ZTE is now being invited to bid for new 4G tenders in continental Europe. We believe that ZTE will have a major breakthrough in developed markets in 2015 which should create growth opportunity to the group. ZTE will be the beneficiary of industry consolidation as operating environment is becoming more favorable in the 4G era.

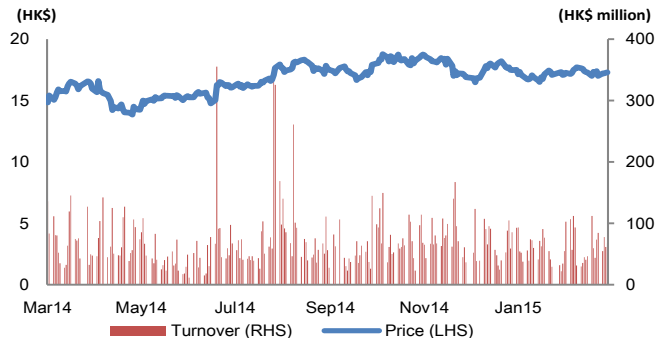
ZTE also expands its product portfolio and the group is now supplying networking products and storage products under its own brand to customers. Gross margin of networking products is as high as 50-60%. Increasing contribution from new products should have positive effect on overall profitability.

Handset division continues to improve. ZTE targets to ship 60m units of smartphone in 2015, up 25% YoY. Management emphasizes that the group will continue to focus on higher value-added products, bringing better user experience to customers, and increasing sales from APP store. The group will focus on unique smart voice command feature as key differentiation from other handset brands. Management also targets to further expand gross profit margin of handset division in 2015.

New business opportunity. Regarding new business areas, ZTE will focus on wireless charging system, internet/IT solutions for government, power, railway & financial sectors. The group signed agreement with over 20 cities in China in deploying high-power wireless-charging system, which will make top line contribution in 2015.

ZTE's management shares our view that the increase localization rate of IT products and software by mainland financial sector creates growth opportunity. ZTE has already secured contracts from financial institutions for providing total solutions including networking products, database software, storage and application.

[ZTE Corporation]



Key Financials (in RMB m)	2013	2014	2015E	2016E
Revenue	75,233.7	81,471.0	91,845.3	98,716.2
Gross Profit	20,458.6	23,712.0	27,082.4	29,175.6
Gross Margin %	27.2	29.1	29.5	29.6
Net Profit	1,357.7	2,634.0	3,326.0	3,785.8
Net Margin %	1.8	3.2	3.6	3.8
EPS (Basic)	0.39	0.77	0.98	1.11
ROE (%)	6.2	11.1	12.5	13.0
Dividend Yield (%)	0.20	1.40	1.48	1.58
PER (x)	38.59	18.10	14.27	12.52
PBR (x)	2.30	1.80	1.70	1.50

Source: Bloomberg, Company Data.

2014 results. ZTE reported a net profit of RMB2.6bn in 2014 which was in line with guidance announced on 19 Jan 2015. Sales were up 8.3% year-on-year (YoY) to Rmb81.2bn with networking equipment sales grew 15% YoY, accounting for 57.4% of total turnover. Handset and terminal sales grew 6.5% YoY and accounted for 28.4% of total turnover in 2014. Sales of other services and software (including government/enterprise projects and smart city) reported YoY decline of 9.7% which was a result of lower overseas services income. The group's gross margin improved about 2ppt YoY to 29.1% in 2014 on across the board gross margin improvement thanks to better product mix.

Our view. We maintain the view that ZTE is no longer a pure equipment supplier. Increasing contribution from new businesses will trigger a re-rating. News flow on LTE network equipment tenders from China & overseas telecom operators, and breakthrough in wireless charging equipment will be share price catalysts.

Figure 1: Peer Comparisons

Ticker	Company	Price Lcy	Market Cap US\$m	PE		EV/EBITDA		P/B		ROE		ROA		Div yield	
				2015F x	2016F x	2015F x	2016F x	2013 x	2014F x	2013 %	2014F %	2013 %	2014F %	2013 %	2014F %
763 HK	Zte Corp-H	17.30	11312.1	14.1	12.5	13.6	12.4	1.9	1.7	6.2	12.5	2.5	2.7	1.4	1.5
000063 CH	Zte Corp-A	21.9	11312.2	19.0	16.5	12.7	12.2	3.0	2.7	6.2	12.4	2.5	2.9	0.9	0.9
2342 HK	Comba Telecom Systems Holdin	2.5	532.6	11.1	9.8	7.5	6.6	1.1	1.0	-6.4	10.1	-0.2	3.6	0.4	2.3
552 HK	China Communications Servi-H	3.3	2938.7	6.7	6.6	3.2	2.9	0.8	0.7	10.6	10.3	4.3	4.8	3.5	4.3
6168 HK	China U-Ton Holdings Ltd	1.3	283.3	n.a.	n.a.	n.a.	n.a.	4.3	n.a.	24.7	n.a.	14.9	n.a.	0.0	n.a.
2369 HK	Coolpad Group Ltd	1.4	770.1	10.4	9.4	8.8	7.7	1.8	1.6	13.5	14.3	4.5	4.2	0.7	1.6
2618 HK	Tcl Communication Tech Hldgs	7.9	1255.7	7.2	6.5	6.7	5.7	2.3	1.9	12.0	28.9	6.4	6.5	4.9	5.0
2000 HK	Sim Technology Group Ltd	0.4	141.8	n.a.	n.a.	n.a.	n.a.	0.6	n.a.	-12.1	n.a.	-3.6	n.a.	0.0	n.a.
941 HK	China Mobile Ltd	101.3	267483.5	14.7	14.1	4.9	4.6	1.9	1.8	16.1	12.7	8.9	8.2	2.8	2.9
728 HK	China Telecom Corp Ltd-H	4.8	50413.8	15.2	13.9	3.9	3.6	1.1	1.0	6.5	6.8	3.2	3.7	2.0	2.2
762 HK	China Unicom Hong Kong Ltd	11.5	35639.6	15.9	13.6	3.4	3.2	1.0	0.9	4.9	6.0	2.2	2.7	2.2	2.3
Average				13.0	11.6	6.5	5.9	1.8	1.5	7.6	12.7	4.3	4.6	1.8	2.7
JNPR US	Juniper Networks Inc	22.7	9242.7	12.1	10.6	6.4	5.9	1.9	2.4	6.2	11.3	-3.6	6.1	0.4	1.7
MSI US	Motorola Solutions Inc	65.4	14160.0	16.6	15.9	9.9	9.1	5.3	29.9	31.7	53.1	11.7	7.3	2.0	2.1
CSCO US	Cisco Systems Inc	27.5	140176.1	12.1	11.5	6.7	6.3	2.4	2.4	18.1	17.9	8.5	9.4	2.8	2.8
ALU FP	Alcatel-Lucent	3.4	10600.6	13.4	10.6	5.9	5.6	5.1	3.7	-41.4	19.5	-0.5	2.2	0.0	0.0
ERICB SS	Ericsson Lm-B Shs	107.6	41779.0	16.1	14.6	8.2	7.4	2.4	2.3	8.7	11.6	4.1	5.3	n.a.	3.4
NOK1V FH	Nokia Oyj	7.0	28203.7	19.7	17.8	9.5	9.3	2.9	2.9	-8.5	15.4	15.0	8.6	n.a.	2.3
Average				15.0	13.5	7.7	7.3	3.3	7.3	2.5	21.5	5.9	6.5	1.3	2.0

Source: Bloomberg

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- SELL : share price will decrease by >20% within 12 months in absolute terms
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