



國泰君安國際
GUOTAI JUNAN INTERNATIONAL

Company Report: ZTE (00763 HK)

公司报告: 中兴通讯(00763 HK)

Ricky Lai 黎柏坚
+852 2609 2603
ricky.lai@gtjas.com.hk

30 March 2015

Sustainable Margins Improvement, "Buy"

利润率持续改善, "买入"

Rating:

Buy

Maintained

评级:

买入 (维持)

6-18m TP 目标价:

HK\$21.00

Revised from 原目标价:

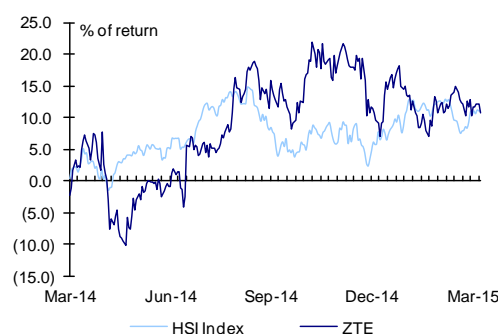
HK\$21.00

Share price 股价:

HK\$17.080

Stock performance

股价表现



Change in Share Price 股价变动	1 M 1 个月	3 M 3 个月	1 Y 1 年
Abs. % 绝对变动 %	(1.2)	0.9	10.8
Rel. % to HS index 相对恒指变动 %	0.2	(3.2)	(0.2)
Avg. share price(HK\$) 平均股价 (港元)	17.3	17.3	16.8

Source: Bloomberg, Guotai Junan International.

- In-line FY14 results.** FY14 gross profit margin was 29.1%, up 1.9ppt yoy, driven by stronger produce shipments for 4G handsets and base stations. We expect FY15-17 gross profit margin to be 29.4%/29.4%/29.7%, respectively, due to stronger 4G product contributions.
- Revise up FY15-16 carriers' networks revenue by 1.0%/1.2%, respectively,** due to telecom operators' 4G network expansions after the grant of FDD-LTE licenses.
- Revise down FY15-16 smartphone shipment estimations by 29.4%/27.0%, respectively,** due to Chinese telecom operators' reduction of handset subsidies and fiercer market competition.
- Maintain the Company's investment rating of "Buy" and the TP of HK\$21.00.** Based on the adjustments of handset terminals and carriers' networks revenue estimations, FY15-16 EPS is revised up by 1.0%/1.4% respectively. The TP represents 16.7x FY15 PER, 15.0x FY16 PER, 13.6x FY17 PER and 2.3x FY15 PBR. We maintain the Company's investment rating of "Buy" due to the Company's profit margin improvement and better revenue growth.
- 2014 财年业绩符合预期。**2014 财年毛利率为 29.1%，同比上升 1.9 个百分点，是由更强的 4G 手机和基站出货量所贡献。我们预期 2015-2017 财年的毛利率分别为 29.4%/ 29.4%/ 29.7%，因较强的 4G 产品贡献。
- 分别上调 2015-2016 财年运营商设备收入 1.0%/1.2%，**是由于电信运营商在授予 FDD-LTE 牌照后扩张 4G 网络。
- 分别下调 2015-2016 财年的智能手机出货预测 29.4%/27.0%，**是由于中国的电信运营商减手机补贴和更激烈的市场竞争。
- 维持公司的投资评级为“买入”及目标价 21.00 港元。**基于终端及运营商设备收入预测的调整，我们分别上调 2015-2016 财年每股纯利预测 1.0%/1.4%。目标价相当于 16.7 倍 2015 年市盈率、15.0 倍 2016 年市盈率、13.6 倍 2017 年市盈率及 2.3 倍 2015 年市净率。我们维持公司的投资评级为“买入”，因利润率的改善及更好的收入增长。

Year End 年结 12/31	Turnover 收入 (RMB m)	Net Profit 股东净利 (RMB m)	EPS 每股净利 (RMB)	EPS 每股净利变动 (Δ%)	PER 市盈率 (x)	BPS 每股净资产 (RMB)	PBR 市净率 (x)	DPS 每股股息 (RMB)	Yield 股息率 (%)	ROE 净资产收益率 (%)
2013A	75,234	1,358	0.395	n.a.	33.8	6.542	2.0	0.030	0.2	6.0
2014A	81,471	2,634	0.766	94.0	17.8	7.237	1.9	0.115	0.8	11.1
2015F	91,438	3,409	0.992	29.4	13.6	7.327	1.8	0.149	1.1	13.6
2016F	99,949	3,802	1.106	11.5	12.2	7.848	1.7	0.166	1.2	14.6
2017F	104,917	4,208	1.224	10.6	11.0	8.284	1.6	0.184	1.4	15.2

Shares in issue (m) 总股数 (m)

3,437.5

Major shareholder 大股东

Zhongxingxin 30.8%

Market cap. (HK\$ m) 市值 (HK\$ m)

58,712.5

Free float (%) 自由流通比率 (%)

69.2

3 month average vol. 3 个月平均成交股数 ('000)

3,650.3

FY15 Net gearing (%) 15 年净负债/股东资金 (%)

20.5

52 Weeks high/low (HK\$) 52 周高/低

18.800 / 13.860

FY15 Est. NAV (HK\$) 15 年每股估值 (港元)

23.0

Source: the Company, Guotai Junan International.

FY14 Results Review:

FY14 results were in-line with expectations. There was a 8.3% yoy improvement in total revenue in FY14 attributable to 14.9% improvement of carriers' network revenue, 6.5% improvement of handset terminals revenue and 9.7% decline of telecom software, services & other product revenue. We expect the Company's revenue and profit margin will improve in FY15 due to the stronger 4G product shipment.

Table-1: ZTE's FY14 Income Statement Analysis

RMB (Million)	FY14	FY13	YoY	Comments
Total revenue	81,471	75,234	8.3%	
-Carriers' networks revenue	46,768	40,696	14.9%	Strong growth with telecom operators' 4G network expansions
-Handset terminals revenue	23,117	21,702	6.5%	Contributed from higher 4G smartphones shipments
-Telecom software systems, services & other product revenue	11,586	12,836	(9.7%)	Decline due to weak decline from international markets
Cost of sales	(57,759)	(54,775)	5.4%	
Gross profit	23,712	20,459	15.9%	
Other income & gains	4,561	4,905	(7.0%)	
Research & development cost	(9,009)	(7,384)	22.0%	Higher cost to support product innovation
Selling & marketing costs	(10,392)	(10,159)	2.3%	
Administrative expenses	(2,138)	(2,259)	(5.4%)	
Other expenses	(1,582)	(2,119)	(25.3%)	
Finance costs	(1,562)	(1,650)	(5.3%)	
Others	(54)	34	N.A.	
Profit before tax	3,538	1,828	93.5%	
Income tax	(810)	(394)	105.6%	
Net profit	2,634	1,358	94.0%	
Basic EPS (RMB)	0.77	0.39	97.4%	
Gross profit margin (%)	29.1	27.2	1.9ppt	Improvement thanks to stronger contribution from higher margin carriers' networks
Net profit margin (%)	3.2	1.8	1.4ppt	

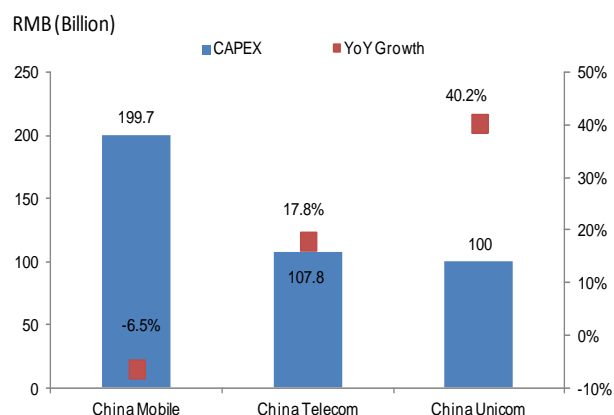
Source: the Company.

FY15-17 gross profit margin is expected to be 29.4%/29.4%/29.7%, respectively. Gross profit margin in FY14 was 29.1%, up 1.9ppt yoy, thanks to stronger contribution from higher margin carriers' networks products. FY14 carriers' networks gross profit margin was 35.6%, up 1.0ppt yoy, driven by higher demand for 4G base stations from telecom operators. We expect the gross profit margin of carriers' networks would improve in FY15-17 due to higher contributions from 4G products and the phasing out of 2G and 3G products. FY14 handset terminals gross profit margin was 15.2%, up 0.6ppt yoy, due to shifting of shipments from feature phones to 4G smartphones. FY14 telecom software systems, services and other products gross profit margin was 30.8%, up 5.9ppt yoy. The increase in gross profit margin for telecommunication software systems, services and other products was mainly attributable to improved gross profit margin for video and network terminals products. ZTE's three product segments showed sustainable improvement in gross profit margin. We expect FY15-17 gross profit margin to be 29.4%/29.4%/29.7%, respectively.

Revise up FY15-16 carriers' networks revenue by 1.0%/1.2%, respectively. FY14 carriers' networks revenue was RMB46.8 billion, up 14.9% yoy, thanks to stronger contribution from 4G products related to 4G network rollout in China and overseas markets. China Mobile (00941 HK), China Unicom (00762 HK) and China Telecom (00728 HK) are expected to

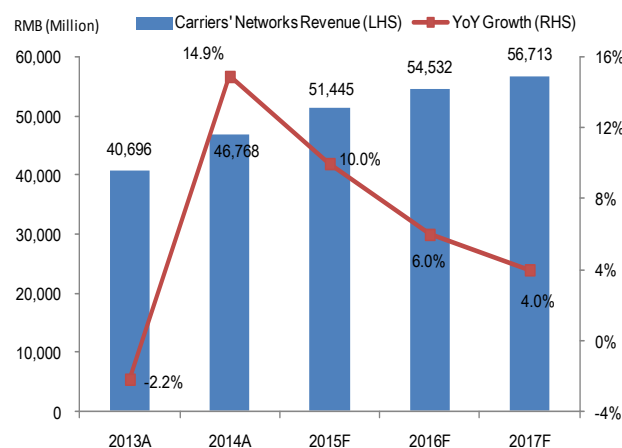
spend RMB199.7 billion, (down 6.5% yoy), RMB100.0 billion (up 17.8% yoy) and RMB107.8 billion (up 40.2% yoy) for CAPEX in FY15, respectively. China Unicom and China Telecom increase CAPEX in FY15 to improve 4G network coverage after the grant of FDD-LTE 4G operating licenses in Feb 2015. We expect ZTE can benefit from higher CAPEX spending by telecom operators with stronger product shipments and improvement in gross profit margin resulted from higher margin 4G product shipments. We revise up FY15-16 carriers' networks revenue by 1.0%/1.2%, respectively.

Figure-1: Chinese Telecom Operators' FY15 CAPEX Estimations



Source: the Company, Guotai Junan International.

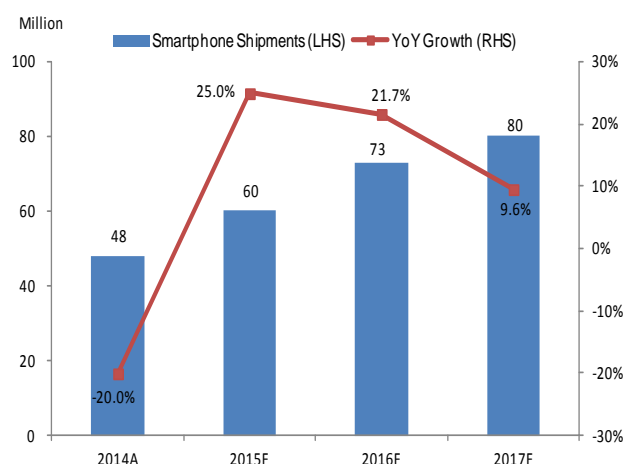
Figure-2: ZTE's Carriers' Networks Revenue and YoY Growth



Source: the Company, Guotai Junan International.

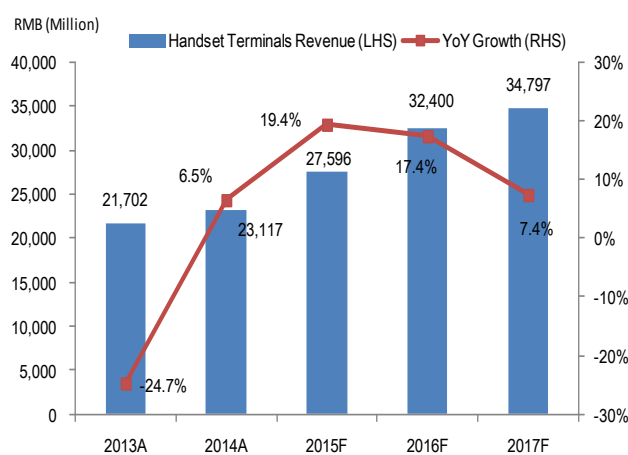
ZTE's FY15-17 smartphone shipments are expected to grow by 25.0%/21.7%/9.6%, respectively. ZTE's terminal shipments in FY14 were 100 million which included 48 million smartphones and the Company guided FY15 smartphone shipments to be 60 million. ZTE's FY14 smartphone shipment was lower than expected due to telecom operators' reduction of handset subsidies and fierce market competition. China Mobile is expected to spend RMB17.0 billion for handset subsidies in FY15, down 9.6% yoy. We reduce FY15-16 smartphone shipment estimations by 29.4%/27.0%, respectively. ZTE's FY15-17 smartphone shipments are expected to be 60 million/73 million/80 million, representing a yoy growth of 25.0%/21.7%/9.6%, respectively. FY15-16 handset terminals revenue is revised down by 2.0%/3.0%, respectively.

Figure-3: ZTE's Smartphone Shipment and YoY Growth



Source: the Company, Guotai Junan International.

Figure-4: ZTE's Handset Terminals Revenue and YoY Growth



Source: the Company, Guotai Junan International.

Revise up FY15-16 telecom software systems, services & other product revenue by 1.5%/2.0%, respectively. The Company guided new revenue generated from government and enterprise would grow by 50% yoy in FY15, which is expected to improve the Company's telecom software systems, services & other product revenue. The Chinese Government

is launching the “Internet +” strategy in 2015 to encourage the usage of cloud computing and “Big Data”. We revise up FY15-16 telecom software systems, services & other product revenue by 1.5%/2.0%, respectively.

Profit Revisions:

FY15-16 net profit is revised up by 1.0%/1.4%, respectively. FY15-16 total revenue is revised up by 1.2%/1.5%, respectively, due to the adjustment of smartphone shipments and carriers’ networks product demand forecasts. FY14-16 net profit is revised up by 1.0%/1.4%, accordingly.

Table-2: Financial Estimation Revisions

RMB (Million)	OLD			NEW			CHANGE		
	2015F	2016F	2017F	2015F	2016F	2017F	2015F	2016F	2017F
Total Revenue	90,354	98,472	N.A.	91,438	99,949	104,917	1.2%	1.5%	N.A.
-Carriers’ network revenue	50,936	53,885	N.A.	51,445	54,532	56,713	1.0%	1.2%	N.A.
-Handset terminals revenue	28,159	33,402	N.A.	27,596	32,400	34,797	(2.0%)	(3.0%)	N.A.
-Telecom software systems, services & others revenue	12,214	12,762	N.A.	12,397	13,017	13,407	1.5%	2.0%	N.A.
Net profit	3,375	3,750	N.A.	3,409	3,802	4,208	1.0%	1.4%	N.A.
EPS (RMB)	0.982	1.091	N.A.	0.992	1.106	1.224	1.0%	1.4%	N.A.

Source: Guotai Junan International.

Valuation:

Maintain the investment rating of “Buy” and TP of HK\$21.00. We maintain the Company’s investment rating of “Buy” due to the Company’s profit margin improvement and benefit from telecom operators’ 4G expansion plan. The TP represents 16.7x FY15 PER, 15.0x FY16 PER, 13.6x FY17 PER and 2.3x FY15 PBR.

Table-3: Peer Comparisons

Company	Ticker	Currency	Price	PER			PB			ROE(%)	EV/EBITDA	ROA (%)
				15F	16F	17F	15F	16F	17F	15F	15F	15F
HK Listed Companies												
Lenovo Group Ltd	992 HK	HKD	11.080	17.5	14.2	11.0	3.9	3.2	2.7	22.8	10.0	4.0
Zte Corp-H	763 HK	HKD	17.080	14.1	12.3	10.6	1.7	1.5	1.3	12.5	11.9	2.7
Tcl Communication Tech Hldgs	2618 HK	HKD	7.820	7.2	6.5	6.0	1.9	1.6	1.3	28.9	5.8	6.5
Comba Telecom System	2342 HK	HKD	2.380	12.0	10.7	5.6	0.9	0.8	0.6	11.9	n.a.	3.6
China Wireless Tech Ltd	2369 HK	HKD	1.370	10.8	9.9	8.6	1.6	1.2	1.0	14.7	6.1	4.2
Simple Average				12.3	10.7	8.3	2.0	1.7	1.4	18.1	8.4	4.2
Weighted Average				15.5	13.0	10.5	2.8	2.4	2.1	18.7	10.4	3.6
Japan Listed Companies												
Toshiba	6502 JP	YEN	513.200	16.0	11.4	10.2	1.6	1.4	1.2	10.1	7.1	2.4
NEC	6701 JP	YEN	350.000	17.7	13.0	11.5	1.2	1.1	1.1	6.6	6.2	2.0
Fujitsu	6702 JP	YEN	825.800	13.0	12.2	11.2	2.5	2.1	1.8	20.6	6.3	4.2
Simple Average				15.5	12.2	11.0	1.8	1.6	1.4	12.5	6.5	2.9
Weighted Average				15.2	12.0	10.8	1.8	1.6	1.4	13.2	6.6	3.0
Taiwan Listed Companies												
HTC Corp	2498 TT	TWD	138.000	46.0	38.7	67.5	1.4	1.4	1.3	3.0	9.4	1.4
Acer Inc	2353 TT	TWD	20.700	28.5	25.6	26.5	1.0	1.0	1.0	3.5	6.1	1.3
Asustek Computer Inc.	2357 TT	TWD	310.000	10.7	10.1	10.0	1.5	1.4	1.2	14.2	6.3	6.9
Simple Average				28.4	24.8	34.7	1.3	1.2	1.2	6.9	7.3	3.2
Weighted Average				23.3	20.5	28.7	1.4	1.3	1.2	9.4	7.1	4.5
US Listed Companies												
Motorola Solutions Inc	MSI US	USD	65.380	20.3	16.6	15.9	30.0	n.a.	n.a.	53.1	11.2	7.3
Cisco Systems Inc	CSCO US	USD	27.130	12.6	12.0	11.3	2.3	2.2	2.1	17.9	6.9	9.4
Juniper Networks Inc	JNPR US	USD	22.290	13.5	11.9	10.4	2.4	2.3	2.0	11.3	7.9	6.1
Simple Average				15.5	13.5	12.5	11.6	2.2	2.0	27.4	8.7	7.6
Weighted Average				13.3	12.4	11.7	4.8	2.2	2.1	20.6	7.3	9.0
Overall Simple Average				18.7	15.9	18.0	1.7	1.5	1.3	12.5	7.4	3.4
Overall Weighted Average				18.0	15.2	16.6	2.0	1.8	1.6	13.8	8.1	3.7

Source: Bloomberg.

30 March 2015

ZTE 中兴通讯 (00763 HK)

Company Report

Financial statement and ratios

Income Statement						Balance Sheet					
Year end Dec, RMB mn	2013A	2014A	2015F	2016F	2017F	Year end Dec, RMB m	2013A	2014A	2015F	2016F	2017F
Total revenue	75,234	81,471	91,438	99,949	104,917	Fixed assets	7,698	7,664	7,786	7,963	8,198
Carrier's networks	40,696	46,768	51,445	54,532	56,713	Intangible assets	3,081	3,742	4,003	4,204	4,330
Terminals	21,702	23,117	27,596	32,400	34,797	Factored long-term trade receivables	2,312	1,702	1,515	1,348	1,200
Software and services	12,836	11,586	12,397	13,017	13,407	Investment properties	1,855	2,004	2,125	2,252	2,387
Cost of sales	(54,775)	(57,759)	(64,552)	(70,561)	(73,801)	Available for sales assets	1,630	1,740	1,914	2,028	2,110
						Other non-current assets	7,074	7,112	9,742	15,379	19,190
Gross profit	20,459	23,712	26,886	29,387	31,116	Total non-current assets	23,651	23,964	27,085	33,175	37,414
Other income	4,905	4,561	4,938	5,197	5,246	Cash	20,118	17,230	19,849	20,435	21,863
R&D costs	(7,384)	(9,009)	(10,058)	(10,994)	(11,541)	Bills & trade receivables	24,894	27,240	23,426	18,741	14,618
Distribution costs	(10,159)	(10,392)	(11,704)	(12,793)	(13,429)	Inventories	12,434	19,592	22,531	25,911	29,797
Admin costs	(2,259)	(2,138)	(2,195)	(2,299)	(2,308)	Other current assets	21,376	22,228	21,241	20,315	19,536
Other expenses	(2,119)	(1,582)	(1,737)	(1,899)	(1,993)	Total current assets	78,822	86,290	87,048	85,402	85,815
Operating profit	3,444	5,153	6,130	6,599	7,090	Total assets	102,473	110,255	114,133	118,577	123,229
Finance costs	(1,650)	(1,562)	(1,505)	(1,452)	(1,404)	Short term loans	15,343	11,041	9,606	8,069	6,455
Profit from associates	35	(53)	(45)	(38)	(33)	Bills and trade payables	24,991	29,626	34,070	37,477	41,225
						Other payables	592	6,628	6,232	5,868	5,535
Profit before tax	1,828	3,538	4,580	5,108	5,654	Other current liabilities	22,439	22,669	22,470	22,306	22,175
Income tax	(394)	(811)	(1,049)	(1,170)	(1,295)	Total current liabilities	63,364	69,965	72,378	73,720	75,390
Profit after tax	1,434	2,728	3,530	3,938	4,359						
Minority interests	(76)	(94)	(122)	(136)	(150)	Long term loans	5,386	10,040	11,044	12,148	13,363
Net profit	1,358	2,634	3,409	3,802	4,208	Payables	6,120	0	0	0	0
EPS (RMB)	0.395	0.766	0.992	1.106	1.224	Other non-current liabilities	3,978	3,957	3,988	4,059	4,172
DPS (RMB)	0.030	0.115	0.149	0.166	0.184	Total non-current liabilities	15,483	13,997	15,032	16,207	17,534
						Issued capital	3,438	3,438	3,438	3,438	3,438
						Reserve	18,992	20,754	21,239	22,970	24,415
						Others	0	688	511	570	631
						Total Shareholders' Equity	22,489	24,879	25,188	26,978	28,484
						MI	1,136	1,414	1,536	1,672	1,822
						Total equity	23,625	26,293	26,723	28,649	30,306
						BPS (RMB)	6.542	7.237	7.327	7.848	8.284
Cash Flow Statement						Financial Ratios					
Year end Dec, RMB m	2013A	2014A	2015F	2016F	2017F	Year end Dec	2013A	2014A	2015F	2016F	2017F
Profit before tax	1,828	3,538	4,580	5,108	5,654	Profitability (%)					
D&A	1,745	1,826	1,857	1,972	2,071	Gross margin	27.2	29.1	29.4	29.4	29.7
Other non-cash items	2,018	1,427	1,419	1,413	1,408	Operating margin	4.6	6.3	6.7	6.6	6.8
Working capital change	(3,100)	(3,317)	(622)	(3,097)	(2,744)	Net margin	1.8	3.2	3.7	3.8	4.0
Interest paid, net	(1,650)	(1,562)	(1,505)	(1,452)	(1,404)	ROA	1.3	2.5	3.0	3.3	3.5
Tax paid	(394)	(811)	(1,049)	(1,170)	(1,295)	ROE	6.0	11.1	13.6	14.6	15.2
Cash flow from operation	447	1,102	4,680	2,774	3,690	Liquidity & Solvency					
CAPEX	(904)	(1,007)	(1,098)	(1,153)	(1,210)	Current ratio (x)	1.2	1.2	1.2	1.2	1.1
Others	(267)	(1,015)	(372)	(439)	(490)	Quick ratio (x)	0.9	0.8	0.9	0.9	0.9
Cash flow from investment	(1,171)	(2,023)	(1,469)	(1,592)	(1,700)						
Bank loan change	(1,015)	(1,812)	(431)	(433)	(399)						
Others	(30)	(103)	(118)	(130)	(137)						
Cash flow from finance	(1,045)	(1,915)	(550)	(563)	(536)						
Cash and cash equivalent change	(1,770)	(2,836)	2,660	619	1,454						
Cash balance at year begin	22,660	20,118	17,230	19,849	20,435						
Effect of FX rate changes	(772)	(52)	(41)	(33)	(27)						
Cash balance at year end	20,118	17,230	19,849	20,435	21,863						

Source: the Company, Guotai Junan International.

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating	Definition
Buy	Relative Performance >15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	Relative Performance <-15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating	Definition
Outperform	Relative Performance >5%; or the fundamental outlook of the sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	Relative Performance <-5%; or the fundamental outlook of the sector is unfavorable.

DISCLOSURE OF INTERESTS

- (1) The Analysts and their associates do not serve as an officer of the issuer mentioned in this Research Report.
- (2) The Analysts and their associates do not have any financial interests in relation to the issuer mentioned in this Research Report.
- (3) Except for Shandong Chenming Paper Holdings Limited-H shares (01812), China All Access (Holdings) Limited (00633), Guangshen Railway Company Limited-H shares (00525), Guotai Junan International Holdings Limited (01788) and Binhai Investment Company Limited (02886), Guotai Junan and its group companies do not hold equal to or more than 1% of the market capitalization of the issuer mentioned in this Research Report
- (4) Guotai Junan and its group companies have not had investment banking relationships with the issuer mentioned in this Research Report within the preceding 12 months.

DISCLAIMER

This Research Report does not constitute an invitation or offer to acquire, purchase or subscribe for securities by Guotai Junan Securities (Hong Kong) Limited ("Guotai Junan"). Guotai Junan and its group companies may do business that relates to companies covered in research reports, including investment banking, investment services and etc. (for example, the placing agent, lead manager, sponsor, underwriter or invest proprietarily).

Any opinions expressed in this report may differ or be contrary to opinions or investment strategies expressed orally or in written form by sales persons, dealers and other professional executives of Guotai Junan group of companies. Any opinions expressed in this report may differ or be contrary to opinions or investment decisions made by the asset management and investment banking groups of Guotai Junan.

Though best effort has been made to ensure the accuracy of the information and data contained in this Research Report, Guotai Junan does not guarantee the accuracy and completeness of the information and data herein. This Research Report may contain some forward-looking estimates and forecasts derived from the assumptions of the future political and economic conditions with inherently unpredictable and mutable situation, so uncertainty may contain. Investors should understand and comprehend the investment objectives and its related risks, and where necessary consult their own financial advisers prior to any investment decision.

This Research Report is not directed at, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject Guotai Junan and its group companies to any registration or licensing requirement within such jurisdiction.

© 2015 Guotai Junan Securities (Hong Kong) Limited. All Rights Reserved.
 27/F., Low Block, Grand Millennium Plaza, 181 Queen's Road Central, Hong Kong.
 Tel.: (852) 2509-9118 Fax: (852) 2509-7793
 Website: www.gtja.com.hk