

ZTT (600522.CH)

Main Businesses Advance Together

Shanghai | TMT | Company report

24 MAY 2016

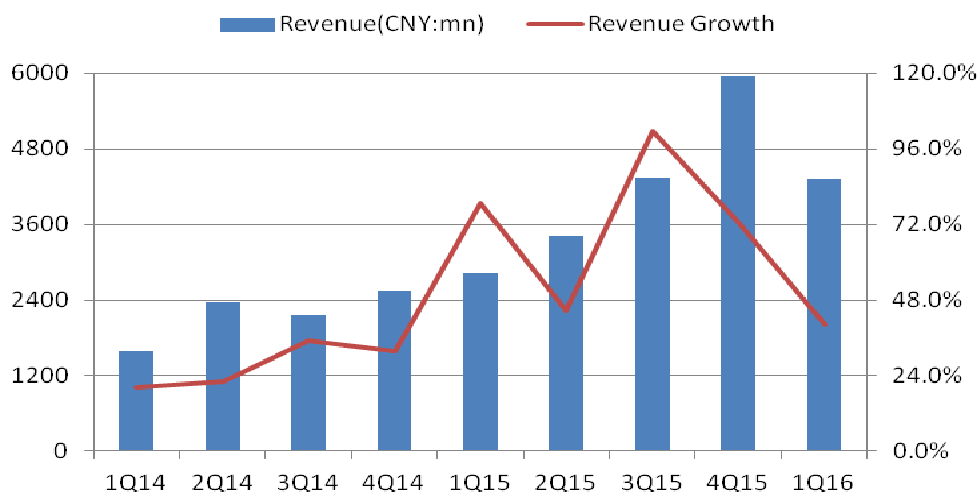
Main Businesses Advance Together

The main businesses of ZTT are communications, electric power, new energy, and submarine cable. In 2015, the company recorded a revenue of RMB16.5 billion, up 73.23% year-on-year; net profit excluding non-recurring items was RMB792 million, a YoY increase of 63.78%. The flourishing downstream demand raised both quantity and price of optical fibers and cables of the company, so the revenue increased by 14.5% to RMB3.46 billion. The demand for upgrading of extra-high voltage grids spurred the wire revenue to rise by 22% to RMB2.38 billion, and cable revenue also surged by 54.1% to RMB1.44 billion. The photovoltaic technology of ZTT realized 104MW PV grid-connected power generation, which brought the new energy business a revenue growth of 180.8%.

Moreover, the profitability of the three businesses of optical fibers and cables, power transmission and new energy has significantly improved, with the gross profit margin increasing by 2.6%, 5.5%, and 5.53% respectively. ZTT Broadband and other two merged companies also realized the promised performance, exceeding the promised revenue by 21.06% in total.

In the first quarter of 2016, the company's performance continued to grow rapidly, achieved a revenue of RMB4.3 billion, a yearly growth of 40%, and achieved a net profit excluding non-recurring items of RMB235 million, a year-on-year growth of 98%, which was largely owed to the steady rise of optical fiber prices and rapid development of products with high gross profit margin, such as submarine cables and special conductors, with year-on-year increase of gross margin of 3.5% to 17.28%.

Quarterly revenue Growth



Source: Company reports, Phillip Securities (HK) Research

Accumulate (Initially)

CMP: CNY 20.73

(Closing price at 20 May 2016)

TARGET: CNY 24.16 (+16.5%)

COMPANY DATA

O/S SHARES (MN) :	1,044
MARKET CAP (CNYMN) :	21,642
52 - WK HI/LO (CNY):	35.40/ 14.57

SHARE HOLDING PATTERN, %

ZTT Group :	29.42
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PRICE PERFORMANCE, %

	1M	3M	1Y
ZTT	7.85	18.32	13.25
SCI	15.61	20.18	49.71

PRICE VS. HS300



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	9493	16492	19887	23518
Net Profit	566	988	1261	1589
EPS, CNY	0.76	0.99	1.21	1.52
PER, x	27.28	20.98	17.16	13.63
BVPS, CNY	9.75	9.81	10.92	12.32
P/BV, x	2.13	2.11	1.90	1.68
ROE, %	10.19	10.59	11.50	12.94
Debt/Equity (%)	50.20	51.13	49.99	49.99

Source: Company reports, Phillip Securities Est.

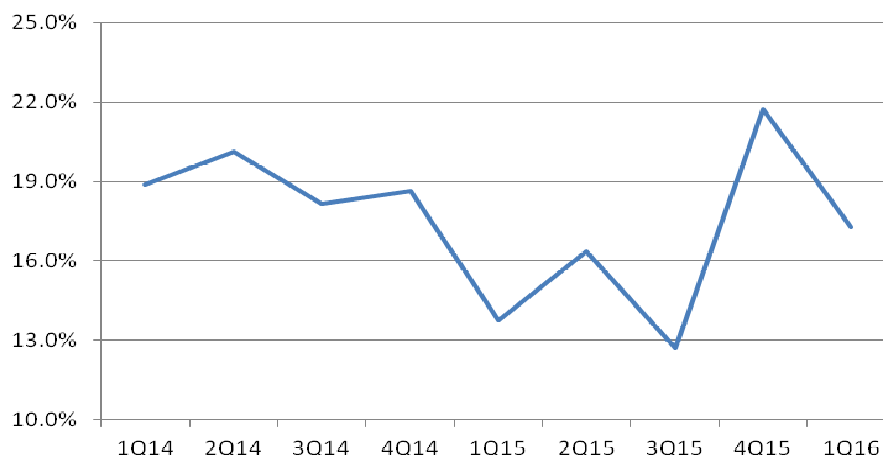
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Gross margin trend

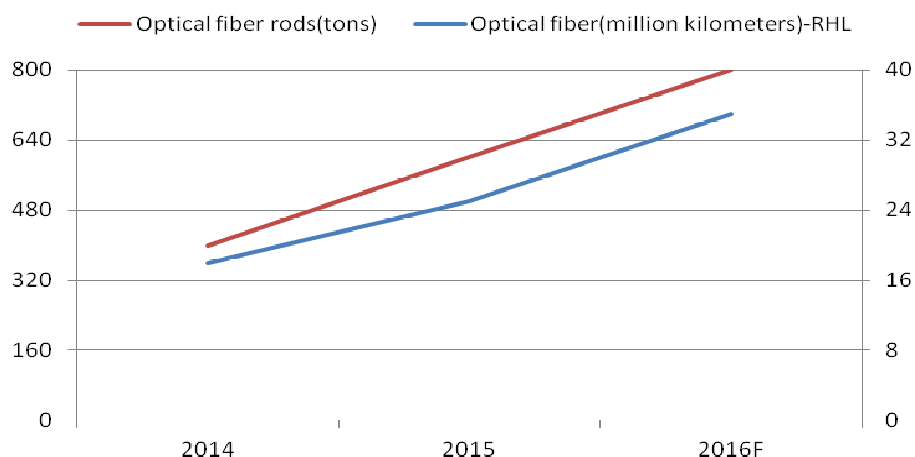


Source: Company reports, Phillip Securities (HK) Research

Rapid Growth Will Maintain its Edge

Given prosperity of the industry, we remain optimistic about ZTT's revenues in 2016. Under the "Broadband China" strategy, operators will continue to increase investment in construction of fixed-line broadband and 4G networks, which will promote a steady rebound of fiber industry, and prices of optical fibers and cables are still rising steadily. Thereby, the company also actively expands its optical fiber production capacity, which will be increased from the current 25 million to 35 million kilometers of fiber core by the end of the year. The company will also improve the capacity of optical fiber rods from 600 tons to 800 tons, and to 1,200 tons in the future, so its growth is expectable.

Capacity Expansion Plan



Source: Company reports, Phillip Securities (HK) Research

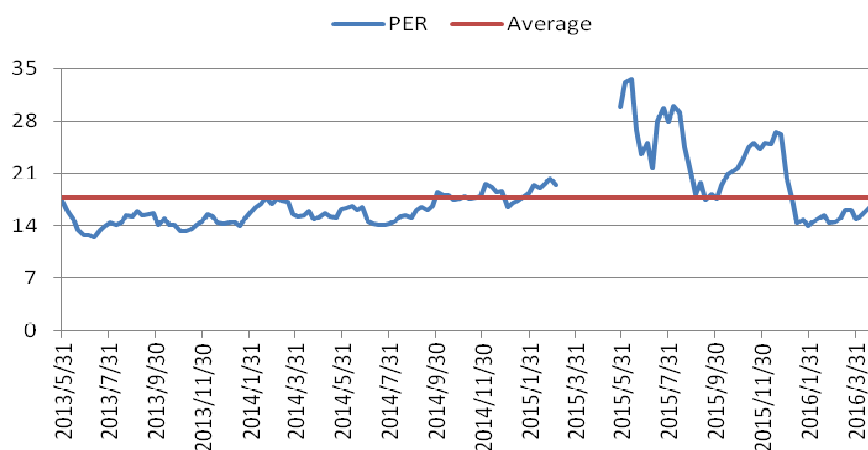
At the same time, the company's profitability is still expected to ascend. In 2015, China's Ministry of Commerce has implemented anti-dumping measures against optical fiber preforms originally from the United States and Japan, which will improve the supply-demand structure, and ZTT's optical fiber preforms will continue to improve its profitability with the improved capacity. In the field of electric power, the company attaches great emphasis on special conductors and submarine cables, and will also constantly expand market shares and gross margin through differentiation strategy.

Private Placement will Underpin the Expansion of Emerging Industries

Recently, the company released a plan of non-public offering of stock, and we are optimistic about its prospects. First of all, benefiting from the explosive growth of new energy vehicles, the demand for the company's energy storage battery far exceeds the supply. After the seasoned offering and production expansion, there will be an annual output of 1.2 billion Ah lithium-ion battery series products, and the new energy business will become the long-term growth factor. Secondly, the company occupies more than 90% market share of the domestic submarine optical cables, and more than 70% market share of submarine cables, with the underwater observation network leading the pack in China and facing market demands of hundreds of billions of yuan. The company's submarine cables and junction boxes will enjoy great dividends after the capacity expansion. Moreover, with the production project of new-type metal-graphene composite products, there will be 4 automatic production lines of graphene-reinforced alloy, expected to achieve an annual production capacity of 4,000 tons. These projects are expected to consolidate the company's competitive advantage in the field of submarine cables, and to develop emerging industries, so as to lay a foundation for long-term growth.

Overall speaking, production capacity expansion of the company is carried out in good order. In the future, new production capacity will promote fast growth of revenues, with marine military industry and new energy expected to become main growth factors in the medium and long terms. We give the target price of RMB24.16, equivalent to 20X EPS of 2016 and an "Accumulate" rating is given. (Closing price at 20 May 2016)

Historical P/E Valuation



Source: Company reports, Phillip Securities (HK) Research

Risks

The development of submarine cable industry falls short of expectations;
The private placement falls short of expectations.

Financials

Periodicity:	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	27.75	27.28	20.98	17.16	13.63
Price to Book	2.79	2.13	2.11	1.90	1.68
Dividend Yield	0.48%	0.53%	0.48%	0.58%	0.72%
Per share data(CNY)					
EPS Adjusted	0.75	0.76	0.99	1.21	1.52
Book Value Per Share	7.44	9.75	9.81	10.92	12.32
Dividends Per Share	0.10	0.11	0.10	0.12	0.15
Growth & Margin					
Revenue growth	-	40.65%	73.74%	20.58%	18.26%
Gross profit growth	-	40.49%	38.22%	25.42%	22.34%
Net profit growth	-	7.41%	74.66%	27.72%	25.94%
Gross Margin	21.05%	21.03%	16.73%	17.40%	18.00%
Operating Margin	10.00%	9.00%	6.86%	7.40%	8.00%
Net Profit Margin	7.80%	5.96%	5.99%	6.34%	6.76%
Dividend Payout Ratio %	13.39%	14.47%	10.12%	9.93%	9.86%
Key ratios					
Return on Assets	6.25%	6.31%	6.86%	7.64%	8.63%
Return on Equity	10.81%	10.19%	10.59%	11.50%	12.94%
Liability ratio	38.58%	33.42%	33.83%	33.33%	33.33%
Effective Tax Rate	16.57%	17.18%	16.09%	16.50%	16.50%
Income Statement(CNY: mn)					
Revenue	6,749	9,493	16,492	19,887	23,518
- Cost of Goods Sold	5,329	7,497	13,734	16,426	19,285
Gross Income	1,421	1,996	2,759	3,460	4,233
- Selling, General & Admin Expenses	746	1,142	1,628	1,989	2,352
Operating Income	675	854	1,131	1,472	1,881
- Interest Expense	95	105	89	90	100
- Foreign Exchange Losses (Gains)	-2	0	-23	-10	-10
- Net Non-Operating Losses (Gains)	-82	-134	-139	-150	-150
Pretax Income	664	884	1,205	1,542	1,941
- Income Tax Expense	110	152	194	254	320
Income Before XO Items	554	732	1,011	1,287	1,621
Net Profit	527	566	988	1,261	1,589

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 20 May 2016)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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