

**BEA securities**

EAST ASIA SECURITIES COMPANY LIMITED

8/F, 10 Des Voeux Road Central, Hong Kong.

Dealing: 2842 3530 / 2842 3475 Research: 2842 3198 Facsimile: 2845 2937 / 2526 7992

HONG KONG RESEARCH**29th November 2004**

Analyst: Ernest Tan

Main Board Listing - Research

中興通訊股份有限公司
ZTE Corporation [Stock Code: 0763]

Sole Global Coordinator and Sole : Goldman Sachs (Asia) L.L.C.**Bookrunner****Joint Lead Managers**

Goldman Sachs (Asia) L.L.C.

Guotai Junan Securities (Hong Kong) Limited

Sector : Information technology**Business** : Provider of high-technology communications equipment in China

Total share offer: 141,067,986 shares
 (15.0% of the enlarged share capital)

Public Offer: 14,106,800 shares (10%)
Placing: 126,961,186 shares (90%)

Greenshoe: 19,083,054 shares

Price: HK\$17.50 – HK\$22.00 per share
Market Cap.: HK\$2.47 billion – HK\$3.10 billion

Forecast FY2004 P/E: 15.6x – 19.6x

Adjusted NTA per share: HK\$7.34 – HK\$7.99

Staffing: 24,000

HK Public Offer period:
 29th November 2004 – 2nd December 2004

Receiving bank: Standard Chartered Bank

Share registrar: Computershare Hong Kong
 Investor Services Limited

Listing date: 9th December 2004

Business of ZTE Corporation

The Group is one of the leading providers of high-technology communications equipment in China. It currently targets the telecom equipment market in China and other fast growing emerging markets by providing customized products and solutions. The Group has established long standing relationships with leading Chinese telecom service providers, including China Netcom, China Unicom and China Mobile. In addition, it has sold its products to more than 150 customers in over 60 countries and regions, including India, Indonesia, Pakistan, Thailand, Russia, Romania, Nigeria and Egypt.

The Group have achieved a leading market position in a broad range of telecommunications products in China. According to CCID, in 2003, the Group was the largest domestic supplier of CDMA systems as well as PHS-based wireless local access systems and handsets in China's wireless telecom market in terms of contract value. It was also one of the top three providers of optical networking, broadband access and circuit-switch products and telecom software systems in China's wireline telecom market in terms of contract value.

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Zhongxingxin, parent company of ZTE Corporation	45.0%
Public shareholders (A shares)	32.1%
Minority promoters*	4.9%
Fortune Trust	2.3%
CASIC Shenzhen	0.7%
	85.0%

*Minority promoters include China Mobile No.7 Research (0.7%); Jilin Posts and Telecommunications (0.7%); Heibei Posts and telecommunications (0.7%); Shanxi telecommunications Industrial (0.7%); Hunan Nantian (1.4%) and Lishan Microelectronics (0.7%)

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein.

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$2,636.4 million

(Assuming the over-allotment option is not exercised, and at an issue price of HK\$19.75 each, which is the mid-point of the indicative price range)

	HK\$ million
Expansion of overseas operations	1,581.8
R&D on products and technologies which are of strategic importance to the Group	1,054.6

Financial Highlights

	Year ended 31 st December			Six months ended 30 th June	
	2001	2002	2003	2003 (un-audited)	2004
			(RMB in millions)		
Turnover	9,440.9	10,795.9	17,036.1	7,036.3	10,179.0
Cost of sales	(6,142.2)	(6,924.2)	(11,226.1)	(4,610.9)	(6,443.6)
Gross profit	3,298.7	3,871.7	5,810.0	2,425.4	3,735.4
Gross margin	34.9%	35.9%	34.1%	34.5%	36.7%
Other revenue and gains, net	119.2	312.1	250.0	81.8	261.8
R & D costs, net	(1,048.3)	(1,127.9)	(1,535.7)	(655.6)	(1,042.6)
Selling and distribution costs	(1,150.3)	(1,277.0)	(1,981.5)	(1,016.0)	(1,447.0)
Administrative expenses	(528.3)	(542.4)	(869.0)	(304.0)	(464.9)
Other operating income/ (expenses), net	10.1	(212.6)	(213.9)	(59.4)	(69.2)
Profit from operating activities	701.1	1,023.9	1,461.9	472.1	973.4
Operating margin	7.4%	9.5%	8.6%	6.7%	9.6%
Finance costs	(160.6)	(122.3)	(171.2)	(58.8)	(58.9)
Share of profit and losses of jointly-controlled entities and associates	3.2	4.8	(3.5)	(3.9)	0.5
Profit before tax	543.7	906.4	1,287.2	409.4	915.0
Tax	(108.0)	(160.3)	(198.6)	(66.4)	(69.8)
Profit before minority interests	435.7	746.1	1,088.6	343.0	845.2
Minority interests	(21.7)	(42.5)	(60.3)	(25.4)	(121.2)
Net profit from ordinary activities attributable to shareholders	414.0	703.6	1,028.3	317.6	724.1
Net margin	4.4%	6.5%	6.0%	4.5%	7.1%
Dividends	152.9	111.2	200.2	-	-
Basic earnings per share	RMB0.53	RMB0.88	RMB1.28	RMB0.40	RMB0.90

Consolidated Balance Sheet Information

	As of 31 st December 31			As of 30 th June
	2001	2002	2003	2004
			(RMB in millions)	
Non-current assets	1,699.4	2,041.0	2,169.7	2,329.5
Cash and cash equivalents	1,854.8	2,784.4	3,572.9	3,827.4
Current assets	7,373.2	9,981.8	14,306.7	15,028.6
Current liabilities	4,730.3	6,976.3	10,733.1	11,168.9
Net current assets	2,642.8	3,005.5	3,533.5	3,859.7
Total assets less current liabilities	4,312.2	5,046.5	5,703.3	6,189.2
Non-current liabilities	1,116.9	1,148.5	876.8	668.3
Minority interests	134.3	215.4	226.6	397.1
Net assets	3,061.0	3,682.6	4,599.9	5,123.9

Strengths/Opportunities

- ✓ The Group is among a few PRC enterprises that have a clear competitive edge in the international arena. It attributes its success to the low cost structure that makes it highly competitive in emerging markets such as India, South Africa and Indonesia, etc. that are more price-sensitive. The Group sees emerging markets as its growth driver in the near future.
- ✓ If China's wireless carriers like China Mobile, China Unicom or China Netcom roll out 3G services next year as expected, the new equipment purchases should give its earnings a strong boost.
- ✓ The recently announced third quarter results of the Group showed that its sales in the PRC domestic market continued growing steadily, i.e. 16% y-o-y to RMB4.56 billion. Overseas sales of CDMA and GSM equipment also remained robust. Overall gross margin rose from 34.90% a year ago to 41.1% in the reporting quarter. As a result, its net profit rose 112% y-o-y to RMB213 million.
- ✓ Pricing of this H-share IPO shows a 20-30% discount to its A-shares trading on the Shenzhen Stock Exchange.

Weaknesses/Threats

- × Valuation wise, the pricing of the counter at 15.6-19.6X FY2004E P/E is not cheap compares with the sector P/E of 15-16X.
- × The introduction of 3G services among wireless carriers might create revenue cannibalisation to the Group's PHS equipment division, as the service providers would scale back their investments in PHS services.

Recommendation: Subscribe