

Telco Equipment Sector

Ericsson's solid 3Q19 and upbeat outlook delivered positive signals to supply chain

Ericsson (ERIC US) topped consensus with 3Q19 earnings and raised FY20E revenue guidance by 9%, given stronger-than-expected 5G demand. Mgmt noted that the global 5G market ramped earlier than expected, and they anticipated large China 5G deployment to start in 2020E, while the competition would be tougher than US market. We believe Ericsson's results suggested 1) global accelerated 5G deployment and 2) share gains of Chinese vendors, such as ZTE (763 HK), and we expect the supply chain, such as SCC (002916 CH) and WUS (002463 CH) to continue to benefit from robust domestic 5G demand.

- **3Q19 beat along with guidance lift.** Adj. operating profit grew 71% YoY, 23% above consensus, while revenue decreased 6% YoY, in line with market expectation. Networks segment (69% of sales) grew 9% YoY with GPM at 42%. By region, North America grew 28% YoY backed by strong 4G/5G demand; Northeast Asia increased 5% YoY on strong Korea 5G demand offset by China's 4G slowdown; Europe and Latin America dropped 5% YoY. The company guided FY20E revenue of SEK230-240bn (previously SEK210-220bn) with OPM unchanged at >10%.
- **Chinese vendors outperformed global peers; Bullish on China 4Q19E demand.** Huawei's 27% total sales growth in 3Q19 and ZTE's 28% YoY sales growth consensus in 2H19E seemed more aggressive, compared with 2% YoY FY19E global RAN equipment market growth forecasted by Dell'Oro, and Ericsson's 4% YoY growth in networks segment adjusted for FX. Going forward, we believe Chinese vendors' global share gains will continue, backed by robust demand and earlier deployment in China. As CU has deployed 28K 5G BTS by mid Oct, considering CU's 50K 5G BTS target for FY19E, we believe domestic 5G deployment will accelerate in 4Q19E. Meanwhile, we think global peers can hardly expand presence in China 5G market, given carriers' various customized equipment requirements under "Co-build, co-share" framework. Hence, we are bullish on ZTE (763 HK) and component players, like SCC (002916 CH).
- **Europe to embrace 5G in 2020E.** Ericsson's results suggested that current European markets haven't stepped into 5G large-scale construction phase. However, we think Huawei brushed US sanctions with continued strong growth in European markets. It now has signed 60 commercial 5G contracts with half from Europe. We believe Europe 5G demand will surge since FY20E and some particular markets (e.g. Spain, Germany and Italy) will drive Chinese vendors' steady growth in overseas segment.
- **China 5G tariff rollout as near-term catalyst.** We expect sector re-rating to continue driven by 5G tariff rollout and 5G deployment acceleration. Bullish on ZTE and component names, like SCC and WUS (002463 CH).

Valuation Table

Name	Ticker	Rating	Mkt Cap (USD mn)	Price (LC)	P/E (x)		P/B (x)		ROE
					FY19E	FY20E	FY19E	FY19E	
ZTE	763 HK	NR	17,809	20.70	17.8	14.7	2.5		15.7
Ericsson	ERIC US	NR	30,221	9.06	30.6	17.3	3.5		6.7
Nokia	NOK US	NR	29,500	5.23	22.2	13.0	1.9		5.5
SCC	002916 CH	NR	7,302	156.35	48.9	35.5	10.8		23.5
WUS	002463 CH	NR	5,969	25.41	38.0	29.1	8.2		21.8

Source: Bloomberg, CMBIS

NOT RATED

China telco equipment Sector

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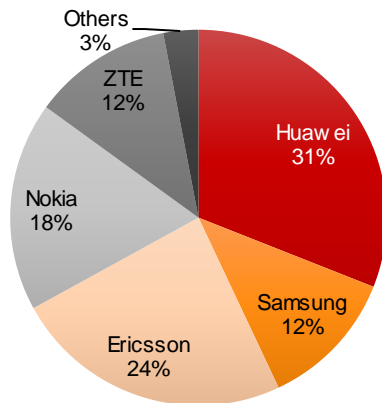
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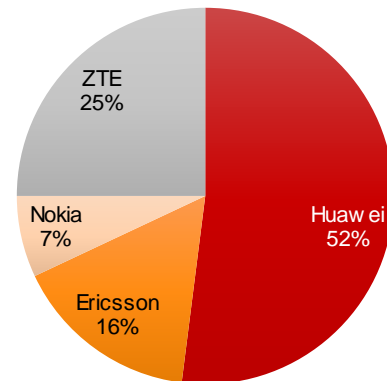
Focus Charts

Figure 1: Total network equipment market shares in 1H19



Source: IDC, HIS Markit, CMBIS

Figure 2: China network equipment market shares in 1H19



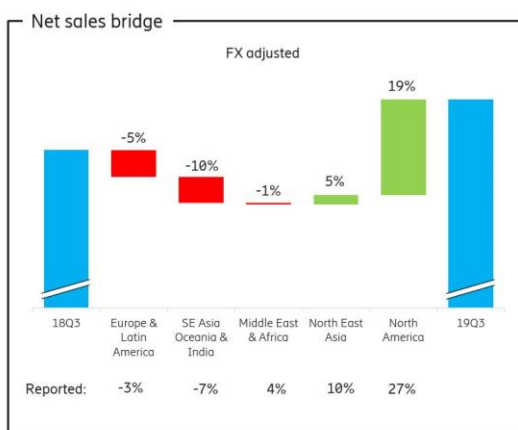
Source: IDC, HIS Markit, CMBIS

Figure 3: Ericsson's quarterly sales breakdown

(SEK mn)	Revenue			Growth		
	1Q19	2Q19	3Q19	1Q19	2Q19	3Q19
South East Asia, Oceania and India	6,148	6,965	7,432	-4%	0%	-7%
North East Asia	3,824	6,516	6,356	13%	37%	10%
North America	16,171	17,699	18,985	43%	23%	27%
Europe and Latin America	13,124	14,085	14,308	1%	1%	-3%
Middle East and Africa	5,412	5,641	6,046	-8%	-3%	4%
Others	4,227	3,904	4,000	21%	-1%	-13%
Total	48,906	54,810	57,127	13%	10%	6%

Source: Company data, CMBIS

Figure 4: Ericsson's 3Q19 sales breakdown by markets



- Europe & Latin America
 - Growth in Europe (Networks and Digital Services) offset by decline in Latin America (large deployments in 2018)
 - Decline in Managed Services from exited contracts
- South East Asia, Oceania & India
 - Strong Managed Services sales
 - Digital Services declined due to lower legacy product sales
- Middle East & Africa
 - 4G and 5G deliveries in key markets
 - Decline driven by contract exits in Managed Services
- North East Asia
 - 5G deliveries in South Korea
 - 4G deployments in mainland China slowed down
- North America
 - 4G and 5G investments
 - Strong Managed Services sales

Ericsson equipment (radio and core) in 19 live 5G networks

Source: Company data

Peers comparison

Company	Ticker	Market Cap (US\$ mn)	Price (LC)	P/E (x)		P/B (x)		ROE (%)	
				FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Equipment									
ZTE	763 HK	17,809	20.70	17.8	14.7	2.5	2.2	15.7	16.0
FiberHome	600498 CH	4,509	27.19	32.6	26.1	2.9	2.6	9.1	10.4
Nokia	NOK US	29,500	5.23	22.2	13.0	1.9	1.9	5.5	7.6
Ericsson	ERIC US	30,221	9.06	30.6	17.3	3.5	3.1	6.7	17.5
Average				25.8	17.8	2.7	2.4	9.3	12.9
Optical Fiber/Cable									
YOFC	6869 HK	2,449	12.56	11.0	8.5	1.0	0.9	9.0	9.4
Hengtong	600487 CH	4,074	15.42	12.5	11.1	2.0	1.7	16.1	18.0
FiberHome	600498 CH	4,509	27.19	32.6	26.1	2.9	2.6	9.1	10.4
Average				18.7	15.2	2.0	1.8	11.4	12.6
OC									
Accelink	002281 CH	2,792	28.96	48.7	36.2	4.9	4.4	10.3	12.6
Innolight	300308 CH	4,059	40.15	42.3	28.7	4.2	3.7	11.2	13.9
O-Net	877 HK	422	4.03	13.2	11.3	1.3	1.2	9.4	10.9
FIT	6088 HK	2,991	3.17	11.0	9.8	1.4	1.2	12.7	13.0
Average				28.8	21.5	2.9	2.6	10.9	12.6
Antenna/RF									
Comba	2342 HK	572	1.77	29.2	13.1	1.2	1.1	3.8	7.6
Tongyu	002792 CH	1,240	26.65	61.9	31.1	4.3	3.8	5.8	12.0
Mobi	947 HK	90	0.87	-	-	-	-	-	-
Sunway	300136 CH	5,093	37.43	32.0	25.0	7.5	5.8	24.7	24.1
Luxshare	002475 CH	21,921	29.40	31.6	23.0	6.0	4.8	18.9	20.8
Average				38.7	23.0	4.7	3.9	13.3	16.2
PCB/CCL									
Shennan	002916 CH	7,302	156.35	48.9	35.5	10.8	8.6	23.5	25.2
Shengyi	600183 CH	8,013	25.53	41.0	33.1	7.2	6.2	18.1	20.0
WUS	002463 CH	5,969	25.41	37.9	29.1	8.2	6.7	21.8	22.6
Average				44.9	34.3	9.0	7.4	20.8	22.6
Infrastructure									
China Tower	788 HK	38,597	1.71	51.7	33.7	1.5	1.4	2.9	4.2
CCS	552 HK	4,194	4.48	9.5	8.4	0.9	0.8	9.3	9.8
Average				30.6	21.1	1.2	1.1	6.1	7.0

Source: Bloomberg, CMBIS

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