Getting bullish on Asian 5G - Global Weekly Review

October 11, 2019 by Chris Hoare

This week we published on our evolving and more upbeat thesis on Asian consumer 5G (HERE), having visited the telcos in China (see HERE for feedback), Korea (HERE) and Japan (HERE) as well as Huawei (HERE).

Despite downbeat expectations we now see the potential for 5G to drive meaningful revenue growth improvements in those countries in Asia that are able to monetise as they have the capacity in place. The 5G handset price premium is dropping rapidly suggesting limited barriers to uptake. Operators are expected to see a c. 20% 5G ARPU uplift in the region, and we think the core use cases (including interactive TV and cloud gaming) could lead to a step up in high end data volumes from c. 20GB/month to potentially 50-100GB/month or even higher.

In developed Asia, the core supply-side building blocks are in place for this demand to be monetised. As we show in the note, wireless capacity in these three countries (China, Korea, Japan) is several times higher than in Western Europe and the US. Japan for instance has indicative wireless network capacity of c. 4 Mbps per pop vs c. 0.5 in both Europe and the US. By the end of this year we expect the like-for-like 5G handset price premium to be as low as $100 and $25 by the end of 2021. As we are seeing in Korea (and already in China where there are reports of 9 million 5G subscribers, well before official commercial launch), we expect Asian consumer demand to be strong.

5G monetisation is expected to be at a c. 20% premium to 4G in these markets. If 5G penetration follows a normal s-curve, reaching c. 85% of the base after 5 years, we show in the note that this would lead to a revenue boost of up to 4% per year compared to the “no-5G” case. Even in countries such as Korea and China where price regulation tends to be tough we would expect regulators to allow the operators to monetise during the heavy capex phase, before forcing price cuts later, as they largely did during the 4G cycle. What this means is that companies which gain share through 5G could see revenue growth move to high single digit levels. We would highlight LG U+, China Telecom and Softbank in this regard.

Japan and Korea are the two best markets to play this in our view, given that in China we continue to forecast capex to come in higher than consensus (HERE).

In Korea the stocks have suffered over the last year as reality around capex and initial 5G competition becomes embedded. This is exactly what we saw in the move to LTE back in 2012, before the stocks rallied almost 70% as revenue growth rallied. We see similar trends developing in Korea, with 5G ARPU 20% higher than 4G and 5G take-up surpassing that of the move to LTE in 2012. The question is what stock to own? In the note we published this week, LG Uplus is the operator most exposed, and we upgraded to a Buy (LINK). The story is very compelling: Firstly, LG’s subscriber base are early adopters and we are already seeing its subscriber base move more rapidly to 5G based off the initial numbers. Secondly, LG is the operator most exposed to the mobile story in Korea with around 60% of revenues driven by mobile, unlike KT where only 30% of revenues come from mobile. And finally, LG’s execution is superior. The operator has been consistently gaining share in an LTE world with stronger branding and reputation, as well as solid network performance. It has allowed the operator to steadily gain share – something we could envisage continuing.

So, by how much can LG’s revenue growth accelerate? A bottom-up analysis could see growth increase from 2% in Q219 to almost 8% in Q120. But this doesn’t allow for potential upside surprise on subscriber take-up or LG’s ability to take subscriber share from competitors – this could see it recording double-digit growth like it did in the move to 4G whilst the stock rallied 140% from trough to peak. It’s certainly a stock that could be the poster-child for 5G development in Asia, and one investors should watch closely.

In Japan (HERE) the set up is particularly interesting. 5G launches in March, which is also when Rakuten is supposed to launch. The market is expecting ARPU weakness on increased competition whereas we see some chance of ARPU strength on 5G. Thus if Rakuten’s launch is relatively soft, we could see revenue growth accelerate just as consensus expects it to weaken. This has happened before. When LTE rolled out, market revenue growth went from -1% to a 3- year CAGR of 5.5%. As we show in the note, market expectations “could” be up to 12% too low for annual revenue growth. We think 5G could well be the final nail in the coffin to the short Japan, and in particular the short Softbank Corp thesis.

We very rarely meet bulls on 5G. We see very little expectation that revenue growth will improve when 5G launches. But the signs are there, at least in those markets that can let rip on volume growth. 9m 5G customers in China prior to commercial launch. 5G ARPU premia of 20-30% in Korea, with 3m customers signed up in six months. A desire among the MNOs to monetise and a history of monetising 4G. If any of this leads to revenue improvement then it is likely that stocks which are exposed perform well.