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# Learnings from the first large scale 5G deployments in Asia

September 28, 2019 by Chris Hoare

We hosted a client tour visiting all the telcos in the early 5G markets in Asia: Japan (feedback HERE), South Korea (HERE) and China (HERE), and finished the trip with a day at Hauwei's HQ in Shenzhen (HERE). Our key takeaway is that we may have been too cautious on the likely revenue impact 5G & IoT is set to have on revenues in these markets. Thus our view shifts from seeing 5G as largely neutral to revenue and overall a negative because of the impact on capex, to potentially a meaningful positive driver of shareholder returns through higher growth. Running the math on this and it seems plausible for the winning companies in these markets (which we would see as Softbank, LG U+, China Telecom) to see mobile service revenue growth head towards high single digit, or even low double digit as the 5G wave impacts their business models, with potentially significant impacts on equity valuations. However, we would hesitate to read across from what is happening in these markets to a more positive view on 5G globally especially in markets which don't have the site density and capacity to satisfy very high levels of traffic as high end packages shift from 20-30GB/month to 100-200GB/month (and to 'properly unlimited' services).

Our first stop was Tokyo (feedback HERE). We came away strengthened in our view that there is sufficient flexibility within the incumbent business models to weather significant revenue pressure if Rakuten proves disruptive, without cash flows and shareholder returns being substantially damaged, but more importantly that 5G and growing IoT revenues may leading to a further revenue acceleration despite Rakuten. The market seems to be pricing returns erosion, but increasingly the stocks seem likely to deliver returns accretion. Hence our bullishness. Our central case has been that while the market is focused on top line pressure (price cuts & Rakuten launch), there is much the industry can do to offset this (HERE). As a result, we do not believe that an inflection in the top line will lead to an inflection in ROIC. By contrast, we think returns will stay strong, and with the operators under increasing pressure to increase payouts to match SB KK's valuation. The path for investors in NTT or the pure mobile operators is positive from here in our view under our central case. However, there is a second possibility which now seems increasingly likely post our trip: namely that 5G & IoT are increasingly monetizable. 5G, due to a price premium and consumers tiering up, leading to growing B2C revenues, and healthy demand for NB-IoT leading to rising enterprise revenues. In total therefore there is the possibility of revenue acceleration just when the market anticipates Rakuten will drive revenue deceleration. For KDDI, DCM and NTT we see the prospect of guidance upgrades next quarter. KDDI is our top pick followed in order by SB Corp, NTT, and DOCOMO.

Our visit to Korea (feedback HERE), suggests the possibility that history is repeating itself. In the move from 3G to 4G (detailed HERE), we saw the stocks initially de-rate on the back of increased capex expectations and a ramp-up in subsidies. This is exactly what the Korean telcos have been facing over the last year as expectations fall to reflect the increased competitive intensity following the 5G launch in April. Our conversations with the operators suggest 2019 capex will peak, but likely to remain high for a few years. Consensus numbers now capture this risk, so what now? Looking at the 3G to 4G transition, this was a decent time to get involved in the industry. The key thing from our perspective is the revenue outlook. Can the operators monetise? It appears from our visit that consumers are wanting the service (net adds tracking well, speeds up to 1Gbps and data usage up ~50% from 4G levels) and are willing to pay for it. This is where the outlook becomes interesting. According to the companies, 70-80% of 5G net adds are choosing the higher priced packages (KRW80,000+). This suggests a 20% uplift in ARPU for those customers who were using 4G unlimited tariffs. If the momentum continues, and ~30% of customers are using 5G by the end of next year, revenue growth can return to the industry which has been hampered by regulatory initiatives which are now lapping. Signs of 5G monetisation and declining competitive intensity could trigger improved sentiment towards the Korean telcos. We will be watching developments closely.

Next stop was Hong Kong to meet the Chinese telcos. We believe we remain in the “phoney war” in China. The telcos reiterated their views from Q2 results, suggesting investment will be sensible and demand-led, although the actual figures discussed suggest higher capex than expected for CU & CT (less so for CM), HERE. This is the key in our view as we think 5G demand will be strong, providing the cover for telcos to announce accelerated capex plans, as 5G demand rises, exactly as we have seen in Korea. Thus we continue to expect capex to surprise to the upside, based on the potential perceived benefit to this from Beijing. The good news is that once the market has absorbed the capex dynamic we think the companies will be in a strong position to monetise higher 5G usage through premium priced packages. Furthermore, since all Chinese operators will launch standalone 5G early next year they will be in a strong position to get the full benefit of 5G, for instance charging gamers a premium for a low latency product using network slicing. Experience in 4G was that regulatory pressure eased during the build out phase and that would seem to make sense in 5G too, and there are clearly signs of competition easing with all the telcos starting to charge for out of bundle data usage rather than speed-throttling. However, that is 12-18 months away; investors need to get through the capex story before looking towards any potential sunlit uplands, in our view. Falling capex expectations & CU/CT co-build have led to a modest rally. We would advise fading this as we think higher capex will still surprise. We got no sense that there has yet been a revenue recovery, suggesting for the time being earnings momentum will remain negative (perhaps except for China Telecom who continue to outperform operationally). We retain our Reduce recommendations on both CT & CM, Neutral on CU and Buy on China Tower.

Finally, we met the Carrier Division of Huawei in Shenzhen. As with our individual company meetings, key takeaways were a slightly more optimistic view of the potential service revenue opportunity in certain Asian markets for 5G and IoT (as might be expected from a drum-beating vendor). In particular, Huawei seemed to confirm our view that Chinese 5G deployment will be broader than the market currently expects and that there should be an opportunity to monetize rapidly rising consumer demand (Huawei’s view is high end users will move from c. 15-20GB/month to 100-200 GB/month or unlimited packages). Huawei also has a view that IoT will be a stronger driver of revenues in certain Asian markets (especially Japan and China) than we had thought.

Overall therefore, we came away from our trip with a more bullish view that 5G (and IoT) may deliver improved revenue trends in those markets which really commit to investment (China, Japan, Korea). Once the capex story has played out, we think there is an increasing potential for revenues to surprise the market in these markets suggesting an improving equity story. Japan is, in our view, the best way to play this at this stage given bearishness around Rakuten’s entry and the ability of the incumbents to launch 5G within existing capex envelopes (for our Japan thesis see HERE), but LG in Korea seems to be an increasingly bullish equity story too.

**Full 12-month historical recommendation changes are available on request**

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