

Networking sector

Promising future for AI; telecoms to trough

Key message

1. End-demand from telecom operators has nearly bottomed out; demand for infrastructure remains sluggish.
2. Demand for AI is robust; 1.6T era in sight.
3. Amongst Taiwanese networking operators, Accton Technologies (2345 TT, NT\$544, OP) is our top pick to benefit from the data center upgrade trend.
4. As telecom operator and enterprise demand recovers, we prefer Wistron NeWeb (6285 TT, NT\$162, OP).

Event

End-demand from telecom operators nearly bottomed; demand for infrastructure remains sluggish. Ericsson (SE) and Nokia (FI) revealed their 2024 outlooks in 1Q24 analyst meetings. Nokia suggested fixed-access business has recovered since 4Q23, that internet infrastructure business will resume growth, and that the mobile network market demand will stay in the doldrums in 2024. Similarly, Ericsson believes global 2024 RAN demand will remain weak and miss consensus of a 4% YoY decline. Cisco (US) stated demand from telecoms and consumer clients will remain lukewarm, but signs of a recovery are emerging. As demand from campuses and data centers has been relatively positive, the firm expects inventory adjustment from clients to come to an end before end-FY24 (FY ends July), echoing Broadcom's (US) view that demand will trough in 2Q24. US telecom operators, such as Verizon, AT&T, T-Mobile, and Comcast, are focused on fixed-access related business, and we thus believe inventory correction for telecoms' fixed-access-related products is in its later stages.

Demand for AI remains robust; 1.6T era in sight. Cisco holds firm to its view that AI-related orders will reach US\$1.0bn in 2025, and states that it will continue to negotiate with clients for more orders. Arista (US) guides that in addition to focusing on AI development, its cloud clients have expanded construction for conventional cloud business. Meanwhile, demand from telecoms and enterprises has started to recover. Arista also guides AI-related sales will reach US\$750mn (1Q24 total sales of US\$1.57bn) and connect 10k-100k GPUs in 2025. Arista and Celestica (US) both believe 800GbE products will be the main spec for high-end switches deployed in data centers. Coherent (US) and Lumentum (US) both guide 1.6T related products will start to contribute to sales in 2025. Hence, regarding data center networking products, we are upbeat about AI-related demand. Demand for conventional data centers is also recovering. As specification upgrades continue, 800GbE products will be the mainstream spec for high-end switches in 2025F, while an upgrade to 1.6T is also underway.

Stocks for Action

For Taiwanese networking operators, Accton Technologies (2345 TT, NT\$537, OP) is our top pick to benefit from the data center upgrade trend. As telecom operator and enterprise demand recovers, we prefer Wistron NeWeb (6285 TT, NT\$165.5, OP), as it has multiple sales catalysts, such as fixed wireless access (FWA), charging piles, and low-Earth-orbit (LEO) satellites. According to 1Q24 results and guidance, we adjust our target prices for Arista and Cisco to a respective US\$372 (35x 2025F EPS) and US\$53 (15x 2025F EPS) and maintain Outperform. We maintain Neutral and revise our target price to US\$40 on Comcast (2024F EPS of US\$4).

Risks

Disappointing demand for AI, telecom and enterprise clients demand recovery slowdown; macroeconomic risks.

Figure 1: Breakdown of 1Q24 results & 2Q24 & 2024 guidance for networking firms in Europe & the US vs. consensus

Company	Ticker	CY1Q24 Review Sales (US\$bn)	EPS	CY2Q24 & CY2024 Guidance vs. Consensus Guidance	Consensus	Industry View
Nokia	NOK US	5.07	0.1	2024 operating profit of €2.3-2.9	€2.46bn	<ul style="list-style-type: none"> - 4Q23 fixed-access business improved; 2024F network infrastructure business to resume growth - 2024F demand from mobile networks to remain sluggish, with India weakening and North America remaining slow - The company guides mobile network business will fall by 10-15% YoY in 2024F, versus a consensus RAN market decline of 4% YoY
Ericsson	ERICB SS	5.13	0.07	1Q24 networking department sales grew 8% QoQ to kr36.4bn	kr38.1bn	<ul style="list-style-type: none"> - 2024F global RAN demand to remain sluggish; the firm says consensus RAN market demand decline of 4% YoY a bit optimistic - In North America, inventory normalizing and AT&T orders will bear fruit in 2H24F - 2H24F India market will decline YoY, on normalizing investment and customers' prudent spending - 2024F North America sales sustainable on Open RAN related orders of US\$14bn from AT&T for 2024-25F
Verizon	VZ US	33	1.15	2024 adjusted EPS of US\$4.5-4.7	US\$4.58	<ul style="list-style-type: none"> - FWA users up 354k, versus 380-400k per quarter in the past - 1Q24 FWA users hit 3.43mn. Company maintains the high end of the 4-5mn user target will be attained earlier than expected - 2024F capex guidance of US\$17-17.5bn maintained - End of ACP (Affordable Connectivity Program) to affect sales by less than 0.5%
T-Mobile	TMUS US	19.6	2	2024 adjusted EBITDA of US\$31.4-31.9bn	US\$31.5bn	<ul style="list-style-type: none"> - 1Q24 FWA users increased by 405k to 5.18mn, slower than 540k in 4Q23, versus an average rise of 500-550k per quarter in the past; 2025F FWA user target is 7-8mn. - Will invest US\$950mn together with EQT and add US\$500mn in 2027-28F to jointly buy Lumos, an optical fiber network supplier, aiming to cover 3.5mn households in 2027-28F - 2024F capex guidance of US\$8.6-9.4bn unchanged
AT&T	T US	30	0.55	2024 adjusted EPS of US\$2.15-2.25	2Q24 sales of US\$30.1bn 2Q24 EPS US\$0.57	<ul style="list-style-type: none"> - Full-year capex guidance of NT\$21-22bn unchanged - Added 252k optical fiber users in 1Q24; optical fiber network remains primary growth driver; the network covers 27.1mn stations, to rise to 30mn stations by end-2025F - 1Q24 FWA users increased by 110k to 200k
Celestica	CLS US	2.21	0.86	2Q24 adjusted EPS of US\$0.75-0.85	US\$0.77	<ul style="list-style-type: none"> - 1Q24 enterprise sales up 72% YoY to US\$685mn, higher than 60% guided at last analyst meeting, driven by AI & ML - 2024F sales weighting of large cloud service suppliers to be higher than the 62% in 2023 - Management believes the unit price of 800G products is less than 2x that of 400G products and hinges on shipments; 2025F 400G shipments to slow and be replaced by 800G products
Comcast	CMCSA US	30.1	1.04	No guidance provided	2Q24 sales of US\$31.4bn	<ul style="list-style-type: none"> - Lost 65k domestic broadband customers in 1Q24. Management says slower declines in users unlikely near-term as ACP is about to end - Wireless customers rose 21% YoY to 700k. Management says wireless business has huge room to grow, with current penetration of just 11% of household broadband users - Theme park-adjusted EBITDA fell 3.9% to US\$632mn on higher operating expenses. Management still optimistic about long-term growth opportunities. - Streaming service Peacock increased paying customers by 3mn this quarter, to 34mn. Adjusted EBITDA losses continued narrowing. Paris Olympics a potential sales driver.
Coherent	COHR US	1.21	0.53	2Q24CY (4Q24FY) sales of US\$1.23-1.32bn Adjusted EPS of US\$0.52-0.68	Sales of US\$1.27bn Adjusted EPS of US\$0.58	<ul style="list-style-type: none"> - 800G products sales up 80% QoQ to US\$200mn. FY4Q24F (fiscal year ends June) related sales to be over US\$250mn - 1.6T products to start pilot run in FY1Q25, with commercial production in CY25 - Demand for general networking capex squeezed by AI and 800G product shipments - Telecom business demand weak and recovery slower than expected
Lumentum	LITE US	0.37	0.29	1Q24CY (3Q24FY) sales of US\$290-315mn Adjusted EPS of US\$0.05-0.1	Sales of US\$310mn Adjusted EPS of US\$0.06	<ul style="list-style-type: none"> - 100G EML sales up 200% QoQ on capacity ramp-up in Japan plant; 100G VCSEL to debut in 2H24F - 200G EML used in 800G/1.6T to help drive growth in CY25 - 1.6T products to be made in Thailand plant - EML/CW laser/VCSEL data center-use products to contribute over US\$300mn in sales a year (17% of FY23 sales)
Arista	ANET US	1.57	1.99	2Q24 sales of US\$1.62-1.65bn	US\$1.62bn	<ul style="list-style-type: none"> - Recently, cloud & titan customers have extended focus from AI to traditional cloud deployment; SP and enterprise demand improving - Order visibility increased from 3 months to over 6 months; FY24 full-year sales to grow 12-14%, up from 10-12% in FY23 - 2025F AI sales guidance of US\$750mn with plans to connect 10k-100k GPUs - 800GbE switch ecosystem to be more mature in 2025F & to ramp up in 2025-26F - Company will branch out to enterprise products, focusing on network security related products first
Cisco	CSCO US	12.7	0.88	4Q24FY sales of US\$13.4-13.6bn Adjusted EPS of US\$0.84-0.86	Sales of US\$13.54bn Adjusted EPS of US\$0.84	<ul style="list-style-type: none"> - Telecom & consumer customer demands still low, but have shown signs of recovery; campus & data center demand to improve. - Expecting customer inventory adjustment to end by the end of FY2024 (July). - 2025F AI-related orders of US\$1bn; plans to negotiate for more related orders - Remain positive on profitability & meeting corporate enterprise demand post-Splunk M&A.

Source: Company data; Bloomberg; KGI Research

Figure 2: Breakdown of Arista's 1Q24 results & 2Q24 forecast revisions vs. consensus

US\$m	1Q24					2Q24F				
	Actual	Consensus	Diff. (%)	QoQ (%)	YoY (%)	Guidance (Midpoint)	Consensus	Diff. (%)	QoQ (%)	YoY (%)
Revenue	1,571	1,551	1.3	2.0	16.3	1,635	1,618	1.0	4.0	12.1
Breakdown										
Product	1,329	1,323	0.4	1.4	13.4		1,380			
Service	243	226	7.5	5.4	35.3		235			
Gross profits	1,001	962	4.1	(0.6)	24.5		1,014			
Product	807	782	3.2	(0.9)	21.7		826			
Service	194	180	8.0	5.1	37.5		188			
Product_cost	522	541	(3.6)	5.2	2.5		554			
Service_cost	48	46	5.5	6.5	27.2		47			
Total expenses	827	890	(7.1)	(8.1)	4.1		928			
Operating income	744	660	12.7	16.3	33.6		690			
EBITDA	760	669	13.5	16.1	31.5		697			
Pretax income	723	703	2.8	4.1	27.6		738			
Net income	638	552	15.6	(4.0)	40.9		580			
EPS (US\$)	1.99	1.73	15.0	(4.3)	39.2		1.81			
Gross margin (%)	63.7	62.0	1.7 ppts	(1.7)ppts	4.2 ppts	64.0	62.7	1.3 ppts	0.3 ppts	3.4 ppts
Product	60.7	59.1	1.6 ppts	(1.4)ppts	4.2 ppts		59.8			
Service	80.1	79.7	0.4 ppts	(0.2)ppts	1.3 ppts		80.2			
OP margin (%)	47.4	42.6	4.8 ppts	5.8 ppts	6.1 ppts	44.0	42.7	1.3 ppts	(3.4)ppts	2.4 ppts
EBITDA margin (%)	48.3	43.1	5.2 ppts	5.9 ppts	5.6 ppts		43.1			
Net margin (%)	40.6	35.6	5.0 ppts	(2.5)ppts	7.1 ppts		35.8			

Source: Company data; Bloomberg; KGI Research

Figure 3: Arista's 2021-25F financial results & forecasts

	Dec-21A	Dec-22A	Dec-23A	Dec-24F	Dec-25F
Revenue (US\$m)	2,948	4,381	5,860	6,711	7,702
Gross profit (US\$m)	1,910	2,711	3,667	4,256	4,984
Operating profit (US\$m)	1,141	1,796	2,257	2,978	3,558
EBITDA (US\$m)	1,191	1,859	2,328	2,999	3,742
Net profit (US\$m)	915	1,448	2,199	2,517	3,423
EPS (US\$)	2.87	4.58	6.94	7.88	10.62
Revenue growth (%)	27.2	48.6	33.8	14.5	14.8
EPS growth (%)	27.0	59.6	51.5	13.5	34.9
Gross margin (%)	64.8	61.9	62.6	63.4	64.7
Operating margin (%)	38.7	41.0	38.5	44.4	46.2
EBITDA margin (%)	40.4	42.4	39.7	44.7	48.6
Net debt to equity (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Return on average equity (%)	23.0	29.6	24.9	26.7	23.7

Source: Company data; Bloomberg; KGI Research

Figure 4: Arista's key operating indicators & weightings

Sales (US\$m)	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2023	2024F	2025F
Product	1,172	1,262	1,286	1,310	1,329	1,401	1,451	1,499	1,518	1,612	1,680	1,745	5,029	5,680	6,555
Service	179	197	224	230	243	251	263	276	277	279	292	298	831	1,032	1,146
Mix (%)															
Product	87	86	85	85	85	85	85	84	85	85	85	85	86	85	85
Service	13	14	15	15	15	15	15	16	15	15	15	15	14	15	15
YoY (%)															
Product	62	42	27	19	13	11	13	14	14	15	16	16	35	13	15
Service	18	19	33	29	35	27	17	20	14	11	11	8	25	24	11

Source: Company data; Bloomberg; KGI Research

Figure 5: Cisco's 3Q FY24 results vs. consensus

US \$mn	3Q24					Guidance	
	Actual	Consensus	Diff. (%)	QoQ (%)	YoY (%)	(mid-point)	Diff. (%)
Total revenue	12,702	12,656	0.4	(13.4)	(6.5)	12,200	4.1
Product	9,024	8,969	0.6	(19.0)	(11.1)		
Services	3,678	3,688	(0.3)	4.2	7.0		
Gross profits	8,675	8,430	2.9	(11.9)	(0.1)	8,319	4.3
Operating income	4,349	4,168	4.3	(19.1)	(1.5)	3,937	10.5
EBITDA	5,210	4,494	15.9	(9.8)	8.4		
Pretax Income	4,386	4,165	5.3	(6.9)	(2.4)		
Net income	3,553	3,347	6.2	(21.5)	(2.4)		
EPS (US\$)	0.88	0.82	7.3	(20.7)	0.0	0.85	3.5
Gross margin (%)	68.3	66.6	1.7 ppts	1.2 ppts	4.4 ppts	66.5	1.8 ppts
OP margin (%)	34.2	32.9	1.3 ppts	(2.4)ppts	1.8 ppts	34.0	0.2 ppts
EBITDA margin (%)	41.0	35.5	5.5 ppts	1.7 ppts	5.6 ppts		
Net margin (%)	28.0	26.4	1.5 ppts	(2.9)ppts	1.2 ppts		

Source: Company data; Bloomberg; KGI Research

Note: FY ends July

Figure 6: Cisco's 4Q FY24 & FY24 forecasts vs. consensus

US \$mn	4Q24F					2024F			
	Guidance (mid-point)	Consensus	Diff. (%)	QoQ (%)	YoY (%)	Guidance (mid-point)	Consensus	Diff. (%)	YoY (%)
Total revenue	13,500	13,250	1.9	6.3	(11.2)	53,700	54,294	(1.1)	(5.8)
Product		9,522					39,928		
Services		3,607					14,366		
Gross profits	9,045	8,850	2.2	4.3	(9.7)		36,423		
Operating income	4,320	4,398	(1.8)	(0.7)	(18.8)		18,315		
EBITDA		4,893					20,655		
Pretax Income		4,327					18,450		
Net income		3,505					14,942		
EPS (US\$)	0.85	0.87	(2.3)	(3.4)	(25.4)	3.70	3.67	0.8	(4.9)
Gross margin (%)	67.0	65.8	1.2 ppts	(1.3)ppts	1.1 ppts		67.1		
OP margin (%)	32.0	33.5	(1.5)ppts	(2.2)ppts	(3.0)ppts		33.7		
EBITDA margin (%)		35.9					38.0		
Net margin (%)		28.6					27.5		

Source: Company data; Bloomberg; KGI Research

Note: FY ends July

Figure 7: Cisco's 2021-25F financial results & forecasts

	Jul-21A	Jul-22A	Jul-23A	Jul-24F	Jul-25F
Revenue (US\$mn)	49,818	51,557	56,998	53,691	55,580
Gross profit (US\$mn)	32,914	33,326	36,788	36,131	37,434
Operating profit (US\$mn)	16,702	17,345	19,071	18,320	18,160
EBITDA (US\$mn)	18,564	18,824	20,930	20,500	20,050
Net profit (US\$mn)	13,636	14,094	15,979	15,099	14,330
EPS (US\$)	3.22	3.36	3.89	3.71	3.53
Revenue growth (%)	1.0	3.5	10.6	(5.8)	3.5
EPS growth (%)	0.3	4.3	15.8	(4.7)	(4.7)
Gross margin (%)	66.1	64.6	64.5	67.3	67.4
Operating margin (%)	33.5	33.6	33.5	34.1	32.7
EBITDA margin (%)	37.3	36.5	36.7	38.2	36.1
Net debt to equity (%)		Net Cash	Net Cash	Net Cash	Net Cash
Return on average equity (%)	33.9	33.8	35.7	32.6	29.9

Source: Company data; Bloomberg; KGI Research

Figure 8: Comcast's 1Q24 results vs. consensus

(US\$m)	1Q24				
	Actual	QoQ (%)	YoY (%)	Consensus	Diff. (%)
Revenue	30,058	(3.8)	1.2	29,833	0.8
Gross profit	21,236	1.1	2.6	20,883	1.7
Gross margin (%)	70.7	3.5 ppts	1.0 ppts	70.0	0.7 ppts
Operating profit	5,810	29.6	2.9	5,785	0.4
Operating margin (%)	19.3	5.0 ppts	0.3 ppts	19.4	(0.1) ppts
Pre-tax profit	5,105	18.7	(2.6)	4,864	5.0
Pre-tax margin (%)	17.0	3.2 ppts	(0.7) ppts	16.3	0.7 ppts
Income tax	1,328	49.0	(10.0)	1,281	3.7
Tax rate (%)	26.0	5.3 ppts	(2.1) ppts	26.3	(0.3) ppts
Net profit	4,171	22.3	7.6	3,925	6.3
Net margin (%)	13.9	3.0 ppts	0.8 ppts	13.2	0.7 ppts
Adj. EPS (US\$)	1.04	23.8	13.0	0.99	5.1

Source: Company data; Bloomberg; KGI Research

Figure 9: Comcast's 2021-25F financial status & forecasts

	Dec-21A	Dec-22A	Dec-23F	Dec-24F	Dec-25F
Revenue (US\$m)	116,385	121,427	121,572	123,877	123,230
Gross profit (US\$m)	79,273	83,206	84,827	86,136	86,797
Operating profit (US\$m)	20,895	22,615	23,314	23,061	24,346
EBITDA (US\$m)	34,708	36,459	37,633	37,046	38,809
Net profit (US\$m)	15,044	16,147	16,493	15,425	16,423
EPS (US\$)	3.23	3.64	3.98	3.98	4.48
Revenue growth (%)	12.4	4.3	0.1	1.9	(0.5)
EPS growth (%)	23.8	12.7	9.3	0.1	12.5
Gross margin (%)	68.1	68.5	69.8	69.5	70.4
Operating margin (%)	18.0	18.6	19.2	18.6	19.8
EBITDA margin (%)	29.8	30.0	31.0	29.9	31.5
Net debt to equity (%)	106.5	127.2	120.8	108.0	104.6
Return on average equity (%)	15.3	19.7	19.8	18.8	18.3

Source: Company data; Bloomberg; KGI Research

Figure 10: Comcast's product mix

Sales (US\$m)	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	2023	2024F	2025F
Connectivity & platforms	20,152	20,360	20,271	20,670	20,275	20,288	20,224	20,423	20,051	20,084	19,993	20,160	81,453	81,210	80,288
Content & experiences	11,075	11,505	10,559	11,499	10,374	9,823	11,717	11,280	10,002	10,167	10,719	11,601	44,638	42,667	42,942
Product mix (%)															
Connectivity & platforms	65	64	66	64	66	67	63	64	67	66	65	63	65	66	65
Content & experiences	35	36	34	36	34	33	37	36	33	34	35	37	35	34	35
YoY (%)															
Connectivity & platforms	-	-	-	-	0.6	(0.4)	(0.2)	(1.2)	(1.1)	(1.0)	(1.1)	(1.3)	-	(0.3)	(1.1)
Content & experiences	-	-	-	-	(6.3)	(14.6)	11.0	(1.9)	(3.6)	3.5	(8.5)	2.8	-	(4.4)	0.6

Source: Company data; Bloomberg; KGI Research

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