

The 2Q 2022 results show that Ericsson and Nokia are sowing the seeds of future revenue growth

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Ericsson and Nokia both recently announced their 2Q 2022 financial results. The figures themselves were solid rather than spectacular, but they provided some positive indicators for the network equipment business in general, as well as some insights into the two vendors' contrasting turnaround strategies.

Ericsson's and Nokia's businesses are very similar in many ways. The companies are a similar size in terms of total revenue and profit, and they are both long-established major suppliers to the telecoms industry. Both have also been through a recent period of decline and are in turnaround mode, with plans heavily tied to 5G.

However, the companies are also quite different in some notable ways, and their results suggest that they may diverge more significantly in the future. Nokia's wireline networks business is increasingly the revenue growth engine, while Ericsson hardly plays in this sector. Nokia has also made greater inroads into the direct-to-enterprise market, though Ericsson is now making stronger moves in this direction following the acquisitions of Cradlepoint and Vonage.

Ericsson and Nokia are both gaining confidence in their key mobile networks businesses

Both vendors reported solid results in 2Q 2022. Ericsson's wireless networks revenue continues to grow steadily (as it has in the past few quarters), while Nokia reported the first growth in its Mobile Networks division's revenue for three quarters. The headline figures were as follows.

- Nokia reported USD5.9 billion in sales, up by 3% year-on-year in constant currency. It also reported a net profit of USD470 million net profit, up by 31% year-on-year.
- Ericsson reported USD6.1 billion in sales, up by 5% year-on-year in constant currency. It reported a net profit of USD460 million.

Both companies reported significant increases in the number of 5G deployments and are optimistic for future growth. Business has been particularly strong for both vendors in North America, and that in Europe has been picking up, particularly for Ericsson. Both Nokia and Ericsson expect to benefit from increasing 5G traffic levels, which will require a continued expansion of 5G networks and a migration to 5G standalone.

Sales by Nokia's Mobile Networks business increased by 1% year-on-year (in constant currency) to EUR2.6 billion (USD2.7 billion). However, this growth was far lower than that in the Network Infrastructure unit (fixed, IP and optical and submarine equipment), sales for which grew by 12% at constant currency to EUR2.2 billion (USD2.3 billion). These two units are now approximately the same size in terms of sales revenue, but Nokia is still known primarily as a mobile business, so signs of a 5G-related turnaround have been essential to ensuring market and operator confidence.

Meanwhile, sales in Ericsson's Networks division rose by 6% year-on-year, driven by significant market share gains in RAN. Both vendors are positive in terms of the outlook for the RAN market for the next 2–3 years, mainly due to 5G network expansions.

Both vendors are grappling with supply chain challenges but are taking different approaches

Both companies have been grappling with a supply chain crisis and component shortages, the impact of which was highlighted in the results calls, along with the companies' contrasting responses. Nokia CEO Pekka Lundmark was more upbeat than his Ericsson counterpart, Börje Ekholm, about the year ahead, and expects component shortages to ease in the second half of the year. As such, Nokia forecasts a full-year increase in mobile networks sales of 5% year-on-year, even though they fell by 2% year-on-year for the first 6 months of 2022.

Pandemic-induced supply chain problems limited both companies' ability to ship some orders that had been placed. Ericsson took a more proactive approach and built a component inventory to ensure that it could fulfil its contracts. Nokia invested less in building up an inventory than Ericsson, and acknowledged that it could have done more mobile business if it had had more supplies. However, Ericsson's policy affected its gross margin because of the cost of stockpiling components. The stock markets responded negatively to Ericsson's results, mainly because of this margin drop, from 43.4% a year earlier to 42.1%. Nokia, which also reported a fall in gross margin from 40.9% to 40.2%, nonetheless received positive reaction from the stock markets, which were chiefly moved by new confidence in its mobile networks turnaround.

It is not just the supply chain issues that cast a cloud over the quarter. Neither vendor called it out, but the slow adoption of 5G standalone has also been dampening results by delaying core network deployments. This is particularly important to Nokia because a significant architecture change could enable it to win customers from Ericsson, rather than just expanding its existing installations.

Nokia may have judged the supply chain crisis better than Ericsson, but it still has to cope with other aspects of the global economic situation, such as the higher costs of components coupled with operators' reduced ability to pay high prices.

Both Ericsson and Nokia are looking beyond mobile networks to drive revenue growth

Mobile networking is the most important part of the business for both companies and both are evaluated broadly in terms of how well they are doing in this sector. However, both are also looking for growth in other areas. Nokia gets only about two thirds of its total revenue from mobile and does about 10% of its business with enterprises, while nearly all of Ericsson's revenue is from telecoms.

Ericsson is investing in technology and services to offer to enterprises: it acquired Cradlepoint in 2021 and Vonage in 2022. We think that both Nokia and Ericsson will put more emphasis on, and get more growth from, enterprise customers going forward, particularly as private 5G grows in importance (this is another area in which Nokia has some advantage).

Cloud services and cloud-based technology are other areas that both vendors are emphasising strategically for growth. Nokia has a cloud and network services segment that it breaks out in financials, while Ericsson

announced the creation of a new Cloud Software and Services business unit in 2Q 2022, which it will be reporting on in the future.

The 2Q 2022 results show that Ericsson and Nokia have similar revenue and profits, both driven most immediately by the degree of 5G adoption and their ability to win and deliver that business. Currently, Ericsson is more successful; Nokia is scrambling to recover from missteps of years past. Looking forward, success in 5G will continue to be the biggest factor for both, but enterprise business and cloud services (where Nokia has the stronger position) are likely to provide greater revenue growth than the traditional mobile RAN business.