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International Stock Market Weekly

Telecom/Infrastructure

Aviat Networks (AVNW.US)

The tech industry has been one of the major beneficiaries of the pandemic and reached new highs in 2020. While the tech titans undoubtedly delivered mind-boggling results last year against the broader indices, they now face regulatory headwinds from governments across the globe, which means they run the risk of declining operational efficiency going forward. However, the tech sector will continue to grow at an incredible rate as the world transforms to accommodate a virtual lifestyle, and some small names in the sector are now well positioned to capitalize on these developments by expanding their businesses and R&D research. Accordingly, we believe companies with considerable growth potential such as Aviat Networks will outpace the industry leaders and generate bigger returns for investors.

The company is the leading player in the wireless transport solutions business and a global provider of microwave networking solutions to public and private operators in communications networks. As the global rollout of 5G accelerates, Aviat is playing a key role in the building of the infrastructure. The company's products enable its customers to accommodate rapidly growing IP-centric, multi-gigabit data services.

Aviat is well-positioned to capitalize on the tremendous market opportunity from the rollout of 5G around the world. It provides the required equipment for critical communications, enables rural regions to have access to broadband, and can take advantage of the demand from emerging economies. At present, the company has a 6% market share and so has ample opportunity for growth. The company is positioned to capture growth thanks to the strong incumbency to grow with the installed base, its compelling value proposition to capture new Tier 2/ ISP accounts and expand its reach with reseller agreements. It offers highly differentiated solutions with innovative products and services for lower TCO while its software and services simplify the microwave lifecycle. It is now expanding its e-commerce and supply chain capabilities to disrupt go-to-market models. Further, it has engaged in several cost-improvement initiatives to drive greater shareholder value including the restructuring of USD3.5mn annualized run rate savings in FY21 and the potential for additional OPEX and COGS savings.

Stock pick for the fourth week of February

Aviat Networks (AVNW.US)

Global rollout of 5G catalyzed by the pandemic

Smaller tech companies with considerable growth potential such as Aviat Networks to outpace the industry leaders and generate bigger returns for investors.

Aviat Networks (NASDAQ: AVNW) designs, manufactures, and sells wireless networking products, solutions, and services. Its products include broadband wireless access base stations, customer premises equipment for fixed and mobile networks, and point-to-point digital microwave radio systems for access, backhaul, trunking, and license-exempt applications. Aviat distributes its products via direct sales to customers as well as agents and resellers.

Aviat crushed expectations with its last earnings release and management guided for lower 2H21 revenues but indicated that their view was on the conservative side. The company boasts a low valuation, decent profitability, robust FCF and is now back to YoY growth, which should help the shares reach multi-year highs. In our view, Aviat is undervalued relative to peers in the technology space and also when compared Ceragon Networks (CNRT.US), its closest competitor. While Aviat's fundamentals are far superior to Ceragon's, the former trades at a ratio that is about half of the latter's 1.3x EV/revenue.

For 2Q FY21, Aviat's revenues jumped by 26% YoY to USD70.5mn, the highest quarterly revenue in more than five years and markedly higher than the consensus. Gross margins surged 550 bp from the previous year to 38.3%, a record high. Adjusted EBITDA climbed from USD0.04mn in 2Q20 to USD10.1mn and cash continues to grow on the b/s at an accelerating rate as the company is debt free. Product sales revenue rose 36.7% YoY to USD 46.69mn, and revenue from services climbed 9.1% YoY. The company reported net income of USD6.64mn, a considerable improvement from the net loss in Q2 FY20. The present EPS estimate is USD0.73 for the quarter ending Mar 31, 2021, up 87.2 YoY. We are also heartened by the fact that the company has managed to beat consensus for the past four consecutive quarters. In addition, the consensus estimate is USD262.9mn for FY21, up 10.2% from the previous year ago.

The company raised its full-year guidance from USD245mn-255mn to USD255-265mn and its adjusted EBITDA projections from USD18mn-22mn to USD28mn-31mn. Management is very confident on the company's business trajectory going forward and emphasized that guidance was very conservative.

Aviat's stock has been on the move with a string of positive news announcements: on February 16 the company announced that ISP provider LTD Broadband, which was a major recipient of the Washington's Rural Digital Opportunity Fund (RDOF) and will deploy Aviat's WTM 4000 microwave and multi-band platform systems in its network middle mile as well as for fiber redundancy. The company also just announced the winning of the Dish Network (DISH.US) deal for microwave transport and we think these are the first of what will be an ongoing flow of positive announcements about new deals.

Rationale

Aviat Networks has started what should be a multi-year growth in profits thanks to the accelerating rollout of 5G. Investments in hardware, software, and services, which will enable Aviat to enjoy a sustained ramp-up in profitability going forward. In the coming years, 5G will have a marked impact on backhaul networks. According to ABI Research on the top 30 markets, 5G mobile subs will grow at a CAGR of 41.2% between 2021-27, up from 378mn subs in 2021 to 4.2bn in 2027. Traffic will skyrocket to 6,268 exabytes annually by 2027, with 5G making up 83% of total traffic.

Aviat is well-positioned in the fast-growing wireless transport market. The company has multiple growth drivers including 5G networks, which require greater capacity and new services, public safety and security-related communications, which is a long-term trend and is driving demand for the company end-to-end solutions, and according to Inkwood Research the communications sector has a CAGR of USD13.2%, which amounts to USD799bn by 2027. For rural broadband, the segment is seeing strong growth today and the US government has committed to developing rural areas which will drive further growth. In addition, initiatives to connect the unconnected in emerging economies is another area creating demand for Aviat solutions. The company is simplifying the complex transport business which creates opportunities for lucrative new software and service offerings, and it is creating new business by removing the cost from the transport lifecycle.

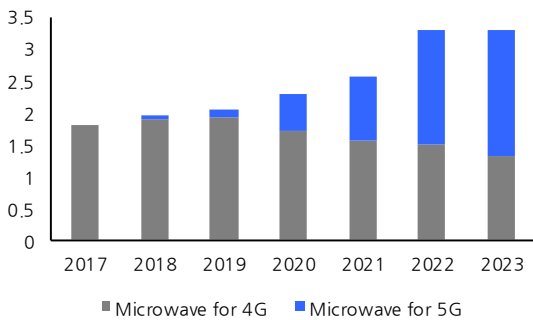
The COVID-19 pandemic is catalyzing the race for rural connectivity around the world. While the subject of providing broadband services to unserved and underserved communities has been a discussion among governments for years, the global pandemic has accelerated the deployment of these services. High-speed Internet is now considered a critical service with people working from home, students distance learning, the rising use of telemedicine, and entertainment, work, and social gatherings now taking place virtually, all via the Internet. This has created an urgent need in rural areas where broadband access is either absent or underserved. Washington recognized the urgency of providing access to rural parts of US and created a USD20bn fund to construct broadband networks in underserved and unserved parts of the country. The first of this grant totally USD9.2bn is being used to provide high-speed broadband to 5.2 million homes and businesses. The largest grant was awarded to LTD Broadband, a regional service provider which will expand its services from its current five states to 15 and is working with Aviat to support its RDOF buildout with Aviat solutions. And there are global solutions similar to the Washington's RDOF initiative which provides an unprecedented growth opportunity with its superior solutions.

Aviat's solutions include best-in-class wireless transport products which feature the industry's highest capacity, highest power ratios, and are the first to integrate microwave and IP/MPLS routing. They are unique multi-band solutions for 5G. Its software and services are highly differentiated and are the industry's only interference monitoring software for microwave. It has full turnkey services, including a network operations center. Its Provision Plus and Aviat Design enables network automation. The company also offers disruptive delivery and supply chain offerings with e-commerce as a go-to market model for its Aviat Store. The company manufacturers in the US and internationally and boasts the industry's best lead times.

Microwave radio systems provide low initial costs, high scalability, service flexibility, and rapid deployment which allows customers to migrate at their discretion. These microwave solutions will enable the faster and more profitable 5G rollouts as carriers continue to provide legacy services and Aviat has is better positioned with its unique offerings to enjoy substantial growth in the years ahead. In short, the company is highly differentiated in 5G, public safety, and rural broadband applications, which makes for a compelling growth story, in our view.

Aviat’s stock has been on the move with a string of positive news announcements recently such as being selected by a US Tier 5G operator as its key microwave transport vendor; and the winning of the Dish Network (NASDAQ: DISH) deal for microwave transport. Dish selected Aviat as its key supplier for 5G microwave equipment for its nationwide deployment of a 5G wireless network, as part of its efforts to become the fourth largest national wireless provider in the US. As part of the deal, Dish will deploy Aviat hardware and software by procuring them from the Aviat Store platform.

Fig 1. 5G is driving demand



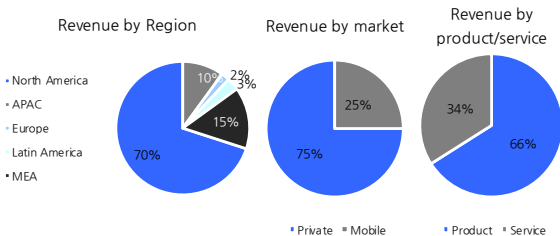
Source: Omdia, Hyundai Motor Securities

Fig 2. 5G fueling Aviat’s growth



Source: Aviat Networks, Hyundai Motor Securities

Fig 3. Global business FY Q221



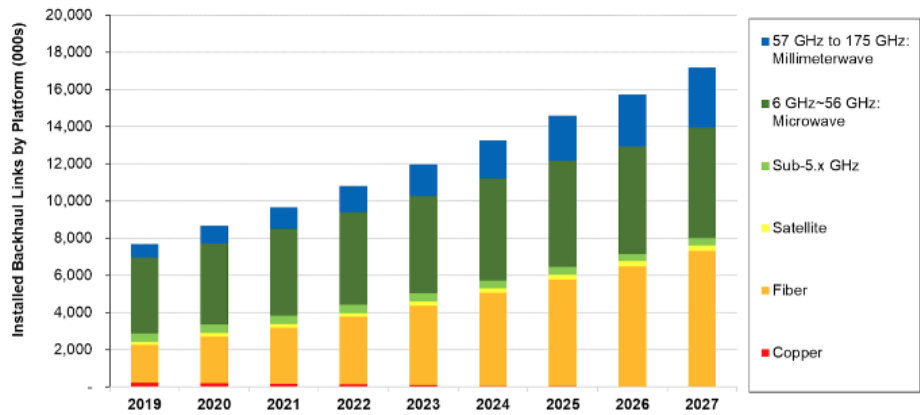
Source: Aviat Networks, Hyundai Motor Securities

Fig 4. Global presence, service and support



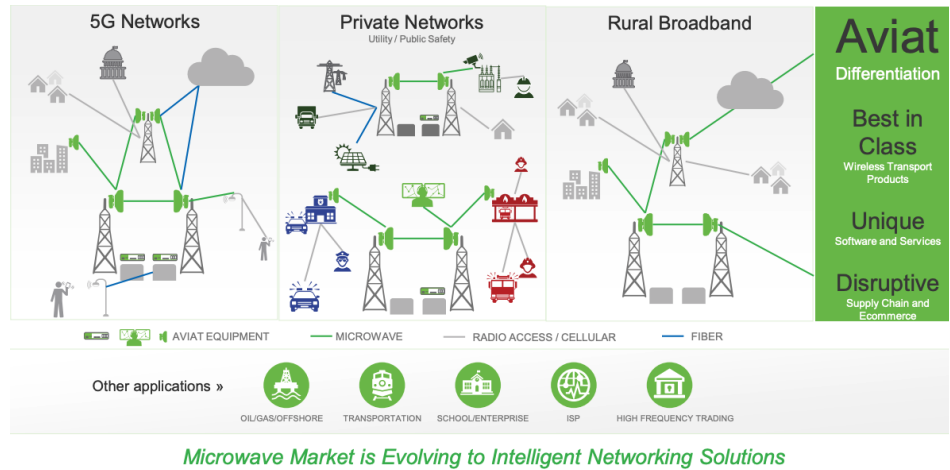
Source: Aviat Networks, Hyundai Motor Securities

Fig 5. Installed backhaul links by platform



Source: Ericsson, Hyundai Motor Securities

Fig 6. Aviat-Pureplay Microwave Transport Solutions



Source: Aviat Networks, Hyundai Motor Securities

Fig 7. Unique offerings with innovative products, s/w & services, and supply chain

	Wireless Transport Products Ex: Multi-Band	Software & Services Ex: Frequency Assurance Software (FAS)	Supply Chain & Delivery Ex: Aviat Store
Unique Attribute	Industry's only single box multi-band solution, integrated design solution	Industry's only expert system for interference monitoring and analysis	Disintermediation of complex distribution / channel market
Demand Driver	Global 5G rollouts	WiFi 6e in USA; tax spectrum regulation worldwide	5G; rural broadband
Customers / Market	5G networks globally; countries with high spectrum costs	Mobile operators and private networks in US; customers globally with interference concerns	Mobile operators and private networks; customers that buy from channel today
Competitor Offering	3 boxes, complex design solution	More network downtime	Channel / distribution
Customer Benefit	Lowest OPEX	More reliability / uptime	Lower cost, simpler experience

Source: Aviat Networks, Hyundai Motor Securities

What is microwave backhaul and why is it critical to connectivity?

Microwave backhaul is the transportation of voice, video, and data traffic between distributed sites and a more centralized point of presence by a radio link. Operators lease microwave spectrum and build networks to deliver services over the air, which is an instant, reliable, and relatively low-cost solution to the exploding global demand for backhaul capacity.

While mobile carriers presently have a few choices when meeting demand for backhaul, most are prohibitive in terms of cost to deploy due to the cost and sheer amount of work involved to deploy either E1 lines or fiber, leaving wireless as the obvious solution. Microwave radio links can be deployed very fast, usually within days at a far lower cost. Accordingly, microwave provides a compelling business case as it provides a flexible solution that delivers measurable advantages for mobile carriers that need tight budgets and deadlines.

With microwave backhaul carriers are able to achieve rapid time-to-service and respond quickly to market developments with systems that can be deployed in hours or days. The ability to upgrade with software provides even more flexibility, providing carriers with the ability to pay as they go, e.g., starting with a relatively low speed link and scaling as needed via software license keys to access more bandwidth. As such upgrades are inexpensive, they drive down the overall cost as capacity rises. When additional expansion is needed, it can be carried out with the addition of capacity aggregation, with the use of multiple radios to drive traffic over a single link. Economies of scale can be achieved with the ability to carry varied traffic types over a single link, enabling the carrier to migrate to more IP-centric traffic over time.

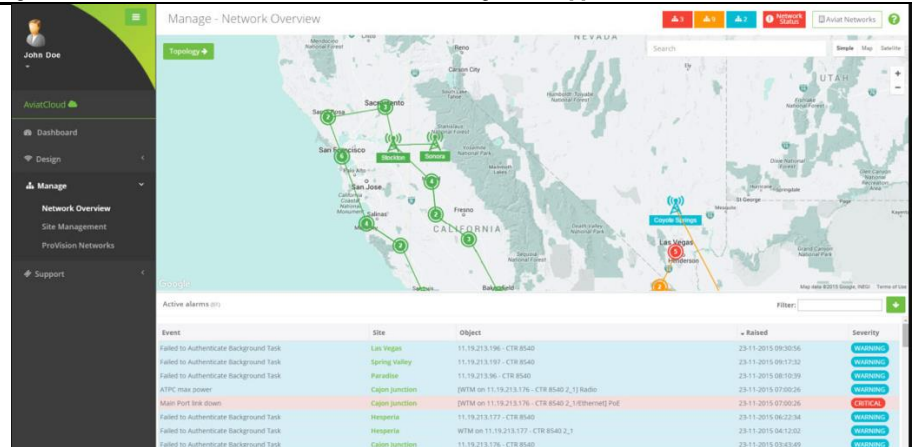
The bottom line is that even under the assumption of no further upside in FY21, YoY top-line growth is still at the 10% level with EBITDA more than double last year's USD13.5mn. Compared to peers, Aviat is an incredible bargain, has a healthier balance sheet, better margins, greater profitability, and a far better growth trajectory now.

Fig 8. Aviat Networks – Key financial metrics for 2019-21

	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21
Revenue	60.5	65.1	54.0	64.2	58.6	56.0	61.4	62.7	66.3	70.5
Gross Margin(%)	29.6	34.6	30.2	35.1	38.6	32.8	35.9	34.9	36.7	38.3
Operating Expenses	18.3	19.2	17.9	19.8	19.5	19.1	19.7	17.5	17.2	18.3
Adjusted EBITDA	0.9	4.5	-0.5	3.9	4.1	0.4	3.5	5.5	8.4	10.1
Cash	28.4	31.5	36.1	31.9	34.5	38.1	39.2	41.6	36.2	43.0
Debt	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	0.0	0.0
Net Cash	19.4	22.5	27.1	22.9	25.5	29.1	30.2	32.6	36.2	43.0

Source: Aviat Networks, Hyundai Motor Securities

Fig 9. Multi-vendor, multi-device, cloud-based management application



Source: Aviat Networks, Hyundai Motor Securities

Fig 10. Aviat versus peers

Aviat vs Peers	2021 EV/Revenue	2021 Sales Multiple	2021 EV/EBITDA
Peer Group Average	1.71	1.84	26.29
AVNW Discount to Peers	-55%	-52%	-74%
Aviat Networks Inc	0.75	0.88	6.89

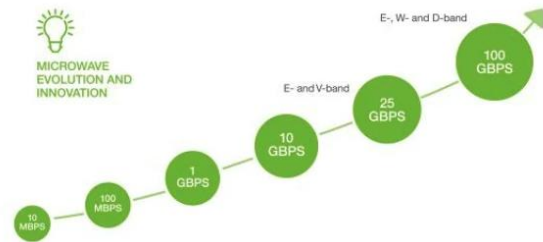
Source: Aviat Networks, Hyundai Motor Securities

Fig 11. End-to-end wireless transport solutions



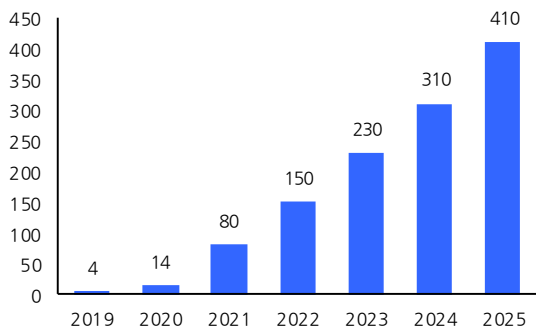
Source: Aviat Networks, Hyundai Motor Securities

Fig 12. Microwave backhaul capacity evolution



Source: Ericsson, Hyundai Motor Securities

Fig 13. 5G connections in North America (2019-25)



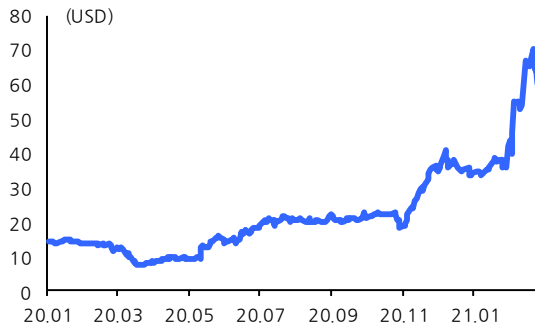
Source: Statista, Hyundai Motor Securities

Fig 14. AviatCare support service



Source: Aviat Networks, Hyundai Motor Securities

Fig 25. AVNW Stock Price



Source: Bloomberg, Hyundai Motor Securities

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Stock ratings distribution (January 1-December 31, 2020)

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MARKETPERFORM	18	11%
SELL	0	0%

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