

nokia: 12- Chapter SVA Teardown

1. Executive Summary: A Zero-Growth Valuation Creates a Stark Value-Creation Mandate

Nokia Corporation's current market valuation is a direct reflection of profound investor skepticism. Our Shareholder Value Analysis (SVA) reveals a company priced for near-zero perpetual growth (0.11%), indicating the market expects a future of stagnation. The core financial diagnosis shows a Return on Invested Capital (ROIC) of 7.08% barely clearing its 6.75% Weighted Average Cost of Capital (WACC), resulting in a negligible Economic Profit of €60 million. This razor-thin ROIC-WACC spread of 0.33% provides no margin for operational missteps or strategic drift. The path to shareholder value is not through speculative top-line growth, which is not priced in, but through a disciplined, mathematically rigorous focus on expanding operating margins and optimizing capital velocity. M&A scenarios are binary: either divest non-core, low-ROIC assets to streamline the portfolio or become a consolidation target for a larger entity seeking scale in the 5G infrastructure market. The executive mandate is unambiguous: surgically re-engineer the cost structure and capital base to widen the value spread and defy the market's bleak expectations.

2. SVA Diagnosis: A Negligible €60M Economic Profit Signals Capital Inefficiency

The fundamental measure of value creation is Economic Profit (NOPLAT minus a charge for the capital employed). Nokia's current operations generate a mere €60 million in Economic Profit on an invested capital base of €18.0 billion. This indicates that the corporation, in its entirety, is creating virtually no value above its cost of capital. The capital charge of €1.215 billion consumes 95% of the Net Operating Profit After Less Adjusted Taxes (NOPLAT), leaving an insignificant surplus for shareholders. The company is effectively a "treadmill entity," running hard to stand still. This performance is untenable and requires immediate strategic intervention focused on the two primary levers of SVA: increasing NOPLAT or decreasing the Invested Capital base.

Methodological Financial Diagnosis

| Metric | Calculation | Value |

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| NOPLAT | $EBITA * (1 - \text{Cash Tax Rate})$ | €1.275 B |

3. ROIC Deconstruction: A 7.08% ROIC Is Dangerously Close to the Cost of Capital

A company's Return on Invested Capital (ROIC) is the primary driver of intrinsic value. Nokia's ROIC of 7.08% is a direct result of the interplay between its NOPLAT margin (profitability) and its invested capital turnover (efficiency). The current ROIC is insufficient to generate meaningful shareholder value, sitting only 33 basis points above the firm's WACC. This precarious position highlights extreme vulnerability to margin compression from competitors like Ericsson and Samsung, or from inefficient capital deployment in next-generation R&D (6G, IoT). The ROIC tree decomposition shows that any slight degradation in operating margins or bloating of the capital base will push ROIC below WACC, leading to active value destruction.

ROIC Tree De-composition

ROIC = NOPLAT Margin x Invested Capital Turnover

7.08% = (NOPLAT / Sales) x (Sales / Invested Capital)

7.08% = (€1.275B / €22.2B) x (€22.2B / €18.0B)

4. The L&T SVA Tree: Margin Compression Is The Primary Source of Value Leakage

The L&T Shareholder Value Analysis Tree provides a granular de-construction of the components of ROIC. For Nokia, the tree reveals that the primary source of value leakage is not capital inefficiency but severe margin compression within its core operations. High operating expenses, particularly in SG&A and R&D relative to the sales they generate in a hyper-competitive market, are eroding EBITA. The path to a higher ROIC runs directly through aggressive cost structure optimization.

| L&T Value Driver | Calculation | Value |

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| Sales | | €22,200 M |

| (-) Operating Expenses | | (€20,500 M) |

5. The Spread-Growth Matrix: The 0.33% Value Spread Prohibits Growth-Oriented Strategies

Value is created when the ROIC-WACC spread is positive. Nokia's current spread is a razor-thin 0.33% (7.08% ROIC - 6.75% WACC). In this state, pursuing top-line growth is value-neutral at best and potentially value-destructive if it requires significant capital investment that fails to generate commensurate returns. The matrix below demonstrates that until the spread is materially widened, any strategy predicated on growth is mathematically unsound. The firm must first earn the right to grow by fixing its core profitability.

Sensitivity of Economic Profit (Millions €)

| ROIC-WACC Spread | -2% Growth | 0% Growth | +2% Growth | +4% Growth |

| :--- | :--- | :--- | :--- | :--- |

| -1.00% | (€120) | (€180) | (€242) | (€307) |

6. Expectations Investing: The Market Implies a Terminal Growth Rate of Only 0.11%

A Reverse Discounted Cash Flow (DCF) model, or Expectations Investing, calculates the future performance implied by a company's current stock price. Applying this methodology to Nokia reveals the market's profoundly low expectations. To justify its current Enterprise Value of ~€19.2 billion, the market is pricing in a perpetual growth rate for Nokia's NOPLAT of a mere 0.11%. This figure is below long-term global GDP growth and inflation estimates, signaling a belief in terminal decline or stagnation. This creates a clear, quantifiable hurdle for management: any strategic plan that can generate and sustain a NOPLAT growth rate above 0.11% will, by definition, create shareholder value by triggering a positive re-rating of the stock.

Reverse DCF Calculation

Enterprise Value (EV) = €19,200 M

WACC = 6.75%

NOPLAT (Year 1) = €1,275 M

7. Street Consensus vs. Intrinsic Value: Analysts Focus on Top-Line Distractions

Wall Street analyst consensus fixates on short-term revenue beats and misses, driven by 5G deployment cycles. This is a strategic distraction. Our SVA model proves that intrinsic value is driven by the ROIC-WACC spread, not by revenue growth in a low-margin environment. Analyst models predicated on multiple expansion are flawed; any sustainable increase in valuation must come from a fundamental improvement in cash flow generation relative to the capital base. The Street's forecast of 1-3% revenue growth is irrelevant if it comes at the expense of NOPLAT margins or requires capital investment that returns less than 6.75%.

| Metric | Street Consensus View | SVA Reality |

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| Primary Driver | Revenue Growth (5G Cycle) | ROIC vs. WACC Spread |

| Key Metric | Quarterly Revenue Surprise | Economic Profit |

8. TSR Deconstruction: An 8% TSR Mandates a 4.5% NOPLAT CAGR

Total Shareholder Return (TSR) is the ultimate metric of performance. Deconstructing a target 8% annual TSR reveals the required operational performance. Given Nokia's current dividend yield of approximately 3.5%, management must deliver an additional 4.5% return through a combination of NOPLAT growth and/or an expansion of its valuation multiple. Assuming a stable multiple (i.e., the market does not re-rate the stock until performance is proven), this requires a compound annual growth rate in NOPLAT of 4.5%. This is significantly above the 0.11% growth rate priced in by the market and represents the quantitative performance target for the executive team.

5-Year TSR Bridge (Target: 8.0%)

Component	Contribution	Implication
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Dividend Yield	+3.5%	Must be sustained by NOPLAT.
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9. MBB Portfolio Matrix: Core Network Infrastructure Must Fund the Future

Plotting Nokia's business segments on a classic MBB (BCG/McKinsey) matrix reveals a portfolio in need of disciplined capital allocation.

Cash Cow (High Share, Low Growth): *Network Infrastructure*. This division is the financial engine of the corporation. It must be managed for maximum cash flow generation with ruthless efficiency. Capital extracted from this unit must be re-allocated with extreme prejudice.

Question Mark (Low Share, High Growth): *Cloud and Network Services, Nokia Technologies (Patents)*. These segments operate in high-growth markets but lack dominant scale. They consume significant capital (R&D, a GTM) and their path to positive ROIC is uncertain. They require either significant investment to become "Stars" or divestiture to avoid becoming "Pets."

Pet (Low Share, Low Growth): Certain legacy product lines within the portfolio. These must be identified and pruned aggressively to release trapped capital and eliminate margin drag.

The strategic imperative is to stop cross-subsidizing underperforming "Question Marks" and "Pets" with cash flow from the core "Cash Cow" unless a mathematically certain, high-ROIC outcome can be guaranteed.

10. M&A Vulnerabilities & Opportunities: A Target for Consolidation or a Candidate for Divestiture

Nokia's strategic position is precarious, making it both a potential M&A target and a candidate for aggressive portfolio reshaping.

Vulnerability (Acquisition Target): With a low valuation multiple (EV/NOPLAT of ~15x) and a significant patent portfolio (Nokia Technologies), Nokia is a viable target for a larger technology or private equity firm. An acquirer could rationalize the cost structure, divest non-core assets, and achieve synergies, justifying a premium over the current share price. The low implied growth rate makes it a classic "value" play for a disciplined financial or strategic buyer.

Opportunity (Divestiture): The board must unemotionally assess the contribution of each business unit to Economic Profit. The *Cloud and Network Services* and *Nokia Technologies* divisions could be candidates for spin-offs or outright sale. Such a move would allow the core *Network Infrastructure* business to focus on its operational strengths, simplify the corporate structure, and return capital to shareholders, likely triggering a positive re-rating of the streamlined "core" entity.

11. Macro-Economic Risk Factors: Geopolitics and Capex Cycles Are Primary Threats

Nokia's low ROIC-WACC spread provides no buffer against macro-economic shocks. Three external factors pose the greatest threat to its financial stability:

1. **Geopolitical Tensions:** The ongoing economic decoupling between the West and China creates supply chain risks and market access uncertainty. Any exclusion from key markets or mandates to "rip and replace" competitor equipment presents both an opportunity and a significant execution risk.
2. **Telecom Capex Cycles:** Nokia's revenue is directly tied to the capital expenditure cycles of major telecom operators. A slowdown in 5G deployment, driven by rising interest rates or a saturated consumer market, would immediately compress revenue and NOPLAT, pushing ROIC below WACC and destroying value.
3. **Enterprise & Cloud Competition:** As networking shifts towards software and cloud-native solutions, Nokia faces intense competition from non-traditional players (e.g., Cisco, Microsoft, Amazon Web Services). Failure to compete effectively in these high-margin software arenas will result in permanent margin erosion.

12. The CEO's Mandate: Win the War on the ROIC-WACC Spread

The strategic conclusion is absolute. The CEO's mandate is not to chase market share or announce ambitious, unfunded growth initiatives. The singular focus must be the mathematical expansion of the ROIC-WACC spread from its current, unacceptable level of 0.33%. This is an internal war fought on two fronts:

1. **Margin Expansion (The NOPLAT Offensive):** Execute a zero-based budgeting program across the entire organization. Every euro of operating expense must be justified by its direct contribution to NOPLAT. Rationalize R&D spending to focus only on projects with a clear, near-term path to profitable commercialization.

2. **Capital Velocity (The Invested Capital Offensive):** Aggressively optimize the balance sheet. Reduce inventory days, accelerate receivables collection, and extend payables. Scrutinize every dollar of CAPEX to ensure it will generate returns well in excess of the 6.75% WACC. Divest or liquidate any asset or business line that is dilutive to the corporate ROIC.

Success is not measured by press releases or analyst commentary. It is measured by the weekly, monthly, and quarterly expansion of Economic Profit. The objective is to prove the market's expectation of 0.11% growth is fundamentally wrong by re-engineering the firm's financial physics.