



Mobile Phone and Allied Products Sector Study

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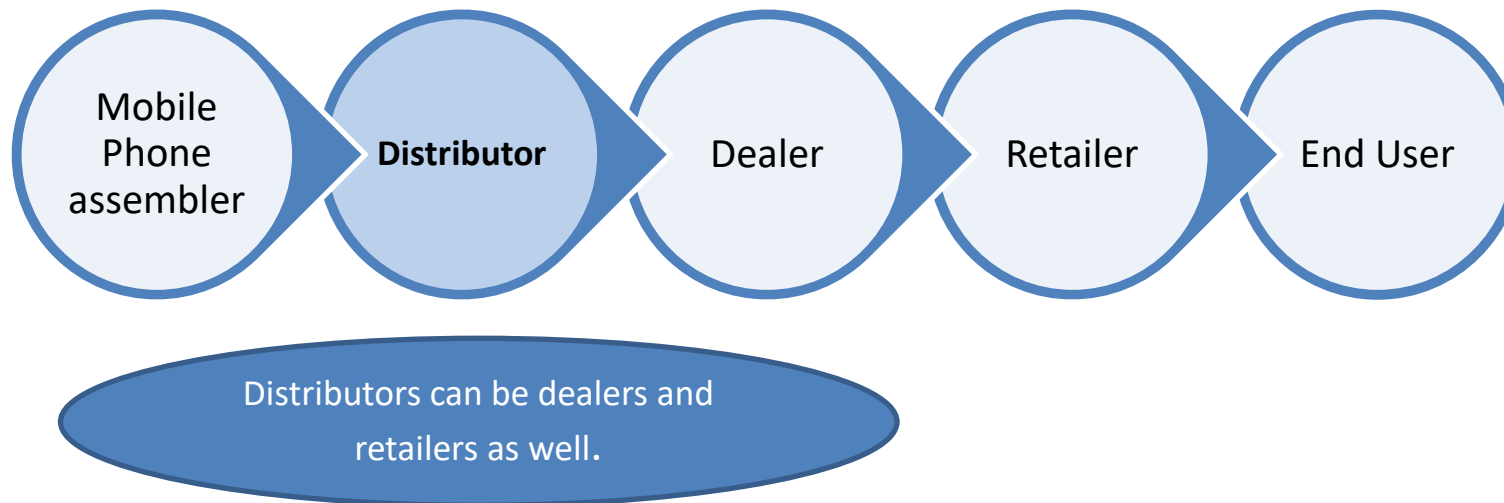


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Mobile Phones and Allied Products

Overview

- This sector study shall focus on the assembler and distributor segment of the Mobile Phone Supply Chain.
- A Mobile phone assembler is involved in manufacturing and/or assembling of mobile phones whereas a mobile phone distributor (or “distributor”) is an entity that buys mobile phones and allied products from the assemblers and sells them to customers either through dealers and retailers or directly.
- Most distributors also provide a range of allied services such as technical support, warranty and after sales services. In the mobile phone supply chain, distributors play an essential role in helping assemblers/principles reach out to markets which they could otherwise not target.
- Distributors are, therefore, responsible to sell the products and provide after sales services to clients.
- Assemblers set the prices of their products and all distributors and dealers are obliged to sell the phones at the predetermined prices, therefore competition in terms of price amongst distributors and dealers becomes very low.



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Global Industry | Overview

- Market structure | Manufacturing:** Although, the mobile phone manufacturing industry is fragmented with a large number of global players, the Industry can still be termed as oligopoly since the top 5 to 6 brands make up a major portion of the market share and control the overall dynamics of the Industry.
- Players:** Top players that lead the market in terms of manufacturing include Apple, Huawei, Samsung, Xiaomi, and Oppo.
- Market size:** Global mobile phone shipments clocked in at ~1,199mln units in CY20 (a decline of ~13% YoY) owing to the economic slowdown amid COVID-19 pandemic. Global shipments in 1HCY21 were recorded at ~660mln units based on which the global shipments for CY21 are estimated at ~1,320mln units, depicting a YoY growth of ~11% in CY21.
- The growth is a reflection of the market regaining potential in CY21. Samsung is leading the market accounting for ~21% of the global shipments. Following it is Xiaomi with a market share of ~15%, as Xiaomi shipped ~52mln smartphones in 2QCY21, becoming the world's second-largest smartphone brand for the first time ever, and Apple stands at 3rd rank in global top five brands based on units. Meanwhile Huawei, which was on the 2nd rank till CY20, has dived to the lowest rank in 1HCY21 among the top 5 brands.



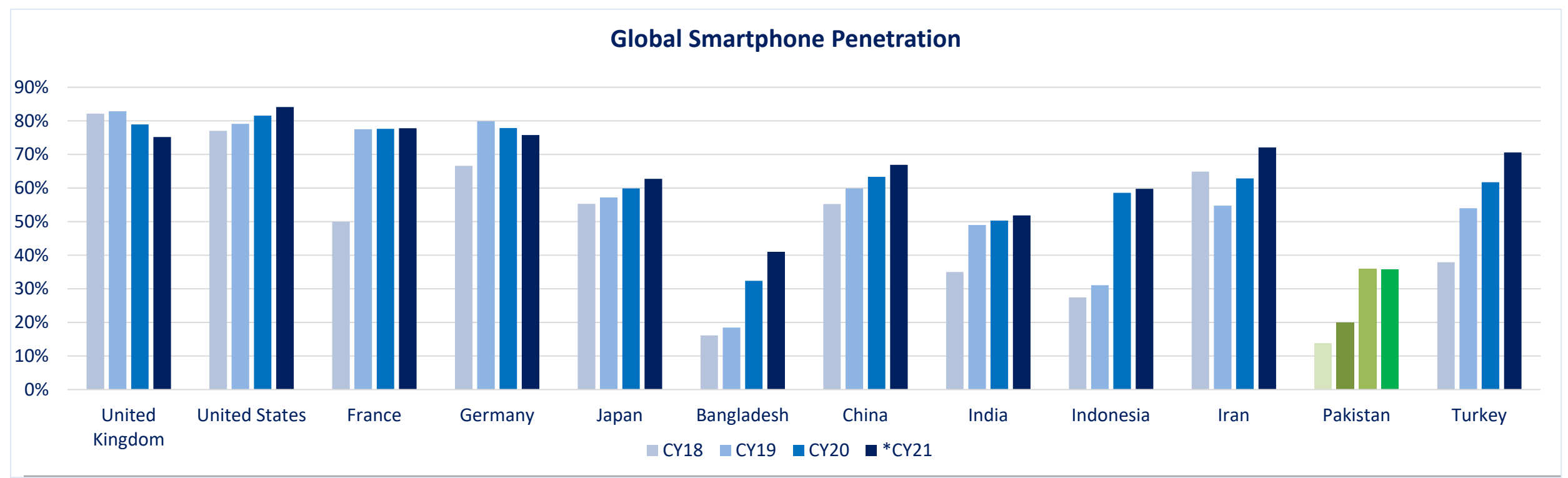
Global Smart phone shipment in (mln) units				
	CY18	CY19	CY20	1HCY21
Apple	257	188	186	96
Huawei	227	241	184	29
Samsung	264	297	241	135
Xiaomi	107	125	137	102
Oppo	110	114	104	70
Others	446	405	347	227
Total	1,410	1,371	1,199	660

*Estimate based on 1HCY21

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Global Industry | Smartphone Penetration

- Smartphones include mobile phones that have advanced functionality beyond making phone calls and sending text messages. Most smartphones have the capability to display photos, play videos, check and send e-mail, and surf the web. Modern smartphones, such as the iPhone and Android based phones, can run third-party applications, which provides limitless functionality.
- USA has the highest smartphone penetration of ~84%, followed by France with ~78%. In terms of smartphone penetration within Asia, Iran is leading the market with ~72% penetration, followed by Turkey (~71%) and China (~67%), respectively. Pakistan has a smartphone penetration of ~36%.



*Estimated

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Local Industry | Overview

- Market structure:** The local mobile phone Industry has historically been import driven. The global manufacturing companies that control the dynamics of International Market are also the key suppliers of mobile phones to the domestic market. These include Apple, Samsung, Oppo, Huawei, Xioami and other Chinese brands that have lately tapped into the domestic landscape. The global assemblers/principles sell their mobile phones in the local market through networks of their authorized distributors on contractual basis. Currently, there are 4 top distributor chains in the country with 7 other small distributors holding lower volumes.
- Market size :** Total mobile phone imports during FY21 were recorded at USD~2,065mln (FY20: USD~1,369mln) registering a significant growth of ~51% YoY. Whereas on a quarterly basis, total mobile phone imports during 1QFY22 are recorded at USD~494mln (1QFY21: USD~492mln), with a growth of ~0.4% from same period last year (SPLY).
- Distributors:** The major mobile phone distributors in the country include Airlink Communication, M&P, Burque Corporations and Advance Telecom. Other distributors are involved in distribution of some local and Chinese mobile phones. Distribution Models for Oppo, Vivo and Q Mobile differs from the rest of the market as they have established their own distribution networks.

Industry Snapshot			
	FY20	FY21	1QFY22
Industry Imports (USD mln)	1,369	2,065	494
Import Growth	81%	51%	0.4%*
Industry Imports** (mln Units)	16	25	9
Assembled Mobiles** (mln Units)	12	13	16
Total Demand** (mln Units)	28	38	25
Industry Structure	Oligopoly		
Top Brands	6	6	6
Top Distributors	4	4	4
Regulator	Pakistan Telecommunication Authority		

*1QFY22 is compared with 1QFY21

**Numbers based upon the data from the period CY19, CY20, 9M CY21

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Local Industry | Market trend




Top End

- Niche market
- More brand loyalty
- least price elastic



Middle

- More players
- Less brand loyalty
- More Competition
- Price Elasticity



Lower End

- New entrants
- More Competition
- No Brand Loyalty
- Most Price elastic

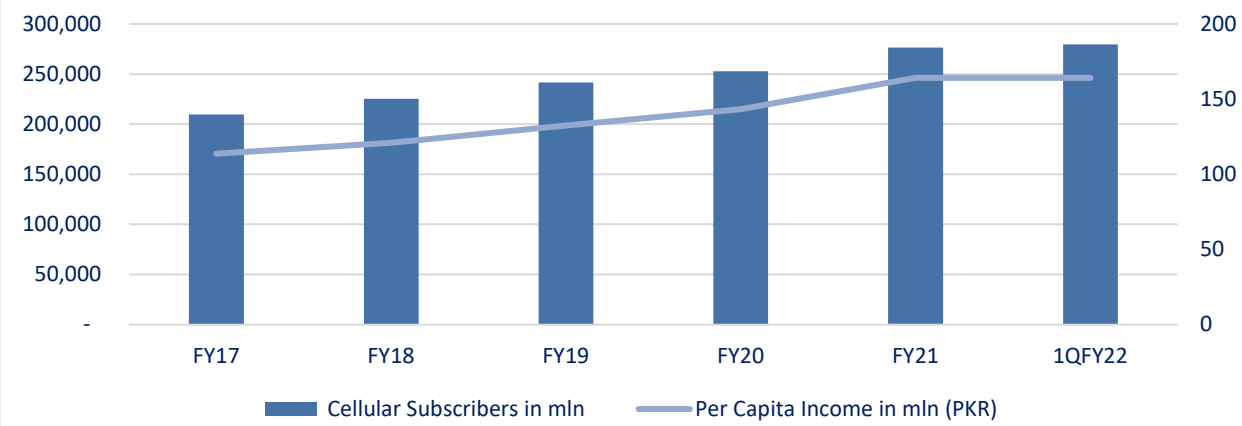


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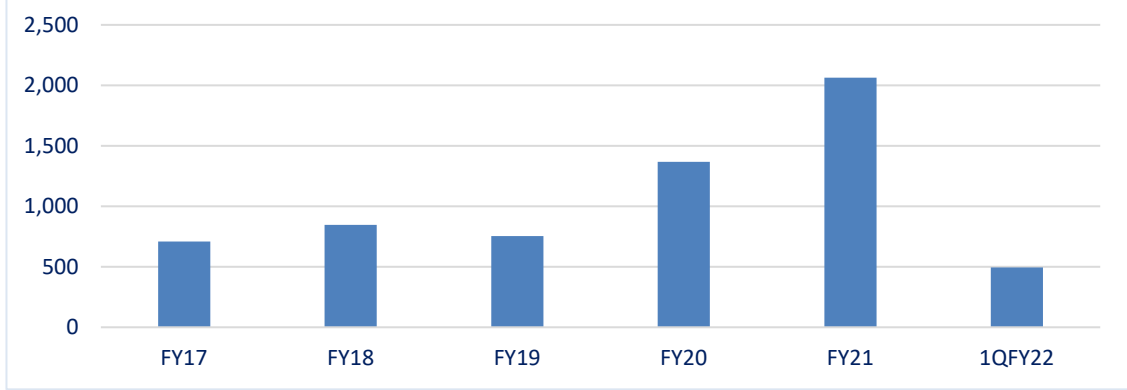
Local Industry | Demand

- The demand of smartphones is linked to the growth of cellular subscribers (based on sims) and average per capita incomes. There has been a parallel growth in per capita incomes and cellular subscribers over the recent past. During FY21, the growth in per capital income was recorded at ~15%, while cellular subscribers grew by ~9%, compared to FY20 (per capita income growth:~8%; cellular subscribers growth:~5%). During 1QFY22, the cellular subscriber grew by ~1% as compared with FY21.
- The emergence of smartphone industry has fostered the overall growth of mobile phones due to improved technology and ease. The smartphone industry has been steadily developing and growing since then, both in market size, as well as in models and suppliers.
- Pakistan has historically relied on imports to meet the demand of mobile phones. In FY21, the import of mobile phones was recorded at USD~2,065mln (FY20: USD~1,369mln), with a YoY growth of ~51%. Whereas on quarterly basis, total mobile phone imports during 1QFY22 were recorded at USD~494mln (1QFY21: USD~492mln), with a YoY growth of ~0.4%.
- Despite the outbreak of COVID-19, the imports of mobile phones increased in FY20, reflecting on the positive impact of Device Identification, Registration and Blocking System (DIRBS) and increased prices of mobile phones.

Per Capita Income Vs Cellular Subscribers



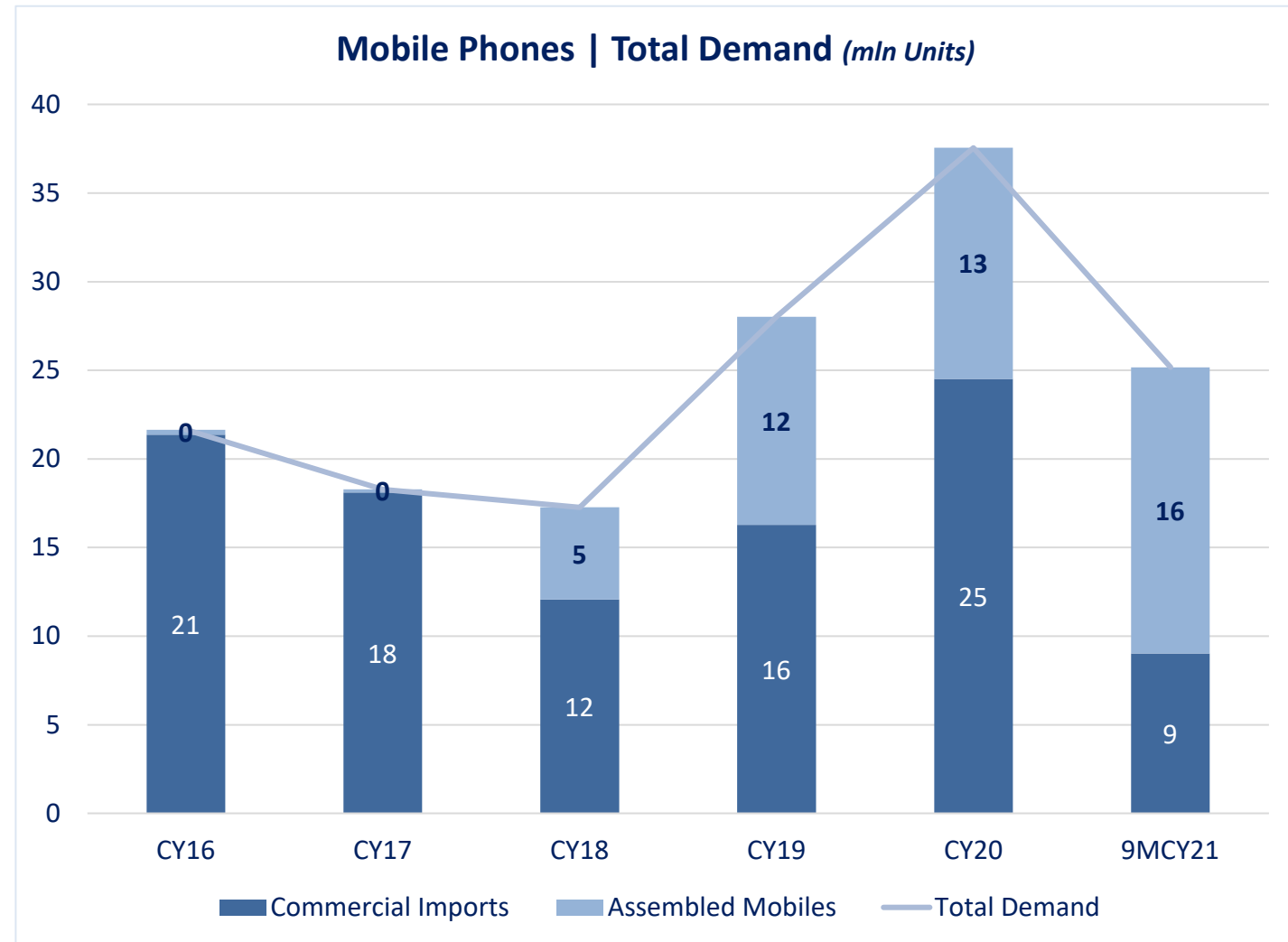
Pakistan Mobile Imports in USD (mln)



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Local Industry | Demand

- The average demand of the sector from CY17 to CY20 stood at ~25mln units, growing at a CAGR of ~15%. During 9MCY21, the demand was recorded at ~25mln units (CY20: ~35mln units). The local demand has historically been met through commercial mobile imports, with only a few local assemblers. But the trend is changing since the past 3 years, during which local assembling has paced up in the market, recording around ~5mln mobile phones in CY18 and rising to ~16mln units during 9MCY21. Meanwhile, commercial imports, which were as high as ~25mln units in CY20 have come down to ~9mln units in 9MCY21 (estimated ~12mln units for full year). This trend reflects a positive materialization of PTA's Mobile Device Manufacturing (MDM) Authorization regulatory regime.
- Based on reports, the combined assembling capacity of Samsung and Oppo has crossed ~1mln handsets per month, while Tecno has enhanced its local mobile phone assembly from 150,000 to 650,000 units per month owing to increase in demand.



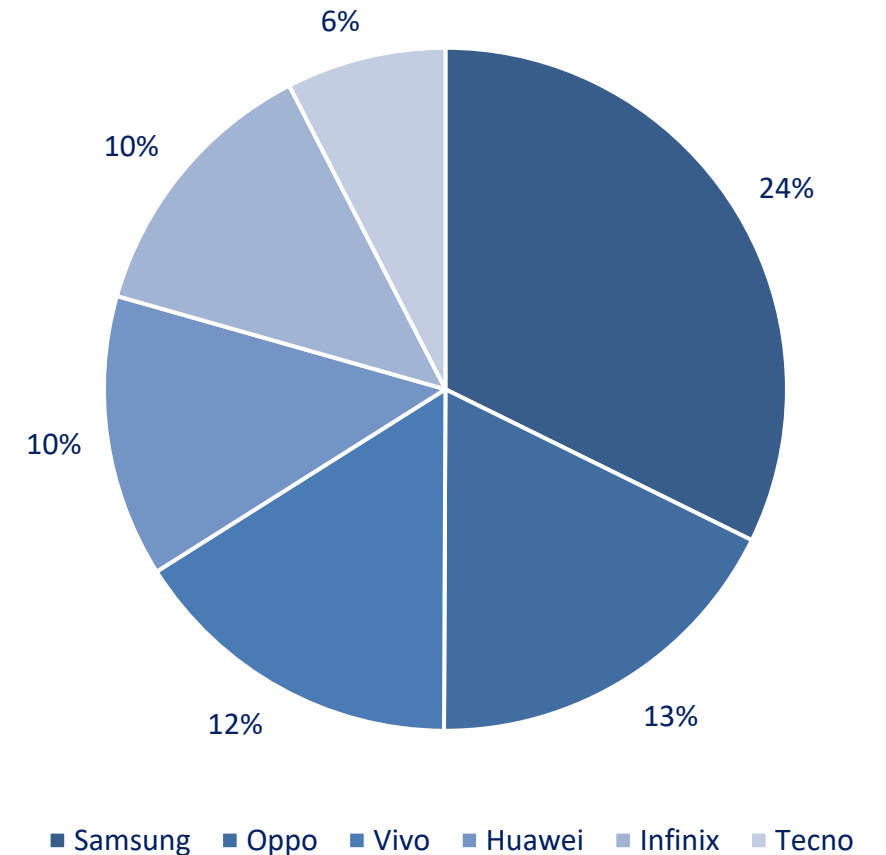
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Local Industry | Market Share

- The top six brands (in terms of value) leading the local market are Samsung, Oppo, Vivo, Huawei, Infinix and Tecno. During 10MCY21, Samsung was ranked at the first position, with a market share of ~24%. Meanwhile Oppo and Vivo were the second and third highest, with a market share of ~13% and ~12% respectively.
- Samsung’s renowned “Galaxy Smartphones” have a competitive advantage over other brands in terms of quality and durability. Other brands including Oppo, Vivo, Tecno and Infinix are preferred more for offering better specifications with lesser prices. However, both internationally and locally, Huawei has lost its market share from ~13% in CY20 to ~10% in 10MCY21.



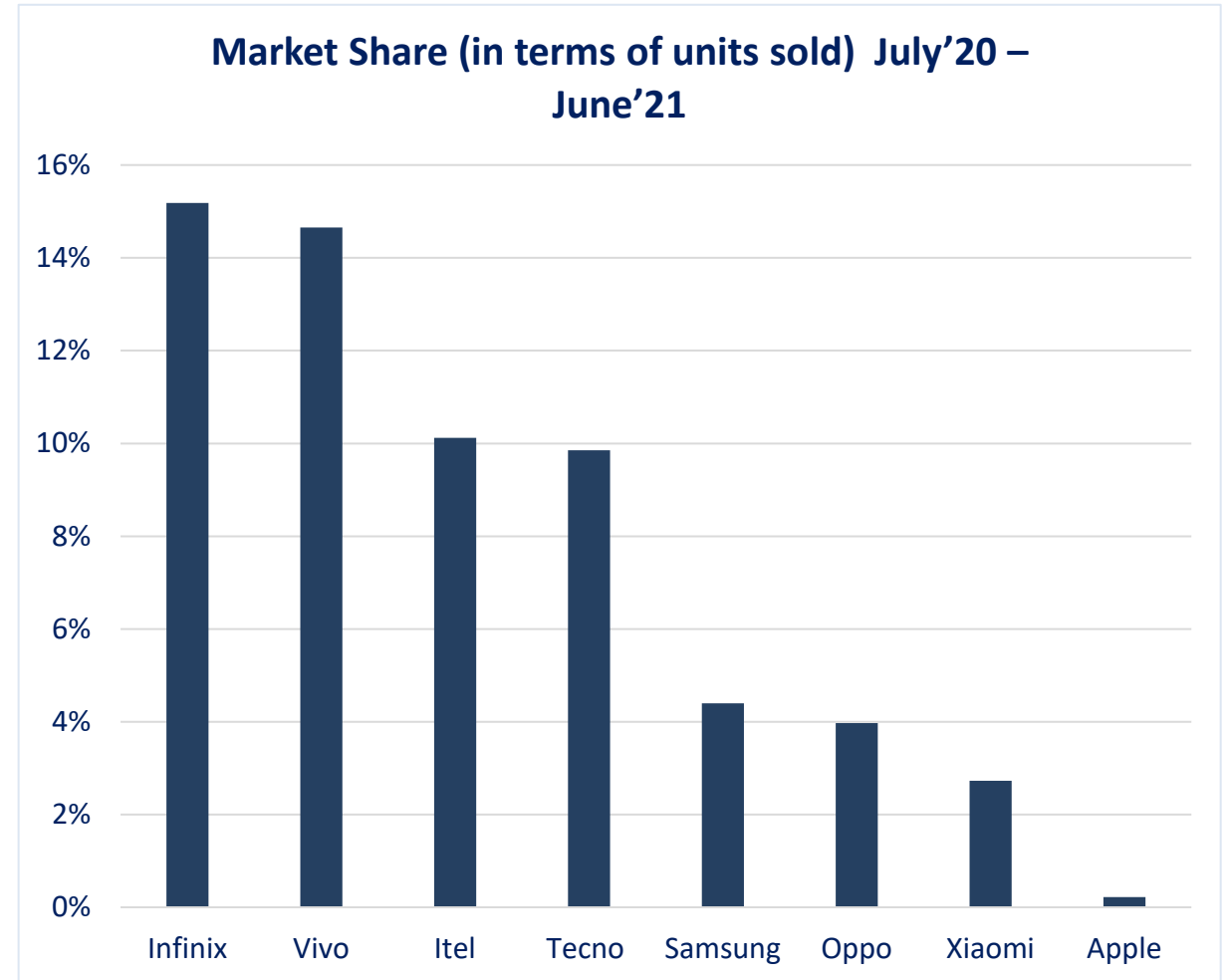
**Market Share of Top brands (in terms of value)
(Jan – Oct'21)**



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Local Industry | Market Share

- In terms of number of mobile phones sold Infinix is leading the market with the market share of ~25%. Following it are the brands Vivo, Itel, Tecno, Samsung, Oppo, Xiaomi and Apple with a market share of ~24%, ~17%, ~16%, ~7%, ~7%, ~4% and ~0.2% respectively.
- Out of these brands Infinix, Vivo, Itel, Oppo and Tecno have initiated their mobile assembling units in Pakistan. Samsung has also invested in local mobile assembling plants. Hence, fostering the local mobile phone industry.
- Based on reports, the combined assembling capacity of Samsung and Oppo has crossed ~1mln handsets per month, while Tecno has enhanced its local mobile phone assembly from 150,000 to 650,000 units per month owing to increase in demand.



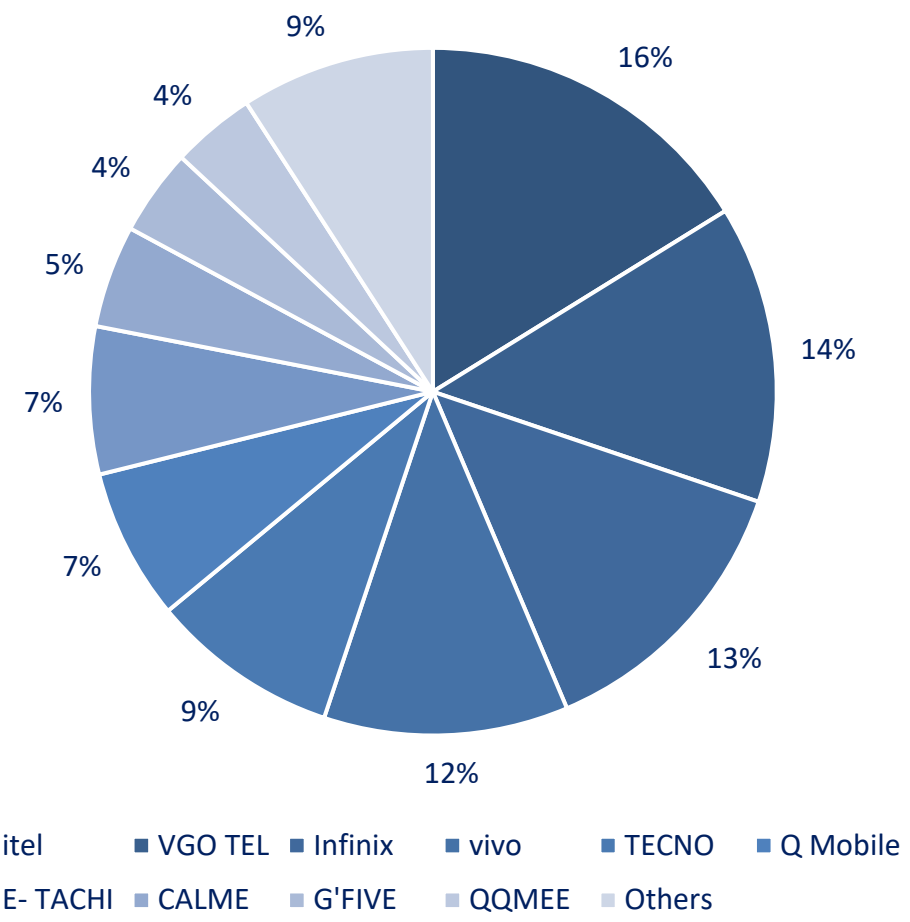
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Local Industry | Supply

Manufacturing/Assembling:

- The Government of Pakistan introduced a comprehensive mobile manufacturing policy to encourage and attract assemblers to establish their units in Pakistan. Till 9MCY21, 26 companies have been issued MDM authorization enabling them to manufacture/assemble mobile devices in Pakistan. The companies include renowned brands such as Samsung, Nokia, Oppo, Tecno, Infinix, VGO TEL, Q-Mobile etc.
- The production of mobile phones by local manufacturing plants has surpassed the number of mobile phone imports in the country. During 9MCY21, the production of mobile phones by local manufacturing plants was ~16mln and imported mobile phones was recorded at ~9mln.

Mobile Phone Assembling Share (9MCY21)



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Local Industry | Distributors

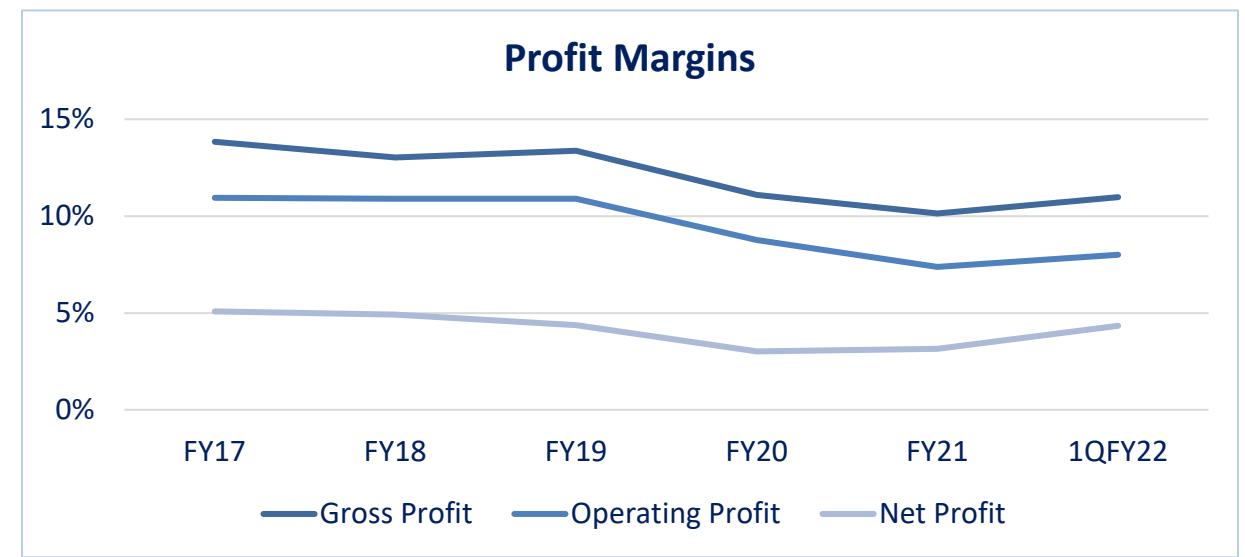
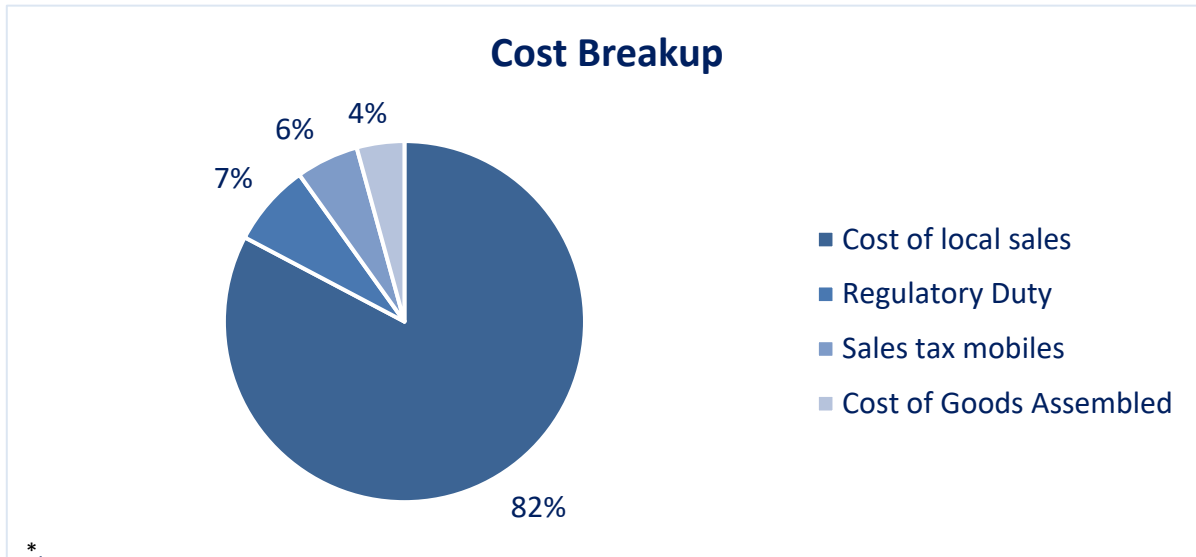
- Currently, there are 4 major mobile distributing partners, that are involved not only in distributing the international brands but assembling and distributing some local phones too. There are 7 other small distributing partners that distribute some local and Chinese mobile phones.
- These top 4 distributors have nationwide network of retailers and dealers to which they sell the mobile phones at pre-determined prices and discounts (if any).
- The distributors generally have contractual relationships with the international brands/principles, which pre-sets the terms and conditions, such as prices, margins, demand, returns and discounts. The market is, therefore, free of price competition and is largely dependent on long standing relationship with the International brands as well as with the dealers.
- Among the top 4 distributing partners, Airlink has the highest overall market share of around ~21% (in terms of units).
- Some mobile manufacturing brands have their own distributing channels including Oppo, Vivo and Q mobile.

Distributing Partners	
Distributors	Mobile Phone Companies
AirLink Communications	Samsung (32%) Xiaomi (21%) Apple (11%) Itel (27%) Tecno (28%)
Muller and Phipps M&P	Samsung Huawei Microsoft Mobile
Burque Corporation	Samsung
Advance Telecom	Microsoft Mobile, Infinix

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Business Risk | Distributors

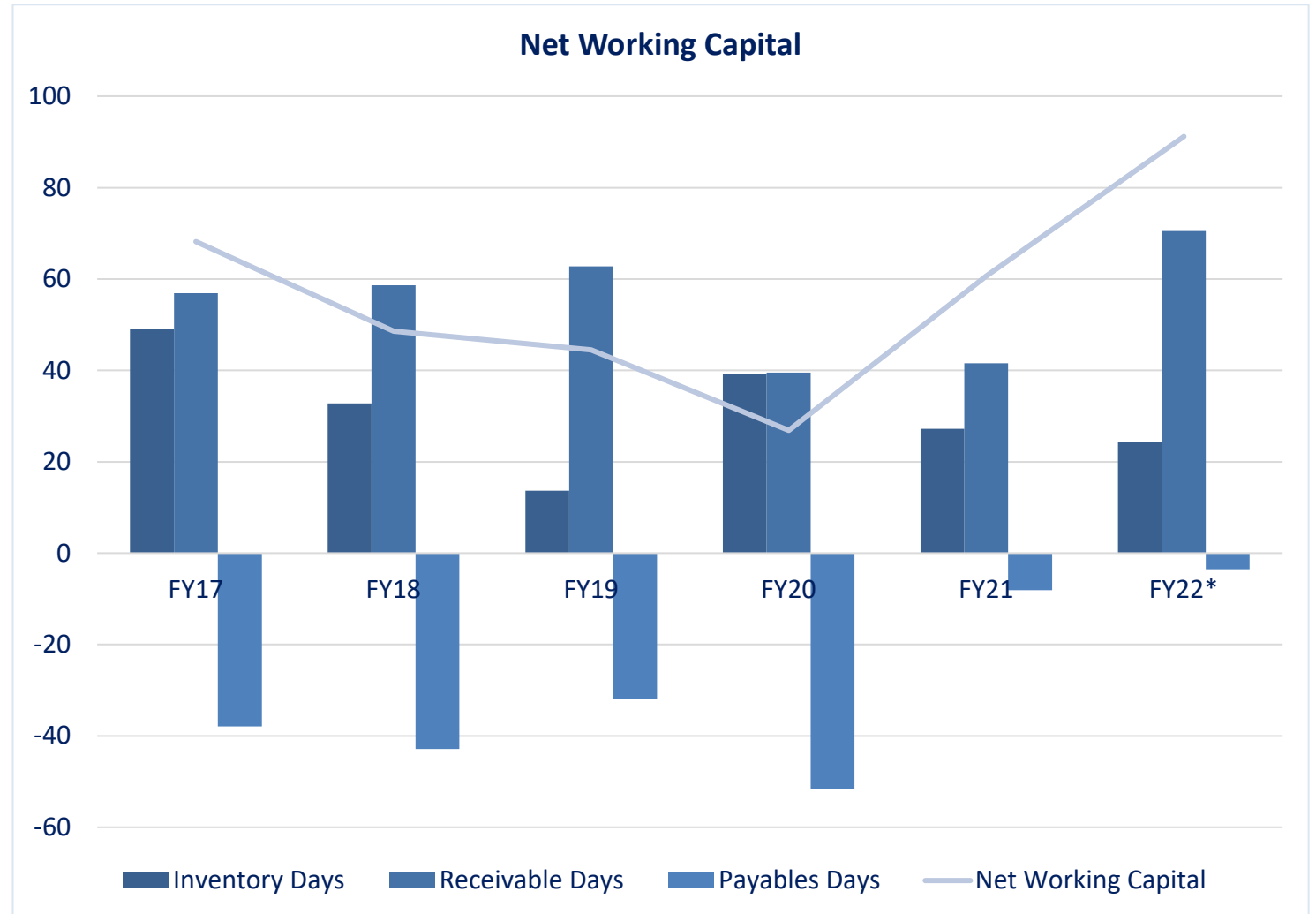
- Profit Margins:** The distributor segment runs on fixed margins. The sector's margins remained relatively stable from FY17 to FY19. During FY20, the gross and operating margins dropped by ~2% each due to increased duty structure and high finance cost. A further decline in gross margins was noted in FY21; gross profit margins fell to ~10% (FY20: ~11%), mainly as a result of a rise in the duty structure, nullifying the effect of higher pricing of the products. Further reason of lower margin was a change in product mix to mid range phones. Despite the decline in gross margins, the reduced finance costs kept the net margins stable at ~3% in FY21 (FY20: ~3%). Finance cost declined by ~21% to PKR~1,102mIn in FY21 as compared to PKR~1,397mIn in FY20. Overall, the net margins during FY20 to FY21 remained stable at ~3%. In 1QFY22, the margins improved due to reduced operating and financial cost.
- Cost Breakup:** Almost ~82% of the direct costs belongs to the cost of local scales, while regulatory duty and sales tax on mobiles constitutes ~7% and ~6% respectively. Cost of Goods assembled reflects the inventory cost associated to the newly installed mobile assembling plants. However, this cost accounts for only ~4% of the total direct costs, which can increase going forward, due to growing number of mobile phones assembled.



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Financial Risk | Working Capital | Distributors

- The Industry's Working capital requirement is a function of financing its trade receivables and inventory. Since the imposition of SBP's directive to maintain 100% margin for Line of Credit (LC), working capital needs have elevated.
- The average net working capital days of the sector hover around 2 months due to the nature of LC transactions for payments to supplier.

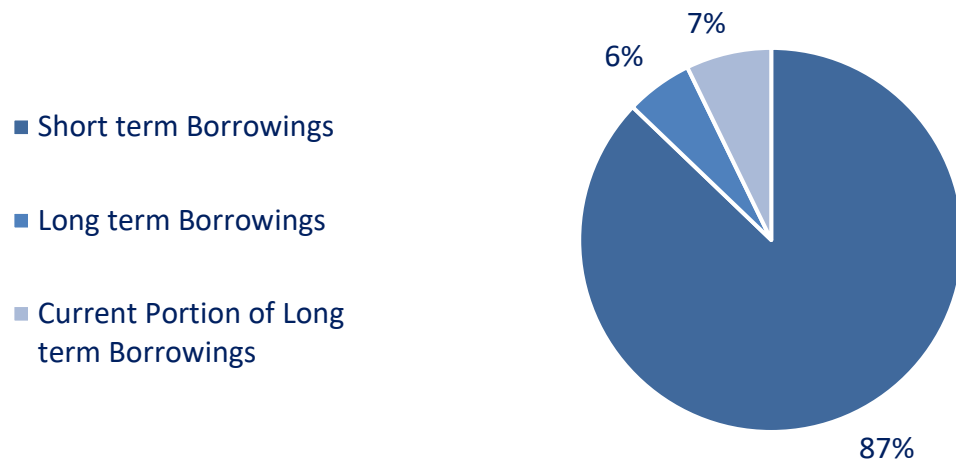


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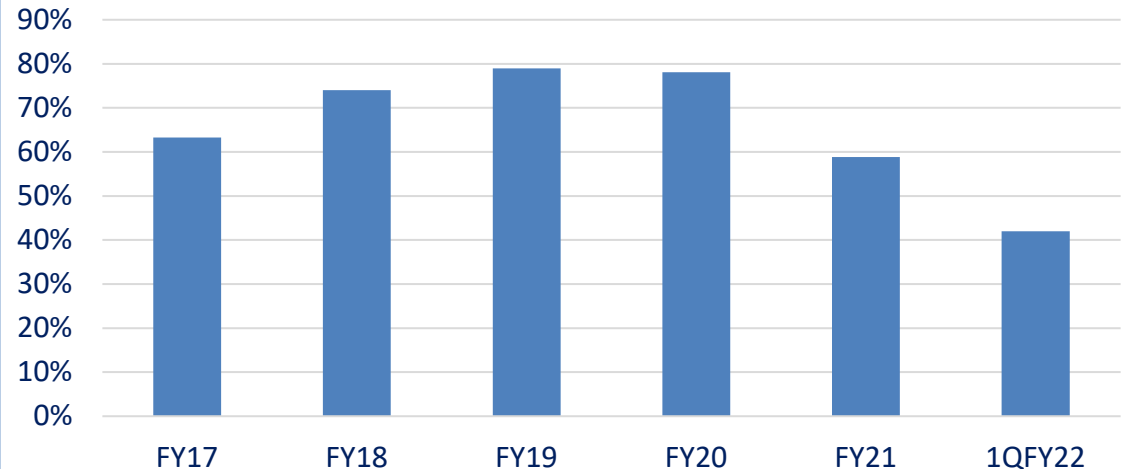
Financial Risk | Borrowings | Distributors

- The total borrowing for the sector as at End-Sep'21 stood at PKR~29,419mIn as compared to PKR~31,752mIn as at End-Sep'20.
- The largest component of the debt mix is short term borrowings (STBs) amounting to ~87% of the total borrowing.
- The average interest cover of the Sector has taken a freefall from ~10x in FY17 to ~3x in FY20. This is majorly on the backdrop of increased short term borrowings, particularly after SBP's imposition of 100% Cash Margin against Imports, and rising Interest costs in FY19 and 9MFY20. In 1QFY22, the interest cover of the sector improved from ~3.3x to~3.7x due to reduced finance costs and improved profits.
- The sector has significantly improved its capital structure with average debt to equity ratio improving from ~78% in FY20 to ~59% in FY21 and further strengthening to ~42% in 1QFY22. This has come on the backdrop of recent listing of one of the largest distributors of the country, resulting in growth in equity and rationalized debt burden.

Borrowing Mix at Sept'21



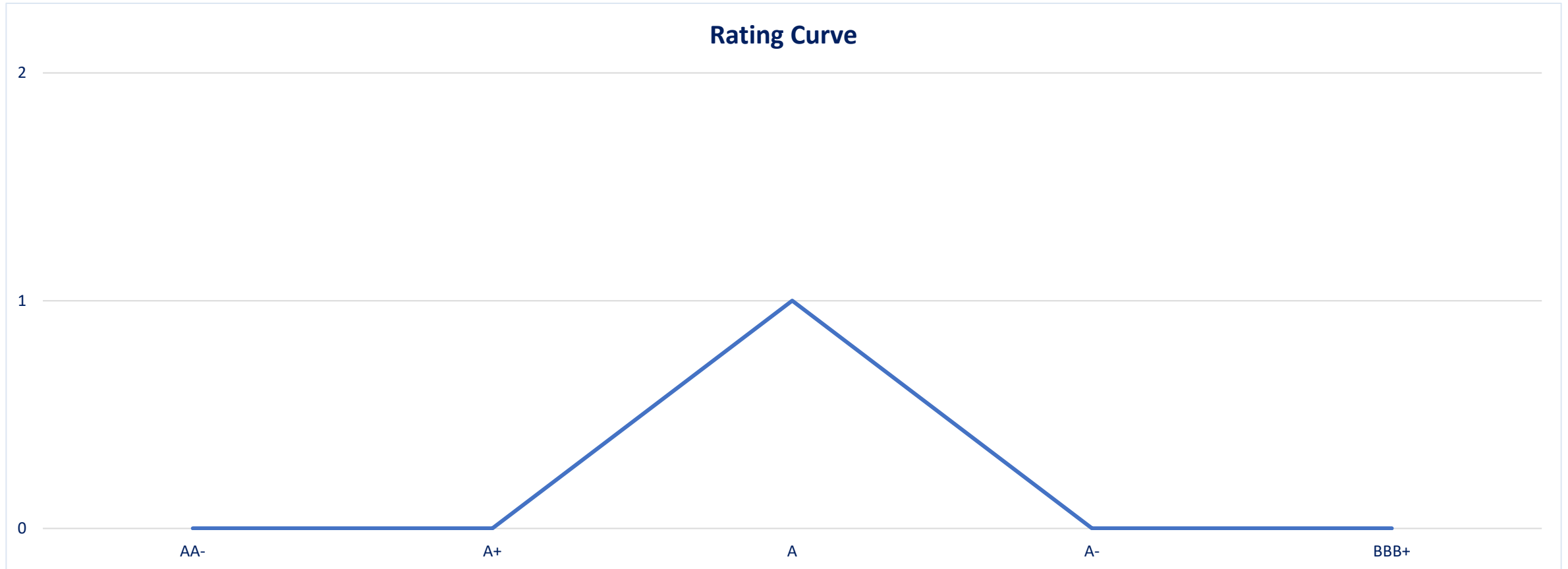
Gearing Ratio



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Rating Curve

- PACRA rates 1 client in Mobile Phones and Allied Products, that is, Airlink Communication Limited.
- Rating Bandwidth of the sector is A.



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Duty and Tax Structure

Duty & Taxes Summary-Finance Act											Punjab Infrastructure Development CESS		
Sr	CIF SLABS	Sales Tax		Regulatory Duty		Levy		Income Tax		Taxes Total (PKR)		PRA	
		PKR		PKR		PKR		PKR		PKR		%age	
		FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22
1	Up to \$ 30	130	130	165	165	-	-	70	70	365	365	0.9	0.9
2	\$ 31 - \$ 100	200	200	1,620	1,620	-	-	100	100	1,920	1,920	0.9	0.9
3	\$ 101 - \$ 200	1,680	1,680	2,430	2,430	400	400	930	930	5,440	5,440	0.9	0.9
4	\$ 201 - \$ 350	1,740	1,740	3,240	3,240	1,200	1,200	970	970	7,150	7,150	0.9	0.9
5	\$ 351 - \$ 500	5,400	5,400	9,450	9,450	2,800	2,800	3,000	3,000	20,650	20,650	0.9	0.9
6	Above \$ 500	9,270	9,270	16,650	16,650	5,600	5,600	5,200	5,200	36,720	36,720	0.9	0.9

Budget FY22

- The second amendment of Tax Laws Ordinance 2021 had omitted first year allowance (available at 90% of the cost of an asset) under section 23A of the Ordinance which allowed a deduction in lieu of first year allowance for installation of plant, machinery and equipment by industrial undertakings set up in specified rural and under developed areas or engaged in manufacturing of cellular mobile phones and qualifying for exemption under clause (126N) of Part I of the Second Schedule to the Ordinance.
- In light of Budget FY22, the government will review the rationalization of regulatory duty on import of Mobile Phones to encourage import substitution.
- The Bill proposes to provide exemption from tax withholding under the provisions of section 153(1)(a) with effect from 1st July 2020 to distributors, dealers, wholesalers and retailers of locally manufactured mobile phone devices as withholding agent.

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Latest Developments

Salient features of Mobile Phone Manufacturing Policy 2020

The Federal Cabinet approved the first ever mobile device manufacturing policy in June 2020 pursuant to a summary moved by Ministry of Industries and Production. The policy has been prepared by Engineering Development Board (EDB), a techno-economic arm of Ministry of Industries and Production (MoIP), and was issued on 28th January 2021.

- Removal of Regulatory Duty for CKD/SKD manufacturing by PTA approved manufactures under Input/Output Co-Efficient Organization (IOCO) approved import authorization.
- Removal of Fixed Income Tax on CKD/SKD manufacturing of mobile devices up to USD 350 category.
- Increase in Fixed Income Tax on USD~351 -500 USD category by PKR~2,000 and USD ~500 by PKR~6,300 on CKD/SKD manufacturing only.
- Removal of Fixed Sales Tax on CKD/SKD manufacturing of mobile devices.
- R&D allowance of 3% to be given to local assemblers for exports of mobile phones.
- Locally assembled/manufactured phones to be exempted from 4% of withholding tax on domestic sales.
- Government to commit maintaining tariff differential between CBU and CKD/SKD till the expiry of the policy.
- Local industry to ensure localization of parts and components as per roadmap included in draft policy.
- EDB to act as Secretariat of Mobile Phone Manufacturing Policy and ensure development of allied parts, components and devices.

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SWOT Analysis



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Outlook: Positive

- Pakistan's mobile phone industry has historically been majorly import driven, but after the issuance of Mobile Device Manufacturing Authorization regulatory regime, the local manufacturing has paced up and surpassed completely imported units in 9MCY21. DIRBS also contributed positively to the mobile ecosystem of Pakistan by eliminating counterfeit device market.
- The smartphone market is competitive dominated by established players such as Samsung, Huawei, Apple, and Xiaomi, among others. Most of these players keep launching new models with small technological changes such as battery power, camera configuration, and/processor. Overall demand for mobile phones has now become less price elastic. For the mid-range categories and below, where brand consciousness is low, mobile phone demand behavior is close to that of a commodity rather than that of a differentiated product.
- The sector is characterized with low to medium business risk. As the sector operates on fixed margins, any change in margins is either associated with changes in the duty structure, or changes in other costs.
- Historically, the sector has had a high dependence on debt particularly due to the imposition of SBP's directive to maintain 100% margin for Line of Credit (LC). Most of the debt book is composed of short term loans. However, the Sector's borrowing as a percentage of its equity base has recently come down to a moderate level (~42% in 1QFY22), after listing of one of the largest distributors of the country.
- The Government's mobile manufacturing policy to attract mobile manufacturing players to establish their plants is a positive step towards the growth of the Sector. This is the first step towards establishing a local competitive manufacturing market. Although localization levels are low, currently, the number of mobile phones that are partly local assembled has outgrown the number of completely imported units. This is also benefitting the economy in terms of job creation. Going forward, the policy should stimulate progress on localization levels in order to reduce dependence on imported phones, and develop a fully competitive local market creating opportunities for export as well.

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