



# Mobile Phone and Allied Products Sector Study

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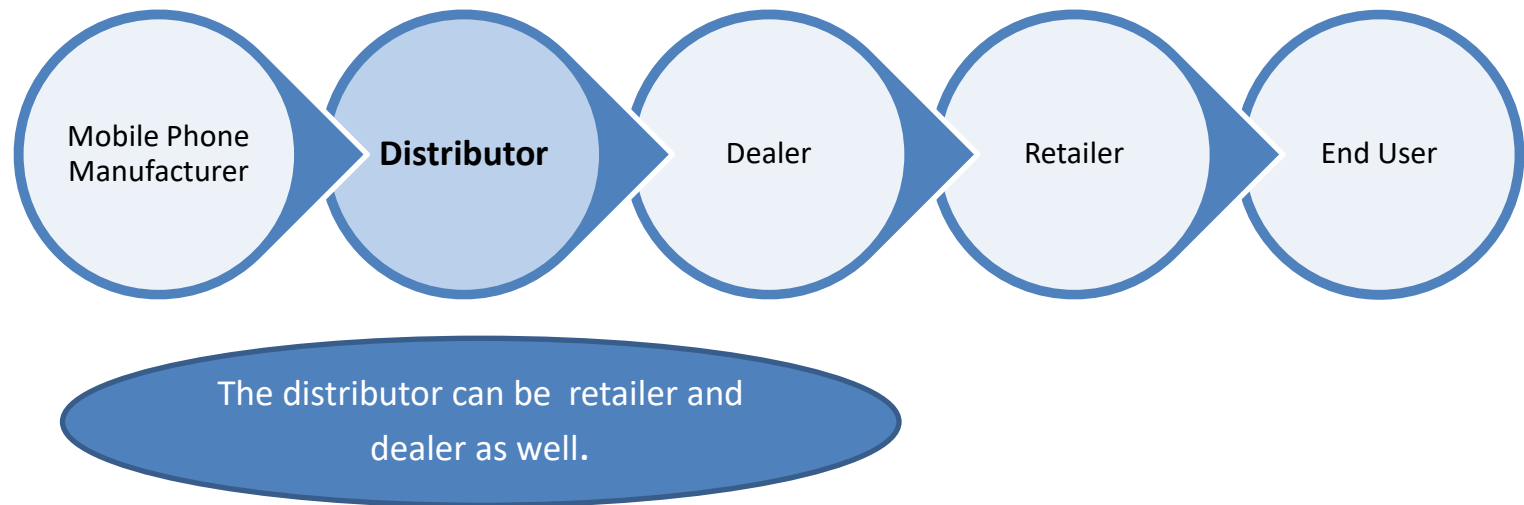
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# Mobile Phones and Allied Products

## Overview

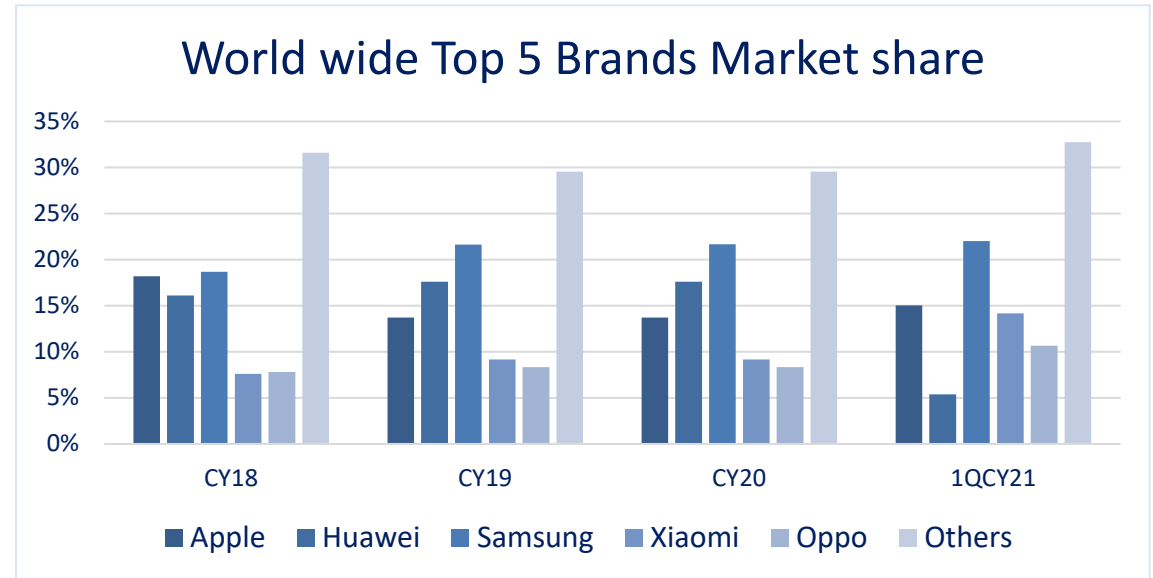
- This sector study shall focus on the manufacturer and distributor component of the Mobile Phone Supply Chain.
- A Mobile phone manufacturer is involved in manufacturing or assembling the mobile phones.
- A mobile phone distributor (or “distributor”) is an entity that buys mobile phones and allied products from the manufacturers 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 are an essential component in helping manufacturers/principles reach out to markets which they could otherwise not target.
- Distributors are responsible to sell the products and provide after sales services to clients.
- Manufacturers 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.



# Mobile Phones and Allied Products

## 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. The market size for CY21\* in terms of global shipments is estimated at ~1,388mln units which depicts an estimated growth of ~16% YoY in CY21.
- This is a reflection that the market has started regaining potential in CY21, with growth in annual shipping. Samsung is leading the market accounting for ~22% of the global shipments. Following it is Apple with a market share of ~15%, while Huawei, which was on the 2<sup>rd</sup> rank till CY20, is ranked the lowest in 1QCY21 in top 5.



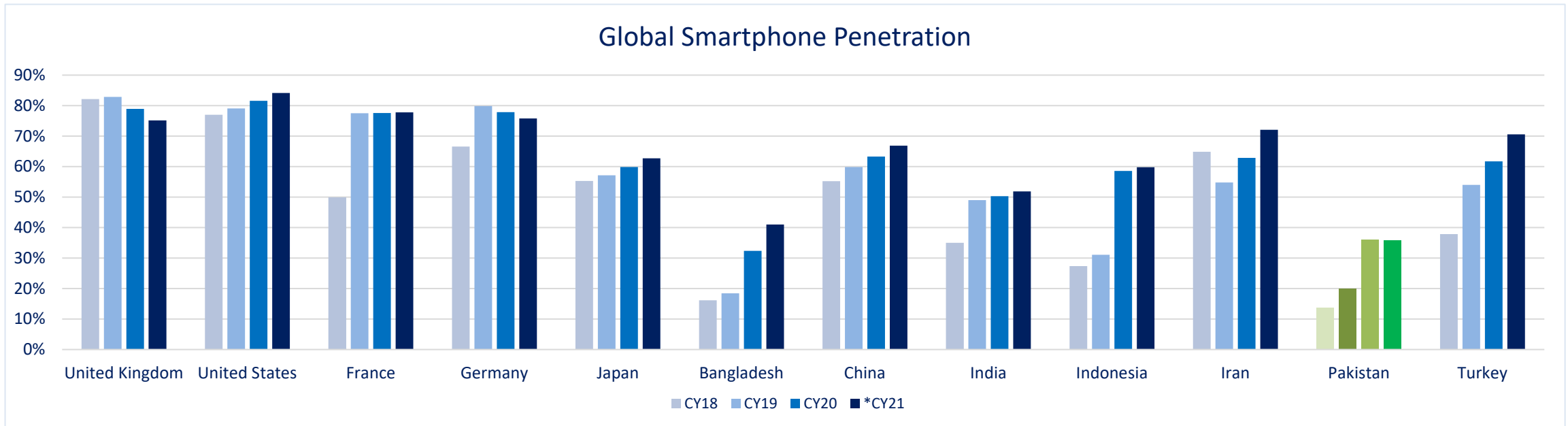
Global Smart phone shipment in (mln) units				
	CY18	CY19	CY20	1QCY21
Apple	257	188	186	52
Huawei	227	241	184	19
Samsung	264	297	241	76
Xiaomi	107	125	137	49
Oppo	110	114	104	37
Others	446	405	347	113
<b>Total</b>	<b>1,410</b>	<b>1,371</b>	<b>1,199</b>	<b>347</b>

\*Estimate based on 1QCY21

# Mobile Phones and Allied Products

## 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%.



# Mobile Phones and Allied Products

## Local Industry | Overview

- Market structure:** The local mobile phone Industry is by far, import driven. This reflects that 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, Xiaomi and other Chinese brands that have lately tapped into the domestic landscape. The global manufacturers/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 for lower volumes.
- Market size :** Total mobile phone imports during 11MFY21 were recorded at USD~1,860mln (FY20: USD~1,369mln) registering a significant growth of ~48% YoY.
- Distributors:** Currently, there are 4 major mobile phone distributors in the country including Airlink Communication, M&P, Green Tech 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	11MFY21
Industry Imports (mln USD)	1,369	1,860
Import Growth	81%	48%
Industry Structure	Oligopoly	
Top Brands	5	5
Top Distributors	4	4
Regulator	Pakistan Telecommunication Authority	Pakistan Telecommunication Authority

# Mobile Phones and Allied Products

## 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

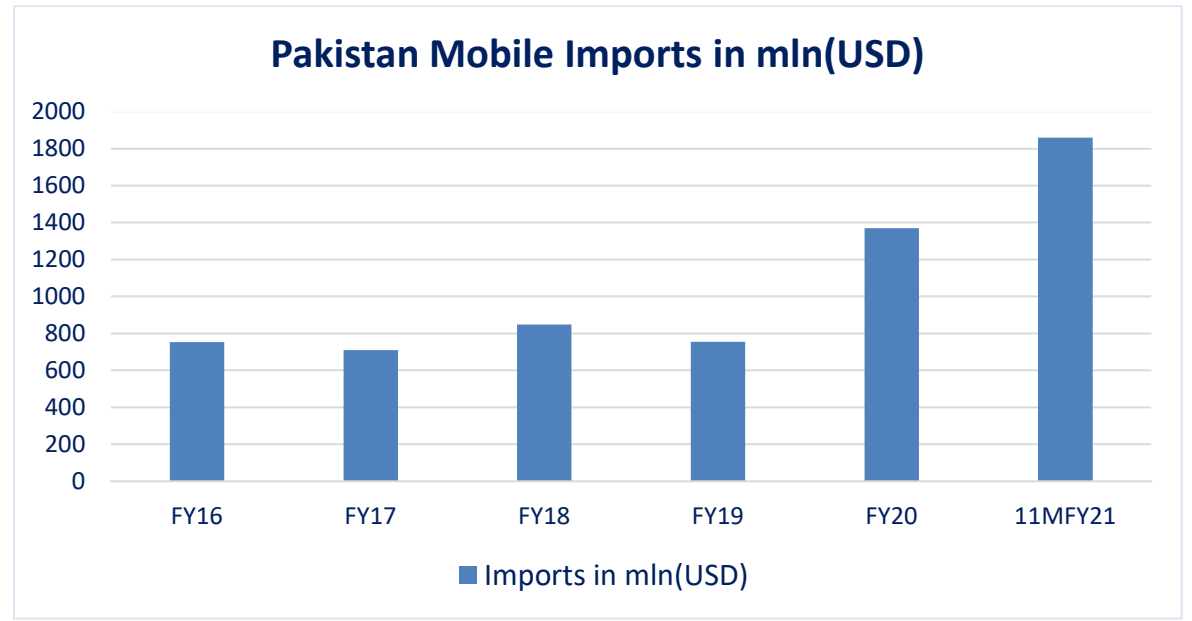
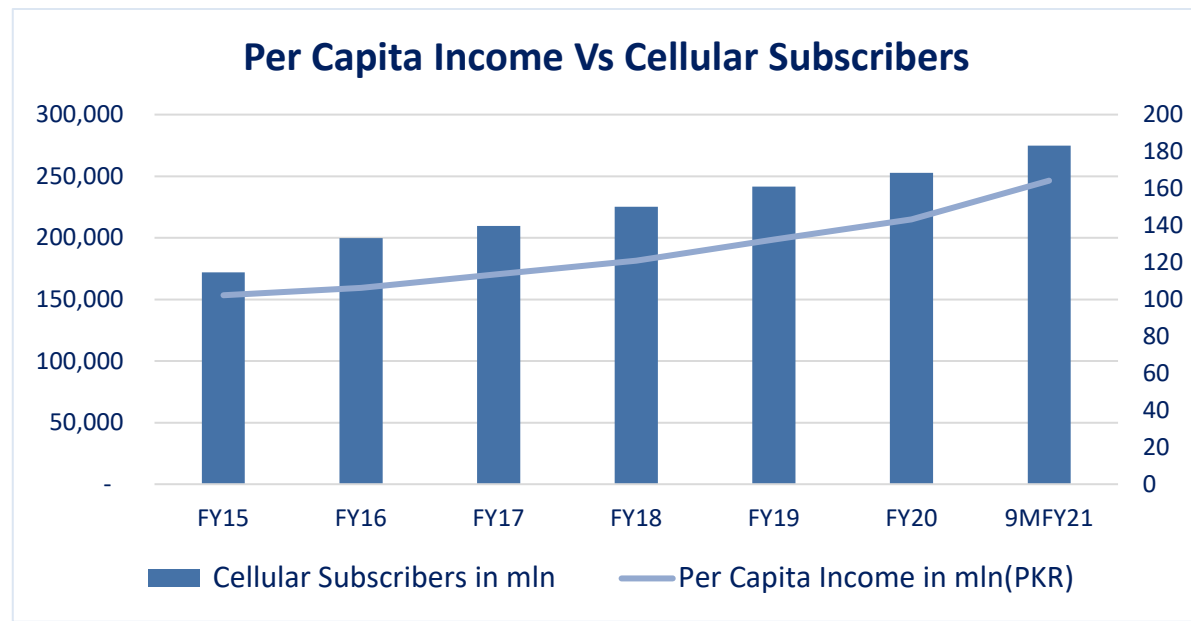
- New entrants
- More Competition
- No Brand Loyalty
- Most Price elastic



# Mobile Phones and Allied Products

## Local Industry | Demand

- The demand of smart phones 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 9MFY21, 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%).
- The emergence of smart phone industry has also increased the demand for mobile industry 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 largely relies on imports to meet the demand of mobile phones. In 11MFY21, the import of mobile phones was recorded at USD~1,860mIn. In FY20, Pakistan imported mobile phones worth USD~1,369mIn as compared to the imports of USD~755mIn in FY19, depicting a growth of ~81%. 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.

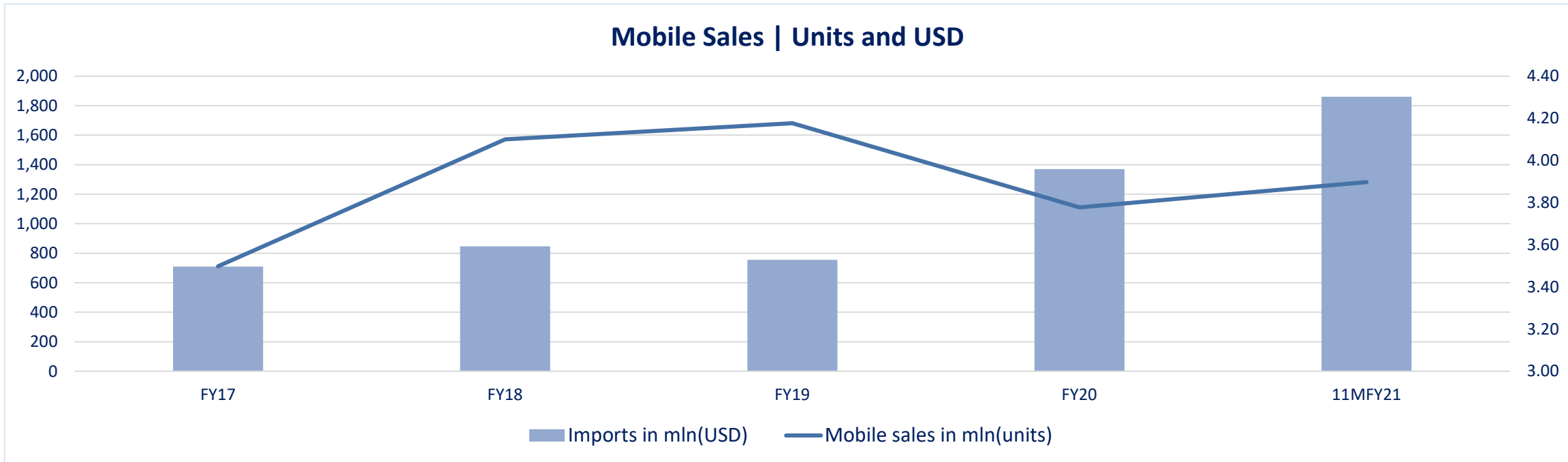




# Mobile Phones and Allied Products

## Local Industry | Demand

- Pakistan relies on imports to meet its mobile phone demand. However, lately, domestic assembling by the principles in collaboration with local partners has also commenced to encourage development of a competitive local market.
- The demand for Mobile phones in USD terms was recorded at USD~1,860mln in 11MFY21 (USD~1,369mln in FY20) registering an increase of ~48% YoY. Meanwhile, based on estimates, the demand in terms of number of mobile phones was recorded at ~3.9mln units in 11MFY21 (~3.8mln units in FY20, a YoY growth of ~13%). This reflects that the implementation of DIRBS has partially contributed to the growth in legal channel imports. The remaining impact is reflective of rising prices which has come as a consequence of price increase by the principles and updates in the duty structure.



\*Mobile Sales units are estimated based on PACRA's client's data which represents ~63% of the market share. Oppo, Vivo, Xiami, Infinix and some small Chinese brands are not accounted for in the estimates.

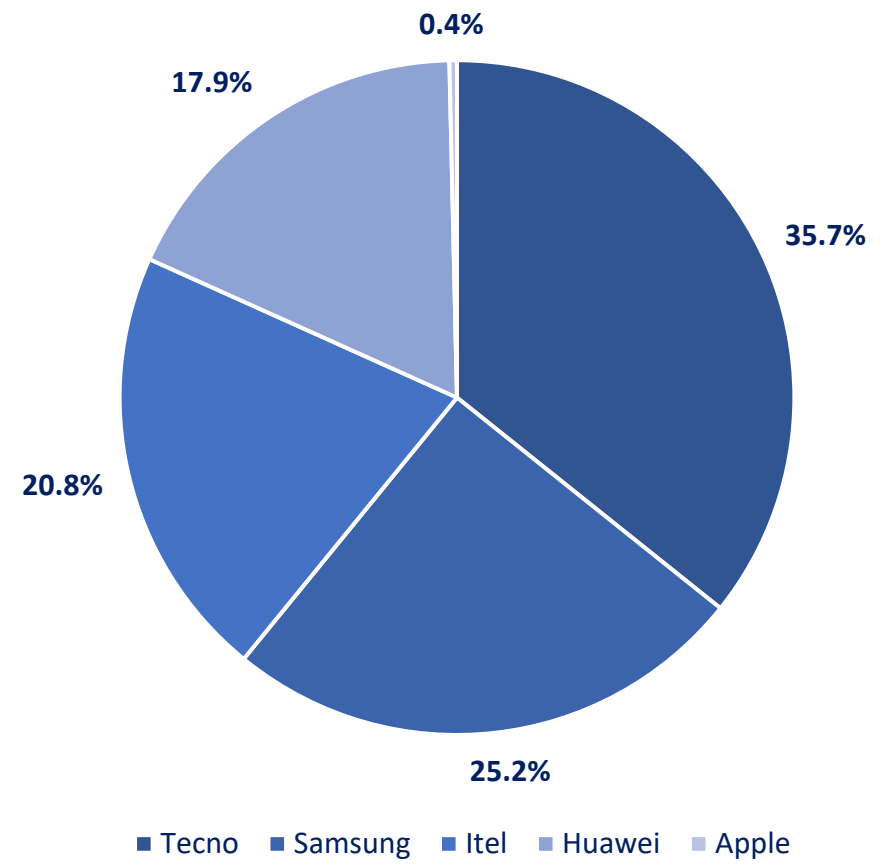
# Mobile Phones and Allied Products

## Local Industry | Supply

### Manufacturing:

- In terms of mobile manufacturing, five brands lead the market, including Samsung, Apple, Tecno, Itel and Huawei.
- Other players include Oppo & Vivo, Q mobile, Xiaomi and some other local and Chinese brands.

Local Mobile Phone Manufacturing Market share (Units)



# Mobile Phones and Allied Products

## Local Industry | Supply

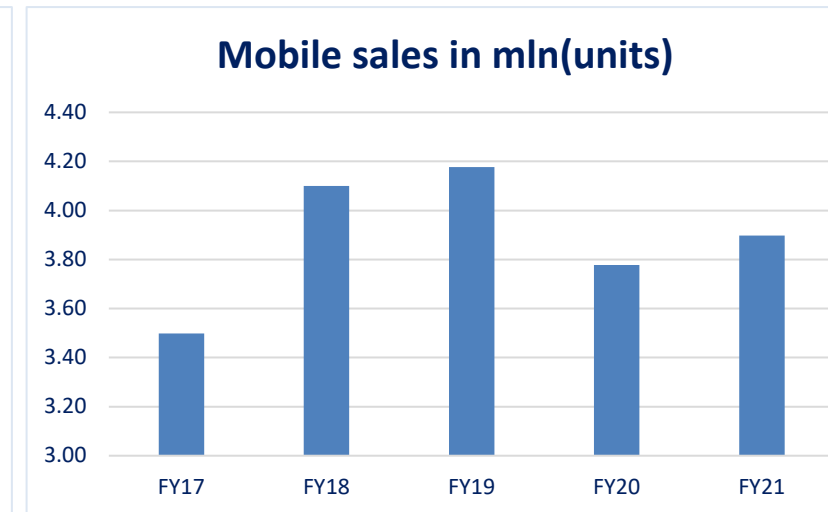
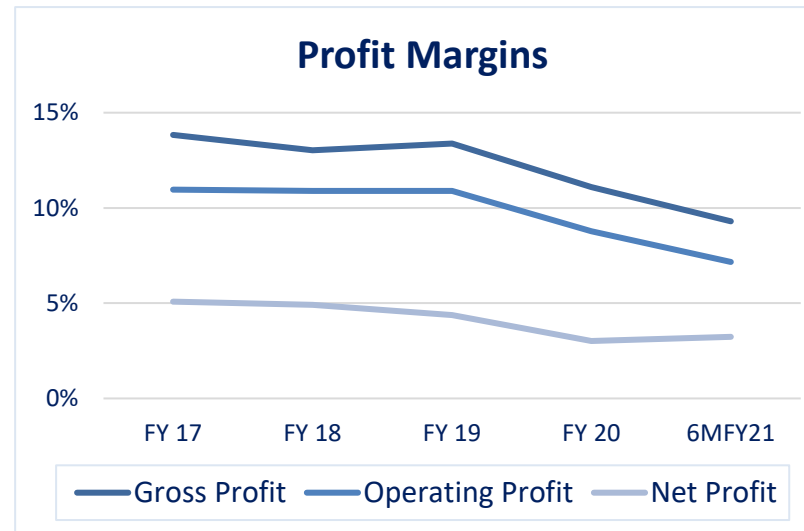
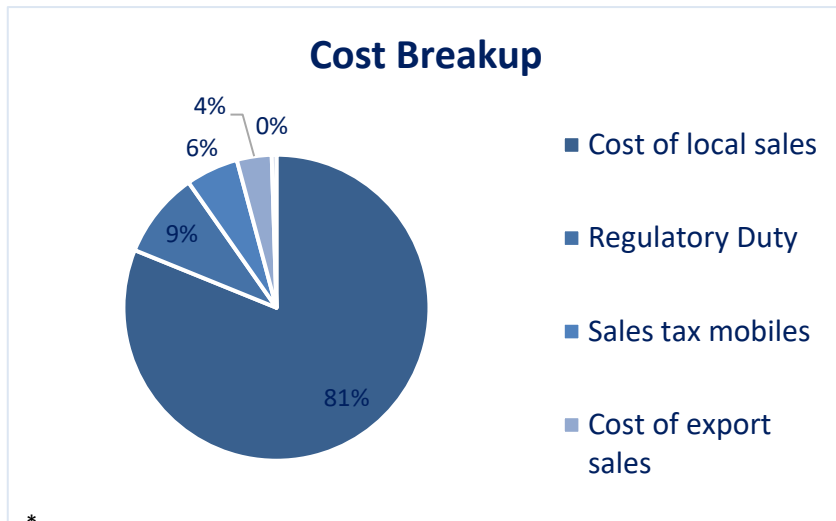
- Currently, there are 4 major mobile distributing partners, that are involved not only in distributing the international brands but assembling and distributing some local phones too. There are almost 7 – 8 other small distributing partners that distribute some local and Chinese mobile phones.
- These 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 usually 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 ~63% (in units).

Distributing Partners	
Distributors	Mobile Phone Companies
Airlink Communications	Samsung Huawei Apple iPhone Iitel Techno
Muller and Phipps M&P	Samsung Huawei Microsoft Mobile
Green Tech	Samsung, lenovo
Advance Telecom	Microsoft Mobile, Infinix

# Mobile Phones and Allied Products

## Business Risk

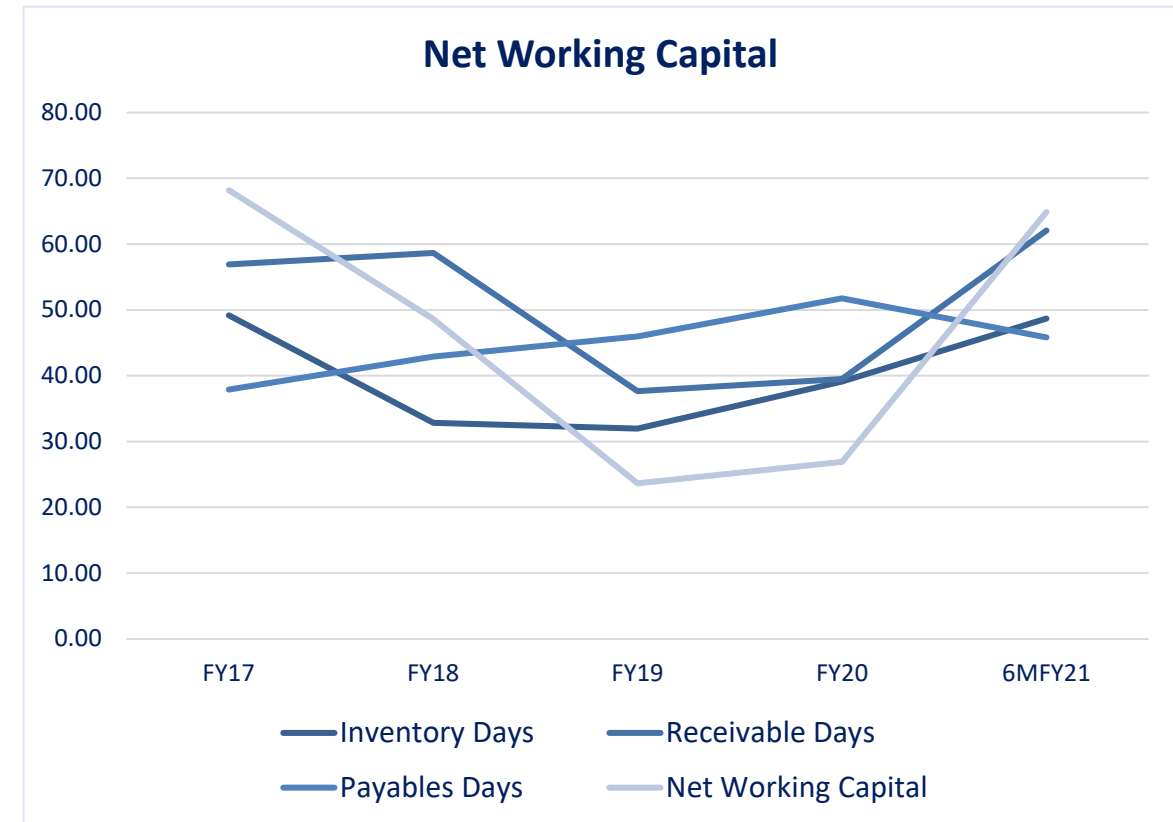
- Profit Margins:** The distributor segment runs on fixed margins. The sector’s margins remained relatively stable from FY17 to FY19. During FY20, the gross and operating margins dropped by ~2% each due to increased duty structure and high finance cost. A further decline in gross margins was noted in 1HFY21 as gross profit margins fell to 9.3% (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 1HFY21 (FY20: ~3%). Finance cost declined by ~20% to PKR~570mln in 1HFY21 as compared to PKR~720mln in 1HFY20. Overall the net margins during FY20 to FY21 remained stable at ~3%
- Cost Breakup:** Almost ~81% of the direct costs belong to the cost of local scales, while regulatory duty and sales tax on mobiles constitutes ~9% and ~6% respectively. Cost of local sales is associated to sales within Pakistan, while cost of export sales is related to sales beyond national borders.



# Mobile Phones and Allied Products

## Financial Risk

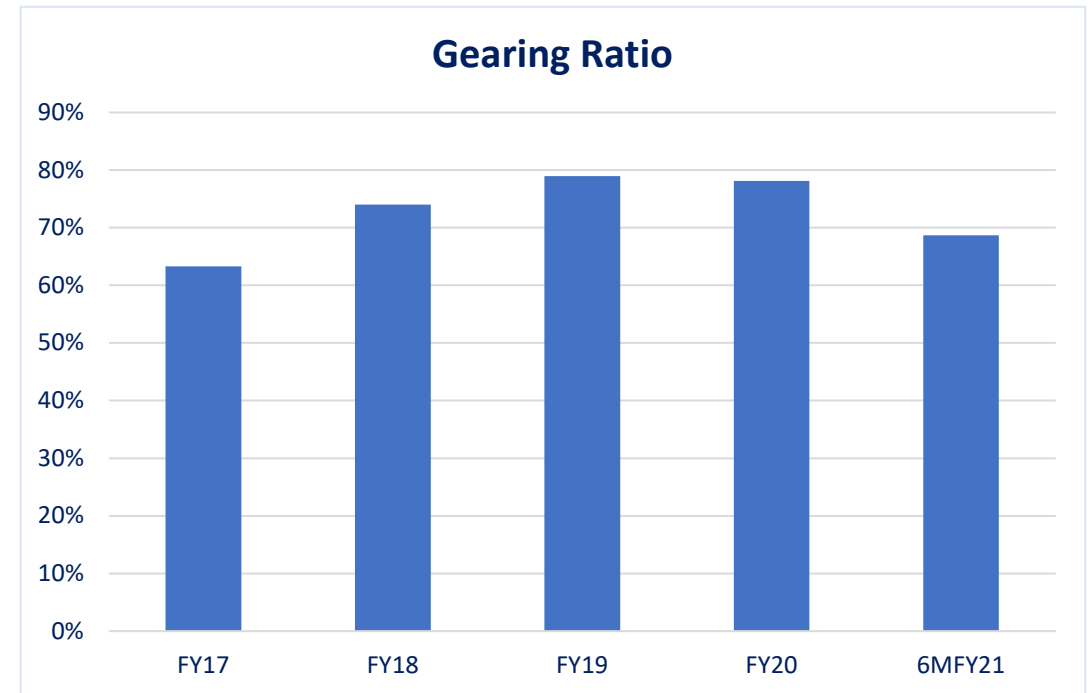
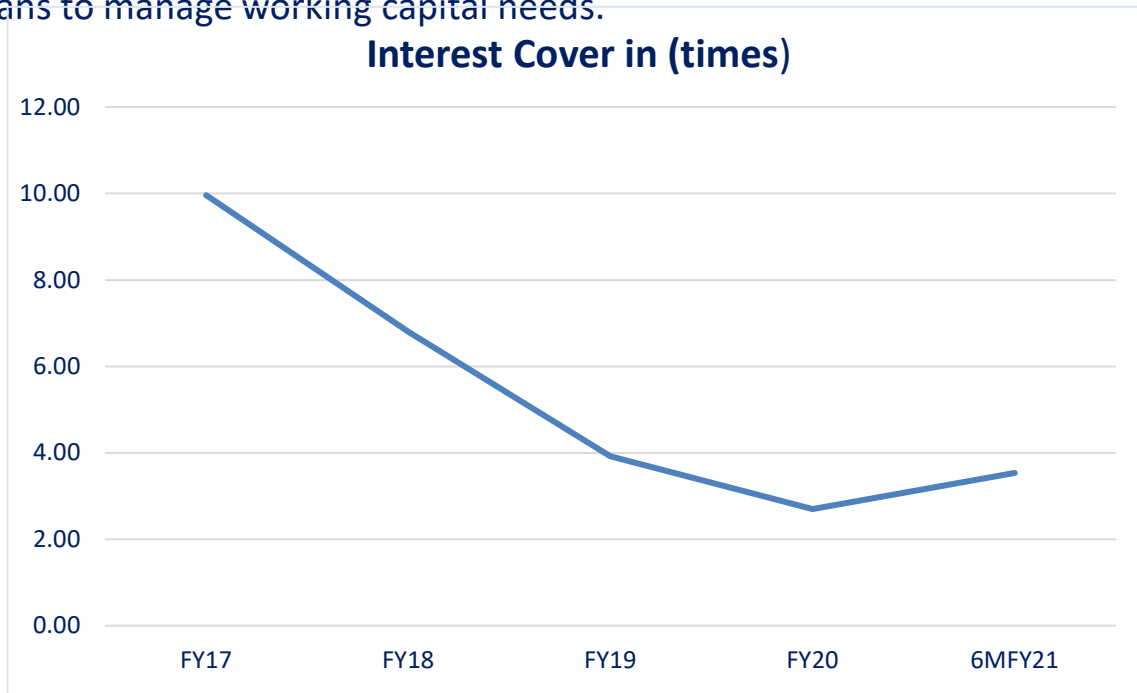
- The Industry’s Working capital requirement is a function of financing its trade receivables and inventory. Since the imposition of SBP's directive to maintain 100% margin for Line of Credit (LC), working capital needs have elevated. Leverage of the Sector has also gone high on the scale.
- The average net working capital of the Sector hover around 2.5-3 months due to the nature of LC Transactions for payments to supplier.
- The inventory days of the sector have improved from FY17 to FY19. While in FY20, the inventory days rose to ~39 days (6MFY21: ~48 days) which is majorly attributable to slump in demand as a result of lockdown and higher prices of smart phones. Overall, the Sector’s working capital average cycle has increased to over 60 days majorly on the backdrop of increased inventory and payable days.
- The higher net working capital days in FY17 and 6MY21 reflects increased receivable and inventory days in their particular period.



# Mobile Phones and Allied Products

## Financial Risk

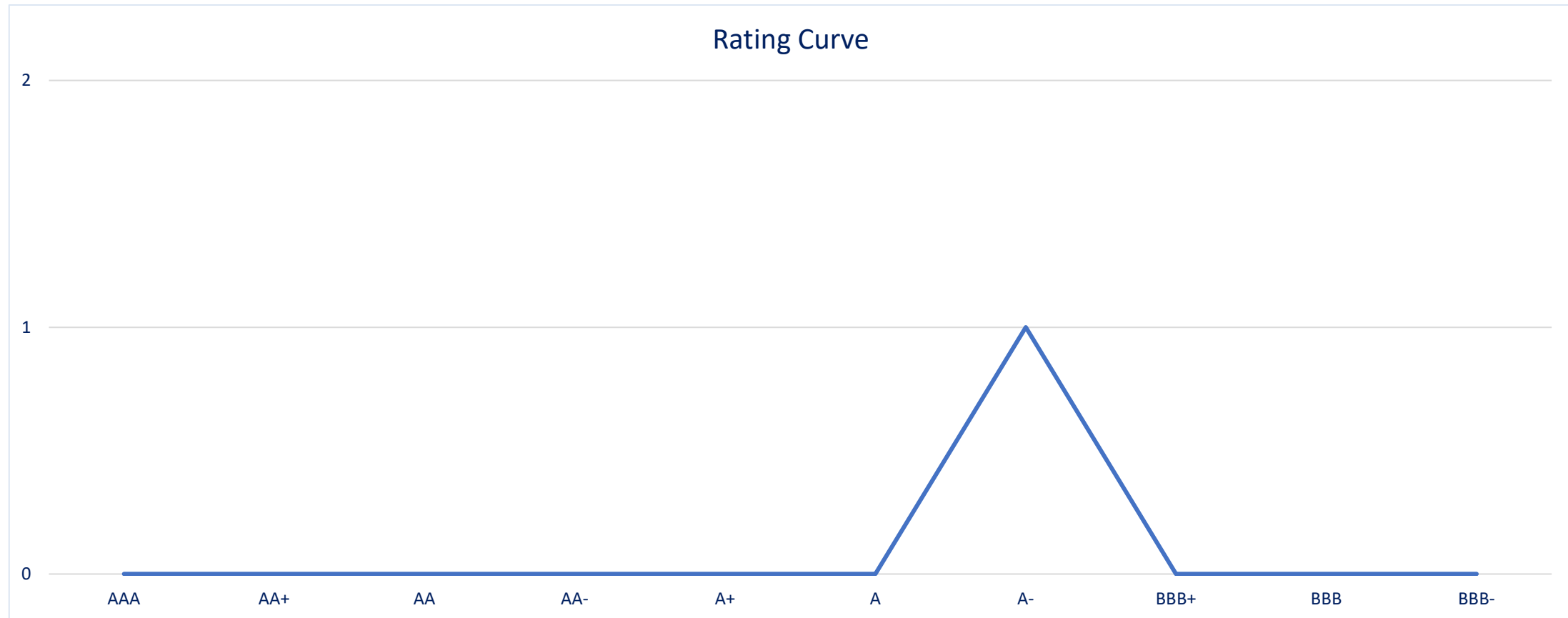
- The average interest cover of the Sector has taken a freefall from ~10x in FY17 to ~3x in FY20. This is majorly on the backdrop of increased short term borrowings, particularly after SBP’s imposition of 100% Cash Margin against Imports, and rising Interest costs in FY19 and FY20. However in FY20 SBP eased cash margin restriction on import of certain items/raw materials, and mobile phones was one on of them. In 1HFY21, the interest cover of the sector improved from ~3x to~4x due to reduced finance cost.
- The sector is highly leveraged with average leveraging ratio above ~60%. As at End 1HFY21, leveraging stood at ~69 % (FY20: ~78%). Total debt remains high clocking in at PKR~12,136mln, as at end-1HFY21 (FY20: PKR~16,378mln). Most of the debt book is composed of short term loans to manage working capital needs.



# Mobile Phones and Allied Products

## Rating Curve

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



# Mobile Phones and Allied Products

## Duty and Tax Structure

Duty & Taxes Summary-Finance Act 2020							Punjab Infrastructure Development CESS
Sr	CIF SLABS	Sales Tax PKR	Regulatory Duty PKR	Levy PKR	Income Tax PKR	Taxes Total (PKR) PKR	PRA %age
1	Up to \$ 30	130	165	-	70	365	0.01
2	\$ 31 - \$ 100	200	1,620	-	100	1,920	0.01
3	\$ 101 - \$ 200	1,680	2,430	400	930	5,440	0.01
4	\$ 201 - \$ 350	1,740	3,240	1,200	970	7,150	0.01
5	\$ 351 - \$ 500	5,400	9,450	2,800	3,000	20,650	0.01
6	Above \$ 500	9,270	16,650	5,600	5,200	36,720	0.01

### 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.



### 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),

- 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 Rs2000 and USD 500 by Rs6300 on CKD/SKD manufacturing only.
- Removal of Fixed Sales Tax on CKD/SKD manufacturing of mobile devices.
- In up to USD 30 category, words “except smart phones” to be inserted for CBU imports under 8517.1219 to avoid misdeclaration.
- R&D allowance of 3% to be given to local manufacturers 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

# Mobile Phone and Allied Products

## SWOT





# Mobile Phone and Allied Products

## Outlook: Stable

- Pakistan's mobile phone industry is majorly import driven. The industry witnessed a decline in growth in terms of global shipment and local sales in FY20 owing to the COVID-19 outbreak. However the market sustained itself with increased sales and import volumes.
- The smartphone market is rather 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 especially in the top niche segments.
- The sector is characterized with low to medium business risk. As the sector operates on fixed margins, any change in margins is associated with the rise in duty structure, or changes in other costs.
- The sector has a high dependence on debt. Total debt remains high, to manage working capital needs. Most of the debt book is composed of short term loans. Moreover, since the imposition of SBP's directive to maintain 100% margin for Line of Credit (LC), working capital needs have elevated.
- During FY21, the government decided to introduce a comprehensive mobile manufacturing policy to encourage and attract mobile manufacturing players to come to Pakistan and establish their plants. This is a positive step towards the growth of the Sector as it will encourage setting up plants for local assembly and enable development of a local competitive manufacturing market. This will also reduce exposure to exchange rate volatility.

# Mobile Phone and Allied Products

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<b>Research Team</b>	<b>Saniya Tauseef</b> <i>Asst. Manager</i> <a href="mailto:saniya.tauseef@pacra.com">saniya.tauseef@pacra.com</a>	<b>Fatima Mahmood</b> <i>Associate Research Analyst</i> <a href="mailto:fatima.mahmood@pacra.com">fatima.mahmood@pacra.com</a>
<p align="center"><b>Contact Number: +92 42 35869504</b></p>		

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