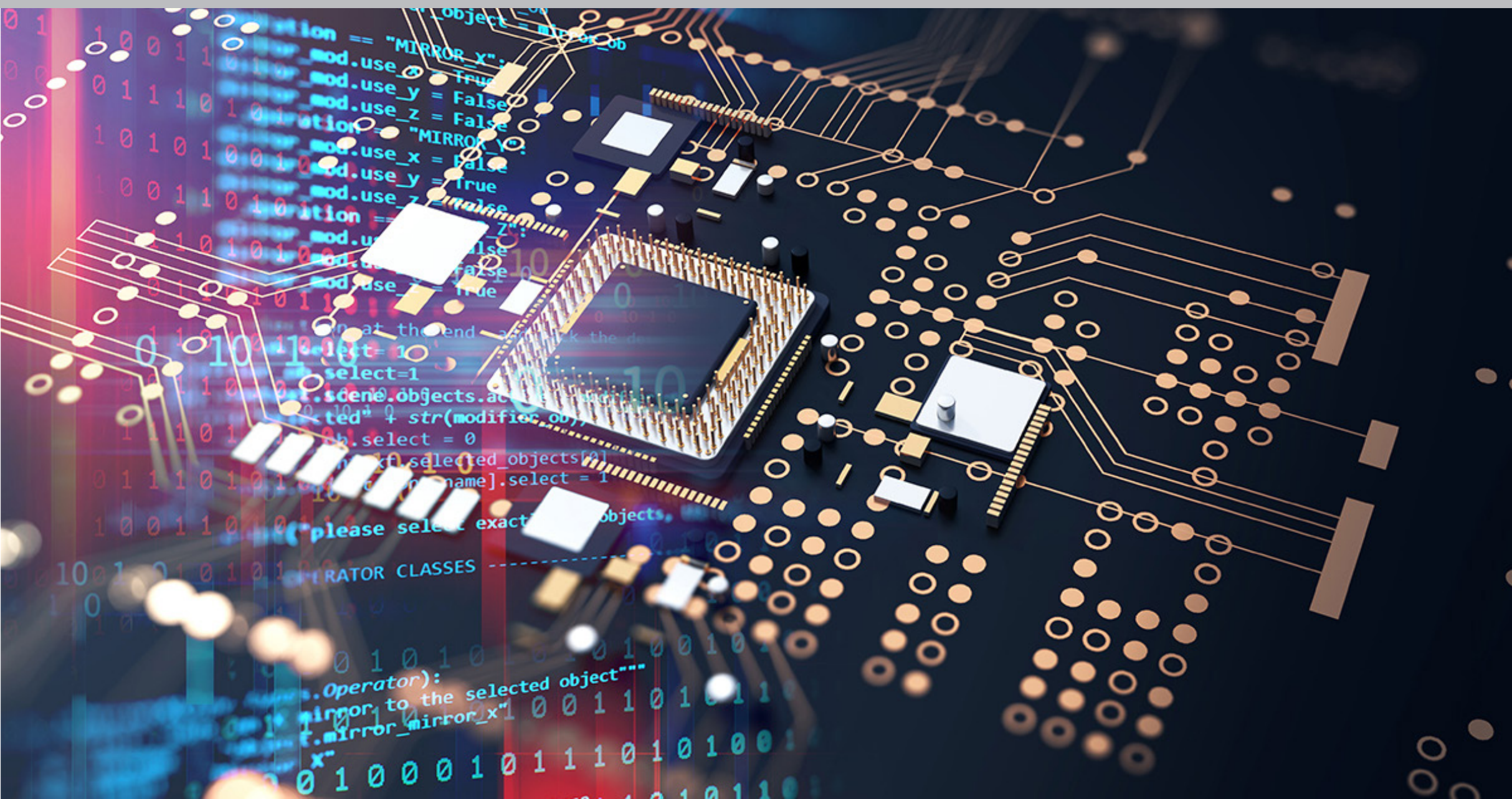


HOUSEHOLD ELECTRONICS SECTOR- AMID COVID-19

August, 2020



- Industry Sub-segments:

- Air conditioners
- Refrigerators/Deep Freezers
- Washing Machines
- LEDs
- Small Kitchen Appliances
 - Toasters
 - Vacuum Cleaners
 - Coffee Machines
 - Irons

Major Revenue Drivers

Minor Segment



Global Trends- Historical Perspective

- Over the past few years, the home appliance market has experienced steady growth, and the positive momentum is expected to continue over the next decade
- Market Size at end-FY19: **\$524b**

Trends Influencing Appliance Market Share

Increase in technological advancements

Rapid urbanization

Growth in the housing sector

Rise in per capita income

Improved living standards

Surge in need for comfort in household chores

Change in consumer lifestyle along with escalating number of smaller households

Global Trends- Historical Perspective

- Major segment contribution: **\$337b**; around 64%
- YoY Revenue growth of 2.3% driven by:
 - Prices – 82%
 - Volumetric Increase – 18%
- Small Appliances Segment: **\$187b**; 36% in revenue and 82% in volumetric sales
 - Kitchen Appliances contributing **\$97b**
- ❑ China has Home Appliances largest consumer market, guided by the high capacity usage and desire for comfortable lifestyle
- ❑ North America is leading the market share in the home appliances market due to the huge boosts in the technology penetration in the country

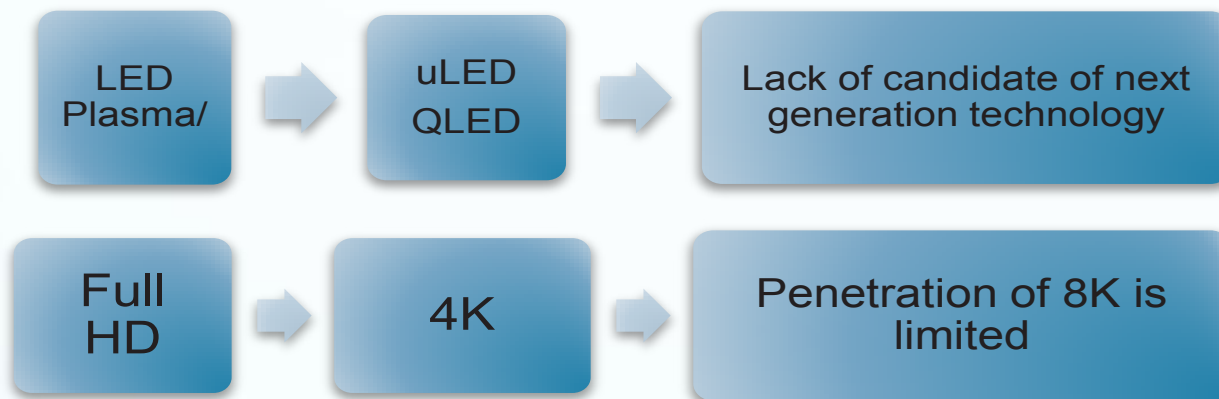
Global Trends- Prospective; Pre-COVID

- Revenue to increase to \$ 849.6b by end-FY25
 - CAGR of 4.1%
- Globally the core growth is projected in 'Lifestyle Infrastructure' business involving comfort and improved efficiency both in terms of time and capital – high demand products include inverter air conditioners and automatic washing machines
 - CAGR of 13%

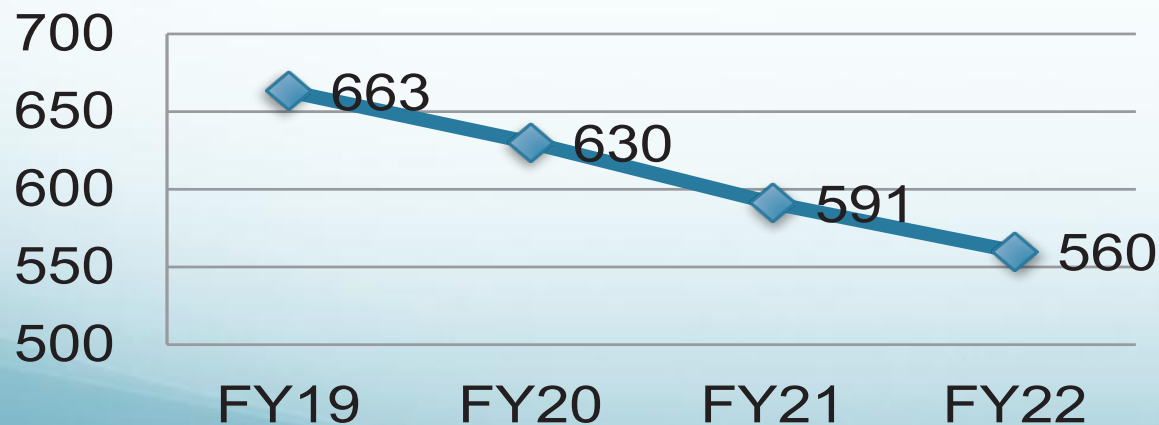
Global Trends- Prospective; Pre-COVID

- ❖ Demand of TVs linked to technological evolution is stagnant; market is shrinking as viewership is shifting to smart portable devices,

- **Technical Evolution of TV**

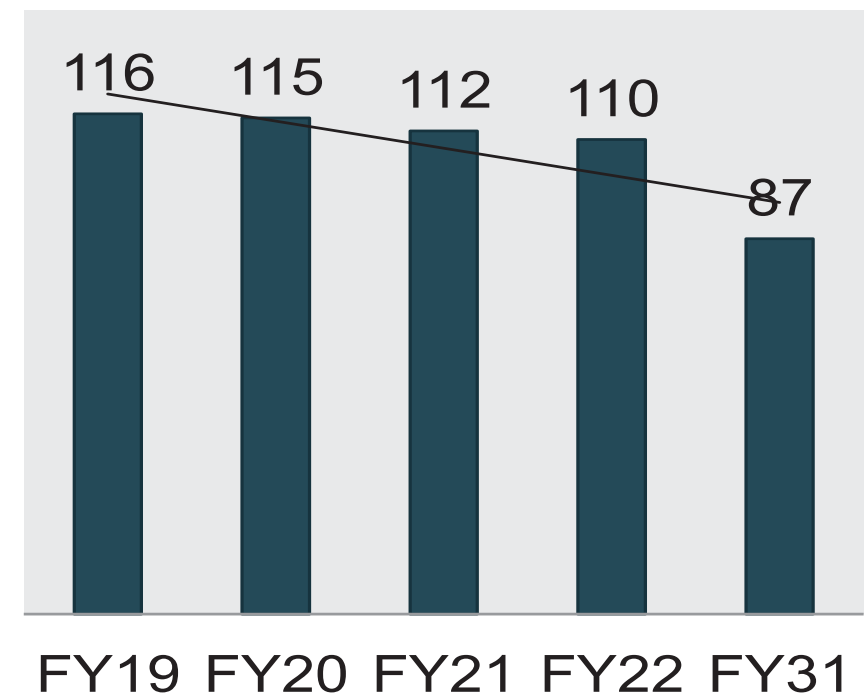


TV Unit Price in Europe (USD)



Global TV Demand

■ Billion USD

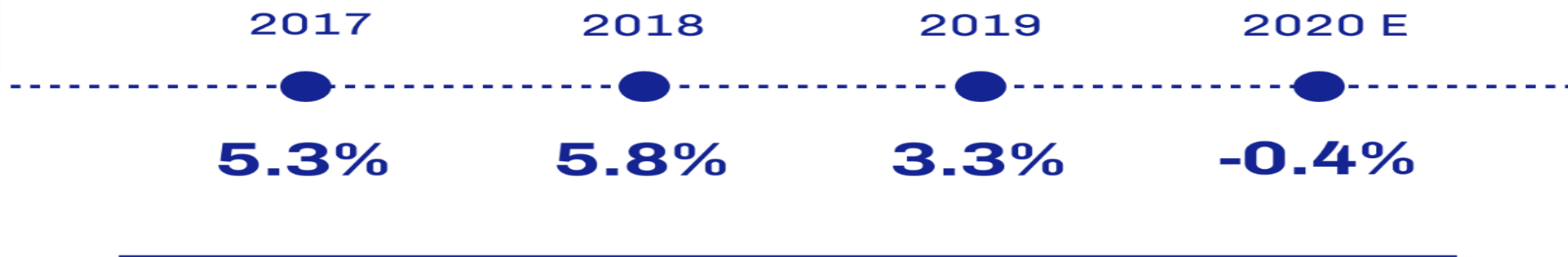


Global Trends- Prospective; Post-COVID

- US imports of household appliances and consumer electronics declined by 9.0% and 15.5% respectively in the past three months including a 4.7% rise in household appliances in May alone. This may be due to availing pricing advantages and channel stuffing in order to maintain factory operations
- Major home appliances manufacturers have entered COVID-19 on a weak profitability or unit sales, after a period of turmoil for their supply chains caused by the U.S.-China trade war.
- The sector has faced challenges throughout the past five months. A high reliance on Chinese suppliers caused considerable disruptions when their manufacturing shutdown in February and March. A drop in demand in the U.S. came later in April and May

Domestic Economy-GDP

GDP over the years



- Closer look at Pakistan's pre-COVID economy reveals that a 73% fall in Current Account Deficit has been achieved largely at the cost of the economic growth
- COVID-19 contributed also to this decline in the GDP, however, pre-Covid-19 the Government at the time of preparing the budget FY19-20 had estimated that GDP Growth rate will fall to 2.4%

Domestic Economy-GDP Contributors

- Large Scale Manufacturing (LSM)
 - 78% share in manufacturing
 - 10.2% contribution to GDP
- Electronics Segment
 - Growth of 23.7%,
 - Share in GDP 2.1%
 - Share in LSM 23.7% (FY18: 73.8%)
- The growth is a function of phenomenal increase in usage of electric motors and compressors which registered a growth, the same is a result of wide usage in washing machines, refrigerator, air conditioners etc.
- The demand for these goods rises in summer as manufacturers build up the inventories
- Improvement of electricity supply also contributed to the performance of this subsector

Table: Group-Wise Growth of LSM for the Period of Jul-Mar 2019-20 Vs Jul-Mar 2018-19

S#	Groups	Weights	% Change (July-March)	
			2018-19	2019-20
1	Textile	20.9	-0.17	-2.57
2	Food, Beverages & Tobacco	12.4	-3.59	-2.33
3	Coal & Petroleum Products	5.5	-6.00	-17.46
4	Pharmaceuticals	3.6	-8.66	-5.38
5	Chemicals	1.7	-4.10	-2.30
6	Automobiles	4.6	-7.56	-36.50
7	Iron & Steel Products	5.4	-11.00	-7.96
8	Fertilizers	4.4	4.50	5.81
9	Electronics	2.0	39.90	-13.54
10	Leather Products	0.9	-0.04	4.96
11	Paper & Board	2.3	-2.48	4.23
12	Engineering Products	0.4	9.90	-7.05
13	Rubber Products	0.3	3.74	4.31
14	Non-Metallic Mineral Products	5.4	-4.93	1.82
15	Wood Products	0.6	-8.24	-22.11

Source: Pakistan Bureau of Statistics

Electronic Segment- Domestic Growth

- Growth in consumer electronic goods segment is driven by:
- Population Growth
 - Sixth largest country in terms of population
 - Average growth rate at 2%
- Urbanization
 - Growth estimated at 1%
- Trend of nuclear families; increased number of house holds
- Increased Disposable Income
 - Per capita income increased by 6%; 2-3% expense made on household appliances
- Improved Standard of Living

Domestic Trends- Historical Perspective

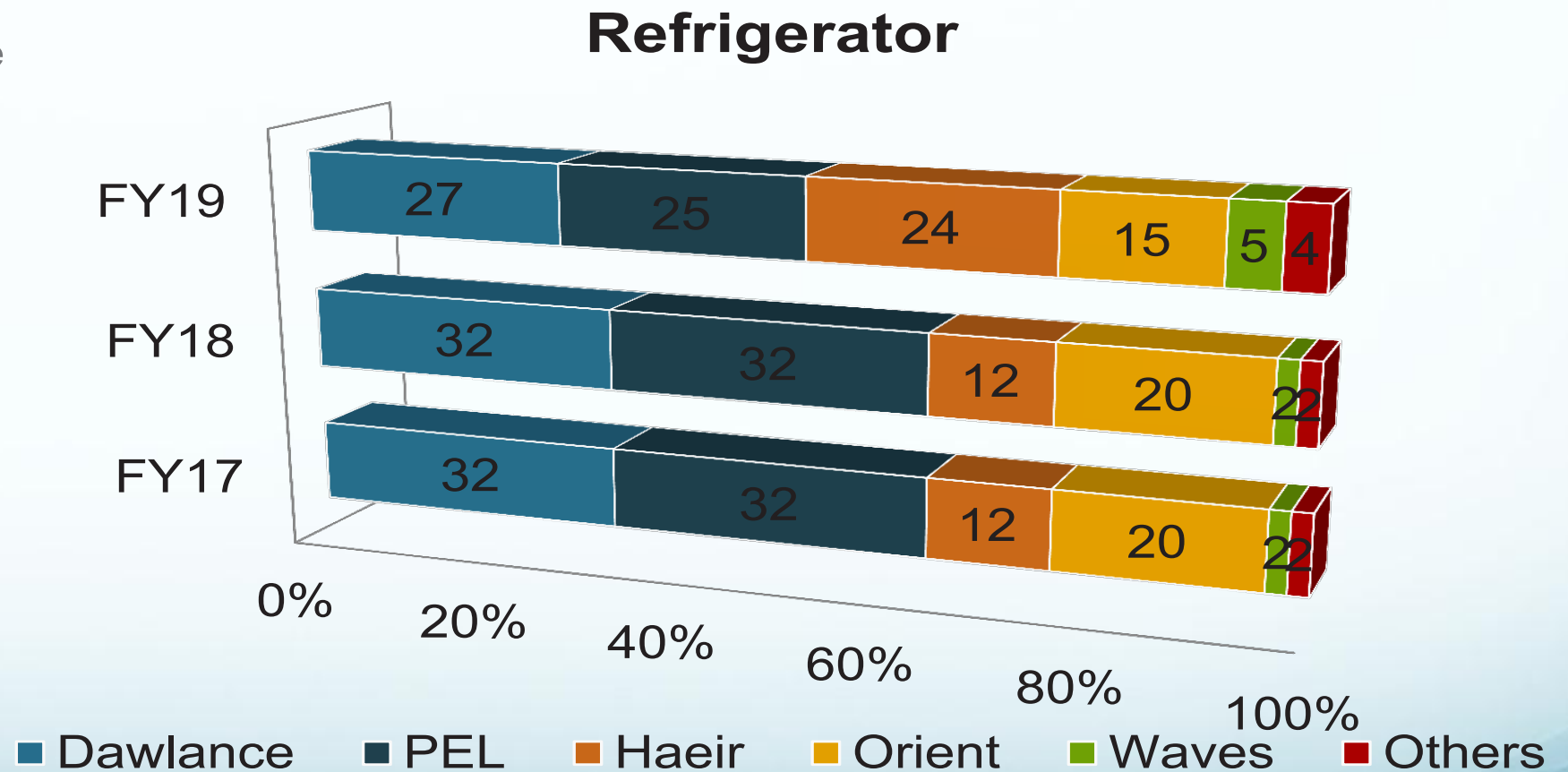
- High Import Dependence
 - The local consumer goods industry is majorly involved in assembling of finished products
 - Major cost component- complete knockdown (CKD) kits are imported; major import is from China
 - Imports from China of electronic equipment amounted US\$3.2b (FY18: US \$3.1b) during FY19
- With depreciation of rupee, the cost of CKD kits surged leading to exponential increase in prices of end products; the same had adversely impacted the volumetric sale prior to onslaught of corona virus pandemic
- However, the topline of the major market players were rescued on account of higher sale price

Trend in Prices

Product Line (Rs/unit)	FY18	FY19	End-April'20
Air Conditioner	58,511	77,051	78,717
Refrigerator	41,704	44,769	45,072
LED TV	28,408	29,962	31,987
Washing Machine	22,547	27,352	39,889
Microwave Oven	10,342	12,250	13,054
Water Dispenser	11,564	13,789	14,897

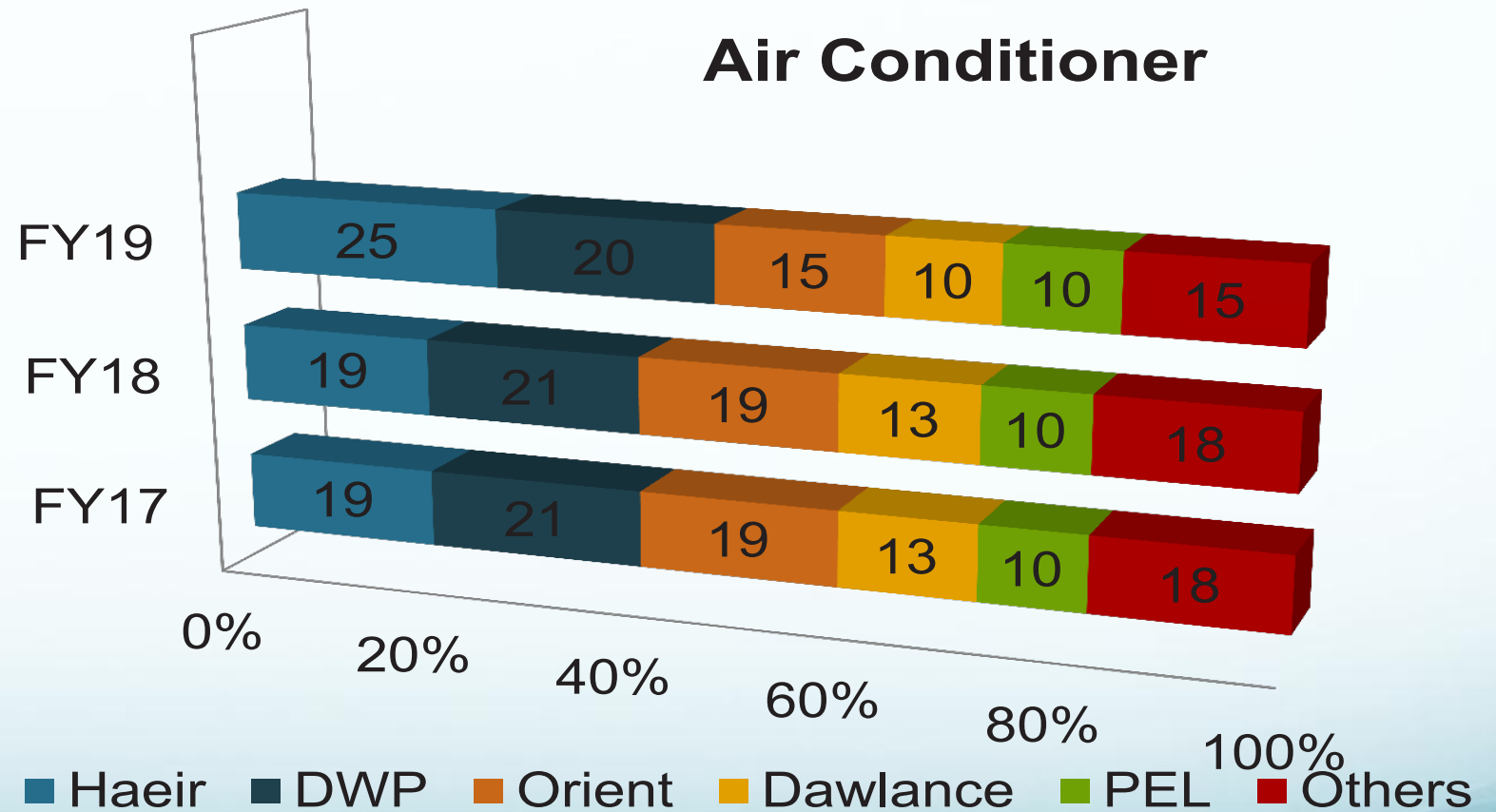
Industry- Market Share

- Sizeable market concentration
- Market Leaders
 - PEL
 - Dawlance



Industry- Market Share

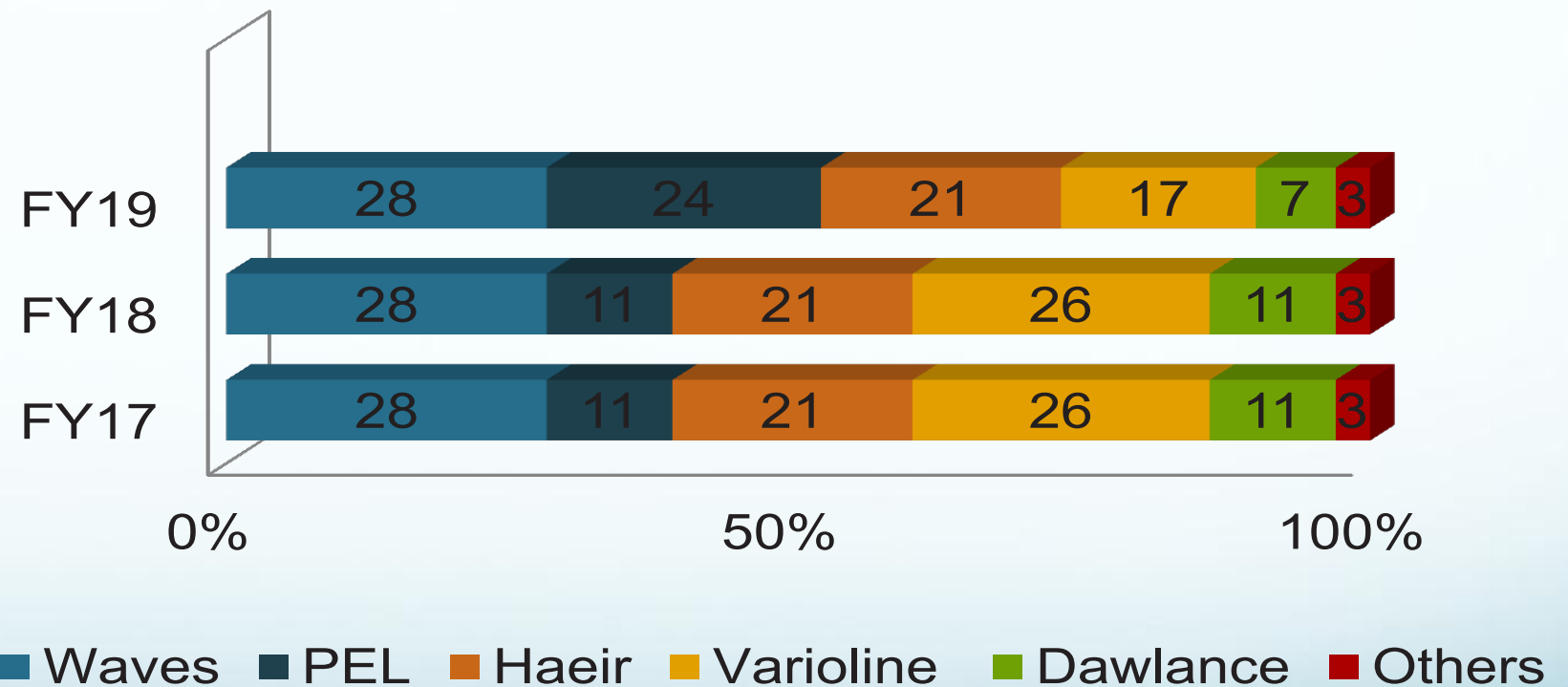
- Top three players constitute 60% market share
- Haeir remains the market leader



Industry- Market Share

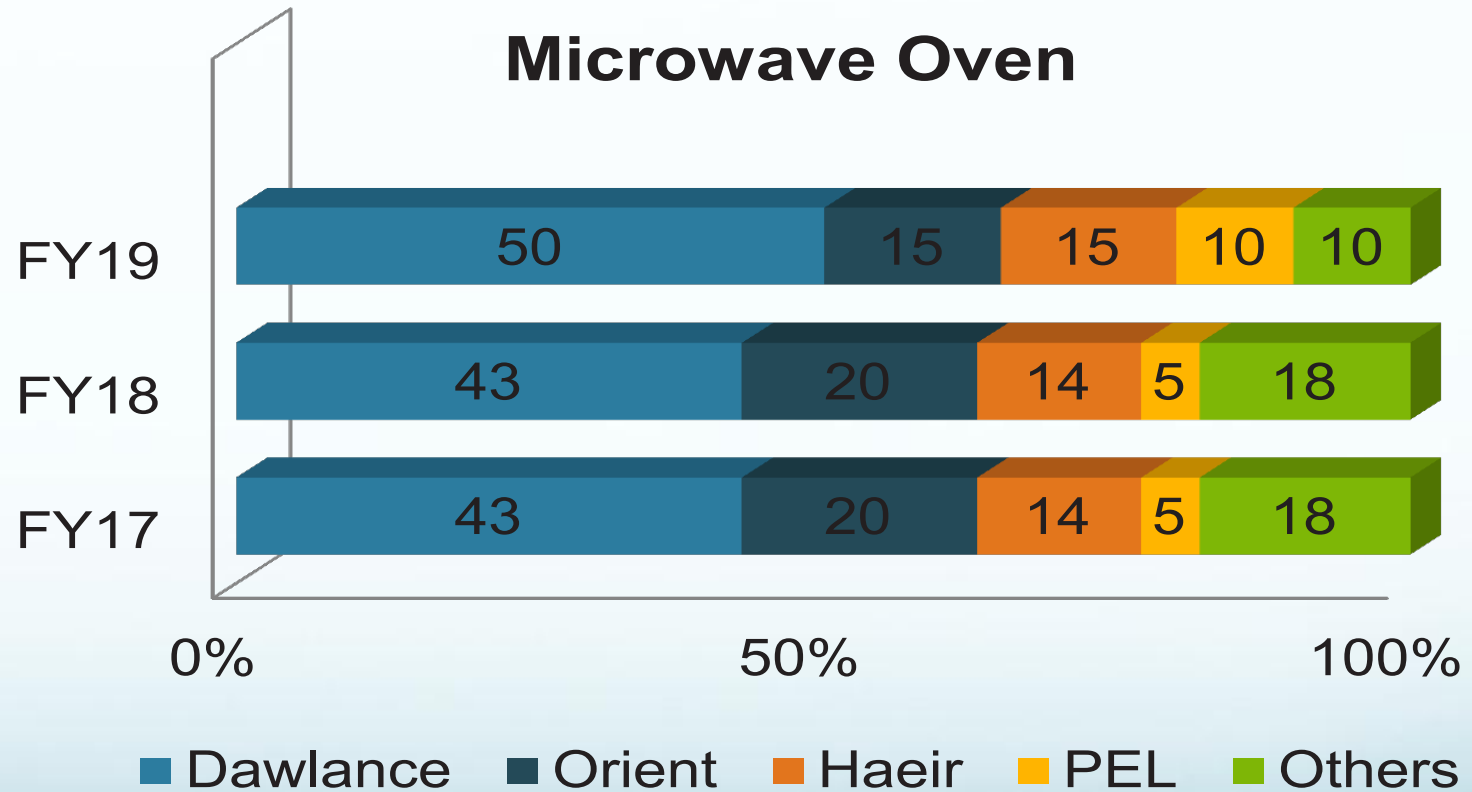
- High market concentration; top three represent 75%
- Market Leaders
 - Waves
 - PEL

Deep Freezer



Industry- Market Share

- High market concentration; top three represent 80%
- Market Leaders
 - Dawlance
 - Orient



Onslaught of COVID-19

- The ongoing year with its unprecedented lockdowns domestically and the world over due to Covid 19 is expected to leave its marks on the economies in the mid term future
- Pakistan's economy had been suffering before the COVID-19 outbreak but it was in no imminent danger of a recession; however pandemic has added to the slowdown
- The government has taken measures to stabilize the economy noting that the fundamentals of the economy had improved as a result of the IMF package, fiscal consolidation and the necessary reforms being undertaken
- However, as the pandemic spread, exports suffered due to cancelled orders from buyers and slow demand, production and logistics suffered due to slow economic activity coupled with plummeted domestic demand

COVID-19- Impact

● GDP

- The Economic Survey revealed that the GDP for FY 2020 was -0.38%, which was largely due to negative growth in the Services Sector that roughly contributes around 61% to the GDP. The stimulus package of the government is likely to provide fillip to this consumption sensitive segment.
- The pandemic seems to stay for a better portion of FY21; hence GDP projections remain weak

● Inflation

- Year-on-year inflation in July 20 was placed at 9.3%
- Oil prices are expected to remain weak in the short term, as uncertainty over the timing of a global recovery persists; for a petroleum importer like Pakistan, this will result in significant cost savings and downward pressure on prices
- Although the economy has been largely re-opened, aggregate demand is likely to stay depressed during most of this year, which will have a dampening effect on prices

COVID-19- Impact

- Monetary Policy
 - In line with market expectations, SBP cut policy rate to 7% in June'20 businesses and economy fight against the coronavirus pandemic. The decision to reduce the policy rate was in line with the view that the inflation outlook has improved further in light of the recent cut in domestic fuel prices as also to kick start the sagging economic growth
 - As a result, inflation could fall closer to the lower end of the previously announced ranges of 11-12% this fiscal year and 7-9% next fiscal year

Production Statistics

Month	Refrigerators (no.)		Deep Freezers (no.)		Air Conditioners (no.)		TV Sets (no.)	
	FY18-19	FY19-20	FY18-19	FY19-20	FY18-19	FY19-20	FY18-19	FY19-20
July	142,081	100,101	15,165	14,586	51,588	38,960	32,134	30,593
Aug	137,082	89,652	13,248	18,206	34,982	32,599	32,278	30,525
Sep	77,013	77,238	6,442	15,324	5,819	6,964	29,856	31,601
Oct	77,013	72,538	6,442	7,455	5,819	6,964	31,601	29,856
Nov	57,237	57,368	5,346	5,025	20,805	5,635	32,967	29,850
Dec	53,972	69,996	5,014	4,644	20,646	7,885	32,700	29,669
Jan	91,049	76,097	5,305	4,878	23,307	16,379	32,300	29,689
Feb	94,819	70,483	8,273	7,073	74,268	18,297	31,104	29,680
Mar	86,107	56,449	29,281	3,598	72,023	13,043	30,788	19,790
Apr	92,492	6,996	33,441	1,048	69,632	5,246	30,668	6,597
May	92,338	8,204	32,368	1,610	68,816	5,956	30,667	7,831
June	92,547	N/A	32,669	N/A	66,581	N/A	30,625	N/A
Total	1,093,750	685,122	192,994	83,447	514,286	157,928	377,688	275,681

COVID-19- Consumer Electronics Sector

- Production numbers exhibit significant decline on account of:
 - Lockdown imposed by end-Mar'20 resulting in closure of non-essential manufacturing units all across the country
 - Lockdown led to companies holding sizable inventory resulting in higher working capital costs
 - Major raw material imports from China; the epicenter of the pandemic leading to delay in shipments, the impact of the same on production magnified in 4Q of FY20, given the procurement orders are given four months prior to demand projections
 - However, the production figures were slashed since start of 3Q of FY20 prior to onslaught of the pandemic in Pakistan on account of readjustment of sale forecasts due to increase in retail prices resulting in suppressed demand
- Recovery of the growth trend is likely to be delayed; production statistics expected to pick pace by start of FY21

Market Players Statistics- Average of Entities Rated by VIS

	FY18	FY19	(End'May'20)
Net Sales (%)	12,261	14,123	9,035
Gross Margin(%)	20.3	20.9	21.1
Net Margin (%)	4.6	4.2	2.0
FFO	671	685	-
Total Debt	4,631	6,226	5,642
FFO/Total Debt (x)	0.14	0.11	-
FFO/Long Term Debt (x)	4.1	1.0	-
Leverage (x)	2.10	2.29	2.00
Gearing (x)	1.28	1.36	1.01
Total Liabilities	7,522	9,965	9,487
Total Equity	5,315	5,963	6,260
Current ratio (x)	1.15	1.13	1.16
(Stock in Trade+ Trade debt)/ STD (x)	1.37	1.52	2.04

Statistics Analysis-Revenue

- There has been noticeable decline in revenues despite significant improvement in retail prices of end products on account of dollar appreciation; the same demonstrates that drop in quantum sales in even more
- The positive momentum in sales halted even prior to the pandemic during 2Q and 3Q of FY20 owing to price escalation indicating high sensitivity of the sector to price driven demand risk
- Demand compression further aggravated after Covid-19 and lockdown due to:
 - Inflation
 - Increased unemployment
 - Reduced buying power of customers
 - Shrunk demand from institutional customers since overall the economy is on a standstill
 - Non-essential nature of products

Statistical Analysis-Revenue

Given the impact of the economic slowdown and the pandemic it would take some time for the consumer electronics segment to recoup. Owing to the following reasons:

- Peak season for the year 2020 has already passed
- Decreased per capita income due to lockdown
- Households are in saving/survival mode whereby cash conservation is the current go to strategy so spending on non-essential items required for comfortable living would be low.
- Overall dampened economic activity

Statistical Analysis-Profitability

- Mixed trend in gross margins on account of:
 - Different product lines & flagship products
 - Extent of diversification in product mix
 - Presence in local/export market
- The drop in gross margins in few companies was an outcome of devaluation of rupee rendering imports expensive, the impact of which could not be fully transferred to customers during the concerned period
- However, the declining trend in net margins was consistent throughout the sector:
 - High finance cost owing to increased benchmark rates
 - Increased operating expenses in line with lofty promotion and advertising on account of competitive market dynamics
- Going forward:
 - Margins expected to improve owing to complete transfer of input price increase to end-consumers coupled with reversal of policy rate

Statistical Analysis-Liquidity Position

- Cash flow position demonstrated downward trend owing to reduced net margins along with increase in financial expense borne
- Funds available in terms of outstanding obligations due declined in line with increased utilization of short-term funding to meet high working capital requirements; the same was a function of sizable unsold inventory
- Subsequently, debt service indicators also dipped
- Current ratio showcased improvement owing to high inventory
- Going forward:
 - Given the current economic outlook amidst the pandemic crisis, the likelihood of materialization of projected sale targets is nominal; therefore the sector might face liquidity stress in the short-term
 - Liquidity management will remain a function of sales quantum, market consolidation and improvement of cash conversion cycle

Statistical Analysis-Capitalization Indicators

- Borrowings of the sector majorly comprise short-term funding
- Equity position of major players ranges between moderate to strong
- Cushion available for absorption of losses; if any arise from after effects of COVID-19 and lockdown
- Leverage indicators have largely increased, although the same is not visible by average statistics on account of highly skewed numbers for one entity, on the back of high dependence of the sector on short-term funds
- Going forward:
 - Inventory management is the key to reduce high leveraging
 - Sizable capex seems unlikely as current focus of the sector is towards sustenance rather than expansion

Regulatory Framework

Descriptive Variable	FY20	
	CBU	AC Parts
Customs Duty	20%	16%
Additional Customs Duty	1%	0%
Regulatory Duty	40%	0%
Sales tax	17%	17%
Additional Sales Tax	3%	0%
<i>*No change since last year</i>		

Protective Measures Amid COVID-19

- SBP has stepped in to provide support to financial institutions and borrowers with a relief package in line with deferment of obligations for a year
- Policy rate cut is also expected to bode well with growth objectives; the same is expected to induce investment in the country by reducing the cost of doing business
- The increase in threshold for registered retailers making taxable supplies to un-registered persons to Rs. 100,000 from Rs.50,000 is expected to be a breather for home appliances sector as majority of products have crossed the Rs. 50,000 price mark in the last one year

Conclusion

- The growth prospects of the sector in the medium-term amid COVID-19 would be dampened owing to:
 - Overall economic uncertainty
 - Global financial crises
 - Adoption of bare minimal sustenance strategies
- However once normal demand picks up, the long –term prospects of the industry are promising in line with:
 - Increased per capita income
 - Better standard of living
 - Improved power supply
 - Internet availability
 - Trend of spending on entertainment related activities
 - Urbanization

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Analyst Contact
Maham Qasim
Manager
Maham.qasim@vis.com.pk