

Podcast Transcript - COVID-19 Second Wave To Test Resilience of India's Growing Smartphone Market

Peter Richardson: [00:00:16] Hello, and welcome to The Counterpoint Podcast. Today we're going to be talking again about the COVID situation. So COVID has been a constant backdrop to life and business for more than a year now different countries around the world have dealt with the pandemic in remarkably different ways with some New Zealand being a good example of getting away pretty lightly while others have fared much worse.

And. What we've seen more recently is different variants of the virus showing up each often being more virulent than previous ones. Only a few months back the Indian government declared that it had successfully faced down the virus. But as the saying goes, pride comes before a fall and now the country is fighting a terrible battle with a second wave.

That is much more impactful than the first. So. Yeah, let's, let's talk about how this second wave of COVID-19 is impacting the Indian smartphone market and its manufacturing sector. And we'll talk in depth about the demand for smartphones, how sales are impacted, what is going on with production and export side of things as well.

And for this, I'm very happy to be joined by two colleagues Tarun Pathak who's a research director here at Counterpoint hi Tarun how are you today?

Tarun Pathak: [00:01:36] Hey, Peter. Thanks. Thanks for the background I'm doing well. I hope you're doing great as well.

Peter Richardson: [00:01:42] Yeah, I'm all right. Coming up on my second vaccination soon.

So looking forward to that, and we're also, we're also joined by Prachir Singh senior analysts that counterpoint, how are you today? Prachir?

Prachir Singh: [00:01:55] Hey Peter, yeah, I'm doing good.

Peter Richardson: [00:01:57] Great, good, good to talk to you both. So. Let's get into this then. So before we talk about the second wave of COVID-19, can we just take a step back and talk about how the smartphone market performed in 2020 and how that has then progressed into the first quarter of this year?

So Tarun, maybe I could ask you to weigh in on that one.

Tarun Pathak: [00:02:23] Sure. So I think Peter If, if there is one key takeaway from 2020 during the first wave of pandemic for India smartphone market, I think that one word summarizes it well, and that is the resilient nature of the smartphone market. Exactly one year back when we were doing forecast and I think you have been a larger part of those discussions and we were looking at how that forecast will pan out by end of 2020, but we guys have been like correlating back to. 2009 scenarios are similar to 2002 and 2011, 12, but then this entire year ended, we saw that the first half of the year, 2020 was very muted and,

and, and rightly so because the first wave hit the country and then we had a longer lockdown and no one knew that what is coming, but.

A lot of the pent up demand that happened that was converted back in 2020 second half. So if you look at the second half of the market in India in 2020 especially near Diwali and going into the November and December, we saw the demand coming back and not only it came back, but it actually cross the previous year's of record.

So we have seen almost like hundred million of smartphone sales in second half of 2020 that never happened before in India. And the closest number was 90 million and the year back. So that summarizes, I think the nature of the market and that was not all everyone estimated. Okay. That 2020 is over. We had a good pent-up demand covered in 2020 second half, but the Q1 2021 was equally surprising. And when we got into the data and looked into the numbers, we also saw that not the entire part of the 2020 demand was absorbed in 2020 only some part of it got carried forward to 2021 as well. And that is why the Q1 2021 was also a record quarter in India clocking almost like 39 million units.

When on an average, the market rate is closer to like 30 million units. During that time, So, that was a summary of 2020, and first quarter of 2021, we also saw a lot of new use cases emerging, like learning from home. And then people are going more into the content consumption. They started using their phones even more.

So the dependency on the smartphones got even higher and India is a big market. We, we have like more than 500 million of installed base of active smartphones, which means you have smart phones that runs into a variety of the different characteristics in terms of specification features. wear and tear.

So, roughly we found that there are around 25 variables that impact the demand, and we can go through one way one during the course of this conversation.

Peter Richardson: [00:05:28] Thanks Tarun yeah. So it was pretty good clear from the numbers that, you know, there was this surge in demand that, that really kind of caught back up with, you know, a lot of what was lost in that very strict lockdown that, that occurred in April 2020 when sales came to an almost complete stop, right.

But, you know, when we got to April this year, so just getting into Q2, then, you know, India started to see this massive surge in COVID cases. And, you know, I think it's, you know, the, the impact has hit the headlines all around the world. So it doesn't seem to have resulted in the same kind of lockdown that we saw a year ago.

So what's, what's occurring across different parts of the country. And how are those. You know, patchy, lockdowns impacting the market now.

Tarun Pathak: [00:06:19] Right. So I think there are two scenarios to to this. So one is very different from the last year. So the last year, lockdown was very stringent this year. It was more like in phases, different states were acting in different capacities.

The log tones were extended. There were certain relaxations in different cities states and even districts. So it was more or less happening at. Different stages, depending on the cases and the rise, but what is drastically different this year from the last year is the consumer sentiment, because last year it was just a lockdown.

Everyone was inside. The number of cases in India per day was closer to like few thousands or so now it is like running in lakhs and this time that no one saw it coming, the damage was even higher. Both in terms of like mentally, emotionally, people were drained out. And that that is where it hit the hardest.

I think no one even thought about like impacting them in a big way than it has really happened. No one anticipated this, saw this coming basically. So April was a really low in terms of consumer sentiments and sales. And we can see similar things happening in May as well. Although the situation is recovering a bit we think that we are past the peak now.

But the true consumer sentiments coming back, I think we are still five to six weeks away from where we can see some signs of recovery coming back into the market.

Peter Richardson: [00:07:49] All right. So Prachir turning to you and something else that, you know, one of the other big trends that we've seen over the last number of years is a smartphone makers establishing production in India.

So Samsung was, has always been there, but you know, others Xiaomi OPPO and quite a number of the OEMs and EMS suppliers have factories across India in different states. So how was the, you know, this, this sort of variety of, of restrictions that Tarun was just talking about, how has that impacted their ability to produce in India?

Prachir Singh: [00:08:22] Yeah. So Peter, if I compare this year to the last year, so last year, what happened was the lockdown was imposed and the factories, all of these factories were almost shut down for one and a half months. And if we, if we see their progression, their progression was gradual. It was not, you can say it was not 80% utilization in just a week.

It took. It took these factories couple of weeks to reach optimum you know, manufacturing stage or manufacturing utilization. So I think that really impacted the supply last year. And most of the brands they were forced to buyout complete headsets. So multiple brands took this route and now and this year, I don't think this has happened, although what we are seeing right now, generally the manufacturing is around 30 to 40% utilization. If we talk in this week some of the factories has been closed. So there are two major clusters in the Indian manufacturing ecosystem. One is the north India, which is surrounding area of Noida and another is in the Southern part of the country.

So if we talk about in the last week of me, the cases in the Northern part of India has started to come down and that has you know Brought up opening up the markets and more public places are being opened and we can see a similar kind of impact on the manufacturing side as well. How about in Southern India cases are rising now, and we can see a similar sort of situation happening inside factories as well.

Like if I give you an example Foxconn in south India and restaurant these two factories reported some COVID cases and what what you know forced to shut down. However, if we. See on an overall basis. I believe in May. The production will hit around 25 to 30% of capacity utilization.

And for overall 2020, we are estimating over 300 million headset manufacturing. .

Peter Richardson: [00:10:22] Okay. , so production is sort of being able to continue in, in some shape or form, but as you say with, you know, maybe Fairly substantial reduction in, in capacity compared to where it could have been, but are we seeing inventories fairly stable because the market has also been closed or at least consumer sentiment has sort of kept people away from purchasing?

Or how should we think about that? So is it, is it a sort of a, a match between the reduction in production capacity that sort of be matched by a reduction in demand? Or is there some sort of imbalance there?

Prachir Singh: [00:10:55] Yeah. So on the inventory side, I think you know the worst hit because there was a declining production due to component shortage as well, which I think we will discuss further .

But the decline in consumer demand has led the inventory from a normal, which was four to five weeks to now it is around eight to nine weeks of inventory that we are seeing in the market. And due to this inventory the brands are forced to not produce more.

Because they want to clear up the inventory, which is lying around in the market right now. So yeah, the inventory situation has gone bad, which we believe will be resolved around third week of June.

Peter Richardson: [00:11:33] All right. Thanks Prachir. So turning back to you, Tarun. So while the number of active cases has been declining a little bit, as Prachir said, it's maybe moving more as a way from, you know, towards the Southern India now.

You know but I think it, it kind of reached a peak of 400,000 cases daily, right? So. The, there seems to be some expectation. There may be a third wave, which we've seen in other markets. And in fact, we're seeing some news today about Vietnam, for example, having a, you know, a bit of a surge so you know, this could be something which we we've continued to see through the rest of this year with, you know, successive waves.

So how should we think about that relative to the growth in the Indian smartphone market?

Tarun Pathak: [00:12:16] So. Yeah, , that's a good question. So if you look at right now in our, like different forecast of different segments, so what we are accounting is at least the possibility of the third wave, not for the next six months or the seventh month.

And there are a couple of reasons behind it, why we are doing that because first of all, a lot will depend on the India vaccination drive that is happening right now. Currently the numbers are not like. Big enough to, to vaccinate the entire population for the at least in the next 22 months. But if you look at, from the overall figures of what government is trying to

do is they are pushing and evaluating different options of whether we have to like bring in more vaccine companies in India and get more options beyond the, just two vaccine makers we have currently. So a lot of it will depend on how fast we are going to vaccinate our population. Although there is also an assumption of the third wave impacting the children and all, but that is also something that has not been proven yet. But one thing is very clear when we pick up our surveys, talking to the different retailers, consumers, there is a general level of awareness that has set in.

And seriousness for this particular pandemic as compared to the last year, people are more careful people. What we believe that after all this nightmare and experience what we had as a country, We will be very, very cautious and very serious about the different steps we take to contain this pandemic. So I think the general level of awareness have gone really up.

And, and that will also have an impact on how people react. After this, these cases come, come down significantly. So once everything is open, I can see people still going out, but with better control there. So, so we believe that at least for this year, we should be fine. And it all depends on the vaccination because , all these vaccinations are pretty effective.

against the current variant what we have, but yeah, uncertainty means on more variants or mutants in, in future also.

Peter Richardson: [00:14:24] Sure, so one of the other trends or developments that we've been contending with, and we've certainly getting a lot of questions from our clients about this is the global component shortage.

That's impacting many sectors. Pretty strongly. So has that had any additional impact in the India situation? I mean, could we say, for example, that actually having the virus suppressing demand potentially kind of helps on the component shortage or is it not as simple as that?

Tarun Pathak: [00:14:53] It is different. So if you look at it's a sum of different things happening globally because India is not immune to what is happening globally. And it's not as a factor of India. Maybe it might be a factor of China as well. So if you look at how this, all the component shortage started is we had this Texas, snow storm happening in mid February. And then we had this Japan earthquake that has happened again during the similar timeframe, then we have an ongoing, like the water crisis in Taiwan.

And if you look at India as a market, we import almost like 88% of the components outside. Only the 12% of the components, the true local value addition, what Counterpoint calls it is happening inside India. So we still are very much dependent on the global markets when it comes to the components and all, and then the shortage is happening on the global scale.

And India is not immune to that. But if you look at it from the demand perspective, I won't call it as a blessing in disguise, but rather it eases some of the pressure from a lot of this component makers. Because on an average, if India market was doing, let's say 14 million per month in the month of April or May then the demand has come down to almost like half like 7 million in let's say April and 5 million in May.

So there is an additional pressure that has that has been taken off. And then the China market is also not growing as everyone anticipated. So China and on average does almost like 33 to 35 million per month, but the market is closing on an average around 25.

So there is a Delta of 10 million units over there, which no one anticipated because people are not upgrading to the 5G phones as fast today as everyone estimated. So these two markets, if you look at the India and China and US to a certain extent contribute to 55% of the global demand. So that, that has taken some pressure on the component players.

But again, we have to be prepared because if you look at in smartphone market, what happens is the demand never gets killed. It's only postponed, right? So in the similar way, this gives some room for these component players to prepare for the second half of 2021, like 2020, the demand came back very strongly pent up demand was there a lot of component players were not ready for that, but this year, then they just not need to tackle the current crisis, but also need to be ready for the pent-up demand happening in the latest stage of 2021. So, we can look at from that dimension as well.

Peter Richardson: [00:17:20] Yeah. And I, I think, you know, that you, you mentioned that Chinese situation with you know, what we saw actually through all of 2020 was that the rebound occurred in China quite quickly because they got the virus under control very early on, but the market never really kind of came back to where it might otherwise have been. And I think this was attributed to the, you know, the replacement cycle lengthening among Chinese consumers.

Are we seeing something similar occurring in India? Or is it more that, you know, there's, as you said earlier, there's, you know, people are using and relying on their smartphone so much to work and learn from home that actually the need to have, you know, certain features, you know, around display or battery and things like that that are actually forcing people to upgrade more quickly. So how should we think about that?

Tarun Pathak: [00:18:13] Right. And, and I think I'll start with a couple of points and I think Prachir can add also because he also made some good points a couple of days back when we were discussing on normally on the market as a whole. So I'll start with a few statistic, Peter India, if you look at the installed base almost 300 million of smartphones in the current installed base might have the RAM capacity less than 2 gigabytes or even lower.

Right. 200 million phones smartphones in the installed base. We'll have display closer to 5.5 inches and the front camera closer to like five MP the rear cameras, third, 13 MP, and the battery capacity as low as like 2,500 milliamperes or 3000. So when you look at, on the other side of it, what is happening is the usage of smart phones has increased almost like 50%. So if I was spending almost like three hours earlier, I'm not spending almost like four and a half hours per day. So that wear and tear of this older phones have increased during the pandemic. People have started relying on these phones more often to consume content, to look at information even the gaming.

So these phones imagine in a normal circumstances would have actually gone six months or even one year In a normal circumstances working, but now what pandemic has done is it has

accelerated that we are anterior even faster, which means a lot of these phones that are there in the current installed base needs immediate replacement.

Now the big question is when that replacement is going to happen, because a lot of our clients ask us This year, it might not be a story of pent up demand, but this year what we are telling them, it might be a story of replacement. The only thing is you need to just find out when that replacement is going to happen, whether it is like happening in let's say May or July or near Diwali on December, even in 2022, that will determine the actual size of the market.

So we have taken a replacement side on an average in India, people replace almost like. After 24 months, which is two years we did a quick consumer research and we found out that during the pandemic, this rate has accelerated it a bit, people are now upgrading almost like 22 months or 23 months. So we took different case scenarios depending upon the, how the projections of the employment will happen for the next six months.

If the unemployment rate goes up, people will hold on for a longer period of time. And then there are certain other factors as well. Like 5g phones are happening and then people find them good enough to purchase this year and then think, okay, I have a good meatier phone, which I can use for the next three years or so.

And then even the upfront cost of the device that has come down in a variety of ways in India, thanks to a lot of OEMs and their partnerships. They have brought it down. So a lot of things are happening on the device financial aspect of it and bringing the perceived value down. So that is helping a lot of users, but a lot of it will still depend on.

How and where people will decide to upgrade their devices. And so there is story from both the demand and the supply side of it. Whether the prices will increase because the components are on shortage or the demand will shift disproportionately, maybe the demand comes back. At once in, let's say August and September, our demand comes in phases like something happened in August then slowly in September, October and November, and then project. I think, feel free to add more to it.

Prachir Singh: [00:21:45] Yeah. So I think we should we should discuss more about the new use cases that India market has shown us. So if I talk about the. e-education or e-learning that everybody is, has been talking about.

So if you see previously what we used to see or witness was that. Average entry age of the smartphone was around 15 years of age, kid of 15 years parents would give them a give that kid a smartphone, but now it has gone down to as low as 11 years. So people are learning via their mobile phones where the laptops and tablets, and that, that has been a growth story for smartphone market this year and the last year as well.

Apart from that. The smartphones to their two older elderly people that has been a use case this year and the last year as well, also the reverse migration. So what happened was when the lockdown was imposed, most of the. People including me and a Tarun as well. We moved to our you know, tier two towns where we were from and a lot of that population has some saved up cash because we are not going out.

We are not going to restaurants or doing any discretionary, you know, purchases. So all of this. Cash is being spent on electronic goods. Most importantly, smartphones because smartphones are now a necessity to the people. Even if I want to go and vaccinate today, I need to log on to the CoWin portal for which I need a smartphone.

And so the, these types of use cases are also, you know making the smartphone adoption, more as we talk and on top of that, if we see the government perspective, if they want to, you know search or, you know, increase the vaccination drive, then it might happen that all these healthcare workers who might do the door to door vaccination may they may need a smartphone. So overall, if we talk about the smartphone market, there are multiple use cases which have happened and which are also in progress or, or which will make headway in the coming quarters which will drive the smartphone market overall.

Peter Richardson: [00:23:47] Okay. Very, very interesting. So I guess the final question then is what does all this imply for our forecast for 2021. So, you know, is, is the, is the second wave going to have a, you know, very serious impact that we don't think will, will be recovered? Or is it that, you know, the use cases that you've just said, well, I couldn't only describe Precima will actually drive people to replace more or, you know, generate more business so we could end up with a 2021 that's actually no worse or potentially even a little bit better than it might otherwise have been. Who wants to take that Prachir? What do you think?

Prachir Singh: [00:24:27] I think internally when we have discussed within team, then the team have multiple opinions. Somebody say that it might drop down to 160 or you know, it will remain at 170 or even go as high as 180 million.

So what during our discussions, we have considered three scenarios in which our current forecast stands at 170 million. In which we believe that component shortage will subside by mid Q3 and the vaccination drive will be, you know will, you know, accelerate, but not to a very high rate because we are still you know dependent on just two vaccine manufacturers in India.

So that we believe the comment will work upon, but at a very moderate rate so that is our current forecast. That is 170 million, our upside forecast, which is around one 80 million that factors in the rapid drop in the COVID cases, the vaccination drive on a war footing as well as a, you know, economy betters in the near term.

The downside scenario, which pegs our market at 152 million just like last year which will not show growth if the third wave hit the country in this year. And vaccination drive will not be as good as it has. It has been the shortage or the shortage would be there. Those you know, gloomy factors, if they persist in the near term and in the longterm, then we might see the market remain flat or even you know, a decline would be there Tarun and you might want to add,

Tarun Pathak: [00:26:02] I think, yeah, there's three factors. So we are still like being on, 170 million. So at 2019, it was 158 million, 2020. We were at like 152 million and 2021 we are estimating at 170 million. So. Again, last year, again, our forecast also fluctuated from 137

million to 145 million. It eventually ended at 152 million. So this year as well, like a lot of people have certain conservative estimates. What we believe that the underlying thing I think I would also like to close this particular podcast on the same note as I started is the resilience.

What out for the resiliency in this particular segment because the smartphone by definition, doesn't qualify under the essential items, what government has listed, but it is very, very essential for a lot of people who are dependent on it, not just to consume content, but also navigate their day-to-day activities.

Because for some, a lot of it is happening. Some kids are. Like educating themselves on the smart phones. People are working day in and day out. And then a lot of gaming communities, they, they are finding these devices to just get out of the, what is happening outside and, and provide some entertainment for that.

And then one thing we have not touched is the feature phone to smartphone. Conversion. I think that is also a very important factor to look into because a lot of people in rural India will find usage of a smartphone. And then we have a Jio factored into play, which everyone is anticipating and bring in the low cost smart phones.

And we have the secondhand smartphones as well. Like. That, that people will actually buy secondhand smartphones or the replay hand-me-down products, or they'll go forward and buy a new product all together. So all these factors will determine where the market will go, but the real factor will be replacement demand.

And at what point will that happen? So it will be a equal pull from the OEMs and the kind of devices we'll see maybe a 5g pull and the upfront cost of the device will do to mine. Which way the market will go. But we are at 170 million as of now.

Peter Richardson: [00:28:13] Excellent guys. This has been very interesting and I think, you know, everything that you've just said in the last couple of minutes Prachir and Tarun indicates, we've got a lot more to talk about.

So maybe we can come back on this in a, in a future podcast. So Taran, Prachir thank you very much. Great having you on today.

Tarun Pathak: [00:28:30] Thanks Peter likewise,

Peter Richardson: [00:28:32] And to our listeners. Thanks very much for joining and please look out for the next installment of The Counterpoint Podcast. Have a great day. Bye now. .