PMN Handset Industry Insight, Q2 2007

Unit shipments

262.3m

+13.9% YoY

Total global market for handset expands in Q207, but growth rate slows from 18.5% YoY in preceeding quarter. Big four manufacturers capture 75.8% of market, up 1.4% percentage points YoY.

Average Selling Price (ASP)

$132

-16.2% YoY

ASP declines across all manufacturers on YoY basis, but Nokia and Motorola see slight improvements in QoQ sequential figures. Samsung sustains largest YoY and QoQ falls.

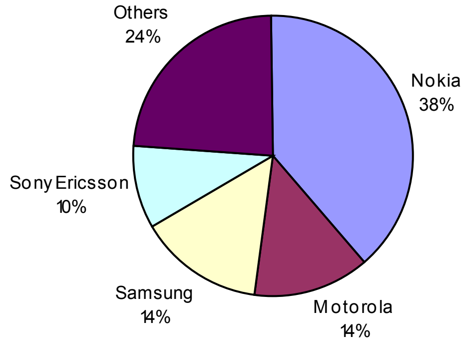
Margins

12.4%

-0.6% YoY

Margins decline YoY at Samsung and Motorola, but improvements at Sony Ericsson and a singularly impressive performance by Nokia ensure relative stability. Nokia's margins jump to 20.9%, nearly double those of Sony Ericsson, which ranks second in this category.

Market share



Nokia was the primary beneficiary of Motorola's continuing market share implosion, picking up 2.5 percentage points from Q107 to Q207. Sony Ericsson (+0.9) and Samsung (+0.4) also saw gains, as did the percentage of the market captured by manufacturers outside the 'big four' tracked by PMN. Samsung surpassed Motorola as the world's second largest handset manufacturer by unit shipments during Q207.

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Q207 summary

Revenues across the big four manufacturers showed a slight YoY increase in Q207, up 0.6% in dollar terms.

Sony Ericsson saw the biggest YoY percentage increase in revenues, up 39.5% at USD 4279m.

Motorola's revenues have nearly halved since they reached their 18 month peak Q406.

Combined profits across the big four were flat YoY at USD 3136m as growth in unit s shipments was off-set by falling ASP. However, the situation differed greatly from manufacturer to manufacturer.

Samsung (USD 350m), which is ranked number two in unit shipments, trailed even further behind Nokia in profitability, with Nokia's results outstripping those of its South Korean competitor by a factor of nearly 7.5x.

Motorola extended its losses from the Q107 period, seeing a USD 799m profit in Q206 crash to a (USD 264m) loss in Q207. Profits fell 133% YoY and 14.3% QoQ.

Nokia accounted for 50.8% of the unit shipments made by the big four manufacturers in Q207, but captured 82.9% of the profits, up from 52.5% in Q206, when it accounted for 45.8% of units. PMN attributes this success to significantly improved margins and strong growth in market share.

Samsung and Sony Ericsson are seeing profitability stagnate and decline as they spend more to maintain their competitive position versus Nokia and seek to capture share from while Motorola continues to suffer from internal turmoil.

Motorola is rapidly reducing headcount and slowly starting to refocus its product portfolio on more advanced devices as it seeks to cut costs and improve ASP in an attempt to return to profitability.

ASP across the four manufacturers continued its downward trend YoY, declining by 16.2% to USD 132 from Q206 to Q207. However, on a QoQ sequential basis, ASP decline slowed in Q207, dropping just 2.6% from Q107. This is an improvement after several quarters when it fell by about 5% per quarter.

Nokia's ASP showed the most resilience, dropping 10.2% YoY, while Samsung saw the largest fall of 29.5%. ASP rose slightly on a sequential QoQ basis for Nokia (+2.2%) and Motorola (+1.8%), but fell for Samsung (-7.5%) and Sony Ericsson (-5.3%).

However, the QoQ upward trend in ASP should be attributed to very different reasons at Nokia and Motorola. For Nokia, the positive results are indicative of strong growth in its high-end device sales. For Motorola, they are the result of a conscious decision to pull back from the aggressive emerging markets growth policy it has pursued in recent quarters. Motorola has achieved a QoQ rising ASP by selling fewer low cost handsets, whereas Nokia's performance is the result of selling more premium products, while at the same time maintaining its strong presence in developing countries.

Samsung and Sony Ericsson are showing themselves to be the most vulnerable to declining ASPs, paying the price of increased market share with steep falls in ASP over the last two quarters. The acceleration in ASP decline is particularly evident for Sony Ericsson in H107 (see Fig. 2), where it had previously maintained relative stability during 2006.

Revenues

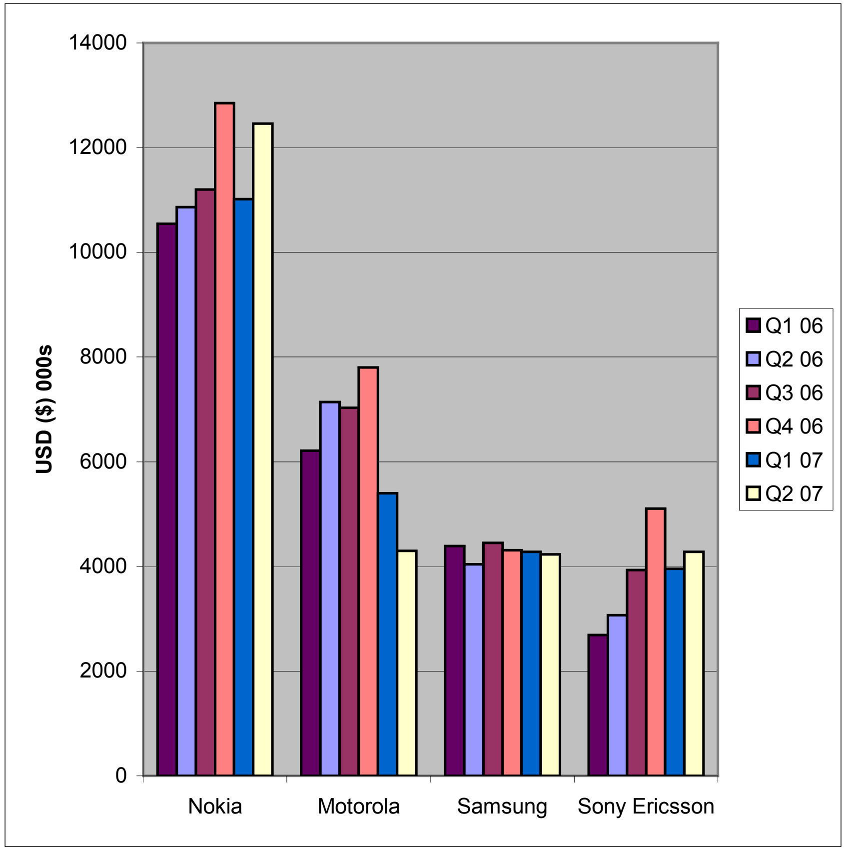

Fig. 1: Revenues in Dollar terms

Analysis: Revenues across the big four manufacturers showed a slight YoY increase in Q207, up 0.6% in dollar terms. On a QoQ basis, revenues grew 2.5% from Q107, following the seasonal pattern of higher revenues stacking up throughout the calendar year and reaching a peak during the Q4 holiday season.

The impact of further Euro strengthening against the Dollar slightly flattered figures from Nokia and Sony Ericsson, which both report their results in Euro. Our conversion figure changed from USD 1.00 = EUR 1.35 in Q107 to USD 1.00 = EUR 1.36 in Q207.

Sony Ericsson saw the biggest YoY percentage increase in revenues, up 39.5% at USD 4279m. It has been the strongest performer in revenue growth among the big four manufacturers for some time. Sony Ericsson's performance enabled it to become the world's second largest handset company by revenues for the first time in its history during Q207 (Samsung and Motorola still sold more units, but Sony Ericsson's has a significantly higher ASP).

Nokia's revenue growth also accelerated rapidly in Q207, showing the kind of uplift normally associated with the spike in Q4 holiday sales. Revenue increased 14.6% YoY to USD 12458. In Q207, Nokia accounted for 49.3 cents of every Dollar spent with the big four, up from 43.3 cents in Q206.

Motorola's revenues have nearly halved since they reached their 18 month peak Q406. They fell 39.8% YoY in Q207. Its ASP has remained relatively stable during this period, so the drop in revenue is due entirely to the collapse in unit shipments.

Revenues at Samsung have remained relatively stable as the company has continued to trade declining ASP in return for market share.

Revenues cont/d…

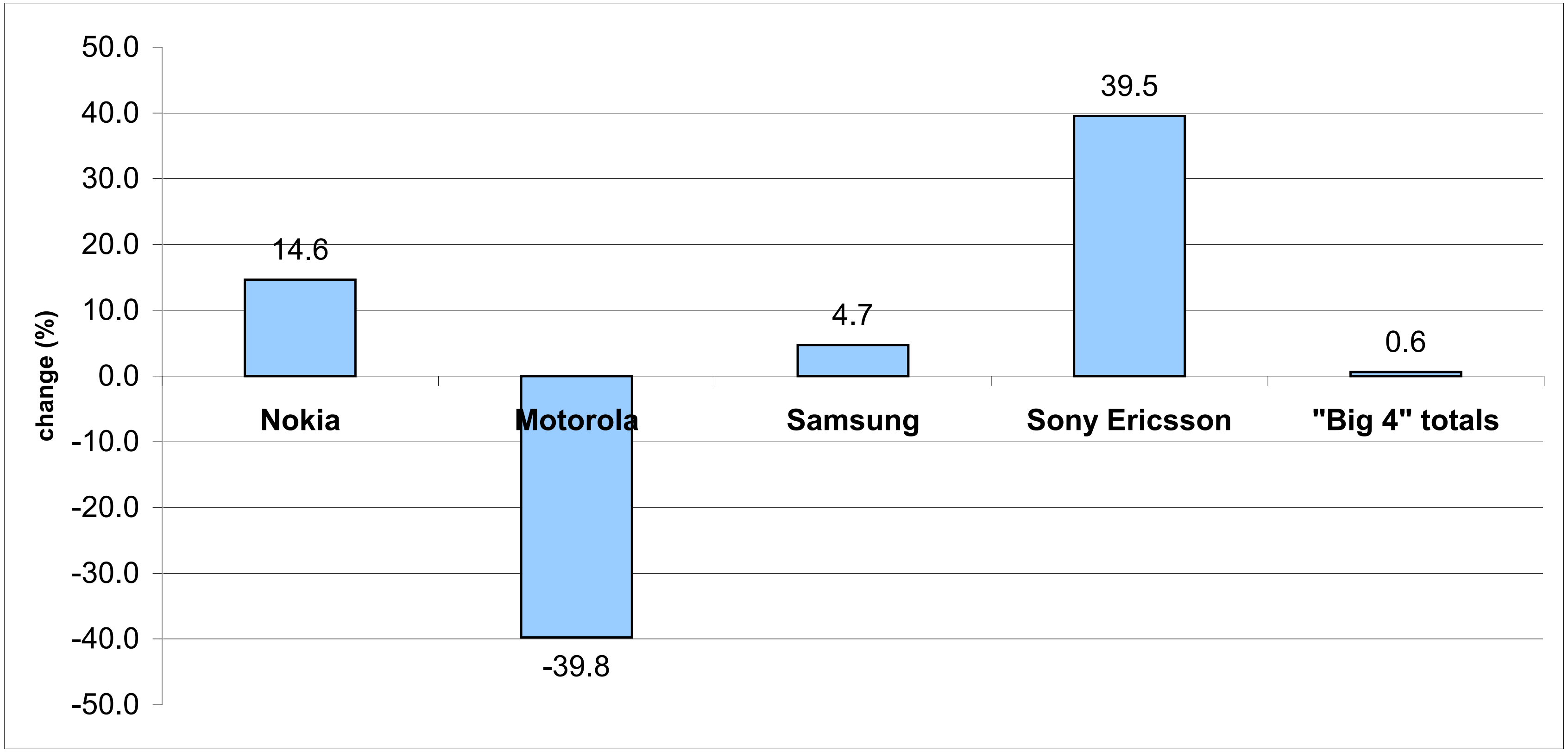

Fig. 2: Q207 YoY percentage change in revenues

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Profits

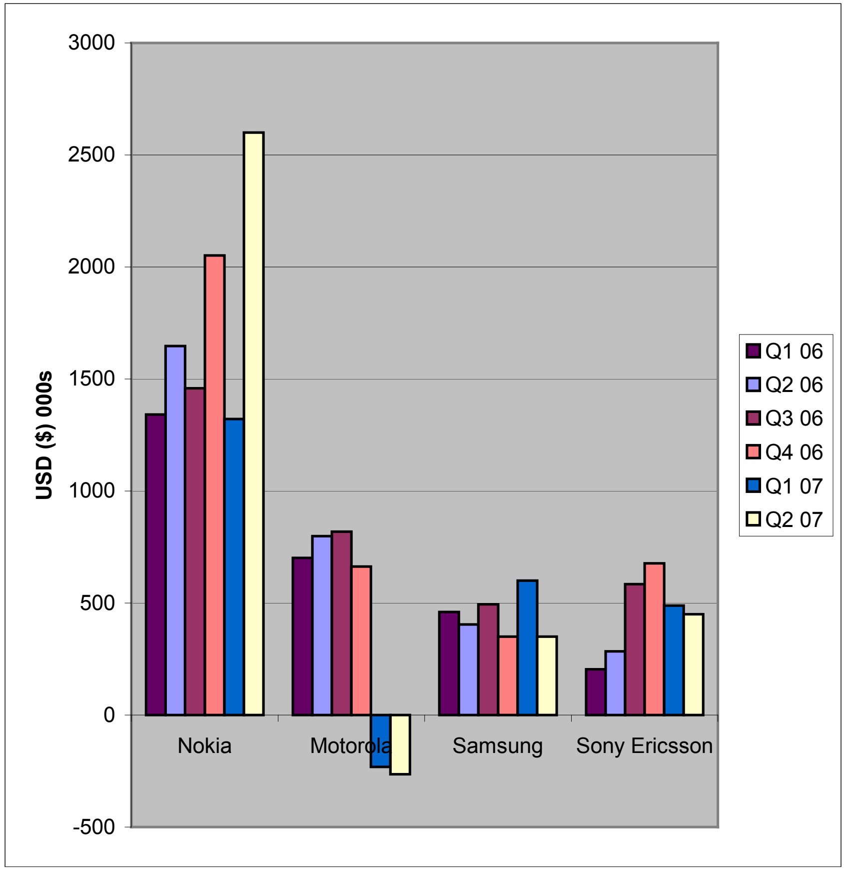

Fig. 3: Profits in Dollar terms

Analysis: Combined profits across the big four were flat YoY at USD 3136m as growth in unit s shipments was off-set by falling ASP. However, the situation differed greatly from manufacturer to manufacturer.

Nokia's Q207 profitability (USD 2600m) outshone all its competitors on both a QoQ and YoY basis, rising 96.7% and 57.9% respectively. Its profits were 5.7x higher than Sony Ericsson (USD 450), which recorded the second highest profits of the four major manufacturers in Q207. This was despite a significant 57.8% YoY increase in profits at Sony Ericsson.

Samsung (USD 350m), which is ranked number two in unit shipments, trailed even further behind Nokia in profitability, with Nokia's results outstripping those of its South Korean competitor by a factor of nearly 7.5x.

Motorola extended its losses from the Q107 period, seeing a USD 799m profit in Q206 crash to a (USD 264m) loss in Q207. Profits fell 133% YoY and 14.3% QoQ.

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Profits cont/d…

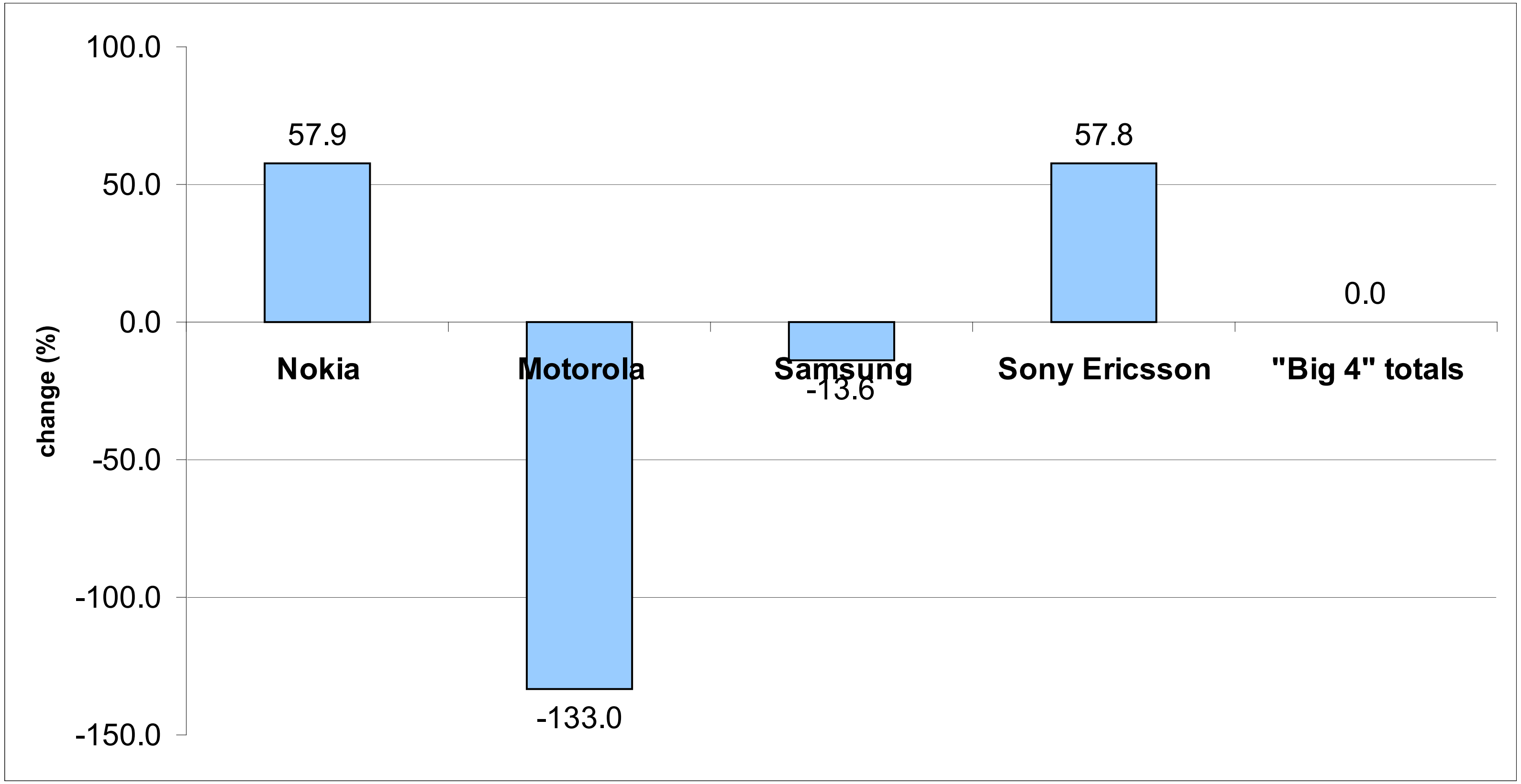

Fig. 4: Q207 YoY percentage change in profits

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Average selling price (ASP)

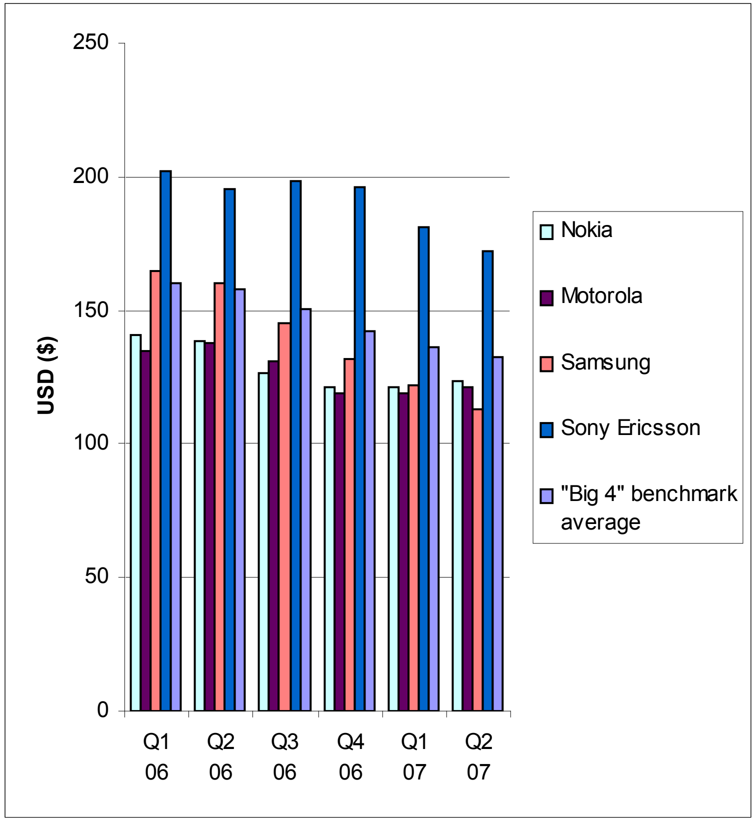

Fig. 1: Average selling price (ASP) – Dollar Amounts

Analysis: ASP across the four manufacturers continued its downward trend YoY, declining by 16.2% to USD 132 from Q206 to Q207. However, on a QoQ sequential basis, ASP decline slowed in Q207, dropping just 2.6% from Q107. This is an improvement after several quarters when it fell by about 5% per quarter.

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Samsung and Sony Ericsson are showing themselves to be the most vulnerable to declining ASPs, paying the price of increased market share with steep falls in ASP over the last two quarters. The acceleration in ASP decline is particularly evident for Sony Ericsson in H107 (see Fig. 2), where it had previously maintained relative stability during 2006.

Nokia's ASP has demonstrated stability for the past six quarters and is now second only to Sony Ericsson in dollar terms.

PMN publications

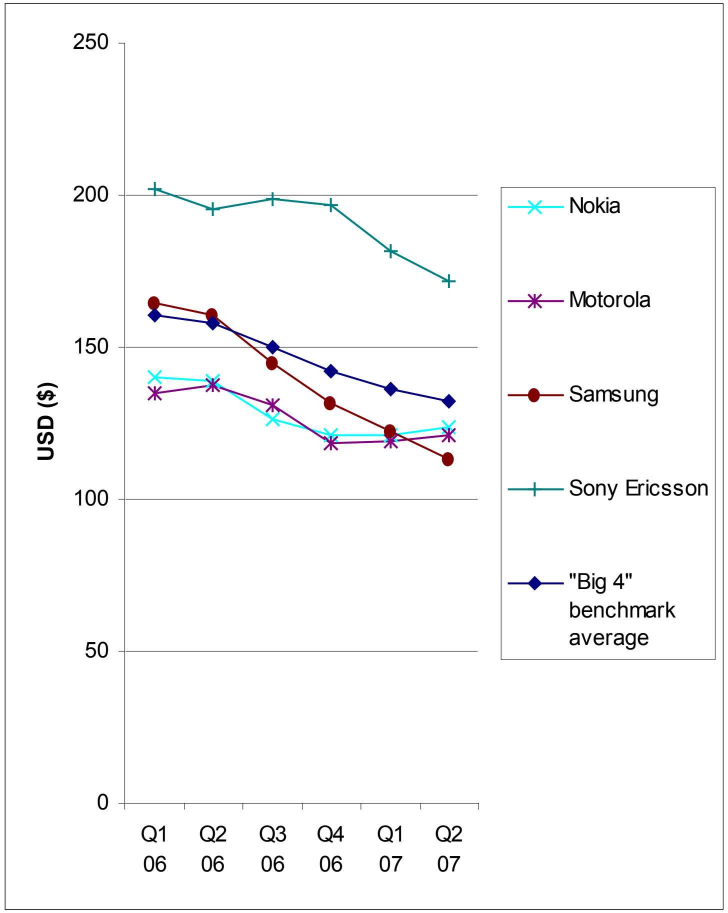

Fig. 2: Average selling price (ASP) – Trend

Average selling price (ASP) – cont/d…

Outlook: A strong product mix and continuing growth in high-end sales will enable Nokia to maintain QoQ ASP stability during Q307. Products such as the N95 and the recent commercial introduction of its E90 Communicator – the most expensive product in its portfolio – may even enable it to extend the slight QoQ rise in ASP it enjoyed during Q207.

Sony Ericsson and Samsung should also start to see a stabilising effect on their ASPs from the introduction of new high-end devices in their respective ranges. Sony Ericsson will start shipping the K850i in Q307, the successor to its popular K810i and a credible competitor to Nokia's N95 with its 5 megapixel camera. Samsung's premium Ultra Series continues to sell well, including the acclaimed U700 3.2 megapixel, HSPA-equipped slider, which breaks new ground for feature-to-weight ratio at just 86g.

Motorola's hopes for boosting its share of the premium market in Q307 rest on its smartphone products - the Q9 (Windows Mobile) and Z8 (Symbian OS). Both products have received some favourable press coverage and offer interesting user experiences, but in a market driven by operator purchasing requirements, these devices are under-specified and unlikely to command premium pricing.

PMN also have concerns over the sustainability of Motorola's strategy of propping up its ASP by reducing exposure to low cost handsets. There is no strength in Motorola's product portfolio to enable it to buck the continuing industry-wide downward trend in ASP. We must conclude, therefore, that there is more downside to current Motorola ASP figure in the medium and long-term, even if it manages to disguise the true picture in the short term by further defensive moves to reduce its exposure to the low ASP environment in emerging markets.

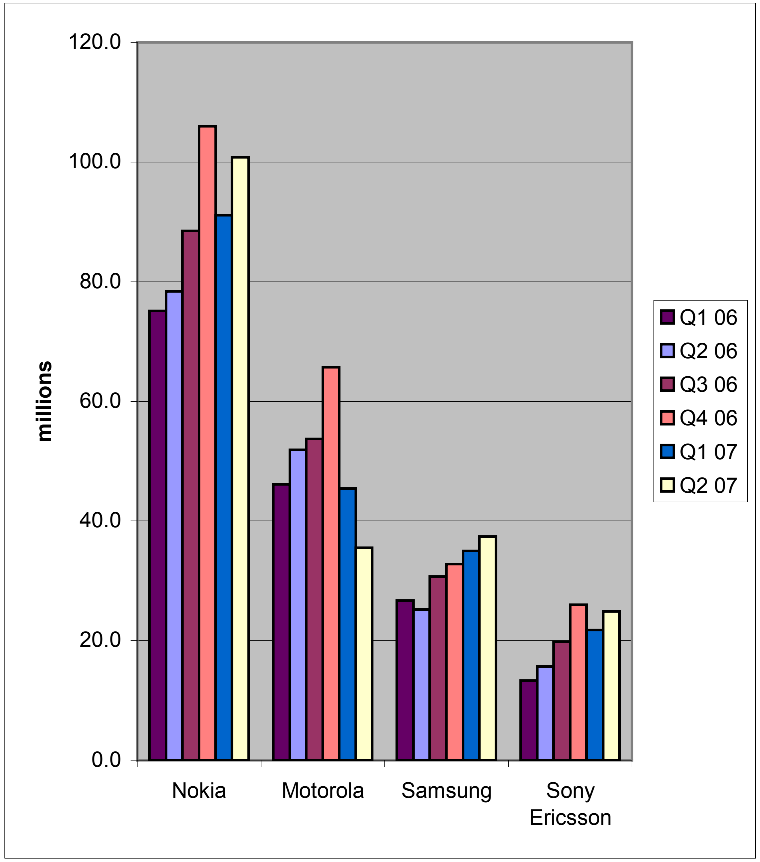

Fig. 3: Unit shipments

Unit shipments and market share

Analysis: With the exception of Motorola, all manufacturers recorded both a sequential QoQ and YoY increase in unit shipments. Sony Ericsson saw the highest percentage increase both QoQ (14.2%) and YoY (58.6%) as shipments in Q207 rose to 24.9m. Motorola's unit shipments declined significantly, dropping 31.6% YoY to 35.5m units. Its poor Q2 performance saw Samsung surpass it as the world's second largest manufacturer on a unit shipment basis, although Motorola's dollar revenues remain slightly higher.

Estimated overall shipment volumes across the industry rose 12.6% YoY to 262.3m units. Even with Motorola's problems, the benchmark of the 'big four' manufacturers expanded their device volumes faster than the rest of the market, posting 16% YoY growth and increasing their overall share of device volumes to 75.8%, 1.8% higher than in the comparable quarter a year ago.

Nokia was the primary beneficiary of Motorola's market share implosion, recording a 12.9% YoY increase in unit shipments during Q207, compared with a 2.8% YoY increase in Q107. The Finnish manufacturer's device volumes reached 100.8m in Q207, only the second time in its history it has surpassed the psychologically significant 100m mark (the seasonally strong Q406 period was the only other time this was achieved). Nokia shipped more handsets in Q207 than all 3 of its closest competitors combined.

Nokia is also demonstrating it is capable of competing at both the high- and low-end of the device market. It shipped 13.9m 'converged' devices in Q207, representing YoY growth of 54% in this category of advanced products, including 9m N-Series and 2m E-Series handsets. It estimates total industry volumes of converged devices reached 29m in Q207, up 53% YoY from 18.9m in Q206.

Unit shipments and market share cont/d…

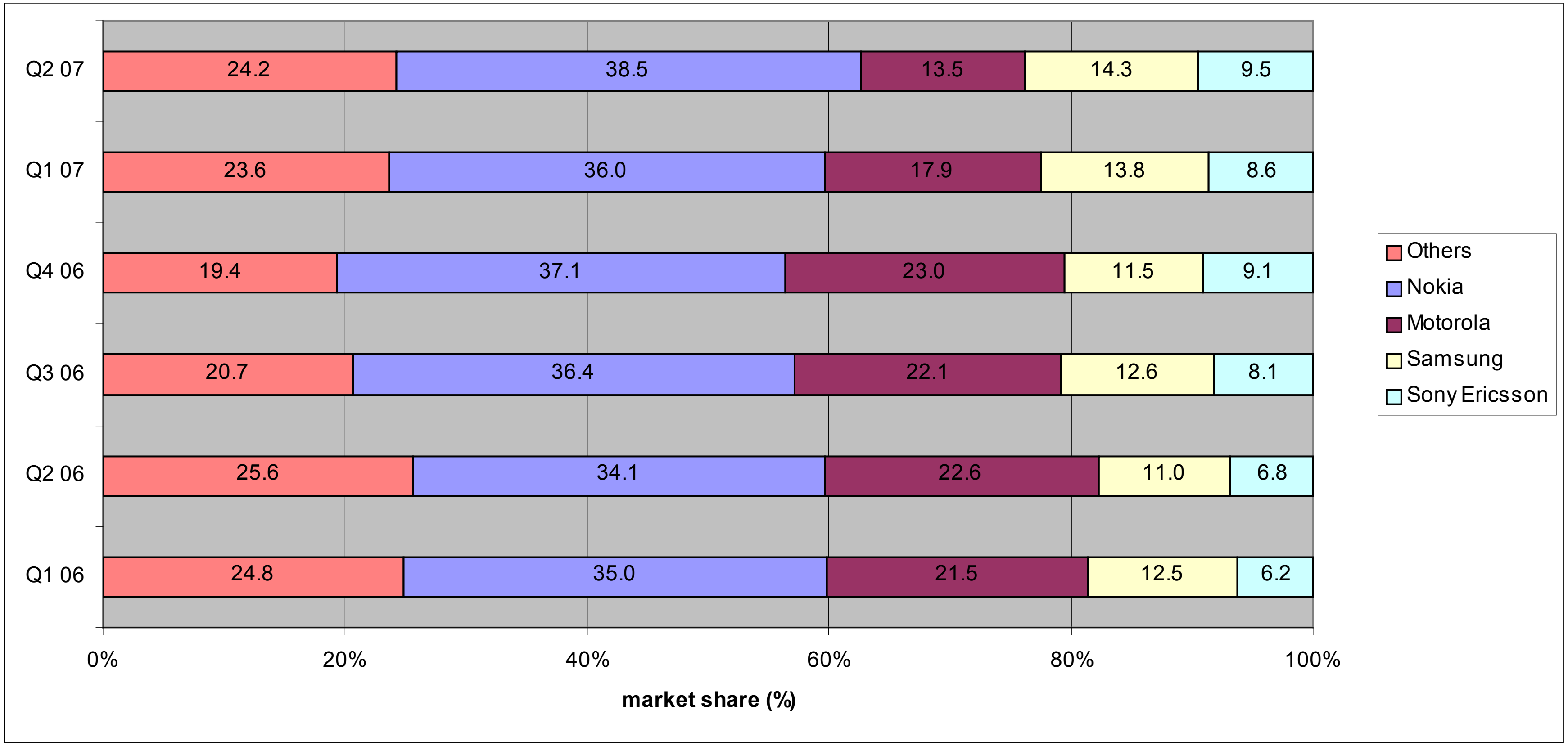

Fig. 4: Market share QoQ (%)

Unit shipments and market share cont/d…

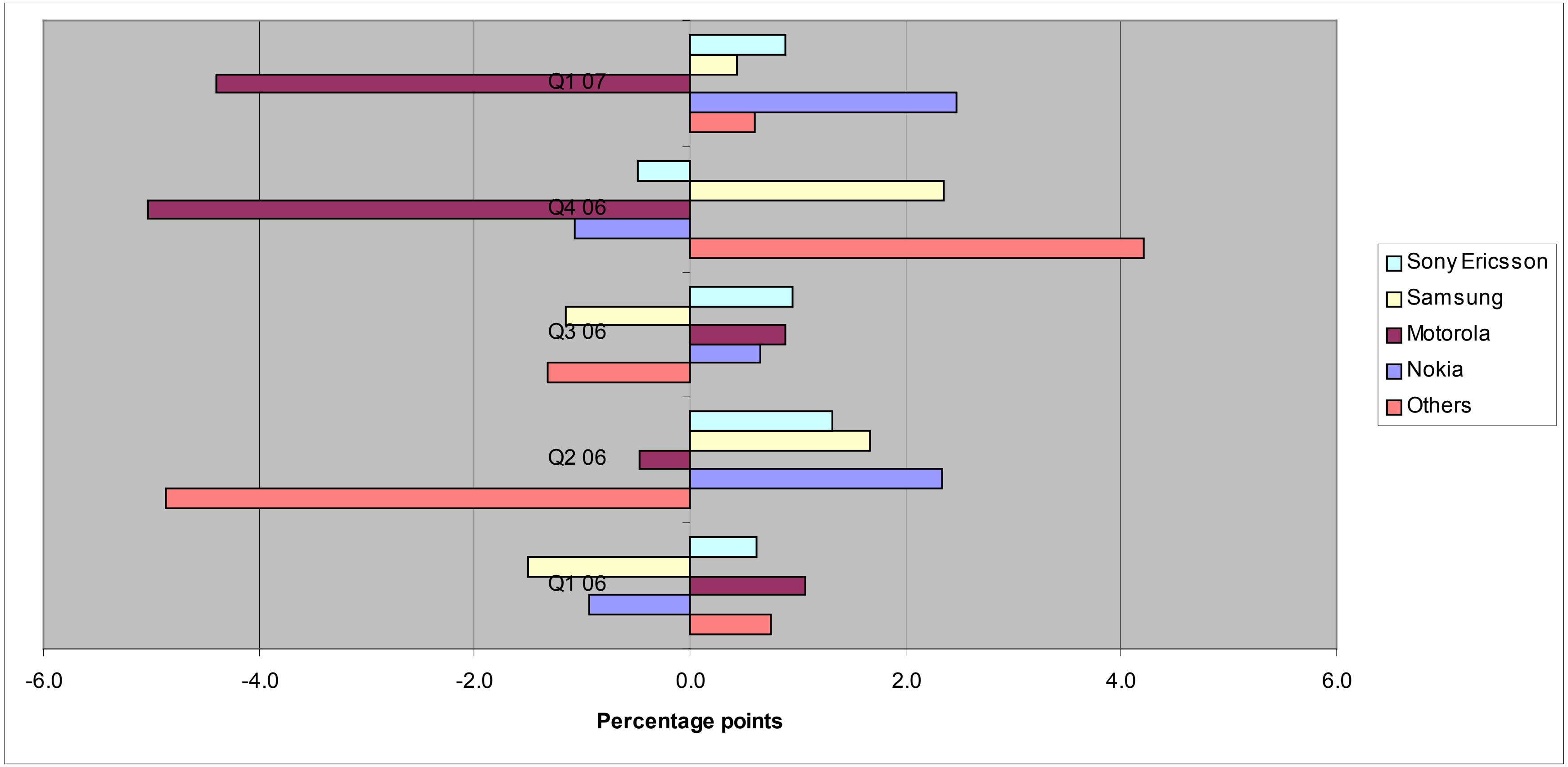

Fig. 5: Market share change QoQ (percentage points)

Unit shipments and market share cont/d…

Outlook: Fig. 4 shows how Motorola's market share is being squeezed on all sides, with Nokia's dominance pressuring it from above and growth at Sony Ericsson and Samsung cutting into its share from below. Motorola has already surrendered its No. 2 position in unit shipments – the question now is how much further it can slide?

PMN believes Q307 will mark a new low for Motorola's market share figures, with little in the company's product portfolio to suggest it can start competing to recover lost ground in GSM markets.

It should also be noted that Motorola is suffering from strong competition in the US – its key CDMA market – where smaller companies like LG are winning orders from Sprint Nextel and Verizon Wireless on the strength of their superior product mix. Fig. 4 shows a correlation between QoQ market share losses at Motorola and an expansion of market share captured by other manufacturers outside the 'Big 4' group tracked by PMN. Q406 – the 18 month highpoint for Motorola's market share at 23% - coincided with the smallest share (19.4%) held by companies outside the 'Big 4'. Conversely, Q207 – the lowpoint for Motorola at 13.5% - saw smaller manufacturers continuing their QoQ market share gain, which increases to 24.2% - the highest it's been for 12 months.

PMN notes greater risks to Q307 market share figures for Motorola and Samsung, the two manufacturers with the largest exposure to the US CDMA business, in the wake of the ITC's ban on importing handsets equipped with Qualcomm's CDMA chipsets. This action, which resulted from a dispute between Qualcomm and rival chipset manufacturer Broadcom, is likely to impact sales of next generation CDMA products. Manufacturers and operators are collaborating with Qualcomm and Broadcom to find a 'workaround' solution, but there the disruption is likely to cause a slowdown in sales of CDMA handsets in the US.

Nokia and Sony Ericsson have an insignificant share of the US CDMA market and are unlikely to suffer any negative results from this situation. They may even benefit from a small uplift as some consumers switch to GSM networks to obtain the latest handsets.

The biggest driver of market share change in the mobile industry continues to be success in developing markets such as India, China, Africa and Latin America. These territories account for almost all of the new subscriber growth in the mobile business and the huge volumes of new customers are now being supported by increasing numbers of replacement handsets from 'emerging market early adopters' who bought their first mobile devices 18 – 24 months ago.

Following Motorola's decision to refocus its handset business on mid- and top-tier products, Nokia remains the only one of the big four manufacturers seriously commited to the high volume, low cost segment in developing countries. PMN expects this to result in further market share gains for the Finnish manufacturer in Q307, especially as its success in emerging markets is now supported by a strong high-end portfolio for developed countries.

Sony Ericsson will also see gains from the continuing expansion of its mid-range portfolio, which is enabling it to target a broader range of customers.

Increased shipments driven by the popularity of Samsung's Ultra range in GSM markets may be counter-acted by exposure to the US CDMA ban. However, PMN notes bullish comments by Samsung's management on forward sales and expects modest QoQ market share gains from the South Korean manufacturer.

There is an outside chance of a further change in global rankings during Q307. Fig. 5 shows that a repeat of Sony Ericsson's Q207 gain of 0.9 percentage points and Motorola's loss of 4.4 percentage points would enable Sony Ericsson to surpass its US rival as the third largest manufacturer by unit volume.

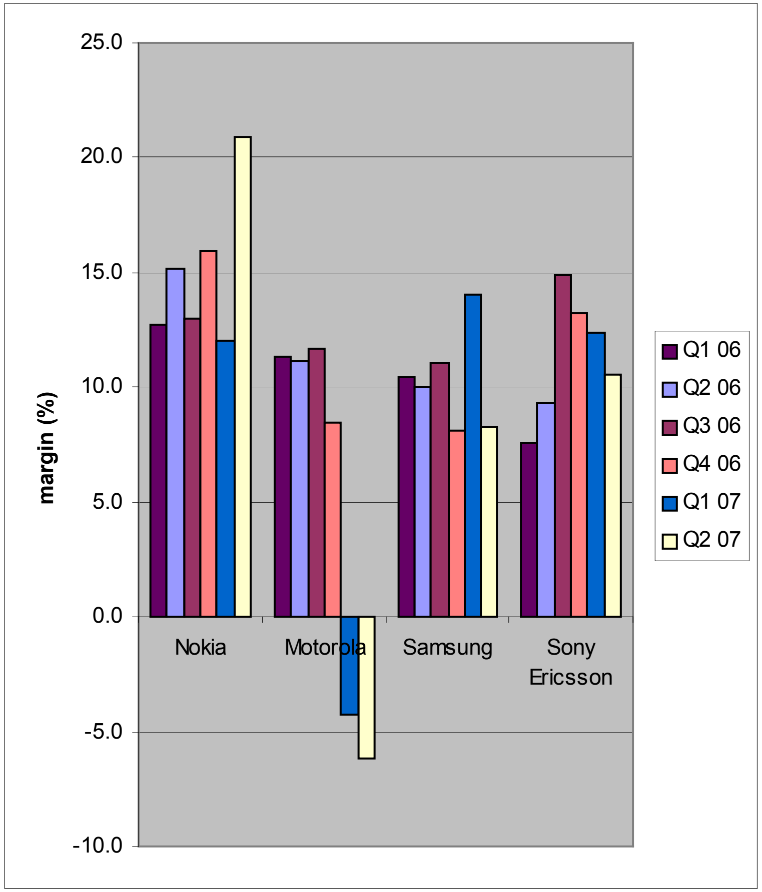

Fig. 6: Margins

Margins

Analysis: Average margins across the four major handset manufacturers were 12.4% in Q207 – a slight drop of -0.6% YoY - but this figure was distorted by Nokia's strong performance. In fact, only the Finnish market leader recorded margins above this average figure (at 20.9%), a significant improvement on the 15.2% it saw a year earlier. As a result, Nokia masked a tough quarter for others in the handset business, who have been forced to sacrifice their margins to maintain market share.

The leap in Nokia's margin performance is even more impressive when considered on a quarter-by-quarter sequential basis. Margins at Nokia have averaged just 13.6% for the last three quarters. Even in the seasonally strong Q4 period, margins only reached 16%. However, QoQ from Q107 to Q207 Nokia's margins improved by 890 basis points.

Margins improved across its device portfolio, as Nokia's scale enabled it improve profitability of both its entry level and premium products. The most significant progress was made in the enterprise product category where devices such as E61i (aka 'Blackberry Killer') and E65 pushed the Enterprise business unit into profit and swung margins from a loss making –22.3% into an 18% positive.

Investors will now be looking to see whether the structural changes the company has made and its continually expanding scale will enable it to sustain these levels, which recall the most buoyant years of Nokia's growth earlier in the decade.

Motorola was the only one of the four manufacturers to record negative margins (-6.1%) as it posted a loss for the second quarter in a row. The loss widened from the Q107 period.

Samsung saw a big QoQ sequential fall of 530 basis points to 8.3%. PMN had previously attributed Samsung's strong Q107 performance (when margins reached 14%) to improved cost control at the South Korean manufacturer. However, in the absence of any guidance from management on one-off costs incurred during Q207 which would have produced such a negative effect on margins, we must now conclude that Q107 was the exception and the company is succumbing to the same pressures affecting the rest of the market. We hypothesise this could be as a result of a conscious decision to spend more money on sales and marketing as it attempts to capitalise on the weakness of its closest competitor (Motorola).

Sony Ericsson, despite recording the highest ASP of all the manufacturers, has seen its margins eroded consistently, posting negative margin growth every quarter since Q306. Its margins remain the second highest in industry at 10.5%, but the cost of competing with a resurgent Nokia at the high-end and the lower margins it is recording on its expanded range of mid- and low-end devices are impacting the out performance it had enjoyed for some time.

Outlook: Nokia's strong performance should continue during Q307 and will exert both a 'push' and 'pull' effect on industry-wide margins. The company's disproportionately large share of the market means its results have a significant skewing effect: on the one hand, Nokia's profitability masks tighter margins at the other three manufacturers and 'pushes' up the overall figure. However, it also has the opposite effect, where the company's scale and marketing power give it the greatest scope for price competition, enabling it to exert pressure on its smaller rivals to increase their sales and marketing spend, thereby 'pulling' down margins.

To illustrate what's happening, it is useful to strip out Nokia's results and analyse the performance of Samsung, Sony Ericsson and Motorola as a combined block accounting for 37.3% of the mobile handset market in Q207. Between them, they saw combined margins of only 4.2% in Q207, less than half the 10.5% they enjoyed in the comparable period a year ago. In contrast, Nokia's margins improved by about 38% in the same timeframe.

PMN believes strengthening product portfolios at Sony Ericsson and Samsung will be largely offset by competition from Nokia in Q307. Motorola will see its margin decline stabilise during the quarter (excluding the impact of one-off costs incurred during its restructuring) as it starts to see some results from cost cutting initiatives started earlier in the year.

The net result should be overall stability or slightly positive margin growth for the combined results of the big four manufacturers, but this will attributable almost entirely to Nokia. Negative YoY margin growth at Samsung, Sony Ericsson and Motorola will be overshadowed by Nokia, which we expect to show a strong YoY improvement from a comparatively weak Q306 quarter and stable or slightly positive margin growth on a sequential basis.

PMN Industry Ranking

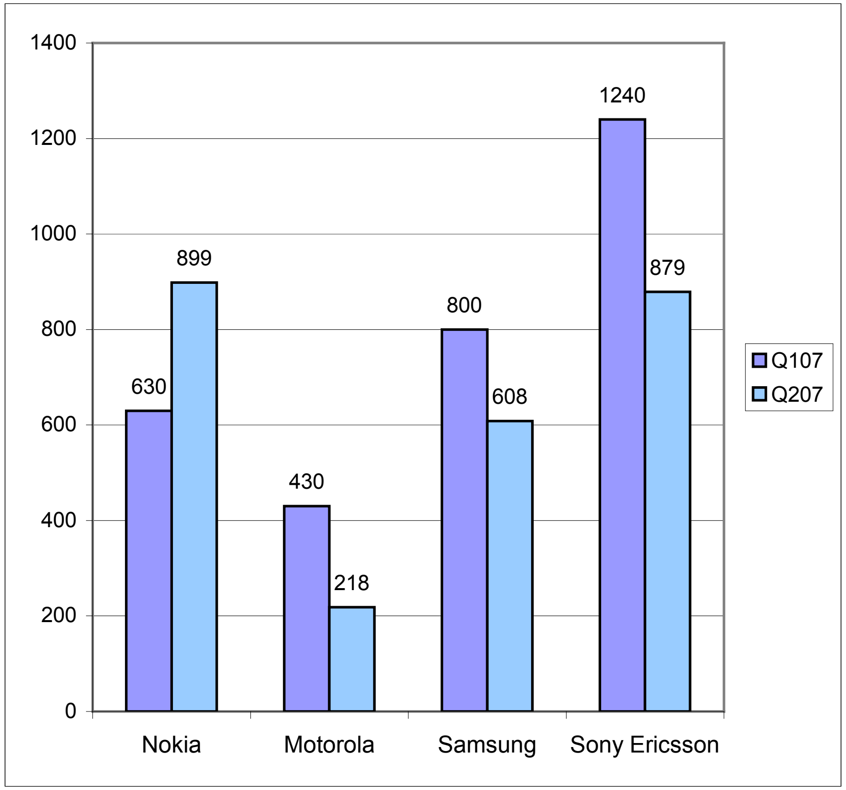

Fig. 7: PMN Industry Ranking

Analysis: Nokia edges Sony Ericsson from first place in PMN's Industry Ranking system, driven by its success in the YoY ASP, margin and profit categories. It was the only manufacturer to improve its score in Q207.

Sony Ericsson took the leading position in sales, market share and unit shipments, but our scoring methodology is designed to favour profitability indicators over raw gains in sales and volume, handing first place to Nokia.

The Finnish manufacturer jumps two places to take the number one spot, while Sony Ericsson slips to second and pushes Samsung into third. Motorola scored lowest in every category apart from ASP and takes last place for the second quarter running, recording an even lower score than previously.