RATING REPORT

Orient Electronics (Pvt.) Limited

REPORT DATE:
March 29, 2019

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	Initial Rating	
	Long-term	Short-term
Entity	A	A-2
Rating Outlook	Stable	
Rating Action	Initial	
Rating Date	*March 26, '19*	

COMPANY INFORMATION	
Incorporated in 2005	External auditors: PKF F.R.A.N.T.S. Chartered Accountants
Private Limited Company	Chairman/CEO: Mian Talat Mahmood Fazal
Key Shareholders (with stake 5% or more):	
Orient Color Labs (Pvt.) Limited – 98%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2016)
https://www.vis.com.pk/kc-meth.aspx

Orient Electronics (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Orient Electronics (Pvt.) Limited was incorporated in August 2005 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017). The company is involved in the manufacturing, assembling and sale of home appliances.

Chairman/CEO Profile:

Mian Talat Mahmood serves as the Chairman and CEO. He has over 30 years of experience in consumer electronics sector.

Financial Snapshot

Tier-1 Equity: end-1HFY19: Rs. 5.71b; end-FY18: Rs. 5.70b; end-FY17: Rs. 4.70b

Assets: end-1HFY19: Rs. 22.4b; end-FY18: Rs. 22.5b; end-FY17: Rs. 11.7b

Profit After Tax: 1HFY19: Rs. 10m; FY18: Rs. 975m; FY17: Rs. 825m

RATING RATIONALE

Orient Electronics (Pvt.) Limited (OEL) is a well-known manufacturer of home appliances in Pakistan. Shareholding of the company is vested with the sponsoring family who have over six decades of experience in the consumer electronics industry. The assigned ratings take into account extensive experience of sponsors in the home appliances industry that has helped OEL maintain healthy relations with the vendors and dealers. The ratings draw comfort from sizeable scale of operations with steadily growing sales and improving gross margins, considerable geographic diversification, strong brand equity and positive demand for air conditioners and refrigerators. Though current ratio has room for improvement, financial risk of the company is considered moderate as depicted by manageable gearing and leverage indicators and adequate debt service coverage. The ratings however, factor in dynamic consumer preferences for electronics goods, high price sensitivity, and vulnerability to foreign exchange risk amidst low pricing power, and weak corporate governance. The ability to sustain and improve its scale of operations, improve profit margins, and maintain leverage indicators around current levels would be the key ratings sensitivities.

Sales and Profits

Net sales of the company increased slightly during FY18 mainly on account of growth in air conditioner and water dispenser businesses. Refrigerators sales, however, remained flat as the impact of higher average selling price was offset by decline in volumetric sales. Sales from LED TV business were recorded lower mainly on account of decline in average selling price and flat volumetric sales. With sales growth emanating from higher average selling prices, gross profits of the company augmented further during FY18. In line with the growing scale of operations, administration and distribution expenses were recorded higher during FY18. The increase in finance cost was due to higher utilization of debt financing during the year. OEL recorded higher net income mainly on account of higher sales and gross margins. The company is projecting further improvement in profitability indicators, going forward.

Liquidity and Cash Flows

OEL showcased some improvement in its liquidity position with the higher generation of cash flows during the period. Funds from operations were recorded higher mainly on the back of increase in non-cash adjustments. The current ratio remained largely stable as the impact of increase in short-term borrowings was offset by reduction in trade & other payables and higher inventory levels. The cash conversion cycle lengthened during FY18, owing to increase in inventory days and reduction in days payable outstanding. OEL witnessed weakening of FFO to long-term debt and FFO to total debt ratios on account of higher utilization of debt financing during F18. The debt service coverage ratio was also recorded lower, though OEL's capacity to meet its financing obligations is considered sufficient.

Funding and Capitalization

Equity base of the company augmented further with the continued retention of profits during 1HFY19.OEL's debt profile comprises a mix of short-term and long-term borrowings. The outstanding balance of long-term borrowings has increased as the company mobilized new debt financing during 1HFY19 to fund the acquisition of land and machinery. Meanwhile, higher advances from customers enabled the company to reduce short-term borrowings. The gearing and debt leverage indicators of the company improved during 1HFY19, with the reduction in total debt and liabilities. As per the management, there is no plan to mobilize new long-term debt over the foreseeable future, and hence, the further augmentation of equity and schedule repayments of existing debt will positively impact the leverage indicators.

Industry Dynamics and Future Outlook

Demand within the consumer durable industry is mainly a function of population growth, GDP per capita, urbanization, changing demographic distribution and growing awareness with trends of technology. Since 2000, population in Pakistan has grown at a rate of 2.4% p.a., while GDP per capita increased to $1,468 (FY16: $1,426) during FY17. Proportion of middle income population has grown to 45% in 2015 as compared to 33% in 2001; the same is projected to increase, going forward.

Moreover, speedy urbanization, higher influx of younger people in the demographic, improved standard of living and greater awareness with new technological trends has and will further translate into healthy demand for consumer durables in Pakistan as they have become a necessity rather than a luxury.

Orient Electronics (Pvt.) Limited — Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*

BALANCE SHEET	FY16	FY17	FY18	1HFY19
Property, Plant & Equipment	2,508	2,862	12,110	12,293
Investment Property	-	-	1,033	1,033
Long-term Advances & Deposits	22	2,599	922	981
Intangible Assets	-	4	4	4
Stock in Trade	2,126	3,253	4,661	4,672
Trade Debts	-	266	307	319
Advances, Deposits, and Prepayments	708	608	978	338
Stores, Spares, & Loose Tools	-	-	36	36
Due From Government	581	1,988	2,442	2,705
Cash and Bank Balance	709	113	52	58
Total Assets	**6,654**	**11,693**	**22,545**	**22,439**
Trade and Other Payables	3,385	5,188	3,962	4,732
Short Term Borrowings	139	1,562	4,313	3,034
Long-Term Borrowings *(Inc. current matur)*	51	30	1,045	1,471
Deferred Liabilities	87	107	553	553
Other Liabilities	-	9	109	76
Total Liabilities	3,661	6,897	9,982	9,866
Tier-1 Equity *(Inc. sponsors loan)*	**2,910**	**4,717**	**5,703**	**5,713**

INCOME STATEMENT	FY16	FY17	FY18	1HFY19
Net Sales	13,793	14,795	15,408	5,146
Gross Profit	1,862	2,182	2,536	884
Operating Profit	942	997	1,010	316
Profit After Tax	529	825	975	10
FFO	634	946	968	n.a

RATIO ANALYSIS	FY16	FY17	FY18	1HFY19
Gross Margin (%)	13.5	14.8	16.5	17.2
Net Working Capital	579	(539)	(604)	(310)
FFO to Long-Term Debt (x)	12.3	31.2	0.93	n.a
FFO to Total Debt (x)	3.33	0.59	0.18	n.a
Debt Servicing Coverage Ratio (x)	5.31	6.62	2.84	n.a
ROAA (%)	-	9.0	5.7	n.a
ROAE (%)	-	25.1	20.8	n.a
Gearing (x)	0.07	0.34	0.94	0.79
Debt Leverage (x)	1.26	1.46	1.75	1.73
Current Ratio	1.16	0.92	0.93	0.96
Inventory + Receivable/Short-term Borrowings (x)	15.32	2.25	1.15	1.64

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure III

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Annexure IV
Name of Rated Entity	Orient Electronics (Pvt.) Limited
Sector	Consumer Appliance
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	(see table below)
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
26/03/2019	A	A-2	Stable	Initial