RATING REPORT

Orient Electronics (Pvt.) Limited

REPORT DATE:
June 29, 2020

RATING ANALYSTS:
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RATING DETAILS				
Rating	**Latest Rating**		**Previous Rating**	
Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	BBB+	A-2	A	A-2
Rating Date	*June 26, '20*		*March 26, '19*	
Rating Outlook	*Stable*		*Stable*	
Rating Action	*Downgrade*		*Initial*	

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 Limited was incorporated in August 2005 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017).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-HFY20: Rs. 7.3b; end-FY19: Rs. 7.2b; end-FY18: Rs. 5.70b

Assets: end-HFY20: Rs. 25.5b; end-FY19: Rs. 25.2b; end-FY18: Rs. 22.5b

Profit After Tax: HFY20: Rs. 28m; FY19: Rs. 956m; FY18: Rs. 975m

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 long-term, relations with the vendors and dealers. The ratings draw comfort from sizeable scale of operations with steadily growing sales, improvement in gross margins, considerable geographic diversification, strong brand recognition 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 ongoing geopolitical scenario, global economic landscape and slowdown in domestic economic activity amidst the COVID-19 pandemic is likely to pose financial risk to the company impacting revenues, profitability, liquidity and debt repayment capacity. Therefore, the ratings incorporate dynamic consumer preferences for electronics goods, high price sensitivity and vulnerability to foreign exchange risk amidst low pricing power. The company's ability to maintain scale of operations, improve profit margins and contain leverage indicators around current levels would be the key ratings sensitivities. Further, disruption in operations due to coronavirus outbreak may be a key business risk factor.

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. Population in Pakistan has grown at a rate of 2.3% per annum in the last decade, while GDP per capita has increased to $1,482 (FY17: $1,465) during FY18 from $520 in FY10. Proportion of middle-income population has grown to 42% in FY17 as compared to 33% in 2001; the same is projected to increase, going forward. Moreover in the medium to long-term, speedy urbanization, higher influx of younger people in the demographic, improved standard of living and greater awareness with new technological trends will further translate into healthy demand for consumer durables in Pakistan as they would become household necessities rather than luxuries.

However in the short-term, the ongoing COVID-19 pandemic shrouding the overall potential of the global economy is expected to hamper the demand dynamics for non-essential electronics market in a developing country where the buying power of consumers is already stressed. Going forward, given the company is heavily dependent on imports and as there have been supply chain disruptions from China, the first epicenter of the pandemic outbreak, the company is likely to face supply side risks during the ongoing year. Further, the company's production facilities, like other industrial units, have been shut down in line with the provincial Government's directive of lockdown.

Growth in Topline: With increase in the average prices of the final retail products coupled with quantum increase in air conditioner sale the topline of the company improved to Rs. 17.0b (FY18: Rs. 15.4b) during FY19. Air conditioner business segment has remained the major revenue driver, followed by refrigerator segment; the same contributed around 49% (FY18: 37%) and 32% (FY18: 37%) respectively, to the total gross revenue. Refrigerators sales exhibited a declining trend; however, the impact of decline in volumetric sales was largely offset by higher average selling price. Sales from LED TV, Microwave and Water Dispenser businesses were recorded lower mainly on account of decline in volumetric sales. The downward trend in sales is an indicator of intense competition faced by the company with existing market players making market capitalization difficult. The declining trend in sales continued during HY20 as well, with quantum sales recorded lower; however the same is not a true reflective of market position given the first half is not a peak season for sale of electronics.

Gross margins of the company exhibited an improving trend; recorded higher at 23.9% (FY19: 19.4%; FY18: 16.5%) as an outcome of higher average sales price per unit of all products coupled with increased contribution of high margin products to the revenue mix. The margin contribution of refrigerator, air-conditioner and water dispenser segments were recorded higher at 30%(FY19: 23%; FY18: 22%); 25% (FY19:18%; FY18: 13%) and 26%(FY19:14%; FY18: 10%) respectively. Further, there was notable increase in the input cost of imported materials' however the same was out paced by the sizable growth in the prices of end retail products. The administration expenses were largely rationalized in terms of sales growth with a slight increase manifested in compensation benefits; however selling and distribution cost declined on account of decline in advertising and freight expenses. However, other expenses increased on a timeline basis to Rs. 533.5m during FY19 as compared to Rs. 238.5m in the preceding year as a result of considerable exchange rate fluctuation loss of Rs. 446.5m (FY18: Rs. 136.1m) booked. In the backdrop of increasing average benchmark interest rates coupled with higher average short-term borrowings and some additional long-term funding, finance cost of the company increased during FY19. Consequently with increase in operating expenses and finance cost, OEL before tax profit was recorded lower during FY19 as compared to preceding year. Subsequently despite increase in sale revenues, accounting for taxation the company's bottom line was reported lower at Rs. 955.8m (FY18: Rs. 975.4m) during FY19.

During HY20, net sales amounted to Rs. 4.4b, the same is far below from the annualized projections of Rs. 25.9b put forward by management for FY20. Gross margins exhibited an increase during ongoing year in line with increase in prices of end-products. As per management, the impact of Pak rupee depreciation has been fully passed on; therefore the margins will be maintained at current levels.

Adequate liquidity; however FFO registered downward trend: Funds from Operations (FFO) declined to Rs. 869.3m (FY18: Rs.967.8m) during FY19 primarily as a result of decline in profitability coupled with increase in financial expense borne. Further, liquidity profile of the company depicted slight deterioration as FFO to long-term debt declined to 0.71x (FY18: 0.93x) as a result of increased reliance on long term financing. Moreover, in line with higher utilization of short-term borrowings, FFO to total debt also stood lower at end-FY19. Further, Debt Service Coverage Ratio (DSCR) albeit declined; however, still remained at comfortable level during the period under review. Stock in trade was recorded slightly lower by end-HY20, as the company was meeting its inventory demand through continuous production, in order to lower the cost associated with holding higher inventory levels. Stock in trade stood higher at Rs. 6.0b (FY18: Rs. 4.7b) at end-FY19, accordingly in order to meet higher working capital needs, short-term borrowings increased during the same period; however the same subsided during the ongoing year. Trade debts were recorded considerably higher at end-FY20; the surge in trade receivables was an outcome of electronic equipment sold to related parties; however the profile of receivables was satisfactory with nearly three-fourth of the receivables falling due within 1 to 3 months.

Advances, prepayments and other receivables declined during the review period mainly on account of repayment of director's loan; meanwhile, the former currently comprise of advances extended to suppliers and related parties. Further, other receivables also decreased on a timeline basis mainly due to payment of sales and income tax received from the government. The trade payables soared to Rs. 5.8b (FY19: Rs.3.8b; FY18: Rs. 4.0b) by end-HY20 largely as a result of higher advances received from customers for the orders to be dispatched during the ongoing year. The current ratio remained largely stable as the impact of increase in short-term borrowings was offset by higher inventory levels. The cash conversion cycle lengthened during FY19, owing to increase in inventory days and reduction in days payable outstanding. Given the current economic outlook amidst the pandemic crisis, the likelihood of materialization of projected revenue targets is nominal; therefore the company might face liquidity stress going forward.

Augmentation in equity on back of profit retention: The equity position of the company has strengthened in line with internal capital generation. Debt profile of the company majorly comprises short-term borrowings with relatively low dependence on long term financing. However, the company obtained a long-term loan amounting to Rs. 612.0m during FY19 to meet working capital requirements, the same is an Islamic Finance Facility entailing a tenor of three years with a six month grace period priced at 12 month Kibor+2%. The principal payment is to made in sixty equal monthly installments; the facility is secured against fixed assets of company with 20% margin. Furthermore, to meet higher working capital requirements emanating from high raw material inventory piled, short-term borrowings peaked to Rs. 5.5b (FY18: Rs. 4.3b) by end-FY19; the same however declined to Rs. 3.7b during HY20. These facilities are secured against charge on finished goods, pledge on present and future current assets, fixed assets and lien on import documents. Higher advances from customers enabled the company to reduce short-term borrowings. Albeit higher utilization of short-term borrowings together with increase in long-term funding, gearing has declined to 0.73x (FY19: 0.93x; FY18: 0.94x) by end-HY20 in line with augmentation of equity base. However, the debt leverage remained at prior years level given the enhancement in equity base was offset by increase in trade payables. 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.

Orient Electronics (Pvt.) Limited **Annexure I**

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**FY19**	**1HFY20**
Property, Plant & Equipment	2,508	2,862	12,110	12,317	12,479
Investment Property	-	-	1,033	1,435	1,435
Long-term Advances & Deposits	22	2,599	922	1,862	2,077
Intangible Assets	-	4	4	3	3
Stock in Trade	2,126	3,253	4,661	6,021	5,008
Trade Debts	-	266	307	217	1,623
Advances, Deposits, and Prepayments	708	608	978	936	669
Stores, Spares, & Loose Tools	-	-	36	39	68
Due From Government	581	1,988	2,442	2,401	2,264
Cash and Bank Balance	709	113	52	14	10
Total Assets	**6,654**	**11,693**	**22,545**	**25,246**	**25,636**
Trade and Other Payables	3,385	5,188	3,962	3,801	5,819
Short Term Borrowings	139	1,562	4,313	5,478	3,651
Long-Term Borrowings *(Inc. current matur)*	51	30	1,045	1,228	1,520
Deferred Liabilities	87	107	553	520	520
Total Liabilities	3,661	6,897	9,982	11,227	11,622
Paid Up Capital	700	700	700	700	700
Tier-1 Equity *(Inc. sponsors loan)*	**2,910**	**4,717**	**5,703**	**7,206**	**7,301**
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**FY19**	**1HFY20**
Net Sales	13,793	14,795	15,408	17,005	4,350
Gross Profit	1,862	2,182	2,536	3,304	1,040
Operating Profit	942	997	1,010	1,447	304
Profit Before Tax	852	1,128	1,366	1,247	67
Profit After Tax	529	825	975	956	28
FFO	634	946	968	869	N/A
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**FY19**	**1HFY20**
Gross Margin (%)	13.5	14.8	16.5	19.4	23.9
Net Working Capital	579	(539)	(604)	(272)	(712)
FFO to Long-Term Debt (x)	12.3	31.2	0.93	0.71	N/A
FFO to Total Debt (x)	3.33	0.59	0.18	0.13	N/A
Debt Servicing Coverage Ratio (x)	5.31	6.62	2.84	1.47	N/A
ROAA (%)	-	9.0	5.7	4.0	0.2
ROAE (%)	-	25.1	20.8	14.8	0.8
Gearing (x)	0.07	0.34	0.94	0.93	0.71
Debt Leverage (x)	1.26	1.46	1.75	1.56	1.59
Current Ratio	1.16	0.92	0.93	0.97	0.93
Inventory + Receivable/Short-term Borrowings (x)	15.32	2.25	1.15	1.14	1.82

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

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 III
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		
26/06/2020	BBB+	A-2	Stable	Downgrade
26/03/2019	A	A-2	Stable	Initial