RATING REPORT

Orient Electronics (Pvt.) Limited

REPORT DATE:
August 27, 2021

RATING ANALYSTS:

Tayyaba Ijaz
tayyaba.ijaz@vis.com.pk

RATING DETAILS				
Rating	**Latest Rating**		**Previous Rating**	
Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	A-	A-2	BBB+	A-2
Rating Date	*August 25, '21*		*June 26, '20*	
Rating Outlook	*Rating Watch-Developing*		*Stable*	
Rating Action	*Upgrade on Rating Watch*		*Downgrade*	

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 2019)
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 Limited was incorporated in August 2005 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017).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-FY21: Rs. 10.3b; end-FY20: Rs. 9.1b; end-FY19: Rs. 7.2b

Assets: end-FY21: Rs. 30.6b; end-FY20: 28.6b; end-FY19: Rs. 25.2b

Profit After Tax: FY21: Rs. 1.2b; FY20: 819m; FY19: Rs. 956m

RATING RATIONALE

Orient Electronics (Pvt.) Limited (OEL) is a reputed manufacturer of home appliances in Pakistan. Shareholding is vested with the sponsoring family who have over six decades of experience in the consumer electronics industry. The company has been able to maintain long-term relations with the vendors and dealers. The ratings factor in growth in sales in FY21 with increase manifested in all major products led by higher volumetric sales and average selling prices. Liquidity is considered adequate in terms of cash flow coverages. Leverage indicators have remained comfortable on the back of augmentation in core equity. The ratings also factor in continued sponsors support in the form of interest free loans.

In the last quarter of FY19, directors of OEL, Orient Color Labs (OCL - Parent company) and Orient Electronic Appliances (Pvt.) Limited (OEAL - An associated company) unanimously approved the scheme of Compromises, Arrangements and Reconstruction under section 279 to 282 of the Companies Act, 2017. The companies had filed a joint application to obtain sanction of, and for other orders facilitating the implementation of scheme in Lahore High Court on June 3, 2019. The principal object of the scheme is to provide for the division of OEL by means of separation of the operations segment (all assets other than immoveable properties) as a going concern from OEL. The operations segment will be transferred to and vested in OEAL while investment in ordinary shares of OEL will be eliminated by OCL against paid up share capital of OEL and the remaining paid-up share capital amount will be divided between the company and OEAL based on proportion of bifurcated net assets excluding surplus on revaluation on property, plant and equipment. Shareholding of OEL and OEAL will be then adjusted between two sponsoring families. Whereas all rights, title and interest in immoveable properties, including freehold land, leasehold land investment property and building on freehold land, with all existing encumbrances would be retained by OEL. After approval of this scheme, OEL operations would include lease out of retained land and building to OEAL in the form of operating lease. The company expects to receive No Objection Certificates (NOCs) from respective banks in near term which will then be submitted to the Court for further process.

Capacity utilization decreased in the outgoing year on account of supply chain disruptions from Covid-19 and the ensuing decrease in demand amidst peak season: Closure of operations for 24 days due to lockdown and supply chain disruptions from China led to lower production of all products, except for microwave ovens, during FY20. OEL manufactured 109.1K units of refrigerators in FY20 as compared to 223.4K in FY19. Air conditioners output was recorded lower at 123.9K units (FY19: 169.4K), LED Televisions production decreased sizably to 43.8K (FY19: 140.6K) along with some decrease in water dispensers manufacturing to 25.8K (FY19: 37.9K). Microwave ovens production increased to 36.1K (FY19: 24K). Meanwhile, the company imported 5.6K washings machines as Completely Built-up (CBU) units in FY20 (FY19: 10K). During FY21, production improved throughout the product lines except for LED TVs, which have witnessed a declining trend.

Units '000'	FY19	FY20
Installed Capacity		
Refrigerator	750	750
Air Conditioner	480	480
Water Dispenser	120	120

LED TV	384	384
Microwave Oven	100	100
Capacity Utilization		
Refrigerator	30%	15%
Air Conditioner	35%	26%
Water Dispenser	32%	22%
LED TV	37%	11%
Microwave Oven	24%	36%

Property, plant and equipment stood at Rs. 15.1b (FY20: Rs. 15.0b; FY19: Rs. 12.3b) at end-FY21; additions in FY20 mainly pertained to freehold land of worth Rs. 2.0b, leasehold land of Rs. 274.6m and capital work in progress of Rs. 572.0m. Freehold land worth Rs. 1.7b has restriction by Lahore Development Authority to be used only for building a hospital. Leasehold land was acquired on lease from Capital Development Authority; the management intends to build a plaza mainly for rental income. Capital work in progress is related to cost incurred on building of hotel (Orient Square). Investment property stood at Rs. 1.8b (FY20: Rs. 1.8b; FY19: Rs. 1.4b) by end-FY21. Investment property has increased in FY20 in line with fair value measurement gain of Rs. 215.3m (FY19: Rs. 401.9m) and addition of land and building amounting Rs. 192.0m (FY19: Nil). Long-term advances and deposits stood at Rs. 29.3m (FY20: Rs. 11.9m; FY19: Rs. 1.9b) where decrease in FY20 was due to capitalization of advance against purchase of freehold land in PP&E.

Growth in topline in the ongoing year: Net sales decreased to Rs. 14.2b (FY19: Rs. 17.0b) in FY20 mainly on account of volumetric decrease in sales due to the impact of pandemic affecting demand for consumer electronics market. The company had an associated concern, namely Orient Home Appliances (Pvt.) Ltd. (OHAL) formed mainly for the purpose of marketing and distribution of OEL products. OHAL was then merged into OEL on June 30, 2019. The revenue would have been even lower if the prior arrangement would have continued with OHAL. Air conditioners segment remained the major revenue driver in FY20, followed by refrigerator segment, contributing around 54% (FY19: 49%) and 32% (FY19: 32%), respectively. OEL reduced production and sales of LED TV due to high competition and increase in input cost of LED in the international market.

Units Sold '000'	FY19	FY20
Refrigerator	201.2	129.3
Air Conditioner	183.7	132.3
Water Dispenser	50.2	27.4
LED TV	125.3	60.6
Microwave Oven	8.7	48.6
Washing Machine	7.7	3.1

Gross margins increased to 24.9% (FY19: 19.4%) mainly on the back of higher average sales price per unit of all products coupled with increased contribution of high margin products to the revenue mix. The positive impact on margins was also due to direct sales to distributors instead of sale to OHAL. The margin contribution of refrigerator, air-conditioner and LED TV segments were recorded higher at 25% (FY19: 23%); 27% (FY19:18%) and 19% (FY19: 13.5%) respectively. Administrative expenses were recorded higher at Rs. 862.0m (FY19: Rs. 813.7m) with increase mainly manifested in entertainment, utilities, and insurance expenses. Selling and distribution expenses increased to Rs. 630.0m (FY19: Rs. 509.6m) mainly due to notable increase in salaries and benefits to Rs. 197.8m (FY19: Rs. 59.0m) and provision for warranty claims of Rs. 93.2m (FY19: Nil); major portion of these expenses was previously borne by OHAL. Advertisement expenses decreased due to cost control measures while freight expenses also stood lower due to sharing the cost with distributors and lower imports. Other operating expenses decreased considerably to Rs. 161.2m (FY19: Rs. 533.5m) mainly on account of lower exchange rate fluctuation loss of Rs. 78.1m (FY19: Rs. 466.5m) largely in line with relatively stable exchange rate parity during the year. Other income decreased to Rs. 226.6m (FY19: 421.5m) mainly due to lower fair value gain on investment property amounting Rs. 215.3m (FY19: Rs. 401.9m) in FY20. The finance cost increased considerably to Rs. 1.1b vis-à-vis Rs. 621.9m in the preceding year owing to higher average borrowings and markup rates during the year. Resultantly, net profit was recorded lower at Rs. 819.0m (FY19: Rs. 955.8m) in FY20.

As per provisional numbers, net sales amounted to Rs. 16.2b during FY21 with major contribution from refrigerators and air conditioner sale. The company managed to sell 175.9K units of refrigerators and 146.3K units of air conditioners in FY21. In addition, 42K water dispensers, 23.3K LED TVs, 54.4K microwave ovens and 5.8K washing machines were sold in FY21. Gross margins remained at 24.8%. Admin expenses amounted to Rs. 921.1m and selling and distribution expenses amounted to Rs. 738.4m. Finance cost was recorded at Rs. 683.7m and was considerably lower relative to preceding year due to lower markup rates. Accounting for taxation, net profit amounted to Rs. 1.2b. Albeit volumetric sales during FY21 were higher vis-à-vis FY20, the company has witnessed a loss of market share over the last few years. VIS would take into account ability of the company to retain its historical market share while maintaining existing financial indicators, going forward.

Adequate liquidity as reflected by cash flows in relations to outstanding obligation: Funds from Operations (FFO) increased to Rs. 1.0b (FY19: Rs. 869.3m) primarily on account of higher non-cash adjustments along with decrease in the amount of income tax paid during FY20. However, due to increasing reliance on long-term borrowings, FFO to long-term debt decreased to 0.50x (FY20: 0.71x). Given lower outstanding short-term borrowings, FFO to total debt increased to 0.28x (FY19: 0.13x) in FY20. Debt Service Coverage Ratio (DSCR) decreased to 1.25x (FY19: 1.47x), though remained at a comfortable level during the period under review. In FY21, FFO increased to Rs. 1.5b mainly on the back of higher profitability. This, along with lower long-term repayments resulted in higher DSCR of 1.96x.

Stock in trade stood higher at Rs. 5.7b (FY20: Rs. 3.8b; FY19: Rs. 6.0b) at end-FY21 due to increase in raw material inventory to Rs. 3.5b (FY20: Rs. 2.8b; FY19: Rs. 3.4b) and higher finished goods stock of Rs. 2.1b (FY20: Rs. 1.0b; FY19: Rs. 2.0b). Inventory levels were lower in FY20 due to supply chain disruptions and prevailing uncertainty at that time. Trade debts stood at Rs. 4.0b (FY20: Rs. 4.0b; FY19: Rs. 217m) at end-FY21. The receivables showed a sizeable increase in FY20 and onward, as previously these were used to be recorded in the books of OHAL. However, aging of receivables is considered satisfactory given around 90% of the receivables fall under six months' bracket. Advances, deposits and prepayments stood higher at Rs. 1.1b (FY20: Rs. 560.8m; FY19: Rs. 946.8m). The increase was mainly manifested in advances to suppliers of Rs. 450.9m (FY20: Rs. 63.1m; FY19: Rs. 276m) and to related parties of Rs. 555.1m (FY20: Rs. 212.9m; FY19: Rs. 231.2m). Amount due from government (net) amounted to Rs. 2.0b (FY20: Rs. 20b; FY19: Rs. 2.4b) is related to income tax and sales tax refundable.

Trade and other payable decreased to Rs. 4.0b (FY20: Rs. 6.0b; FY19: Rs. 3.8b) by end-FY21 mainly due to decrease in trade creditors to Rs. 3.0b (FY20: Rs. 3.8b; FY19: Rs. 2.3b) and advances from customers to Rs. 312.8m (FY20: Rs. 1.0b; FY19: 1.2b). Outstanding trade creditors increased in FY20 as the company availed extended credit period provided by some local and foreign suppliers in pandemic. Additionally, the company obtained interest free loan from directors amounting Rs. 845.9m (FY19: Nil) in FY20 for working capital requirement. Overall credit terms with major import vendors has remained intact, ranging from 90-150 days. Current ratio improved slightly to 1.25x (FY20: 1.11x; FY19: 0.97x). Coverage of short-term borrowings via trade debts and inventory remained adequate at 1.75x (FY19: 2.06x; FY19: 1.14x) by end-FY21.

Profit retention and interest free loans from sponsors have supported the capitalization: Core equity of the company augmented to Rs. 10.3b (FY20: Rs. 9.1b; FY19: Rs. 7.2b) by end-FY21 on the back of profit retention. Additionally, sponsors have continued to support equity in form of unsecured interest free loan, payable on discretion of the company, amounting to Rs. 2.7b (FY20: Rs. 2.7b; FY19: Rs. 1.7b). Total equity stood at Rs. 17.1b (FY20: Rs. 15.8b; FY19: 14.0b) after incorporating revaluation surplus on property, plant and equipment. Debt profile of the company majorly comprises short-term borrowings amounting to Rs. 5.6b (FY20: 3.8b; FY19: Rs. 5.5b) at end-FY21. Long-term borrowings including current portion increased to Rs. 3.2b (FY20: Rs. 2.2b; FY19: Rs. 1.2b) by end-FY21. The company mobilized an additional long-term borrowing of Rs. 1.0b in 4QFY21 under bridge financing for ongoing real estate project of Orient Square. In addition, OEL has mobilized long-term facility of Rs. 127m for some civil work, and an Islamic facility of Rs. 360m in FY21 under SBP refinance scheme for payment of salaries and wages carrying markup at rate of 5% per annum. In FY20, the company obtained term finance facilities to the tune of Rs. 1.5b, priced at 6M KIBOR plus 2% for the purchase land. In June, 2020, OEL deferred loans amounting to Rs. 3.98b out of which Rs. 1.84b pertained to short-term facilities comprising finance against import documents and Rs. 2.14b were related to long-term loans. These short-term facilities which were due on different dates were deferred by the banks for 180 days to one year and have been fully repaid as of now. Long-term repayment amounting to Rs. 420m has been made as per the maturity period. Despite notable increase in overall debt levels, the impact on gearing (FY21: 0.86x; FY20: 0.66x; FY19: 0.93x) was somewhat diluted due to higher equity base while debt leverage decreased to 1.32x (FY20: 1.40x; FY19: 1.56x).

Orient Electronics (Pvt.) Limited Annexure I

Financial Summary (in PKR millions)				
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21***
Property, Plant & Equipment	12,110	12,317	15,039	15103
Investment Property	1,033	1,435	1,843	1,843
Long-term Advances & Deposits	922	1,862	12	29
Intangible Assets	4	3	3	3
Stock in Trade	4,661	6,021	3,791	5,739
Trade Debts	307	217	4,047	4,058
Advances, Deposits, and Prepayments	978	936	561	1,138
Stores, Spares, & Loose Tools	36	39	96	95
Due From Government	2,442	2,401	2,000	1,955
Cash and Bank Balance	52	14	1,188	665
Total Assets	**22,545**	**25,246**	**28,579**	**30,627**
Trade and Other Payables	3,962	3,801	5,991	4,027
Short Term Borrowings	4,313	5,478	3,810	5,593
Long-Term Borrowings *(Including current maturity)*	1,045	1,228	2,154	3,219
Deferred Liabilities	553	520	501	501
Other Liabilities	109	200	286	216
Total Liabilities	9,982	11,227	12,742	13,556
Paid Up Capital	700	700	700	700
Tier-1 Equity	**5,703**	**7,206**	**9,070**	**10,303**
Total Equity	**12,563**	**14,019**	**15,838**	**17,071**
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21***
Net Sales	15,408	17,005	14,179	16,246
Gross Profit	2,536	3,304	3,528	4,024
Operating Profit	1,010	1,447	1,875	2,216
Profit Before Tax	1,366	1,247	1,084	1,559
Profit After Tax	975	956	819	1,234
FFO	968	869	1,080	1,454
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21***
Gross Margin (%)	16.5	19.4	24.9	24.8
Net Margin (%)	6.3	5.6	5.8	7.6
Net Working Capital	(604)	(272)	1,119	2,708
FFO to Long-Term Debt (x)	0.93	0.71	0.50	0.45
FFO to Total Debt (x)	0.18	0.13	0.28	0.16
Debt Servicing Coverage Ratio (x)	2.84	1.47	1.25	-
ROAA (%)	5.7	4.0	3.0	4.2
ROAE (%)	20.8	14.8	10.1	12.7
Gearing (x)	0.94	0.93	0.66	0.86
Debt Leverage (x)	1.75	1.56	1.40	1.32
Current Ratio	0.93	0.97	1.11	1.25
Inventory + Receivable/Short-term Borrowings (x)	1.15	1.14	2.06	1.75

**Unaudited*

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	
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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Due Diligence Meetings Conducted	

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
25/08/2021	A-	A-2	Rating Watch-Developing	Upgrade on Rating Watch
26/06/2020	BBB+	A-2	Stable	Downgrade
26/03/2019	A	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Waseem Khalid	Senior Deputy Manager Finance	June 04, 2021
Mr. Aleem Amin	CFO	July 06, 2021 & August 05, 2021
Mr. Kashif Siddiqui	Deputy Manager Finance	August 05, 2021