RATING REPORT

Orient Electronics (Pvt.) Limited

REPORT DATE:
May 09, 2023

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity Rating	A-	A-2	A-	A-2
Rating Date	*May 09, 2023*		*March 17, 2022*	
Rating Outlook	*Rating Watch-Negative*		*Rating Watch-Developing*	
Rating Action	*Maintained*		*Update*	

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 (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

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 Limited was incorporated in August 2005 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017).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 of the Company. He has over 30 years of experience in consumer electronics sector.

Financial Snapshot
Tier-1 Equity: end-FY22: Rs. 8.3b; end-FY21: Rs. 8.8b; end-FY20: Rs. 9.1b
Assets: end-FY22: Rs. 37.9b; end-FY21: 37b; end-FY20: Rs. 28.6b
Profit After Tax: FY22: Rs. 609m; FY21: Rs. 942m; FY20: Rs. 819m

RATING RATIONALE

Corporate profile

Orient Electronics (Pvt.) Limited (OEL) is a renowned local home appliances manufacturer which produces air conditioners, refrigerators, LED TVs, water dispensers, microwaves ovens and other electronic goods. The company is a subsidiary of Orient Color Labs (Pvt.) Ltd. (OCL), shareholding of which is vested within the two sponsoring families who have over six decades of industry experience.

During FY19, the directors of OEL, OCL and Orient Electronic Appliances (Pvt.) Ltd. (OEAL – an associated company) unanimously approved the approved the scheme of Compromises, Arrangements and Reconstruction under section 279 to 282 of the Companies Act, 2017. According to the scheme, the operations segment (all assets other than immoveable properties) of OEL will be separated as a going concern and will be transferred and vested to OEAL while OEL will retain the rights, title and interest in immoveable properties. Additionally, investment of ordinary shares in OEL by OCL will be eliminated against paid-up share capital of OEL while the remaining paid-up share capital will be divided between OEL and OEAL based on proportion of net assets (excluding revaluation surplus on property, plant and equipment). Shareholding of OEL and OEAL will then by divided between the two sponsoring families. Ultimately, after approval of this scheme, OEL operations would include lease out of retained land and building to OEAL in the form of operating lease. According to management, the company is awaiting court orders to sanction the scheme.

Elevated business risk on the account of challenging macroeconomic environment

The home appliances industry contributes about 4% to total large-scale manufacturing (LSM) and is characterized by medium business risk. The industry constitutes of about 53 players and is dominated by several local and international companies including PEL, Arcelik (Dawlance), Orient, Haier, and Waves. Along with differentiation in terms of price and quality, effective branding plays an important role in the competitive dynamics of the industry to capture market share. Demand for the industry emanates from both original and replacement markets and is largely a function of per capita income, population growth, technological innovation, rapid urbanization and seasonality.

Ongoing challenging macroeconomic environment of the country reflected in the form of import curtailments, currency devaluation, soaring inflation, high power costs and hike in policy rate have negatively affected the performance of the sector. This is evident through the decline in the LSM index by about 4.4% YoY during Jan'23. Additionally, given that the industry relies heavily on imported raw materials, with localization levels ranging between 20-25%, the import restrictions have caused significant supply-side issues consequently elevating the business risk profile.

Two-fold rationale of notable decline in capacity utilization- seasonal effect and unavailability of raw material due to import restrictions

Available Production Capacity (units)			
	FY21	FY22	1HFY23
Split Air Conditioner	480,000	480,000	240,000
Refrigerators	750,000	750,000	375,000
Water Dispenser	120,000	120,000	60,000
Microwave Oven	720,000	720,000	360,000
LED TV	384,000	384,000	192,000
Washing Machines	72,000	72,000	36,000
Actual Production (units)			
	FY21	FY22	1HFY23
Split Air Conditioner	139,298	128,480	8,608
Refrigerators	188,789	103,182	34,038
Water Dispenser	42,192	50,451	15,398
Microwave Oven	51,280	55,367	1,317
LED TV	21,199	22,052	4,013
Washing Machines	2,160	7,063	1,744
Capacity Utilization (%)			
	FY21	FY22	1HFY23
Split Air Conditioner	29.0%	26.8%	3.6%
Refrigerators	25.2%	13.8%	9.1%
Water Dispenser	35.2%	42.0%	25.7%
Microwave Oven	7.1%	7.7%	0.4%
LED TV	5.5%	5.7%	2.1%
Washing Machines	3.0%	9.8%	4.8%

During the ongoing year, capacity utilization has witnessed a significant decrease across all product segments. This is attributable to two factors: 1) seasonality factor and 2) limited raw material availability. In 8MFY23, the company sustained production through utilization of older stock, however, influx of additional raw material expected by end-May'23 will help improve sales revenue. According to management, production of the microwave oven, LED TV and washing machine product lines will be halted during 2HFY23 and focus will be on the remaining product lines. Furthermore, the management plans to increase localization levels in the production of air conditioners, which is the main revenue driver over the rating horizon. As per plan, about 40% of total output is expected to be locally procured yielding transport cost savings of around 25%. However, plans have been delayed due to import restrictions on the required machinery.

Decrease in topline owing to volumetric decline; uptick in gross margins attributable to inventory gains and costs transferred to customers whereas notable pressure on net margins due to elevated financing costs

The company registered a 14.2% decline in sales revenue during FY22 with the same reported at Rs. 13.9b (FY21: Rs. 16.2b) owing primarily to a decrease in quantum sold. Breakdown of net sales by quantity sold can be seen below:

	FY21		FY22		1HFY23	
	Quantity Sold (Units)	%	Quantity Sold (Units)	%	Quantity Sold (Units)	%
Split Air conditioner	155,645	31.1%	133,663	33.4%	13,395	18.0%
Refrigerators	185,445	37.0%	140,146	35.0%	36,500	49.1%
Water Dispenser	57,328	11.4%	49,566	12.4%	10,844	14.6%
Microwave Oven	63,587	12.7%	53,886	13.5%	1,560	2.1%
LED TV	28,839	5.8%	16,583	4.1%	10,166	13.7%

Washing Machines	10,358	2.1%	6,364	1.6%	1,922	2.6%
Total	**501,202**	**100.0%**	**400,208**	**100.0%**	**74,387**	**100.0%**

Gross margins rose to 26.1% in FY22 (FY21: 20%) largely on the back of higher selling prices as the company passed on higher raw material costs to customers. Cost of sales amounted to Rs. 10.3b (FY21: Rs. 13b) with raw materials constituting about 92.1% of cost of goods manufactured (FY21: 94.6%). Administrative expenses as well as selling and distribution costs rose to Rs. 837.6m and Rs. 804.9m, respectively (FY21: Rs. 687.7m, Rs. 716.1m) on the back of inflationary pressures. Other income declined to Rs. 323.3m (FY21: Rs. 475.3m) due to lower gain on revaluation of investment property. The aforementioned along with elevated finance costs reduced net margins to 4.4% (FY21: 5.8%) in FY22.

During 1HFY23, the company's topline was reported at Rs. 4.7b largely due to seasonality effect along with raw material constraints. Inclining gross margins of 30.2% in the same period were a determinant of inventory gains given utilization of older stock for production. However, net margins were squeezed to 2.7% in HYFY23 owing to greater burden of debt financing. Going forward, the management expects to maintain the topline at Rs. 14b in FY23 as seasonal sales are expected to increase during 2HFY23. However, overall quantum is expected to be lower with growth in net sales being primarily price driven. Total unit sales for FY23 are expected to be about 80K air conditioners, 50K for refrigerators, 30K for water dispensers. Production for remaining product lines is planned to be halted in the short-term, as per management.

Stressed liquidity position on the account of lower cash flow coverages; pressure on debt-servicing capacity

With subdued net margins in FY22 and HYFY23, liquidity coverages particularly debt service capacity weakened, improvement of which is essential to sustain ratings. In 1HFY23, Funds from Operations (FFO) decreased to Rs. 156m (FY22: Rs. 734m; FY21: Rs. 721m) with FFO to total debt decreasing to 0.04x (FY22: 0.09x; FY21: 0.08x) despite overall decline in debt levels. Debt-service coverage ratio (DSCR) remained under pressure, standing at 0.84x (FY22: 0.63x; FY21: 1.16x) in 1HFY23.

Stock-in-trade stood at around Rs. 3.3b at end-Dec'22 (FY22: Rs 4.9b; FY21: Rs. 4.3b) which provided coverage for about one month. The company was able to import only Rs. 400m worth of raw materials since July'22 owing to import restrictions, however, with opening of LCs in March'23, arrival of imported raw materials of about Rs. 2b is expected by end-May'23 which will meet projected sales targets. According to management, the company was able to negotiate change in LC terms with foreign suppliers from LC at sight to usance LC with 365-day period with no cash margin in order to circumvent restrictions imposed by the Central Bank. Impact of exchange rate risk arising as a result of the aforementioned change is yet to be seen.

Aging schedule remained satisfactory as trade debts which stood at Rs. 3.6b at end-FY22 (FY21: Rs. 3.6b) were due up to 180 days. Trade and other payables decreased notably to Rs. 3.7b (FY22: Rs. 6.1b; FY21: Rs. 4.6b) at end-Dec'22 primarily due to lower trade creditors and customer advances. Short-term borrowing coverage and current ratio remained stable at end-Dec'22, standing at 1.32x and 1.03x, respectively (FY22: 1.28x; 0.93x; FY21: 1.54x, 1x). Moreover, net operating cycle witnessed a decrease owing to notable decrease in payable turnover.

With lower working capital needs due to import restrictions and re-profiling of debt structure has improved capitalization indicators during the ongoing year; maintaining the same over the rating horizon will be critical

The company's tier-1 remained stable at around Rs. 8.4b at end-Dec'22 (FY22: Rs. 8.3b; FY21: Rs. 8.8b) out of which about Rs 250m pertained to loans from sponsors (FY22: Rs 250m; FY21: Rs. 1.5b). Overall debt profile constitutes largely of short-term borrowings which decreased to Rs. 4.2b (FY22: Rs. 6.6b; FY21: Rs. 5.8b) due to partial re-profiling of the same into long-term debt, consequently increasing long-term borrowings to Rs. 3.2b (FY22: Rs. 1.6b; FY21: Rs. 3.2b) at end-Dec'22. Gearing decreased to 0.88x (FY22: 1.00x; FY21: 1.02x) on the account of lower total borrowings while leverage also declined to 1.47x, (FY22: 1.98x: FY21: 1.67x) at end-Dec'22 due to lower trade payables and reversal of advance against assets held for sale of Rs. 800m pertaining to sale of land incurred in FY22. Going forward, however, VIS expects capitalization indicators to be under stress owing to increase in trade payables with shift in LC terms. The company's ability to maintain adequate internal capital generation and effectively keep its capitalization ratios at levels that commensurate with the benchmarks for the assigned ratings will be important.

Financial Summary (in PKR millions)					
BALANCE SHEET	**FY19**	**FY20**	**FY21**	**FY22**	**1HFY23**
Property, Plant & Equipment	12,317	15,039	22,302	22,195	22,554
Investment Property	1,435	1,843	2,316	2,261	2,261
Long-term Advances & Deposits	1,862	12	31	25	23
Intangible Assets	3	3	2	6	6
Stock in Trade	6,021	3,791	5,314	4,936	3,256
Trade Debts	217	4,047	3,608	3,577	2,268
Advances, Deposits, and Prepayments	936	561	716	1,558	1,115
Stores, Spares, & Loose Tools	39	96	92	76	114
Due From Government	2,401	2,000	2,044	2,124	2,243
Cash and Bank Balance	14	1,188	609	240	207
Total Assets	**25,246**	**28,579**	**37,034**	**37,937**	**34,049**
Trade and Other Payables (including director's loan in FY22)	3,801	5,990	4,609	6,090	3,688
Trade and Other Payables (excluding director's loan in FY22)	3,801	5,990	4,609	5,393	3,688
Short Term Borrowings	5,478	3,810	5,810	6,642	4,179
Long-Term Borrowings *(including current maturity)*	1,228	2,154	3,242	1,581	3,223
Total Borrowings	**6,706**	**5,964**	**9,052**	**8,223**	**7,403**
Deferred Liabilities	520	501	733	732	729
Other Liabilities	200	287	375	1,296	504
Total Liabilities	**11,227**	**12,742**	**14,769**	**16,341**	**12,324**
Paid Up Capital	700	700	700	700	700
Tier-1 Equity	**7,206**	**9,070**	**8,832**	**8,260**	**8,388**
Total Equity	**14,019**	**15,838**	**22,265**	**21,596**	**21,724**
INCOME STATEMENT	**FY19**	**FY20**	**FY21**	**FY22**	**1HFY23**
Net Sales	17,005	14,179	16,209	13,942	4,730
Gross Profit	3,304	3,528	3,244	3,646	1,428
Operating Profit	1,447	1,875	1,385	1,555	651
Profit Before Tax	1,247	1,084	1,179	930	182
Profit After Tax	956	819	942	609	129
FFO	869	1,080	721	734	156
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**	**FY22**	**1HFY23**
Gross Margin (%)	19.4%	24.9%	20.0%	26.1%	30.2%
Net Margin (%)	5.6%	5.8%	5.8%	4.4%	2.7%
Net Working Capital	(272)	1,119	29	(1,004)	253
FFO to Long-Term Debt (x)	0.71	0.50	0.22	0.46	0.10
FFO to Total Debt (x)	0.13	0.18	0.08	0.09	0.04
Debt Servicing Coverage Ratio (x)	1.14	1.46	1.16	0.63	0.84
ROAA (%)	4.0%	3.0%	2.9%	1.6%	0.7%
ROAE (%)	14.8%	10.1%	10.5%	7.1%	3.1%
Gearing (x)	0.93	0.66	1.02	1.00	0.88
Debt Leverage (x)	1.56	1.40	1.67	1.98	1.47
Current Ratio (x)	0.97	1.11	1.00	0.93	1.03
Inventory + Receivable/Short-term Borrowings (x)	1.14	2.06	1.54	1.28	1.32
Net Operating Cycle (days)	45	55	65	86	69

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

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
09/05/2023	A-	A-2	Rating Watch-Negative	Maintained
17/03/2023	A-	A-2	Rating Watch-Developing	Update
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

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

Name	Designation	Date
Mr. Kashif Siddiqui	Deputy Manager Finance	March 17, 2023