RATING REPORT

Orient Electronics (Pvt.) Limited

REPORT DATE:
May 23, 2024

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Latest Rating	
	Long-term	Long-term	Long-term	Short-term
Entity Rating	A-	A-2	A-	A-2
Rating Date	*May 23, 2024*		*May 09, 2023*	
Outlook / Rating Watch	*Negative*		*Rating Watch-Negative*	
Rating Action	*Maintained*		*Maintained*	

COMPANY INFORMATION

Incorporated in 2005	**External auditors:** Abdul Rahman & Co. Chartered Accountants
Private Limited Company	**Chairman/CEO:** Mian Talat Mahmood Fazal
Key Shareholders (with stake 5% or more):	
Orient Color Labs (Pvt.) Limited – 97.86%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates:
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Orient Electronics (Pvt.) Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

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 Limited was incorporated in August 2005 under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017).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.

Corporate profile

Orient Electronics (Private) Limited ('OEL' or 'the Company') was incorporated on August 23, 2005. The activities of the Company include manufacturing, assembling, and sales of air conditioners, refrigerators, deep freezers, LED TV, water dispensers, microwave ovens, other home appliances, and trading of related electrical equipment. The factory and registered office of the Company are located at 26 - KM Multan Road, Lahore.

The Company's parent company is Orient Color Labs (Private) Limited ('the Parent Company' or 'OCL') which holds 97.86% of total share capital of the Company.

Key Rating Drivers

Medium to high business risk profile characterized by heightened exposure to cyclicality and exchange rate risk. However, medium level of competition among top players in the sector provides support.

VIS categorizes the household appliances industry's business risk profile as medium to high, characterized by significant exposure to cyclicality and exchange rate fluctuations due to local assembly with limited localization. However, only moderate competition among top players, with major market share held by key players in each segment, provides support to the industry's overall risk profile.

Household appliance market is a sub-segment of 'Electrical Equipment' group within the large-scale manufacturing sector, accounting for ~2% of Large-Scale Manufacturing (LSM) sub-segment of the economy. As it is a 'brand' driven market, pricing and marketing strategies play a key role in attracting market shares and can vary entirely for different players among different product segments. In addition, an industry dominated by well recognized brands, extensive capital requirements and a long cash cycle act as high entry barriers. Duty protection in the form of additional customs and regulatory duties provides price advantage to local players.

The appliance market generates demand from both original (first-hand) and replacement markets. Growth is directly related to per capita income, population growth, technological innovation, energy-efficient products, rapid urbanization, and seasonality. In terms of major products, refrigerators have the highest value share, followed by air conditioners, televisions, washing machines, deep freezers, and other products.

Throughout the year, the industry was marred by the slump in demand resulting from stressed economic activity and a contraction in consumer disposable income. Furthermore, production constraints resulting from import restrictions exacerbated the sector's performance challenges. As such the market size in CY23 reported severe contraction. Although some improvements have been observed in macroeconomic conditions, persistent issues such as high energy costs, inflation, and interest rates continue to pose obstacles to the industry's growth prospects going forward.

Revenue growth was constrained by lower volumetric sales despite surge in selling price. Gross margins remain stable, supported by increasing prices and inventory gains while net margins turn negative with elevated financial burden from higher policy rates in FY23.

In FY23, the Company experienced a reduction in revenue stemming from declines in sales volumes across various segments. However, gross margins remained stable despite significant surge in input costs, with PKR depreciation during the year. The Company managed to forward its increasing cost pressures onto customers and benefit from inventory gains on older inventory. Nevertheless, net margins became negative on account of pressure from surge in local interest rates of more than 800 bps in FY23. Gross and net margins were reported at 26.3% (FY22: 26.1%) and -0.7% (FY22: 4.4%), respectively. In 3QFY24, with support from continuous increases in selling prices gross margins have further increased to 33.4%, consequently, net margins also recovered to 3.0%.

Adequate capitalization profile, with improving metrics on account of lower short-term debt utilization in FY23 and 3QFY24.

In FY23, the Company witnessed an enhancement in its capitalization profile, characterized by a reduction in short-term debt utilization, achieved by limiting the extension of its working capital gap. The Company was able to reduce its stock in trade and trade debt to an extent to result in a cash inflow from working capital. As a result, gearing and leverage ratios improved to 0.6x (FY22: 1.0x) and 1.3x (FY22: 2.0x), respectively. In 3QFY24, while gearing further improved to 0.4x, leverage remained unchanged.

Current ratio improved to adequate levels. Inflation of payable cycle a potential liquidity risk.

The Company's liquidity profile improved to adequate level to 1.0x (FY22: 0.9x) in FY23. OEL mostly achieved it by correcting its balance sheet mismatch through a fresh drawdown of long-term debt facility while reducing its short-term debt. The current ratio remained stable at 1.0x in 3QFY24.

Meanwhile, while the cash conversion cycle turned negative, it was mostly on account of an inflation of the payable cycle to 381 days (FY22: 190 days). This extension of the payable cycle emanates potential liquidity risks. Payable cycle remains around 357 days in 3QFY24. However, much of this is attributed to payment delays caused by LC restrictions.

Strained coverage profile with constrained topline and operational margins in FY23. However, active sponsor support continues to provide support to assigned ratings.

As a result of constrained Funds from Operations (FFO) on account of erosion in operational margins, the Company reported pressure on its coverage profile with the debt service coverage ratio (DSCR) eroding to 0.5x (FY22: 1.0x). However, OEL managed to recover its DSCR to 0.83x with improvement in operational margins in 3QFY24 albeit remaining under stress. Ongoing active sponsor support continues to provide support to assigned ratings.

<u>Consideration for Future Reviews</u>

Moving forward, ratings will be sensitive to improvement in the Company's profitability profile and the recovery of its coverage profile to levels adequate to be commensurate with assigned ratings. Additionally, ongoing active sponsor support will be a key consideration for future reviews.

Orient Electronics (Pvt.) Limited

REGULATORY DISCLOSURES						Annexure I
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	Outlook / Rating Watch	Rating Action	
	RATING TYPE: ENTITY					
	23/05/2024	A-	A-2	Negative	Maintained	
	09/05/2023	A-	A-2	Rating Watch-Negative	Maintained	
	17/03/2023	A-	A-2	Rating Watch-Dev	Update	
	25/08/2021	A-	A-2	Rating Watch-Dev	Upgrade on RW	
	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 Siddique	Senior Deputy Manager Finance	May 15, 2024			