RATING REPORT

Digital World Pakistan (Pvt.) Limited

REPORT DATE:

July 2, 2021

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	A-	A-2	BBB+	A-2
Rating Date	*Jun 30, '21*		*July 13, '20*	
Rating Outlook	*Stable*		*Stable*	
Rating Action	*Upgrade*		*Downgrade*	

COMPANY INFORMATION

Incorporated in 2000	External Auditors: Parker Russell-A.J.S. Chartered Accountants
Private Limited Company	Chairman/CEO: Mr. Muhammad Farooq Naseem
Key Shareholders (with stake 5% or more):	
Mr. Muhammad Farooq Naseem – 46%	
Mrs. Roohi Farooq Naseem – 28%	
Mr. Aftab A. Tapal – 6%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (May 2019)

https://www.vis.com.pk/kc-meth.aspx

OVERVIEW OF THE INSTITUTION

Digital World Pakistan (Pvt.) Limited (DWPL) was incorporated in 2000 as a private limited company under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017). The company is engaged in manufacturing and sale of consumer electronic products.

Profile of the Chairman/CEO

Mr. Muhammad Farooq Naseem is the founder of DWPL. He serves the company as Chairman of the Board and Chief Executive Officer. Mr. Farooq has over 25 years of experience in Electronics, Information Technology, Textile and Agro industries.

Financial Snapshot

Tier-I Equity: end-1HFY21: Rs. 2.8b; end-FY20: Rs. 2.6b; end-FY19: Rs. 2.3b

Assets: end-1HFY21: Rs. 10.5b; end-FY20: Rs. 10.8b; end-FY19: Rs. 12.3b

Profit After Tax: 1HFY21: Rs. 133m; FY20: Rs. 415m; FY19: Rs. 456m

RATING RATIONALE

The assigned ratings of Digital World Pakistan (Pvt.) Limited (DWPL) take into account sponsors' industry experience, particularly in the end-to-end supply chain management, strong brand recognition and loyalty among customers in the consumer durable industry and long-standing business relations with vendors and dealers. The ratings draw comfort from largely sustained topline and profitability during the outgoing year despite supply and demand disruptions due to pandemic. The ratings also incorporate healthy sales growth in the ongoing year with increase manifested in all major products. Leverage indicators have improved in line with higher equity base. Debt service coverage, albeit decreased, has remained adequate. Cognizant of high competition, the company has launched EcoStar-branded air-conditioners to tap lower segment of the market in FY19. Given significant dependence on distribution rights of Gree-branded products, ratings will remain sensitive to the maintenance of strategic relations with Gree Electric Appliances Inc. The ratings would also remain sensitive to dynamic consumer preferences for electronics goods, high price sensitivity and vulnerability to foreign exchange risk amidst low pricing power. Sustained growth in revenues while containing leverage indicators would remain key rating drivers, going forward.

Company's introduction: DWPL is one of the four companies of DWP Group and is involved in import, assembly and sale of home appliances, including air conditioners, televisions, microwave ovens and water dispensers, among others. Other group companies include DWP Technologies (Pvt.) Limited (DWPTL), DWP Engineering Industries (Pvt.) Limited (DWPEIL), and Elchem Power (Pvt.) Limited (EPL).

DWPL is one of the top-tier companies operating in the consumer electronics industry of Pakistan. Its business model revolves around import, assembly, and distribution of audio, video home entertainment products and home appliances in the local market. DWPL was the sole distributor and assembler of Samsung AV and HA products for Pakistan from 2000 to 2009. The company currently has distribution and patent agreements with Gree Electric Appliances Inc. (GEA) – the leading air conditioner maker globally, under which the company imports GREE-branded completely knocked-down (CKD) kits of air conditioners, televisions, and other products, and assembles and sells them across the country. DWPL has been the sole distributor for GREE in Pakistan since 2005. The company launched its own brand called "EcoStar" with product range comprising televisions and other household electronics while in FY19, the company also launched EcoStar-branded air-conditioners to tap lower segment of the market amid high competition. The market positioning of 'Gree' in terms of local market assemblers is favorable; the company is therefore able to charge premium prices. Furthermore, DWPL holds 28% estimated share in the air conditioners market for 2020 and have depicted growth in tandem with the overall industry growth while company's share in LED market is 14%.

Overall capacity utilization was lower in FY20 due to supply chain disruption from lockdown and lower demand amid first wave of pandemic; meanwhile, given uptick in demand for company's products after partial lifting of lockdowns and restoration of cross-border shipments, the same showed improvement in the ongoing year: Installed capacity of air conditioners (ACs), LED televisions remained intact during the review period while microwave production with a total capacity of 100K units came online in FY20. As per the business model, procurement cycle of CKD air conditioners for the next summer season normally starts with the specs finalization in August and pricing negotiated in September – October every year. Around 50% of estimated orders are placed in December while prices are locked for no more than three months. DWPL takes deliveries of CKD kits in February and starts dispatching assembled units from March onwards. Given lockdown in China, supply chain was disrupted and the overall production was slashed in last two quarters of FY20. Number of air conditioners imported for assembling decreased by 39% to 170,935 units (FY19: 280,692 units) along with 47% decrease in LED televisions to 72,787 units (FY19: 137,160 units). Average per unit cost witnessed increase for both of the products.

Number of air conditioners assembled by DWPL during FY20 decreased to 199.1K units (FY19: 248.9K) along with lower production of LED of 79.3K units (FY19: 158.7K) resulting in decrease in capacity utilization to 36% and 17% (FY19: 45% and 34%), respectively. HA production increased to 20.3K (FY19: 11.9K) owing to microwave ovens production, however, overall capacity utilization of HA remained largely the same at 11% (FY19: 13%). In 1HFY21, production of LED remained sizeable while air conditioners production seemed subdued given the stock procurement starts in February. Installed capacity and utilization levels are tabulated below:

	FY19	FY20	1HFY21
Installed Capacity			
AC	550,000	550,000	275,000
LED	460,000	460,000	230,000
HA	90,000	190,000	95,000
Actual Production			
AC	248,901	199,120	63,237
LED	158,655	79,314	72,317
HA	11,946	20,295	10,265
Capacity Utilization			
AC	45%	36%	23%
LED	34%	17%	31%
HA	13%	11%	11%

DWPL has a presence across the country, though cities of Lahore, Karachi, Rawalpindi and Gujranwala contributes around three-fourth to total sales. The company has a network of more than 1000 dealers (FY19: 750) across the country while company-owned outlets and service centers decreased to 17 and 18 (FY19: 20 and 28), respectively due to consolidation in order to control operating costs. Property, plant and equipment stood at Rs. 1.52b (FY20: Rs. 1.54b; FY19: Rs. 1.51b) at end-1HFY21. During FY20, the company made a capex of Rs. 248.9m on localization of air conditioner heat exchanger which is expected to lower freight cost borne by the company.

Sales exhibited an upward trajectory in the ongoing year: Topline witnessed a slight dip to Rs. 15.3b (FY19: Rs. 15.9b) in the outgoing year on account of volumetric decrease in sales of air conditioners and LED televisions. During FY20, DWPL sold 205.7k air conditioners (FY19: 257.6k) while LED televisions sales declined to 77.9k (FY19: 180.6k) mainly owing to pandemic impacting the demand dynamics of non-essential electronics market. Meanwhile, volumetric sales of home appliances witnessed an increase to 32.1K units (FY19: 17.4K). Higher product prices have helped in largely sustaining revenue and profitability.

Gross margins largely intact at 15.29% (FY19: 15.53%) in FY20. The average per unit cost of AC and LED increased to Rs. 55,657 per unit (FY19: Rs. 41,711) and Rs. 13,113 (FY19: Rs. 9,524) respectively during FY20. The margin contributions of AC, LED and home appliances segments were recorded at 15.4% (FY19: 15.9%); 14.2% (FY19: 14.2%) and 17.2% (FY19: 17.4%) respectively. Administration expenses were recorded slightly higher at Rs. 778.6m (FY19: Rs. 753.9m) in FY20. Distribution and selling expenses decreased to Rs. 633.9m (FY19: Rs. 861.7m) primarily owing to notable decrease in advertisement expenses to Rs. 573.3m (FY19: Rs. 788.5m). Finance cost was recorded higher at Rs. 288.8m (FY19: Rs. 128.7m) in FY20 on account of higher average short-term borrowings obtained during the year. Accounting for taxation, the company reported net profit of Rs. 414.5m (FY19: Rs. 455.5m) during FY20.

During 1HFY21, net sales were recorded higher at Rs. 6.3b vis-à-vis Rs. 5.0b in the corresponding period of previous year. Unit sales exhibited increasing trend in all segments including LED televisions, air conditioners and home appliances (1HFY21: 72,317 units, 63,237 units and 25,622 units, respectively; 1HFY20: 54,871 units, 48,641 units and 16,360 units, respectively). The company has largely sustained gross margins in 1HFY21 reflecting the ability of the company to fully pass on the impact of increase in input cost. Notable growth in revenues is exhibited in 2HFY20 amid peak season while the increase was mainly manifested in sale of air-conditioners. The company has recorded Rs. 14.3b of revenue in Jan-May'21 with total net sales of Rs. 20.6b in the first 11 months of FY21. The management has projected sales of Rs. 3.9b for the month of Jun'21. Total sales of FY21 are projected at Rs. 24.5b (FY20: Rs. 15.3b), posting a growth of 60% on YoY basis. With sizeable increase in quantum sales, profitability is expected to augment in the ongoing year. Actual production and sales data for Jan-May'21 and projected data for Jun'21 is tabulated below:

	Air Conditioners (Units)		**LED TV (Units)**		**Other HA (Units)**		**Total (Units)**	
Months	Production	Sales	Production	Sales	Production	Sales	Production	Sales
21-Jan	25,313	16,710	7,113	10,646	10	3,770	32,436	31,126
21-Feb	37,250	32,192	3,005	6,146	-	2,297	40,255	40,635
21-Mar	38,981	41,301	15,029	11,787	2,496	3,922	56,506	57,010
21-Apr	41,380	41,316	7,549	7,388	3,515	2,226	52,444	50,930
21-May	34,234	35,901	8,445	7,460	2,633	1,792	45,312	45,153
Jun-21 (P)	44,234	45,901	11,445	10,460	2,933	2,492	45,312	58,853
Total	**221,392**	**213,321**	**52,586**	**53,887**	**11,587**	**16,499**	**272,265**	**283,707**

Product-wise unit sales on a timeline basis is tabulated below:

(Sales in Units)	**FY19**	**FY20**	**FY21***
AC	257,574	205,720	276,558
LED	180,644	77,894	126,204
HA	17,345	32,096	41,813

**includes projected sales for the month of June'21*

Adequate debt service coverage: Funds from Operations (FFO) amounted to Rs. 356.6m (FY19: Rs. 341.0m) in FY20. Slight increase in FFO was mainly a function of higher non-cash adjustments and some decrease in income tax paid during FY20. However, with increase in long-term borrowings, FFO to long-term debt decreased to 0.84x (FY19: 1.99x) while FFO to total debt remained at 0.09x (FY19: 0.07x). Further, Debt Service Coverage Ratio (DSCR), albeit declined to 2.05x (FY19: 4.0x) in line with higher long-term repayment and finance cost paid, remained at comfortable level.

Stock in trade was recorded higher at Rs. 4.2b (FY20: Rs. 2.7b; FY19: Rs. 4.2b) at end-1HFY21 due to increase in finished goods inventory and stock in transit. DWPL tends to maintain a buffer stock of air conditioners to cater to any unexpected increase in demand during peak season. Meanwhile, stock in trade at end-FY20 was lower largely due to decrease in raw material inventories. Trade debts were recorded at Rs. 977.7m (FY20: Rs. 2.8b; FY19: Rs. 3.9b) at end-1HFY21. The proportion of credit sales in the sales mix remained at 46% (FY20: 46%; FY19: 34%) in the ongoing year. Proportion of credit sales was increased in FY20 in order to maintain market share. However, the profile of receivables remained satisfactory with the entire trade debts falling due within 1 to 3 months' bracket. The company provide credit period of 60 to 90 days to its dealers.

Loans and advances increased to Rs. 2.1b (FY20: Rs. 1.7b; FY19: Rs. 1.2b) and mainly constituted advance income tax (net) of Rs. 1.1b (FY20: Rs. 1.1b; FY19: Rs. 958.5m) and advance against land amounting Rs. 496.7m (FY20: Rs. 385m; FY19: Rs. Nil). Trade deposits and short-term prepayments comprised prepaid insurance and security deposits. Current ratio stood at 1.26x (FY20: 1.21x; FY19: 1.14x) at end-1HFY21. Coverage of short-term borrowings via trade debts and stock in trade remained adequate at 1.26x (FY20: 1.56x; FY19: 1.50x).

Equity base strengthened in line with internal capital generation: Core equity increased to Rs. 2.8b (FY20: Rs. 2.6b; FY19: Rs. 2.3b) on back of profit retention. Debt profile of the company mainly comprised short-term borrowings which amounted to Rs. 4.1b (FY20: Rs. 3.5b; FY19: Rs. 5.4b) at end-1HFY21. DWPL uses a mix of running finance facilities, finance against trust receipts and letter of credit facilities to meet working capital requirements. Long-term borrowings including current portion stood higher at Rs. 562.8m (FY20: Rs. 426.1m; FY19: Rs. 171.3m). These include term finance facilities from banks amounting Rs. 273.2m (FY20: Rs. 100.5m) at end-1HFY21 under SBP refinance scheme for payment of wages and salaries as a relief under Covid-19, carrying subsidized markup rate. The company has outstanding term finance facility of Rs. 240m (FY20: Rs. 270m; FY19: Rs. 100m) at end-1HFY21. Lease liabilities stood at Rs. 43.5m (FY20: Rs. 47.1m; FY19: Rs. 55.7m). The company deferred repayment of borrowings amounting Rs. 1.8b under SBP relief which have been fully repaid as of now. Trade and other payables stood lower at Rs. 2.5b (FY20: Rs. 3.6b; FY19: Rs. 3.8b) mainly due to decrease in creditors for goods and supplies amounting to Rs. 2.2b (FY20: Rs. 3.0b; FY19: Rs. 3.3b) and sales tax payable at end-1HFY21. Gearing stood at 1.68x (FY20: 1.49x; FY19: 2.37x) while debt leverage continues to decrease to 2.72x (FY20: 3.04x; FY19: 4.20x) by end-1HFY21.

Digital World Pakistan (Pvt.) Limited — Annexure I

BALANCE SHEET	FY18	FY19	FY20	1HFY21
Non-Current Assets	1,174	1,513	1,542	1,524
Stock in Trade	3,448	4,160	2,716	4,206
Trade Debts	274	3,920	2,806	978
Other Current Assets	1,743	1,232	1,768	2,221
Cash and Bank Balance	1,615	1,478	1,993	1,546
Total Assets	**8,254**	**12,303**	**10,825**	**10,475**
Trade and Other Payables	1,419	3,836	3,644	2,487
Short Term Borrowings	4,411	5,381	3,531	4,125
Long-Term Borrowings *(Inc. current matur)*	49	171	426	563
Other Liabilities	381	445	454	398
Total Liabilities	**6,260**	**9,833**	**8,055**	**7,572**
Paid Up Capital	571	571	571	571
Tier-1 Equity	**1,853**	**2,342**	**2,649**	**2,784**
Total Equity	1,994	2,470	2,770	2,903

INCOME STATEMENT	FY18	FY19	FY20	1HFY21
Net Sales	12,858	15,880	15,267	6,297
Gross Profit	2,080	2,467	2,334	966
Operating Profit	676	851	921	353
Profit Before Tax	586	686	606	272
Profit After Tax	387	456	415	133
FFO	529	341	357	150

RATIO ANALYSIS	FY18	FY19	FY20	1HFY21
Gross Margin (%)	16.2	15.5	15.3	15.3
Net Margin (%)	2.9	2.9	2.7	2.1
Net Working Capital	1,032	1,286	1,613	1,830
FFO to Long-Term Debt (x)	10.81	1.99	0.84	0.53*
FFO to Total Debt (x)	0.12	0.06	0.09	0.06*
Debt Servicing Coverage Ratio (x)	9.24	4.0	2.06	2.54
ROAA (%)	5.0	4.4	3.6	2.5*
ROAE (%)	21.6	21.7	16.6	9.8*
Gearing (x)	2.41	2.37	1.49	1.68
Debt Leverage (x)	3.69	4.20	3.04	2.72
Inventory + Receivable/Short-term Borrowings (x)	0.84	1.50	1.56	1.26
Current Ratio (x)	1.17	1.14	1.21	1.26

**Annualized*

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	Digital World Pakistan (Pvt.) Limited
Sector	Consumer Appliances
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30/06/2021	A-	A-2	Stable	Upgrade
13/07/2020	BBB+	A-2	Stable	Downgrade
28/02/2019	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information.

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Liaquat Ali	Senior Manager Banking & Finance/Company Secretary	June 02, 2021