RATING REPORT

Digital World Pakistan (Pvt.) Limited

REPORT DATE:
July 19, 2022

RATING ANALYSTS:

Asfia Aziz
asfia.aziz@vis.com.pk

Muhammad Taha
m.taha@vis.com.pk

RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	A-	A-2	A-	A-2
Rating Date	*July 19, '22*		*June 30, '21*	
Rating Outlook	*Stable*		*Stable*	
Rating Action	*Reaffirmed*		*Upgrade*	

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 (August 2021)
https://www.vis.com.pk/kc-meth.aspx

Digital World Pakistan (Pvt.) Limited

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 Limited (DWPL) was incorporated in 2000 as a private limited company under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017).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.

RATING RATIONALE

Digital World Pakistan (Pvt.) Limited (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. Other group companies include DWP Technologies (Pvt.) Limited (DWPTL), DWP Engineering Industries (Pvt.) Limited (DWPEIL), and Elchem Power (Pvt.) Limited (EPL). The assigned ratings of 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 durables industry, and long-standing business relations with vendors and dealers.

DWPL has distribution and patent agreements with Gree Electric Appliances Inc. (GEA) – the leading air conditioner maker globally since 2005, under which the company imports GREE-branded completely knocked-down (CKD) kits of air conditioners, assembles, and sells them across the country. Gree has managed to establish a reputation of reliability by delivering high quality products over the years. This in turn has offered the possibility to charge premium prices while maintaining a significant position in the market. DWPL holds the second largest position in the AC business segment of the country after Haier.

Leveraging on the strengths developed over the years via the partnership with Gree, the company recently launched EcoStar branded air conditioners and televisions of its own. The brand has had a noticeable growth over time. In the TV segment, EcoStar competes equally with TCL.

Capacity utilization levels remained on the lower side, albeit depicted some improvement in FY21 as business operations and economic activity resumed post COVID-19. Given reliance on imported contents for the assembly of products (barring Eco Star TV and AC which has comparatively greater localization levels), the company plans to incur capital expenditure on a consistent basis to increase localization rate.

Production levels for both products (ACs and TVs/LCDs) increased in FY21 Given management projections for rising demand of cheaper alternates of consumer durables, the company has sufficient room to cater the same.

Business risk is somewhat mitigated by an established position and a growing presence in the market.

Few local and international players including PEL, Dawlance, Haier, Gree, TCL, and Samsung mainly dominate Home Appliance industry in Pakistan. Demand for these products is largely impacted by changes in disposable incomes and consumer lifestyles. As COVID-19 related lockdowns were gradually lifted and economic activity resumed, the industry experienced a YoY growth of 43% in CY21 and was valued at Rs. 215b. Most of the companies operating in the sector have a low level of localization. Major components such as condenser, evaporator, and fan blades are imported into the country and assembled to form the final product. Hence, these entities remain exposed to the risk of an increase in raw material cost due to currency depreciation, and to manage this risk the company is undertaking localization to reduce exposure on foreign exchange risk.

A significant uptick in sales on the back of volumetric growth and rising prices.

Revenue for FY21 rose by 61% attributable to a 43% volumetric growth and 13% price increase. The growth was achieved despite a COVID-19 induced slowdown in the market. While there is a seasonal nature to sales with bulk of sales occurring during summer season, topline of the company closed above 20% higher in 1HFY22 than corresponding period in previous year, and is on track to increase by more than 20% for FY22.

The company has an extensive network of around 2,000 dealers and 16 service centers across the country. Geographic concentration remains in major cities due to their high population density. Cities of Lahore, Karachi, Rawalpindi and Gujranwala contributes around three-fourth to total sales in FY21. Going forward, the management projects a sustainable pattern of YoY growth in the topline, ensured by a consistent increase in volumes. Sales mix is expected to remain similar, with Gree ACs accounting for bulk of the sales in volumetric terms, followed by EcoStar TVs and EcoStar ACs.

Improvement in profitability indicators on a timeline basis.

Gross margin for FY21 depicted an increase and was reported at 16.0% (FY20: 15.3%, FY19: 15.5%) and further increased to 16.8% in HY22. Given company's strong position in the market, higher freight charges and raw material costs because of currency devaluation were successfully passed on to the consumers. There was a noticeable rise in the distribution and selling expenses during the year because of higher advertisement and promotion related expenditure for building brand equity to counter rising prices and inflationary environment. Despite the aforementioned along with greater WPPF & WWF charges, net margins (1HFY22: 3.6%, FY21: 3.5%) of the company were reported slightly higher in the outgoing and ongoing year supported by higher other income and lower finance charges. Other income increased on account of one-off gain arising on the sale of vehicles. Since the past two years, the company has taken the initiative of increasing the share of localization in the overall operations by manufacturing various components. This is expected to reduce the impact of currency devaluation and rising freight costs, helping to maintain or improve profitability indicators. Going forward, bottom line of the entity is projected to trend upwards on the back of expected increase in revenue supported by growing demand of the consumer market. However, net disposable incomes as a result of sizeable inflation may slowdown revenue growth. Furthermore, increasing interest cost may drag the overall profitability profile. Ratings are underpinned on maintaining profitability indicators going forward.

An adequate liquidity profile.

Funds from Operations (FFO) of the company went up by 20% during FY21. Given the seasonal nature of business in 1HFY22, FFO was reported lower in annualized terms, but should increase during the summer season and close on a positive note Consequently, with lower activity in the half of the ongoing year, the quantum of working capital requirements reduced. Cash flow coverages remain adequate against outstanding obligations with FFO to Total Debt and FFO to Long Term Debt were reported at 16% (FY21: 9%, FY20: 9%) and 52% (FY21: 118%, FY20: 84%) during HY22, respectively. Debt servicing coverage has declined over the period to 1.19x

(FY21: 1.6x), but remains at a reasonable level in the full preceding year. Sufficient coverage of stock in trade and trade debts is available against outstanding short-term obligations. 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 30 to 60 days to its dealers. Current ratio has stood above 1.00x depicting adequate liquidity profile. Liquidity may further be eased depending on early release of tax refunds due from the GoP. Going forward, the projected uptick in profit in 2HFY22 is likely to raise the level of periodic cash flows, which should help in improving the liquidity profile.

While leverage levels increased on a timeline basis due to higher trade payables led by extended payment cycle; gearing levels have improved through profit retention.

Equity base (excluding revaluation surplus) of the company increased at end-FY21 by 35%. With dividend payment in HY22, growth in equity base was limited with the same reported at end-Dec'21. Long-term debt increased at end-1HFY22 to finance the localization project of various components. However, at the same time, quantum of short-term borrowings has significantly reduced because of lower working capital needs in the season. Consequently, gearing and leverage ratios have substantially improved at the end of the period and were reported at 0.6x (1.4x, 1.5x), 1.9x (4.1x, 3.0x), respectively at end-Dec'21. Leverage levels increased in FY21 due to extended payment terms with suppliers and negative cash conversion cycle. Going forward, short-term borrowings are expected to rise in line with the projected increase in sales to finance the associated working capital requirements. Further, given no additional drawdown of long-term debt in the rating horizon, leverage and gearing levels are expected to remain within manageable levels. Ratings remain dependent on meeting projected capitalization indicators.

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure I

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 II
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				
19/07/2022	A-	A-2	Stable	Reaffirmed
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.
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Due Diligence Meetings Conducted	

Name	Designation	Date
Mr. Liaqat Ali	DGM Banking & Finance	April 13, 2022
Mr. Hamza Shahbaz	Manager Banking	April 13, 2022