RATING REPORT

Digital World Pakistan (Pvt.) Limited

REPORT DATE:
Aug 18, 2023

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	A-	A-2
Rating Date	*Aug 18, '23*		*July 19, '22*	
Rating Outlook	*Negative*		*Stable*	
Rating Action	*Maintained*		*Reaffirmed*	

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)

Applicable Rating Criteria: Corporates (May 2023):
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

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 Limited (DWPL) was incorporated in 2000 as a private limited company under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017).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

Corporate Profile

Digital World Pakistan (Pvt.) Limited (DWPL) is primarily engaged in the assembly of home appliances, particularly, air conditioners, televisions, microwaves ovens and water dispensers. The Company 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 them and sells across the country. It has also introduced its own AC and television product lines in recent years under the brand name 'EcoStar' which has comparatively greater localization levels.

DWPL is part of the DWP Group which is largely involved in the consumer electronics and technology industries. Other group entities include DWP Technologies (Pvt.) Ltd. (DWPTL), DWP Engineering Industries (Pvt.) Limited (DWPEIL), and Elchem Power (Pvt.) Limited (EPL). Previous plans to merge DWP with DWP Engineering Industries (Pvt.) Ltd. have been put on hold, according to management, owing to challenging macroeconomic conditions. Additionally, Elchem Power (Pvt.) Ltd., which was engaged in the manufacture of UPS batteries, has currently shut down operations. An associated entity, namely, Calicom Industries (Pvt.) Ltd., was set up as a holding company to acquire 70% shareholding od Dandot Cement Ltd. through equity purchase, in order to diversify the overall group's exposure.

Elevated business risk as macroeconomic deterioration posed supply and demand-side challenges

The local home appliances industry consists of about 53 players and is dominated by a few local and international companies including PEL, Arcelik (Dawlance), Gree, Orient, Haier, and Waves. In terms of market share, DWPL's GREE brand is positioned amongst one of the leading brands owing to its reputation of reliability and delivering high quality products. The Company's superior product offerings also allow it to charge a premium to consumers and pass on higher costs easily.

The overall industry's reliance on key imported electrical components such as condenser, motors, and fan blades, results in significant exposure to price and exchange rate risks. Given the imposition of import restrictions and sharp currency devaluation in the ongoing year due to macroeconomic deterioration, the industry faced severe supply-side issues that has elevated overall business risk profile for the sector. Consequently, the Company has been utilizing inventory acquired during FY22 to meet the demand requirements in the ongoing year. However, according to management, LCs of about Rs. 3-4b have been opened during 4QFY23 which will allow for the procurement of necessary raw materials in the upcoming year. Additionally, the Company has been shifting away from the assembly of imported kits towards procuring parts locally, particularly for its primary product segment, ACs, which have achieved a localization rate of about 70%. While the raw materials utilized in local production are ultimately still imported by suppliers, the Company benefits in the form of reduced freight charges.

Furthermore, demand, which is largely a function of per capita income and consumer lifestyles, has also been notably impacted by the current macroeconomic turmoil as the high inflationary environment has eroded the purchasing power of consumers significantly. Going forward, VIS expects the industry's demand outlook to remain suppressed.

Lower capacity utilization due to supply constraints

During 9MFY23, overall capacity utilization declined by more than half to 16.6% (FY22: 38.6%, FY21: 35.8%). Majority of product lines witnessed a notable reduction in output, particularly the air conditioner segment which is the main revenue driver, due to lack of raw material availability on account of import restrictions as well as demand compression given rising prices. According to management, inventory procured in the previous year will be utilized till end-June'23. Additionally, multi-purpose machinery was installed during the ongoing year which was utilized primarily to manufacture washing machines but can be used in the production of other electronic appliances as well such as heaters and small home appliances. Breakdown of capacity utilization by segment can be seen below:

According to management, plans to merge DWPL and DWP Engineering into a single entity were underway as both companies shared common management and plant facilities. However, the proposed merger was put on hold as execution of the same would require further capital expenditure of Rs. 5b which the Company decided against given the current high policy rates.

Topline growth in FY22 contributed by higher selling prices; however, with supply side constraints and suppressed demand, revenue base and bottom line was subdued in 9MFY23

Net sales registered a 10.1% uptick in the outgoing year amounting to Rs. 27b (FY21: Rs. 24.6b) despite a 5.2% decline in volumetric growth as average prices rose by 16.1%. In terms of sales mix, Gree ACs contributed about 82.5% to the topline followed by EcoStar TVs at 11.8%, EcoStar ACs at 3.6% and other home appliances at 2.1% in FY22. Furthermore, the Company expanded its geographic reach to four additional cities which include Peshawar, Sahiwal, Bahawalpur and Sukkur. However, revenue generation remained concentrated in the three major cities, namely, Lahore, Rawalpindi and Karachi at 25.5%, 17.4% and 15.2%, respectively (FY21: 28.4%, 18.9%, 18.7%), owing to high population density. Moreover, client concentration remained relatively manageable with the top 10 clients constituting about 25% of net sales (FY21: 15.1%) in FY22.

Gross margins remained stable at 16.1% (FY21: 16%) in FY22 as higher raw material costs were passed on to consumers. On the other hand, net margins showed only a slight decrease to 3.3% (FY21: 3.5%) in FY22 as increase in financing cost to Rs. 456.5m (FY21: Rs. 125.1m), in line with higher debt levels and policy rate, was partially offset by reduction in distribution costs to Rs. 1.5b (FY21: Rs. 1.7b) due to lower promotional activity. Administrative expense, however, increased to Rs. 920m (FY21: Rs. 843m) in conjunction with inflation. Other charges pertained to staff benefit funds also rose to Rs. 105.5m (FY21: Rs. 93.1m) while other income increased to Rs. 70m (FY21: Rs. 37.5m) owing to one-off gain on disposal of fixed operating assets in FY22.

During 9MFY23, sales revenue was reported at Rs. 11.3b. Besides impact of seasonality, this decrease as compared to last year largely emanates from lack of raw material availability which drove up prices across all product lines sharply, suppressing demand. Sales mix showed a shift in the ongoing year from the premium GREE ACs towards the cheaper EcoStar ACs, which the management expects to continue moving forward as high inflationary environment has diminished purchasing power of consumers. Gross margins increased to 17.5% due to inventory gains however, sizeable financing costs of Rs. 284.2m due to policy rate hike compressed net margin to 1.4% in 9MFY23. For FY23, the management expects to generate Rs. 14.4b in revenue being significantly lower as compared to FY22. Going forward, given uncertainty pertaining to import restrictions amidst the ongoing foreign exchange crunch and unprecedented inflation, demand is expected to remain depressed while high policy rate environment will continue to drag the overall profitability performance. The ratings will be underpinned on improvement in profitability indicators over the rating horizon to benchmarks for the assigned ratings.

Stressed liquidity profile

Funds from Operations (FFO) decreased in 9MFY23 to Rs. 57.9m (FY22: Rs. 1.3b, Rs. 428.5m) in conjunction with declining profitability. Consequently, reduction in cash flow coverages was witnessed with FFO to Long-Term Debt and FFO to Total Debt decreasing to 0.17x (FY22: 2.62x, FY21: 1.18x) and 0.02x (FY22: 0.17x, FY21: 0.09x), respectively in 9MFY23. Additionally, debt-servicing coverage also significantly reduced to 0.74x (FY22: 2.76x, FY21: 1.57x) in 9MFY23 being below the benchmarks for the assigned ratings.

Stock-in-trade stood at about Rs. 3.8b (FY22: Rs. 8.9b, FY21: Rs. 5.5b) at end-Mar'23 which will provide sufficient coverage till end-June'23, according to management. Inflow of raw materials for the upcoming year is expected with the opening of LCs amounting to Rs. 3-4b in 4QFY23. Total trade debts stood at Rs. 1.3b at end-Mar'23 (FY22: Rs. 3.1b, FY21: Rs. 3.7b), all of which were due within 3-6 months depicting a satisfactory aging schedule. Despite decline in both inventory and trade debts, current ratio increased to 1.28x at end-March'23 (FY22: 1.16x, FY21: 1.14x). This is largely attributable to increase in interest-free loans to associated companies, namely, DWP Engineering Industries (Private) Limited & Calicom Industries (Pvt.) Ltd., for capital expenditure on plant facilities amounting to a sizeable Rs. 5.1b (FY22: Rs. 3.4b) at end-Mar'23 along with as reduction in trade payables and short-term borrowings as working capital requirements decreased with lower business activity. Short-term borrowing coverage declined to 1.2x (FY22: 1.67x, FY21: 2.08x) at end-Mar'23. Additionally, the firm also has notable liquidity tied up in tax refunds due from the government standing at Rs. 2b (FY22: Rs. 2.5b, FY21: Rs. 1.9b) at end-Mar'23. Short-term investments exposure in JS Bank's TFCs stood at Rs. 20m (FY22: Rs. 20m, FY21: Rs. 20m) at end-Mar'23. Net operating cycle, albeit higher due to lower inventory turnover, remained adequate compared to industry median. Ratings are strongly underpinned on projected improvement in debt servicing capacity. Release of tied-up liquidity in loans to related party and tax refunds from GoP will be critical.

Improvement in gearing levels at end-Mar'23 on account of lower business activity

At end-March'23, Tier-1 equity remained stable at about Rs. 4.3b (FY22: Rs. 4.3b, FY21: Rs. 3.5b) due to a meager amount of profit retention. According to management, no dividend payout is expected for FY23 owing to suppressed profitability. With lower business activity and lower consequent working capital requirements, short-term borrowings reduced to Rs. 4b (FY22: Rs. 7.2b, FY21: Rs. 4.5b) at end-Mar'23. Remaining debt constituted of long-term borrowings amounting to about Rs. 448.3m (FY22: Rs. 499.1m, FY21: Rs. 362.7m) which was incurred primarily to import machinery. With lower debt levels, gearing and leverage indicators declined to 1.03x (FY22: 1.8x, FY21: 1.37x) and 2.38x (FY22: 4.06x, FY21: 4.09x) at end-9MFY23, respectively. Leverage remains on the higher side on the account of sizeable trade payables, however, slowdown in demand during the ongoing year contributed to reduction in the same. Going forward, although the Company has no plans of additional long-term debt drawdown, however with projected increase in business activity, capitalization indicators are expected to increase. The ratings will be sensitive to maintenance of the same at levels that commensurate with the rating benchmarks.

REGULATORY DISCLOSURES — Annexure I

Name of Rated Entity	Digital World Pakistan (Pvt.) Limited
Sector	Consumer Appliances
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	see table below
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	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
18/08/2023	A-	A-2	Negative	Maintain
19/07/2022	A-	A-2	Stable	Reaffirm
30/06/2021	A-	A-2	Stable	Upgrade
13/07/2020	BBB+	A-2	Stable	Downgrade
28/02/2019	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Liaquat Ali	DGM Banking & Finance	June 2, 2023
Mr. Shakeeb Shahzad	Manager Banking	June 2, 2023