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COMMON PRE-SEEN
(KC1 TO KC4)

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Electro Techno Distributors PLC (ETD PLC)

Brief history

In the early 1970s David Fernando was a lawyer carrying out his practice in Colombo. He was a young member of a prestigious business club in Colombo and met a lot of professionals, businessmen, government officials and diplomats who visited there. As a result he was able to build good contacts with various kinds of people who had high living standards.

The government of Sri Lanka stopped all kinds of imports and tried to encourage local industries during the period 1970 – 1977 when a closed economy was practiced. David saw the opportunity that was created by this policy of the Sri Lankan government. He discussed this with his close associates when he met them at the club and they were impressed. He thought of starting a new business Electro Techno Trading Company as a partnership in Kollupitiya with his close friend Joseph Emmanuel who was a retired diplomat. Both of them collected second-hand used electronic and electrical equipment/appliances such as radios, washing machines, and luxury imported items from influential people who left the country for migration after completing their tenures in Sri Lanka. With this humble initiative they successfully created demand for those items in the domestic market and earned a good profit.

Immediately after the general election in 1977, an open economy was introduced and most of the import restrictions were lifted. David and Joseph both agreed to convert the partnership into a limited liability company under the name Electro Techno Distributors (Pvt) Ltd (ETD) in 1978 and expanded the business to acquire agencies of prestigious brands for electronic and electrical appliances. They opened their second showroom in Bambalapitiya for both second-hand and brand new items such as radios, washing machines, grinders, ovens and other convenient gadgets.

Growth strategy

David emphasised that the company should promote its brands island-wide and create demand for its imported goods. He wanted to be the pioneer in introducing world class brands to the Sri Lankan community. After the television (TV) was introduced in Sri Lanka, he had a successful negotiation with the Japanese counterpart and obtained the agency for the TV brand and introduced it successfully. The company advertised through electronic media just after the TV was introduced and was able to attract people and create a market among the Sri Lankan community for its imported and second-hand goods. This was the golden era for new businesses and ETD was able to tap the market as the pioneer in introducing world class branded goods to Sri Lanka.

ETD had the opportunity to achieve rapid growth owing to the open economy and the significant increase in the disposable incomes of people. The visionary leadership of David took the company to the next level by listing the company on the Colombo Stock Exchange in 1989. David saw the future lifestyles/living standards of the youth and their ambitions,

and thought to make their lives easy by starting a company to facilitate the demand for hire purchase among consumers who wished to buy luxury and semi-luxury goods. Hence ET Finance (Pvt) Ltd was established in 1998 as a registered finance establishment under the Finance Companies Act No. 78 of 1988. This company was listed on the Colombo Stock Exchange in 2010.

David wanted to diversify the business by supplying, installing and maintaining equipment and appliances for the construction industry since he saw the opportunities in Sri Lanka for this particular industry. ET Engineering (Pvt) Ltd was established in 2005 to introduce world-renowned, trusted engineering solutions and products to the local industry. David invited Kamal Seneviratne, a prominent mechanical engineer who had experience in working in world class manufacturing companies in Europe, USA and Japan, to be the CEO of the company. The company's reputation for the reliability of its products and services was built over a decade. ET Engineering provides a complete range of mechanical, ventilation and air conditioning (MVAC) solutions, which includes supply, installation, maintenance and after sales services. In addition, the company is also engaged in supplying, installing, testing and commissioning of elevators, escalators and traveller systems and security surveillance products, which include sophisticated internet protocol based systems covering multiple locations with central monitoring and generators. The scope of work undertaken by the company covers engineering solutions for complete air conditioning services and total solutions for movement in high-rise buildings, shopping complexes, hospitals, hotels, factories etc.

ET Engineering is equipped with a trained and experienced team of engineers and technical staff who are geared to provide reliable and quick services to both applied and unitary air conditioning systems with back-up services of a fully equipped, ultra-modern workshop and on-call services. A separate division for after sales and maintenance provides round-the-clock after sales support for key corporate clients.

After graduating as an electrical engineer from a prestigious university in USA, and obtaining his MBA from the world famous Harvard University, Edward Fernando, David's eldest son returned to Sri Lanka with a dream of starting a manufacturing plant for producing home appliances. This idea was highly appreciated by his father. ETD PLC invested Rs. 550 million in capital assets and established ET Electricals (Pvt) Ltd on 22 December 2012 as a fully owned subsidiary. Edward was appointed as the CEO of the new company and he was also elected as a director of ETD PLC since 2011. ET Electricals has given highest priority for environmental protection by manufacturing and assembling innovative, eco-friendly and energy saving products such as washing machines, refrigerators, cookers, household air-conditions, and solar PV system installations. The company has entered an agreement with ETD PLC to sell all the goods it has manufactured. ET Electricals has also agreed to provide after sales services for all electrical and household appliances sold by ETD PLC.

Joseph is also pursuing the board to approve his new business plan for fashion and footwear, which will be a high growth sector for ETD PLC in the future.

David, the chairman of ETD Group, brought a novel idea of getting involved in developing a modern shopping complex, which will have shopping stores or “a hotel”, and residential apartments, since the demand for such complexes will rise with the completion of the Megapolis and Port City project in Colombo. As a result David proposed this project in 2014, which led to the creation of ET City Developer (Pvt) Ltd, a joint venture company between ETD PLC and Hex Shang Ltd, a property developer in Hong Kong. Per the agreement, 60% of equity was introduced by ETD PLC while the balance 40% was introduced by Hex Shang Ltd at the beginning of 2015, and decisions about relevant activities require unanimous consent of both parties.

ETD PLC has an island-wide network of over 320 showrooms, as well as over 12 supreme showrooms (which offer the entire product line) in strategic locations around Sri Lanka, which offer round-the-clock assistance to customers. Currently over 300 authorised dealers represent the company island-wide, bringing various innovative products within the reach of every family and household in the country. All products sold by the group carry a trusted guarantee of quality and reliable after sales service.

The company remains the preferred choice of partner for global brands looking to break into the Sri Lankan market.

David happily invited his team for his daughter’s wedding and announced that his new son-in-law is Nihal Kulatunga who currently serves as an independent director of the group. Helena Dabare and Ajith Perera also serve as independent directors of ETD PLC.

Chairman’s briefing

At a recent board meeting David mentioned that the retail industry was badly affected by the policy instability caused by repeated changes in policy directives. Such lack of clarity disrupts operational cash flows and prevents long-term investment planning by the private sector, which ultimately disrupts growth of the country. Policy predictability and consistency is vital for retail sector welfare and he hopes to see the current tax regime rationalising into a more practical format in the near future. The consumer goods retail sector, which tends to be comparatively more price elastic, can be expected to respond to the latest cost increase with a disproportionately lower growth in demand. As retail activities are the main contributor to group profits, sustaining the current growth momentum is going to be a challenge. In the current scenario, the top priority in 2018/19 will be to maintain bottom line growth. Therefore, in 2018/19 ETD PLC will focus on leveraging its distribution network and product portfolio to maintain growth, while also targeting exclusive business rights with leading brands. David believes that their investments in digitalisation of the supply chain will also contribute to competitive advantages.

Risk management and internal control processes

ETD Group has its own internal audit processes implemented to ensure that effective controls are in place. These processes are extended across all of the group's operations such as receivables management, inventory management, cash management and internal checks and balances. The internal audit department of ETD PLC carries out regular reviews on the risk management function and internal control system. The audit committee chaired by Nihal Kulatunga, a chartered accountant by profession, monitors, reviews and evaluates the effectiveness of internal controls over financial reporting. The board of directors of the group has identified risk management as an iterative process, which with each cycle can contribute progressively to organisational improvement by providing the management with a greater insight into risks and their impact by taking the risk appetite of the company into consideration. The reports submitted by the audit teams with significant audit findings are then analysed and brainstormed to find sustainable risk mitigation strategies. This process continuously improves and strengthens internal controls and risk governance procedures, and risk management reporting results in a well-defined risk management culture.

However, rising interest rates lead to increased cost of funds which will adversely affect the profits available to shareholders and impede re-investment of profits in profitable ventures. ETD PLC's strong business relationships with lenders help in negotiations to obtain credit. The group treasury division is entrusted with monitoring borrowings, payments and keeping relationships with the banks. ETD PLC has consolidated its corporate image and brand name over the years and has a positive image in the trading industry which it has also expanded across the country to various other industries. The board of directors and the senior management continuously review strategic moves to obtain a competitive edge. IT systems and risk information technology have evolved as a source of competitive advantage. The ERP system of ETD PLC is a core competence to maintain the leadership position in the industry. Any failure in the ERP system, IT infrastructure or IT security may severely affect the business. The IT system was recently upgraded by the professionally qualified internal IT division.

The external auditor, KV Associates, (Chartered Accountants), carried out a surprise physical inventory verification in selected showrooms as part of the audit as at 31 March 2018 and reported many discrepancies/shortages as well as obsolete items that have not been classified as obsolete, and reported this in their interim report to the board of directors on 20 April 2018.

Financial strategies

Norman Subasinghe, the group finance director who is a chartered accountant, endorsed the chairman's briefing and mentioned that they seriously needed to relook at the financial strategies and risk management policies due to the current economic trends and the existing financing strategies.

The original plan of the joint venture was to breakeven at the end of the 3rd year (2017). Norman was doubtful about this investment and wanted the board of directors to re-consider the financial impact on the group in the future if the venture fails.

Further, Norman reported that the Department of Inland Revenue has issued an intimation letter for the year of assessment 2015/16 challenging the deductibility of certain expenses of ETD PLC.

Norman mentioned that although ET Finance PLC had earned profits during the past years, there were non-performing loans which were not yet categorised as non-performing assets in the balance sheet. He said that this was significant and they should not highlight it in this year's financial statements, since the impact to the bottom line would be substantial and it will badly reflect on the group's performance. They needed to look at fresh financing methods to overcome the problem. Norman commented that the major contribution to revenue came from ETD PLC and the operating profit of the group had decreased during the year under review (2017/18), although revenue had increased. He wants to re-formulate the financial strategies to manage the supply chain of the group using the existing ERP system without further investment.

The unaudited financial statements show an impairment of related party receivables amounting to Rs. 24.068 million from Health Care (Pvt) Ltd, which is owned by Leena Fernando (Edward's wife).

The Central Bank of Sri Lanka recently brought various measures to improve the financial strength of finance companies in the country, and these measures have contributed positively to ET Finance PLC. This was discussed at the board meeting of ETD PLC held recently. The board of directors was concerned about the current performance and financial position of its finance company and requested Norman to carry out a comparison with a peer company (benchmark) to establish and identify key areas for improvement. Norman extracted the following information from a similar-sized finance company USB PLC.

	USB PLC
Number of shares	3,200,000
Earnings after tax (Rs.)	35,850,000
Earnings per share (EPS) (Rs.)	11
Market price per share (Rs.)	234
Price earnings (P/E) ratio	21

It was revealed that the current market price of a share of ET Finance was Rs. 99 and the total number of shares issued by the company was 4,256,000 as at 31 March 2018. Both companies engage in similar product portfolios within the classification of a finance company.

Over the recent few years ET Finance was able to achieve a steady growth in its share price. The same trend is expected for the next three years as well. However, ET Finance will not have the financial strength to cope with the need for expansion and promotional campaigns due to tight controls imposed by the authorities. This is assumed to be a problem in the medium term, beyond which the prospects could be very good. USB PLC has not been so aggressive in expansions and has managed to maintain conservative expansions and a relatively stable earnings and dividends per share. Its P/E ratio is higher than that of ET Finance and it has also reached the top position in the finance industry. However the board of directors of USB PLC has realised that unless it undertakes a major expansion project and promotional campaigns, its profit will peak in the next three years and then decline significantly.

Unfortunately, due to USB's poor human resources management it has lost certain necessary management skills which are possessed in similar finance companies such as ET Finance PLC.

Norman also reported the following financial information requested by the CEO of ETD PLC.

Beta of ETD PLC (based on ASPI): 1.5
Market rate of return: 16%
Central bank treasury bill rate: 10%
Inflation of Sri Lanka: 6%
Number of shares (ETD PLC): 21,850,000
Market price per share (ETD PLC): Rs. 175

Other current information

The CEO of ETD PLC recently submitted a brief report about the performance of the company and pointed out that the earnings after tax has drastically dropped this year. However with the recent improvements made by the management to improve efficiency and productivity, he expects the earnings before interest and tax (based on 2017/18 performance) to grow at 10% per annum during 2018/19 and 2019/20, 8% per annum during 2020/21 and 2021/22, and a steady growth of 5% per annum for the next 6 years.

The CEO also mentioned that the board of directors of ETD PLC has considered to declare a 20% dividend in the future since the company has not declared dividends in previous years due to various expansion programmes. However the share price has shown a steady growth.

The company presently enjoys the lowest interest rate for its short-term as well as long-term borrowings since the company is a VIP customer of the bank. Non-current interest bearing borrowings comprise 6% redeemable secured debentures, and current interest bearing borrowings comprise short-term loans, import financing loans etc. with an interest rate of 12%. The board of directors is concerned about the future higher inflation rate forecasted and the possibility of obtaining borrowings at the present rates for long terms and short terms.

Table 1: Subsidiaries of ETD PLC as at 31 March 2018

	% holding
ET Finance PLC	70
ET Engineering (Pvt) Ltd	100
ET Electricals (Pvt) Ltd	100

Table 2: Shareholdings of ETD PLC as at 31 March 2018

	% holding
Mr David Fernando	20
Mrs Kanchana Fernando (David's wife)	10
Mr Joseph Emmanuel	20
Mr Edward Fernando	10
Mr Shiran Fonseka	5
Mrs Suranga Seneviratne	5
Mr Keerthi Weerasekara	5
Public owned	25
Total	100

Table 3: Board of directors of ETD PLC

Mr David Fernando
Mr Joseph Emmanuel
Mr Edward Fernando
Mr Norman Subasinghe
Mrs Helena Dabare
Mr Nihal Kulatunga
Dr Ajith Perera

The financial information of ETD Group is given in Annexures 1 to 6.

Annexure -1

Electro Techno Distributors PLC Statement of profit or loss

Year ended 31 March	Group		Company	
	2018	2017	2018	2017
	(Unaudited)		(Unaudited)	
	Rs.'000			
Revenue	7,292,645	7,200,202	3,217,152	3,210,149
Cost of sales	(5,511,457)	(5,272,146)	(2,422,727)	(2,279,626)
Gross profit	1,781,188	1,928,056	794,425	930,523
Other operating income	54,329	24,761	35,245	20,142
Administrative expenses	(630,551)	(614,279)	(355,258)	(345,524)
Selling and distribution expenses	(671,255)	(645,242)	(161,452)	(145,150)
Operating profit	533,711	693,296	312,960	459,991
Impairment of related party receivables	(24,068)	-	(24,068)	-
Finance cost	(199,970)	(190,556)	(158,460)	(170,070)
Finance income	7,210	6,576	7,210	6,576
Share of joint venture's loss	(58,994)	(55,456)	-	-
Profit before income tax and value added tax on financial services from continuing operations	257,889	453,860	137,642	296,497
Value added tax on financial services	(89,625)	(86,343)	-	-
Income tax expenses	(63,830)	(118,016)	(20,211)	(65,208)
Profit /(loss) for the year	104,434	249,501	117,431	231,289
Attributed to:				
Equity holders of parent	97,009	236,803	117,431	231,289
Non-controlling interest	7,425	12,698	-	-
	104,434	249,501	117,431	231,289

Annexure -2

Electro Techno Distributors PLC
Statement of comprehensive income

Year ended 31 March	Group		Company	
	2018	2017	2018	2017
	(Unaudited)		(Unaudited)	
	Rs.'000			
Profit for the year	104,434	249,501	117,431	231,289
Other comprehensive income				
Other comprehensive income to be reclassified to profit or loss in subsequent periods:				
Gain/(loss)on available-for-sale financial assets	-	(13)	-	-
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	-	(13)	-	-
Other comprehensive income not to be reclassified to profit or loss in subsequent periods:				
Revaluation gain	-	9,676	-	8,987
Actuarial gain on defined benefit plans	901	1,179	707	877
Tax effect	(283)	(1,067)	(190)	(806)
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	618	9,788	517	9,058
Total other comprehensive income for the year, net of tax	618	9,775	517	9,058
Total comprehensive income for the year, net of tax	105,052	259,276	117,948	240,347
Attributed to:				
Equity holders of parent	97,627	246,578	117,948	240,347
Non-controlling interest	7,425	12,698	-	-
	105,052	259,276	117,948	240,347

Annexure-3

Electro Techno Distributors PLC Statement of financial position

As at 31 March	Group		Company	
	2018 (Unaudited)	2017	2018 (Unaudited)	2017
	Rs. '000			
ASSETS				
Non-current assets				
Property, plant and equipment	1,274,810	1,016,732	950,460	814,235
Leasehold land payments	254,250	257,350	254,250	257,350
Investment properties	22,461	23,851	22,452	23,851
Lease rentals receivable and stock out on hire	915,711	872,280	-	-
Intangible assets	64,140	56,670	38,630	37,490
Investments in subsidiaries	-	-	1,238,518	1,238,518
Investments in a joint venture	2,241,551	2,075,169	2,423,593	2,198,216
Other financial assets	452,390	367,870	46,350	46,350
Deferred tax assets	393,700	374,250	-	-
Trade and other receivables	1,702,850	1,872,460	-	-
	7,321,863	6,916,632	4,974,253	4,616,010
Current assets				
Inventories	2,130,841	2,258,329	1,572,200	1,510,965
Trade and other receivables	1,869,335	2,232,601	1,220,635	1,772,192
Lease rentals receivable and stock out on hire	833,800	823,720	-	-
Income tax receivables	20,591	458	14,285	-
Other financial assets	644,900	398,816	1,465	1,222
Securities purchased under repurchase agreement	25,081	63,015	-	-
Cash and short term deposits	108,687	178,437	98,513	66,370
	5,633,235	5,955,376	2,907,098	3,350,749
Total assets	12,955,098	12,872,008	7,881,351	7,966,759

EQUITY AND LIABILITIES				
Equity				
Stated capital	218,500	218,500	218,500	218,500
Other components of equity	457,150	457,150	399,040	399,040
Retained earnings	6,461,127	6,363,500	4,689,708	4,571,760
Equity attributable to equity holders of the parent	7,136,777	7,039,150	5,307,248	5,189,300
Non-controlling interest	141,341	133,916	-	-
Total equity	7,278,118	7,173,066	5,307,248	5,189,300
Non-current liabilities				
Interest bearing borrowings	950,000	720,250	750,250	650,250
Employee benefits liabilities	258,670	236,790	159,340	149,770
Trade and other payables	1,220,360	1,697,850	-	-
	2,429,030	2,654,890	909,590	800,020
	9,707,148	9,827,956	6,216,838	5,989,320
Current liabilities				
Trade and other payables	1,847,020	1,582,046	828,954	941,474
Warranty provision	355,327	313,860	15,226	26,565
Income tax liabilities	12,520	40,342	-	25,650
Interest bearing borrowings	1,033,083	1,107,804	820,333	983,750
	3,247,950	3,044,052	1,664,513	1,977,439
Total equity and liabilities	12,955,098	12,872,008	7,881,351	7,966,759

Annexure-4
Individual company performance of ETD Group

	ETD PLC		ET Engineering		ET Electricals		ET Finance	
Year ended 31 March	2018	2017	2018	2017	2018	2017	2018	2017
	(Unaudited)		(Unaudited)		(Unaudited)		(Unaudited)	
	Rs.'000							
Revenue	3,217,152	3,210,149	1,625,062	1,550,071	925,422	726,198	2,845,250	2,785,250
Less: Cost of sales	(2,422,727)	(2,279,626)	(1,541,574)	(1,469,645)	(719,339)	(537,387)	(2,148,058)	(2,056,954)
Gross profit	794,425	930,523	83,488	80,426	206,083	188,811	697,192	728,296
Other operating income	35,245	20,142	-	-	-	-	19,084	4,619
Administrative expenses	(355,258)	(345,524)	(78,251)	(74,251)	(112,521)	(110,254)	(84,521)	(84,250)
Selling and distribution expenses	(161,452)	(145,150)	-	-	(26,125)	(21,252)	(483,678)	(478,840)
Operating profit	312,960	459,991	5,237	6,175	67,437	57,305	148,077	169,825
Impairment of related party receivables	(24,068)	-	-	-	-	-	-	-
Finance income	7,210	6,576	-	-	-	-	-	-
Finance cost	(158,460)	(170,070)	(26,252)	(13,951)	(15,258)	(6,535)	-	-
Profit before income tax	137,642	296,497	(21,015)	(7,776)	52,179	50,770	148,077	169,825
VAT on financial services	-	-	-	-	-	-	(89,625)	(86,343)
Income tax expenses	(20,211)	(65,208)	(2,415)	(3,452)	(7,502)	(8,202)	(33,702)	(41,154)
Profit for the year	117,431	231,289	(23,430)	(11,228)	44,677	42,568	24,750	42,328

Assets and liabilities								
Non-current assets	4,974,253	4,616,010	209,303	230,105	755,810	762,847	2,803,057	2,669,235
Current assets	2,907,098	3,350,749	723,229	739,532	760,658	850,142	1,242,250	1,014,953
Total assets	7,881,351	7,966,759	932,532	969,637	1,516,468	1,612,989	4,045,307	3,684,188
Non-current liabilities	909,590	800,020	41,222	38,853	133,065	150,108	1,345,153	1,665,909
Current liabilities	1,664,513	1,977,439	340,282	148,189	452,950	243,782	790,205	674,642
Total liabilities	2,574,103	2,777,459	381,504	187,042	586,015	393,890	2,135,358	2,340,551

Annexure-5
Investments in subsidiaries

	% holding	Value	
		2018	2017
		Rs.'000	
ET Engineering (Pvt) Ltd	100	125,000	125,000
ET Electricals (Pvt) Ltd	100	575,250	575,250
ET Finance PLC	70	538,268	538,268
		1,238,518	1,238,518

Annexure-6
Investments in a joint venture

	2018	2017
	(Unaudited)	
	Rs.	Rs.
Summarised statement of profit or loss		
Revenue	-	-
Operating expenses	(126,604,000)	(88,161,924)
Finance income	45,096,807	51,630,697
Finance cost	(16,817,464)	(55,895,439)
Profit for the year	(98,324,657)	(92,426,666)
Group's share of profit for the year	(58,994,794)	(55,456,000)
Summarised statement of financial position		
Non-current assets	3,833,209,908	2,506,496,456
Current assets	3,750,405,231	3,521,315,334
Non-current liabilities	(280,291,065)	(931,590,484)
Current liabilities	(3,568,534,492)	(1,250,640,315)
Equity	3,734,789,582	3,845,580,991
Group's carrying amount of the investment	2,241,551,196	2,075,168,990
Equity reconciliation		
Carrying value as at 1 April	2,075,168,990	1,736,208,070
Investment made during the year	225,377,000	394,416,920
Share of loss	(58,994,794)	(55,456,000)
Carrying value as at 31 March	2,241,551,196	2,075,168,990