Pak Elektron Limited (PEL)

RATINGS (JUNE 2006)

Pak Elektron Limited

Entity	
Long Term	A
Short Term	A1

Financial Data

PKR (mln)

	31-Mar-06	30-Jun-05
Total Assets	9,435.8	8,011.7
Equity	2,012.5	1,682.1
Net Income	361.4*	346.7
Gross Margin (%)	24.43	21.94
Current Ratio	1.12	1.15
Total Debt / Equity (%)	254.39	263.19
Total Debt / Equity** (%)	172.48	167.11

* For the nine-months ended Mar 31, 2006.
** Considering preference shares as part of equity because of its characteristics.

ANALYSTS

Moin Khalid
+92 42 586 9504
moin@pacra.com

Shahzad Saleem
+92 42 586 9504
shahzad@pacra.com

Rating Rationale

Assessment

- The ratings reflect the company's diversified revenue base that ensures stability in earnings, despite a highly competitive environment. While aligning its products and processes to changing market dynamics, the management has been successful in withstanding the competitive pressures through continuous initiatives at product upgradation and development, cost optimisation, and emphasis on product quality. The capital structure of the company, though relatively highly leveraged at present, is expected to improve with augmentation in the equity base through increasing trend in profitability and planned issue of preference shares in the near future.
- PEL operates in two business segments, power equipment and appliances. The company recorded appreciable improvement in profitability in recent years, on the back of increasing sales volumes arising from a robust growth in demand in both the segments. The power division accounts for nearly 40% of the total sales at present, though its share in the company's overall operating revenues is comparatively higher owing to better operating margins. The market for power equipment is primarily dominated by local producers, owing to price competitiveness of the local industry. Due to relatively limited number of players for each product, an outcome of a more specialized nature of this segment, there exists a tacit understanding among producers that helps in price stability, thereby resulting in stable margins. Given the fact that no producer currently has a definitive edge in terms of production capacities, technology and cost efficiencies, this understanding is expected to hold, going forward. The major customer of power equipments is WAPDA*, followed by KESC. The initiation of the much needed system upgradation/revamping process and higher level of development expenditure by WAPDA particularly on Rural Electrification, together with improved economic outlook resulting in higher construction and industrial activity in the country are the prime drivers behind the substantial growth in demand for power equipment, which is expected to remain strong in the coming years. PEL, being the leading player in this market, is well positioned to capitalize on these emerging opportunities. The company has recently negotiated a revision in sale prices of its products with WAPDA, which is expected to provide a cushion against increasing raw material costs. Going forward, the management intends to focus more on this segment, owing to better level of margins and less working capital requirements compared to appliances segment, as sales to WAPDA are made against inland sight LCs and the major raw material requirements are met locally.
- The demand in the home appliances market has risen sharply in recent years on the back of availability of consumer financing, higher level of foreign remittances, and reduction in product prices. The market for home appliances is highly competitive in nature, with large number of market players and an increasing influx of imported goods, exerting constant pressure on margins. Unlike other home appliances products, the refrigerator market in Pakistan – the forte of PEL – is primarily dominated by local producers, attributable to price competitiveness of the local industry. The share of PEL in the refrigerators market has increased over the years, and is currently around one-third of the total market, contributing a sizeable portion in the company's overall revenues. After rationalization of the duty structure, the management has recently commenced in-house production of split air conditioners, as against previous policy of importing CBUs. PEL has plans to further expand the range of products currently being produced by the company. However, considering the intense competition in these products, both from local producers and also from imported products, the market penetration is expected to be difficult. Meanwhile, the overall margins in this segment remain susceptible to increasing competitive pressures.
- The capital structure of the company, despite improvement in recent years through retention of improved profits and issue of right shares, is relatively highly leveraged at present. However, comfort can be drawn from the preference shares amounting to PKR 605mln, which are redeemable at the option of PEL or otherwise convertible into the equity of the company. The management is currently in the process of raising long-term funds of PKR 800mln through issuing securitized term finance certificates under SPV structure. The proceeds of the TFC issue would be utilized for debt reprofiling, and also for meeting part of the capex requirement. Going forward, with increasing emphasis on power segment and improving working capital management, the working capital requirements are not expected to increase, leading to overall reduction in debt levels. Meanwhile, with further augmentation of the equity base through improved profitability prospects and proposed issue of preference shares of PKR 300mln in the near future, the financial leverage of the company is likely to decline to comfortable levels, with a consequential improvement in coverages.

Background

- PEL was incorporated as a public limited company in 1956, and is currently listed on all the stock exchanges in Pakistan. The company is a leading manufacturer of power equipment and home appliances products. The power division primarily manufactures transformers, energy meters, and switchgears. To achieve further diversification, the management is planning to undertake turnkey construction contracts in the power sector, and in this regard has recently won a contract for erection of a grid station. The appliances division mainly specializes in refrigerators and split air conditioners, while television and microwave oven has also been added to the product range during the year. PEL has an extensive nationwide dealership network, with over one thousand outlets and adequate after sales service arrangements.
- The majority ownership in the company was acquired by Saigol Group in 1978, having diversified business interests in textiles, energy and automobiles sectors. While effectively family controlled, the company is run by professional management. The company's Chairman/Chief Executive, Mr. Naseem Saigol, who is also the Chairman of Saigol Group of Companies, is a renowned businessman, and actively participates in the strategic management of the company and overlooks policymaking. The Managing Director of PEL is a Chartered Accountant by profession, and has been associated with the company for the last seven years.

* *This includes the successor distribution companies.*

PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.