

PAK ELEKTRON LIMITED (PEL)

RATINGS (SEPTEMBER 2007)

	New	Previous
Entity		
Long Term	A	A
Short Term	A1	A1
TFCs		
Privately-placed, Secured (PKR 500mln)	A	A
Privately-placed, Secured Sukuk (PKR 1,200mln)	A+	-

SUMMARY DATA
(Amounts in PKR mln)

	30-Jun-07*	30-Jun-06
Total Assets	11,505.3	10,107.7
Equity	2,660.9	2,078.5
Turnover	11,812.1	9,408.0
Net Income	606.9	442.1
Gross Margin (%)	21.55	21.77
ROE (%)	25.60	23.41
EBITDA Int. Cover	2.08	1.93
Debt / Equity (%)	205.26	253.06
Debt / Equity** (%)	148.71	173.46

** Based on un-audited figures*
*** Considering preference shares as part of equity*
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TFC ISSUES

■ The company intends to issue a secured privately-placed Sukuk of PKR 1,200mln in the near future. The Sukuk is for a tenor of 5 years carrying profit at the rate of 3-months KIBOR plus 175bps, with a floor of 10% and a cap of 25%, payable quarterly in arrears. Principal redemption will be based on diminishing Musharakah with a grace period of 18 months. The instrument is secured by way of first pari passu charge on specific assets of the company with a 25% margin. Moreover, total charges on these assets would not increase the market value till the full redemption of the instrument. Considering the security structure, PACRA has assigned A+ rating, notch higher than the long-term entity rating, to the instrument.

■ PEL has issued privately placed secured TFCs of PKR 500mln in Jun07. This issue is for a tenor of 5 years carrying profit at the rate of 6-months KIBOR plus 325bps, payable semi-annually. Principal redemption will be in six equal semi-annual installments commencing from the 30th month after the issuance (Dec09). The instrument is secured by way of ranking charge to be upgraded to first pari passu charge within 120 days after issuance over all current and fixed assets of the company. A reserve fund of PKR 50mln, created out of issue amount, will be maintained till the final redemption.

ASSESSMENT

- The ratings reflect PEL's diversified revenue sources that help in performance sustainability in a highly competitive operating environment. The ratings also take into account the company's well-conceived business strategy of maintaining revenue growth. Meanwhile, cognizant of changing market dynamics and intensifying competition, PEL has placed higher emphasis on product development, while focusing on product quality. Although the company is accumulating additional debt, gearing is likely to remain at existing levels due to augmentation in the equity base through the increasing trend in profitability.
- The company's overall operations encompass two business segments (a) power equipment and (b) appliances. PEL maintained its growth momentum during FY07 with around 25% increase in turnover. However, the growth was mainly driven by the power division. The sales of appliances division decreased due to decline in refrigerator sales, an outcome of increased competition. PEL's net profit showed healthy YoY growth on the back of higher turnover and maintained gross margins. The revision in sales price of its products with WAPDA, the major power equipment customer, has enabled PEL to sustain its gross margins despite increasing raw material prices. Moreover, the inherent price stability in power products, emanating from the implicit understanding among relatively limited number of players for each product, leads to stable margins. The company is expecting to maintain the growth momentum on the back of certain recently taken initiatives, in addition to recovery in sales of appliances division.
- The demand growth for power products is expected to continue on the back of ongoing upgradation/revamping process and higher level of development expenditure by WAPDA and increasing construction and industrial activity in the country. PEL, being the leading player in this market, is well positioned to capitalize on these emerging opportunities. Moreover, the power division is expected to benefit significantly from a few new initiatives including (a) installation of grid stations on turnkey basis, and, (b) manufacturing of power transformers. Meanwhile, to diversify its customer base and explore further growth opportunities, the management is planning to establish a new factory for power products primarily for exports. This plant is expected to start production in early FY09. PEL is also pursuing export of distribution transformers. These initiatives, while providing synergic benefits, would help the company in maintaining growth in profitability.
- PEL has also embarked upon certain initiatives in appliances segment to ease pressure on margins due to its highly competitive nature with a large number of market players and continuing influx of imported goods. In this context, PEL has acquired a distributor's license from Whirlpool (a leading global brand in home appliances) and is now striving for getting technical collaboration to manufacture refrigerators (including no frost) and air conditioners. This relationship, if established, would assist the company in accumulating technical know-how of international standards. By virtue of this, PEL plans to enter into the high-end home appliances segment. Meanwhile, newly introduced products of the appliances division – mini refrigerators, washing machines and small diesel generators – have received a positive response. This, while contributing towards the top line, would help in complementing the whole range of appliances.
- The capital structure of the company remained relatively highly leveraged as at end-Mar07. However, the preference shares of PKR 605mln, redeemable at the option of PEL or otherwise convertible into ordinary shares, provide a degree of comfort. The management is in the process of raising long-term funds of PKR 800mln through issuing securitized term finance certificates under the SPV structure. This would reduce the company's dependence on short-term running finance. The proceeds of the TFCs issue would be utilized for debt re-profiling, and also for meeting part of the capex and working capital requirements. Despite improved profitability levels, the overall cash flows from operations have remained stressed due to significant increase in the working capital requirements. Going forward, with further augmentation of the equity base through improved profitability prospects and proposed issue of preference shares of around PKR 300mln in the near future, the financial leverage of the company is projected to decline, with consequential improvement in coverages. However, an additional amount of around PKR 750mln would be required for establishing the new factory, which is likely to dilute the expected positive impact on gearing. Meanwhile, the proposed Sukuk instrument would not lead to increase in the company's gearing level since it is being issued to swap a part of existing borrowing. At the same time, it would have positive bearing on PEL's financial charges due to comparatively low profit rate.

KEY RATING DRIVERS

- These ratings are dependent on the effective execution of the company's overall growth plans. In this regard, the success of initiatives in power division, both in terms of timing and contribution towards the profitability, would be crucial. Moreover, any adverse change in credit terms with WAPDA, could significantly stress the company's cash flows and/or inability to pass on any sharp increase in cost of inputs, resulting in squeezing the margins. This could have negative implications for the company's prospects. Meanwhile, ratings are likely to benefit once the major expansion and diversification plans start contributing towards profitability with reduction in gearing.

PROFILE

- PEL, incorporated in 1956, is 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 company has embarked upon undertaking erection of grid stations on turnkey basis. The appliances division mainly specializes in refrigerators and split air conditioners, while some new products have also been added to the product range. PEL has an extensive nationwide dealership network of over one thousand outlets, and adequate after sales service arrangements. The company plans to bid for National Power Construction Company, a government owned company in the business of erecting transmission lines in Saudi Arabia, which is expected to be privatized in the near future.
- Saigol Group, who acquired the majority ownership in PEL in 1978, has diversified business interests in textile and energy 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, a Chartered Accountant by profession, has been associated with the company for the last eight years.