

RATINGS (MAY 2010)
PAK ELEKTRON LIMITED (PEL)

	NEW	PREVIOUS
ENTITY		
Long Term	A	A
Short Term	A1	A1
SUKUKS		
Privately-placed, Secured Sukuk (PKR 1,200mln)	A+	A+
Privately-placed, Secured Sukuk (PKR 2,000mln)	A+	A+

FINANCIAL DATA

PKR (mln)

	Mar 10**	Dec 09*	Jun 09
Total Assets	23,107	22,935	19,070
Equity	8,691	8,561	6,796
Net Income	130	161	261
ROE (%)	6.02	4.2	4.2
ROA (%)	2.25	1.59	1.51
Total Debt/ Equity %	110	114	122
Total Debt/ Adjusted Equity %	219	233	207

*Six months audited accounts, company changed its year end to Dec from Jun

** Unaudited results for 3 months

ANALYSTS

Hira Sajjad
+92 42 586 9504
hira.sajjad@pacra.com

Awais Z. Khan
+92 42 586 9504
awais@pacra.com

SUKUK ISSUES

- The company has in issue a secured privately-placed Sukuk of PKR 1,200mln based on diminishing Musharakah. The Sukuk, issued in Sep07, is for a tenor of 5 years (inclusive of 18 months grace period) 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. The principal redemption, to be done in fourteen equal quarterly installments begun in Jun 09. The instrument is secured by way of first pari passu charge on specific assets of the company with a 25% margin.
- PEL issued its second secured privately-placed Sukuk of PKR 1,100mln in Jun 08 for a tenor of 7 years, with a 3 years grace period. The instrument carries profit at the rate of 3-months KIBOR plus 100bps, with a floor of 8% and a cap of 25%, payable quarterly in arrears. The principal would be repaid in sixteen quarterly installments beginning Jun-11. The instrument is secured by way of first pari passu charge on specific assets of the company.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect PEL's established position in the domestic appliances and power sectors and ensuing diversified revenue stream that insulates the company from inherent cyclical fluctuations. The ratings take into account the management's cognizance of product development and technological up gradation to withstand competition and changing business dynamics. Meanwhile, financial profile of the company remains under pressure due to high leveraging and maturity mismatches in debt structure.
- The company's ability to sustain its competitive position, while maintaining its margins, is critical. Moreover, successful execution of recent business initiatives – expansion in power division and strategic partnership with LG – would be important. Meanwhile, maintaining leveraging at an acceptable level and proactive debt management remains crucial. Furthermore, unfavorable credit term changes with WAPDA and KESC, leading to stressed cashflows may have negative rating implications.

ASSESSMENT

- The company's overall operations encompass two business segments (a) power and (b) home appliances. Recently, PEL has also embarked upon undertaking erection of grid stations on turnkey basis. Over the years, the contribution of power segment in the overall turnover has increased, (FY09: 51%; FY08:45%) comprising majority of total sales. The home appliance sector is characterized of high competition, comparatively low margins and seasonal demand swings, whereas power segment comprises few competitors and better margins but the demand is sensitive to the government's preference for power infrastructure.
- During FY09, the topline grew by 16% (FY08: 7%) due to higher demand for power division products and sticky demand of certain appliances as well. The gross margin remained stable (around 23%) despite increasing material costs, as the world commodity prices surged in the first half of FY09, and devaluation of Pak Rupee. The profitability of the company came under pressure due to high financial charges (FY09: PKR 1,373mln, FY08: PKR 994mln), on the back of increased leveraging and rising interest rate scenario.
- PEL has changed its accounting year to December from June, to synchronize the accounting year with the seasonal business pattern. During period ending Dec-2009, the company's turnover declined moderately (8%). However, the profitability of the company improved mainly attributable to better gross margins (32%) and relatively lower financial charges. The company continued these trends during 1Q2010.
- The company established a new factory for manufacturing distribution transformers, (commenced operations in Nov09) hence increasing capacity and improving cost management. PEL is also exploring new export avenues (the Middle East and Eastern Europe) for its power products. However, in the short-term the demand for power products would remain reliant on WAPDA/KESC and their financial footing. In the appliance division PEL successfully executed the first stage (distributorship rights) of the strategic partnership with internationally renowned LG. In this regards, PEL has designated separate brand managers for LG and PEL appliances who would follow distinct marketing strategy for each brand. These initiatives are expected to augment PEL's market penetration and overall share, while improving its product range. However, technical collaboration between PEL and LG has been delayed.
- Going forward, the company plans to incur CAPEX of around PKR 1.4bln for technological up gradation of its existing facilities. PEL is also in the process of implementing Oracle based ERP system (Oracle E-Business Suite) across the organization.
- The cashflows of the company depict seasonal fluctuation due to inventory built up prior to peak season (summer) and liberal credit terms with appliances distributors. With sales mix skewed more towards Power division, where credit terms are more favorable cashflows of the company improved. Nevertheless, the coverages remained under pressure due to higher quantum of borrowings.
- The company continues to maintain a highly leveraged structure, signifying financial risk. Also there is considerable maturity mismatch in PEL's debt profile, as short-term debt comprises majority of the overall borrowings (57%). The management's strategy is to synchronize short-term maturities with trade receivables and inventory dilution. However, any delay in receivables or impediment in credit line rollover could hamper the company's ability to meet its obligations. With future CAPEX plans, the leveraging is expected to remain high. The company is exploring various options to reduce debt levels mainly through equity injection by a suitable partner, but this initiative is still in preliminary stages.

PROFILE

- PEL, incorporated in 1956, is listed on all the stock exchanges in Pakistan. Saigol Group, which acquired the majority ownership (~ 53% at end-09) in PEL in 1978, has business interests in textile and energy sectors.
- The overall control of the company vests in the ten members BoD that includes four representatives of the Saigol family- two Executive Directors- in addition to one NIT and three NBP nominees. PEL's Chairman and Chief Executive, Mr. Naseem Saigol, who is also the Chairman of the Saigol Group of Companies, actively participates in strategy formulation and overlooks policymaking. The Managing Director of PEL, a Chartered Accountant by profession, has been associated with the company for the last ten years. The company this year has further strengthened its human resource by inducting qualified and experienced staff.