



RATINGS (JUNE 2011)

PAK ELEKTRON LIMITED (PEL)

	NEW	PREVIOUS
ENTITY		
Long Term	A-	A
Short Term	A2	A1
SUKUKS (Privately-placed, Secured)		
PKR 1,200mln	A	A+
PKR 1,100mln	A	A+

FINANCIAL DATA

PKR (mln)

	Mar-11 [^]	Dec10	Dec 09*	Jun 09
Total Assets	25,180	25,530	22,935	19,070
Total Debt	12,825	12,098	9,772	8,307
Equity	8,279	8,729	8,561	6,796
Turnover	2,753	17,523	4,631	14,622
Net Income	(450)	189	161	261
EBITDA	256	2,729	1,171	2,207
EBITDA /				
Gross Interest (x)	1.85	1.89	1.89	1.61

* Year end changed to Dec from June, 6months accounts

[^] Based on unaudited results for 3 months.

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SUKUK ISSUES

- The company issued a secured privately-placed Sukuk of PKR 1,200mln based on diminishing Musharakah in Sep07 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. The principal redemption in fourteen equal quarterly installments began in Jun-09. The remaining six installments (PKR 514mln) have been rescheduled with suspension of principal repayment for two years and it would recommence from Jun-13 with final redemption in Sep-14.
- PEL issued its second secured privately placed Sukuk of PKR 1,100mln in Jun-08 for a tenor of 7 years. 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 instrument originally had 3 years grace period which is now extended by another one and a half years. The principal redemption in sixteen quarterly installments will commence from Jun-13 with full redemption planned in Mar-17.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect diverse businesses - power equipments and home appliances - of PEL, but these are also exposed to seasonality and cyclicity. Consequently, the company has complex working capital management and seasonal cashflows. Meanwhile, the challenging financial risk is magnified by PEL's high leveraged capital structure.
- The ratings would depend on the company's ability to effectively utilize the grace period available in repayment of its majority long-term debt to improve its financial risk profile. Meanwhile, efficient working capital management, while reducing overall leveraging as planned, would remain important.

ASSESSMENT

- PEL operates in two business segments, power and home appliances. The home appliance sector is characterized by high competition, comparatively low margins and seasonal demand swings. The power segment has few competitors and relatively better margins but the demand is sensitive to need for infrastructure development and financial profile of the key buyer – WAPDA. In the past there has been a gradual shift in PEL's business mix towards higher margin power segment [(Sales mix: Power (CY10: 47%, FY09: 51%) Appliances (CY10: 53%, FY09: 49%)]. However, in CY10, turnover growth in power division slowed down (2010: 13%, 2009: 33%). This was on account of hold up in the Distribution Transformer orders, a consequence of prolonged deliberations with WAPDA pertaining to design specifications. Similarly, pace of growth in Appliance division was arrested due to delay in timely clearance of imported inventory. In addition, overall decline in gross margins (CY10: 21%, Dec-09: 32%) was witnessed due to rising input costs. Meanwhile, bottomline profitability was eroded (Dec10: PKR 189mln, FY09: PKR 261mln) by material financial charges brought on by increase in short term borrowing and higher interest rate scenario.
- Historically, the first two quarters of a calendar year are categorized by peak demand/sales for PEL's appliances and the profitability is maximized in this period. However, topline growth in 1QCY11 shrank substantially compared with corresponding period last year (1QCY11: -37%). on account of a) continuing halt in production of transformer segment and b) high inflation alongwith persistent power crisis that crippled the demand in appliance industry. Moreover, high financial charges completely eroded the bottomline profitability PEL reported its first ever 1Q loss in 1QCY11 (PKR: - 450mln).
- Recent positive developments like resumption of operations in power division as well as liquidation/dilution of previously piled up inventory, pertaining to 'LG' split air conditioners, are expected to ease the stressed business profile of the company, going forward. In this regard, the company has started receiving orders for Distribution Transformers and expects a reasonable capacity utilization in ongoing year. Meanwhile, lately the company focused towards improving efficiency of appliances manufacturing process alongwith product research and development. The company has launched a completely new range of Refrigerators designed to suit the preference of urban customers. This is expected to add high margin business volumes.
- The Appliance industry is categorized by cyclical and seasonal demand. Accordingly, inventory is built up prior to demand season (Sep-Dec). Hence, the last two quarters of the calendar year are mainly slow in terms of demand/sales and the availability of free cash flow is squeezed. During CY10, the situation is accentuated by higher than normal inventory pile up in both divisions, leading to expanded short-term borrowing. Consequently, accompanied by subdued profitability the company's coverages deteriorated.
- With relatively leveraged capital structure (61:39), the management, over the years, has been following the strategy of synchronizing short term borrowings with trade receivables and inventory levels. Although, risky, in the past the company has been able to liquidate inventories on time and generate internal cash to pay off its short term obligations. However, in the current scenario with delay in inventory liquidation and subdued business, even in the peak season, meeting debt obligation became a serious concern. Cognizant of the ensuing pressures, the company, with the consent of majority of its lenders has obtained a grace period of two years on most of its long term borrowings, without entering into any debt restructuring unfavorable to the lenders. This relief, while supporting debt coverages in the short-term would allow the company to utilize the funds to boost its core operations.

PROFILE

- PEL, incorporated in 1956, is listed on all the stock exchanges in Pakistan. The company is now majority owned (~ 53% at end Mar11) by Saigol Group, which has business interests in textile and energy sectors. While effectively family controlled, the company is run by professional management.
- The overall control of the company vests in the ten members BoD that includes five 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, 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 over ten years.