



The Pakistan Credit Rating Agency Limited

Rating Report

Pak Elektron Limited | PP Sukuk | Feb-18

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Sep-2018	AA-	-	Stable	Initial	-
10-Jan-2018	AA-	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

In Pakistan, performance of the electronics sector is largely dependent on global raw material prices, which makes the sector vulnerable to external dynamics. However, the sector posted a growth of 39% in 2017-18, backed by rise in disposable income, technological advancement and rising awareness among population. Production of transformers grew by 43%, air conditioner by 24% and deep freezers by 5%. However, a dip of 31% was witnessed in the production of refrigerators, in 2017-18.

The ratings reflect PEL's diversified revenue stream and strong presence in Appliances and Power products market. The Company, while aiming brand expansion, has continued to focus on enhancing actual production in the key revenue generating products and intends to introduce new products (TV and Washing Machine). However, strong competition led to a decline in sales, in 1HCY18. The Company could not completely pass on the increased raw material costs which squeezed its margin and impacted profitability. The Company's cash flows came under pressure and coupled with larger quantum of borrowings deteriorated the coverage ratio. PEL's capital structure is characterized by intermediate leverage due to new financing obtained to support inclining business volumes. High working capital needs emanating from long inventory and receivable cycle expose the company to financial risk.

The ratings take in to account strong business dynamics in Appliances and Power segments. Any further deterioration in margins, in turn, profitability may lead to downward rating revision. However, the Company's ability to strengthen its business profile by improving volumetric sales remains critical. Meanwhile, close monitoring of working capital requirements and debt servicing capacity remain imperative. Maintaining strong coverages and managing financial risk prudently is crucial for the ratings.

Disclosure

Name of Rated Entity	Pak Elektron Limited PP Sukuk Feb-18
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology Corporate Ratings(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Household Appliances(Jan-18)
Rating Analysts	Shahzad Saleem shahzad@pacra.com +92-42-35869504

Profile

Legal Structure Pak Elektron Limited is listed on Pakistan Stock Exchange.

Background PEL was incorporated as a Public Limited Company in 1956. Saigol group acquired major shareholding in the Company in 1978, making it a flagship Company of the group.

Operations The Company is principally engaged in manufacturing and sale of electrical equipment and home appliances.

Ownership

Ownership Structure Saigol Group owns 50.3% stake in PEL through family members, with Mr. Naseem Saigol holding the major share (25.1%). 19.7% of ownership vests with the local institutions while, foreign investors hold 8.1% stake of the Company. Remaining 21.9% stake is owned by general public.

Stability Ownership of the business is seen as stable as the major ownership vests with Saigol family.

Business Acumen Saigol Group is one of the leading industrial groups of the country with interests in services, manufacturing home appliances and electrical equipment, textile and power generation.

Financial Strength PEL is owned and managed by a strong business empire, naming Siagol Group. The Group has significant standing in country's Textile, Engineering, Cement, Food and Allied and Energy sectors.

Governance

Board Structure BoD comprises one independent, six non-executive and three executive directors. Saigol family has prominent presence on the board. Apt board size, presence of independent oversight, and a female director on board indicates well framed governance structure.

Members' Profile All the BoD members have relevant expertise. Boards Chairman, Mr. Naseem Saigol, holds directorships of various entities of Siagol Group and was an office bearer of various trade associations. During CY17, Mr. Jamal Baquar and Ms. Azra Shoaib filled the vacancy as Mr. Khalid Siddiq Tirmizey, Mr. Mirza Babur Baig and Mr. Wajahat A. resigned.

Board Effectiveness The Board ensures effectiveness through Audit Committee and Human Resource and Remuneration Committee. Each comprises 4 members. During the year, four Board meetings, with majority attendance, were held to discuss PEL's performance, approve its financial statements and make strategic decisions.

Financial Transparency The Audit Committee ensures accuracy of the Company's accounts and internal controls. PEL's external auditors, M/s Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants, have expressed an unqualified opinion on the financial reports for CY17. The firm has been QCR rated by ICAP and are in Category 'A' of SBP panel.

Management

Organizational Structure PEL operates through two main business divisions: a) Appliances, and b) Power. However, Finance, IT, Human Resource and Internal Audit departments work as shared services for the main divisions. Both Divisional Heads report to the Company's CEO/MD, who reports to the Board. However, Head of Internal Audit reports administratively to the CEO/MD and functionally to the Board Audit Committee.

Management Team The Company's management comprise veteran professionals. Mr. M. Murad Saigol, CEO/MD, joined PEL in 2005 and monitors all of the strategic and operational affairs of the Company.

Effectiveness Keeping in view the size and operations of the Company, management lacks effectiveness as there are no management committees in place. Thus, indicating a room for improvement.

MIS PEL has implemented different modules of Oracle E-business Suite to cater diversified operational and accounting needs of the Company. Moreover, the Company has implemented Oracle Financials and Oracle Supply Chain to manage procurement, inventory and orders. The implementation of Oracle Discrete Manufacturing has been implemented in the Power and Appliances division. Personalized software for HR and payroll has also been implemented.

Control Environment To ensure operational efficiency, the Company has setup an internal audit function. Regular reviews are undertaken by the internal audit function to overlook the Company's operational control.

Business Risk

Industry Dynamics In Pakistan, performance of the electronics sector is largely dependent on global raw material prices, which makes the sector vulnerable to external dynamics. However, the sector posted a growth of 39% in 2017-18. This growth was backed by rise in disposable income, technological advancement and rising awareness among population. Production of transformers grew by 43%, air conditioner by 24% and deep freezers by 5%. However, a dip of 31% was witnessed in the production of refrigerators, in 2017-18.

Relative Position PEL holds a moderate share in the overall appliance market due to high competition. However, the Company holds high market share in refrigerators (30%). On the Power side, PEL is the market leader. 81% and 40% of the market is held by the Company's power and distribution transformers, respectively.

Revenues PEL generates revenue from its two main divisions, Appliances (66%) and Power (34%). In CY17, the Company's gross sales posted a growth of 24% (YoY) backed by Appliances division. Revenue generated by the Appliances division showed an increase of 42% backed by volumes - air conditioners (245%), deep freezers (65%) and refrigerators (17%). In Power division, some decline was witnessed in the orders received from WAPDA and private sector. Revenue from distribution and power transformers declined by 5% and 74%, respectively. However, revenue received from energy meters showed a volumetric growth (38%). In 1HCY18, the Company's gross sales showed a volumetric decline of 13% (YoY). Both divisions registered the dip in the revenue - Appliance ~ 9% and Power ~ 25%. Revenue from refrigerators and transformers witnessed the highest decline of 16% and 34%, respectively, in their respective divisions. Going forward, the management foresees reversal of this trend through introduction of new products in appliances and better procurement by WAPDA.

Margins In CY17, the Company's G.P margin deteriorated due to significant increase in trade discounts to capture the market share (CY17: 29.4%, CY16: 30.9%). An increase of 65% in selling and marketing costs inline with the volumetric growth (CY17: PKR 2.7bln, CY16: 1.6bln) led to a decline in the Company's operating margins (CY17: 16.6%, CY16: 20.8%). In 1HCY18, margins squeezed further by increased raw material costs and the Company's inability to pass on the cost to end consumer (1HCY18 - Gross: 25.4%, Operating: 14.5%).

Sustainability To expand the brand, PEL intends to launch Television. For this, the Company expects a CAPEX of PKR 10m in CY18, and another PKR 100m as CAPEX in CY19. The management is also planning to launch semi-automatic and automatic Washing Machines by the mid of CY19 with a CAPEX of PKR 500mln.

Financial Risk

Working Capital High inventory levels and receivable days kept the net working capital days on the higher side (1HCY18: 231 days, 1HCY17: 95 days, CY17: 242 days, CY16: 118 days). High receivable days emanate from circular debt issues in the power segment. Thus, strict discipline in working capital management is require to sustain the short term borrowing buffer.

Coverages Interest coverage (1HCY18: 2.5x, CY17: 3.2x) is a function of an increase of 45% in the Company's short term borrowings (1HCY18: PKR 12bln, CY17: PKR 7bln) and stressed cash flows. This deteriorated the Company's total coverages to 1.3x in 1HCY18 (CY17: 1.4x). The rising interest rate environment may further impact coverages and does not bode well for PEL.

Capitalization PEL's capital structure is characterized by intermediate leverage of 38.6% (CY17: 33%) due to new financing obtained to support the upcoming CAPEX. The Company is planning to issue new debt but overall leveraging is expected to remain moderate. Any delay in issuance of debt will put pressure on financial profile.



Pak Elektron Limited

BALANCE SHEET	30-Jun-18	31-Dec-17	31-Dec-16	31-Dec-15
	1HCY18	CY17	CY16	CY15
Non-Current Assets	19,832	18,890	18,041	16,710
Investments (Incl. associates)	34	31	49	94
Equity	34	31	49	94
Debt	-	-	-	-
Current Assets	28,914	24,995	22,236	19,345
Inventory	12,003	9,543	8,974	7,206
Trade Receivables	11,586	10,728	8,433	7,700
Others	4,072	3,497	4,059	4,006
Total Assets	48,781	43,916	40,327	36,149
Debt	17,397	13,305	11,375	12,773
Short-term	12,001	7,227	4,982	4,669
Long-term (Incl. Current Maturity of long-term debt)	5,396	6,078	6,393	8,104
Other shortterm liabilities	1,391	1,158	1,075	1,076
Other Longterm Liabilities	2,374	2,452	2,367	2,305
Shareholder's Equity	27,619	27,001	25,511	19,996
Total Liabilities & Equity	48,781	43,916	40,327	36,149

INCOME STATEMENT

Turnover	16,700	31,000	26,834	25,122
Gross Profit	4,246	9,116	8,284	7,434
Other Income	(2)	(5)	0	(13)
Financial Charges	(1,031)	(1,547)	(1,497)	(1,665)
Net Income	1,215	3,308	3,670	2,880

Cashflow Statement

Free Cashflow from Operations (FCFO)	2,558	4,933	5,584	5,468
Net Cash changes in Working Capital	(3,892)	(1,941)	(2,358)	(1,721)
Net Cash from Operating Activities	(2,102)	1,849	2,023	2,065
Net Cash from Investing Activities	(1,360)	(2,223)	(2,356)	(2,537)
Net Cash from Financing Activities	3,511	307	308	710
Net Cash generated during the period	49	(68)	(25)	238

Ratio Analysis

Performance

Turnover Growth (SPLY)	-13.8%	15.5%	6.8%	22.4%
Gross Margin	25.4%	29.4%	30.9%	29.6%
Net Margin	7.3%	10.7%	13.7%	11.5%
ROE	9.0%	12.8%	14.5%	14.7%

Coverages

Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	1.3	1.4	1.7	1.5
Interest Coverage (X) (FCFO/Gross Interest)	2.5	3.2	3.7	3.3
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	1.1	1.8	1.6	2.1

Liquidity

Short-term Trade Leverage (1- (STB)/ Net Trade Assets OR (Liabilities)	0.7	0.6	0.7	0.7
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	231.3	241.5	218.8	213.3

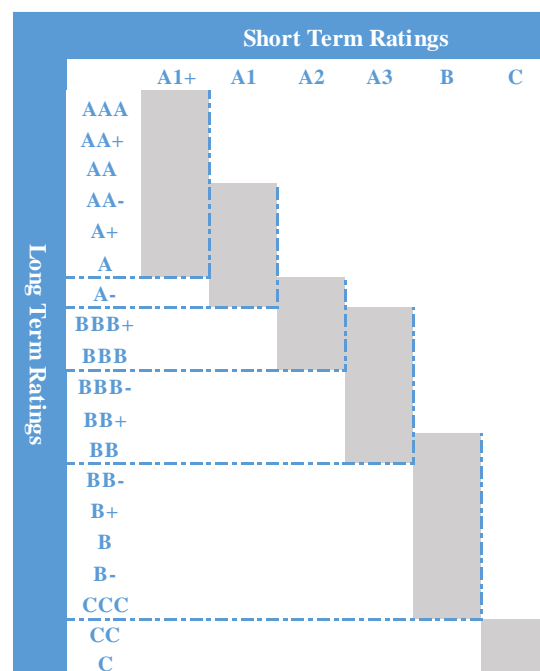
Capital Structure

Total Debt/Total Debt+Equity	36.0%	36.9%	35.3%	45.7%
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Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+ AA AA-	Very high credit quality. Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	A1	A strong capacity for timely repayment.
A+ A A-	High credit quality. Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
BBB+ BBB BBB-	Good credit quality. Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
BB+ BB BB-	Moderate risk. Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
B+ B B-	High credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.	C	An inadequate capacity to ensure timely repayment.
CCC CC C	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.		
D	Obligations are currently in default.		



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

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- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA’s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

Probability of Default

- (22) PACRA’s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA’s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA’s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

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Regulatory and Supplementary Disclosure

Repayment Schedule Sukuk-IV

Annexure B

SUKUK Amount (PKR '000)	1,500,000
Period (months)	15
Repayment	Quarterly
Pricing	3 K + 1.05%

Date		Installment	Beginning Principal	Payment		Ending Principal
				Principal	Markup	
12-Feb-18			1,500,000	-	-	1,500,000
15-May-18	92	28,016	1,500,000	-	28,015.89	1,500,000
13-Aug-18	90	27,407	1,500,000	-	27,406.85	1,500,000
12-Nov-18	91	27,711	1,500,000	-	27,711.37	1,500,000
12-Feb-19	92	28,016	1,500,000	-	28,015.89	1,500,000
19-May-19	92	1,528,016	1,500,000	1,500,000	28,015.89	-
		1,639,166		1,500,000	139,166	