The Pakistan Credit Rating Agency Limited

Rating Report

Pak Elektron Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Jul-2020	A+	A1	Negative	Maintain	YES
03-Mar-2020	A+	A1	Stable	Maintain	-
02-Sep-2019	A+	A1	Stable	Maintain	-
09-Mar-2019	A+	A1	Stable	Maintain	-
10-Sep-2018	A+	A1	Stable	Maintain	-
10-Jan-2018	A+	A1	Stable	Maintain	-
26-Apr-2017	A+	A1	Stable	Maintain	-
03-Dec-2016	A+	A1	Stable	Upgrade	
04-Dec-2015	A	A1	Stable	Upgrade	-
12-Dec-2014	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Pakistan’s household appliances sector is largely dependent on global raw material prices, making it susceptible to external dynamics. Amidst COVID-19 outbreak, challenging economic conditions and strong competition have proved to be an impediment to industry growth. The highest impact was witnessed in ACs and deep freezers production which fell by 78%, QoQ, followed by refrigerators (40%) and TV (31%). On the power front, transformers and switch gears production also posted a dip of 28% and 39%, respectively. Sustaining operations and generating cashflows will be tough in current environment. The situation may worsen if pandemic prolongs for a significant time.
The ratings reflects Pak Elektron Ltd.'s (PEL) diversified revenue stream and strong presence in Appliances and Power segments. The Company has continued to focus on enhancing its product slate. The recent slowdown in industry sales, especially appliances division, contracted the Company's revenues. Gross margins posted a dip, as it absorbed the impact of high costs. Sales in power division remained low as PSDP spending and government projects were sparse during 1QCY20. Consequently, the Company suffered a loss in 1QCY20. The profitability is expected to remain under pressure as appliance production was shutdown in line with provincial government directives. The Company has resumed full operations and sales have picked up lately, especially in power division (Power Transformers). The cashflows remained under pressure and, coupled with high quantum of borrowings, resulted in deteriorated coverages. PEL is exposed to financial risk owing to long inventory and receivable cycle. However, the Company was able to reduce inventory and receivable days, creating cushion at trade levels. Capital structure is characterized by intermediate leveraging. Going forward, measures announced by SBP is expected to provide relief in terms of debt servicing and lower interest cost. The management intends to match last years sales on the back of better performance of power division, compensating sales loss in appliance division. The Negative Outlook and 'Rating Watch' signify adverse impact of COVID-19 outbreak, economic slowdown and prevailing uncertainty. PACRA will monitor the prevailing situation and update the ratings accordingly.

The ratings are dependent on the management's ability to sustain operations and sales in prevailing challenges. Meanwhile, any significant deterioration in sales and margins will impact the ratings. Close monitoring of working capital requirements to improve cash cycle and debt servicing remains imperative. Managing liquidity and financial risk are crucial for the ratings.

Disclosure

Name of Rated Entity	Pak Elektron Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Household Appliances(Feb-20)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Profile

Legal Structure Pak Elektron Limited ('PEL' or 'the Company') is a public limited company, listed on the Pakistan Stock Exchange.

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

Operations The Company is principally engaged in manufacturing and sale of electrical capital goods and domestic home appliances.

Ownership

Ownership Structure Saigol Group owns majority shareholding in the Company (51%) through family members with Mr. Naseem Siagol (25%) holding the majority stake. Remaining shareholding is split between the general public (26%), insurance companies (6.6%), foreign investors (6%) and financial institutions (4.7%).

Stability Ownership of the business is seen as stable since major shareholding lies with Saigol family with no changes expected in near future.

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 The Group has strong business profile with significant standing in the country's Textile, Engineering and Energy sectors.

Governance

Board Structure The Company's Board of Directors comprises nine members including the Chairman, with three executive directors, three non-executive directors and three independent directors. The Board has high representation of Saigol Group, with six individuals (three executive and three non-executive) belonging to the group. Additionally, there are two nominees of National Bank while one independent director is a nominee of National Investment Trust.

Members' Profile All BoD members have relevant expertise. Board's Chairman, Mr. Naseem Saigol, holds directorship of various entities of Siagol Group and was an office bearer of various trade associations. Independent Director, Mr. Syed Haroon Rashid, has over twenty years of experience and has worked in various financial as well as non-financial institutions.

Board Effectiveness The Board ensures oversight through an Audit Committee and a Human Resource & Remuneration Committee. Both committees are headed by Mr. Asad Ullah Khawaja, an independent director, and nominee of NIT. Each committee comprises 4 members. During CY19, four board meetings were convened.

Financial Transparency M/s Rehman Sarfaraz Rahim Iqbal Rafiq & Co., Chartered Accountants, classified in category 'A' by SBP with satisfactory QCR rating, are the external auditors of the Company. The firm has expressed an unqualified opinion on the annual financial statements of PEL.

Management

Organizational Structure The Company has a well-defined organizational structure, designed in-line with its two main divisions – Home Appliances and Power. Each division has separate departments for the following functions: i) Production, ii) Quality Control, iii) Research and Development, iv) Marketing, v) Supply Chain, and vi) Planning. However, Finance, IT, Human Resource and Internal Audit departments work as shared services.

Management Team The Company's management comprises of experienced individuals who possess significant market knowledge and technical know-how. Mr. Murad Saigol, the CEO, has been associated with the Company since 2005. He is supported by Mr. Zeid Yousuf Saigol who heads the power division as Director Operations.

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

MIS PEL has implemented different modules of Oracle E-business Suite to cater diversified operational and accounting needs of the Company. Oracle Financials and Oracle Supply Chain manages procurement, inventory and order booking. Oracle Discrete for manufacturing has also been implemented in both divisions. Moreover, personalized software for HR and payroll has also been deployed.

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

Business Risk

Industry Dynamics Pakistan's household appliances sector is largely dependent on global raw material prices, making it susceptible to external dynamics. Amidst COVID-19 outbreak, lock down and closure of shops, challenging economic conditions and strong competition among industry players have proved to be an impediment to industry growth. This is reflected by lower production across major categories of household appliances and curtailed prices. The highest impact was witnessed in air conditioners and deep freezers production which fell by 78%, QoQ, followed by refrigerators (40%) and television sets (31%). On the power front, production of transformers and switch gears also suffered a decline of 28% and 39%, respectively. Uncertainty amidst COVID-19 has created challenges for the industry. Sustaining operations and generating cashflows will be tough in current environment as demand has been impacted.

Relative Position PEL holds a moderate share in the overall appliance market. However, it benefits from a high market share in refrigerators (25%). On the Power side, PEL is the market leader, with 81%, 31% and 42% of the market held in power & distribution transformers and switchgears, respectively.

Revenues The Company sources its revenue from two divisions, namely, Power (26%) and Home Appliances (74%). During CY19, sales clocked in at PKR 27,900mln, declining by 2%, (CY18: PKR 28,445mln). Revenue from the appliances division witnessed an increased by 2% on the back of improved revenues from split ACs (31%). This was mitigated to an extent by declining refrigerator (6%) and deep freezer (15%) sales. Power division's revenue registered a decline of 26%, in CY19, due to lack of government projects and slow ordering from WAPDA distribution companies. During 1QCY20, sales declined by 9% to PKR 5,989mln (1QCY19: PKR 6,616mln), due to 18% contraction in revenue from appliances division's revenue. However, revenue from power division's grew by 29% in 1QCY20.

Margins During CY19, gross margin declined slightly by 1ppts and stood at 24% (CY18: 25%). This is attributable to high raw material costs aggravated by rupee devaluation. The Company largely passed on costs on the consumers. Impact of reduced marketing expenses by 11% help sustain operating margin which decreased by 1ppt to 12% during CY19 (CY18: 13%). Moreover, high interest rates burdened the Company with high finance costs leading to a downward trend in net profit margin (CY19: 3%, CY18: 5%). The Company posted a net income of PKR 879mln in CY19 (CY18: PKR 1,371mln). During 1QCY20, gross margin dipped to 22% (1QCY19: 27%), due to elevated raw material costs. The Company posted a net loss of PKR 557mln (1QCY19: Net Profit PKR 416mln) as a result of high finance costs (1QCY20: PKR 767mln, 1QCY19: PKR 575mln). Net margin stood at -9.3% (1QCY19: 6.3%).

Sustainability Going forward, the Company is expected to benefit from the relief provided by SBP in terms of loan deferment and interest rate cuts. The management intends to match last years sales on the back of better performance of power division, compensating sales loss in appliance division. However, sustaining operations and generating cashflows will be tough in current environment as demand has been impacted. The situation may worsen if lock down prolongs for a significant time.

Financial Risk

Working Capital During CY19, the Company's working capital days continue to remain elevated owing to high inventories and trade receivables during its peak season (April – October), which stood at 122 days and 128 days, respectively (CY18: 121 days and 134 days). As a result, PEL's net working capital days stood at 243 days (CY18: 250 days). Similarly, during 1QCY20, net working capital days further declined to 257 days, mainly due to high receivables days emanating from the appliances division, and stood at 144 days.

Coverages High finance costs have stressed the interest coverage (CY19: 1.7x, CY18: 2x). Similarly, core and total coverage also deteriorated (CY19: 0.8x, CY18: 1x). Due to lower cashflows, interest coverage further declined during 1QCY20 to 0.6x (1QCY19: 2.5x) with Core and coverage down to 0.5x, (1QCY19: 1.2x). Cashflows are expected to remain under pressure. However, lower interest rates and loan deferment will provided much need respite.

Capitalization The Company's capital structure comprises a debt-to-equity ratio of 35% during CY19 (CY18: 37%). Total borrowings witnessed a decline of 10%, on the back of reduction in short-term borrowings. Total debt is still dominated by short-term borrowings, representing 70%. During Dec-19, the Company issued a privately placed Sukuk-V, for working capital requirements. The Sukuk is worth PKR 1,200mln, at a discount rate of 3MK +150bps and will be redeemed at face value, with tenure of 15 months. The Sukuk is issued to finance working capital requirements of the Company. Going forward, positive outcome of debt relief measures announced by SBP remain important.

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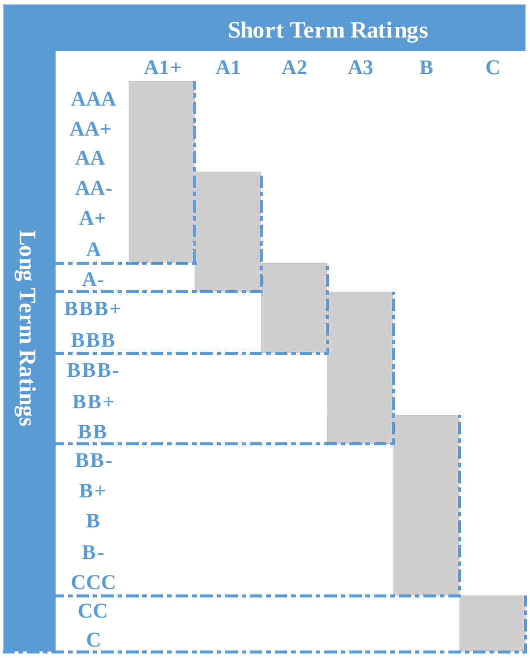
Pak Elektron Limited	Mar-20	Dec-19	Sep-19	Jun-19	Mar-19	Dec-18
Household Appliances	3M	12M	9M	6M	3M	12M
A BALANCE SHEET						
1 Non-Current Assets	25,488	24,836	24,533	24,326	24,088	23,745
2 Investments	16	22	21	21	21	22
3 Related Party Exposure	4	6	3	5	5	7
4 Current Assets	26,689	26,447	26,042	27,570	28,656	28,325
a Inventories	*7,989*	*7,794*	*7,984*	*9,751*	*10,889*	*10,786*
b Trade Receivables	*9,558*	*9,318*	*8,906*	*10,140*	*10,378*	*10,182*
5 Total Assets	52,197	51,311	50,599	51,922	52,771	52,100
6 Current Liabilities	1,554	1,708	1,420	1,377	1,341	1,332
a Trade Payables	*425*	*469*	*403*	*410*	*419*	*415*
7 Borrowings	17,171	15,604	14,910	16,224	17,599	17,364
8 Related Party Exposure	450	450	450	450	450	450
9 Non-Current Liabilities	3,341	3,311	3,120	3,232	3,135	3,125
10 Net Assets	29,682	30,239	30,700	30,639	30,246	29,830
11 Shareholders' Equity	29,682	30,239	30,700	30,639	30,246	29,830
B INCOME STATEMENT						
1 Sales	5,989	27,900	22,612	16,803	6,616	28,445
a Cost of Good Sold	*(4,670)*	*(21,327)*	*(17,270)*	*(12,764)*	*(4,846)*	*(21,448)*
2 Gross Profit	1,319	6,573	5,342	4,038	1,770	6,997
a Operating Expenses	(1,023)	(3,191)	(2,415)	(1,733)	(722)	(3,289)
3 Operating Profit	296	3,382	2,926	2,305	1,048	3,709
a Non Operating Income or (Expense)	*(22)*	*(21)*	*(28)*	*(13)*	*(17)*	*(48)*
4 Profit or (Loss) before Interest and Tax	275	3,361	2,898	2,292	1,031	3,661
a Total Finance Cost	*(767)*	*(2,480)*	*(1,902)*	*(1,366)*	*(575)*	*(2,103)*
b Taxation	*(64)*	*(2)*	*(126)*	*(117)*	*(39)*	*(186)*
6 Net Income Or (Loss)	(557)	879	870	809	416	1,371
C CASH FLOW STATEMENT						
a Free Cash Flows from Operations (FCFO)	*380*	*3,868*	*2,504*	*2,562*	*1,134*	*3,356*
b Net Cash from Operating Activities before Working Capital Changes	*(302)*	*1,737*	*905*	*1,255*	*623*	*1,942*
c Changes in Working Capital	*(336)*	*2,023*	*3,106*	*1,048*	*(273)*	*(2,032)*
1 Net Cash provided by Operating Activities	(638)	3,760	4,011	2,303	350	(89)
2 Net Cash (Used in) or Available From Investing Activities	(924)	(1,905)	(1,505)	(988)	(563)	(3,375)
3 Net Cash (Used in) or Available From Financing Activities	1,566	(1,812)	(2,456)	(1,240)	233	3,451
4 Net Cash generated or (Used) during the period	4	43	50	75	19	(13)
D RATIO ANALYSIS						
1 Performance						
a Sales Growth (for the period)	-14.1%	-1.9%	6.0%	18.1%	-7.0%	-8.2%
b Gross Profit Margin	22.0%	23.6%	23.6%	24.0%	26.8%	24.6%
c Net Profit Margin	-9.3%	3.1%	3.8%	4.8%	6.3%	4.8%
d Cash Conversion Efficiency (EBITDA/Sales)	7.2%	15.0%	13.2%	16.5%	18.2%	14.6%
e Return on Equity (ROE)	-7.4%	2.9%	3.8%	5.4%	5.5%	4.9%
2 Working Capital Management						
a Gross Working Capital (Average Days)	264	249	229	222	291	256
b Net Working Capital (Average Days)	257	243	224	217	286	250
c Current Ratio (Total Current Assets/Total Current Liabilities)	17.2	15.5	18.3	20.0	21.4	21.3
3 Coverages						
a EBITDA / Finance Cost	0.6	1.9	2.0	2.6	2.7	2.5
b FCFO / Finance Cost+CMLTB+Excess STB	0.5	0.8	0.8	1.2	1.2	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-4.5	3.1	4.0	1.8	2.1	2.9
4 Capital Structure (Total Debt/Total Debt+Equity)						
a Total Borrowings / Total Borrowings+Equity	37.3%	34.7%	33.3%	35.2%	37.4%	37.4%
b Interest or Markup Payable (Days)	59.2	80.2	93.8	77.2	80.0	86.9
c Average Borrowing Rate	16.4%	13.1%	11.9%	12.3%	10.0%	10.4%

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	
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
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.
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.
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+ 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.
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.

Short Term Ratings	
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(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)
Proprietary Information