The Pakistan Credit Rating Agency Limited

Rating Report

Pak Elektron Limited | PP Sukuk | Dec-19

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Jan-2020	A+	-	Stable	Initial	-
09-Jul-2019	A+	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The rating reflects PEL's diversified revenue stream and strong presence in Appliances and Power products market. The Company, by leveraging its brand, has continued to focus on enhancing product slate and revenues with introduction of new products (TV and Water Dispenser). Despite an upward revision in prices, the Company's could not pass on increased raw material costs due to stiff competition, keeping margins and profitably subdued in 9MCY19. The Company's cash flows have remained under pressure on YoY basis, and coupled with larger quantum of borrowings, impacted coverage ratios. PEL’s capital structure is characterized by intermediate leveraging to support high inventory levels. High working capital needs, emanating from long inventory and receivable cycle, exposes the Company to financial risk. Although working capital management has improved recently, higher interest rates and, ensuing finance cost along with maturity of long term debt, exerts pressure on the financial profile of the Company. The Company has recently issued a Privately Placed Sukuk to finance working capital requirements after redeeming the Commercial Paper issued for same purpose.

The ratings are dependent on the management's ability to maintain its market share and margins. Any further deterioration in margins, in turn, profitability may impact the ratings adversely. Meanwhile, close monitoring of working capital requirements to improve cash cycle and debt servicing capacity remain imperative. Maintaining coverages and managing financial risk prudently remain crucial for the ratings.

Disclosure

Name of Rated Entity	Pak Elektron Limited | PP Sukuk | Dec-19
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-19),PACRA_Methodology_Debt Instrument_FY19(Jun-19),Methodology | Sukuk(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(Mar-19)
Rating Analysts	Faiqa Qamar | faiqa.qamar@pacra.com | +92-42-35869504

Household Appliances

Profile

Legal Structure Pak Elektron Limited (PEL) 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 equipment and home appliances.

Ownership

Ownership Structure Saigol Group owns majority shareholding in the Company (~50%) through family members with Mr. Naseem Siagol holding ~25%. Remaining shareholding is split between the general public (~26%), local institutions (~19%), foreign investors (~4%) and others (~1%).
Stability Ownership of the business is seen as stable as the major ownership vests with Saigol family with no changes expected.
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 sponsors have strong knowledge and expertise in industrial manufacturing. The Group has significant standing in country's Textile, Engineering, Real estate and Energy sectors.

Governance

Board Structure BoD comprises nine members. These include one independent, five non-executive and three executive directors. Saigol family has prominent presence on the board. Apt board size, presence of independent oversight and presence of a female director indicates a well framed governance structure.
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. During 9MCY19, Mr. Sheikh Mohammad Shakeel resigned from the directorship of the Company.
Board Effectiveness The Board ensures effectiveness oversight through Audit Committee and Human Resource and Remuneration Committee. Each committee comprises 4 members. During 9MCY19, three meetings were convened among board members.
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 CY18. 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, who reports to the Board. However, Head of Internal Audit reports administratively to the CEO and functionally to the Board Audit Committee
Management Team The Company's management comprises veteran professionals. Mr. M. Murad Saigol, CEO, joined PEL in 2005 and monitors all 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 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 Industry headwinds, intensified by weakening domestic currency, rising inflation and stiff competition reserves have negatively impacted industry players. Pakistan's household appliances sector is largely dependent on global raw material prices, making it susceptible to external dynamics. Challenging economic conditions and transition of current government have proved to be a serious impediment to industry growth. This is reflected by lower production across major categories of household appliances during CY19. The highest impact was witnessed in refrigerator production which fell by 30% YoY, followed by television sets (-8%). However, production of Deep Freezers surged by 75% in the CY19 for the industry. On the power front, production of transformers and switch gears suffered a decline of 39% and 40% respectively, whereas, electric meters produce decreased by 13% YoY.
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 of 32%. On the Power side, PEL is the market leader with 40% and 25% of the market share in transformers and switch gears, respectively.
Revenues The Company generates its revenue from two divisions, namely, Appliances (79%) and Power (21%). Revenue stood at PKR 39bln, posting a decline of ~8% in CY18, primarily due to sub-par performance of the power division and slowing demand. Similar trend was observed during 9MCY19 in which revenue amounted to ~PKR 30bln, a dip of 2%, QoQ. The power sector remained under pressure, registering a decline of ~17% due to slow ordering by WAPDA and distribution companies. However, the appliances division, posted solid performance, led by LED TVs and split ACs. The division's revenue increased by 3%. Although the Company sold fewer units across all products, upward revision of prices helped in maintaining the topline.
Margins Margins during CY18 remained depressed owing to high raw material costs aggravated by rupee devaluation with the Company's inability to pass costs on to consumers due to stiff competition. Gross margin during CY18 declined by 4ppts and stood at 25%. Similarly, impact of high production costs trickled down impacting operating margin. An increase in prices during 9MCY19 helped the Company to maintain margins. The same impact was witnessed on the operating level, which saw operating margin at 12.9% (9MCY18~13.1%). Net profit margin during 9MCY19 stood at ~3.8% (9MCY18~5.6%) owing to rising finance costs.
Sustainability The Company's revenue stream is likely to benefit from newly launched products (LED TVs and Water dispensers). Nonetheless, the Company is expected to face challenges as inflationary pressures (and resulting impact on disposable income) may dampen demand. On the other hand, the performance of power division may improve if the government focuses on infrastructure development and reforms in energy sector.

Financial Risk

Working Capital The Company's working capital days declined and stood at 224 days during 9MCY19 (9MCY18: 229 days) mainly owing to lower receivable days after its peak season (April - October). The Company maintains from a healthy cushion to borrow additional funds at the trade level.
Coverages Coverage ratios have been under stress and deteriorated owing to rising finance costs. A decrease was witnessed in 9MCY19 which saw interest coverage standing at 1.7x (9MCY18: 2.7x) and total coverage standing at 0.8x (9MCY18: 1.2x). Going forward, coverages are expected to improve with lesser quantum of borrowings and no further increase in interest rates.
Capitalization The Company has a leveraged capital structure represented by a debt-to-equity ratio of ~33% during 9MCY19 (9MCY18~39.6%). Total borrowings witnessed a decrease of of 14.2% during 9MCY19, owing to long term financing redeemed. The Company has issued a privately placed Sukuk, for working capital requirements, worth PKR 1,200mln, with a tenor of 15 months.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Pak Elektron Limited Household Appliances	Sep-19 9M	Dec-18 12M	Sep-18 9M	Dec-17 12M	Sep-17 9M	Dec-16 12M
A BALANCE SHEET						
1 Non-Current Assets	24,533	23,745	20,238	18,890	18,568	18,041
2 Investments	21	22	21	22	22	23
3 Related Party Exposure	3	7	8	9	18	26
4 Current Assets	26,042	28,325	28,643	24,995	27,822	22,236
a Inventories	*7,984*	*10,786*	*10,439*	*8,150*	*12,182*	*7,846*
b Trade Receivables	*8,906*	*10,182*	*11,272*	*10,728*	*10,931*	*8,433*
5 Total Assets	50,599	52,100	48,909	43,916	46,430	40,327
6 Current Liabilities	1,420	1,332	1,450	1,158	1,929	1,075
a Trade Payables	*403*	*415*	*479*	*498*	*1,701*	*327*
7 Borrowings	14,910	17,364	15,943	13,305	14,267	11,375
8 Related Party Exposure	450	450	450	450	450	450
9 Non-Current Liabilities	3,120	3,125	2,280	2,452	2,500	2,367
10 Net Assets	30,700	29,830	28,786	26,551	27,284	25,061
11 Shareholders' Equity	30,700	29,830	27,286	26,551	27,284	25,061
B INCOME STATEMENT						
1 Sales	22,612	28,445	23,721	31,000	26,060	26,834
a Cost of Good Sold	*(17,270)*	*(21,448)*	*(17,887)*	*(21,884)*	*(18,336)*	*(18,550)*
2 Gross Profit	5,342	6,997	5,834	9,116	7,724	8,284
a Operating Expenses	(2,415)	(3,289)	(2,738)	(3,802)	(2,937)	(2,512)
3 Operating Profit	2,926	3,709	3,096	5,314	4,787	5,772
a Non Operating Income or (Expense)	*(28)*	*(48)*	*12*	*(164)*	*17*	*(155)*
4 Profit or (Loss) before Interest and Tax	2,898	3,661	3,108	5,150	4,804	5,617
a Total Finance Cost	*(1,902)*	*(2,103)*	*(1,610)*	*(1,547)*	*(1,234)*	*(1,497)*
b Taxation	*(126)*	*(186)*	*(167)*	*(295)*	*(599)*	*(450)*
6 Net Income Or (Loss)	870	1,371	1,332	3,308	2,972	3,671
C CASH FLOW STATEMENT						
a Free Cash Flows from Operations (FCFO)	*2,504*	*3,356*	*3,256*	*4,933*	*4,997*	*5,585*
b Net Cash from Operating Activities before Working Capital Changes	*905*	*1,942*	*1,969*	*3,789*	*3,835*	*4,381*
c Changes in Working Capital	*3,106*	*(2,032)*	*(3,473)*	*(1,941)*	*(5,499)*	*(2,358)*
1 Net Cash provided by Operating Activities	4,011	(89)	(1,504)	1,849	(1,664)	2,023
2 Net Cash (Used in) or Available From Investing Activities	(1,505)	(3,375)	(1,982)	(2,223)	(1,187)	(2,356)
3 Net Cash (Used in) or Available From Financing Activities	(2,456)	3,451	3,548	307	2,893	308
4 Net Cash generated or (Used) during the period	50	(13)	62	(68)	42	(25)
D RATIO ANALYSIS						
1 Performance						
a Sales Growth (for the period)	6.0%	-8.2%	2.0%	15.5%	29.5%	6.8%
b Gross Profit Margin	23.6%	24.6%	24.6%	29.4%	29.6%	30.9%
c Net Profit Margin	3.8%	4.8%	5.6%	10.7%	11.4%	13.7%
d Cash Conversion Efficiency (EBITDA/Sales)	13.2%	14.6%	15.8%	18.7%	21.0%	23.3%
e Return on Equity (ROE)	3.8%	4.9%	6.6%	12.8%	15.1%	16.5%
2 Working Capital Management						
a Gross Working Capital (Average Days)	229	256	234	207	217	226
b Net Working Capital (Average Days)	224	250	229	202	206	221
c Current Ratio (Total Current Assets/Total Current Liabilities)	18.3	21.3	19.7	21.6	14.4	20.7
3 Coverages						
a EBITDA / Finance Cost	2.0	2.5	3.1	5.0	6.0	5.6
b FCFO / Finance Cost+CMLTB+Excess STB	0.8	1.0	2.0	1.7	2.2	1.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	4.0	2.9	2.0	1.7	1.2	1.5
4 Capital Structure (Total Debt/Total Debt+Equity)						
a Total Borrowings / Total Borrowings+Equity	33.3%	37.4%	37.5%	34.1%	35.0%	32.1%
b Interest or Markup Payable (Days)	93.8	86.9	112.1	52.3	0.0	52.6
c Average Borrowing Rate	11.9%	10.4%	10.5%	9.0%	9.2%	8.8%

Debt Instrument Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying 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

Rating	Definition
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

Rating	Definition
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

Regulatory and Supplementary Disclosure

PP - Sukuk (TBI)	
Placement	Privately Placed Sukuk
Issue size	Up to PKR 1,200mln
Issue date	Dec-19
Tenure	Fifteen (15) months
Profit Rate	3Months KIBOR + 150 bps
Profit Payment	Three (3) months from the date of first draw down and subsequently every three (3) months thereafter
Principal Repayment	One bullet payment at maturity at the end of the fifteenth month from the date of issue
Call Option	Only after the expiry of twelve (12) months from the date of first disbursement
Security	First joint pari passu hypothecation charge over current assets the Issuer with 25% margin Personal guarantee of Mr. Naseem Saigol
Investment Agent	Al Baraka Bank (Pakistan) Limited
Trustee	Pak Brunei Investment Company Limited

Installment	Due Date	Days	Principal	Mark Up	Total Installment	Outstanding Balance
			--------------- PKR 000's ---------------			
0	Dec-19		-	-	-	1,200,000
1	Mar-20	92	-	44,220	44,220	1,200,000
2	Jun-20	90	-	44,220	44,220	1,200,000
3	Sep-20	91	-	44,220	44,220	1,200,000
4	Dec-20	92	-	44,220	44,220	1,200,000
5	Mar-21	92	1,200,000	44,220	1,244,220	-