



The Pakistan Credit Rating Agency Limited

Rating Report

Avanceon Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
10-Jun-2022	A-	A2	Stable	Maintain	-
11-Jun-2021	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Avanceon Limited (the Company) ratings reflect a reputable business profile in the technology segments of industrial automation, process control, system integration, energy management, and support services. Avanceon Limited is the ultimate parent company and has four subsidiaries including two wholly-owned. The Company has extended its business footprints in Qatar, KSA, UAE, and the USA. One of the previously wholly-owned subsidiaries Octopus Digital Limited has got listed on PSX. Octopus deals in cloud computing and provides real-time dashboards to various organizations. The business strategy hinges on a low fixed cost model, having billable hours internationally but clocking in Pakistan. The Company's major customer base belongs to, the oil & gas, food & beverages, power generation, chemicals, and cement industries. Aftermarket sales business has been completely shifted to Octopus. The ratings are derived from the company's consolidated strength. During CY21, Avanceon has generated a revenue of PKR 7.1bln depicting ~10% growth (CY20: PKR 6.4bln) on a consolidated basis. In geographical distribution, a major portion of the revenue is derived from Qatar followed by Pakistan, approximately 63% of the business is generated through project revenue, the remaining 29% through equipment/hardware sales, and 8% through aftermarket sale services. The revenue collection from different projects is split into multiple projects and geographics which augments diversification. Avanceon has a low leveraged capital structure which provides comfort to financial risk. A Conservative borrowing approach is expected to sustain and future projects will be funded through internally generated cash flows and joint ventures. The Company has a considerable amount of intercompany trade receivables with aging over 3 years and causing deterioration in the working capital cycle. According to the management representation, inter-company receivables will gradually convert into equity.

The ratings are dependent on the relative positioning of the company in the automation industry while sustaining the topline profitability and low leveraged capital structure. Volatility in trade receivables remains a key area of consideration. Financial discipline is considered core to the ratings, with enduring emphasis on maintaining relevant coverages.

Disclosure

Name of Rated Entity	Avanceon Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Technology(May-21)
Rating Analysts	Muhammad Harris Ghaffar harris.ghaffar@pacra.com +92-42-35869504

Profile

Legal Structure Avanceon Limited is a listed public limited holding company.

Background Avanceon Limited (the Holding Company) was incorporated in Pakistan on 26 March 2003 as a private limited Company which was converted to a public Company on 31 March 2008 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). The Company is listed on Pakistan Stock Exchange Limited.

Operations The principal activity of the Holding Company is to provide industrial automation, process control and systems integration solutions, to trade in products of automation and control equipment and provide related technical services. Currently, company has two wholly owned subsidiaries which includes Avanceon Free Zone Establishment, UAE (AFZE) and Avanceon Saudi for Energy Co. They have two other subsidiaries which includes Avanceon Automation and Control W.L.L (AVAC) Qatar & Octopus Digital Limited.

Ownership

Ownership Structure The majority shareholding is vested in Mr. Bakhtiar Hameed Wain(CEO and founder of the company) of 61.3% and Mr. Amir Wain 10.8%.

Stability Company has stable ownership structure from the last ten years after the exit of engro in 2012. Avanceon has two wholly owned subsidiaries 100% ownership which includes Avanceon Free Zone Establishment, UAE (AFZE) and Avanceon Saudi for Energy Co. The other one subsidiary is at Qatar(Avanceon Automation and Control W.L.L) having 49% ownership stake and recently Octopus digital Limited has gone public. Avanceon have 80% ownership entrust in Octopus digital limited and remaining is free float to the public.

Business Acumen Mr. Bakhtiar Hameed Wain has more than 36 years of experience in industrial Automation. He started this business back in 1984 and built this Avanceon brand with their vast commitment towards his work and stupendous leadership skills.

Financial Strength Company has strong equity base of PKR 8.95bln mainly supplement through ample amount of accumulated unappropriated profit of PKR 3.68bln. They generated consistent positive cash generated from operations. At Dec-21 company has cash generated from operations of PKR 1,541mln.

Governance

Board Structure Company has seven BOD's which includes three independent , two executive (CEO and president of the company) and two non-executive directors. Mr. Mohammad Shahid Mir is being appointed as a Director in place of Mr. Naveed Ali Baig(he has resigned) with effect from 14 December 2020 to complete the remaining term till 28 May 2023.

Members' Profile Mr. Bakhtiar Hameed Wain is the CEO and founder of the company having more than 30 years of industry experience. All of the board members are experienced professionals with diversified backgrounds. They have more than 28 years of experience on average.

Board Effectiveness Company has board committees in place for better and effective corporate governance. Board committees are as follows: i) Audit Committee and ii) HR Committee. Each committee have one independent director which reflects good corporate governance practice.

Financial Transparency EY Ford Rhodes is their Auditors(A rated Category) and gives unqualified opinion about financial statements CY21.

Management

Organizational Structure The company has an adequate organizational structure. The operations of the company have been bifurcated into four broad functional areas which comprise: i) Operations, ii) Finance, iii) Sales and iv) Human resource. Each function is further divided into sub-units. The entire operational set-up of the company falls under the purview of CEO.

Management Team Mr. Bakhtiar Hameed Wain is the CEO and founder of the company over 30 years of experience in leading global companies such as Exxon Chemicals, Fauji Fertilizer, ICI Ltd and Avanceon Limited. Mr. Tanveer Karamat is the president of the company having extensive experience in selling automation solutions to the oil and gas sector. Mr. Saeed Ullah Khan Niazi is the CFO of the company with over 15 years of experience corporate investment, treasury, accounting and audit. Overall management has well diversified experience of automation and digitalization industry. Higher management is a combo of young and experience. The overall average experience of the management is ~ 19 years.

Effectiveness To oversee and assess the overall performance of management Avanceon have one management committee in line which consist of two members; CEO Mr. Bakhtiar Hameed Wain and President Mr. Tanveer Karamat.

MIS Company MIS strategy is strongly linked with enhancement of operational efficiency. They have well established ERP(Enterprise resource planning) systems and MS share portal for business operational intelligence to support. This has enabled them to make accurate and timely business decisions.

Control Environment Avanceon have adequate internal control system in the company and its regular assessment through internal audit activities. They have also outsource their internal audit to Anjum Nasir for enhancement of internal Audit activities efficiency. These controls include safe-guarding of assets, maintaining of proper accounting records complying with legislation and ensuring the reliability of financial information

Business Risk

Industry Dynamics Automation holds the key to radically empowering several sectors of Pakistan's economy. From manufacturing, production (oil and gas, OMC's and refineries, Foods & Beverages, Chemicals) and agriculture to services and logistics, technology can enhance the capacities, efficiencies and production quality of virtually every human activity. The global information technology (IT) market size is expected to grow from USD8,384.32 bln in 2021 to USD9,325.69 bln in 2022 at a compound annual growth rate (CAGR) of 11.2%. The growth in the market is mainly due to the companies rearranging their operations and recovering from the COVID-19 impact

Relative Position Avanceon is the only company in Pakistan industrial Automation industry. They doesn't have any competitor so, they are the market leaders and capture ~100% market share.

Revenues Company has generated a revenue of PKR 7.1bln at the end of Dec-21 (CY20: PKR 6.4bln) on consolidated basis. In geographical distribution, ~48% of the revenue is generated in Qatar and approximately 26% in Pakistan. In segment wise business distribution approximately 67% of the business generated through project revenue, remaining 29% through sale of goods and 4% only through services. Major chunk of business comes through Oil and gas sector both up and downstream. Then, after that Food and Beverages, Power, Chemicals and Cement. The revenue collection from different projects is split into multiple projects and Geographic's which augments diversification.

Margins Company has maintained consistently high operating profit margins from the last three years which reflects the efficient translation of top line into higher net profitability. They have gross profit margin of 32.0% during CY21 (CY20: 28.6%). Net profit margin is 27.1% at CY21(CY20: 16.2%). The business strategy hinges on low fixed cost model, having billable hours internationally but clocking in Pakistan.

Sustainability In a current scenario Avanceon doesn't have any competitor in the market due to uniqueness and differentiation of their product. MNC's, Oil and Gas, food and beverages industries etc are their clients which time to time provide them stable and recurring business. For 2022, they have considerable amount of projects in pipeline. In automation five verticals are in Pakistan Oil and gas, food and beverages, fast moving consumer goods, water and waste water, and specialized infrastructure. A new vertical, purely based on data, Octopus digital, has recently been carved out. Octopus Digital Limited (ODL) during CY21 has gone public and raise PKR 1bln.

Financial Risk

Working Capital Company capital structure is mainly dominated by short term borrowings of PKR 714mln predominately from standard chartered bank and long term borrowings of PKR 70mln. Company doesn't have any plan in future for further enhancement of borrowings and they prefer to fund future projects through equity. Net Working capital days stand at 112 days during CY21 increase due to hike in average trade receivable days (CY21: 224 days, CY21: 160days).

Coverages Company has positive FCFO. During CY21 company has generated FCFO of PKR 1,541mln (CY20: PKR 1,381mln). FCFO / Finance Cost ratio is 14.2x at CY21 (CY20: 14.2x) remains stagnant over the last two years as borrowings of the Company just increase by ~PKR 200mln from last corresponding period.

Capitalization Company has paid up capital of PKR 2.6bln and equity base of PKR 8.3bln at CY21. Equity of the company expects to beef up in the equity next quarter mainly due to higher accumulated unappropriated profits (CY21: PKR 3.4bln) and gain on dilution of interest. They have ~9.3% debt to capital ratio reflects low leveraging in their capital structure.



Avanceon Limited Technology	Mar-22 3M	Dec-21 12M	Dec-20 12M	Dec-19 12M
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A BALANCE SHEET

1 Non-Current Assets	604	558	543	535
2 Investments	1,157	968	877	845
3 Related Party Exposure	39	33	8	-
4 Current Assets	12,369	12,121	8,566	6,977
<i>a Inventories</i>	144	73	124	161
<i>b Trade Receivables</i>	5,260	5,551	3,168	2,481
5 Total Assets	14,169	13,679	9,994	8,357
6 Current Liabilities	4,015	4,077	3,618	3,052
<i>a Trade Payables</i>	1,664	2,363	2,202	1,322
7 Borrowings	860	854	619	714
8 Related Party Exposure	205	292	35	3
9 Non-Current Liabilities	132	123	101	81
10 Net Assets	8,957	8,333	5,622	4,507
11 Shareholders' Equity	8,957	8,333	5,622	4,507

B INCOME STATEMENT

1 Sales	1,330	7,118	6,445	4,896
<i>a Cost of Good Sold</i>	(866)	(4,840)	(4,603)	(3,412)
2 Gross Profit	464	2,278	1,842	1,484
<i>a Operating Expenses</i>	(221)	(938)	(685)	(705)
3 Operating Profit	243	1,340	1,157	779
<i>a Non Operating Income or (Expense)</i>	179	544	159	309
4 Profit or (Loss) before Interest and Tax	422	1,883	1,316	1,087
<i>a Total Finance Cost</i>	(46)	(125)	(132)	(124)
<i>b Taxation</i>	(15)	(159)	(138)	(51)
6 Net Income Or (Loss)	360	1,600	1,045	912

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	227	1,541	1,381	1,265
<i>b Net Cash from Operating Activities before Working Capital t</i>	192	1,419	1,254	1,219
<i>c Changes in Working Capital</i>	(471)	(1,502)	(569)	(1,317)
1 Net Cash provided by Operating Activities	(279)	(83)	685	(98)
2 Net Cash (Used in) or Available From Investing Activities	(15)	(271)	100	(22)
3 Net Cash (Used in) or Available From Financing Activities	(82)	1,139	(363)	172
4 Net Cash generated or (Used) during the period	(376)	785	422	52

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	-25.3%	10.4%	31.6%	40.7%
<i>b Gross Profit Margin</i>	34.9%	32.0%	28.6%	30.3%
<i>c Net Profit Margin</i>	27.1%	22.5%	16.2%	18.6%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Ca</i>	-18.4%	0.6%	12.6%	-1.1%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (To</i>	16.7%	22.9%	20.6%	23.0%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	378	229	168	232
<i>b Net Working Capital (Average Days)</i>	240	112	68	148
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	3.1	3.0	2.4	2.3
3 Coverages				
<i>a EBITDA / Finance Cost</i>	7.3	15.0	14.4	17.0
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	4.0	8.6	8.6	10.1
<i>c Debt Payback (Total Borrowings+Excess STB)/(FCFO-Fin</i>	0.2	0.1	0.1	0.1
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity,</i>	8.8%	9.3%	9.9%	13.7%
<i>b Interest or Markup Payable (Days)</i>	9.4	19.9	46.6	54.9
<i>c Entity Average Borrowing Rate</i>	22.0%	16.7%	13.8%	12.9%

Credit Rating

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term 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.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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(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

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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.
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- (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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