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
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	-

Rating Rationale and Key Rating Drivers

Industry headwinds, intensified by weakening domestic currency, widening fiscal imbalance and strong competition among players have negatively impacted domestic appliances industry. 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 an impediment to power industry (transformers and switch gears) growth as well. This is reflected by lower production across major categories of household appliances and power during CY18. The highest impact was witnessed in refrigerator production which fell by 12% YoY, followed by television sets (-8%) and deep freezers (-5%).

The ratings reflect 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). However, strong competition and slowdown in Power division led to a decline in sales, in 9MCY18. 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 coverage ratios. PEL's capital structure is characterized by intermediate leverage due to new financing obtained to support higher inventory levels. High working capital needs, emanating from long inventory and receivable cycle, expose the company to financial risk. The Company is in the process of issuing a Commercial Paper to finance working capital requirements.

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 strong coverages and managing financial risk prudently is 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-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Household Appliances(Mar-19)
Rating Analysts	Adnan Dilawar | adnan@pacra.com | +92-42-35869504

Household Appliances

Profile

Legal Structure Pak Elektron Limited (PEL) is a public limited company, listed on 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 of the Company (~50%) through family members with Mr. Naseem Siagol (~25%) holding the majority stake. Remaining shareholding is split between the general public (~23%), local institutions (~21%) and foreign investors (~5%). During the period under review, a shift in ownership was observed in which shareholding of Modarbas and Mutual Funds declined by ~8%, shifting to the general public.

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 PEL is owned and managed by a strong business empire, naming Siagol Group. The Group has significant standing in country's Textile, Engineering, Real estate 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 presence of a female director indicates a well framed governance structure.

Members' Profile All the 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 9MCY17, Mr. Azam Saigol resigned from the directorship of the Company and was replaced by Mr. Syed Haroon Rashid (Non-executive Director).

Board Effectiveness The Board ensures effectiveness oversight through Audit Committee and Human Resource and Remuneration Committee. Each committee comprises 4 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 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 comprises 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 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, widening fiscal imbalance, rising inflation and dwindling foreign exchange 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 CY18. The highest impact was witnessed in refrigerator production which fell by 12% YoY, followed by television sets (-8%) and deep freezers (-5%).

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 (32%). 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 its revenue from two main divisions, namely, Appliances (70%) and Power (30%). During 9MCY17, gross sales stood at ~PKR 30,912mln, receding by ~9% mainly owing to marked slowdown in the Company's power division which registered a decline of ~25%, YoY. Declining power sales are attributable to slow ordering from WAPDA distribution companies amid a cloudy political environment and lack of government direction. Similarly, the appliances division witnessed a mild slowdown and contracted by ~2% on the back of declining refrigerator and split AC sales. Impact of slow market demand in the appliances division remained subdued as the Company engaged in aggressive marketing campaigns which lead to improved revenues from deep freezers and microwaves ovens. Additionally, introduction of water dispensers and LED TVs also helped support revenues.

Margins During 9MCY18, gross margin declined by 5ppts and stood at ~25% (9MCY17: ~30%). A decline in the ratio is attributable to high raw material costs aggravated by rupee devaluation. Reduction in gross margin reflects the Company's inability to pass costs on the consumers. Additionally, elevated trade discounts further constrained profitability. Similarly, impact of increased cost of raw materials was reflected in operating margin which also weakened by 5ppts, standing at ~13% during 9MCY18 (9MCY17: ~18%). Moreover, an increase in policy rates burdened the Company with high finance costs, leading it to maintain a downward trend in net profit margin, standing at ~6% during 9MCY18 (CY17: 11%; 9MCY17: 11%).

Sustainability The Company's revenue stream is likely to benefit from recently launched products (LED TVs and Water dispensers) which have yielded encouraging results. Nonetheless, the products require time to develop and establish their presence in the market as they are in the early stages of their life cycle. Similarly, the future prospects for the power division are expected to improve as the current government tackles issues inherited with some signs of progress visible.

Financial Risk

Working Capital The Company maintains a strong position on working capital management and benefits from a healthy cushion to borrow additional funds. However, owing to high inventory levels and trade receivables, net working capital days remained elevated and stood at 247 days during 9MCY18 (CY17: 242 days; 9MCY17: 207 days).

Coverages Declining cashflows and rising finance costs have put due stress on coverages, weakening their overall position. During 9MCY18, interest coverage shrunk to 2.7x as compared to 4.3x during CY17 (9MCY17: 5.5x). Similarly, total coverage also deteriorated and stood at 1.2x (CY17: 1.5x; 9MCY17: 2.2x). Going forward, continuation of monetary tightening is expected to keep coverages under stress. Additionally, upcoming retirement of debt instruments will add further pressure on coverage ratios.

Capitalization The Company has a leveraged capital structure represented by a debt-to-equity ratio of ~39% during 9MCY18. Total borrowings witnessed an increase of 31% during 9MCY18, on the back of a surge in short-term borrowings which represent 83% of the debt structure. Going forward, the Company is in the process of issuing a privately placed Commercial Paper, for working capital requirements, worth PKR 1,200mln.

PKR mln

Pak Elektron Limited
Listed Public Limited

BALANCE SHEET	Sep-18	Dec-17	Dec-16	Dec-15
	9M	12M	12M	12M
a Non-Current Assets	**20,238**	**18,890**	**18,041**	**16,710**
b Investments (Incl. Associates)	**28**	**31**	**49**	**94**
Equity Instruments	8	9	26	9
Debt Instruments	21	22	23	86
c Current Assets	**28,643**	**24,995**	**22,236**	**19,345**
Inventory	10,439	8,150	7,846	6,182
Trade Receivables	11,272	10,728	8,433	7,700
Others	6,932	6,118	5,957	5,463
d Total Assets	**48,909**	**43,916**	**40,327**	**36,149**
e Debt/Borrowings	**17,443**	**13,305**	**11,375**	**12,773**
Short-Term	12,434	7,571	8,133	8,548
Long-Term (Incl. Current Maturity of Long-Term Debt)	5,009	5,734	3,242	4,225
Other Short-Term Liabilities	1,450	1,158	1,075	1,076
Other Long-Term Liabilities	2,280	2,452	2,367	2,305
f Shareholder's Equity	**27,736**	**27,001**	**25,511**	**19,996**
g Total Liabilities & Equity	**48,909**	**43,916**	**40,327**	**36,149**

INCOME STATEMENT				
a Turnover	**23,721**	**31,000**	**26,834**	**25,122**
b Gross Profit	5,834	9,116	8,284	7,434
c Net Other Income	11	(153)	(158)	22
d Financial Charges	(1,610)	(1,547)	(1,497)	(1,665)
e Net Income	**1,332**	**3,308**	**3,671**	**2,880**

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	3,256	4,933	5,585	5,468
b Total Cashflows (TCF)	3,256	4,933	5,585	5,468
c Net Cash changes in Working Capital	(3,473)	(1,941)	(2,358)	(1,721)
d Net Cash from Operating Activities	(1,504)	1,849	2,023	2,065
e Net Cash from InvestingActivities	(1,982)	(2,223)	(2,356)	(2,537)
f Net Cash from Financing Activities	3,548	307	308	710
g Net Cash generated during the period	62	(68)	(25)	238

RATIO ANALYSIS				
a Performance				
Turnover Growth	2%	16%	7%	22%
Gross Margin	25%	29%	31%	30%
Net Margin	6%	11%	14%	11%
ROE	7%	13%	16%	17%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+U	1.2	1.5	1.9	1.6
Interest Coverage (X) (FCFO/Gross Interest)	2.7	4.3	5.0	3.8
Debt Payback (Years) (Total Debt (excluding Covered Short T	2.5	1.7	1.5	2.1
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable D	229	202	221	178
d Capital Structure (Total Debt/Total Debt+Equity)	39%	33%	31%	40%

Rating Scale

Credit Rating Scale & Definitions

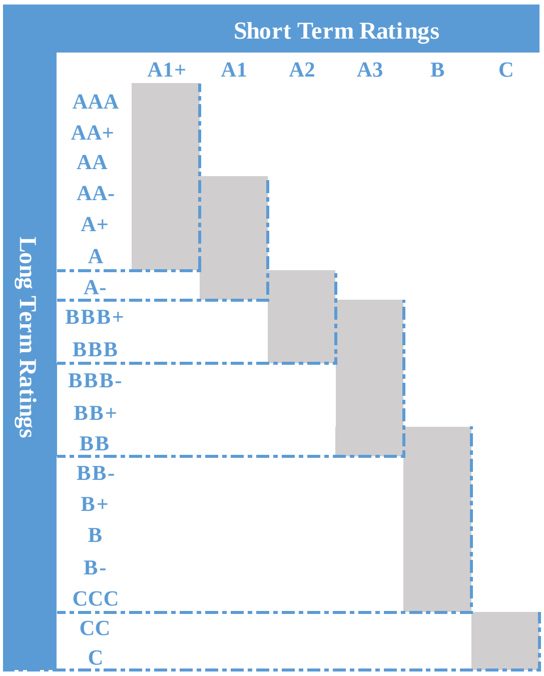
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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