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
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

Industry headwinds, intensified by weakening domestic currency, widening fiscal imbalance and strong competition among players has negatively impacted the domestic appliances industry, as reflected by lower volumetric sales. Moreover, dependence on global raw materials adds further pressure. Challenging economic conditions and transition of current government have proved to be an impediment to power industry (transformers and switch gears) growth as well. According to the Pakistan Bureau of Statistics, during 6MCY19, the highest impact was witnessed in refrigerator production which fell by ~28% YoY, followed by air conditioners (~11%) and television sets (~1%). On the other hand, a 31%, YoY, increase was observed in deep freezer production during 6MCY19.

The rating reflects Pak Elektron Limited's (PEL) 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 recent revision of prices the Company witnessed a contraction in margins owing to elevated costs arising from a depreciated Pakistani Rupee and high borrowing costs. The Company's cashflows have remained under pressure and, coupled with high quantum of borrowings, resulted in deteriorated coverage ratios. Rising interest rates add further pressure on the Company. PEL is exposed to financial risk owing to its long inventory and receivable cycle. Although an improvement in working capital cycle was observed during 6MCY19, room for further improvement exists. The Company’s capital structure is characterized by intermediate leveraging owing to financing obtained to support high inventory levels. The Company has (March, 2019) issued a Commercial Paper to finance working capital requirements and is currently in the process of issuing a Privately Placed Sukuk for the 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 strong coverage ratios and managing financial risk prudently remains crucial for the rating.

Disclosure	
Name of Rated Entity	Pak Elektron Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Household Appliances(Mar-19)
Rating Analysts	Silwat Malik | silwat.malik@pacra.com | +92-42-35869504

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 (~26%), local institutions (~19%), foreign investors (~4%) and others (~1%).

Stability Ownership of the business is seen as stable since major shareholding lies 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 a prominent presence on the board. Apt board size, 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 CY18, 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 effective oversight through an Audit Committee and a Human Resource and Remuneration Committee. Each committee comprises 4 members. During CY18, four 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/MD, who report 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 6MCY19. The highest impact was witnessed in refrigerator production which fell by ~28% YoY, followed by air conditioners (-11%) and television sets (-1%). On the other hand, a ~31%, YoY, increase was observed in deep freezers during 6MCY19.

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. On the Power side, PEL is the market leader,whereby, 81% and 40% of the market is held by the Company's power and distribution transformers, respectively.

Revenues The Company generates its revenue from two divisions, namely, Appliances (81%) and Power (19%). Revenues in 6MCY19 improved, during which gross revenue registered a marginal increase of ~3%, YoY, standing at ~PKR 23,077mln. Although a relatively lower number of units were sold due to slow demand, the Company was able to retain revenues owing to an upward revision in prices. The power sector continued to remain sluggish during 6MCY19, registering a decline of ~5% in gross revenue, attributable to slow ordering by WAPDA distribution companies. On the other hand, the appliances division, led by solid performance by split ACs, was able to increase segment revenue by 5% in 6MCY19. Nonetheless, net revenue remained stagnant owing to lower contract sales and exports. This resulted in net revenue of ~PKR 16,803mln during 6MCY19, an increase of 1% over 6MCY18.

Margins Despite revision of prices during 6MCY19, gross margin remained under pressure. This was mainly attributable to inflated costs owing to PKR devaluation, leading to a gross margin of ~24% during 6MCY19 (6MCY18: ~25%). This led to a decline of 1ppt in operating margin as well which stood at ~14% in 6MCY19 (6MCY18: ~15%). However, impact was subdued primarily owing to a reduction in selling and marketing costs. Net profit margin during the half came under pressure owing to high finance costs arising from interest rate hikes. During 6MCY19 finance costs rose by 32% to ~PKR 1,366mln, as compared to ~PKR 1,031mln in 6MCY18. The Company posted net profit worth ~PKR 809mln during 6MCY19 (6MCY18: ~1,215mln), translating into a margin of 5% (6MCY18: ~7%).

Sustainability The Company's revenue stream will remain dependent on recently launched products (LED TVs and Water dispensers), which have supported revenues. Nonetheless, challenges are expected to be faced as inflationary pressures (and resulting impact on disposable income) will dampen demand while new products will require time to develop. On the other hand, future prospects for the power division are expected to improve as the current government tackles issues.

Financial Risk

Working Capital The Company's working capital days continue to remain elevated owing to high inventories and trade receivables during its peak season (April – October). The Company displayed improved working capital management during 6MCY19 with net working capital days standing at 217 days (6MCY18: 238 days). This is primarily a factor of better receivable management. However, room for further improvement in working capital discipline exists. Moreover, sustained short-term cushion provides comfort.

Coverages Coverage ratios have been under stress and have deteriorated owing to rising finance costs. During 6MCY19, interest coverage stood at 2.4x, declining as compared to 3.3x during 6MCY18, owing to high finance costs. Similarly, total coverage registered a slight decline and fell to 1.2x during 6MCY19 (6MCY18: 1.5x). Going forward, elevated interest rates are likely to keep coverage ratios under pressure.

Capitalization The Company has a moderately leveraged capital structure, represented by a debt-to-equity ratio of ~35% during 6MCY19. Total borrowings during 6MCY19 contracted by ~6%, YoY, on the back of lower short-term borrowings. Going forward, the Company is in the process of issuing a privately placed Sukuk worth PKR 1,500mln. The instrument will have a tenor of 15 months and will be utilized for working capital requirements. Additionally, the Company previously issued a commercial paper during March, 2019, for working capital requirements. The paper is worth ~PKR 1,200mln and will mature in December, 2019.

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Financial Summary
PKR mln

Pak Elektron Limited Household Appliances	Jun-19 6M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Non-Current Assets	24,326	23,745	18,890	18,041
2 Investments	21	22	22	23
3 Related Party Exposure	5	7	9	26
4 Current Assets	27,570	28,325	24,995	22,236
a Inventories	*9,751*	*10,786*	*8,150*	*7,846*
b Trade Receivables	*10,140*	*10,182*	*10,728*	*8,433*
5 Total Assets	51,922	52,100	43,916	40,327
6 Current Liabilities	1,377	1,332	1,158	1,075
a Trade Payables	*410*	*415*	*498*	*327*
7 Borrowings	16,224	17,364	13,305	11,375
8 Related Party Exposure	450	450	450	450
9 Non-Current Liabilities	3,232	3,125	2,452	2,367
10 Net Assets	30,639	29,830	26,551	25,061
11 Shareholders' Equity	30,639	29,830	26,551	25,061
B INCOME STATEMENT				
1 Sales	16,803	28,445	31,000	26,834
a Cost of Good Sold	*(12,764)*	*(21,448)*	*(21,884)*	*(18,550)*
2 Gross Porfit	4,038	6,997	9,116	8,284
a Operating Expenses	(1,733)	(3,289)	(3,802)	(2,512)
3 Operating Profit	2,305	3,709	5,314	5,772
a Non Operating Income	*(13)*	*(48)*	*(164)*	*(155)*
4 Profit or (Loss) before Interest and Tax	2,292	3,661	5,150	5,617
a Total Finance Cost	*(1,366)*	*(2,103)*	*(1,547)*	*(1,497)*
b Taxation	*(117)*	*(186)*	*(295)*	*(450)*
6 Net Income Or (Loss)	809	1,371	3,308	3,671
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*2,562*	*3,356*	*4,933*	*5,585*
b Net Cash from Operating Activities before Working Capital Changes	*1,255*	*1,942*	*3,789*	*4,381*
c Changes in Working Capital	*1,048*	*(2,032)*	*(1,941)*	*(2,358)*
1 Net Cash provided by Operating Activities	2,303	(89)	1,849	2,023
2 Net Cash (Used in) or Available From Investing Activities	(988)	(3,375)	(2,223)	(2,356)
3 Net Cash (Used in) or Available From Financing Activities	(1,240)	3,451	307	308
4 Net Cash generated or (Used) during the period	75	(13)	(68)	(25)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	18.1%	-8.2%	15.5%	6.8%
b Gross Profit Margin	24.0%	24.6%	29.4%	30.9%
c Net Profit Margin	4.8%	4.8%	10.7%	13.7%
d Cash Conversion Efficiency (EBITDA/Sales)	16.5%	14.6%	18.7%	23.3%
e Return on Equity (ROE)	5.4%	4.9%	12.8%	16.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	222	256	207	226
b Net Working Capital (Average Days)	217	250	202	221
c Current Ratio (Total Current Assets/Total Current Liabilities)	20.0	21.3	21.6	20.7
3 Coverages				
a EBITDA / Finance Cost	2.6	2.5	5.0	5.6
b FCFO / Finance Cost+CMLTB+Excess STB	1.2	1.0	1.7	1.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.8	2.9	1.7	1.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	35%	37%	34%	32%
b Interest or Markup Payable (Days)	0.7	0.7	0.5	0.4
c Average Borrowing Rate	12.3%	10.4%	9.0%	8.8%

Credit Rating Scale & Definitions

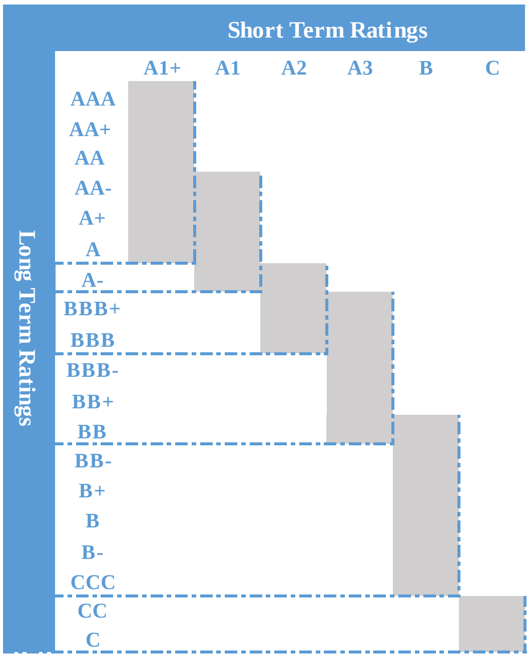
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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