



The Pakistan Credit Rating Agency Limited

Rating Report

Pak Elektron Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

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

Rating Rationale and Key Rating Drivers

Pakistan's household appliances sector is largely dependent on global raw material prices, making it susceptible to external dynamics. Challenging economic conditions, strong competition among industry players and transition of current government have proved to be an 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% during CY19. On the power front, production of electric meters, transformers and switch gears suffered a decline of 13%, 39% and 40% respectively.

The rating reflects Pak Elektron Limited's (PEL) diversified revenue stream and strong presence in Appliances and Power segments. The Company, by leveraging its brand, has continued to focus on enhancing product slate. The recent slowdown in industry sales, especially refrigerator, contracted the Company's revenues slightly. The Company maintained its gross margins by passing on the impact of cost to consumers. Sales in power segment remained low as PSDP spending and government projects were sparse. The Company net income was suppressed by high borrowing cost. The Company's cashflows remained under pressure and, coupled with high quantum of borrowings, resulted in deteriorated coverage ratios. PEL is exposed to financial risk owing to its long inventory and receivable cycle. However, the Company was able to reduce its inventory and receivable days on YoY basis, creating further cushion at trade levels. The Company's capital structure is characterized by intermediate leveraging owing to financing obtained to support high inventory levels. The Company has issued privately placed Sukuk V (Dec-19) to finance working capital requirements.

The ratings are dependent on the management's ability to maintain its market share and margins. Any significant 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	Methodology Corporate Ratings(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Household Appliances(Feb-20)
Rating Analysts	Faiqa Qamar faiqa.qamar@pacra.com +92-42-35869504

Profile

Legal Structure Pak Elektron Limited ('PEL' or 'the Company') is a public limited company, listed on the Pakistan Stock Exchange.
Background PEL was incorporated in 1956. Saigol group acquired major shareholding in the Company in 1978, making it the flagship entity of the group.
Operations The Company is principally engaged in manufacturing and sale of electrical capital goods and domestic home appliances.

Ownership

Ownership Structure Saigol Group owns majority shareholding in the Company (51%) through family members with Mr. Naseem Saigol (25%) holding the majority stake. Remaining shareholding is split between the general public (26%), insurance companies (6.6%), foreign investors (6%) and financial institutions (4.7%).
Stability Ownership of the business is seen as stable since major shareholding lies with Saigol family with no changes expected in near future.
Business Acumen Saigol Group is one of the leading industrial groups of the country with interests in services, manufacturing home appliances and electrical equipment, textile and power generation.
Financial Strength The Group has strong business profile with significant standing in the country's Textile, Engineering and Energy sectors.

Governance

Board Structure The Company's Board of Directors comprises nine members including the Chairman, three executive directors, three non-executive directors and three independent directors. The Board has high representation of Saigol Group, with six individuals (three executive and three non-executive) belonging to the group. Additionally, there are two nominees of National Bank while one independent director is a nominee of National Investment Trust.
Members' Profile All BoD members have relevant expertise. Board's Chairman, Mr. Naseem Saigol, holds directorship of various entities of Saigol Group and was an office bearer of various trade associations. Independent Director, Mr. Syed Haroon Rashid, has over twenty years of experience and has worked in various financial as well as non-financial institutions.
Board Effectiveness The Board ensures effective oversight through an Audit Committee and a Human Resource & Remuneration Committee. Both committees are headed by Mr. Asad Ullah Khawaja, an independent director, and nominee of NIT. Each committee comprises 4 members. During CY19, four board meetings were convened.
Financial Transparency M/s Rehman Sarfaraz Rahim Iqbal Rafiq & Co., Chartered Accountants, classified in category 'A' by SBP with satisfactory QCR rating, are the external auditors of the Company. The firm has expressed an unqualified opinion on the annual financial statements of PEL.

Management

Organizational Structure The Company has a well-defined organizational structure, designed in-line with its two main divisions – Home Appliances and Power. Each division has separate departments for the following functions: i) Production, ii) Quality Control, iii) Research and Development, iv) Marketing, v) Supply Chain, and vi) Planning. However, Finance, IT, Human Resource and Internal Audit departments work as shared services.
Management Team The Company's management comprises of experienced individuals who possess significant market knowledge and technical know-how. Mr. Murad Saigol, the Chief Executive Officer, has been associated with the Company since 2005. He is ably supported by Mr. Zeid Yousuf Saigol who heads the power division as Director Operations.
Effectiveness Keeping in view the size and operations of the Company, management lacks effectiveness as there are no management committees in place. Thus, indicating room for improvement.
MIS PEL has implemented different modules of Oracle E-business Suite to cater diversified operational and accounting needs of the Company. Oracle Financials and Oracle Supply Chain manages procurement, inventory and order booking. Oracle Discrete for manufacturing has also been implemented in both divisions. Moreover, personalized software for HR and payroll has also been deployed.
Control Environment To ensure operational efficiency, the Company has setup an internal audit function. Regular reviews are undertaken by the internal audit function.

Business Risk

Industry Dynamics Pakistan's household appliances sector is largely dependent on global raw material prices, making it susceptible to external dynamics. Challenging economic conditions, strong competition among industry players and transition of current government have proved to be an 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% during CY19. On the power front, production of electric meters, transformers and switch gears suffered a decline of 13%, 39% and 40% respectively.
Relative Position PEL holds a moderate share in the overall appliance market due to high competition. However, it benefits from a high market share in refrigerators (32%). On the Power side, PEL is the market leader, with 81%, 31% and 42% of the market held in power transformers, distribution transformers and switchgears, respectively.
Revenues The Company sources its revenue from two divisions, namely, Power (21%) and Home Appliances (79%). During 3QCY19, sales clocked in at PKR 22,612mln, declining by 5%, (3QCY18: 23,721mln). The appliances division witnessed a slowdown and contracted by 12% on the back of declining refrigerator (22%) and deep freezer (19%) sales. This was mitigated to an extent by improved revenues from split ACs (25%). Power division also registered a decline of 46%, in 3QCY19, due to lack of government projects and slow ordering from WAPDA distribution companies.
Margins During 3QCY19, gross margin declined slightly by 1ppts and stood at 24% (3QCY18: 25%). This is attributable to high raw material costs aggravated by rupee devaluation. The Company's largely passed on costs to the consumers. Impact of reduced marketing expenses by 15% was reflected in operating margin which remained stable at 13% during 3QCY19 (3QCY18: 13%). Moreover, a high interest rates burdened the Company with rising finance costs leading to a downward trend in net profit margin (3QCY19: 3.8%, 3QCY18: 5.6%). The Company posted a net income of PKR 870Mmln in 3QCY19 (3QCY18: PKR 1,322mln).
Sustainability Going forward, the Company's revenue stream is likely to benefit from new products; LED TVs and Washing Machine, as they gain footings. Similarly, power division is expected to benefit as government spending and projects are revived. The Company is looking at export front but the quantum remains small.

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). However, PEL displayed improved working capital management during 3QCY19 with net working capital days standing at 224 days (3QCY18: 229 days). This is primarily a factor of better receivable management and lower inventory. However, room for further improvement in working capital discipline exists. Moreover, sustained short-term cushion for borrowings of trade level provides comfort.
Coverages Lower cashflows and rising finance costs have put stress on coverages, which weakened overall. During 3QCY19, interest coverage shrunk to 1.7x as compared to 2.7x during 3QCY18. Similarly, core and total coverage also deteriorated (3QCY19: 0.8x, 3QCY18: 1.2x). Going forward, high interest rates are expected to keep coverages under stress.
Capitalization The Company's capital structure is represented by a debt-to-equity ratio of 33% during 3QCY19 (3QCY18: 40%). Total borrowings witnessed a decline of 15% during 3QCY19, on the back of reduction in short-term borrowings. Total debt is still dominated by short-term borrowings, representing 64% of the debt structure. The Company has issued a privately placed Sukuk-V, for working capital requirements. The Sukuk is worth PKR 1,200mln, at a discount rate of 3MK +150bps that will be redeemed at face value, with tenure of 15 months. This Sukuk is issued to finance working capital requirements of the Company.



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
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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	17,443	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	27,286	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)

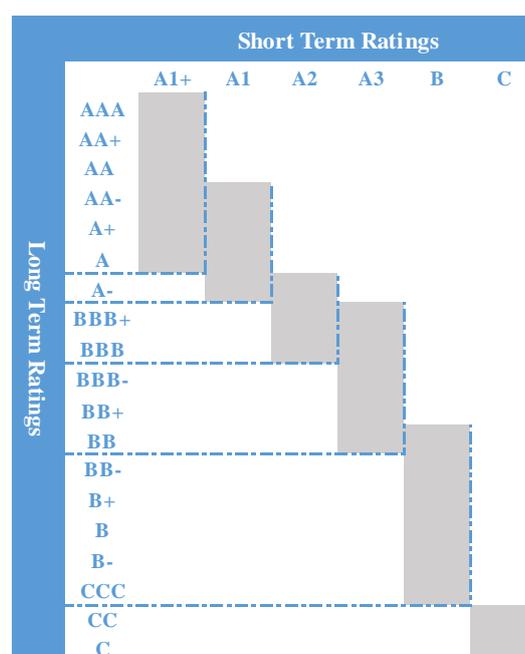
D RATIO ANALYSIS

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	1.2	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%	39.6%	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%	10.0%	9.0%	9.2%	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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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

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- (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)

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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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