



## The Pakistan Credit Rating Agency Limited

### Rating Report

#### Pak Elektron Limited | CP

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
22-Aug-2019	-	A1	Stable	Maintain	-
20-Feb-2019	-	A1	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. Pakistan's household appliances sector is largely dependent on imported 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 rating reflects PEL's diversified revenue stream and strong presence in Appliances and Power products market. The Company, by leveraging its brand, has continued to focus on enhancing product slate and revenues with introduction of new products (TV and Water Dispenser). The Company witnessed a contraction in margins as it was unable to fully pass on increased raw material costs in CY18. However, margins and an upward revision of prices during 1QCY19, provided some relief to margins and profitability. The Company's cashflows have remained under pressure and, coupled with larger quantum of borrowings, deteriorated coverage ratios. PEL's capital structure is characterized by intermediate leveraging 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 rising interest rates create further pressure on the Company. The Company has recently issued a Commercial Paper to finance working capital requirements and is 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 improving coverages, managing financial risk prudently and successful issuance of debt remains crucial for the rating.

#### Disclosure

<b>Name of Rated Entity</b>	Pak Elektron Limited   CP
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Methodology_Debt Instrument_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
<b>Related Research</b>	Sector Study   Household Appliances(Mar-19)
<b>Rating Analysts</b>	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 Saigol (~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 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 Saigol 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 Saigol 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 effectiveness oversight through Audit Committee and 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 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 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** The Company generates its revenue from two divisions, namely, Appliances (70%) and Power (30%). Revenue during CY18 stood at PKR 38,990mln, declining by ~8%, primarily due to sub-par performance by the power division and slowing demand. However an improvement was observed during 3MCY19 during which revenue totaled to ~PKR 8,575, increasing by 2%, YoY. Performance by the power sector continued to remain sluggish, registering a decline of ~4% due to slow ordering by WAPDA distribution companies. However, the appliances division, led by solid performance by refrigerators and split ACs, was able to increase revenues by 5%. Although slow demand led to the Company selling lower units across all products, upward revision of prices yielded positive results.

**Margins** Margins during CY18 remained depressed owing high raw material costs aggravated by rupee devaluation in conjunction with the Company's inability to pass costs on to consumers due to stiff competition. Gross margin during CY18 declined by 4ppts and stood at 25%. Similarly, impact of high production costs trickled down impacting operating margin by 4ppts also. An increase in prices during 3MCY19 helped the Company improved margins to ~27% in 3MCY19. The same impact was witnessed on the operating level which saw operating margin improve by 3ppts to 16%. Net profit margin during 3MCY19 remained under pressure at ~6% (3MCY18: 9%) owing to rising finance costs between high borrowings and substantial interest rate hikes.

**Sustainability** The Company's revenue stream is likely to benefit from recently launched products (LED TVs and Water dispensers) which have supported revenues. Nonetheless, the Company is expected to face challenges as inflationary pressures (and resulting impact on disposable income) will dampen demand while new products will require time to develop and establish their presence. On the other hand, 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's working capital days remained elevated and stood at 286 days during 3MCY19 (CY18: 250 days) owing to high inventory levels ahead of its peak season (April - October) and trade receivables. However, the Company benefits from a healthy cushion to borrow additional funds, reflecting positively.

**Coverages** Coverage ratios have been under stress and have deteriorated owing to rising finance costs. A slight improvement was witnessed in 3MCY19 which saw interest coverage standing at 2.5x (CY18: 2.0x, 3MCY18: 3.5x) and total coverage standing at 1.2x (CY18: 1.0x, 3MCY18: 1.3x). Going forward, continuation of monetary tightening and higher quantum of borrowings is expected to keep coverage ratios under stress. Additionally, upcoming retirement of commercial paper, due in December, 2019, will add further pressure on coverage ratios.

**Capitalization** The Company has a leveraged capital structure represented by a debt-to-equity ratio of ~37% during 3MCY19. Total borrowings witnessed an increase of 14% during 3MCY19 over CY18 owing to long term financing obtained. Going forward, the Company is in the process of issuing a privately placed Sukuk, for working capital requirements, worth PKR 1,500mln, with a tenor of 15 months.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Pak Elektron Limited Household Appliances	Mar-19 3M	Dec-18 12M	Dec-17 12M	Dec-16 12M
<b>A BALANCE SHEET</b>				
1 Non-Current Assets	24,088	23,745	18,890	18,041
2 Investments	21	22	22	23
3 Related Party Exposure	5	7	9	26
4 Current Assets	28,656	28,325	24,995	22,236
a Inventories	10,889	10,786	8,150	7,846
b Trade Receivables	10,378	10,182	10,728	8,433
5 Total Assets	52,771	52,100	43,916	40,327
6 Current Liabilities	1,341	1,332	1,158	1,075
a Trade Payables	419	415	498	327
7 Borrowings	17,599	17,364	12,961	11,375
8 Related Party Exposure	450	450	450	450
9 Non-Current Liabilities	3,135	3,125	2,452	2,367
10 Net Assets	30,246	29,830	26,895	25,061
11 Shareholders' Equity	30,246	29,830	26,551	25,061
<b>B INCOME STATEMENT</b>				
1 Sales	6,616	28,445	31,000	26,834
a Cost of Good Sold	(4,846)	(21,448)	(21,884)	(18,550)
2 Gross Profit	1,770	6,997	9,116	8,284
a Operating Expenses	(722)	(3,289)	(3,802)	(2,512)
3 Operating Profit	1,048	3,709	5,314	5,772
a Non Operating Income	(17)	(48)	(164)	(155)
4 Profit or (Loss) before Interest and Tax	1,031	3,661	5,150	5,617
a Total Finance Cost	(575)	(2,103)	(1,547)	(1,497)
b Taxation	(39)	(186)	(295)	(450)
6 Net Income Or (Loss)	416	1,371	3,308	3,671
<b>C CASH FLOW STATEMENT</b>				
a Free Cash Flows from Operations (FCFO)	1,134	3,356	4,933	5,585
b Net Cash from Operating Activities before Working Capital Changes	623	1,942	3,789	4,381
c Changes in Working Capital	(273)	(2,032)	(1,941)	(2,358)
1 Net Cash provided by Operating Activities	350	(89)	1,849	2,023
2 Net Cash (Used in) or Available From Investing Activities	(563)	(3,375)	(2,223)	(2,356)
3 Net Cash (Used in) or Available From Financing Activities	233	3,451	307	308
4 Net Cash generated or (Used) during the period	19	(13)	(68)	(25)
<b>D RATIO ANALYSIS</b>				
1 Performance				
a Sales Growth (for the period)	-7.0%	-8.2%	15.5%	6.8%
b Gross Profit Margin	26.8%	24.6%	29.4%	30.9%
c Net Profit Margin	6.3%	4.8%	10.7%	13.7%
d Cash Conversion Efficiency (EBITDA/Sales)	18.2%	14.6%	18.7%	23.3%
e Return on Equity (ROE)	5.5%	4.9%	12.8%	16.5%
2 Working Capital Management				
a Gross Working Capital (Average Days)	291	256	207	226
b Net Working Capital (Average Days)	286	250	202	221
c Current Ratio (Total Current Assets/Total Current Liabilities)	21.4	21.3	21.6	20.7
3 Coverages				
a EBITDA / Finance Cost	2.7	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)	2.1	2.9	1.6	1.5
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	37.4%	37.4%	33.6%	32.1%
b Interest or Markup Payable (Days)	0.7	0.7	0.5	0.4
c Average Borrowing Rate	10.0%	10.5%	9.2%	8.8%



## Regulatory and Supplementary Disclosure

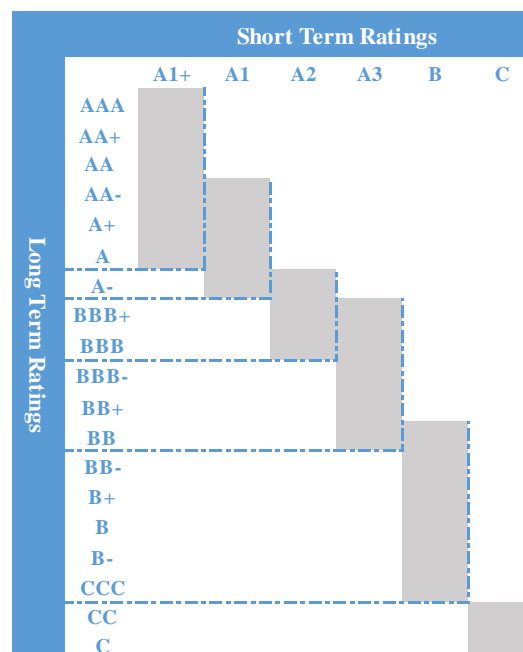
Sukuk	
Placement	Privately Placed Commercial Paper
Issue size	PKR 1,200mln
Issue date	21st March, 2019
Tenor	Nine (9) months
Profit Rate	9Months KIBOR + 125 bps .
Principal Repayment	Nine (9) months from issue date
Security	Unsecured
Trustee	Pak Brunei Investment Company Limited

Installment	Year	Due Date	Days	Principal	Mark Up	Total Installment	Outstanding Balance
----- PKR 000's -----							
0	2019	21-Mar-19	-	-	-	-	1,087,590
1	2019	16-Dec-19	254	1,087,590	112,410	1,200,000	-

## 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	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+	<b>Very high credit quality.</b> 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.
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A+	<b>High credit quality.</b> 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.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
A		C	An inadequate capacity to ensure timely repayment.
A-			
BBB+	<b>Good credit quality.</b> 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			
BBB-			
BB+	<b>Moderate risk.</b> 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.</b> 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			
B-			
CCC	<b>Very high credit risk.</b> 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.		
CC			
C			
D	Obligations are currently in default.		



<b>Outlook (Stable, Positive, Negative, Developing)</b> 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'.	<b>Rating Watch</b> 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.	<b>Suspension</b> 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.	<b>Withdrawn</b> 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.	<b>Harmonization</b> A change in rating due to revision in applicable methodology or underlying scale.
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- 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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- (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)
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(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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