The Pakistan Credit Rating Agency Limited

PAK ELEKTRON LIMITED

	UPDATE [DEC-16]	INITIAL [OCT-16]
Sukuk III	A+	A
Outlook	Stable	Stable

REPORT CONTENTS

DECEMBER 2016

Profile &Ownership
- Pak Elektron Limited (PEL), listed on Pakistan Stock Exchange, was established in 1956.
- Flagship Company of the Saigol Group (SG) engaged in manufacturing and sale of home appliances, and electrical and power equipment.
- PEL is majority owned by Saigol Group (50%), which has interests in energy and textile sectors.

Governance
- BoD comprises eleven members including six nominees of Saigol Group, three nominees of National Bank of Pakistan, and one nominee of Bank of Punjab and National Investment Trust Limited, each
- Nominees of Saigol group comprising three executive (including two family members) and three non-executive directors (including two family members)
- Mr. Naseem Saigol, a chemical engineer by profession, is the chairman of the board and the group

Management
- Organizational structure divided in two divisions; Appliances and Power
- Mr. Murad Saigol is Chief Executive Officer of the Company. In Oct-16 he was appointed for an additional three year term.
- Mr. Zeid Saigol is the Director Operations of Power Division.
- Mr. Manzar Hasan, the CFO of the Company, has ample experience with the Company, and is an integral part of the team.
- Experienced and stable management team.

Systems & Controls
- Successfully implemented Oracle Financials, Supply Chain, HR, and Payroll.
- Currently implementing Oracle Discrete Manufacturing, Business Intelligence, and Enterprise Asset Management.

Business Risk
- During 9MCY16, PEL witnessed a significant YoY growth of 24% in its topline
- Sales in the Appliances Division are dominated by Refrigerators (1HCY16: 79%; 1HCY15: 83%), followed by Air Conditioners (1HCY16: 10%; 1HCY14: 6%) and Deep Freezers (1HCY16: 9%; 1HCY15: 10%).
- Power Division's sales are spearheaded by Distribution Transformers (1HCY16: 48%; 1HCY15: 33%), followed by Power Transformers (1HCY16: 26%; 1HCY15: 16%) and Switch Gears (1HCY16: 17%; 1HCY15: 14%).
- The increase in topline did not translate into an increase in gross margins (9MCY16: 30.3%; 9MCY15: 32.5%).The lower margins were because of increased discounts provided to maintain market share.
- The financial charges also declined by 9.3% leading to a 13% increase in the Company's profit after tax (9MCY16: PKR 3,006; 9MCY15: PKR 2,660mln).
- The management would focus on increasing market share in its high margin products mainly refrigerators and air conditioners in appliances segment, and distribution transformers and energy meters in power segment.
- The Company is also targeting to bring its total debt down to Rs. 10bln by end-Dec 2018.

Financial Risk
- Significant working capital requirement; a facet of high inventory and receivable days (Net cash cycle: 9MCY16: 189 days; 9MCY15: 210 days)
- During 9MCY16, rise in pretax profit resulted in a slight increase in Company's FCFO (9MCY16: PKR 4,953mln; end-Sep15: PKR 4,856mln). These high cash flows provide significant debt coverage (1HCY16: 2.3x; 1HCY15: 1.9x).
- During CY16, the Company made a right issue of PKR 1,000mln at a premium of PKR 2,981mln. This, along with higher retained earnings resulted in a decline in debt to debt plus equity (net of revaluation surplus) to 35.6% (end-Dec15: 45.7%).

Sukuks
- Sukuk II was issued in Mar08 for PKR 1,100mln. The instrument has a life till March 2019. The profit on issue, payable quarterly, is at 3M Kibor + 100bps.
- PEL's Privately Placed Sukuk, having tenor of fifteen months, carries a profit rate of 3 months KIBOR plus 2.5%. Issued on 25th August 2016, the redemption will be at face value at the time of maturity on 24th November 2017.

RATING RATIONALE

The ratings reflect PEL's strong business profile in its respective markets - Appliances and Power - supplemented by its strong brand. The Company, while aiming to diversify its product base, has continued focus on improving quality and cost efficiency in its key revenue generating products. This resulted in higher sales volumes. The performance of the Company is well supported by healthy business margins. Improved profitability, in turn cash flows strengthened the Company's debt servicing ability; thus risk absorption capacity has beefed up. The company has relatively high working capital needs emanating from long inventory and receivable cycle expose the Company to financial risk. Lately, the management's focused efforts has provided relief and contained respective financial risk. Comfort is also drawn from sponsors' support to manage these needs (equity injection and retention of profits). Meanwhile, the Company has articulated an adequate debt management policy a) total debt would be restricted to 2.5 times of free cash flows [end-Sep16: 1.3] and b) short-term borrowings would not exceed 50% of net working capital needs [end-Sep16: 26%].

KEY RATING DRIVERS

Ratings take in to account improving business dynamics in Appliances and Power segments apart from the company's strengthening business risk profile. Increase in market share, with sustainable cashflows, would benefit the ratings. Meanwhile, close monitoring of working capital requirements and debt servicing capacity remain imperative to maintain the company's financial health; wherein, any deterioration would have negative implications.

PKR mln

Pak Elektron Limited (PEL)

BALANCE SHEET	30-Sep-16	31-Dec-15	31-Dec-14	31-Dec-13
	9MCY16	Annual	Annual	Annual
Non-Current Assets	**17,881**	**16,710**	**15,004**	**15,287**
Investments (Incl. associates)	**39**	**94**	**64**	**8**
Equity	21	9	8	8
Debt	-	-	-	-
Others	19	86	56	-
Current Assets	**21,974**	**19,345**	**17,459**	**11,848**
Inventory (including spares)	9,532	7,999	6,779	4,169
Trade Receivables	8,716	7,700	7,702	5,666
Others	3,726	3,646	2,978	2,013
Total Assets	**39,894**	**36,149**	**32,527**	**27,143**
Debt	**11,120**	**12,773**	**13,110**	**11,110**
Short-term	4,425	4,669	4,243	4,960
Long-term (Inlc. Current Maturity of long-term debt)	6,695	8,104	8,867	6,150
Other shortterm liabilities	1,654	1,076	1,382	2,400
Other Longterm Liabilities	2,334	2,305	2,440	2,474
Shareholder's Equity	**24,786**	**19,996**	**15,595**	**11,158**
Total Liabilities & Equity	**39,894**	**36,149**	**32,527**	**27,143**
INCOME STATEMENT				
Turnover	**5,653**	**6,315**	**4,816**	**16,469**
Gross Profit	1,738	1,315	1,470	4,055
Net Other Income	8	0	(103)	(9)
Financial Charges	(376)	(344)	(475)	(1,819)
Net Income	**741**	**220**	**627**	**607**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	4,953	5,468	5,024	3,064
Net Cash changes in Working Capital	(2,698)	(1,721)	(5,761)	(1,495)
Net Cash from Operating Activities	994	2,065	(3,484)	63
Net Cash from InvestingActivities	(1,660)	(2,537)	(495)	(394)
Net Cash from Financing Activities	678	710	4,041	393
Ratio Analysis				
Performance				
Turnover Growth	19.3%	22.4%	24.6%	-7.3%
Gross Margin	30.3%	29.6%	30.7%	24.6%
Net Margin	13.4%	11.5%	10.9%	3.7%
ROE	16.3%	14.7%	15.4%	5.4%
Coverages				
Interest Coverage (FCFO/Gross Interest)	4.1	3.3	2.7	1.7
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	2.1	1.5	1.5	1.4
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	2.1	1.5	1.5	1.4
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.3	2.1	2.8	4.9
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	189	213	189	195
Capital Structure (Total Debt/Total Debt+Equity)	31.0%	39.0%	45.7%	49.9%

STANDARD RATING SCALES & 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 or 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**. "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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, a suspended 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, or e) the entity/issuer defaults.

Regulatory and Supplementary Disclosure

Name of Issuer	Pak Elektron Limited
Name of Issue	Pak Elektron Limited | Sukuk III
Sector	Engineering
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
03-Dec-16	A	-	Stable	Upgrade
06-Oct-16	A	-	Stable	Initial
25-Mar-16	A-	-	Stable	Preliminary

Instrument Details

Nature of Instrument	Size of Issue (PKR mln)	Tenor (months)	Redemption	Security	Trustee
Sukuk III	1,072	15	The redemption will be at face value at the time of maturity on 24th November 2017 and profit payments are quarterly at 3 months KIBOR plus 2.5%.	Ranking charge over current assets of the issuer with 25% margin to be upgraded to first pari passu hypothecation charge within 180 days from the date of issuance.	AI Baraka Bank (Pakistan) Limited

Related Criteria and Research
Household Appliances Sector Study
Electrical Distribution Sector Study

Methodology: Corporate Rating Methodology

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Rating Team Statement

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