The Pakistan Credit Rating Agency Limited

MICROTECH INDUSTRIES (PRIVATE) LIMITED

	NEW [DEC-16]	INITIAL [MAR-16]
Entity		
Long Term	BBB+	BBB+
Short Term	A2	A2
Outlook	Stable	Stable

REPORT CONTENTS

DECEMBER 2016

Profile & Ownership

- MicroTech Industries (Private) Limited (MicroTech), incorporated in 2003, manufactures digital and smart meters and also provides indigenous smart metering energy solutions; significant market share in smart metering
- Majority (55%) owned by Saeed family – key sponsors – followed by Siddiqi family (45%)

Governance

- Limited board size. Two members board, both are shareholders and holds executive positions
- No segregation in the role of CEO & Chairman
- Need for improvement in governance structure to bring independent oversight and guidance to management strategy

Management

- The CEO and key shareholder – Mr. Nauman Saeed – is engineer by profession and carries over two decades of experience in the field of technology
- Well-designed organization structure with a long associated professional and experienced management team
- In-house Research and Development function

Operational Risk

- Adequate technology infrastructure (internally developed ERP); MIS reporting needs improvement
- A state of the art in-house Surface-Mount Technology to produce electronic circuits
- Accredited with ISO and IEC certifications

Performance

- Business model comprises tender based sales; hence price sensitivity is high
- Key challenge include delays in implementation of projects due to bureaucratic procedural inefficiencies
- In FY16, digital metering segment contributed ¬72% towards revenues (FY15: ¬34%), while the remaining attributed to smart meters. The change in topline mix is due to one-off smart meter IRG project in FY15
- Despite increase in number of meters sold, topline declined by ¬26% in FY16 on account of lower per unit price. Margins slashed owing to sale of lower margin digital meters
- Despite significant decline in finance cost YoY, profit before taxation declined by ¬55%
- Upcoming smart metering ADB projects – first phase US$480mln – a likely opportunity for business expansion
- MiroTech plans to augment its revenue base through diversification in related businesses. At the same time, focus is to reduce operational costs. In this regard installation of Injecting Molding plant is under process; CoD expected in Jan17. Furthermore, geographical diversification is on cards in medium term

Financial Risk

- Working capital requirements are a function of its receivables and inventory, for which the company relies on a mix of internal generation and STBs
- Receivables as a percentage of sales remained significant; hence cash days are stretched (end-Jun16: 91days, end-Jun15: 85days)
- Coverages, decreased YoY; though remained adequate (end-Jun16; interest: 1.8x, debt service: 1.4x)
- Low leveraged capital structure

RATING RATIONALE

The ratings reflect MicroTech's adequate business profile characterised by healthy market share in energy meter manufacturing segment. The company's key strength lies in its indigenous Research and Development infrastructure and an able management team spearheading the company's operations. Tender-based model exposes the company to i) concentration risk - single product and single buyer, and ii) volatility in revenue and margins. At the same time, inherent risks of procedural delays in awarding contract and price sensitivity remain. However, comfort is drawn from the company's currently favourable competitive position in high margin smart metering business, and sizeable business potential [particularly for smart meters] in local market, also unveiled by lately initiated foreign funded government projects focused towards infrastructure reforms. However, its translation in revenues may take time. MicroTech is eyeing revenues augmentation through, i) expansion in existing capacity, though small, and ii) diversification in related business; installation of Injecting Molding plant is underway. The company's financial risk profile is adequate. The company's financial requirement emanate from its needs to fund its working capital (mainly receivables) and arranging requisite quantum of guarantees for soliciting business volumes. Current structure of bank limits provide reasonable support to the company's growth targets. However, participation in any new large project; expected to roll-out by the government over the medium-term, may require further capacities.

KEY RATING DRIVERS

The ratings are dependent on the company's ability to adapt to technological progression in its line of business to maintain its market position particularly in local industry. Proactive management of business affairs, thus sustaining margins, is imperative. Meanwhile, strengthening in governance structure is needed to improve independent oversight of board.

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Energy Meters

Financials (Summary)

PKR mln

Microtech Industries (Private) Limited

BALANCE SHEET	30-Jun-16	30-Jun-15	30-Jun-14
	Annual	Annual	Annual
Non-Current Assets	**446**	**381**	**472**
Investments (Incl. associates)	**-**	**50**	**-**
Equity	-	-	-
Debt	-	50	-
Current Assets	**723**	**887**	**763**
Inventory	173	197	180
Trade Receivables	303	499	414
Others	246	191	169
Total Assets	**1,169**	**1,318**	**1,235**
Debt	**179**	**263**	**214**
Short-term	146	234	198
Long-term (Inlc. Current Maturity of long-term debt)	32	29	16
Other shortterm liabilities	291	395	386
Other Longterm Liabilities	120	105	96
Shareholder's Equity	**579**	**555**	**539**
Total Liabilities & Equity	**1,169**	**1,318**	**1,235**
INCOME STATEMENT			
Turnover	**1,439**	**1,952**	**1,065**
Gross Profit	300	484	238
Net Other Income	(6)	(130)	4
Financial Charges	(37)	(89)	(70)
Net Income	**8**	**21**	**21**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	66	305	135
Net Cash changes in Working Capital	86	47	(164)
Net Cash from Operating Activities	115	263	(101)
Net Cash from InvestingActivities	(30)	(133)	(30)
Net Cash from Financing Activities	(106)	(164)	141
Ratio Analysis			
Performance			
Turnover Growth	-26.3%	83.3%	-7.4%
Gross Margin	20.8%	24.8%	22.3%
Net Margin	0.6%	1.1%	2.0%
ROE	1.3%	4.0%	4.2%
Coverages			
Interest Coverage (FCFO/Gross Interest)	1.8	3.4	1.9
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	1.5	3.1	1.7
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	1.5	3.1	1.7
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	1.1	0.1	0.2
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	91.2	85.0	143.9
Capital Structure (Total Debt/Total Debt+Equity)	23.6%	32.2%	44.2%

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STANDARD 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. This capacity is highly unlikely to be adversely affected by foreseeable events.
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-	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**Highly speculative.** Significant 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	**High default 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.

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 with in 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, 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, or e) the entity/issuer defaults.

Name of Issuer	MicroTech Industries (Private) Limited
Sector	Energy Meters
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
30-Dec-16	BBB+	A2	Stable	Maintain
07-Mar-16	BBB+	A2	Stable	Initial

Related Criteria and Research

Rating Methodology — Corporate Rating Methodology

Sector Research — Electrical Engineering | Viewpoint | Dec-16

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Rating Team Statement

Rating Procedure

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

Rating Shopping

PACRA maintains principle of integrity in seeking rating business.

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Conflict of Interest

PACRA, the analysts involved in the rating process, and members of its rating committee do not have any conflict of interest relating to the credit rating done by them

The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest

The analysts and members of the rating committees including the external members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA

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PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer

PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so

PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct

PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality

PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties

Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

Prohibition

Probability of Default (PD)

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