

RATING REPORT

EMCO Industries Limited (EMCO)

REPORT DATE:

December 5, 2023

RATING ANALYSTS:

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Rating Category	Latest Rating	Previous Rating
Entity	A-/A-2	A-/A-2
Rating Date	December 5, 2023	November 14, 2022
Rating Outlook	Stable	Stable
Rating Action	Reaffirmed	Reaffirmed

COMPANY INFORMATION

Incorporated in 1954	External auditors: Crowe Hussain Chaudhary & Co. Chartered Accountants
Public Listed Company	Chairman of the Board: Mr. Javid Shafiq Siddiqi
Key Stakeholders (with stake 5% or more):	Chief Executive Officer: Mr. Salem Rehman
<i>ICC. (Pvt) Limited – 8.4%</i>	
<i>Mr. Ahsan Subail Mannan – 7.7%</i>	
<i>Mr. Pervaiz Shafiq Siddiqi – 6.9%</i>	
<i>Mr. Javaid Shafiq Siddiqi – 6.9%</i>	
<i>Mrs. Amina Wadalawala – 6.8%</i>	
<i>Associated Engineers (Pvt.) Limited – 5.7%</i>	
<i>Mr. Muhammad Zulqarnain Mahmood Khan – 5.4%</i>	
<i>Mrs. Ayesha Noorani – 5.3%</i>	
<i>Mr. Usman Haq – 5.2%</i>	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2023)

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>**APPLICABLE RATING SCALE(S)**

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

EMCO Industries Limited (EMCO)

OVERVIEW OF THE INSTITUTION	RATING RATIONALE
<p>EMCO Industries was established in 1954 and is involved in production and sale of high/low porcelain-based insulators, switchgears, and substation products used in power sector.</p> <p>CEO Profile: Mr. Salem Rehman Mr. Rehman has been on the board of EMCO industries since 2010 and holds a Bachelor of Science degree in Industrial Engineering & Operations Management from Purdue University (Indiana, USA) and an MBA from INSEAD (France/Singapore).</p>	<p>Corporate Profile</p> <p>EMCO Industries Limited (“EMCO” or “the Company”) was incorporated as a Joint Stock Company in Pakistan on August 17, 1954, by the name of Electric Equipment Manufacturing Company (Private) Limited. Later, it was converted into a public company on August 20, 1983, and its name was changed to EMCO Industries Limited on September 12, 1983.</p> <p>The Company is involved in the production and sale of high/low porcelain-based insulators, switchgears, and substation products used in power sector.</p> <p>Key Rating Drivers</p> <p>Leading presence in the industry and strong clientele base provide comfort to ratings.</p> <p>EMCO Industries Limited maintains a market share of ~75% in the electrical equipment manufacturing industry of Pakistan. It only faces slight competition from import substitutions and smaller companies in the sector, which cater to the needs of private institutions. EMCO has recently expanded to produce high voltage porcelain insulators, switchgear and substation products to become the only local producer of this highly specialized product. This provides import substitution to electricity transmission and distribution companies in the country. The same is expected to support EMCO strengthen its foothold in the market.</p> <p>EMCO’s customer base includes government institutions and premium private sector electricity generation companies providing the Company with stable demand.</p> <p>In FY23, import restrictions imposed by the government of Pakistan affected EMCO’s production due to consequent detention and demurrage charges on imports. This inflated the landed costs of imported materials during the period. Sharp devaluation of PKR with high-energy rates further compounded pressure on manufacturing costs. Demand during the year was constrained by floods, as most infrastructural development projects were affected during this period. However, the rehabilitation of damaged electricity infrastructure supported sales in the latter half of FY23 and is expected to support demand in FY24 in addition to new projects.</p> <p>Profitability supported by its capital-intensive products, favorable pricing, and premium customer base.</p> <p>EMCO Industries Limited reported a 37% increase in its topline, rising to PKR 3.5 bln in FY23, (FY22: PKR 2.5 bln). This increase can be attributed to the Company’s ability to transfer inflationary pressure onto its customers coupled with improved sales of company’s high margin switchgear product. Consequently, gross margins increased to 27.2% (FY22: 23.6%) during the period under review.</p>

However, higher finance costs from heightened discount rates and increased debt drawdown for BMR projects constrained improvement in net margins. EMCO reported only a 0.14% decrease in net margins to 8.3% (FY22: 8.4%).

Going forward, management plans to adopt an export-oriented approach, which is expected to further support the Company's profitability.

Debt drawdown for BMR project resulted in capitalization metric deterioration.

EMCO's leverage and gearing ratio reported a marginal deterioration to 2.0x (FY22: 1.8x) and 1.2x (FY22: 1.1x) in FY23. This was mainly a result of the Company's BMR project to increase its insulator production capacity to 6,500 tonnes (FY22: 5,000 tonnes) in FY23 to cater to rising demand. In addition, due to higher working capital requirements the Company increased its short-term debt utilization in FY23.

Going forward, ratings will remain sensitive to the Company's ability to maintain its capitalization profile in line with assigned ratings.

Ratings draw support from the Company's healthy liquidity and coverage metrics.

The liquidity profile remained healthy with a current ratio of 1.6x, improving slightly from 1.5x in SPLY. However, much of the liquidity stems from stock in trade and trade debts with cash and bank balances reported at only PKR 18.4 mln (FY22: PKR 15.7 mln).

Meanwhile the coverage profile of the Company reported a decline with debt service coverage ratio (DSCR) eroding to 2.4x (FY22: 2.9x) during the year. This was despite an improvement in the funds from operations to PKR 490.8 mln (FY22: PKR 357 mln) on account of improved operating profits. The deterioration in the coverage profile is attributable to higher financial burden from the 825 bps increase in policy rates as well as higher debt utilization during the period. Meanwhile, with increased stock in trade and trade debt, short-term debt coverage strengthened to 2.3x (FY22: 2.0x).

Going forward, maintenance of the liquidity and coverage metrics commensurate of assigned ratings will be important rating considerations.

EMCO Industries Limited

Appendix I

FINANCIAL SUMMARY					
	(PKR Millions)				
BALANCE SHEET	FY19	FY20	FY21	FY22	FY23
Property, plant and equipment	1,149.3	1,362.7	1,887.9	2,398.4	2,814.4
Stock in Trade	449.8	610.4	594.2	760.0	1,241.0
Trade debts	533.5	366.1	593.1	624.1	749.0
Cash and bank balances	5.3	43.9	40.6	15.7	18.4
Total Assets	2,457.4	2,691.2	3,476.0	4,244.3	5,338.6
Trade and Other Payables	272.0	272.3	326.6	341.7	524.6
Long-term Debt (incl. current portion and lease liability)	303.9	283.6	213.0	349.5	719.2
Short-Term Borrowings	614.4	547.2	650.6	690.4	851.5
Total Debt	918.4	830.8	863.6	1,039.9	1,570.7
Total Liabilities	1,291.6	1,217.6	1,404.9	1,738.0	2,553.4
Paid up Capital	350.0	350.0	350.0	350.0	350.0
Equity (excl. Revaluation Surplus)	408.0	547.4	768.7	970.8	1,270.0
INCOME STATEMENT	FY19	FY20	FY21	FY22	FY23
Net Sales	1,385.9	1,598.0	2,077.3	2,586.3	3,545.5
Gross Profit	347.5	379.6	527.4	611.2	964.3
Operating Profit	170.3	255.0	333.9	350.8	644.4
Finance Costs	81.8	97.4	87.5	103.3	248.0
Profit Before Tax	138.7	163.1	279.8	278.0	419.9
Profit After Tax	144.5	117.9	201.9	217.0	292.9
RATIO ANALYSIS	FY19	FY20	FY21	FY22	FY23
Gross Margin (%)	25.1%	23.8%	25.4%	23.6%	27.2%
Net Margin (%)	10.4%	7.4%	9.7%	8.4%	8.3%
Funds from Operation (FFO)	242.9	229.3	354.4	357.1	490.8
FFO to Total Debt (%)	26.5%	27.6%	41.0%	34.3%	31.2%
FFO to Long Term Debt (%)	79.9%	80.9%	166.4%	102.2%	68.2%
Gearing (x)	2.3	1.5	1.1	1.1	1.2
Leverage (x)	3.2	2.2	1.8	1.8	2.0
Debt Servicing Coverage Ratio (x)	2.2	2.0	2.6	2.9	2.4
Current Ratio	1.2	1.4	1.4	1.5	1.6
(Stock in trade + trade debts) / STD (x)	1.6	1.8	1.8	2.0	2.3
Return on Average Assets (%)	6.0%	4.6%	6.5%	5.6%	6.1%
Return on Average Equity (%)	54.2%	24.7%	30.7%	24.9%	26.1%

REGULATORY DISCLOSURES				Appendix II	
Name of Rated Entity	EMCO Industries Limited				
Sector	Engineering				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	December 5, 2023	A-	A-2	Stable	Reaffirmed
	November 14, 2022	A-	A-2	Stable	Reaffirmed
	December 7, 2021	A-	A-2	Stable	Reaffirmed
	October 27, 2020	A-	A-2	Stable	Initial
Statement by the Rating Team	VIS, 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(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
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Due Diligence Meetings Conducted	S.No.	Name	Designation	Date	
	1.	Mr. Salem Rehman	Chief Executive Officer	November 17, 2023	
	2.	Mr. Riaz Ahmad	Chief Financial Officer		