RATING REPORT

Avanceon Limited (AL)

REPORT DATE:

October 29, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	BBB-	A-2
Rating Date	*30th Sep'19*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 2003	External auditors: EY Ford Rhodes & Co. Chartered Accountants
Public (listed) Limited Company	Chairman of the Board: Mr. Khalid Hameed Wain
Key Shareholders (with stake 5% or more):	CEO: Mr. Bakhtiar Hameed Wain
M. Bakhtiar Hameed Wain – 62.0%	
M. Amir Wain – 11.0%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Industrial Corporates (May 2019)   https://www.vis.com.pk/kc-meth.aspx

Avanceon Limited

OVERVIEW OF THE INSTITUTION

Avanceon Limited (AL) was incorporated as a private limited company in 2003 under the Companies Ordinance 1984 and was later converted to a public limited company in 2008. The company is primarily engaged in trading in products of automation and control equipment and provision of related technical services.

Profile of the Chairman

Mr. Khalid H. Wain has over four decades of international experience in electrical engineering, cost engineering, project management and business strategy.

Profile of the CEO

Mr. Bakhtiar Wain, a mechanical engineer by profession with over three decades of relevant experience in renowned global companies such as Exxon Chemicals, Fauji Fertilizer and ICI.

Financial Snapshot

Total Equity: end-1Q19:Rs. 2.9b; end-FY18: Rs. 2.8b; end-FY17: Rs. 2.6b

Assets: end-1Q19: Rs 3.8b; end-FY18: Rs. 3.7b; end-FY17: Rs 3.4b

Profit After Tax: 1Q18: Rs. 84m; FY18: Rs., 578m; FY17: Rs.462m

RATING RATIONALE

The ratings assigned to Avanceon Limited (AL) take into account the company's consolidated presence in highly skilled business segment along with its two subsidiaries in Dubai and Qatar and an associated under taking in USA involving provision of automation and control solutions. The ratings are driven by relatively high business risk profile of the company emanating from long collection period of receivables, typical in the business undertaken by the company; the same has also put a drag on company's liquidity indicators despite healthy gross margins. The ratings draw comfort from the company's long-term strategic alliances secured with renowned original equipment manufacturers all across the globe. The ratings incorporate minimal reliance of the company on long-term borrowings, low leverage indicators, strong corporate governance framework and adequate debt service converges. The ratings will remain dependent upon company's ability to timely recover the receivables funds coupled with maintenance of leverage indicators.

Key Rating Drivers:

Sales & Profitability: During FY18, the company's profitability showcased improvement, despite a decline in margins on account of sustained positive momentum in revenues, one time forex gain and rationalized finance cost. The slight growth in AL's revenue stream is a function of overall improved market penetration in the local market in securing higher quantum of projects and increase in product sales. On the other hand, revenue from aftermarket sales largely remained at prior year's level. The net sales were recorded at Rs. 1.3b (FY17: 1.3b) during FY18 with around two-thirds of the total sales directed in the local market with major customers comprising OMCs (Hascol, Shell, Attock) and Fast Moving Consumer Goods companies including Nestle. The company follows a Made to Order business model with around three month orders in hand at all times. Given imported raw material comprises majority of the production cost, the gross margins slightly declined during FY18 in line with increase in input raw material expense coupled with higher salaries and allowances given to production staff. Overall profitability indicators received a strong boost from one-off foreign exchange gain amounting to Rs. 442.2m reaped during FY18. Going forward, future profitability is contingent upon the projected growth in volumetric sales. Further, currency devaluation favorably impacting profitability remains given a sizable proportion of company's sales are made to export customers.

Liquidity: Over the past two years the liquidity profile of the company exhibited a volatile trend; given the improvement in profitability metrics during FY18 was largely driven by one-off event of higher exchange gain, the same did not translate into the liquidity indicators with Funds from Operations (FFO) recorded lower at Rs. 230.3m (FY17: Rs. 281.7m) during FY18 in line with reduced margins. Further, the accumulation of receivables overdue for more than a year has also put a drag on company's liquidity profile. Subsequently, the same has led to higher working capital requirement despite no sizable increase in scale of operations, therefore; short-term borrowings increased to Rs. 262.3m by end-1QFY19. However, on account of low quantum of long-term obligations carried on the balance sheet Debt Service Coverage Ratio (DSCR) and FFO/Long-Term Debt remain healthy at 2.7(x) (FY17: 4.6(x)) and 0.65x (FY17: 0.84x), during FY18 respectively. Current ratio remains well above 1x on a timeline basis. Stock in trade and trade debts at 7.22(x) at end-March'19 are well in excess of short-term borrowings. As per the aging of receivables, more than half fall into less than one year overdue category mainly affected by intercompany receivables. The delayed receivable recovery mainly from subsidiary company stems from the company's business model as it is involved in provision of services and has long-term contracts with clients entailing longer tenor for completion of projects. However, the same also indicates difficulty for associates in recovery of receivables from counter parties. Given the operations of the company are largely interlined with related parties and involve major intercompany transactions, therefore VIS has also looked into the consolidated numbers of the group.

Capitalization Structure: Total equity of the company increased on account of internal capital generation. The company's debt matrix primarily comprises short-term borrowings. Moreover, AL does not plan to raise long term financing in the foreseeable future. Short-term borrowings have been mobilized for working capital requirements and stood at Rs. 262.3m at end-FY18. At end-FY18, gearing and leverage ratio stood at 0.13(x) (FY17: 0.14(x)) and 0.33(x) (FY17: 0.34(x)), respectively. Given the business model with no equity injection planned by the sponsors in the foreseeable future, the leverage indicators are likely to remain at current levels. Despite expected positive impetus in earnings in line with sizable new projects in the pipeline, pressure on equity and liquidity profile is unlikely to be alleviated owing to significant growth in overdue receivables.

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Corporate Governance and Internal Controls: Board composition is considered adequate comprising seven members including two independent directors. Senior management team of the company comprises experienced resources having relevant experience in the industry. Moreover, the IT department maintains daily backup of data. Internal Audit department performs pre-audit regularly along with functional audits with the help of an Audit Manual. Consequently, Internal Audit, Information Technology functions and overall corporate governance of the company are considered adequate given status of a public limited company.

Avanceon Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*		*(Standalone)*	
BALANCE SHEET	**FY17**	**FY18**	**1Q19**
Property Plant and Equipment	274.2	325.9	320.9
Long Term Deposits	18.1	19.1	20.5
Investment in Subsidiary	473.7	482.2	482.2
Trade Debts	1,622.2	1,763.6	1,844.9
Prepayments and other Receivables	932.1	1,036.5	1,072.7
Cash & Bank Balances	54.8	17.4	32.3
Other Assets	48.1	50.0	49.9
Total Assets	3,423.2	3,694.7	3,823.4
Trade and Other Payables	480.0	209.1	252.1
Short Term Borrowings	221.3	248.9	262.3
Long-Term Borrowings *(Inc. current matur)*	114.5	103.5	91.5
Unpaid Dividend	74.0	283.1	283.0
Other liabilities	13.5	24.4	24.4
Tier-1 Equity	2,373.8	2,657.8	2,742.4
Total Equity	2,519.9	2,825.7	2,910.1
INCOME STATEMENT	**FY17**	**FY18**	**1Q19**
Net Sales	1,260.6	1,297.0	300.5
Gross Profit	481.6	471.9	112.9
Operating Profit	529.3	680.2	95.8
Profit After Tax	462.1	577.8	84.4
FFO	281.7	230.3	43.9
RATIO ANALYSIS	**FY17**	**FY18**	**1Q19**
Gross Margin (%)	38.2	36.4	37.6
Net Working Capital	1,838	2,084	2,162
FFO to Long-Term Debt	2.46	2.22	1.92
FFO to Total Debt (%)	0.84	0.65	0.50
Debt Servicing Coverage Ratio (x)	4.60	2.68	3.09
ROAA (%)	14.5	16.2	9.0
ROAE (%)	21.1	23.0	12.5
Gearing (x)	0.14	0.13	0.13
Debt Leverage (x)	0.38	0.33	0.33
Trade Debts + Inventory to ST Borrowings (x)	7.55	7.28	7.22

Avanceon Limited

Appendix II

FINANCIAL SUMMARY *(amounts in PKR millions)*		*(Consolidated)*	
BALANCE SHEET	**FY17**	**FY18**	**1Q19**
Property Plant and Equipment	277.1	337.1	333.6
Long Term Deposits	33.3	37.9	43.4
Investment in Subsidiary	599.3	746.1	753.6
Trade Debts	2,892.6	3,981.9	4,171.8
Prepayments and other Receivables	337.1	562.3	649.8
Cash & Bank Balances	-	1.3	1.3
Other Assets	457.6	326.9	435.7
Total Assets	4,597.0	5,993.5	6,389.2
Trade and Other Payables	1,280.3	1,766.2	2,192.2
Short Term Borrowings	339.6	312.1	326.0
Long-Term Borrowings *(Inc. current matur)*	116.0	110.1	97.6
Other liabilities	123.0	371.2	179.2
Tier-1 Equity	2,592.0	3,265.9	3,426.5
Total Equity	2,738.1	3,433.9	3,594.2
INCOME STATEMENT	**FY17**	**FY18**	**1Q19**
Net Sales	2,813.9	3,480.9	697.1
Gross Profit	974.7	1,012.3	263.5
Operating Profit	667.7	916.0	174.4
Profit After Tax	563.5	766.7	147.3
FFO	592.2	555.3	114.9
RATIO ANALYSIS	**FY17**	**FY18**	**1Q19**
Gross Margin (%)	34.6	29.1	37.8
Net Working Capital	1,949.5	2,466.4	2,605.6
FFO to Long-Term Debt	5.10	5.04	4.71
FFO to Total Debt (%)	1.30	1.32	1.08
Debt Servicing Coverage Ratio (x)	9.62	5.59	3.69
ROAA (%)	14.3	14.5	9.5
ROAE (%)	21.0	26.2	19.7
Gearing (x)	0.14	0.16	0.12
Debt Leverage (x)	0.57	1.00	0.87
Trade Debts + Inventory to ST Borrowings (x)	4.53	6.65	7.31

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix III

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix IV
Name of Rated Entity	Avanceon Limited
Sector	Automation and Control Systems
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30-09-2019	BBB-	A-2	Stable	Initial

Instrument Structure	N/A
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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