RATING REPORT

Allied Industries Hub (Pvt.) Limited

REPORT DATE:
June 28, 2019

RATING ANALYSTS:

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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	BBB	A-2
Rating Outlook	Stable	
Rating Date	*28th June 2019*	

COMPANY INFORMATION	
Incorporated in 1982	**External auditors:** Mushtaq & Co. Chartered Accountants
Private Limited Company	**Chief Executive Officer:** Mr. Imran Aftab
Key Shareholders(with stake 5% or more):	
Mr. Imran Aftab – 54.6%	
Mr. Naveed Aftab – 25.1%	
Mr. Danish Aftab – 8.3%	
Mr. Kamran Aftab – 8.1%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (May 2016)* ***http://www.vis.com.pk/docs/Corporate-Methodology-201605.pdf***

Allied Industries Hub (Pvt.) Limited

OVERVIEW OF THE INSTITUTION

Allied Industries Hub (Pvt.) Limited was incorporated in 1982 as a (Private) Limited entity. Financial Statements of the company for FY18 were audited by Mushtaq and Company Chartered Accountants

Profile of CEO

Mr Imran Aftab has been the CEO of AIHPL since 1998. He is also the Chairman of Allied Group.

RATING RATIONALE

Allied Industries Hub (Pvt.) Limited (AIHPL) was incorporated in 1981, as a part of Allied Group. The group comprises three companies: Allied Wires & Cables (Pvt) Ltd (AWCPL), Allied Industries Hub (Pvt.) Limited and Validus Engineering (Pvt.) Ltd. AIHPL and AWCPL are involved in the manufacturing of wires and cables; whereas Validus Engineering (Pvt.) Ltd manufactures power and distribution transformers. With an objective of forward vertical integration in the power and distribution sector, the group recently completed acquisition of Validus Engineering (Pvt.) Ltd. The group holds 69.32% shareholding in the company, while the remaining shareholding is vested with SAAS (Pvt.) Ltd.

AIHPL is principally involved in the manufacturing of copper rod, wires and cables. The company mainly deals in copper products, and caters a small proportion of aluminum market which is mostly order based.

Business risk profile is characterized by high competitive intensity; economic slowdown, currency devaluation and competition from undocumented sector are major impediments for growth of the industry. However, overall business risk profile is supported by stable and growing demand for wires & cables

Pakistani wiring & cable industry is characterized by significant competitive intensity with existence of few large players in the organized sector, and numerous small unorganized firms. Copper and aluminum are the two conductors used for manufacturing wires and cables. Hence volatility in prices of both these metals is a factor that affects prices of raw materials and margins of companies. Ability of the companies to pass the increase in prices of raw materials in the form of higher product prices depends upon the type of end-consumer. Sales to corporate clients are based on a formula as per which increases in prices of raw materials are automatically adjusted in the final prices. In case of retail clients, final product prices are increased gradually to the minimize the impact on final demand, while price increases cannot be passed on to the end-consumer in case of tender business due to imposition of no escalation clause during the price validity period which lasts from 90-150 days. The companies hedge their risk by procuring raw material in advance in case of tender business.

Demand for copper based wire and cables are estimated at around 150,000 metric tonnes per annum. Around 80% of the demand is catered by small unorganized firms, while the remaining demand is satisfied by the organized sector. AIHPL and Pakistan Cables Limited are the two leading players in case of copper based products, while Fast Cables and Newage cables are the leading manufacturers in case of aluminum based products.

Overall business risk profile is supported by stable and growing demand for wires & cables in the country from housing, energy, automotive, construction and other segments. However, intense market competition exists in the retail market segments from informal manufacturers in the unorganized sector operating domestically. VIS expects demand for wires & cables to remain stable over the medium term on account of favorable demand outlook for industries catered to. Moreover, with the government's recent efforts to document economy, share of the organized sector is expected to increase as tax burden on the undocumented sector will make their products more expensive.

Prominent market position and extensive experience of sponsors in the cable industry

The assigned ratings incorporate AIHPL's position as one of the top ten cable & wiring manufacturers in the country in terms of market share. Moreover, ratings draw comfort from experience and track record of the sponsors in the cable industry.

Diversified product portfolio and underutilized capacity indicates room to meet any future growth in demand. Manufacturing technology provides AIHPL a comparative advantage over its competitors in terms of cost

	FY16	FY17	FY18
Copper Rod /Wire			
Installed capacity (MT)	7,500.0	7,500.0	7,500.0
Actual production (MT)	1,606.1	1,652.2	1,733.2
Capacity utilization	**21.4%**	**22.0%**	**23.1%**
Enamelled. Copper Wire			
Installed capacity (MT)	1,400.0	1,400.0	1,400.0
Actual production (MT)	554.2	586.7	610.3
Capacity utilization	**39.6%**	**41.9%**	**43.6%**
Copper Wire Strip			
Installed capacity (MT)	300.0	300.0	300.0
Actual production (MT)	148.7	142.3	154.9
Capacity utilization	**49.6%**	**47.4%**	**51.6%**
PVC Cables			
Installed capacity (meters)	6,000,000	6,000,000	6,000,000
Actual production (meters)	2,246,212	2,397,844	2,566,410
Capacity utilization	**37.4%**	**40.0%**	**42.8%**

The company has dedicated plants for Copper Rod/ Wire, Enamelled. Copper, Copper Wire Strip and PVC Cables to cater to clients requirements. In case of aluminum based products, the company imports aluminum rod based on order size and subsequently converts it into wire and cables.

Copper rod is one of the primary raw materials to manufacture cables and wires. AIHPL has a melting furnace unit which uses sharp furnace technology that has the ability to manufacture (99.9% pure copper) copper rod by using copper scrap and copper cathode. This particular technology provides a competitive edge to AIHPL as it the sole owner of this technology in Pakistan. Utilization of copper scrap enables the company to manufacture product at a lower price vis-à-vis competitors.

Enamelled Copper wire is a raw material for every electrical appliance along with transformer industry. Copper wire strip is a basic raw material for transformer industry.

PVC is used in cables and wires for insulation, bedding and sheathing. The company has recently acquired PVC plant that processes granules to make PVC compound. Prior to the PVC plant, AIHPL use to import or locally procure the PVC compound.

Modest increase in revenue base during the last three years. Outlook on the sales is positive due to rising demand and government's efforts to document economy

Sales of the company have grown at a Compound Annual Growth Rate (CAGR) of 3.8% in the period from FY16-FY18. Net Sales of the company were reported at Rs. 863.5m (FY18: Rs. 1.5b; Rs. 1.5b (FY17: Rs. 1.4b; FY16: Rs. 1.3b) in HYFY19. Growth in net sales can be attributed to a combination of increase in average selling price and volumetric growth.

The company classifies its sales into three categories: Utility/Power, Corporate clients and end Consumer clients. Corporate clients formed the largest proportion of overall sales (45.9%) in HYFY19, followed by Utility/Power segment sales (35.5%), which include tender based business. In the last three fiscal years, the growth in corporate sales was the major driver for increase in overall sales. Concentration is witnessed in terms of client wise sales as top-5 clients accounted for 71.2% (FY18: 61.1%: FY18: 61.1%, FY17: 61.9%; FY16: 62.4%) of total gross sales in HYFY19. Some of the largest buyers include K-Electric, Pak Electron Ltd., and Pakistan WAPDA Foundation. Around 5-7% of the total gross sales constitute sales to group companies.

Going forward, the management is projecting healthy growth in topline due to growth in demand, especially from the power sector. Moreover, with forward vertical integration, the management is also expecting notable increase in sales of enamelled wire and copper strips to the group company, Validus Engineering, as copper wire and cables constitute approximately 40% of the cost of a transformer. Management is also planning to target export market as recent currency devaluation has made the products of AHIPL more attractive to foreign clients. Lastly, government's efforts to document the economy may provide positive impetus to sales to retail clients.

Margins are comparable to peer companies; operational efficiency, pricing strategy and efficient procurement are considered important in view of the rising competition

Gross Margins of the company have improved on a timeline basis (HYFY19: 18.9%; FY18: 13.5%; FY17: 12.4%; FY16: 11.9%). The improvement in the margins can be associated with production efficiencies and efficient procurement of raw material. Raw material, primarily comprising imported copper cathodes, copper rod and copper scrap, represents more than 80% of the total cost of goods sold on average. Due to reliance on imported raw materials, AIHPL remains exposed to currency devaluation risk and volatility in metal prices. However, with recent currency devaluation, the company has been able to sustain its margins on account of greater dependence on locally procured copper scrap. Moreover, given the sizeable proportion of corporate sales in overall sales mix, the management is able to pass the increase in prices of raw materials to the customers with a minimum lag. In case of tender business, the management hedges the price volatility risk by procuring raw material in advance. Hence, the impact of metal price volatility is also minimal on margins. Given the risk of inventory loss and prevalent volatility in base metal prices along with increasing competition, efficient procurement, operational efficiencies and pricing strategy are key drivers for gross margins.

Improvement in gross profit margins has translated improvement in net profit margin (HYFY19: 5.0%; FY18: 2.3%; FY17: 2.1%; FY16: 2.0%) on timeline basis, albeit at slower pace. Distribution cost, administrative expenses and other operating expenses have increased in line with sales growth. However, finance cost of the company has also trended upwards due to higher average short term borrowings to meet working capital requirements and increase in interest rates.

Capitalization and Funding

Equity base (excluding revaluation surplus) of the company has grown to Rs. 507.0 (FY18: Rs. 464.9m; FY17: Rs. 396.7m; FY16: Rs. 342.3m) at end-HYFY19. Equity base (excluding revaluation surplus) of the company has increased on timeline basis primarily on account of profit retention and partly due to additional equity injection. Borrowings utilized by the company are short term in nature as the management utilizes debt for working capital needs only, while sponsor capital injects capital for any Capex requirements. Gearing and leverage ratios stood at 3.0x (FY18: 2.8x; FY17: 2.9x; FY16: 3.1x) and 3.7x (FY18: 3.7x; FY17: 3.8x; FY16: 4.5x), respectively. Leverage indicators have trended upwards during the last two years due to higher working capital requirements to maintain higher inventory level. Management has also recently acquired long term loan amounting to Rs. 270.0m for acquisition of Validus Engineering. Given the additional borrowing planned to be undertaken by management, cushion in debt servicing is projected to decline in the medium term but will remain at adequate level in the long term.

Liquidity

In line with enhanced earning profile, Fund Flow from Operations (FFO) has improved on timeline basis. Resultantly, FFO in relation to long term debt was also witnessed higher at 3.2x (FY18: 2.1x; FY17: 2.0x; FY16: 0.9x) while debt servicing coverage ratio equaled 1.9x (FY18: 1.8x; FY17: 1.3x; FY16: 1.5x) at end-HYFY19. Working capital cycle remains on the higher side on account of high Days Inventory Outstanding. Ageing of trade debts remains manageable. Current ratio is considered satisfactory as it remains above 1.0x (FY18: 1.08x; FY17: 1.04x). Stock in trade and trade debts also provide adequate coverage for short term borrowings.

Financial Summary (amounts in PKR millions)				Appendix I
	FY16	FY17	FY18	HYFY19
BALANCE SHEET				
Property, Plant and Equipment	555.7	541.7	1,025.3	1,033.0
Other Fixed Assets	43.3	43.3	43.3	43.6
Stock-in-Trade	799.0	864.0	949.3	1,026.1
Trade Debts	512.7	477.7	563.2	648.8
Cash & Bank Balances	60.3	45.5	45.6	70.6
Total Assets	2,072.3	2,085.4	2,697.8	2,878.0
Trade and Other Payables	333.8	243.5	261.2	231.3
Long Term Debt (including contingencies and commitments)	1.8	-	2.3	1.4
Short Term Debt	1,071.2	1,137.3	1,309.7	1,496.6
Total Debt	1,076.3	1,139.1	1,314.1	1,499.0
Total Liabilities	1,593.5	1,741.1	2,112.2	2,397.9
Total Equity (excluding revaluation)	342.3	396.7	464.9	507.0
Total Equity (including revaluation)	542.5	591.4	964.1	996.6
INCOME STATEMENT				
Net Sales	1,308.1	1,402.6	1,506.1	863.5
Gross Profit	155.4	174.0	203.4	162.8
Operating Profit	110.3	123.9	146.8	130.4
Profit After Tax	26.3	28.8	35.3	43.3
RATIO ANALYSIS				
Gross Margin (%)	11.9%	12.4%	13.5%	18.9%
Net Profit Margin	1.4%	1.4%	1.8%	3.8%
Net Working Capital	51.9	105.2	38.1	61.7
FFO to Total Debt (%)	4.3%	3.1%	7.0%	5.3%
FFO to Long Term Debt (%)	898.4%	1958.8%	2106.8%	3242.3%
Debt Servicing Coverage Ratio (x)	1.5	1.3	1.8	1.9
ROAA (%)	0.88%	0.94%	1.15%	2.33%
ROAE (%)	5.6%	5.3%	6.4%	13.4%
Gearing (x)	3.1	2.9	2.8	3.0
Leverage (x)	4.5	3.8	3.7	3.7

RATING SCALE & DEFINITION

Appendix II

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 III
Name of Rated Entity	Allied Industries Hub (Pvt.) Limited
Sector	Cable & Wire Manufacturing
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Rating History:

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