RATING REPORT

The Imperial Electric Company (Pvt.) Ltd. (IEC)

REPORT DATE:
February 6th, 2023

RATING ANALYSTS:

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RATING DETAILS		
	Initial Ratings	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-2
Rating Date	February 6th, 2023	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 1961	External Auditors: Riaz Ahmad, Saqib, Gohar & Co.
	Managing Director/CEO: Mr. Tahir Rehman
Private Limited Company	
Key Shareholders (with 5% stake or more):	
Mr. Usman Haq – 18.65%	
Mrs. Ayesha Noorani – 17.90%	
Mr. Tahir Rehman – 10.42%	
Mr. Salem Rehman – 10.04%	
Mr. Rafae Akbar Rehman – 10.04%	
Mr. Reza Rehman – 9.50%	
Mr. Hamza Rehman – 9.50%	
Mr. Tariq Rehman – 9.43%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Imperial Electric Company (Pvt.) Ltd. (IEC)

OVERVIEW OF THE INSTITUTION

IEC was incorporated in 1961 as a private limited company. It is involved in the manufacture, sale and installation of various types of electrical goods such as diesel generators, low-voltage circuit breakers, and lighting products. The head office and manufacturing plant are located in Lahore.

Profile of the CEO

Mr. Tahir Rehman holds a Bachelor's degree. He has over 4 decades of experience in the relevant industry

Financial Snapshot

Tier-1 Equity: end-FY22: Rs. 1.05b; end-FY21: Rs. 860.3m; end-FY20: Rs. 768.9m

Assets: end-FY22: Rs. 2.1b; end-FY21: Rs. 1.9b; end-FY20: Rs. 1.9b

Profit After Tax: FY22: Rs. 200.2m; FY21: Rs. 81.1m; FY20: Rs. 0.8m

RATING RATIONALE

IEC is primarily engaged in the manufacture, installation and after-sale services of diesel generators as well as the distribution of low-voltage (LV) electrical components, lighting products and airfield lighting systems for aviation industry. Despite being in bidding process, the company has relatively stable topline and gross margins. Contribution from the manufacturing division has decreased lately due to lower volumetric output resulting from issues pertaining to procurement of imported raw materials. According to the management, the company has shifted its focus on local raw materials to address the issue; the efficacy of the aforementioned initiative remains to be seen. While notable client concentration is present, the same is moderated through the long-term nature of contracts with customers.

The liquidity profile remained satisfactory owing to healthy cash flow coverages and effective working capital management. Capitalization levels remained sound as the company witnessed timeline improvement in internal capital generation whilst maintaining low debt levels. The company plans not to mobilize any long-term borrowings going forward as its production process is primarily labor-intensive. Meanwhile, IEC has recently acquired a wholly owned subsidiary, solar solutions company from own sources in order to tap solar energy market. The management expects notable contribution in the topline from the solar company from FY24 onwards. The related business risk is considered high to medium as the company has to mobilize business from bidding process. However, the associated risk is mitigated to a certain extent due to the company's long-standing contracts with renowned multinational telecom service providers. Going forward, the ratings will be sensitive to the company's ability to achieved projected topline performance whilst maintaining current capitalization and liquidity levels.

Lower capacity utilization in the outgoing year; long-term expansion of product portfolio into solar energy: IEC has a total production capacity of 46,950 KVA for its diesel generator division. Actual production decreased to 22,490 KVA (FY21: 29,540 KVA) with capacity utilization of 47.9% (FY21: 62.9%) due to difficulties in acquiring imported raw materials arising from restrictions in opening Letters of Credit (LCs) during 2HFY22. Breakdown for actual production and capacity utilization can be seen below:

Capacity Utilization			
	FY20	**FY21**	**FY22**
Production Capacity (KVA)	46,950	46,950	46,950
Actual Production (KVA)	11,632	29,540	22,490
Capacity Utilization (%)	24.8%	62.9%	47.9%

According to management, as the production primarily pertains to assembly and testing of equipment, therefore, no capex will be required in the foreseeable future. Meanwhile, the company's long-term expansion strategy is focused on enhancing its presence in the power generation sector by adding solar energy to its product portfolio through the acquisition of solar energy solutions provider, namely EBR Energy (Pvt.) Ltd. The company was acquired in Oct'22 as a wholly owned subsidiary for a sum of Rs. 190m from own sources.

The company has shareholding in associated companies, namely ICC (Pvt.) Ltd. and EMCO Industries Limited Ltd., of about 16.9% and 1.7% respectively (FY21: 16.9%, 1.7%). Textile Sourcing International (TSI), a dormant company - primarily engaged in business support activities - is a wholly owned subsidiary of IEC. The company has booked 100% impairment loss against investment in TSI.

Despite lower manufacturing revenue, slight increase in topline was witnessed due to higher contribution from aviation and low-voltage (LV) electrical components divisions; Gross margins remained largely stable: Net sales increased slightly to Rs. 2.3b (FY21: Rs. 2.2b) in the outgoing year. The manufacturing division majorly contributed to the topline, about 62.2% (FY21: 73.2%) followed by aviation and then low-voltage (LV) electrical components and lighting divisions. Net revenue generated from the manufacturing division witnessed a decrease to Rs. 1.4b in FY22 (FY21: Rs. 1.6b) owing to a 28.9% decrease in volumetric output to 22,490 KVA (FY21: 29,540 KVA) with issues pertaining to procurement of raw material mainly in the second half of the outgoing year. Contribution from low-voltage electrical components increased due to onboarding of a new vendor during the year while income generated from long-term contracts from aviation division also stood higher. Lighting division witnessed a slight decrease in net revenue. Division-wise breakdown can be seen below:

Division-Wise Revenue Breakdown				
	FY21		FY22	
Manufacturing	1,599.4	73.2%	1,443.8	62.2%
Aviation	333.2	15.3%	478.6	20.6%
LV Electrical Components	184.9	8.5%	343.5	14.8%
Lighting	66.3	3.0%	55.8	2.4%
Total	**2,183.9**	**100.0%**	**2,321.7**	**100.0%**

The company has a high client-concentration with 82.6% of revenue contributed by the top seven clients and 47.7% from one client. The associated risk is mitigated through the long-term nature of contracts with clients. Customer-wise breakdown of revenue is as below:

Customer-Wise Revenue Breakdown		
	FY22	
Deodar (Pvt.) Ltd./Jazz	1,107.8	47.7%
Huawei	331.1	14.3%
CCECC-Matracon-Habib Joint Venture	244.2	10.5%
ADB Safegate	155.1	6.7%
Sialkot Int. Airport Pvt. Ltd.	43.4	1.9%
Directorate of Procurement (Air)	29.7	1.3%
Civil Aviation Authority	6.0	0.3%
Other (various customers)	404.5	17.4%
Total	**2,321.7**	**100%**

Gross profit increased in the outgoing year to Rs. 531.7m (FY21: Rs. 491.6m) while gross margin remained relatively stable at 22.9% (FY21: 22.5%). Cost of revenue and services amounted to Rs. 1.8b (FY21: Rs. 1.7b) and consisted primarily of raw materials which constitutes 83.4% (FY21: 90.6%) of cost of goods manufactured. According to the management, about 70% of total raw materials costs pertained to imported components which exposes the company to exchange rate risk. However, in the outgoing year, this risk was mitigated through the management's shift in focus to the procurement of local supplies for the majority of the imported components despite an approximate 10-12% price differential to relieve supply pressure owing to difficulty in opening of imported Letters of Credit (LCs). Additionally, expenses other than material cost contribute notably to total cost of revenue and services, is 16.4% and 16%, respectively (FY21: 17.5%, 5.3%).

Administrative and distribution expenses increased in FY22 to Rs. 104.8m and Rs. 108.5m, respectively (FY21: Rs. 78.3m, Rs. 103.8m) on the account of inflationary pressure. Finance cost decreased to Rs. 27.8m (FY21: Rs. 35.6m) owing to lower borrowings. Other expenses increased to Rs. 30.3m (FY21: Rs. 16.8m) primarily due to impairment charged against long-term investment amounting Rs. 7.5m. Other income also increased to Rs. 93.2m (FY21: Rs. 59.5m) mainly on the back of foreign exchange gains. Moreover, share of loss from investment in associates was lower at Rs. (87.5)m (FY21: Rs. (185.7)m) largely due to reduction in losses pertaining to ICC (Pvt.) Ltd. amounting Rs. (91.1)m (FY21: Rs. (185.1)m).

During HY23, the company generated net revenue of Rs. 700m and is targeting Rs. 2.5b in FY23 out of which Rs. 550m will be related to trading income pertaining to LV electrical components and lighting products. However, according to management, if current market conditions and difficulties in obtaining import LCs prevail, total net revenue could decrease to Rs. 1.7b in the ongoing year. Additionally, the company's current long-term contracts amount to Rs. 5.2b out of which Rs. 3b is already recognized as revenue. Moreover, the management is expecting considerable increase in revenues due to its solar energy segment in the following year, with net sales targeted at Rs. 3.5b during FY24.

Healthy liquidity position and adequate working capital management despite change witnessed in aging of receivables: The company's Funds from Operations (FFO) have been increasing on a timeline basis amounting to Rs. 316.9m (FY21: Rs. 252.3m) in FY22. With higher FFO and lower total borrowings, FFO to total debt stood higher at 2.25x (FY21: 1.02x). Debt coverage ratio remained significant at 5.31x (FY21: 6.63x).

Trade receivables stood at Rs. 396.1m (FY21: Rs. 412.3m); however, the aging schedule witnessed some changes in FY22. Receivables above between 60 days to 1 year increased to 22.9% (FY21: 0.5%) and due for greater than 1 year stood higher at 25.8% (FY21: 15.7%). Breakdown of receivables aging is as below:

Receivable and Contract Assets Ageing				
	FY21	%	**FY22**	%
Not past due	102.8	24.9%	145.5	36.7%
1-60 days	242.6	58.8%	57.7	14.6%
61 days - 1 year	2.2	0.5%	90.6	22.9%
>1 year (incl. impairment)	64.7	15.7%	102.3	25.8%
Total	**412.3**	**100%**	**396.2**	**100%**

According to management, the changes were primarily due to payment terms with one of the major clients, Huawei, which dictate that 10% of sales will be paid to the company after 26 months.

Additionally, clients were provided with longer credit terms for LV electrical components procured from a new vendor on-boarded during the outgoing year. Payment terms with clients are normally 30 to 75 days for sale and installation of goods as well as maintenance services while contracts pertaining to supply of electrical goods usually have terms of 30 to 90 days. Advances, prepayments and other receivables increased to Rs. 101.2m (FY21: Rs. 85.3m) mainly due to higher adjustable sales tax amounting to Rs. 47.9m (FY21: Rs. 17.6m). Stock-in-trade increased to Rs. 433.2m (FY21: Rs. 367.6m) with higher stock purchased for trading. Short-term investments amounting to Rs. 100m (FY21: nil) pertained to Term Deposit Certificates with a markup of 13.25% during FY22. Cash and bank balances stood at Rs. 12.7m (FY21: Rs. 4.6m).

Current ratio and short-term borrowing ratio remained sound at 2.36x and 6.87x (FY21: 2.09x, 3.85x) respectively. Net operating cycle, though deteriorated slightly in the outgoing year primarily on the account of lower inventory turnover, remained manageable relative to the industry.

Low level of gearing owing to equity expansion and decrease in borrowings: Tier-1 equity increased to Rs. 1.05b (FY21: Rs. 860.3m) primarily on the account of higher internal capital generation. The company paid cash dividend amounting to Rs. 15m (FY21: nil) in the outgoing year. Total liabilities decreased to Rs. 671.5m (FY21: 698.2m) mainly due to lower contract liabilities and decrease in borrowings. Payment terms with suppliers for raw materials are Letters of Credit (LC) for imported goods while local purchases are either on local LCs or 30-45 days.

Total borrowings amounted to Rs. 140.6m (FY21: Rs. 247.2m) mainly consisted of short-term debt which constituted 86% of overall debt mix. Short-term running finance facility and Murabaha finance facility have limits of Rs. 328m and Rs. 30m, respectively (FY21: Rs. 318m, Rs. 30m) with mark-up/profit of 3-6 months KIBOR plus 1-2.25%. Additionally, limit for non-funded facility from various commercial banks amounted to Rs. 444m. Long-term borrowings decreased to Rs. 19.7m (FY21: Rs. 52.8m), primarily consisted of current portion of long-term debt mobilized in the previous year's pertaining to SBP's Salaries and Wages Refinance Scheme. The management plans not to mobilize any long-term debt in the foreseeable future.

Both gearing and leverage indicators showcased continuing improvement on a timeline basis, and stood at 0.13x and 0.64x, respectively (FY21: 0.29x, 0.81x) at end-FY22. Moreover, gearing and leverage adjusted net of debt exhibited further improvement, amounting to 0.03x and 0.53x, respectively (FY21: 0.28x, 0.81x). The company is expected to maintain low leveraged capital structure, going forward.

The Imperial Electric Company (Pvt.) Ltd. (IEC) Appendix I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**30-Jun-20**	**30-Jun-21**	**30-Jun-22**
Non-Current Assets	867.5	773.4	712.0
Stock-in-Trade (incl. stores and spares)	378.6	367.6	435.2
Trade Debts	421.9	412.3	396.1
Advances, Prepayments and other Receivables	36.0	85.3	101.2
Cash & Bank Balances	71.0	4.6	12.7
Short-term Investments	-	-	100.0
Other Assets	147.9	257.7	342.3
Total Assets	**1,923.0**	**1,900.9**	**2,099.4**
Trade and Other Payables	287.4	248.1	334.9
Short Term Borrowings	394.8	194.3	121.0
Long-Term Borrowings *(Inc. current maturity)*	6.1	52.8	19.7
Other Liabilities	184.4	202.9	195.9
Paid Up Capital	75.0	75.0	75.0
Tier-1 Equity	768.9	860.3	1,049.2
Total Equity	1,050.3	1,202.8	1,427.9
INCOME STATEMENT	**30-Jun-20**	**30-Jun-21**	**30-Jun-22**
Net Sales	1,056.7	2,183.9	2,321.7
Gross Profit	293.4	491.6	531.7
Operating Profit	134.7	309.4	318.3
Profit Before Tax	(7.2)	134.9	266.0
Profit After Tax	0.8	81.1	200.2
FFO	76.6	252.3	316.9
RATIO ANALYSIS	**30-Jun-20**	**30-Jun-21**	**30-Jun-22**
Gross Margin (%)	27.8%	22.5%	22.9%
Net Margin (%)	0.1%	3.7%	8.6%
Net Working Capital	255.4	589.0	800.1
Current Ratio (x)	1.32	2.09	2.36
FFO to Long-Term Debt(x)	12.56	4.78	16.09
FFO to Total Debt (x)	0.19	1.02	2.25
Debt Servicing Coverage Ratio (x)	2.00	6.63	5.31
ROAA (%)	0.0%	4.2%	10.0%
ROAE (%)	0.1%	7.2%	15.2%
Gearing (x)	0.52	0.29	0.13
Debt Leverage (x)	1.14	0.81	0.64
(Stock in Trade+ Trade Debts) to Short-term Borrowings (x)	1.95	3.85	6.87
Cash Conversion Cycle (days)	146	84	100

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 III
Name of Rated Entity	The Imperial Electric Company (Pvt.) Ltd.
Sector	Electrical Equipment
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
February 6th, 2023	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Kashif Butt	CFO	5-Jan-2023
2	Mr. Khalid Latif	Snr. Manager Finance	5-Jan-2023