

PAKISTAN CABLE

MARKET VISTA

REP-019

PAEL: Dealing with a tough audience

- Reading annual accounts for PAEL, we prune our estimates based on abundant demand headwinds for both business segments, GMs caving-in to rising cost pressures and higher finance costs as the firm supplants working capital outflows with (now costlier) ST borrowing
- Moreover, dismal sales performance in CY19 crystallizes our soft outlook with macro headwinds, combined with additional constraints on the horizon (power tariff hikes, controlled public sector power outlays), keeping us tilted towards subdued earnings growth over the medium term
- On the cost side, subdued COGs headers and below the line expense elements allude to the firm suppressing expansionary (push based sales) efforts, where the launch of the LED TV segment was relatively muted and failed to garner demand
- Amending our estimates based on observed financial metrics in detailed accounts we map out a terse macro backdrop, reflected in stretched CY19/20 P/E of 10.3/7.1x, , where we find our TP of PkR 23.6/sh implies a Neutral stance
- We flag any pickup in public sector power spending and additional barriers to import of appliances as key developments which would make us re-visit our investment case.

CY18 accounts show a slowdown: Running a detailed analysis of the recently released annual accounts for PAEL, we prune our estimates for earnings growth CY18-21F Gross Sales/NPAT CAGR of 12.1/18.2%, cut due to: 1) demand headwinds for both business segments sapping topline sales growth (CY18 gross sales -8%YoY) expected to persist through till FY20 (FY19/20 gross sales growth assumed at 1.5/16.2%YoY), 2) drastic dip in GM to 24.6%, well below our forecasts over FY20-22 (FY20-22 average GM forecast lowered to 24.1% in CY18 vs. 26.7% previously), and 3) higher finance costs, as the firm balances working capital strains (PkR3.4bn in net working capital outflows for the year) with taking on short term borrowing (PkR5.6bn in additional ST borrowing) leading to sustained climb in finance cost.

Ali Asghar Poonawala
ali.poonawala@akdsecurities.net
111-253-111 Ext: 646



NEUTRAL

TARGET PRICE (PkR) **23.6** SHARE PRICE (PkR) **21.89**
 UPSIDE/DOWNSIDE **13.2%** DIV. YIELD **2.4%**

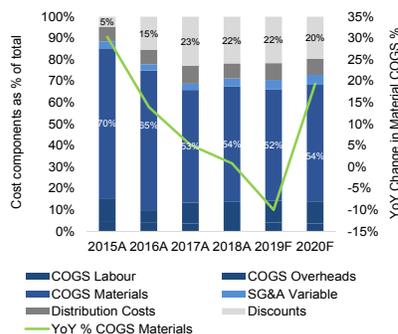
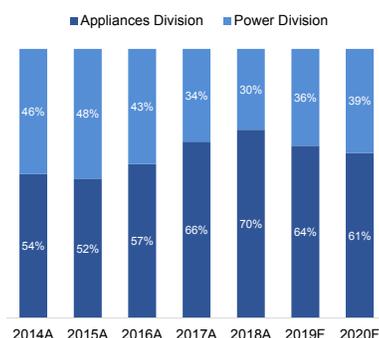
PAEL: Key Ratio

	CY18A	CY19F	CY20F
Gross Margin	24.6%	23.9%	23.3%
EBITDA Margin	15.9%	20.4%	18.6%
Net Profit Margin	4.8%	3.5%	4.6%
PER (x)	7.6	10.3	7.1
ROE (ex-Reval Surplus)	5.8%	4.0%	5.6%
BVS (PkR)	60.8	63.3	65.2
P/BVS(x)	0.3	0.3	0.3
DPS (PkR)	-	0.5	1.0

Source: Company Report & AKD Research

Power division in need of a rescue

...as higher inventory levels slowdown material COGS



Source: Company Accounts & AKD Research

Growth is unlikely to appear in the medium-term: Additionally, the firm contends with hefty headwinds, constraining demand over the medium term where dismal sales performance in CY19 crystallizes our soft outlook (rising fuel prices and PkR weakness raising inflationary dampeners to consumer durables demand), with appliance unit sales growth down for every category of goods sold (AC sales, a growth segment, witnessed ~26%YoY slide in quantity sold) while the same stagnation persisted in the power division (Switchgear sales growth the only surprise with ~45%YoY growth).



AKD Securities Limited

Curtailed costs are nothing to write home about: On the costs side, COG manufactured (down 4%YoY, constitutes 79% of COGS) was relatively constrained, considering the firm contended with a softening PkR and that ~80% of material COGS were imported. This control over material cost elements can be attributed to: 1) slowing demand leading to longer inventory lead times, where year-end devaluation impact is yet to be passed on, and 2) effective cost curtailment and reduced cost of duties on imported materials. Depreciation expense was also contained, where translations/adjustments were recorded, while below the line expenses were constrained as well. Additional variable cost elements including discounts, warranty expenses and wages were curtailed, where the launch of a new product segment (LED TVs) was completed in the period with minimal pickup in expense. Despite competitive pressures in stable market share segments (Refrigerators, Deep Freezer), PAEL's entry into the highly contested LED tv segment seems to have begun with a half-hearted effort, which is expected to pickup in CY19 as the firm expands its footprint in this market segment.

Working capital remains the Achilles heel: Working capital and balance sheet developments include: 1) inventory days averaging ~122x vs. ~94x in CY17, signifying PAEL's move to increase pricing lag for products i.e. greater space time for passing-on costlier inventory to product prices, 2) payables/receivables near levels seen in CY17 where the expansion of operations and efforts to penetrate the LED TV market in CY19 may introduce additional strains on working capital, and 3) paying down LT finances as per debt schedules, with PkR1.67bn cleared in CY18, where we expect the firm to approach lenders for a long term facility (with lower cost of borrowing) to minimize working capital strains and cut back on expensive ST borrowing.

Investment Perspective: Amending our estimates based on observed financial metrics in detailed accounts we map out a terse macro backdrop (at least till CY20) forecasting CY19/20 EPS of PkR2.02/2.93/sh. At current levels the stock trades at a stretched CY19/20 P/E of 10.3/7.1x, where we find our TP of PkR 23.6/sh implies a Neutral stance (upside of 15.6% inclusive of CY19 D/Y of 2.4%). Key developments we will be tracking to amend out estimates include: 1) pickup in public sector power spending, spurred by improved mechanism for implementing MYT in DISCOs, circular debt clearance at DISCO level and higher power tariffs and, 2) barriers to import of appliances, where imposition of RDs, CD would be welcome, while reduction of levies on import of kits for manufacturing would be positive (developments on FTAs also key).

PAEL: EPS Estimate

	CY19F	CY20	CY21F TP	(PkR)
Old EPS	3.15	4.25	5.85	28.20
New EPS	2.02	2.93	4.39	23.61
Change	-35.9%	-31.0%	-24.9%	-16.3%

Source: AKD Research

Disclosure Section

Neither the information nor any opinion expressed herein constitutes an offer or a solicitation of an offer to transact in any securities or other financial instrument and is for the personal information of the recipient containing general information only. AKD Securities Limited (hereinafter referred as AKDS) is not soliciting any action based upon it. This report is not intended to provide personal investment advice nor does it provide individually tailored investment advice. This report does not take into account the specific investment objectives, financial situation/financial circumstances and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. AKDS recommends that investors independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities or strategies discussed in this report may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Reports prepared by AKDS research personnel are based on public information. AKDS makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. Facts and views presented in this report have not been reviewed by and may not reflect information known to professionals in other business areas of AKDS including investment banking personnel. AKDS has established information barriers between certain business groups maintaining complete independence of this research report.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. Neither AKDS, nor any of its affiliates or their research analysts have any authority whatsoever to make any representation or warranty on behalf of the issuer(s). AKDS Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

We have taken all reasonable care to ensure that the information contained herein is accurate, up to date, and complies with all prevailing Pakistani legislations. However, no liability can be accepted for any errors or omissions, or for any loss resulting from the use of the information provided as any data and research material provided ahead of an investment decision are for information purposes only. We shall not be liable for any errors in the provision of this information, or for any actions taken in reliance thereon. We reserve the right to amend, alter, or withdraw any of the information contained in these pages at any time and without notice. No liability is accepted for such changes.

Stock Ratings

Investors should carefully read the definitions of all ratings used in each research report. In addition, research reports contain information carrying the analyst's view and investors should carefully read the entire research report and not infer its contents from the rating ascribed by the analyst. In any case, ratings or research should not be used or relied upon as investment advice. An investor's decision to buy, sell or hold a stock should depend on individual circumstances and other considerations. AKDS uses a three tier rating system: i) Buy, ii) Neutral and iii) Sell (new rating system effective Sep 10'18) with total returns (capital upside + dividend yield) benchmarked against the expected one year forward floating (variable) risk free rate (10yr PIB) plus risk premium.

New Rating Definitions

Buy	> 19% expected total return (Rf: 13% + Rp: 6%)
Neutral	> 13% to < 19% expected total return
Sell	< 13% expected total return (Rf: 13%)

Old Rating Definitions (Discontinued)

Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Analyst Certification of Independence

The analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

The research analysts, strategists or research associates principally having received compensation responsible for the preparation of this AKDS research report based upon various factors including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Disclosure of Interest Area

AKDS and the authoring analyst do not have any interest in any companies recommended in this research report irrespective of the fact that AKD Securities Limited may have, within the last three years, served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investment concerned or a related investment.

Regional Disclosures (Outside Pakistan)

The information provided in this report and the report itself is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject AKDS or its affiliates to any registration or licensing requirements within such jurisdiction or country.

Furthermore, all copyrights, patents, intellectual and other property in the information contained in this report are held by AKDS. No rights of any kind are licensed or assigned or shall otherwise pass to persons accessing this information. You may print copies of the report or information contained within herein for your own private non-commercial use only, provided that you do not change any copyright, trade mark or other proprietary notices. All other copying, reproducing, transmitting, distributing or displaying of material in this report (by any means and in whole or in part) is prohibited.

For the United States

Compliance Notice.

This research report prepared by AKD Securities Limited is distributed in the United States to Major US Institutional Investors (as defined in Rule 15a-6 under the Securities Exchange Act of 1934, as amended) only by Decker & Co, LLC, a broker-dealer registered in the US (registered under Section 15 of Securities Exchange Act of 1934, as amended). All responsibility for the distribution of this report by Decker & Co, LLC in the US shall be borne by Decker & Co, LLC. All resulting transactions by a US person or entity should be effected through a registered broker-dealer in the US. This report is not directed at you if AKD Securities Limited or Decker & Co, LLC is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that Decker & Co, LLC and AKD Securities Limited are permitted to provide research material concerning investment to you under relevant applicable legislations and regulations.