

**PACE PAKISTAN LIMITED (PACE)****RATINGS (APRIL 2007)**

PACE PAKISTAN LIMITED

ENTITY	NEW
Long Term	A+
Short Term	A1
PROPOSED TFC <i>Secured, listed</i> (PKR 1,500mln)	AA-

FINANCIAL DATA

PKR (mln)

	31-Dec-06*	30-Jun-06
Total Assets	3,557.0	2,638.9
Equity	2,230.0	1,489.8
Turnover	75.3	563.7
Gross profits	14.1	116.8
Net Income	121.3	327.0
Gross Margin	18.7%	20.7%
ROE	6.5%	24.7%
Net Debt / Equity	32.4%	49.1%

*Based on six months results.

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PROPOSED TFC ISSUE

PACE intends to issue its first secured TFC of PKR 1,500mln in the near-term for a tenure of 5 years. The profit payment is based on six months KIBOR plus 3% with no floor and cap. The principal repayment is in 6 semi-annual installments with first installment would be due at the end of 30th month from the date of issue. The issue is secured by first pari passu charge on assets (movable and immovable) by way of equitable mortgage of immovable properties and hypothecation of movable assets with 25% margin. Given the nature of security, PACRA assigns a rating of AA- (Double A minus) to the proposed TFC, that is, a one-notch higher rating than the long-term entity rating.

ASSESSMENT

- The ratings reflect the company's sound management structure and a well-conceived business strategy. The company, with its established niche in developing one-stop mega shopping malls, is embarked upon aggressive expansion into other dimensions of real estate development. Meanwhile, with an adequate capital structure and a portfolio of real estate assets, PACE possesses a sound risk absorption capacity.
- PACE is mainly engaged in a) development of real estate projects, b) generating rental income from real estate assets comprising retained properties in its own projects, and c) management of its projects subsequent to handing over to buyers. The company has completed three shopping malls and currently working on eight projects of diversified nature including shopping malls, office/residential tower, housing scheme and a multi-facility mega complex. However, over the medium-term, the focus of the management is to capitalize on its niche of developing and managing concept shopping malls with nationwide operations. The company undertakes its projects both directly and in association with other partners. To date, most of the company's projects are based in Lahore. Going forward, the management intends to expand its operations to other locations, starting with main cities in the province of Punjab and in Karachi. Over the longer term, the management intends to build a sizeable portfolio of investment properties. This would provide a substantial and stable income stream in the form of rentals. Meanwhile, following its aggressive expansion strategy, the company is considering a number of diversified new projects.
- The company recognizes revenue on delivery basis as against stage of completion, as the former policy is more tax efficient. However, because of this policy, the company's reported revenues depict a volatile pattern, with periods in which no projects are handed over reporting subdued profitability as reflected in 1H FY07. Nevertheless, the company, despite volatility in construction material prices, has managed gross margins of above 15%. However, the most critical factor in ensuring high margins is timely completion of a project, avoiding any undue cost over-runs. The management, being cognizant of the importance of this factor, puts greater emphasis on reviewing and properly planning all aspects of a given project prior to its formal launch. Meanwhile as against its previous practice of selling a larger portion of its projects at the time of launch, the management intends to follow a gradual sale pattern. This is expected to generate higher revenues because of the expected price escalation during the implementation stage of projects as per recent trends.
- Project planning at PACE is a comprehensive and analytical process. The company has developed in-house technical resources including engineers, architects and surveyors. For ensuring validity of legal title, PACE has separate land acquisition department. The company has in place an experienced project monitoring and execution team, who is responsible for achieving the desired quality while ensuring the completion of projects within budgeted costs and specified time line. In addition to this in-house infrastructure, the company also hires international and local consultants for planning, design and construction supervision from time to time.
- The company's cash flows relating to a particular project remain under stress prior to formal launch of the project due to initial investment in land and commencement of construction activity. However, once a project is launched, cash inflows in the form of installment payments by buyers are usually in excess of cash outflows. In the meantime, the company meets its funding requirements through short-term borrowings. Given the company's aggressive expansion strategy and its decision of gradual sale of its projects, the cash flows are expected to remain under stress. The management, recognizing the probable cash pattern, is in the process of raising long-term TFCs. Meanwhile, with increasing cash flows on account of installments from buyers, coverages are likely to remain at adequate levels. Moreover, comfort can be drawn from investment properties held by the company with market value of more than PKR 898mln at end-Dec-06, which can be sold to generate liquidity in any contingency.
- The company has a low-leveraged capital structure with total debt being less than 40% of the equity at end-06. Although the proposed borrowing would increase the gearing level, the company would continue to maintain a sound capital structure.

KEY RATING DRIVERS

- These ratings are dependent on effective implementation of the management's aggressive growth strategy while ensuring robust demand for its projects and maintaining its margins. This becomes more important, given PACE's gradual inroad into the areas of housing, office buildings and multi-facilities complexes, which with large number of established players – local and international – have high degree of competition. Meanwhile, the company's inability to attract the desired number of buyers for its upcoming projects and/or prolonged delay in completion of its projects would have negative implications for ratings.

PROFILE

- PACE Pakistan Limited, incorporated in 1992, was acquired by First Capital/Worldcall Group in 1998. The company has been listed on Karachi and Lahore stock exchanges since February 2007.
- PACE has a diverse shareholding pattern. Apart from First Capital/Worldcall Group (45%), Millennium Global High Yield Fund Limited (24%) is the other major shareholder of the company. First Capital/Worldcall group has interests in diversified businesses including telecom, financial services, insurance, media and real estate. Mr. Salmaan Taseer – the CEO of PACE – is a chartered accountant with senior management experience spanning over four decades.

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