

RATINGS (MAY 2010)

**PACE (PAKISTAN) LIMITED
(PACE)**

	NEW	PREVIOUS
Entity		
Long Term	A	A
Short Term	A1	A1
TFC		
PKR 1,500mln	A+	A+
SUKUK		
PKR 400mln	A+	A+
Outlook	Negative	-

FINANCIAL DATA

PKR (mln)

	1HFY10*	FY09	FY08
Total Assets	9,611	9,025	8,561
Equity	6,045	5,194	4,561
Turnover	759	1,262	1,531
Gross profits	93	317	526
Net Income	192	437	1,407
ROE %	6.8	8.9	36.3
Debt/Equity %	52.8	67.2	72.9

* Based on reviewed accounts for 6 months ended December 31, 2009

ANALYSTS

Ahmed Ali Ehsan
+92 42 586 9504
ahmed.ehsan@pacra.com

Sana Khan
+92 42 586 9504
sana.khan@pacra.com

TFC/SUKUK ISSUES

- Pace issued its first secured and listed TFCs of PKR 1,500mln in Feb-08 for a tenure of 5 years. The profit payment is based on six months KIBOR plus 1.5%. The principal repayment is in 6 semi-annual installments with first installment due in August 2010. 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.
- The company issued a sukuk of PKR 400mln for a period of 3.5 years (including 1 year grace period) in October 2009. The repayment of principal in 10 equal quarterly installments will start from January, 2011. The issue is secured by way equitable mortgage over specific properties located in Model Town Link Road and Gulberg II, Lahore with 25% margin.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect strong brand name of Pace in real estate sector – especially in its niche market of development and management of concept shopping malls – its established track record and sizeable investment properties. Furthermore, the management has diversified its project portfolio by venturing into housing and tower construction. The ratings incorporate the low leveraged capital structure of Pace. However, the cash flows of the company are under pressure due to the prevalent downturn in the real estate sector, which in turn, could impact Pace’s financial profile.
- The management’s ability to timely complete its ongoing projects and generate adequate cashflows through an effective sales strategy is crucial. Meanwhile, any merger or acquisition activity constraining Pace’s financial profile would negatively impact the ratings.

ASSESSMENT

- Real estate sector in Pakistan grew impressively in the last few years, in line with the benign economic environment, but has come under pressure lately. Various socio-economic factors, coupled with high cost of borrowing and limited credit expansion, have significantly impacted the demand. Moreover, the uncertainty regarding the depth of economic slowdown and worsening law and order situation has further dampened consumer sentiments. Thus, the business prospects of the sector, especially in the near term, are expected to remain subdued.
- Pace, since the launch of its first shopping mall in Gulberg, has completed five more similar concept shopping malls to date. Currently, in addition to a shopping mall (Pace Model Town Extension), the company is developing a residential project (Pace Woodlands) and office space (Pace Tower). The company engages team of reputed consultants and contractors for its various projects, while maintaining strong in-house project monitoring systems. During 2009, Pace underwent organizational restructuring to improve cost structure, resulting in consolidation of some job functions. This could potentially affect the control environment, especially considering the company’s broad project slate.
- During FY09, the turnover of the company decreased by 18% due to passive demand in the real estate sector. The gross margins also declined on account of inflationary pressures and higher proportion of the sale of lower margin residential units. Moreover, lower revaluation gain on investment properties (2009: PKR 472.9mln, 2008: PKR 1,245.4mln) and exchange loss suffered on foreign currency bond impacted profitability. The topline increased in 1HFY10 on the back of higher sales of Pace Woodlands’ houses and certain investment properties. However, as the fair value gains on the latter had been recognized in previous periods, the profitability was subdued in 1HFY10.
- During 1HFY10, Pace has increased its holding in Pace Barka Properties Limited (PBPL) (1HFY10: 38%, FY09: 20%), a group company. Although it is expected to yield synergies, significant cost needs to be incurred for the completion of PBPL’s main project, Pace Circle. Given the strong position of Pace in the group, it may be leveraged to lend support.
- The company plans to continue following its envisaged policy of holding investment properties in its projects (upto 30% of the saleable areas) to benefit from increasing property prices in the form of capital gains and to generate stable rental income. Moreover, it provides the company a source of liquidity in case of financial distress. The management intends to complete the current projects and expand its footprints by constructing more shopping malls in Lahore. In this regard, the company has selected Allama Iqbal Town and Shalimar Town as potential locations. Furthermore, the company also plans to start projects in Multan, Faisalabad, Rawalpindi and Sialkot.
- The completion of current projects has been delayed due to bearish trend in the real estate sector. Pace Model Town Extension and Pace Tower projects were initially planned to be completed in December 2009, however, completion dates have been revised to June 2010 and December 2010 respectively. In this regard, the total cost to be incurred on these projects amounts to around PKR 498mln. The resulting delay in sales receipts has affected the cash flows and coverages of the company. Coverages could be further impacted if the company’s cash flows continue to remain under pressure.
- The company has traditionally maintained a low-leveraged capital structure. However, to adjust to the prevalent operating environment, the company is launching sales in the latter stage of project completion with extended payment period and an incentive in certain cases. To bridge the funding gaps, Pace has started relying on borrowings to complete its ongoing projects.

PROFILE

- Pace (Pakistan) Limited (Pace), incorporated in 1992, was acquired by First Capital Group (FCG) in 1998. The company has been listed on Karachi and Lahore stock exchanges since February 2007. Pace has a diverse shareholding pattern. Apart from FCG (30%), Millennium Global High Yield Fund Limited (16%) – an overseas hedge fund – is the other major shareholder of the company. Mr. Hoqani – an Omani investor – alongwith Mr. Salmaan Taseer and associates, are key sponsors of FCG. The group has interests in diversified businesses, including financial services, media and real estate. Lately, FCG’s financial profile and franchise value has come under pressure.
- The Board of Directors of Pace comprises eight members. Mr. Salmaan Taseer – the CEO of Pace and Chairman of First Capital Group – is a Chartered Accountant by profession having senior management experience spanning over four decades. He is assisted by a team of qualified and experienced professionals.