



PRIME ELECTRONICS SECURITIZATION COMPANY LIMITED

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SECURITIZATION COMPANY
LIMITED (PESCL)

RATING (JUNE 2007)

Securitized TFC AA-
PKR 800mln

ANALYSTS

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TRANSACTION SUMMARY

- PESCL is a non bankruptcy-remote special purpose vehicle (SPV) incorporated under the Companies (Asset Backed Securitization) Rules, 1999. The SPV will acquire the right over future cashflows of Pak Elektron Limited (PEL) originating from the sales of transformers, energy meters, switchgears and other equipment to Water and Power Development Authority (WAPDA*), through inland LCs.
- The SPV will generate the funds required to purchase the right over LCs against WAPDA's purchase orders, through issuing term finance certificates. The transaction between PESCL and PEL will be a true sale. Payments to the TFC holders shall be made from collection against sales to WAPDA, assigned in the form of inland LCs to the SPV. The TFC will have a tenor of 5 years, carrying profit based on average ask rate of 6 months KIBOR plus 250bps, payable monthly. The principal will be redeemed in equal monthly instalments in arrears.
- PEL was incorporated as a public limited company in 1956, and is currently listed on all the stock exchanges in Pakistan. The company is a leading manufacturer of power equipment and domestic appliances. The power division primarily manufactures transformers, energy meters and switchgears, and major proportion of its sales are to WAPDA. The majority ownership in the company was acquired by Saigol Group in 1978, having diversified business interests in textiles, engineering, and energy sectors. PEL plans to utilize the funds raised through the TFC for expanding its business operations to meet the increasing demand in both the power equipment and home appliances market, and also for debt reprofiling.

RATING RATIONALE

- The cash flows to be generated from sale of equipment to WAPDA are considered very strong to allow PESCL to meet the contractual TFC obligations comfortably. The TFC is, therefore, assigned a rating of 'AA-' (Double A Minus) implying a very low expectation of credit risk emanating from a very strong capacity for timely redemption of TFC obligations. This opinion is based on evaluation of various risk factors as summarized below:
 - **Demand Risk:** The demand for electrical distributional equipment from WAPDA has increased substantially in recent years, attributable to the initiation of the much needed system revamping process, increasing power load, and notably enhanced focus on village electrification under Rural Electrification Programme of GoP. Given the ongoing continuation of these development programmes and considering the emphasis on replacement and up-gradation of exiting distribution network, the demand from WAPDA is likely to stay firm, going forward.
 - **Business Generation Risk:** PEL, despite a stiff competition amongst local manufacturers, has maintained its leading share in sale of transformers, energy meters and switchgears to WAPDA. This is attributable to the management's continuous initiatives for incorporating new technologies into existing production processes, product innovation and upgradation, inter alia to meet WAPDA's requirements, cost optimisation and strict quality standards. The availability of major raw material components at comparable prices internationally and the high freight costs involved in importing the power equipment products, adds to the competitive strength of the local industry against imported products.
 - **Performance Risk:** The capacity utilization at present is around 80-85% of the installed production capacity. Meanwhile, the management is planning sizeable capex in the coming years to meet the expected increase in demand. The company's prior track record in respect of timely deliveries to WAPDA has been satisfactory, due to adequate production capacity and effective and efficient production planning and control processes.
 - **Collection Risk:** As sales to WAPDA are made against inland LCs, the collection risk is minimal.
 - **Cash flow Risk:** The cashflows arising from sales to WAPDA provide a very strong coverage against payments under TFC obligations. Going forward, the coverage is likely to be further enhanced due to improving trend in sales to WAPDA and with gradual decrease in the outstanding amount of principal.
- The potential risk of timely repayment against TFC obligation is further mitigated by the following structural features of the TFC:
 - The SPV transaction imposes on PEL an affirmative covenant that the monthly securitized sales will atleast be equal to twice the amount of instalment due for any given month. Further, based on the estimated cash flows, a Reserve Fund, equal to three upcoming instalments, is to be created within the initial two months. This reserve mitigates the risk arising from any temporary disruption in the cash inflows.
 - The LCs at minimum equivalent to 50% of the total principal will be assigned to the trustees of the transaction, at the time of issuance of the TFCs. The LCs account will be enhanced by 10% at the beginning of the every 12 months period, going forward. In case WAPDA LCs are less than the required level, the funds received from WAPDA under assigned LCs will not be released to PEL, and will be retained in the Reserve Account, till the time assigned LCs are over and above the minimum required level. The above security arrangement provides high coverage of cashflows for TFC repayments and protects the cashflows from any prolonged decline in the amount of orders received. Meanwhile, the principal coverage is also enhanced over the term of the TFC.
 - If the mode of payment against sales to WAPDA is changed from LCs to any alternative form, the trustee will have the right to restructure the terms and conditions of the TFC for ensuring timely payment of TFC obligations. The revision, if any, shall be subject to the approval of the majority TFC holders.
 - In the event of any force majeure situation (as defined in purchase orders issued from WAPDA), resulting in undue delay in the performance of the contracts, the trustee can also restructure the terms and conditions of the TFC, subject to approval of the majority TFC holders.

* This includes the successor distribution companies, DISCOs.

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