

PAK ELEKTRON LIMITED (PEL)

- Delays in Payment of Interest on Sukuk Issues

1.1 PEL, incorporated in 1956, is principally engaged in manufacturing and sale of home appliances and power transformers. PEL is the flagship company of Saigol Group, which acquired majority shareholding in the company in 1978.

1.2 PACRA formed its first rating opinion on PEL in June 2006 and assigned a long-term entity rating of “A”.

The company issued a secured privately-placed Sukuk of PKR 1,200mln in September 2007, which was rated “A+”. This was followed by issue of the company’s second secured privately placed Sukuk of PKR 1, 100mln in June 2008, which was also assigned a rating of “A+”.

1.3 The company had an established position in the domestic appliances and power sectors. As both the segments had a separate consumption market, the business model of the company dictated a diversified revenue stream. In recent years, the company indulged in expansion activities keeping in view the increasing demand of transformers - a high margin business. The expansion was mainly financed through sizeable borrowing. The second Sukuk was primarily issued in this regard. The transformer factory started commercial operations in 2010. However, on account of hold up in the Distribution Transformer orders, a consequence of prolonged deliberations with WAPDA pertaining to design specifications, the company could not capitalize on this investment. Similarly, during 2010 pace of growth in Appliance division was slowed down due to delay in timely clearance of imported inventory. As a result, operating cashflows became negative. High leveraging and maturity mismatches in debt structure further aggravated these problems thereby, severely damaging PEL’s ability to meet its debt obligations on time.


1.4 Keeping in view these circumstances, the management entered into negotiations with all of its lenders to allow a two year grace period on its long term liabilities. The same was formally granted by all the lenders except NBP – the largest lender, wherein tacit consent was given but documentation was pending. PACRA deliberated on the developments and downgraded the long term and short term entity rating of the company “A-/A2 and Sukuk rating to “A”, while placing the ratings on “**Rating Watch**”. PACRA also communicated its decision in Jul-11 to keep the ratings on rating watch till finalization of ongoing debt rescheduling; wherein any disruption/variation would lead to further negative rating action.

1.5 As per PEL’s management, the whole restructuring was to be completed by end-Oct11. Furthermore, the management was of the view that the company would achieve cash break even by end-Oct11. Nevertheless, installments (comprising only the interest as the principal had been allowed an additional grace period of two years) against the two Sukuks due on Sep 28, 2011 and Sep 30, 2011, respectively, were delayed which were subsequently repaid within the forbearance period as per PACRA’s applicable default policy¹. PACRA, for the second time, downgraded the entity and sukuk ratings to ‘**BBB**’ and ‘**BBB+**’, respectively, on account of continuous pressure on the company’s financial profile mainly emanating from cash flow constraints, thereby impacting its debt servicing capacity. Meanwhile, the **Rating Watch** was intact till finalization of the rescheduling arrangements.

1.6 PEL continued to face significant liquidity constraints which translated into the company failing to timely honor its debt obligations. PEL defaulted on installments of Sukuk I and Sukuk II due on December 28, 2011 and December 31, 2011, respectively. The company was unable to arrange funds for repayment of these installments within the forbearance period (as per PACRA’s applicable default policy), which lapsed on January 13, 2012 and January 16, 2012. Consequently, PACRA downgraded the entity and Sukuk Ratings of PEL to “**D**”. The inability to timely honor these payments was attributed to significant liquidity constraints primarily driven by low business activity, and in turn, limited cash flows.

1.7 Currently, the company is making efforts to revive its operational profitability. In this regard, working on a two-pronged strategy is underway whereby i) additional working capital lines have been

	Jul-06	Jul-07	Jul-08	Aug-09	Jun-10	Jul-11	Oct-11	Jan-12	
AA-									AA-
A+									A+
A						RW			A
A-						RW			A-
BBB+							RW		BBB+
BBB							RW		BBB
BBB-									BBB-
BB+									BB+
BB									BB
BB-									BB-
B									B
C									C
SD/D									SD/D

Rating Watch RW Entity Ratings
 Negative Outlook  Instrument Ratings

¹ PACRA’s Default Policy is available on www.pacra.com.

arranged to add volumes to core operations, and ii) restructuring of long-term financial obligations (inclusive of principal and interest payment) on soft terms to provide breathing space is being discussed with lenders. A favorable outcome of the negotiations and revival of business operations to generate required liquidity may lead to revision of the ratings from its current level. PACRA will continue to monitor the developments and update its rating opinion accordingly.

1.8 As per PACRA’s Default Recognition Policy (“What is Default”), entity ratings, put on the default counter (whether D or SD), remain under surveillance on a best-effort basis and updated using both public and non-public sources, till the time the rating relationship is terminated either at the client’s request or made to terminate by PACRA on account of lack of information needed to continue surveillance on the ratings. Instruments, assigned a D rating, remain under surveillance (till fully settled) and are updated using both public and non-public sources, on a best effort basis.

Key References:

January 16, 2012	PACRA Downgrades Ratings of Pak Elektron Limited
October 7, 2011	PACRA Revises ratings of Pak Elektron Limited
July 8, 2011	PACRA Revises Ratings of Pak Elektron Limited

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