



PAKISTAN RESEARCH Real Estate Sector

BUY

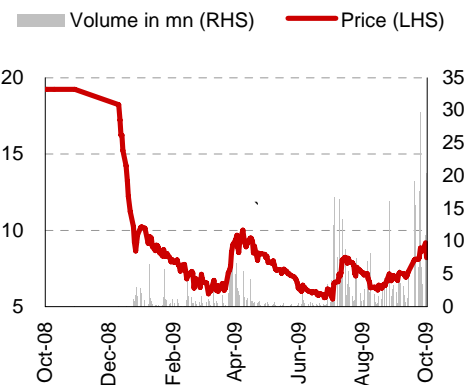
Target: 9.8 PKR

Current Price: 8.1 PKR

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Price and Volume Graph



Pace Pakistan Limited: Concrete Play

INVESTMENT SUMMARY

■ First listed local real estate company: Initiating coverage with a BUY

We initiate our coverage on Pace Pakistan Limited (PACE) with a fair value of PKR9.8/share offering an upside potential of 21% to current price. Growing from a company worth only PKR252mn in FY01, PACE has developed into a PKR8.6bn enterprise by FY08. The cornerstone of Pace's business strategy is to capitalize on the escalating demand for quality entertainment, hospitality, residential and commercial properties by developing shopping venues, office spaces, and residential/apartment buildings and hotels across Pakistan.

■ Playing the demographics

Pakistan has a population of over 163mn growing at an annual rate of 2%. The median age of the population is 22 years and 37% of the population is below 14 years of age. Urbanization is growing at 3.5% p.a. The demographic evolution of the country depicted in growing population and urbanization poses immense surge in the demand for housing units, recreational activities, health centers and education centers.

The attractive potential is expected to be largely capitalized upon by property developers going forward. The real estate boom post 9/11 saw an end in FY09 on account of decelerating GDP growth, depressed per capita income growth, lower FDI and stock market collapse. However, going forward, easing monetary cycle, recovery in private sector credit off take, improved FDI, increasing foreign remittances and improving growth outlook promise well for real estate prices.

■ Attractive valuations; Fair value at PKR9.8 with an upside potential of 21%

Backed by concerns on delays in construction projects, depressed real estate prices and absence of any triggers; the stock has largely underperformed the recent market rally. The stock is currently trading at FY10E PER of 1.7x which represents a discount of 370% to BMA Universe FY10E of 8.0x.

Pace's asset base is expected to grow 1.5 times during the next four years from PKR35/share to PKR52/share in FY12. We recommend a BUY with a DCF based fair value of PKR9.8/share

Financial

	FY08A	FY09E	FY10E	FY11E	FY12E
Net Sales (PKR mn)	1,461	1,492	1,899	1,033	567
EBIT (PKR mn)	1,700	1,009	1,469	1,664	1,798
Net Profit After Tax (PKR mn)	1,407	655	1,146	1,383	1,571
EPS (PKR)	5.81	2.71	4.74	5.71	6.49
EPS growth (%)	181%	-53%	75%	21%	14%
ROE (%)	36%	13%	20%	19%	18%
PER (x)	4.89	3.00	1.71	1.42	1.25
BVPS(x)	19	22	27	32	39
PBV(x)	1.50	0.37	0.30	0.25	0.21

Source: BMA Research

Bloomberg	PACE PA
Current Price	PKR 8.1/sh
Market Cap	PKR 1,962.6 mn
	USD 23.64 mn
Free Float	67%
Shares O/S mn	242.0
52 week High-Low	19.24/ 5.51



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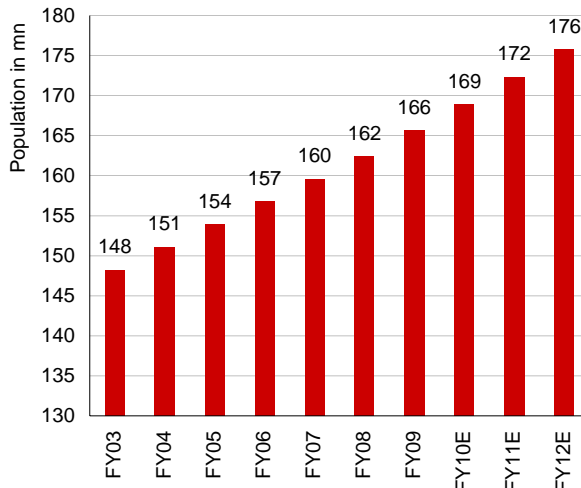
INVESTMENT RATIONALE

Constructive demographics for Infrastructure development:

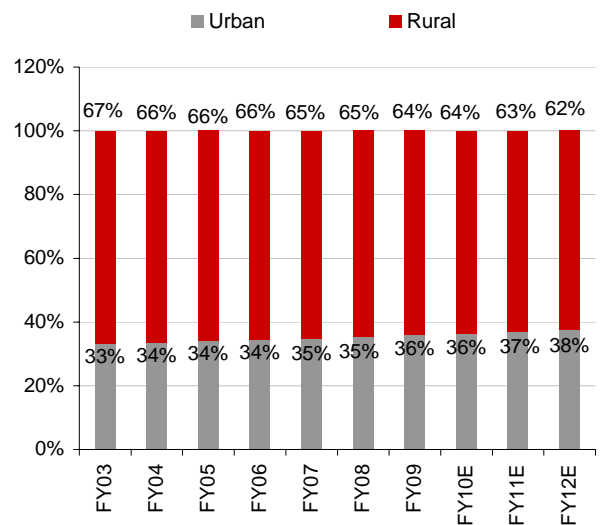
Pakistan has a population of over 163mn growing at an annual rate of 2%. The median age of the population is 22 years and 37% of the population is below 14years of age. The ongoing high population growth will take Pakistan's population to 194mn by the year 2020.

Urbanization is growing at 3.5% p.a. The country's burgeoning population, its stunning 2% annual growth rate, strong inward migration (rural-urban migration) and huge adolescent segment constitutes a population momentum that has serious implications for mounting demand of housing units, recreational activities, health centers and education centers. According to a report released by Federal Bureau of Statistics in 2005, there were nearly 19mn houses in the country for a population of 149mn people. The required number of housing units for the population was estimated at 25.8mn reflecting a shortfall of over 6mn housing units. This number is likely to have escalated to date. Consequently there is a lot of scope for heavy escalation in real estate business in Pakistan to meet this backlog. This opportunity is likely to be exploited by real estate developers.

Population



Urban/Rural Population



Source: Federal Bureau of Statistics, BMA Research

Real Estate crisis approaching closing stages

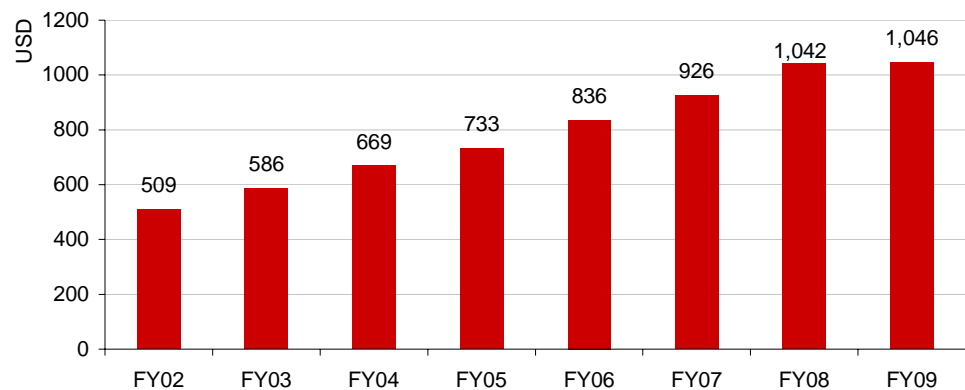
The real estate sector in Pakistan saw a boom post 9/11, on account of massive inward remittances, FDI, easy availability of credit and lax monetary policy. However in FY09, decelerating GDP growth, depressed per capita income growth, declining FDI and stock market collapse adversely hurt the real estate prices which posted a decline of about 25% on average.

Pakistan missed all its envisaged macroeconomic targets during FY09 owing to domestic and external shocks. The economy had began showing signs of a recession in FY08 which fully set-in in FY09 with GDP growth of only 2% during the



year. In FY09 the country received USD3.7bn in FDI which was 31 per cent less than the preceding year. Pakistan's per capita real income rose by mere 2.5 percent in the year as against 3.4 percent the previous year. Per capita income in dollar terms rose from USD1,042 in FY08 to USD1,046 in FY09, thereby showing marginal increase of 0.3 percent owing to slower economic growth and the depreciation of Pak rupee.

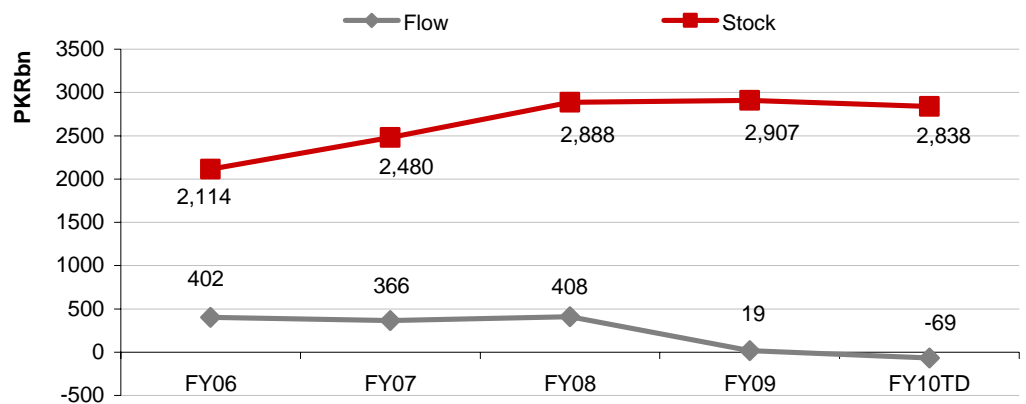
Per Capita Income



Source: Economic Survey, BMA Research

Furthermore, the decline in flow of private sector credit during FY09 depressingly impaired the real estate prices. The private sector off take declined on account of deteriorating macroeconomic condition, break down in law and order, persistent power outages, decline in international commodity prices, high interest rates and risk aversion by the banking sector. In prospect, lower interest rates, inter-bank liquidity, restoration of law and order and bridging of the power deficit are prone to improve credit off take; a positive impetus for real estate prices.

Credit to Private Sector

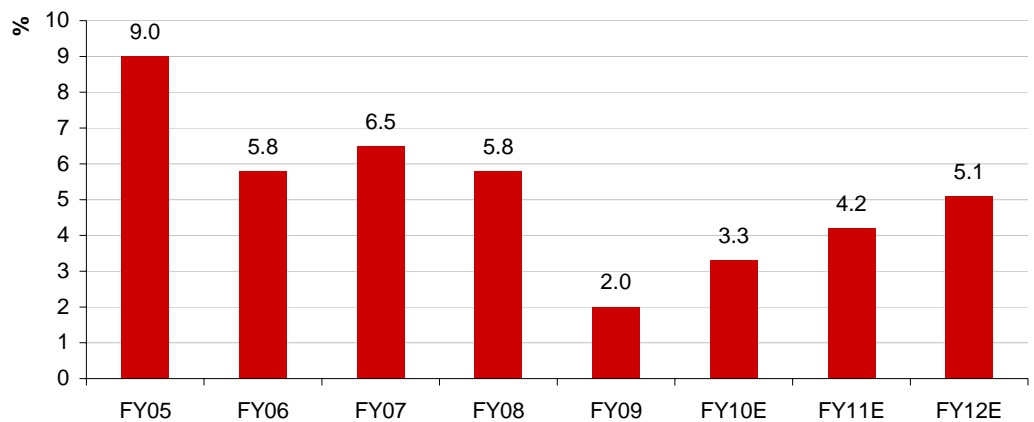


Source: Economic Survey, BMA Research



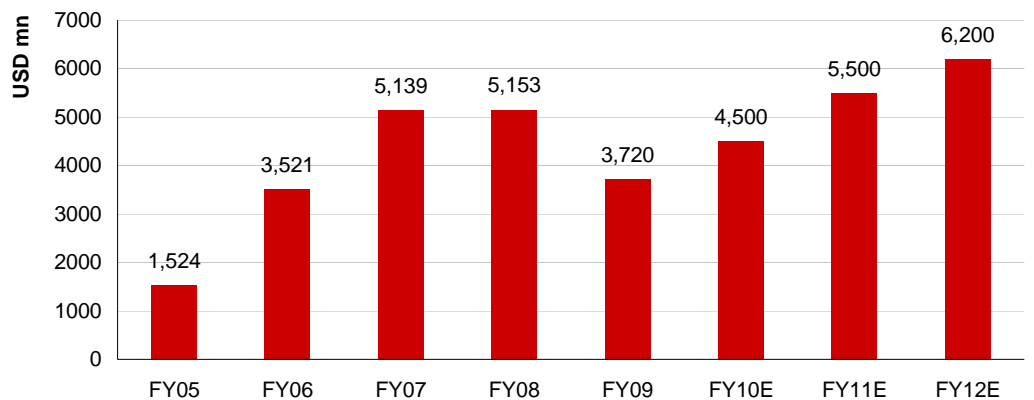
Furthermore, the domestic political and economic challenges, coupled with global asset price meltdown, had its impact on both the real estate as well as stock market of Pakistan. However revival in macroeconomic outlook and return of liquidity in the capital markets has resulted in 65% growth in KSE100 during 2009 and over 90% since Jan09 lows. With real estate market in Pakistan lacking liquidity and publicly quoted prices, we believe that it will take soon follow the revival in equity markets; albeit with a lag.

GDP Growth



Source: Economic Survey, BMA Research

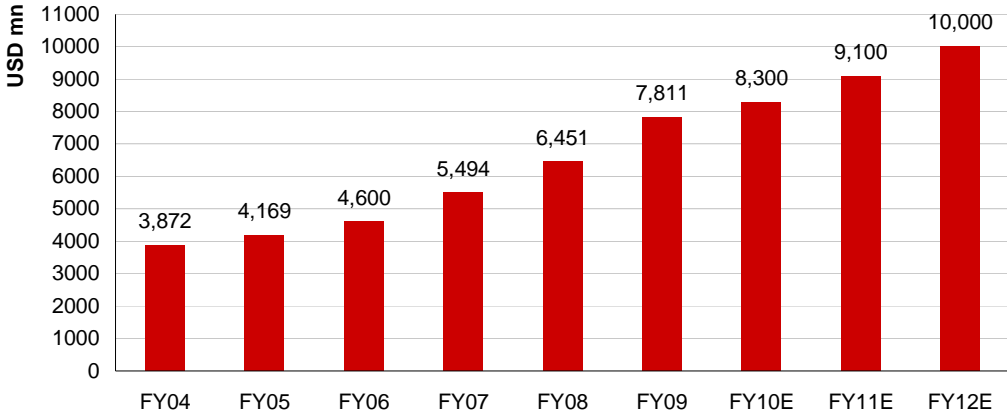
Foreign Direct Investment in Pakistan



Source: Economic Survey, BMA Research



Foreign Remittances to Pakistan



Source: Economic Survey, BMA Research

Unscathed Consumerism

Real private consumption rose by 5.2 percent in FY09 as against negative growth of 1.3 percent attained in FY08. PACE is positioned such that it caters to the upper middle class, which has a low elasticity of demand for consumer spending. The segment bears its resilience to the economic recession; consequently we do not come across significant decline in consumerism.



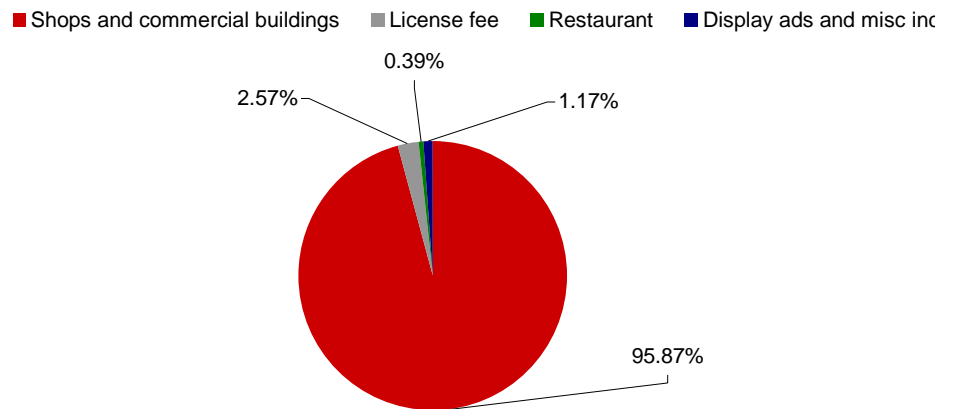
PACE PAKISTAN: BUSINESS MODEL

Revenue sources

The company is organized into four business segments:

- **Real Estate Sale:** development and sales of commercial buildings and shops
- **Investment Properties:** properties held to earn rentals or for capital appreciation or both
- **License fee:** revenue arising from licensing area to Sindbad Wonderland
- **Others:** businesses that individually do not meet the criteria of a reportable segment

Contribution to Revenue FY08



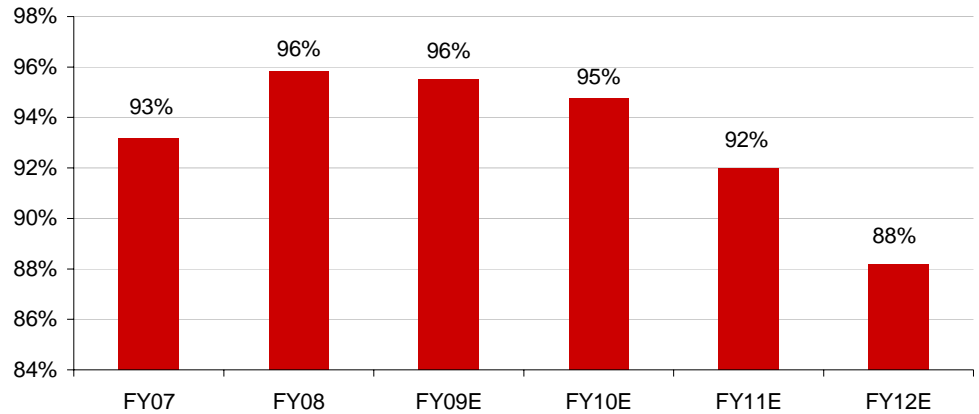
Source: Company Annual Report

Real Estate Sale: Principal business seeks potential

The core business of PACE is construction and development of shopping plazas, housing schemes, hotel complexes and office buildings, along with combination of the aforementioned. Revenue from completed projects, usually sold to retailers forms the major revenue stream for the company. The construction is administered by the company via consultants appointed for design and structure while civil works are consigned on the basis of open bidding. An associated company, by the name of Trident Construct (Pvt.) Limited, provides construction services for a large number of Pace's ventures.



Contribution of Real Estate Sale to Revenue (%)



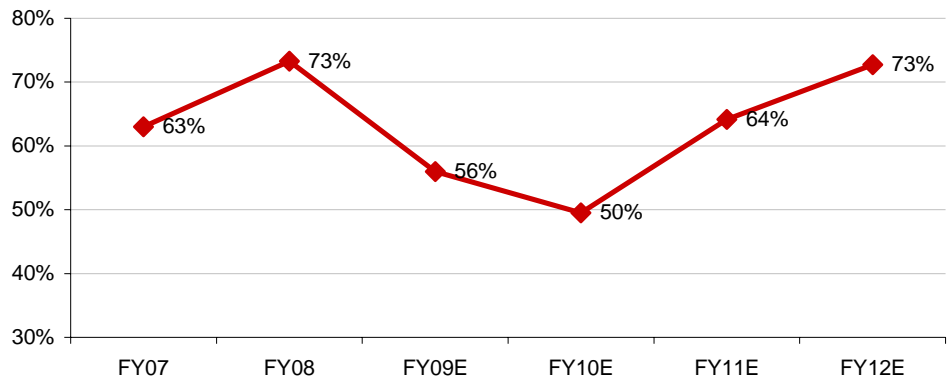
Source: BMA Research

■ **Investment Property:** Capital appreciation poised to boost bottom-line

Capital appreciation, one of the key contributors to the bottom-line, is earned when projects are completed and transferred from inventory to investment property. This is owing to the fact that inventory is carried at cost while investment property is recorded at market price which gives rise to fair value gain; transferred through the income statement to the balance sheet. Similarly, area already classified as investment property is marked to market after evaluation by professionally qualified independent property valuation experts.

The capital appreciation of the same also remains a major earning driver. The capital appreciation and fair value gains are not taxed until the property is disposed off. We expect property prices to rise again gradually beginning FY10 and we do not expect the company to sell off the investment property in the near future. Investment property is therefore expected to provide tax free fair value gains.

Change in Investment Property to EBIT



Source: BMA Research



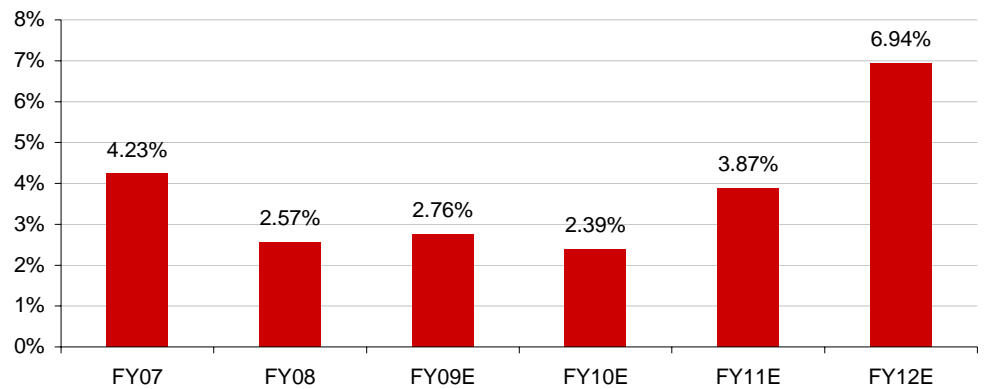
■ License fee : Augments Revenue

The company retains 10-15% of the malls/buildings for capital appreciation and license fee generation. License fee is mainly generated from two areas:

- The top floor is licensed to Sindbad Wonderland for setting up the amusement area. Restaurants are also set up on the same floor; however, its contribution to the total revenue is marginal, only 3% in FY08.
- The basement area is licensed to super-market operators for setting up a convenient store. The company generates fee as a percent of profits from the managing partner (the percentage may vary according to the location of the project).

We expect the license fee to post an annual growth of 10% on account of the fact that despite economic downturn; the upper middle class segment utilizing these facilities is least affected and has shown resilience.

Contribution of License Fee to Revenue %

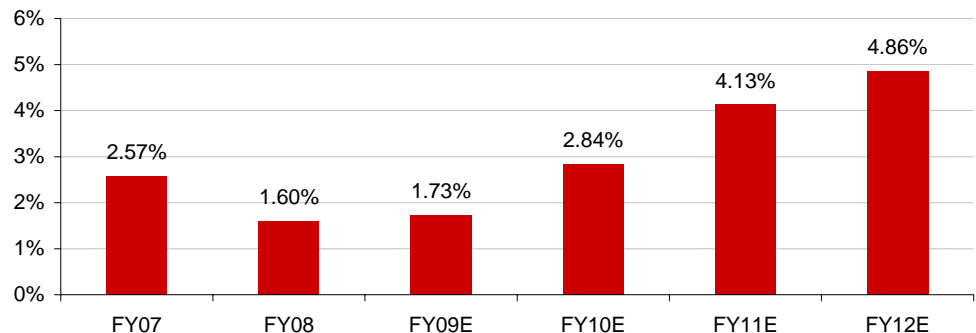


Source: BMA Research

■ Management / Service fee : Nominal

PACE retains management control of the buildings and charges service fee for electricity and other utility facilities from shop owners. This control is retained to preserve the quality and brand name of PACE projects.

Contribution of Service Income to Revenues



Source: BMA Research



PROJECTS IN PIPELINE

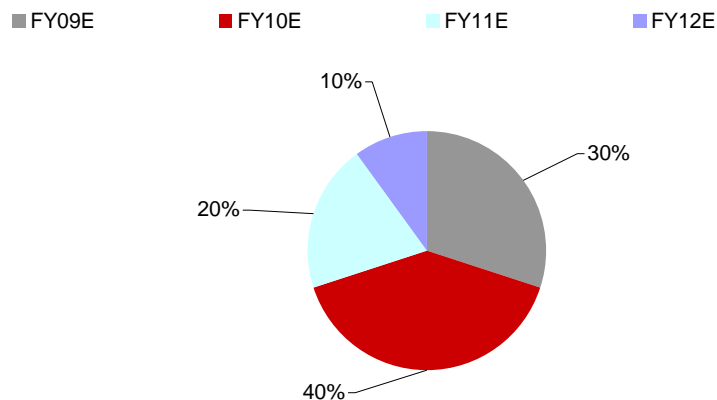
Pace Towers

Pace towers is a 24-storey building in Gulberg. The 24-storey building will have state-of-the-art facilities and comforts with five floors for offices and 104 luxurious apartments, including eight penthouses and two and three-bedroom luxury apartments. The total revenue expected to be fetched is PKR2.5bn whereas the company expects to earn an average gross margin of 35% on the project.

The current trend of designer outlets in Gulberg has led the company to revise its plans of utilizing five floors as office space. The company now intends to turn these floors reserved for offices into shopping mall/designer outlets which is expected to increase the net revenue by PKR950mn.

Pace Towers is expected to come online in FY10. We expect revenues from this project to follow the pattern shown below:

Pattern of Revenue Recognition



Source: BMA Research

Pace Model Town Extension

Pace Model Town Link Road shopping mall is the Company's second operational shopping mall in Lahore providing great shopping opportunities to more than two million customers per annum.

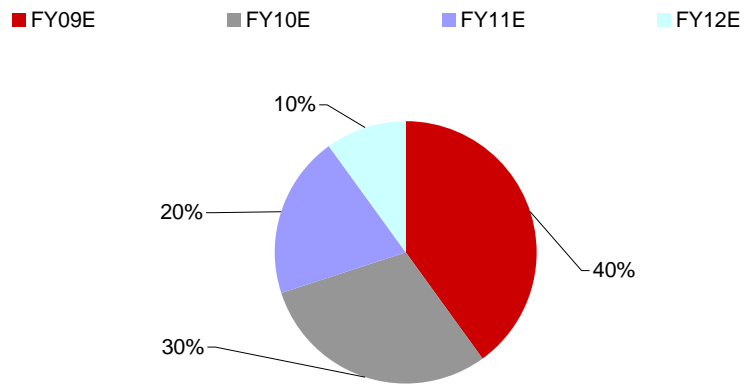
■ Extension to existing shopping mall

Considering the immense demand for additional shopping and entertainment area in the vicinity, the Company is developing an extension on a 4 Kanal land adjacent to the existing project. The extension to Model Town shopping Mall project shall house two basements for necessary parking and will be internally connected to the existing building.

The model town extension is expected to reap total revenues of PKR750mn for the company with an average gross margin of 35%. The project is projected to be completed by Dec09. We look ahead to revenues from the project to depict the following pattern:



Pattern of Revenue Recognition



Source: BMA Research

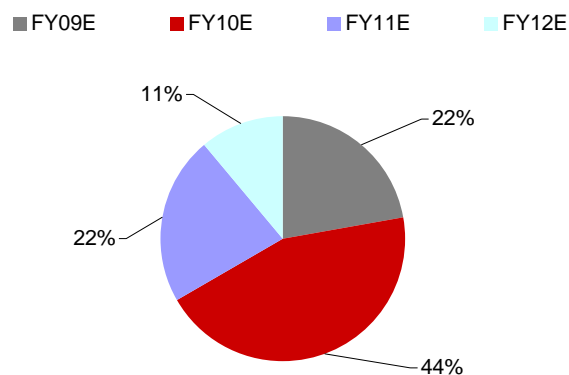
Pace Woodland

The company held 52% share in Pace Woodland and has taken over 90 houses out of 160 houses. The revenue fetched from each house is expected to be PKR7.5mn whereas the cost of each is about PKR5.5mn.

Pace Woodlands is a residential project designed for affordable luxuries. Away from the hustle of the city, yet just 1.5 km away from Phase V, DHA Lahore, it spreads over 20 acres of peaceful, lush green land area. Pace Woodlands is ready to welcome its residents in January of 2010.

More than 20 houses have already been sold during FY09 and we anticipate revenues from the project to show the following pattern:

Pattern of Revenue Recognition



Source: BMA Research



Some of the ambitious projects put on hold

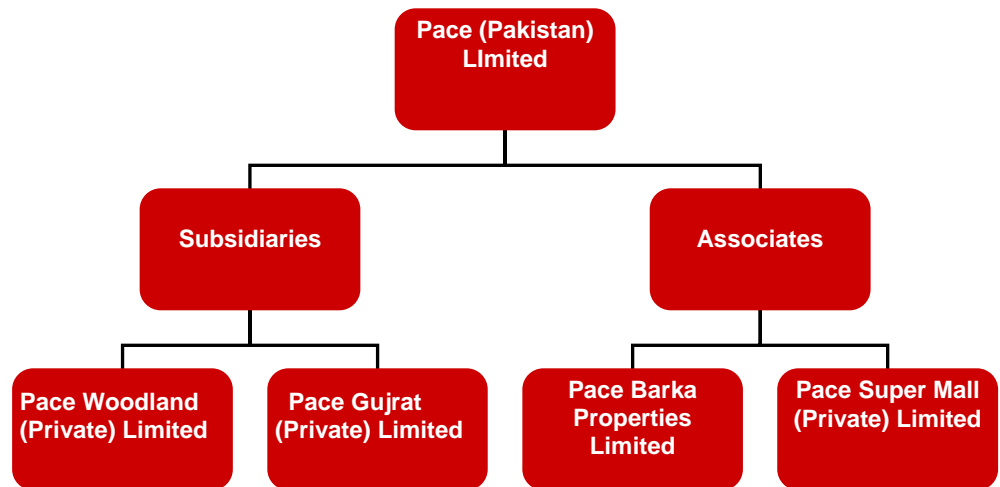
Keeping the current scenario in mind the company has currently shelved most of its planned projects and has opted to concentrate its efforts on completion of the ongoing projects. Karachi Multi-use project which was planned to be completed by 2010 has currently been sidelined owing to the slowdown in economy and the high construction cost prevalent in Karachi. Similarly projects such as Pace Tower, Karachi and Pace Circle (including Hyatt Regency), Lahore have also been shelved.

Going forward, as the economy revives; the company may choose to go ahead with some of these projects. We have not taken these projects into account owing to lack of revised assessment available on them. However, if all plays in Pace's favor we might just as well see new projects initiated, offering upside to our valuation.



SUBSIDIARIES AND ASSOCIATED COMPANIES

Pace Pakistan Limited has two subsidiaries and two associated companies; all of which are unquoted.



Source: Company Annual Report

Pace Barka Properties Limited

PACE Pakistan had 22% stake in PACE Barka (associate company) with an equity investment of PKR300mn made in FY07. During FY08, Pace Barka made a 125% right issue out of which 37.5mn shares of PKR10/share were offered to Pace (Pakistan) Limited. Pace (Pakistan) Limited accepted only 30mn shares, consequently changing the percentage of interest held to 19.66% and total equity investment to PKR600mn. However, it is still considered an associated undertaking due to common directorship and significant influence of the holding company.

PACE Barka is the developer of Pace Circle. The project comprises of an international grand luxury hotel (Hyatt Regency) a world-class shopping mall, state-of-the-art apartment building and a modern office block. In order to raise finances, the Company had intentions to conduct an IPO. However, the existing deceleration in the stock market has daunted its plans. The company now plans to proceed with the IPO once the equity markets recover.



REVENUE RECOGNITION POLICY

Prior to FY08, revenue from the primary business was recognised when agreement for sell was made, possession was handed over to the buyer and no future economic benefit was expected. However in FY08, the company was allowed by its auditors to record revenues on Percentage-of-Completion method. This will reduce the volatility in earnings that was seen in the company's financial statements. In FY08, the company recorded additional revenue of PKR187mn on account of change in revenue recognition policy which constituted about 14% of the total revenue from sale of shops and commercial buildings.

The company now pursues the following revenue recognition policy:

Revenue from restaurant sales is recognised on dispatch/delivery of goods to the customers.

Licensee fee is charged on the basis of area leased out or respective gross turnover achieved by the principals who operate from Pace premises under agreements.

Revenue from sale of land, condominiums, shops/counters and villas is recognized when significant risks and rewards of ownership have been transferred to the buyer, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the property sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the entity and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue from sales agreements where the control and the significant risks and rewards of ownership of the work in progress are transferred by the Company to the buyer in its current state as construction progresses is measured using the percentage of completion method. The stage of completion is measured by reference to the costs incurred up to the balance sheet date as a percentage of total estimated costs for each project.

Revenue from sales agreements where significant risks and rewards are not passed on to the buyer as construction progresses are recognized when possession is handed over to the buyer and the Company does not expect any further future economic benefits from such property.



VALUATION AND FINANCIALS

We initiate our coverage on Pace Pakistan limited. We have used Discounted Cash Flow (DCF) valuation method to assess the company as absence of real estate valuations in Pakistan render Net Asset Value (NAV) based valuations unreliable. Using the DCF model, we have come up with a fair value of PKR9.8/share assuming a terminal growth rate of 2.5%.

Pace Pakistan limited share price has seen wide fluctuation over the past two years. Yesterday's closing price of PKR 8.1/share reflects FY10E PER of 1.71x; a discount to BMA Universe FY10E PER of 8.0x. We recommend a BUY with the fair value of PKR 9.8/share offering an upside potential of 21% to current levels.

Sensitivity Analysis

Sensitivity to WACC and Terminal growth					
	WACC				
Terminal growth rate	14%	15%	16%	17%	18%
1.5%	10.9	9.4	8.1	7.0	5.9
2.0%	11.8	10.2	8.8	7.5	6.5
2.5%	12.7	11.0	9.8	8.2	7.0
3.0%	13.8	11.9	10.3	8.9	7.6
3.5%	15.0	12.9	11.1	9.6	8.3

Source: BMA Research



KEY FINANCIALS

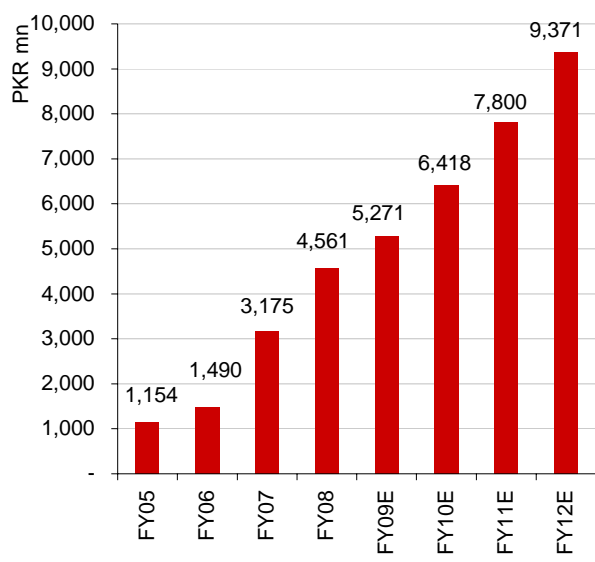
PKR millions	FY08A	FY09E	FY10E	FY11E	FY12E
Income Statement					
Net Sales	1,461	1,492	1,899	1,033	567
% Change	138%	2%	27%	-46%	-45%
Cost of Goods Sold	(935)	(953)	(1,157)	(647)	(369)
Gross Profit	526	539	743	386	198
EBIT	1,700	1,009	1,469	1,664	1,798
Changes in investment property	1,245	565	727	1,068	1,308
Financial Charges	246	319	262	209	145
Net Profit Before Tax	1,453	690	1,207	1,455	1,654
Net Profit After Tax	1,407	655	1,146	1,383	1,571
% Change	181%	-53%	75%	21%	14%
Balance Sheet					
Assets					
Fixed Assets	4,864	5,619	6,887	8,331	9,924
Current Assets	3,697	3,892	3,631	3,119	2,704
Total Assets	8,561	9,511	10,518	11,450	12,628
Liabilities					
Current Liabilities	2,042	2,708	2,964	2,889	2,345
LT Liabilities	1,959	1,532	1,136	761	912
Shareholders equity	4,561	5,271	6,418	7,800	9,371
Total Liab. And S/H Equity	8,561	9,511	10,518	11,450	12,628
Cash Flow					
Cash flow Operating	(1,084)	(143)	(256)	1,576	795
Cash flow Investing	(868)	44	(274)	(67)	70
Cash flow Financing	2,959	169	(271)	(416)	(436)



KEY FINANCIAL RATIOS

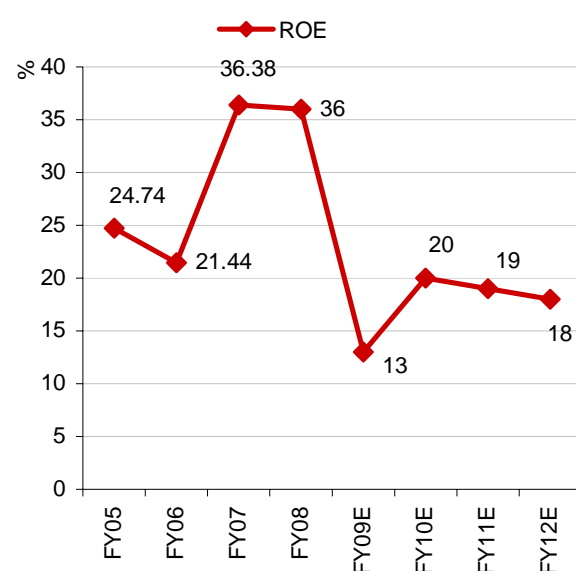
Ratios	FY08A	FY09E	FY10E	FY11E	FY12E
EPS (PKR)	5.8	2.7	4.7	5.7	6.5
EPS growth (%)	181%	-53%	75%	21%	14%
Gross Margin (%)	36%	36%	39%	37%	35%
EBIT Margin (%)	116%	68%	77%	161%	317%
Net Profit Margin (%)	99%	46%	64%	141%	292%
ROA (%)	23%	7%	11%	12%	13%
ROE (%)	36%	13%	20%	19%	18%
PER (x)	1.4	3.0	1.7	1.4	1.3
BVPS (x)	19	22	27	32	39
PBV (x)	1.50	0.37	0.30	0.25	0.21
Current Ratio (x)	1.8	1.4	1.2	1.1	1.2
LT debt/ Equity	0.4	0.3	0.2	0.1	0.1
LT debt/ Total Assets	0.2	0.2	0.1	0.1	0.1

Shareholder's Equity



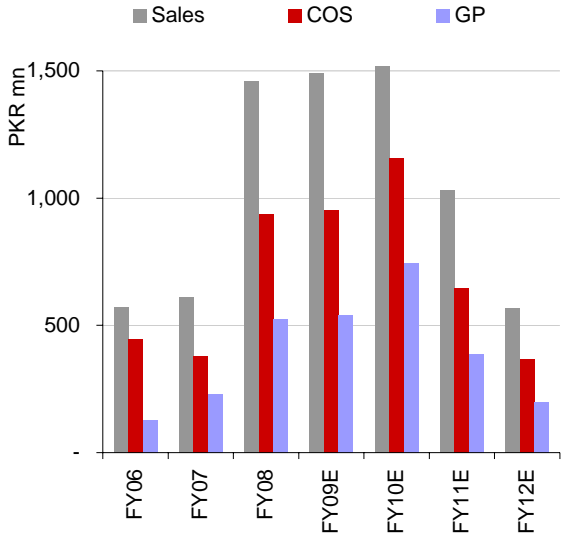
Source: BMA Research

Return on Equity



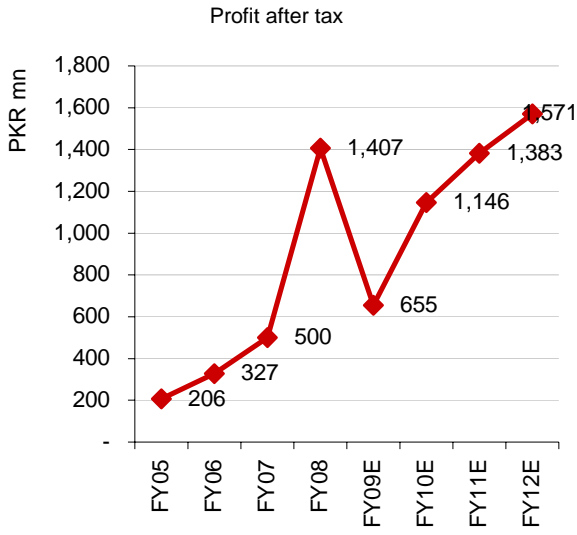


Sales, COGS and Gross Profit



Source: BMA Research

Profit after Tax





RISKS TO THESIS

■ Upside potential

In our valuations, we have taken into account only two projects that are under progress since the company has shelved the other projects for the time being. If going forward, the company decided to undertake any other projects in addition to those that we have accounted for, it will render upside potential to our fair value.

■ Downside risks

Real Estate prices: In our forecasts, we predict property prices to pick up gradually post FY10. However, if the prices continue to remain lackluster, our valuations will most likely be distorted downwards.

Timeline for completion of projects: As per the information provided by the company, Pace Towers is expected to be completed in FY10. However, to be on the conservative side, we expect it to extend beyond FY10. Similarly, Model Town Extension is expected to be completed by Dec 2009. We expect it to be completed by end of FY10. The revenues from sale of these projects are subject to their respective time of completion and the prevailing property prices at the time of their sale. Deviations from our expectations of time of completion may distort our forecasts upwards or downwards.

Economic Projections: Our economic projections relating to GDP growth, FDI and foreign remittances may not materialize as expected. A better or worse picture will distort our valuations either way.



PACE PAKISTAN: ABOUT THE COMPANY

Pace (Pakistan) Limited commenced its business in 1992 as a consumer retailing and mall management endeavor, however it redefined itself after takeover by 'First Capital Securities Corporation' in 1998, as a real estate developer/construction company. The evolution of the company has unlocked access to a number of untapped avenues which would generate revenues for the company. At present, the Company is engaged in building, acquiring, managing and selling condominiums, departmental stores, shopping plazas, super markets, utility stores, housing societies and in carrying out commercial, industrial and other related activities in and out of Pakistan.

Pace became public limited company in Jan07 by listing its shares on Karachi and Lahore Stock Exchanges and received an accolade of being first listed local real estate company in Pakistan. Pace is the part of the conglomerate 'First Capital Limited' which operates in financial services, media and telecom industries.



DISCLAIMER

This memorandum is produced by BMA Capital Management Limited and is only for the use of their clients. While the information contained herein is from sources believed reliable, we do not represent that it is accurate or complete and should not be relied upon as such. Opinions expressed may be revised at any time. This memorandum is for information only and is not an offer to buy or sell, or solicitation of any offer to buy or sell the securities mentioned.

ANALYST CERTIFICATION

I, Saniya Rizwan, hereby certify that this report represents my personal opinions and analysis of information. All views are accurately expressed to the best of my knowledge. I certify that no part of my remuneration is linked either directly or indirectly to recommendations or analysis covered in this report.