Special Section: GDR Issuances

Global Depository Receipts (GDRs) provide investors an opportunity to reach beyond the geographical confines of their parent country. Recent years have seen a growing number of emerging market countries opting to raise capital from international investors through issues of depository receipts (**Box 1**).

Depository receipts have become increasingly popular because they give companies, particularly those from developing markets, a convenient way to attract a broad range of investors than is possible locally (**Box 2**).

Pakistan entered the GDR market in 1994 through the issuance of Reg S / 144A offering of Pakistan Telecommunication (Sep 1994), Hub Power Company Limited (Oct 1994), and Pakistan Cement Limited (Nov 1994). There is no trading volume data available for these securities, although an ADR converted price is being quoted on Bloomberg.

In line with global trends, Pakistan saw a revival of GDR issues during 2006, after a gap of more than 10 years. So far MCB, Oil and Gas Development Corporation Limited (OGDC) and United Bank Limited (UBL) have successfully launched GDRs amounting to a total sum of US$1.5 billion at the London Stock Exchange (**Table 1**).

Box 1: Depository Receipts

A depositary receipt (DR) is a negotiable instrument representing ownership of a given number of a company's shares and can be listed and traded independently of the underlying stock, in a different jurisdiction. Since the 1920s, American Depositary Receipt (ADR) is one of the most common types of DRs which provide opportunities to companies to raise funds from international markets, while also diversifying their portfolios. Global Depositary Receipts (GDRs), European DRs and International DRs are other types of DRs traded at international bourses. GDRs are commonly listed on European stock exchanges, but offerings do occur elsewhere. In April 2007, the first ever listing on the Singapore stock exchange took place. Both ADRs and GDRs are usually denominated in U.S. dollars, but can also be denominated in other currencies.

Table 1: Recent GDRs Issued

Amount in Million US $, Numbers in Millions

			No. of Issuance		Conversion upto Oct 2007	
	Issuance Date	Amount Raised	GDRs	Ordinary shares*	GDRs	Ordinary shares*
MCB	Oct-06	150	8.6	34.5	4.6	18.5
OGDCL**	Dec-06	738	39.1	390.6	33.0	329.7
UBL	Jun-07	650	50.6	202.3	11.8	47.2

*against GDRs

** GDR re-issuance totaled to 14.8 million of ordinary shares till Oct 2007

Source: Local custodian banks

The GDRs of OGDC, MCB and UBL have a two way convertibility option, however this convertibility is limited to the number of GDRs issued at the time of initial offering. This facility is beneficial in providing the investors arbitrage opportunity and also in hedging risk. This option gives foreign investors the ability to convert their GDRs into local ordinary shares and reconvert their ordinary shares into GDRs, which would be subject to the availability of headroom.[1] This convertibility facility has been widely used by the investors and so far around 49.4 million GDRs have been converted. Specifically 33 million GDRs of OGDCL, 4.6 million GDRs of MCB and 11.8 million GDRs of UBL have been converted.

[1] Headroom is the number of GDRs available for convertibility, as a result of cancellation.

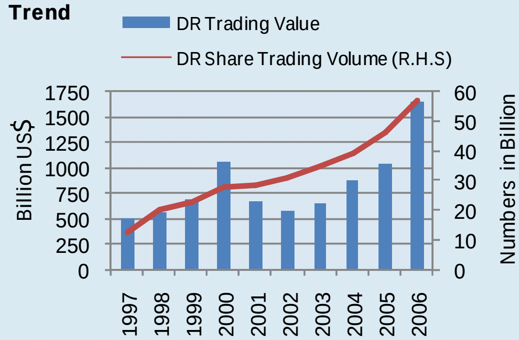
Encouraged by the positive response of international investors towards Pakistani GDRs, the government is planning to issue other GDRs of leading banks in the public sector i.e. National Bank, Habib Bank, in addition to a power generation company i.e. Kot Addu Power Company.

Box 2: Strong Growth of GDRs Anticipated

According to JP Morgan Depository Receipts Group, Depository Receipts (DR) have gained widespread popularity across the globe as more and more companies are using this tool to access cross border capital and as an investment option to facilitate global exposure. Looking at this rising interest, it is anticipated that during 2007 there will be a strong and record-setting growth in liquidity and capital raised from American Depository Receipts (ADRs) and Global Depository Receipts (GDR).

During the last five years a tremendous growth in trading values of GDRs has been observed. GDRs showed a record liquidity during 2006 (**Figure 1**) with a rise in trading volumes by 22 percent to reach 57 billion shares, and rise in trading values by 58 percent to reach US$1,657 billion as compared with the previous year. In 2006, Oil and Gas, Telecommunications and Mining were the top three sectors with almost 40 percent of the overall trading value.

Figure 1:DR Trading Volume and Trading Value Trend



Source: JP Morgan DR Report, January 2007

From a regional perspective, Korea, Taiwan and India remained dominant in Asia in term of issuing GDRs during 2006, whereas there has been a significant demand for GDRs from new markets in Asia including Pakistan and Vietnam. The main driving force behind this phenomenon was privatization, and increasing appetite for emerging markets exposure.

In Europe, Russian issuers were dominant in raising capital through DRs where Russian oil and gas giant Rosneft Oil Company JSC raised approximately US$6.4 billion in DR form which is the largest ever offering of DRs. Moreover, another 12 Russian issuers raised capital in DR form, where metals & mining, and oil and gas sector remained dominant.

In Latin America, the dominant market was Brazil which almost covers two thirds of new DR entrants for the region. Argentina also revisited the international capital market during 2006 after a gap of almost five years.

Expected trends in 2007 :

- Looking at the strong demand of GDRs across the globe, a robust growth of GDRs could be anticipated in 2007. It is also anticipated that GDRs will dominate the market viz-à-viz ADRs in 2007 which is mainly due to the expected reporting and compliance regulations for global issuers as a result of U.S. Sarbanes–Oxley requirements.

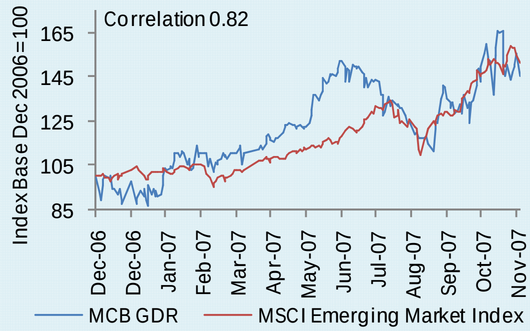
- Further, DR markets will be dominated by countries from South America and Asia in 2007 where Brazil, Russia, India and China will dominate the new GDRs issues.

- Rise in demand of specialized DRs and DR-based investment and fund vehicles.

Source: JP Morgan DR Report, January 2007

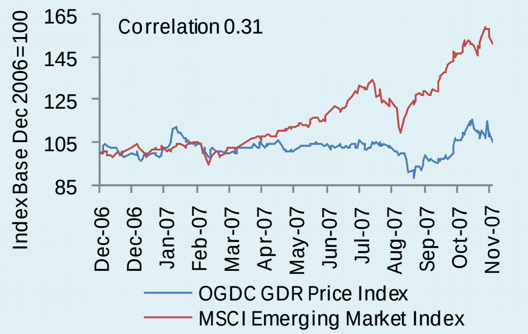
In recognition of the implications of this growing demand of Depository Receipts (DRs) by Pakistani companies, and the preference to raise funds from international capital markets, State Bank of Pakistan (SBP) has issued detailed guidelines for banks and Development Finance Institutions (DFIs) for issuing and listing of DRs in the international market. The scrutiny of bank/DFIs through these rigorous requirements is seen to be a prudent and proactive measure, targeted to ensure that only financially sound and stable banks/DFIs would go for GDR issuances.

Figure 1: MCB GDR Index Performance Versus MSCI Emerging Market Index



Source: Bloomberg

Figure 2: OGDC Index Performance Versus MSCI Emerging Market Index

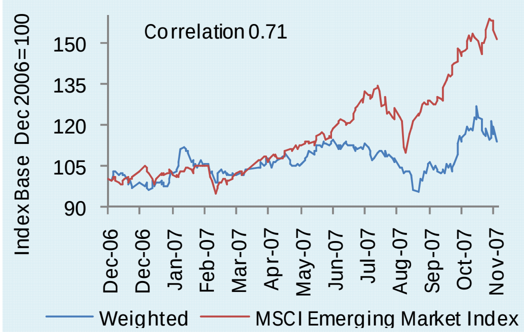


Source: Bloomberg

Performance of GDRs

For evaluating the performance of Pakistani GDRs vis-à-vis emerging markets stocks, a stocks indexing methodology has been used. The Morgan Stanley Capital International (MSCI) Emerging Markets Index (EMI) has been used as the benchmark to compare the performance of OGDC and MCB GDRs. For this purpose, price indices for both OGDC and MCB have been created. For the sake of consistency, December 2006 has been used as the base period.

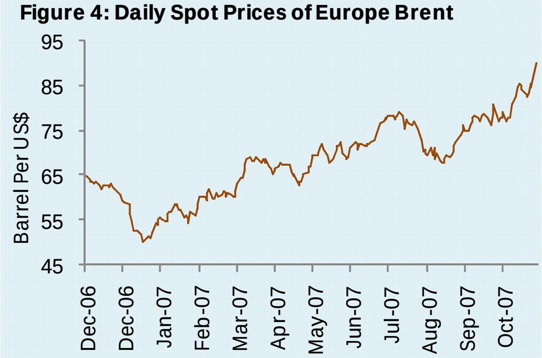
Figure 3 : Weighted Index Performance Versus MSCI Emerging Market Index



Source: Bloomberg

Furthermore, in order to gauge the combined performance vis-à-vis MSCI EMI, a combined market-capitalization weighted index (MCWI) for MCB and OGDC has also been created. Correlation coefficient generated from these indices show that the MSCI-EMI has a positive correlation of 0.82 and 0.31 respectively with MCB (**Figure 1**) and OGDC (**Figure 2**), whereas the combined index has a positive correlation of 0.71 (**Figure 3**). MCB GDR has performed well as compared to OGDC GDR and has been successful in attracting substantial attention of foreign investors. This interest is attributed to the remarkable performance of the banking sector in the last 3 years, which is also evident in the rising foreign stake in the banking sector in the form of FDI. The performance of the OGDC GDR in comparison is attributed in large part to the high volatility in the international oil prices (**Figure 4**).

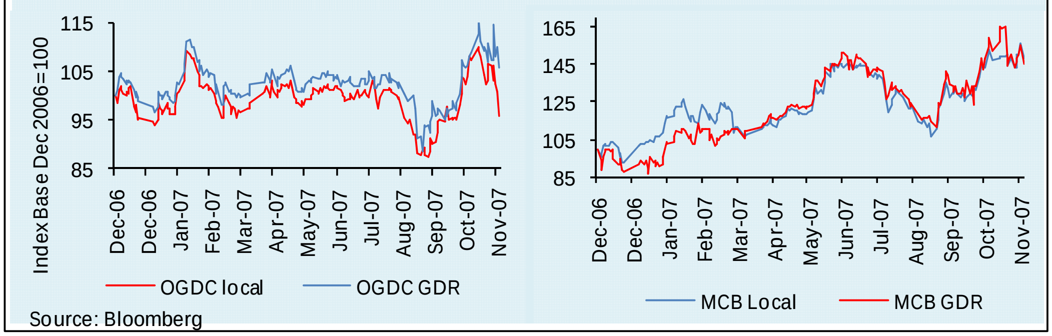
Figure 4: Daily Spot Prices of Europe Brent



Source: Energy Information Administration

In addition to international comparison, MCB and OGDC GDRs' price movements in domestic and international markets have also been assesses. Results show that both OGDC and MCB share prices have performed well in the international market (**Figure 5).** Whereas the OGDC GDR price stayed above the domestic price for the period under consideration, the price of the MCB GDR was more closely aligned to its domestic price. This difference in the domestic and international prices reflects room for arbitrage opportunities for foreign investors. As stated earlier, this fungibility facility has been widely used by the foreign investors.

Figure 5: Performance of MCB and OGDC Share Prices in Domestic & Foreign Markets



Source: Bloomberg