7 Capital Market

7.1 Overview

For yet another year, the Karachi Stock Exchange (KSE) retained its pre-eminent position in Pakistan's capital markets, accounting for over 60 percent of the shares traded (by volume) and, the majority of the debt and equity[1] listings during FY03. Thus, in light of its leading role, the discussion on Pakistan's capital markets has been largely based on the performance of the Karachi market and its benchmark KSE-100 Index.

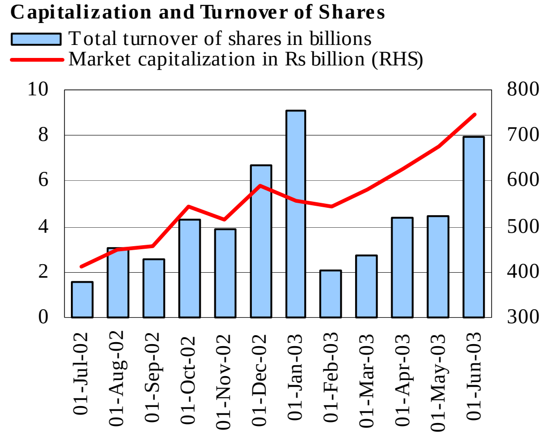
Table 7.1: Key Indicators of the Stock Market (KSE)
Rupees and Stocks in billions

Indicators	FY 02	FY03
Price indices		
KSE-100 index	1,770.1	3,402.5
Year on year change in KSE-100 index (%)	29.5	92.2
SBP General index of share prices	106.7	204.9
Year on year change in SBP General index (%)	-10.1	91.9
Market size		
Market capitalization	407.6	746.0
Market capitalization as a percentage of GDP	11.2	18.6
No. of listed companies	725	706
Market liquidity		
Value traded	805.6	2246.9
Total turnover of shares traded	29.0	52.7
Value traded as a percentage of GDP	22.2	55.9
Turnover ratio	1.98	3.01
Average daily value traded	3.3	9.1
Average daily turnover of shares	0.121	0.214
Paid-up capital at KSE	**260.6**	**300.9**

Pakistan's equity market was one of the best performing equity markets in the world during FY03. Not only did the benchmark KSE-100 Index continue its FY02 up trend into the succeeding year, its growth rate accelerated, as the Index broke its previous all-time high[2] to reach as high as 3402.5 points by the close of FY03, up a stunning 92.2 percent for the year. The broader SBP general index of share prices also mirrored this record performance, rising 91.9 percent through FY03 (see **Table 7.1**).

The rise in the indices, which was visible throughout the year corresponding to a substantial increase in the size of the market; the market capitalization of the listed stocks rose by an impressive 83.0 percent during FY03. As a result, the market capitalization as a percentage of GDP rose for a second successive year, from 11.2 percent by end-June 2002 to 18.6 percent by end-June 2003 (see **Figure 7.1**).

Figure 7.1: Monthly Movement of Market Capitalization and Turnover of Shares



The strength of the market rally, which extended through practically all of FY03, is visible in the substantial increase in both, the average daily traded volume and the turnover ratio.[3] The former rose 75 percent YoY to 214 million shares in FY03, while the increase in the latter was a relatively more sedate 52.0 percent.

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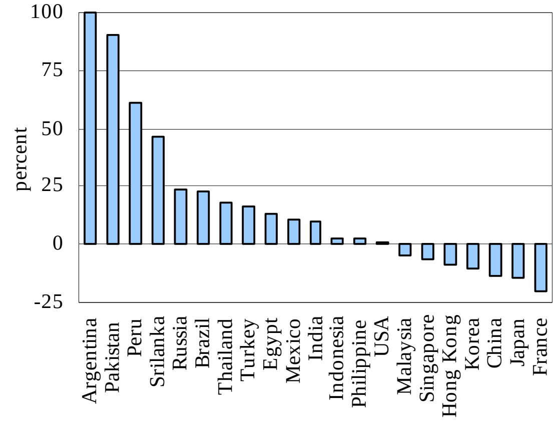
[1] In fact, the stocks listed in the other two stock exchanges in the country essentially, comprise a sub-set of the stocks listed in at the KSE.
[2] The previous high of the KSE-100 Index was 2661.31 on March 22, 1994.
[3] Turnover ratio is defined as the Value Traded for the year divided by the Market Capitalization for the same year.

In terms of the comparative regional performance too, the KSE emerged better than most other equity markets in the world during FY03 (see **Figure 7.2**).

Figure 7.2: FY03 Performance of Selected Markets



This exceptional FY03 performance of the KSE-100 was aided by the confluence of a number of positive factors, spread though the year, including expectations of a significant increase in corporate profitability, burgeoning market liquidity & concomitant decline in interest rates, hopes for the early privatization of large profitable public sector companies (e.g. PSO, OGDC, etc.), and the general increase in optimism based on hopes of a broader recovery in the economy. Of these, the first three arguably had the dominant influence.

In particular, as shown in **Table 7.2**, the net profit after tax for different sectors has increased substantially over the past two calendar years, as proxied by the earnings data on listed corporates. During 2002, the corporate earnings on average grew by 53.6 percent over and above 84.3 percent increase recorded in 2001. Specifically, the aggregate earnings of these companies increased by Rs 16.4 billion in 2002, compared to that in the preceding year, with larger increases evident in *transport & communication*, *cotton textiles*, and *chemicals*.

Table 7.2: Sector-wise Corporate Earning

billion Rupees

Sectors	**2000**	**2001**	**2002**	**change 2002 over 2001** (percent)
Overall	**16.6**	**30.6**	**47.0**	53.6
Cotton and other textile	13.7*	5.7	6.0	5.3
- Cotton textile	12.1	3.1	4.0	29.0
Other textile	1.6	2.6	1.9	-26.9
Chemical	0.9	-0.8	6.2	-875.0
Engineering	1.0	1.3	3.2	146.2
Sugar and allied industries	-0.1	-1.1	-0.8	-27.3
Paper and board	1.3	1.0	1.5	50.0
Cement	-0.2	-1.9	-0.1	-94.7
Fuel and energy	-11.2	5.4	2.5	-53.7
Transport & communication	9.1	17.7	23.7	33.9
Miscellaneous	***2.3***	***3.3***	***4.9***	48.5
Tobacco	-0.4	0.7	1.4	100.0
Jute	0.1	-0.2	-0.2	0.0
Vanaspati and allied industries	-0.3	-0.3	0.0	-100.0
Others	2.9	3.0	3.7	23.3

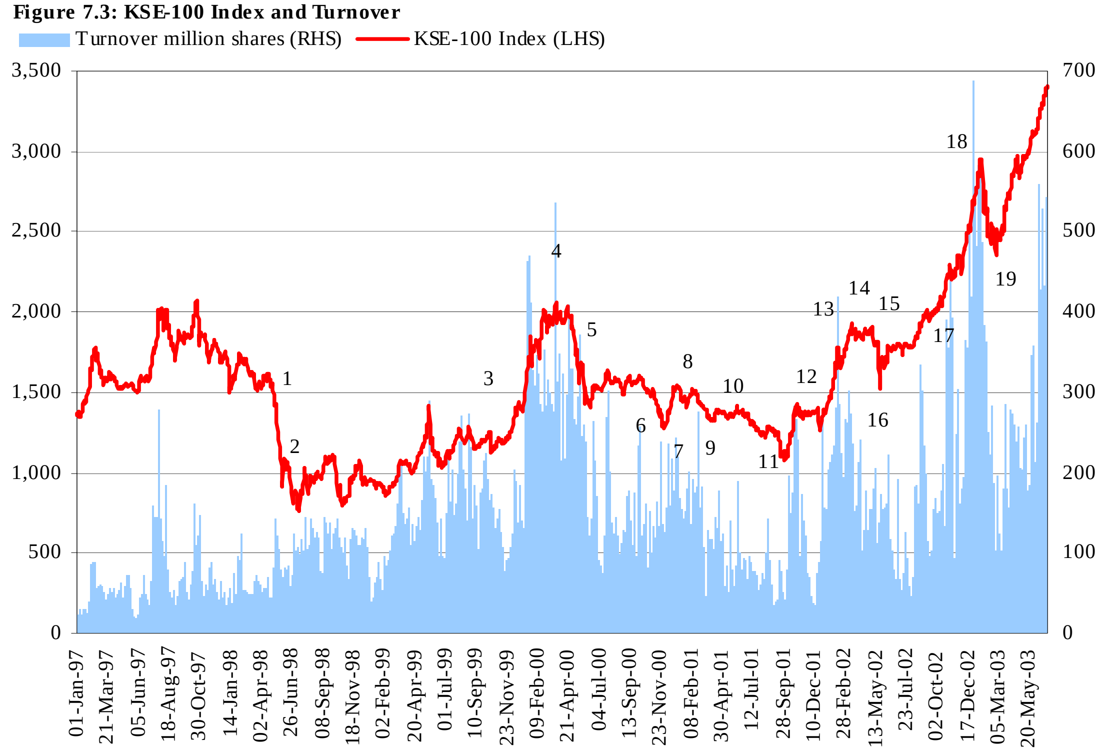
* Increase is due to revaluation of fixed assets.

7.2 Market Developments in FY03

Initially during FY03, the KSE-100 traded in narrow range around the 1850-point levels, probably reflecting the residual concerns over the tensions with India as well as the uncertainty over the forthcoming October 2002 elections. However, buying re-surfaced in August 2002 with the announcement of strong corporate results by the market leaders.[4] This upsurge persisted for the rest of the first quarter with the KSE-100 index breaking the psychological barrier of 2000 points on September 6, 2002 (see **Figure 7.3**).

[4] Unilever, Shell Pakistan, PSO, Adamjee Insurance, Hubco and PTCL announced strong corporate results during August and September 2002. The dividend announced by the Pakistan State Oil (PSO) on August 22, 2002 (80 percent cash divided and 20 percent bonus shares) was particularly important in propelling the Index upwards. PSO last announced such bonus payouts in FY99.

Figure 7.3: KSE-100 Index and Turnover



1. India detonated nuclear device, May 11, 1998
2. Pakistan went nuclear, May 28, 1998
3. Change of Government, October 12, 1999
4. KSE-100 Index at 29 month high of 2054.43
5. Trading remained suspended because of settlement problems by some of KSE members on May 30, 2000
6. SEC prohibited blank selling, November 2000
7. Pakistan managed to secure SBA with IMF, end-November 2000
8. SEC ordered change in Article of Association of KSE on December 31, 2000. This was to improve the corporate governance of the stock exchanges and reorganize them to improve their management and operational efficiency.
9. T+3 settlement system was initially introduced in two scrips (Telecard and Ibrahim Fibre) on April 2, 2001
10. Decision to defer the implementation of T+3 settlement system for couple of months in mid-May 2001
11. Terrorist attacks in New York created jitters in the market, September 11, 2001
12. Terrorist attack on Indian Parliament. Market sustained the shock initially but fell afterwards due to extreme measures taken by Indian government
13. KSE-100 Index fell due to enforcement of minimum capital adequacy requirement for brokers
14. Presidential referendum, April 30, 2002
15. Terrorist attack in Karachi, May 8, 2002
16. The KSE-100 shed 8.28 percent in last 15 days of May 2002 due to escalation in tension with India
17. Start of rally driven by good corporate performance and unprecedented liquidity in the market.
18. The up trend, driven by excessive liquidity, was broken due hike in badla financing rates (as brokers faced capital adequacy limits) forcing weak holders to sell.
19. However, market fundamentals (good corporate results, attractive market valuations) and liquidity forced start another rally.

The energy stocks mainly led this market rally with stocks of Hubco, PSO, Shell, Sui North and Sui South in the limelight. The greater interest in these companies stemmed from a number of factors including: (1) high profits for the oil marketing companies (PSO, Shell) as a result of an increase in their margins and (2) positive expectations following progress on the privatization process of PSO, and. (3) the increased attraction due to falling interest rates (Hubco, Sui Northern, Sui Southern).

The market rally continued into Q2-FY03, fueled not only by additional good corporate results, positive political developments[5] and rating actions on Pakistan's sovereign ratings,[6] but also the easier monetary stance of the SBP. Specifically, the sharp slide in lending rates (and consequently deposits rates) following the November 2002 discount rate cut by the SBP, significantly raised investor appetite for equity investment. In fact, the continual rise in the market and the relatively easy availability of cheap credit led to a gradual build-up of speculative positions in the market, leaving it vulnerable to a shock.

This vulnerability came to the fore in Q3-FY03 shortly after the KSE-100 index breached its previous all-time high to reach 2920.6 points, when the combination of large open-interest positions and a sharp spike in the *Carry Over Trade* (COT financing) rates (for details see **Section 7.4**), punctured the speculative demand.[7] The ensuing sell-off forced a massive adjustment, and the market performance remained subdued for a period, before the positive fundamentals, led by healthy corporate profits, high market liquidity, and now-attractive valuations re-ignited a rally in March 2003. Thereafter, the ascent of the KSE-100 accelerated, powered by signs of improving relations with India and a business friendly budget (including the retention of a capital gains, tax exemption on equity investments for another year, and indicating the early divesture of government enterprises).[8] The KSE-100 thus closed the year on a high note, at 3402.5 points.

7.3 Sector-wise Performance of the Karachi Stock Exchange

The three large sectors dominating market capitalization in KSE are fuel & energy, transport & communication, and chemicals & pharmaceuticals. Each one of these sectors has market capitalization of over Rs 100 billion. Together they account for 55 percent of the total market capitalization of the KSE in 2003. In terms of traded value, however fuel and energy is unrivalled with two-third of total value traded. The fuel & energy sector clearly outperformed all other sectors both in terms of market activity as depicted by its traded value as well as in terms of the market size as reflected by the market capitalization. This was mainly under the lead of blue chips in the fuel & energy sector namely PSO, Shell, Hubco, Sui Northern and Sui Southern Gas Ltd; this sector registered a market capitalization of Rs 190.4 billion which was 25.2 percent of the total market capitalization (see **Table 7.2**).

[5] On the political front, the outcome of the October 2002 elections in favor of parties supportive of the Musharraf government was welcomed by the market who saw in this development a increased likelihood of political stability and the continuation of the economic policies started by the military regime. In particular, equity investors expected the continuation of the capital market reforms and, more importantly, prompt divesture of the government's holdings, as well as the listing of some large profitable public enterprises.

[6] In November 2002, Moody's changed its outlook on Pakistan's 'B3' sovereign rating from stable to positive, and later, in December 2002, S&P upgraded its Pakistan long term foreign currency sovereign rating from 'B minus' to 'B'.

[7] Carry Over Trade (COT) refers to the financing of trades by a third party that a purchaser does not wish to pay for immediately.

[8] The government has planned to divest 5 percent shares in Sui Southern Gas, totaling to 33.56 million shares. Similarly, out of 410.34 million issued shares of the National Bank of Pakistan, the divestment of 3.2 percent shares held by the government will amount to an induction of 13.1 million shares in the market. Besides, there is a plan to sell all the shares of Pakistan Petroleum Limited, Oil and Gas Development Corporation, Pakistan International Airlines and Attock Refinery, which might yield Rs 4 billion, helping the government in achieving around 40 percent of the target. All these transactions would be routed through the stock exchange, which would enhance the market capitalization, and deepen the market base.

The higher trading activity in the sector was due to the strong corporate results of key companies as well as the expectation on the privatization of PSO.

The *transport* & *communication* sector and *chemical* and pharmaceutical sectors were next, with a market capitalization of Rs 122.9 billion (16.3 percent of the total) and Rs 107.2 billion (14.2 percent of total) respectively. In terms of market activity, the chemical and pharmaceutical sectors edged past *transport* & *communication* (see **Table 7.3**). While PTCL was the volume leader in the *transport* & *communication* sector, ICI Ltd. was the favored stock in the *chemical* sector.

All other sectors trailed significantly behind the above three, *although investment banks* did show good performance and there was some activity observed in the *cement* sector as well. The rest of the market remained dormant. This suggests that even in FY03, when the market performed outstandingly, the nature of the market performance at micro level remained largely similar to that observed in the preceding years, suggesting that the market remained highly concentrated.

Table 7.3 Sector wise Performance of KSE

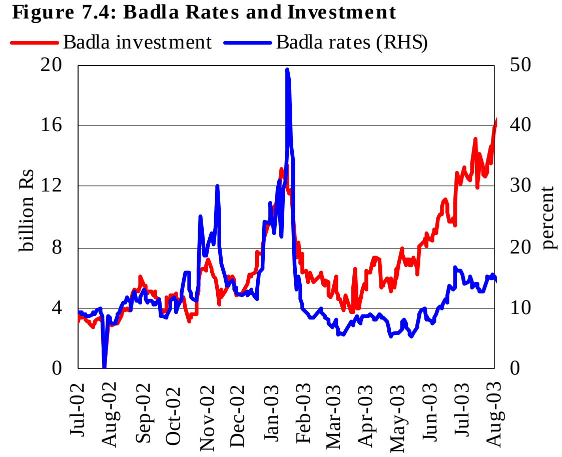
	Market capitalization		Traded value	
Sector	billion Rs	percent	billion Rs	percent
Fuel & energy	190.4	25.2	2018.4	65.5
Transport & comm.	122.9	16.3	310.1	10.1
Chemical & pharma	107.2	14.2	330.9	10.7
Inv. Cos & banks	65.8	8.7	120.4	3.9
Food & allied	36.4	4.8	1.6	0.1
Cement	32.8	4.3	108.9	3.5
Auto & allied	30.6	4.1	34.1	1.1
Tex. composite	23.7	3.1	36.5	1.2
Synthetic & rayon	23.4	3.1	35.1	1.1
Insurance	20.9	2.8	44.1	1.4
Tex. spinning	15.4	2.0	1.4	0.0
Misc.	13.9	1.8	0.6	0.0
Paper & board	12.2	1.6	1.8	0.1
Tobacco	12.0	1.6	0.4	0.0
Mutual fund	9.7	1.3	27.1	0.9
Sugar & allied	7.3	1.0	2.0	0.1
Modarabas	7.2	0.9	2.0	0.1
Leasing	7.1	0.9	2.0	0.1
Cables & electrical goods	4.4	0.6	0.6	0.0
Engineering	4.3	0.6	0.5	0.0
Glass & ceramics	3.0	0.4	0.9	0.0
Tex. weaving	2.3	0.3	0.5	0.0
Jute	1.1	0.1	0.0	0.0
Leather & tanning	0.7	0.1	0.0	0.0
Woolen & tex.	0.6	0.1	0.0	0.0
Vanaspati & allied	0.5	0.1	0.2	0.0
Construction	0.1	0.0	0.0	0.0

7.4 The COT (Badla) Market

During FY03, the heavy liquidity in the COT market meant that, on average, COT rates were relatively low even despite significant increases in the COT volumes. Specifically, the COT rates typically ranged between 8 percent to 10 percent for much of the year, although the COT volumes averaged Rs 6.2 billion (up approximately 54 percent from the average level in the preceding year).

For the first half of FY03, the COT market witnessed a gradual rise in the COT volumes, roughly paralleling the rise in the index. However, the rise in COT volumes then accelerated sharply in November 2002, probably reflecting: (1) the fall in interest rates rendered speculative investments less risky; and (2) a change in the COT rules that lowered the risk of a sudden squeeze in the availability of COT financing. As mentioned earlier, the resulting increase in speculative positions largely based on the availability of cheap financing left the market quite vulnerable (see **Figure 7.4**) to a jump in the COT rate.

Figure 7.4: Badla Rates and Investment



Not surprisingly therefore, the KSE-100 lost its momentum abruptly with the emergence of problems in the availability of COT financing. Specifically, a number of brokers providing COT had almost consumed their exposure limits as the market rose, and the resulting shortage in financing led to a spike in the COT rate, forcing the closure of speculative positions and a sharp market correction. Subsequently, the high liquidity in the interbank market increasingly found its way into the equity market as well. Thus, March 2003 onwards, COT rates saw only a small rise despite a considerable increase in COT volumes.

In any case, it is expected that the systemic risk as well as the volatility associated with COT financing will be eliminated through the introduction of margin financing (which is expected to be implemented by end-December 2003).

7.5 Corporate Debt Market

Pakistan's bond market has seen increased corporate issuances following the rationalization of National Saving Schemes in FY00. In fact, activity in the corporate bond market accelerated in FY03 as well, as issuers sought to take advantage of relatively low interest rates to lock-in long-term funds. Specifically, FY03 saw 21 new issues worth over Rs 10.4 billion, against 17 issues totaling Rs 9.5 billion in FY02 (see **Figure 7.5**). However, despite the considerable increase in issuances, the outstanding stock of listed corporate debt remains a low 2 percent of GDP.

Figure 7.5: Growth in TFC Market

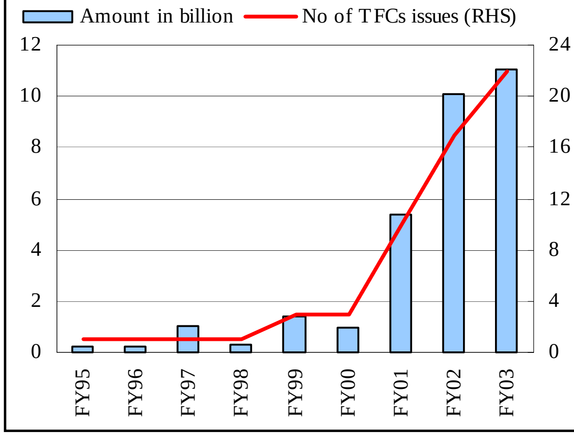


Table 7.4: Overall composition of Listed TFCs*

	since FY95	FY01	FY02	FY03
Total issued	62	11	17	21
Fixed	23	7	4	0
Floating	39	4	13	21
Anchored to discount rate	25	3	8	13
Anchored to PIBs	14	1	5	8

It is interesting to note that, in contrast to FY02, all of the listed corporate bonds were floating rate issues, probably reflecting the volatility in interest rates (see **Table 7.4**). However, since most of these FY03 floating rate issues had floors between 7 percent and 12 percent, the cost of funds for these issuers remains significantly higher than the prevailing market rates for corresponding tenors.

In fact, one of the major reasons for a slight decline in issuer interest in TFCs towards the end of FY03 is the increased availability of cheap loans from commercial banks.

Of the FY03 total issues, 8 TFC issues worth over Rs 3.4 billion were by manufacturing concerns, while another 7, worth approximately Rs 2.2 billion were by leasing companies. The remaining issues were by banks or services companies (see **Figure 7.6**).

Figure 7.6: TFC Issues during FY03

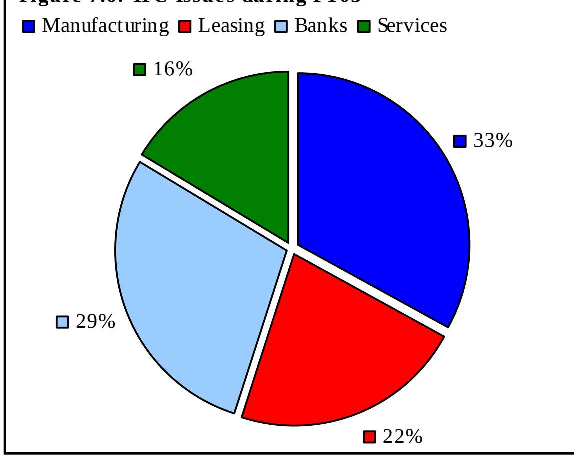


Table 7.5: Corporate Debt (Issues since July 2002)

million Rupees

Security	Issue Date	Maturity	Issue Size	Coupon Rate
Engro chemical 2	4-Jul-02	4-Jul-07	1000	Weighted average last 3 cut off 5 year PIB + 1.15%, Floor 11%, Ceiling 15%
Maple leaf cement	18-Jul-02	18-Jul-06	225	5 Years PIB Rate + 2.50%, Floor 15.25%, Ceiling 17.75%
Dawood leasing 2	25-Jul-02	25-Jul-07	250	DR + 1.75% Floor 12.25%, Ceiling 16.25%
Orix leasing 2	29-Jul-02	29-Jul-06	710	DR + 2, Floor 10%, Ceiling 13%
MCB	8-Aug-02	8-Feb-07	1600	5 years PIB cut off yield + 1.50%, Floor 11.75%, Ceiling 15.75%
Crescent leasing 2	4-Sep-02	4-Sep-07	250	Base Rate+ 2% p.a. Floor at 12.25% and cap of 15.75% where base rate is the cut-off yield on the last successful SBP auction of 5-year PIBs.
World call	30-Sep-02	30-Sep-07	350	DR + 1.75% Floor 12.25%, Cap 16.25%
Shakarganj mills 2	2-Sep-03	2-Sep	200	DR+200bps Floor 12.25%, Cap 15.75%
Quetta textile mills	24-Oct-02	24-Oct-07	750	DR +2.50%, Floor 13%, Cap 18%
Bank Al-Falah	19-Dec-02	19-Dec-08	650	Cut-off yield of 5 yrs PIB + 1.35%
				Floor 10.00% , Cap 15.00%
Union bank	19-Dec-02	19-Dec-08	750	Cut-off yield of 5 yrs PIB + 2.25%
				Floor 11.00% , Cap 15.50%
Security leasing 2	9-Jan-03	9-Jan-07	299	SBP Dis Rate + 2.25
				First Year floor 11.50, Cap: 15.50
				for 2-4 Years floor 11.00, Cap: 15.50
KASB leasing (Pak apex lease)	15-Jan-03	15-Jan-08	200	Base rate + 2.25%, Floor 11.50%, ceiling 14.50%
Gulistan textile mills Ltd	29-Jan-03	28-Jan-08	400	SBP Dis Rate + 2.25%, Floor 11.00% , Cap 17.00%
Gulshan spinning mills	29-Jan-03	28-Jan-08	400	SBP Dis Rate + 2.25%, Floor 11.00% , Cap 17.00%
Paramount spinning mills	29-Jan-03	28-Jan-08	200	SBP Dis Rate + 2.00%, Floor 10.90% , Cap 17.00%
Paramount leasing Ltd.2	7-Feb-03	6-Feb-07	325	SBP Dis Rate + 2.50%, Floor 11.50% , Cap 14.50%
Paktel	27-Mar-03	26-Mar-06	840	SBP Discount rate +2.0%, For 1st Year, floor of 12% and a cap of 16% ,For 2-3 Years, floor of 11.50% and a cap of 16%
Jahangir siddiqui & co Ltd	18-Apr-03	18-Apr-08	500	SBP Dis Rate + 1.50%, Floor 7.50% , Cap 13.00%
Trust leasing corp. Ltd	3-Jun-03	3-Jun-08	250	SBP Dis Rate + 2.00%, Floor 9.00% , Cap 14.00%
Ittehad chemical	27-Jun-03	27-Jun-08	250	SBP Dis Rate + 2.50%, Floor 7.00% , Cap 12.00%

7.6 Performance of NBFIs during FY03 [9]

Total assets of NBFIs grew by 14 percent supplying Rs 22.9 billion. This growth was largely motivated by the boom in domestic stock market and the expectations of further interest rate cuts in the money market, leading to higher allocation towards investment rather than advances. As a result, the share of investment in total assets rose from 21.7 percent in FY02 to 31.7 percent in FY03 (see **Table 7.6**). DFIs alone raised their investment by Rs 10 billion. Similarly investment banks almost doubled in both

Table 7.6: Investment by NBFIs

million Rupees

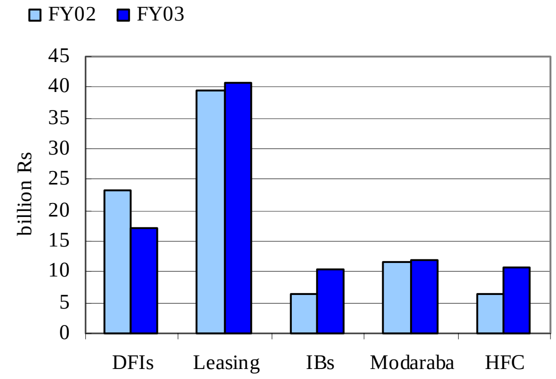
	FY02	FY03
DFIs		
FIBs	1,766.0	4,275.0
Treasury bills	971.6	3898.3
Shares	9,950.7	14,399.4
Leasing companies		
FIBs	1,404.6	3,016.6
Treasury bills	51.5	24.6
Shares	891.8	1,368.2
Investment banks		
FIBs	337.2	4,684.7
Treasury bills	0	40
Shares	2,703.5	5,153.8

[9] NBFIs include development finance institutions, investment banks, leasing companies, modaraba companies and housing finance companies. Data used in this section needs an early clarification. For performance indicators, end-December data of institutions have been used from audited balance sheets. Whereas FY03 performance is presented through data from un-audited balance sheets of institutions at end-June.

stock markets and government securities. Rest of the institutions posted marginal growth.

On the other hand, there was little progress in the financing activities by these institutions, as the total advances grew only marginally (see **Figure 7.7**). This was mainly due to shifting focus of DFIs from advances to investments and net retirements by public sector enterprises. Larger contribution in the latter decline was because of one of the joint venture companies, total assets of which declined by Rs 3 billion.

Figure 7.7: Advances by NBFIs



Advances to earning assets declined from 56.4 percent in FY02 to 55.3 percent in FY03, while investments to earning assets increased from 31.8 percent to 34 percent (see **Table 7.7**). The good news, however, was the significant strengthening of capital ratios of the NBFIs during the year along with rising profitability.

Table 7.7: Performance Indicators of NBFIs

percent

	FY01	FY02
Capital to liability ratio	29.58	35.6
Growth rate of capital	0.5	30.26
Growth rate of assets	12.26	1.62
Earning assets to total assets	77.6	76.78
Advances to earning assets	56.44	55.36
Investment to earning assets	31.82	33.98
Return on average assets	1.16	2.88
Return on average equity	4.84	13.16

7.6.1 Development Finance Institutions

During FY03, the equity of all these institutions grew sharply, mainly due to huge profits booked at end of financial year 2002, with Pak-Libya Holding Company (PLHC) being the only exception. On the other hand, growth in deposits remained negative because foreign currency deposits continued to fall.

As mentioned earlier, investments of DFIs grew very sharply both in the government securities and the stock markets. Investment in shares accounted for almost 59 percent of their total equity posing a threat to the capital adequacy of these institutions. By contrast, the growth in advances remained sluggish largely on account of a greater fall in asset portfolio of one of the old joint venture companies, which is in the process of liquidating unprofitable asset holdings (see **Table 7.8**).

Table 7.8: Performance Indicators of DFIs

percent

	CY01	CY02
Capital to liability ratio	18.9	34.9
Equity to total asset ratio	15.9	28.1
Lease finance to earning assets	1.5	3.9
Advances to earning assets	44.5	32.4
Inv. to earning assets	47.7	55.1
Inv. in subsidiaries to total investment	11.7	9.1
Inv. in Govt securities to earning assets	10.5	11.8
Return on average assets	1.8	6.8
Return on average equity	11.0	30.6

7.6.2 Investment Banks

FY03 proved to be a better year for investment banks. The shift in asset portfolios of these banks does not show much difference from what was observed in the case of DFIs (see **Table 7.9)**. Investment rose much sharply on account of visible returns available on securities. But contrary to the trend in DFIs', advances of investment banks also rose in FY03 (especially the net credit to private sector). However, 77 percent of the sectoral growth came only from Trust Investment Bank, with a net credit growth of Rs 15 billion during the year. None of the other companies showed any remarkable performance. It should also be noted that this particular bank has been merged with another investment bank. These two, jointly took over Doha Bank, to establish a new commercial bank. Hence, the assets of this company would no longer be the part of this group from the next fiscal year. It may be recalled that major players in this category, Al-Meezan, Al-Faysal and Crescent bank have already merged into commercial banks.

Table 7.9: Performance of Investment Banks

percent

	CY01	CY02
Capital to liability ratio	11	20
Growth rate of capital	-12.6	43.8
Equity to total asset ratio	9.9	16.7
Lease finance to earning assets	25.5	25.1
Short term finance to earning assets	21.1	15.3
Investments to earning assets	47.7	55.2
Return on average assets	-4	1.6
Return on average equity	-32.6	12.1

7.6.3 Leasing Companies

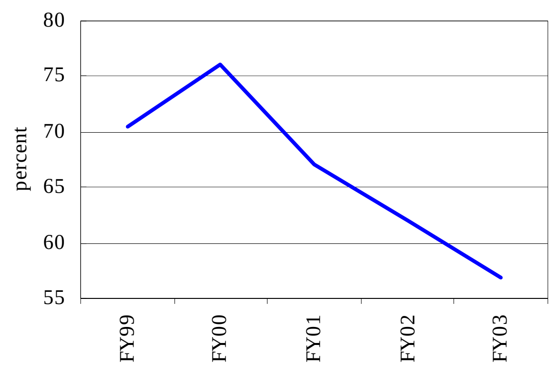
During FY03, financing activities of leasing companies remained subdued. Advances grew only by Rs 1 billion, whereas investment approximately doubled. The reason seems to be the aggressive take up of leasing activities by commercial banks. More specifically, much publicized auto financing/leasing by banks have restricted the portfolios of leasing companies that is evident from Rs 11.7 billion auto-financing provided by commercial banks during FY03. This shift of business from leasing companies to commercial banks is on three grounds: (1) commercial banks have access to even remote areas of the country whereas, leasing companies are operational only in the major cities; (2) surplus and low-cost liquidity available to banks enabled them to operate on lower margins; and (3) effective marketing by commercial banks. Leasing companies, on the other hand, do not have enough resources to run advertising campaigns on such a large scale. To survive in such a competition, leasing companies had to squeeze profit margins, and to target non-traditional business activities like agriculture, SME etc. (see **Table 7.10**).

Table 7.10: Performance of Leasing Sector

percent

	CY02	CY03
Capital to liability ratio	18.8	17.3
Growth rate capital	7.8	2.7
Earning assets to total assets	71.5	71.4
Lease finance to earning assets	90.6	89.8
Investments to earning assets	7.6	8.2
Return on average assets	0.9	0.1
Return on average equity	4.6	0.5

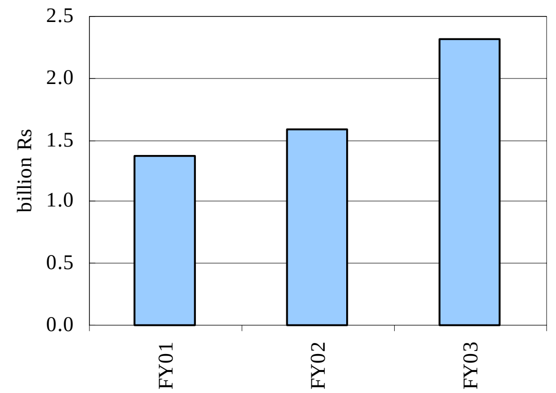
Figure 7.8: Share of Corporate Sector in Pvt Sector Financing by Leasing cos.



One thing is also noticeable. Unlike previous years, when corporate sector used to constitute the considerable portion of private sector financing by leasing companies, last two years witnessed an increasing focus towards consumer and small business sector (see **Figure 7.8**). This might be attributable to an increase in other modes of financing available to the corporate sector.

On the resource side, along with mobilizing funds through certificate of deposits/ certificate of investments, leasing companies have also entered in long-term bond market to acquire long-term funds. During FY03, seven companies issued TFCs amounting to Rs 2.3 billion against Rs 1.6 billion worth issues last year (see **Figure 7.9**).

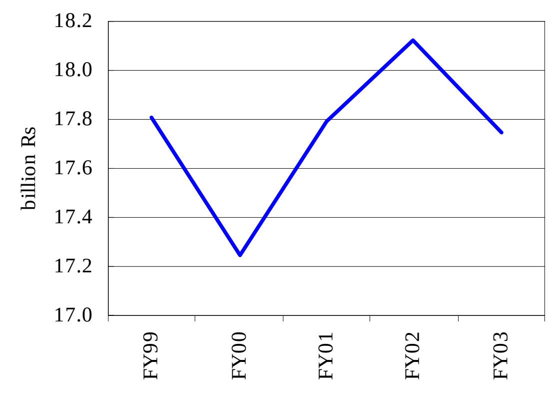
Figure 7.9: TFCs Issued by Leasing Companies



7.6.4 Modaraba Companies

During FY03, total assets of modaraba companies fell by Rs 378 million. In fact, for the last few years, the business has stagnated in this sector as the total assets in FY03 are almost the same as were in FY99 (see **Figure 7.10**). This is due to the fact that these companies are facing problems in mobilizing funds, as 32 percent of their total funding comprises commercial bank borrowing. But, in order to avail the financing facilities from commercial banks, minimum rating of BBB is required. Also, the instruments approved by Religious Board are not acceptable by the banks. These borrowings are at considerably high rate and as a result, these institutions are not able to compete successfully with other NBFIs. In this regard, SECP has given permission to a number of modarabas to mobilize funds through Term Finance Certificates (TFCs) based on Musharika, so that these companies can mobilize funds at cheaper rates.[10]

Figure 7.10: Assets of Modaraba Companies



Capital gains on investment during CY02 increased the earnings of modaraba companies (see **Table 7.11**). Assets of these companies registered a fall mainly due to a decline in their investment. Advances on the other hand posted marginal growth especially in the area of lease finance.

Table 7.11: Performance of Modaraba Companies

percent

	FY01	FY02
Capital to liability ratio	75.6	78.1
Growth rate capital	-11.4	14.4
Lease finance to earning assets	54.1	57.8
Morabha and musharaka to earning assets	21.7	22.3
Investments to earning assets	22.1	19.2
Return on average assets	3.5	4.4
Return on average equity	7.7	10

7.6.5 Housing Finance Companies

During FY03, credit extended by HFCs grew sharply mainly through HBFC's new line of products introduced in FY02[11] (see **Figure 7.11**). During Q4-FY02, the company introduced *Ghar Aasaan Scheme* (construction /extension and purchase of house) and *Shandaar Ghar Scheme* (Home improvement Scheme) in Q4-FY03. In the

[10] This implies, that the return on these certificates would be calculated on the basis of profits earned by an institution through the use of these funds.

[11] Since HBFC constitute for almost 97 percent of total housing finance companies' assets, any progress made by it would be reflected fully in entire group's numbers.

former scheme alone, the company was able to make disbursement of Rs 1 billion during the year. The main source of financing from the company is a credit line from SBP, but during FY03, borrowings from SBP showed a net retirement of Rs 1 billion.

Investment of HFCs grew by Rs 1.2 billion, due to their increased holding of T-bills. Unlike other NBFIs, investment in stock market does not constitute a significant part of HFC's assets. This is because as per prudential regulations that confine HBFCs investment portfolio to government securities only.

Figure 7.11: Advances by Housing Finance Companies