8 Capital Markets

As seen in **Table 8.1**, the key indicators of market activity of KSE, the leading stock exchange of the country, showed marked improvement during the first 11 months of FY04, with the period witnessing new all-time highs for the KSE-100 index, market turnover and capitalization.

The increase in the market capitalization is particularly significant. Not only has it jumped to 27.0 percent of GDP at end-May 2004 (from 9.5 percent at end-June 2003.[1] The market liquidity indicators also improved reflected by an enhancement in almost all indicators. The resulting increase in investor confidence and market depth is also reflected in shape of 10 floatations during the Jan-May 2004 compared to 13 in the preceding three years. Importantly, most of the public offerings were heavily oversubscribed.

Table 8.1: Key Indicators of the Stock Market (KSE)
Rupees and Stocks in billions, and change in percent

Indicators	Q4-FY03	FY04 Q1	FY04 Q2	Jan-May 2004
Price indices				
KSE-100 index	3,402.5	4,027.3	4,471.6	5,497.8
Change since end-June 2003	N/A	18.4	31.4	61.6
Change during the period	25.3	18.4	11.0	22.9
SBP General index	204.9	223.2	253.5	331.5
Change since end-June 2003	N/A	8.9	23.8	61.8
Change during the period	44.7	8.9	13.6	30.7
Market size				
Market capitalization	458.3	876.1	938.2	1,467.9
Market capit. (as % of GDP)	9.5	16.1	17.3	27.0
No. of listed companies	723	700	701	685
Market liquidity				
Value traded	333.5	1,680.9	755.1	2,067.7
Turnover of shares traded	7.2	32.0	13.2	43.4
Value traded (as % of GDP)	6.9	31.0	13.9	38.1
Turnover ratio	0.7	1.9	0.8	1.4
Average daily value traded	5.1	26.7	13.0	20.7
Avg. daily turnover of shares	0.1	0.5	0.3	0.4
Paid-up capital at KSE	275.0	305.4	313.3	371.2

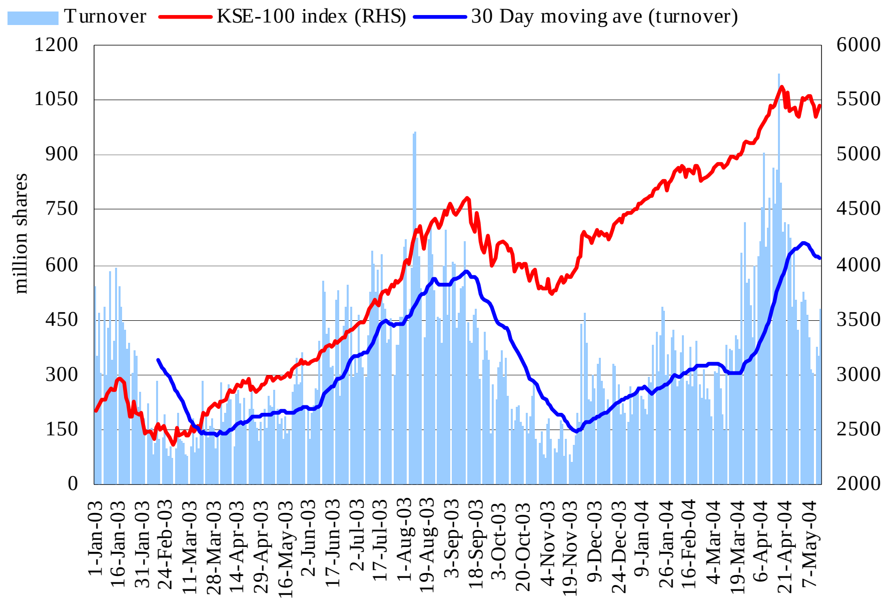
Despite visible improvement in equity markets the corporate debt market remained almost inactive during Jan-May 2004 period with only one issue of Rs 0.8 million compared with seven listed issues worth Rs 2.7 billion in Q3-FY03. The lower activity in corporate debt market largely reflects the availability of cheaper finance from commercial banks.

A significant development was the recomposition of the benchmark KSE-100 Index on the basis of Re-composition Rules and Procedure on March 29, 2004 (the revised index is applicable since April 1, 2004). In order to better reflect the

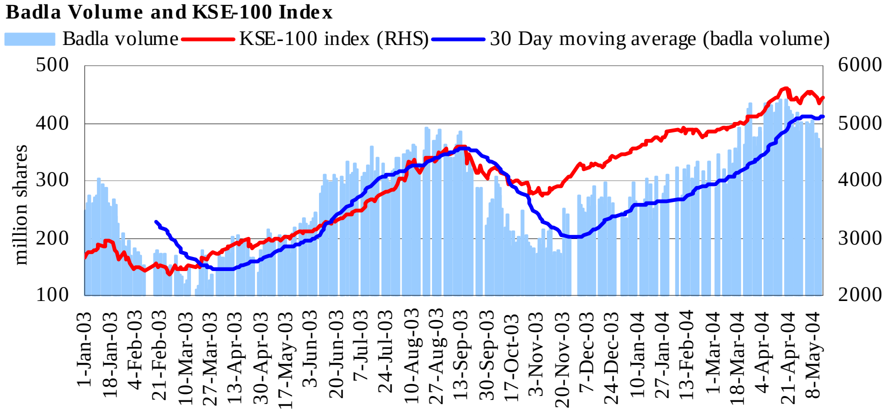
[1] The number of listed companies declined during the period, as a number were merged into other listed entities, and others were de-listed. However, the period also saw a few new listings including some large government owned companies. As a result, the market capitalization increased significantly.

increased diversity of companies listed at the KSE, the listed companies were divided into 34 sectors instead of the 17 sectors earlier, and the re-composed index includes a selection of companies from each these 34 sectors (excluding *Open-End Mutual Funds*). Based on the prices of February 27, 2004, the recomposed KSE-100 index captures approximately 88.0 percent of the total KSE market capitalization.

Figure 8.1: KSE-100 Index and Turnover



Badla Volume and KSE-100 Index



8.1 KSE performance during Jan-Apr 2004

As shown in **Figure 8.1**, the market witnessed greater volatility after reaching its peak in mid-April 2004. The higher volatility and market correction market primarily resulted from large leveraged positions and rising badla rates.

The beginning of Q3-FY04, witnessed further momentum in November 2003 rally (see **Section 8.1** in **SBP *Second Quarterly Report***) as investors gained confidence from the positive news on the political front (President's vote of confidence, a successful SAARC summit in Islamabad) and growing expectations of good corporate results.

However, during February 2004 (see **Figure 8.2**) the KSE-100 index witnessed subdued activity primarily due to: (1) a rise in badla volumes and rates, (2) weaker than expected results of corporates such PAKO and the gas utilities (SSGC and SNGPL) which had attracted strong investor interest; and, (3) expectations of a rise in interest rates (see **Section** on **Money Markets**). Nonetheless, the overall market optimism is reflected the in the fact that out of 89 days trading (during Jan-Apr 2004), the KSE-100 index saw an increase from the preceding day on 61 occasions and declined on only 28.

Figure 8.2: Changes in KSE-100 Index

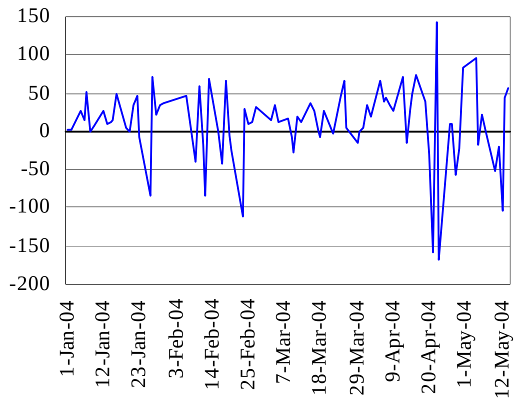


Table 8.2: KSE-100 Index Analysis

shares in million

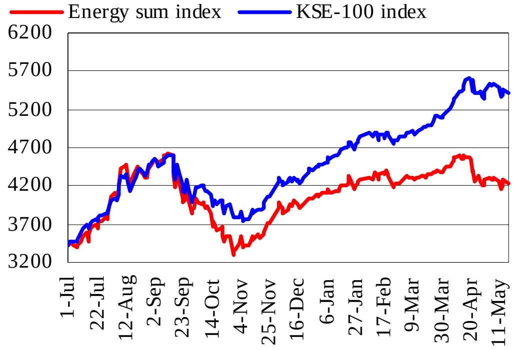
	Index	Turnover
Q1-FY04		
Average	4,099.3	492.4
Max	4,606.0	960.8
Range	1,173.5	821.2
St-dev	361.0	148.6
Variation	0.1	0.3
Q2-FY04		
Average	4,081.3	212.3
Max	4,471.6	469.3
Range	739.3	406.2
St-dev	215.4	92.6
Variation	0.1	0.4
Jan-Apr 2004		
Average	4,979.5	436.4
Max	5,620.7	1,122.5
Range	1,147.6	973.0
St-dev	306.3	207.2
Variation	0.1	0.5

Nonetheless, post-February 24, 2004 events such as an increase in cement production quotas amidst rising demand, good results by market leader PTCL, decline in badla rates, good results of banks such as MCB and NBP, etc. helped drive a strong rally until the late-April 2004 market correction.

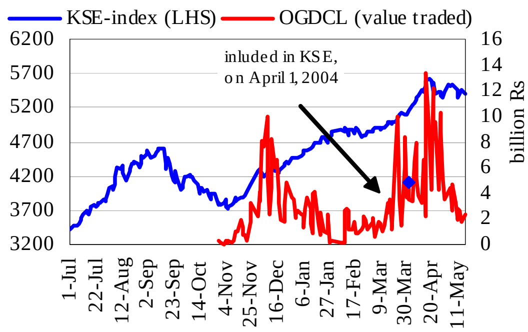
As seen in **Table 8.2**, the average level of index and turnover of shares during Jan-Apr 2004 period compared favorably with the preceding two quarters (only the average turnover is less than the corresponding Q1-FY04 value). This reflects the overall bullish trend in the market, which allowed the market to post new records for the KSE-100 index and turnover of shares on April 19, 2004.

However, the market witnessed higher volatility (measured by trading range, standard deviation, as well as the coefficient of variation) in the period Jan-Apr 2004. Plausible explanation for this include: (1) technical corrections due profit taking and higher levels of badla activity, (2) inclusion of OGDCL in KSE in April 2004 as the largest cap stock, which led to portfolio rebalancing (generating very high turnover in the scrip).

Figure 8.3: Energy Sector v/s KSE-100 Index



The Energy Index is calculated by taking market capitalization of energy sector for July 1, 2003 as base (3432), and tracking the relative changes in the market capitalization of energy stocks afterwards. (excluding OGDCL)



8.2 Market Movers

In fact, as visible from **Table 8.3**, the inclusion of OGDCL almost doubled the turnover in the top ten scrips during April 200, taking their share of total turnover from 51.8 percent in January 2004 to 64.3 in April 2004.

As shown in **Figure 8.3**, energy stocks remained the major market movers during Jan-Apr 2004. However, the contribution of energy stocks excluding OGDCL fell in April 2004; primarily due to inclusion of the new market heavy weight. The

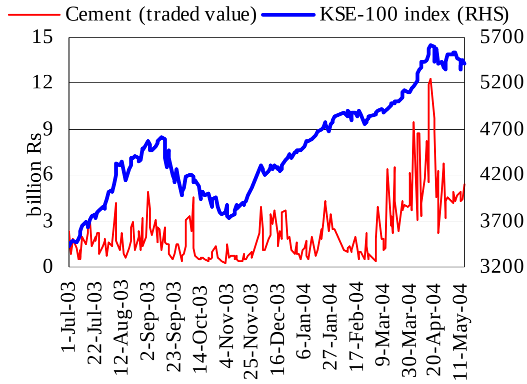
Table 8.3: Top Symbols Turnover Jan-April 2004
million shares

Jan-04		Feb-04		Mar-04		Apr-04	
SNGP	517.3	PTC	653.5	OGDC	1134.2	OGDC	2122.9
DGKC	456.4	OGDC	446.1	DGKC	597.0	PTC	1319.2
PTC	452.3	DSFL	306.3	FCCL	515.7	DGKC	1157.9
DFML	346.4	HUBC	300.8	LUCK	479.0	FCCL	1127.1
FCCL	336.2	PIAA	281.6	PTC	459.4	HUBC	826.4
SSGC	328.9	DGKC	235.5	PIAA	407.1	SSGC	776.3
FFBL	328.3	SSGC	227.8	DSFL	400.2	LUCK	690.7
LUCK	292.4	FFBL	194.6	FFBL	295.8	NBP	682.3
HUBC	286.9	PSO	190.3	MLCF	280.5	FFBL	667.0
DSFL	268.5	SNGP	164.6	NBP	255.9	MCB	572.9
Total	***3,613.5***	***Total***	***3,001.1***	***Total***	***4,824.9***	***Total***	***9,942.8***

Source: KSE website (www.kse.net.pk)

historic peak of KSE-100 index in April 2004 coincided with heavy investments in OGDCL – highest volume in a scrip. Furthermore, OGDCL was also very active in the badla market.

Figure 8.4: Cement Sector v/s KSE-100



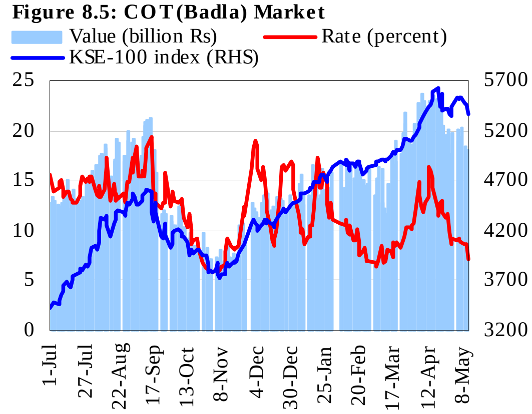
Apart from *energy sector*, the *cement stocks* also performed very well during Jan-Apr 2004, especially getting a boost in Mar-Apr 2004 on the back of positive developments in the sector in the shape of enhanced production quota, expectation of higher cement demand for the future and expansion plans unveiled by some companies and more importantly, the fact that the cement sector showed substantial growth in profitability in Jan-Mar 2004 compared to the corresponding period last year. The **Figure 8.4** shows a sharp rise in trading activity in cement stocks during March 2004, which together with the energy stocks, help propel the KSE-100 index to a new all-time high on April 19, 2004.

It is interesting to note that the investors' confidence in market movers remained intact even during bearish periods, as reflected by sharp declines in trading volumes in these stocks when the market declined.

8.3 COT (Badla) Financing

As shown in **Figure 8.5**, the carry over (Badla) market again played an important role in building an aggressive market rally during in Mar-Apr 2004, and a small technical correction occurred only when the weak holders were forced to liquidate holdings amidst very high badla rates.

Figure 8.5: COT (Badla) Market



The decline in badla rates and volumes in Jan-Feb 2004 may probably reflect the decline in speculative interest after a small market correction.

However, as speculative interest revived amidst continuing positive developments, the badla-financed volumes began rising again resulting in a steep rise in badla rates during Mar-Apr 2004. This eventually led to a sharp technical correction as the KSE-100 breached the 5600 mark.

Table 8.4: COT Market Summary

	Volume (million shares)	Value (billion Rupees)	Rate (percent)
Q1-FY04			
Average	333.1	15.7	14.6
Max	391.2	21.2	19.3
Total	19,986.8	942.4	-
St-dev	32.7	2.8	1.7
Q2-FY04			
Average	230.8	10.1	11.0
Max	306.4	13.6	19.0
Total	13,387.9	584.4	-
St-dev	38.9	2.3	3.9
Jan-Apr 2004			
Average	338.3	17.1	10.7
Max	442.3	23.8	17.3
Total	27,062.1	1,366.5	-
St-dev	63.7	3.4	2.7

The **Table 8.4** shows that the average badla rate during Jan-Apr 2004 was lower than the preceding two quarters, despite a sharp rise in average badla volume and value (reflecting the initial higher liquidity and lower volume). Moreover, the volatility shows a decline compared with the preceding quarter; though it was still much higher than in Q1-FY04, probably reflecting; (1) investors' mixed sentiments regarding market movements amidst high level of weak holding at very high rates during Mar-Apr 2004, and (2) announcement of PIB jumbo issue in April 2004. The strengthening expectation of interest rates increases appear be constraining a strong rally in the equity market.

8.4 Corporate Earnings[2]

As seen in **Table 8.5**, the overall earnings of the 78 selected companies, representing different sectors, for Jan-Mar 2004 increased by Rs 7.9 billion (46.4 percent) compared with the corresponding period of last year. More importantly, very few companies showed a net loss, though some companies showed a decline in profitability.

Table 8.5: PAT of Selected Companies (quarterly results)
million Rupees

Sector	Sample	Jan-Mar 2003	Jan-Mar 2004	Percent change
Oil & gas (exp.)	3	7,543.6	7,664.6	1.6
Tech & comm.	2	576.4	6,296.7	992.5
Commercial bank	11	2,778.6	3,227.9	16.2
Oil & gas (mkt.)	4	2,551.4	2,112.4	-17.2
Investment banks	3	337.4	1,004.3	197.6
Cement	10	196.6	963.0	389.7
Fertilizer	4	465.8	916.5	96.8
Auto	6	762.5	781.3	2.5
Chemical	6	348.1	725.3	108.4
Refinery	4	1,122.9	663.0	-41.0
Textile (com.)	5	311.6	624.0	100.2
Pharmaceutical	3	361.3	539.2	49.2
Paper and board	4	631.4	489.1	-22.5
Insurance	5	565.5	454.1	-19.7
Synthetic & rayon	3	223.8	365.8	63.5
Power gen. & dis	5	-1,644.9	-1,738.0	-5.7
Total	**78**	**17,132.2**	**25,089.3**	**46.4**

The highest YoY gain in profits was achieved by the *technology & communication* sector (largely reflecting the performance of PTCL) followed by *cement (*amidst rising capacity utilization and declining costs*)*, *investment banks*, *textile (composite)*, and *chemical* sectors (all have shown a triple digit growth in PAT).[3]

The decline in the profitability of the OMC probably results from the decline in the retail market share of Shell, and the fall in furnace oil usage that hit the profitability of PSO. The lower furnace oil consumption also explains the fall in the profitability of refineries, which has to operate at lower capacities following a supply glut in refined products in the domestic market.

---

[2] Based on a sample of 78 companies across different sectors. This information is not comparable over various SBP reports due to changing sample. Also, given the small samples, the sectoral performance is only indicative trend (and could potentially be biased).

[3] The dismal performance of the *power generation & distribution sector* largely reflects the losses incurred by KESC.

Box 8.1: Margin Financing

Carry Over Transaction (COT)/Badla financing is invoked only in Pakistan. At present the size the Badla financing has reached an amount of over Rs. 22 billion and the prevailing badla rate ranges between 10-13%. While this system of badla financing has added liquidity to the market it has been one of the major causes of market crises experienced over the last few years.

Margin Trading Rules, 2004 aim to introduce margin financing and margin trading to reduce the systemic risk associated with carry over transaction (badla) financing, enhance transparency and replace badla with margin financing in a phased manner as and when deemed fit by the Securities and Exchange Commission of Pakistan (SECP).

It is pointed out that the introduction of Rules for Margin Trading also forms part of the conditionalities of the Asian Development Bank's Financial Markets Governance Program Loan (FMGPL) 2002-2005. The Margin Trading Rules have been finalized in consultation with the stock exchanges as well as the Central Depository Company. Further these rules have also been discussed with State Bank of Pakistan, which is simultaneously finalizing guidelines for banks to provide margin financing.

With the introduction of the Margin Trading Rules the present risk of the clearing house of the exchanges would be minimized and the brokers would be responsible for carrying out the due diligence of their clients before allowing margin financing. Moreover the new system would facilitate the development of the futures market in the country.

Conceptually margin financing is pre-trade financing whereas badla financing is post trade financing. Besides, the Margin Trading Rules would help in promoting retail investment in the country and would facilitate the development of the futures market.

Interestingly, however, the profitability of companies in both sectors is expected to improve going forward, principally due to rising oil prices (which should lead to inventory gains and higher margins) as well as higher domestic consumption of furnace oil due to rising dependence on thermal electricity generation.

8.5 New Floatation, Mergers and De-listings

The increase in size and liquidity of the equity markets paved the way for increased number of floatations. In specific terms, 10 floatations (including 3 mutual funds) during the Jan-May 2004 compares very well to only about 13 in last three years. More importantly, most of the public offerings were heavily oversubscribed (see **Table 8.6**).

Following the one of the core objective of KSE to maintain the quality of listed securities, with sound track record and having larger public interest, six companies were de-listed (see **Table 8.7**).[4]

[4] It is desirable to allow sponsors of closely held, illiquid companies, to buy-back the minority shareholding where there is little or no public interest. In this respect, the stock exchange has kept a

8.6 Corporate Bond Market

Despite visible improvement in equity markets the corporate debt market remained almost inactive during Jan-Apr 2004 period with only one issue of Rs 0.8 million compared with seven issues worth Rs 2.7 billion during Q3-FY03 (which was one of the largest issuance during a quarter).

The lower activity in corporate debt market largely reflects the availability of cheaper finance from the commercial banks.[5] However, the recent changes in interest rate expectations, particularly following the Apr-May 2004 up-trend in long-term interest rates may result in the revival of corporate debt issuance (as corporates seek to lock-in long-term rates).

Table 8.6: New Floatation - KSE
million Rupees

Company	Date	Price	Amount
2003			
Ittehad chemicals ltd	07-Mar-03	17.8	110.9
TRG Pakistan	07-May-03	10.0	200.0
PICT	28-Aug-03	10.0	160.0
NBP - 3rd offer	13-Oct-03	46.0	604.0
ODGC	14-Nov-03	32.0	6,881.5
Total			7,956.4
2004 (till date)			
Wolrdcall Broadband	7-Jan-04	10.0	300.0
Sui Southern gas	9-Feb-04	26.0	1,745.1
Madcap Films Ltd	24-Feb-04	15.0	150.0
Callmate Telips	28-Apr-04	10.0	150.0
Southern networks limited	12-May-04	10.0	150.0
Bank Alfalah	17-May-04	30.0	1,200.0
PIA	31-May-04	22.0	2,531.6
Total			6,226.7

Table 8.7 De-listings during (Jan-April 2004)

Company	Date	Capital (million Rs)
F.P. Textile Mills Limited *	1-Jan-04	5.0
Pakistan Fisheries Limited *	9-Jan-04	3.0
Lease Pak Limited*	30-Mar-04	133.2
Star Textile Mills Limited*	9-Apr-04	54.5
Pioneer Cables *	27-Apr-04	35.5
Spencer & Company (Pak) Limited *	11-May-04	15.4

* De-listed after completing formalities of buy back of shares.
Source: KSE website (www..kse.net.pk)

8.7 Mutual Funds

The aggregate (net) assets under management of mutual funds increased to Rs 86.5 billion by end-March 2004 compared with the 39.3 billion at the end of

vigil when deciding the buy-back price at which the sponsors desire to purchase the minority shareholding.

[5] Besides corporate sector also get the benefit of lower transaction costs, e.g., the listing procedure and related documentation requirements.

CY02, representing a massive rise of 120.7 percent in last the 15 months (see **Table 8.8**). This substantial improvement owes to a combination of factors, such as: (1) the phenomenal rally in the equity market which inflated that value of stocks, (2) the launch of new funds, and (3) the increased investor interest stemming from the low yields on fixed income investments (especially following the decline in returns of NSS).

Table 8.8: Mutual Funds (Net Assets)
billion Rupees

Open-End				Close-End			
	Dec '02	**Dec '03**	**Mar' 03**		**Dec '02**	**Dec '03**	**Mar' 03**
Balance Fund				Al-Meezan Mutual Fund	0.4	1.1	1.2
Unit Trust of Pakistan	1.3	2.7	3.1	Asian Stocks Fund	0.1	0.1	0.1
Bond/Income Fund			0.0	BSJS Balanced Fund	0.5	0.5	1.6
Metro Bank - PSF		0.5	1.0	Dominion Stock Fund			0.0
Equity Funds				First Capital Mutual Fund	0.1	0.1	0.1
Crosby Dragon Fund*			0.4	Golden Arrow Stocks Fund	0.1	0.2	0.2
Meezan Islamic Fund		1.0	1.2	Investec Mutual Fund			0.05
National Investment Trust	26.7	43.6	50.1	ICP Lot 'A' - ABAMCO	2.0	3.4	4.2
Pakistan Stock Market Fund	0.4	1.3	1.2	ICP Lot 'B' - PICIC	2.0	5.4	5.4
UTP Islamic Fund		0.8	0.7	ICP SEMF - PICIC	3.8	6.4	7.0
Money Market Fund				Pakistan Cap. Market Fund*			1.5
Dawood Money Mkt Fund		0.7	0.8	Pakistan Premier Fund	0.5	1.1	0.03
Pakistan Income Fund	0.7	2.6	3.0	Prudential Stock Fund			0.03
UTP Income Fund	0.2	1.0	1.3	Safeway Mutual Fund			0.4
United Money Market Fund	0.3	2.2	2.1	Tri-Star Mutual Fund	0.2		
Total	29.6	56.4	64.8	**Total**	9.6	18.2	21.7

* Crosby Dragon Fund - launched in December 2003 and Pakistan Capital Market Fund - launched in January 2004
Source: Mutual Fund Association of Pakistan

Another indication of the higher interest in mutual fund business can be gauged from the fact that 12 (6 open and 6 closed-end) mutual funds have started operations since March 2003, out of which 6 were initiated during Jan-Apr 2004. In addition, a few more mutual funds are expected to be launched in May-Jun 2004.

Open-end

As shown in **Figure 8.6**, the NAVs of open-end mutual funds continue to follow the rise of the KSE-100 index during Jan-Apr 2004.

Interestingly, since July 2002, all open-end funds have consistently under-performed the market, although (not surprisingly), the rise of pure equity funds closely track the changes in the KSE-100 index (suggesting diversified holdings similar to the index).

The underperformance of the balanced and the fixed income funds, however, appears to reflection of the low interest rate environment.

Closed-end

As shown in **Figure 8.7**, the NAVs of (selected) closed-end mutual funds also performed in line with the stock market trends. However, the increase in value of investments of closed-end mutual funds seems to be slightly below the percentage change in KSE-100 index primarily due to the announcement of rights issues.

Figure 8.6: Sale Price Indices (open-end MFs)

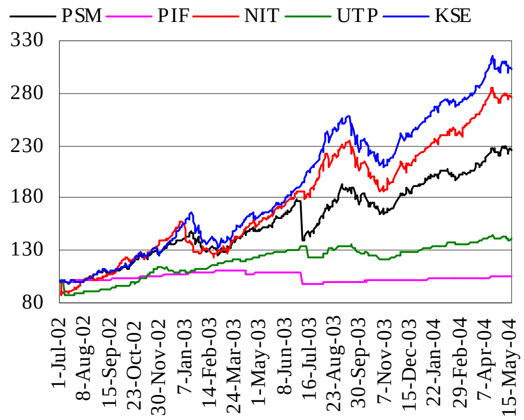


Figure 8.7: Closed-end Mutual Funds (NAV)