Listed Debt Capital Instruments

January 2024

Overview

What is DCM

- A Debt Capital Market (DCM) is a market in which companies and governments raise funds through the trade of debt securities, including corporate bonds, government bonds, Credit Default Swaps etc.
- Debt securities can vary dependent upon their tenor – long term vs short term, their collateral - secured vs unsecured, and whether they are to be listed or not.

Investors

- Individuals
- AMCs
- Insurance Companies
- Corporates
- Banks
- HNWIs

Nature of Issuance

- Retail Listed Accessible to All
- Privately Placed (Subsequently Listed) Offer to qualified institutional buyers (QIBs)
- Privately Placed – Offered to Asset managers and banks

Types of DCM Instruments

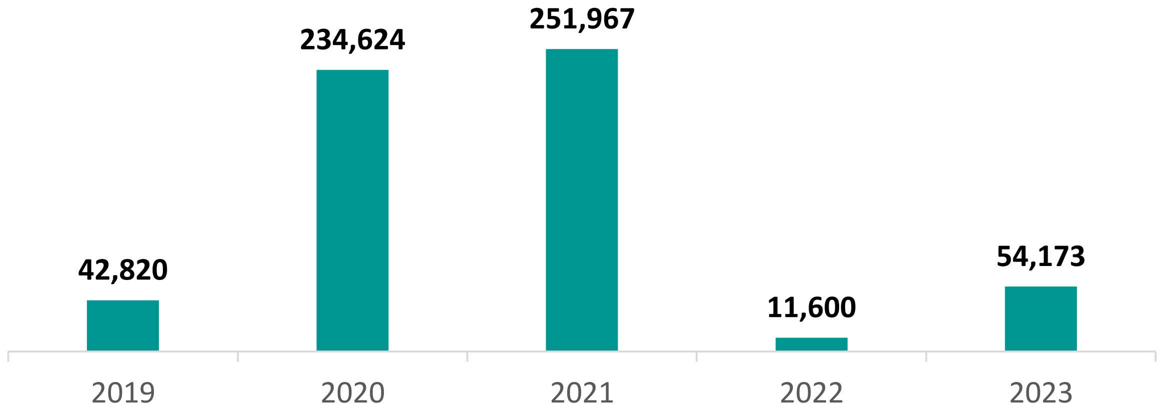
- Term Finance Certificates
- Commercia Paper
- Islamic Sukuks
- Convertible Bonds

Current Market Dynamics

Debt Market Overview

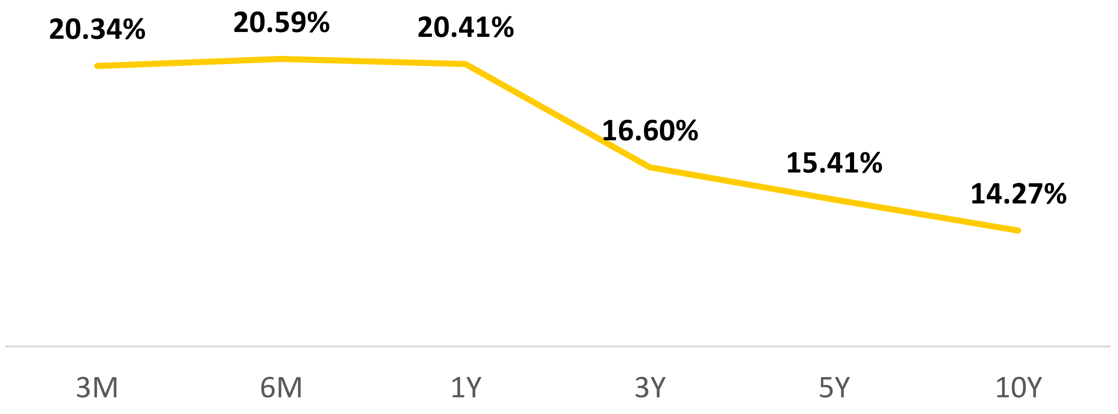
- The PSX witnesses issuance of 10 privately placed debt securities of over PKR 50Bn in FY23. Notable issuers included HBL, BAFL, K-Electric and TPL Corp.
- Majority of these issues were of short tenor due to inverted shape of yield curve where at present there is a spread of approximately 400-500 bps between short and long maturities.
- Due to popularity of short tenor debt instruments, the publicly listed debt capital markets is inactive as it entails long issuance process.

Debt Issuance (PKR Bn)



Source: PSX Annual Report 2023

Yield Curve (%)



Source: MUFAP

- Debt issuance during 2020 and 2021 included listing of two PKR 200 Bn Pakistan Energy Sukuks.
- The primary purpose of issuing Pakistan Energy Sukuks was resolving liquidity crisis of Pakistan Power sector.
- This was the first ever debt issuance through book building at PSX and represented an important milestone in DCM of Pakistan.

Why choose listed?

1. Raising capital through listed Debt Capital Markets (DCM) instruments provides borrower access to non conventional finance and reduce reliance on conventional finance lines.
2. Issuing a listed debt instrument acts as a marketing tool for the issuer. It enhances public understanding of the issuer, builds credibility and improves reputation.
3. Listed debt instruments entail one time cost and effort. Post listing it provides a reliable platform to issuer for all future raising of debt.
4. Existence of potential secondary market would enhance investor’s confidence in issuer’s debt instruments and assist in redirecting capital flows upfront.
5. The process of issuing listed debt instrument would improve corporate governance of the issuer which will ultimately lead to improvement in credit rating
6. Listed debt instruments are potentially cheaper than privately placed instrument due to greater liquidity

What is holding listed DCM transactions back?

1	**Limited Investor Universe**	• The existing active investor base on the PSX is limited to approximately 500,000 participants, encompassing brokers, asset management companies (AMCs), and individual investors. • Most of these investors are already captured by Equity Capital Markets.
2	**Lack of Liquidity/ Inactivity of Secondary Market**	• The volume of activity in debt capital markets is restricted due to lack of active secondary market.
3	**Cost of Issuance**	• Costs of issuing debt instruments are substantial high due to marketing cost, induction expense, listing charges, and stamp duty on TFCs.
4	**Lack of Awareness**	• In general public there is lack of awareness regarding DCM specifically what it entails and what sort of investment venues it offers. Moreover, there are currently no specific incentives in place for either investors or issuers to encourage participation in Debt Capital Markets (DCM)
5	**Appropriateness**	• Identifying individuals who possess ability, knowledge and capability to invest and have patience to invest for the long term is challenging and costly.
6	**Regulatory Impediment**	• Activity in DCM between 2017-2021 was very limited, as banks (which are ideally placed to advise on issuing a debt instrument) were not allowed to act as Consultant to the Issue (CTI)

What is holding listed DCM transactions back? - continued

7 Cumbersome Listing Process & Requirements	• The process of issuing listed debt instrument is long and cumbersome as it entails multiple regulatory approvals of both PSX and SECP. • Requirement of historical financials and minimum paid up capital are key impediments in issuance of Asset Back Securities
8 Crowding Out	• The Government, as the largest borrower, crowds out the private sector by absorbing limited liquidity from markets through issuance of T-bills, PIBs and Defense saving certificates.
9 Lack of Credit Ratings	• The credit rating agencies lack sufficient capacity to cover broad range of issuers and financial instruments and assign rating. • A key impediment in development of DCM is lack of credit ratings across most private entities as instrument's credit rating is derived from issuing entity's credit rating.
9 Inverted Yield Curve	• In current scenario of inverted yield curve, the issuers are mostly interested in short term instruments.

What could be done?

1 Investor Education	• Mass education campaigns in consultation with brokers are required to create awareness and built investor confidence. • Highlight fixed and less risky nature of return profile of debt instruments.
2 Consolidation of DCM	• A single platform should be created to facilitate DCM instead of current scenario where Government, private, mutual funds, and bank instruments are traded in separate windows. This fragmentation results in low volumes for capital market platform.
3 Government to issues debt at SOE level	• The Government should ensure issuance of debt capital instruments at SOE level instead of borrowing through issuance of T-Bills, PIBS and Defense saving certificates to improve traction in DCM.
4 Fiscal Incentives	• The Government should offer targeted fiscal incentives to both investors as well as issuers in DCM for market development. • As the market develops, these incentives can gradually be withdrawn.
5 Credit Ratings/Improve capacity	• Government should offer regulatory and financial support to built capacity of credit rating agencies. • It is essential to make it obligatory for all entities to obtain credit ratings to ensure a seamless transmission to the credit rating of the financial instruments.
6 Regulatory Changes	• Regulations should be simplified by decreasing the cumbersome documentation involved in listing and issuance of debt instruments.
7 Implementation of one window operation	• Government should provide one platform for issuing debt instruments as currently issuers are expected to deal with both SECP and PSX requirements.

Annexure

HBL’s Recent Contributions

PTCL

- **First** Short Term Sukuk by **the Telecom Sector**
- **First** Capital Market Issuance by **PTCL** worth PKR 5 Bn

K-Electric

- **8** Short Term Sukuk Issuances worth **PKR 37.3 Bn**
- Utilized the Inverse Dutch Auction method for pricing
- Widened K-Electric’s investor base

K-Electric

- **3 Retail Listed** Secured Sukuk worth PKR 53Bn
- These were some of the largest Sukuk Issues in the county by a corporation
- ***Case studies on the next slide***

Lucky Electric Power Company

- **7** Short Term Sukuk Issuances worth **PKR 38 Bn**
- Expanded Lucky- Electric’s investor base significantly
- Decreased pricing to a spread of 30bps

HUBCO

- First Short Term Sukuk Issuance by HUBCO worth PKR 6 Bn
- Achieved spread parity with its running finance lines

OBS – We Make A Difference In People’s Life®

- Long Term Sukuk worth PKR 2.9 Bn
- Enabled OBS to access funds for its acquisition ventures

Recent Products under Development

Convertible Bond

- Convertible bond is a **hybrid** security with debt- and equity-like features.
- A type of bond that the holder can **convert** into a **specified number of shares** of common stock in the issuing company or cash of equal value.
- Companies with a **low credit rating** and **high growth potential** often issue convertible bonds.

Asset Backed Securities

- Asset-backed securities (ABS) are collateralized by a pool of assets – usually ones that generate a **cash flow from debt** such as auto loans, house loans, leases, credit card debt, royalties or receivables. For investors, asset-backed securities are an alternative to investing in corporate debt.
- HBL is currently working on an ABS transaction which shall be listed in nature.

Social Impact Bond

A social impact bond (SIB) is a contract with the public sector or governing authority or multilateral aid agency, whereby it pays for **better social outcomes** in certain areas and passes on part of the savings achieved to investors.

- Investing in social impact bonds has risen in recent years as a way for companies to **expand their social responsibility**.
- They feature a fixed term, but they do not offer a fixed rate of return to investors. Instead, the repayment of the bonds primarily depends on **the success of the project** that has been subsidized using the bonds.

Green Bond

A "**Green Bond**", also referred to as a "**Climate Bond**" or "**Sustainable Bond**" is a type of Fixed Income instrument that is specifically earmarked to raise money for climate and environmental projects.

- Becoming increasingly common as a trend towards Environmental, Social & Governmental "**ESG**" strategy.
- Pakistan issued its first green Eurobond bond, **the Indus Bond**, via Water and Power Development Authority Pakistan "**WAPDA**" to fund a hydroelectric project amounting to USD 500 million at 7.5% in May 2021.