

Special Section II: Financial Analysis of the Listed Corporate Sector

The corporate sector constitutes a dominant portion of the banking system's asset portfolio, with a share of 59.0 percent in total bank credit at end-June CY08. The mutual interdependence of the corporate sector and the banks on each other has implications on the stability of the bank-centric financial sector, which makes it necessary to monitor the sources of systemic risk which can potentially arise from the behavior and financing patterns of the corporate sector. Any vulnerability in the financial health of the corporate sector can have a direct impact on credit quality, banks' earnings, and thus on financial stability.

Since late 2007, Pakistan's economy is experiencing a cyclical downturn, primarily driven by various indigenous and exogenous factors. These negative developments in the economy have had a certain degree of impact on the growth of the corporate sector, as a result of which its growth (in terms of profits) during CY07 decelerated to 13.6 percent, as compared to 20.7 percent in the preceding year. The downturn has been most pronounced in sectors which mainly cater to the domestic market. High inflation prevalent in the economy, coupled with high international commodity prices, among other factors, have created a challenging operating environment for the industrial sector.

In Pakistan, the corporate sector mainly comprises of industrial and manufacturing firms operating in both the public and private sectors. By the end of CY07, the total number of registered companies with the SECP was at 50,847. Out of these, there were only 657 companies listed on the stock exchange. The analysis of the corporate sector in this section is however, based on the 437 listed companies which form part of the non-financial corporate sector. Out of these, the number of companies in the private sector was 419, with 18 listed public sector entities. Among these, the textile sector has a leading share with 158 companies, whereas the number of companies in other sectors ranges from 8 to 41 (**Table 1**).

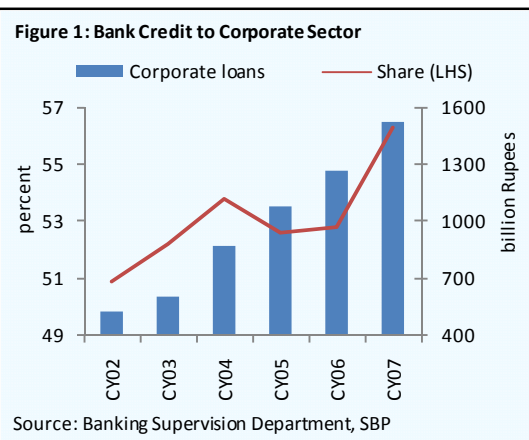
Table 1 : Sector-wise Number of Listed Companies in CY07

Private Sector	419
Public Sector	18
Textile	158
Misc	65
Engineering	41
Sugar	36
Chemical	34
Fuel & Energy	27
Cement	20
Other Textile	20
Trans & Communication	12
Paper & Board	10
Vanaspiti	8
Overall	437

Source: Statistics Department, State Bank of Pakistan

As mentioned earlier, the corporate sector is the largest client of the banking sector. **Figure 1** shows bank credit to the corporate sector for the period CY02 to H1-CY08. Since CY02, the amount of credit extended has increased three-fold, from Rs. 524.5 billion to Rs.1,844.2 billion in H1-CY08, while its share in total credit remained above 50 percent over the same period.

Table 2 shows the share of bank credit to leading stakeholders of the corporate sector. The textile industry and the commerce & trade sector continue to be the dominant



users of bank credit, although their respective shares have decreased from 21.8 percent and 9.4 percent in CY06, to 19.9 percent and 8.7 percent in CY07, respectively.

Table 2 also reflects the distribution of credit between the private and the public corporate sector entities. Over the period from CY03-07, there has not been a significant change in the credit composition in these two sectors, as the average share of the public and private corporate sectors over this period was 4.9 percent and 48.9 percent, respectively.

Table 2: Bank Credit to Corporate Sector

billion Rupees, share in percent					
	CY03	CY04	CY05	CY06	CY07
Total Credit to Corporate Sector	606.5	873.0	1,076.2	1,269.6	1,520.2
Growth	15.6	43.9	23.3	18.0	19.7
Share in Credit					
Public Corporate Sector	4.8	5.4	4.5	4.2	4.9
Private Corporate Sector	47.9	48.6	49.3	48.3	48.9
Textile	26.2	25.1	24.3	21.8	19.9
Commerce and Trade	7.6	9.0	9.7	9.4	8.7
Cement	1.5	1.6	2.2	2.9	3.2
Transport and Communication	1.9	2.7	2.9	3.3	3.2
Chemical	3.1	3.6	3.0	3.0	3.1
Engineering	4.0	2.6	2.8	2.9	3.0
Fuel and Energy	0.5	0.7	0.9	1.1	2.5
Paper and Board	0.5	0.7	0.9	1.1	2.5
Sugar	1.3	1.4	1.7	1.9	1.9
Vanaspati	1.3	1.2	0.9	0.9	1.0

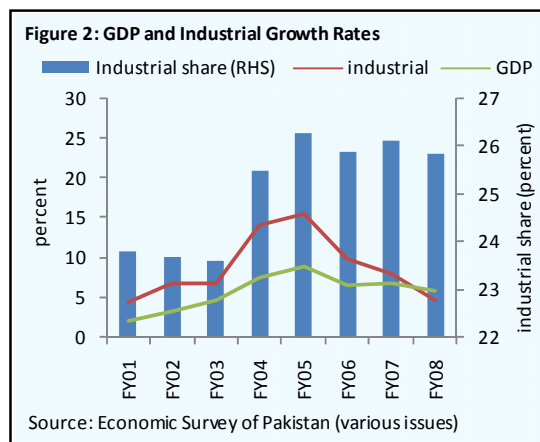
Source: Statistics Department, State Bank

Sectoral Performance Analysis

The corporate sector is influenced by a number of factors in its operating environment, such as economic growth, inflation, interest rates, adequate supply of energy, availability and prices of raw material, incomes and expenditure behavior of economic agents etc. There is a strong positive correlation of about 0.81 between GDP growth and the growth in the industrial sector. The relative decline in the growth of the corporate sector since FY05 is due to the aforementioned factors, such that the growth has decelerated to 4.6 percent in FY08 from its peak level of 15.5 percent in FY05 (**Figure 2**).

Sharp decline in the industrial growth is also evident from the fact that for the first time since FY01, the overall GDP growth has surpassed the growth in the industrial sector. The major sources of this decrease were the manufacturing and the electricity and gas distribution sectors, the growth of which decreased to 5.4 percent and -14.7 percent in FY08, from 8.2 percent and 2.5 percent in FY07 respectively. The share of the industrial growth in overall GDP growth for the period FY01-08 was on average 25.0 percent.

The rate of growth of major industries is shown in **Table 3**. The overall growth of selected industries decreased to 4.7 percent in FY08, as compared to the 18.0 percent growth observed during FY05. The growth of the largest sector, textile, decelerated to 2.6 percent in FY08, in



comparison with the robust performance in FY05, due to multiple factors such as a lower than average cotton crop yield, fuel and gas deficiencies, coupled with frequent breakdowns, high cost of production and an overall unfavorable economic environment. The food, beverages and tobacco industry witnessed an increase in growth over FY07 by 9.8 percent. Pharmaceuticals industry is the leading performer of the year with a robust growth of 29.7 percent over the previous year. Four industries namely Pharmaceuticals, Non-metallic mineral products, Engineering industries and Wood and wood products witnessed growth rate in double digits during the year.

Table 3: Growth Rates of Selected Industries

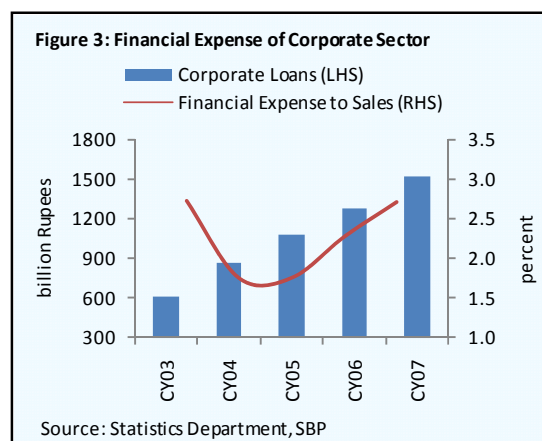
Items	FY03	FY04	FY05	FY06	FY07	FY08
Textile	3.6	6.5	27.2	3.2	8.5	2.6
Food, Beverages & Tobacco	1.4	13.7	3.1	5.2	8.0	9.8
Petroleum Products	3.1	4.7	9.7	2.2	-1.8	6.5
Pharmaceuticals	2.3	14	4.1	12.6	12.2	29.7
Chemicals	14.2	25.1	10.0	11.2	11.7	2.6
Non-Metallic Mineral Prod	9.8	18.5	26.9	13.2	23.1	17.2
Automobile	46.6	50.7	34.0	25.8	3.8	-0.1
Metal Industries	12.6	11.1	9.4	5.3	10.7	-8.3
Fertilizers	-7.4	65.5	25.7	5.0	-7.7	-12.2
Electronics	27.9	61.6	38.3	37.9	9.4	-3.2
Leather Products	-2.5	31.5	-5.3	5.8	8.6	4.5
Paper & Board	15.6	7.6	3.9	13.3	-2.2	-5.4
Engineering Industries	35.7	16.1	21.7	30.8	28.8	15.2
Rubber Products	20.6	26.9	12.7	12.1	27.4	-4.1
Wood & Wood Products	7.1	87.8	238.7	40.6	30.3	20.0
Overall	7.5	18.4	17.9	9.5	8.4	4.7

Source: Federal Bureau of Statistics

Sector-wise Analysis of Financial Indicators

Until the first part of CY05, the corporate sector availed bank finance at a low rate of interest. Rise in disposable income due to huge inflows of worker remittances and strong economic growth, and the access to purchasing power facilitated by banks' consumer finance products, translated into greater demand in the economy, and hence higher growth and profitability for the industrial sector. However, rising inflation since CY05 had an impact on this trend. Growth in corporate sector loans decreased to its lowest level in the last five years, to 20.0 percent in CY07, from its peak of 44.0 percent in CY04. This low growth was largely driven by the lower credit off-take by various sectors like Textiles, Chemicals, and Engineering, largely due to a certain degree of slowdown in overall economic activities in the economy and rising financial costs.

However, a closer inspection of the corporate sector's financial expense to total expense ratio shows that financial expenses are a minimal portion of total expenses, and the impact of the tight monetary policy has not dampened the overall performance of the corporate sector (**Figure 3**). In CY05 when the interest rates were lower, the (average) financial cost to total sales was about 1.6 percent which has increased to 2.5 percent in the year CY07. However, the sector-wise



financial expense to total expense ratio portrays a different picture, such that this ratio for some of the more leveraged sectors lies well above the sector average, ranging from 5.7 percent to 7.1 percent. This issue will be discussed in more detail later in this section.

The discussion below is dedicated to a sector-wise analysis of the financial indicators of the corporate sector.

Debt to Equity Ratio

Leverage indicators are used for an assessment of a company's pattern and mode of financing. **Table 4** lists the sector-wise debt to equity ratio of the corporate sector. It is clear from the data that the overall debt to equity ratio was at its lowest of 1.16 times in CY05, and has been increasing since then, reaching 144.1 percent in CY07. Cement, Transport and Communication, Paper & Board, Fuel & Energy and the Sugar industry have seen an increase in their respective debt to equity ratio (**Table 4**). On the other hand, from CY04 onwards, the textile sector's debt to equity ratio has been decreasing consistently, and has reached 1.8 times in CY07 from 2.2 in CY04. Similarly the ratio for the Engineering sector has decreased to 1.3 times in CY07 as compared to 2.0 in CY05.

Table 4: Sector wise Debt to equity Ratio

	2003	2004	2005	2006	2007
Public Corporate Sector	1.6	1.4	1.3	1.3	1.2
Private Corporate Sector	1.6	1.3	1.2	1.2	1.2
Textile	2.5	2.2	2.1	1.9	1.8
Cement	1.3	1.4	1.0	1.6	2.0
Transport and Communication	0.8	1.0	0.7	1.1	1.5
Chemical	1.3	1.1	1.0	1.0	1.1
Engineering	2.0	1.9	2.0	1.7	1.3
Fuel & Energy	1.5	1.1	0.8	1.1	1.3
Paper & Board	0.7	0.6	0.5	0.6	9.6
Sugar	4.0	3.7	3.1	3.0	3.4
Overall	1.5	1.3	1.1	1.3	1.4

Source: Federal Bureau of Statistics

Financial Expense to Total Expense

As discussed earlier, the financial expenses of the corporate sector have increased due to rising interest rates. **Table 5** shows the sector-wise financial expense to total expense ratio. It is evident from the data that since CY05, the overall financial cost (averaged across the sectors) has increased, reaching 2.5 percent in CY07, its highest level since CY03. However, this ratio for the textile, cement, transport and communication and sugar sectors is well above the sectoral average of 2.5 percent, ranging from 5.7 percent to 7.1 percent, reflecting their dependence on bank borrowing for running their operations.

During CY07, the textile sector, i.e. the leading industry in the corporate sector, witnessed a sharp increase in financial cost to 6.5 percent, compared to 2.6 percent in CY04. For cement, transport and communication, sugar and paper and board sectors, the ratio has almost doubled in CY07 as compared to CY05. Although the overall financial expense to total expense ratio is still low at 2.5 percent, but it differs across sectors due to the degree of leverage in each sector (**Table 5**). The rising trend in this ratio in some sectors raises concerns for financial stability, given the pressure on the debt servicing cost of the companies operating in these sectors.

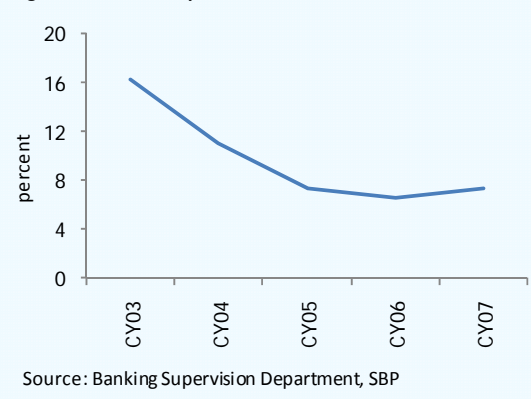
Table 5 : Sector wise Financial Expense to Total Expense

percent	2003	2004	2005	2006	2007
Public Corporate Sector	1.7	1.0	0.8	1.1	1.4
Private Corporate Sector	2.9	1.9	2.1	2.6	3.1
Textile	3.9	2.6	3.9	5.9	6.5
Cement	6.3	3.6	3.7	4.8	7.1
Transport and Communication	4.1	2.8	2.8	4.2	5.7
Chemical	2.2	1.8	2.0	2.7	3.1
Engineering	1.6	0.8	0.8	1.2	1.5
Fuel & Energy	1.6	1.0	0.8	0.8	0.9
Paper & Board	2.3	1.7	1.6	1.5	3.0
Sugar	4.4	3.3	3.5	4.8	6.5
Vanaspati	2.3	2.0	1.7	2.1	2.7
Overall	2.4	1.6	1.6	2.1	2.5

Source: State Bank of Pakistan

Figure 4 shows the non performing loans of the corporate sector for the period CY03 to CY07. Encouragingly, despite the rising interest rates in the last two years, the share of non-performing loans in total loans had declined consistently from CY01 until CY06, but then witnessed a small proportion of incremental NPLs in CY07. Importantly, despite the rise in financing cost during CY07, its NPL to loans ratio is still lower in comparison with the CY03-04 level when the interest rates were much lower. This shows the resilience and financial capacity of the corporate sector to service its debt obligations as they fall due.

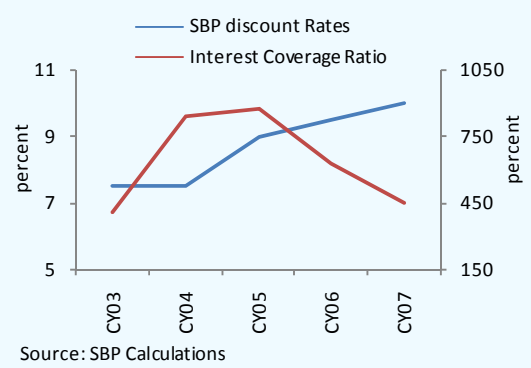
Figure 4: NPLs of Corporate Sector



Interest Coverage Ratio (ICR)

The corporate sector’s capacity for servicing its debt obligations can be gauged by using the Interest coverage ratio (ICR).¹ **Figure 5** shows the relationship of the ICR and discount rate. It is evident from the figure that the ICR and the discount rate are inversely related. With an increase in the discount rate, the ICR ratio deteriorates and vice-versa. In CY03-04 when interest rates were relatively lower and the macroeconomic environment was largely favorable, the ICR touches its peak of 8.7 times, but started to

Figure 5: Relationship of Interest Coverage ratio and Discount Rate



¹ ICR is generally used to determine how easily a company can pay the interest component on its outstanding debt, expressed in terms of the number of times the income covers the interest expense. The lower the ratio, the more the company is burdened by debt expenses and vice-versa. An ICR of 1.5 or lower indicates a certain degree of weakness in the company’s capacity to meet interest payments. An ICR of under 1.0 indicates that the company is not generating sufficient revenues to meet its interest expenses.

decline subsequently, as the interest rates started to rise, reaching 4.5 times in CY07. The current macroeconomic environment indicates challenging times for the corporate sector.

Sector wise ICRs of the corporate sector are presented in **Table 6**. The impact of the rise in interest rates has had a variable impact across the sectors. ICRs for almost all the sectors deteriorated rapidly in CY07 as compared to CY06. The ICRs of Textile, Sugar and Vanaspati sectors, which started deteriorating during CY06 continued to do so in CY07, and went below the required level of 1.5 times. On the other hand, ICRs of other sectors, while having declined, are still strong. In an era of high interest rates and high cost of production, the ICR of the corporate sector is expected to deteriorate further in the future and some of the already financially vulnerable sectors like Textile, Sugar and Vanaspati would need to manage their financing requirements more closely.

Table 6 : Sector wise Interest Coverage Ratio

	2003	2004	2005	2006	2007
Public Corporate Sector	3.1	7.0	8.2	6.5	4.8
Private Corporate Sector	6.9	12.8	10.8	5.4	3.1
Textile	1.9	2.2	2.4	1.6	1.4
Cement	0.6	4.2	6.5	6.5	1.8
Transport and Communication	11.3	15.7	11.4	4.3	2.5
Chemical	3.8	11.2	10.9	7.4	7.9
Engineering	8.3	13.2	10.9	8.6	5.9
Fuel & Energy	3.2	11.3	14.9	14.8	10.9
Paper & Board	9.7	10.8	10.8	30.2	12.2
Sugar	0.8	1.6	2.6	1.5	0.9
Vanaspati	1.2	2.7	1.0	0.5	-0.5
Overall	4.1	8.4	8.7	6.2	4.5

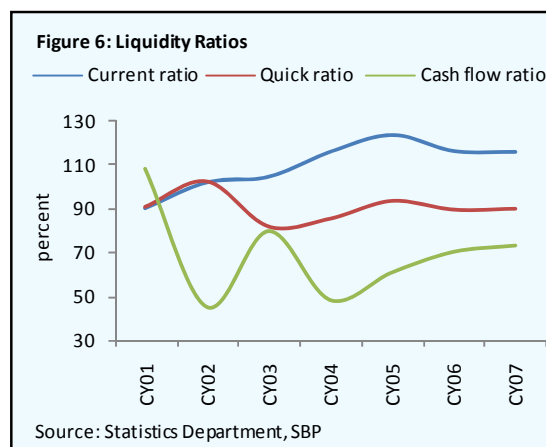
Source: State Bank of Pakistan

Liquidity Ratio

The operating cash-flow ratio reflects how well current liabilities are covered by the cash flows generated from a company's operations. Since FY01, this ratio has exhibited a cyclical trend and stood on average at 6.9. However, since FY04 onwards this ratio has improved steadily (**Figure 6**).

Sector wise Current Ratio

Figure (7) shows the sector-wise average current ratio for the corporate sector. While the average current ratio for the textile, engineering, cement, chemical, paper and board industries witnessed consistent improvement since CY05, indicating the stable health of these industries, while the current ratio of the fuel & energy, transport and communication, sugar and vanaspati industries have been declining since then. The average current ratio for the paper & board sector for the period CY07 stood was 2.5 times, the highest in the group, whereas the lowest average current ratio is that of the vanaspati and allied industries, at 0.37 percent during CY07.

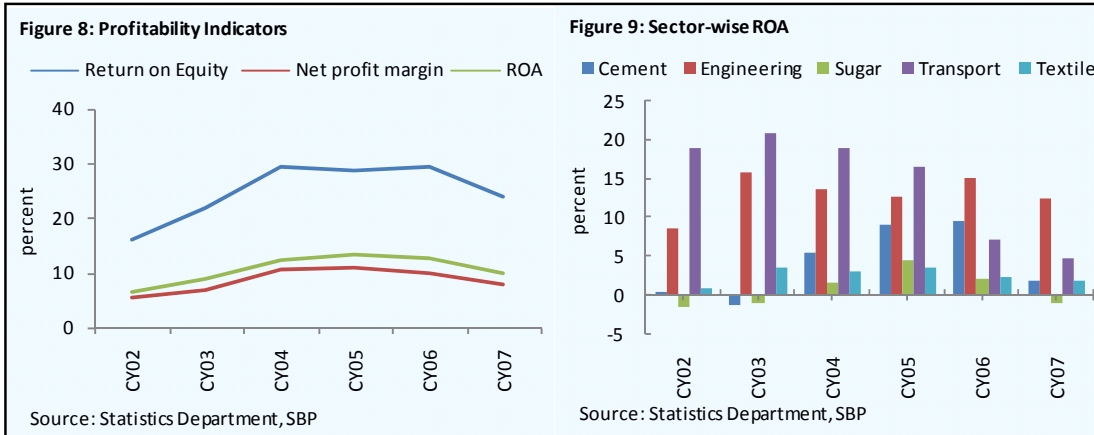
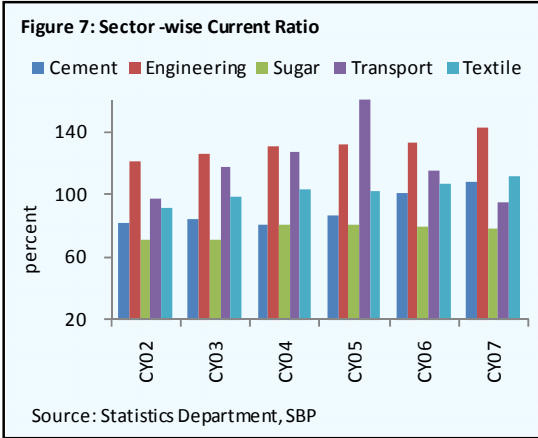


Profitability Indicators

Rise in interest rates, tight monetary conditions and weakening macroeconomic fundamentals have also negatively impacted the profitability indicators of the corporate sector, which showed some deterioration in CY07 (Figure 8). During CY07, various sectors, such as Textile, Cement, Engineering, Fuel & energy, and Sugar have recorded low profit margins, as compared to CY06.

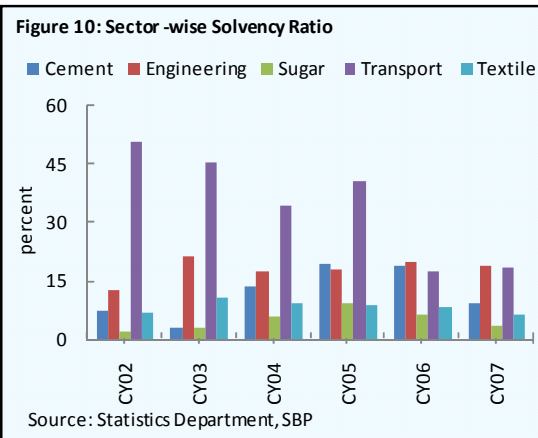
Sector wise Return on Assets (ROA)

Figure 9 shows the sector-wise Return on Assets (ROA) analysis of the corporate sectors. During CY07, ROA of almost all sectors, except chemical and paper & board witnessed deterioration. Transport & communication and Cement sectors have seen sharp deterioration since CY05, the ROA of these sectors has reached to 4.9 percent and 2.0 percent in CY07, from their relatively higher ROA of around 17.0 percent and 10.0 percent, respectively, during CY05. Similarly, textile sector has seen a decline in ROA since CY05 which declined further to 1.9 percent in CY07 as compare to 3.6 percent in CY05. On the other hand, chemical sector has fared better, with 19.4 percent ROA in the group, followed by fuel & energy, paper & board and Engineering the ROA of which was over 12.0 percent in CY07.



Sector wise Solvency Ratio

Figure 10 shows the sector-wise solvency ratio for the corporate sector. During CY07, a number of sectors witnessed deterioration in their respective solvency ratios except chemical and transport & communication, the ratios of which improved slightly. The solvency ratio of chemical sector, although down from its CY05 level, stood highest in the group during CY07. Sharp deterioration has been witnessed in the Paper & board sector, the ratio of which slipped to 29.5 percent in CY07 from 62.0 percent in CY06. Similarly, solvency ratios pertaining to textile, cement, and sugar



sectors have consistently deteriorated since CY05 onwards, reaching 6.3 percent, 9.0 percent and 3.4 percent respectively in CY07, as compared to relatively higher solvency ratios of 8.7 percent, 19.4 percent and 9.1 percent respectively in CY05.

Corporate Financing Patterns

Four ways of business financing are traditionally practiced. **Table 7** shows the pattern of corporate financing for the period CY02 to CY07. Clearly, financing through banks is dominant for the entire period. On average banks fulfill 98.5 percent of the financing needs of the corporate sector, 0.8 percent financing is met by issuing term finance certificates (TFCs) and 0.7 percent of the total corporate financing needs are satisfied through initial public offerings (IPOs).

Table 7: Corporate Financing from Different Sources

billion Rupees			
Year	Banks	IPO*	TFC*
CY02	524.5	0.1	4.7
CY03	606.5	2.5	19.5
CY04	873.0	21.7	0.0
CY05	1076.2	9.8	6.6
CY06	1269.6	3.0	3.0
CY07	1520.2	4.9	4.0

Source: SBP and KSE

* The IPOs and TFCs issued by financial institutions are not included.

Figure 11 shows the types of financing needs for the period FY05 to FY08 (till March). In FY08, 24.1 percent loans were for working capital, followed by fixed investment at 20.7 percent share and 13.7 percent share of trade finance. On average working capital has the dominant share for the entire period of about 23.1 percent of the total corporate financing. The share of trade finance is the lowest for the last two years.

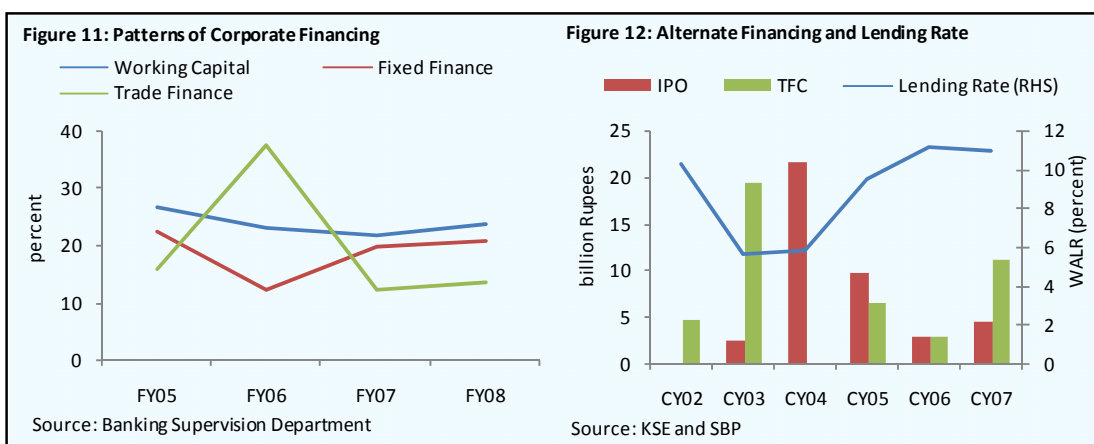


Figure 12 shows the alternate financing and lending rate patterns. It is very clear from the figure that in low interest era CY03-04 the amount of alternate financing, TFCs and IPOs is at its highest level of 19.5 billion and 21.7 billion respectively. The trends in weighted average lending rates and alternate finance shows that with increase in weighted average lending rates the volume of alternate finance decreases and vice-versa.