

Box 7.1: Financial Performance and Soundness of Top Borrowing Groups of Banking Sector

Introduction

The large private sector corporate firms are one of largest borrowers from the banking sector, as corporate segment uses 66.5 percent of the banks' total loans and advances. Most large borrowers are also part of business conglomerates, which in aggregate have even greater exposure thus further adding to element of concentration in credit risk of banks. SBP has set concentration limits on banks' exposure to single borrower and borrowing groups as well as aggregate limit on large exposures. Due to the large size of exposures and borrowings from multiple banks, any deterioration in the financial standing and delinquencies of large corporate borrowers and borrowing groups could have systemic repercussions for the banking sector. Therefore, sound financial health and stable performance of large borrowers and borrowing groups is critical for the stability of the banking system. In this box, repayment behavior and capacity as well as overall financial health of large borrowers and borrowing groups of the banking system have been analyzed based on the following:

- a. Banks' own assessment of large borrowers and borrowing groups' credit worthiness as captured through ORR of borrowers assigned by banks.
- b. Borrowers' repayment behavior in terms of any overdue in the payment of their obligations to banks.
- c. Latest financial indicators of leading corporate borrowers as well as market-based indicators which show how investors value these firms.¹⁷⁸

Assessment of Credit Worthiness

The credit worthiness was assessed for top 30 borrowing groups (comprising 247 firms) based on ORR assigned by banks. Identified firms of

these groups hold around 20.03 percent of the corporate/commercial lending portfolio of banks as on December 31, 2021.

ORR framework: SBP requires banks /DFIs to compile both ORR (a kind of credit rating which is assessed by the lending institution itself) of corporate borrowers and Facility Rating of each financing facilities availed by them.¹⁷⁹ The ORR reflects the credit worthiness of the borrower and is one possible predictor of borrower's default or satisfactory performance. The rating continuum comprises 1 to 12, with 1 to 9 scales for performing categories and 10 to 12 for default categories.

Assessment of Results

Based on ORR of different borrowing entities of the groups, overall average rating (weighted by size of loans) of each group was compiled to assess the strength of these groups. Our assessment indicated that most of the top 30 groups have medium or good quality ratings. It is important to note that during CY21 top 30 groups of the banking system improved their credit worthiness in terms of ORR ratings as compared to CY20, which was marked by lockdowns especially during the first half of CY20. The internal credit rating profile of the large borrower groups has improved from CY20 to CY21 as reflected in the favorable shift in the frequency distribution curve of credit rating. In fact, overall frequency distribution curve of credit rating in Dec-21 is improved as compared to Dec-19 indicating that that top 30 borrowing groups in Dec-21 have better credit ratings than in Dec-19, the period just before COVID-19 (**Chart 7.1.1**).

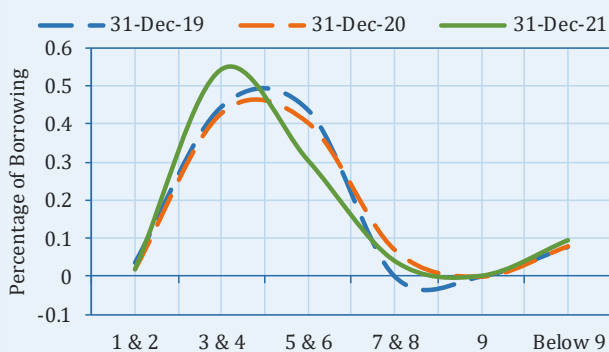
The shift in ORR also reflects a conservative approach on the part of banks to lend to better quality borrowers. As discussed in the following

¹⁷⁸ Fetched from Bloomberg utility which captures and compiles indicators of listed firms

¹⁷⁹ [BSD Circular No. 8 of 2007](#)

paragraphs, the financial and market-based indicators in CY21 show robust financial performance of the leading borrowing firms of the banking sector and stable market-based indicators which reflect investors' perception about these firms.

Chart 7.1.1: Internal Credit Rating of 30 Large Borrowing Groups



Source: SBP Estimates

Financial Soundness and Market Performance of Listed Firms of Top 30 Borrowing Groups

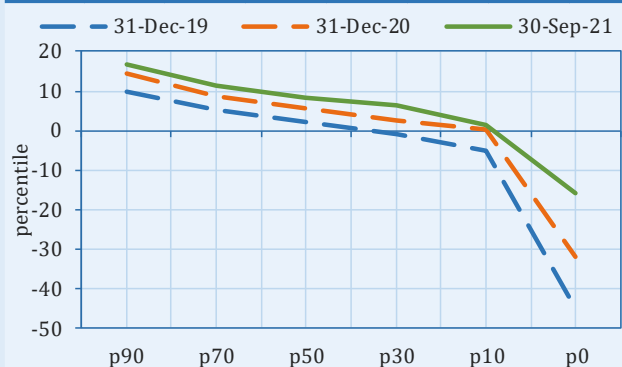
As per Pakistan Stock Exchange (PSX) data, a total of 536 companies (including default companies) were listed in PSX as of end CY21. Based on the available information from diversified source, it has been identified that out of these 536 listed companies, 84 firms belonged to top 30 borrowing groups of the banking sector. To analyze the financial soundness of these firms and assess how they are valued by the market and general investors, a detailed assessment of these 84 listed firms was done using the financial and market-based indicators. Following analysis evaluates various indicators of these firms, including ROA, ROE, Current Ratio (CR), ICR, Gross Margin (GM), Earning per Share (EPS) and Price-to-Book (P/B) Ratio based on the latest available data for the period ended Sep-21 vis-à-vis data of end Dec-20 and Dec-19.

The analysis of data shows that in CY21 most of the top borrowing companies showed improvement in financial indicators which is in line with strong recovery in economic indicators in CY21. Various financial and market indicators

show that in the first three quarters of CY21, top borrowing companies have shown resilient performance despite rising international commodity prices and inflation specially in the second half of CY21.

The ROA across the entire sample of these firms improved in the first three quarters of CY21 as compared to both Dec-20 and Dec-19 as firms saw higher profitability in CY21 as compared to the last two years (Chart 7.1.2).

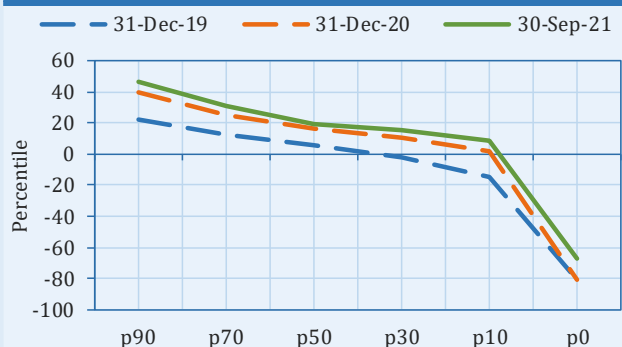
Chart 7.1.2: Percentile Distribution on ROA of Companies



Source: Bloomberg, SBP

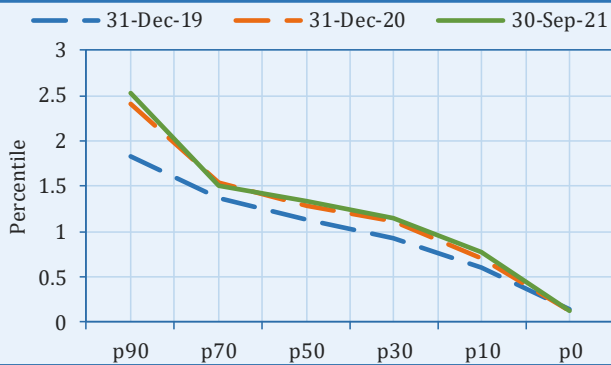
Similarly, the ROE in the first three quarters of CY21 shows appreciation across the entire sample of these firms due to higher profitability in CY21 as compared to the last two years (Chart 7.1.3).

Chart 7.1.3: Percentile Distribution on ROE of



Source: Bloomberg

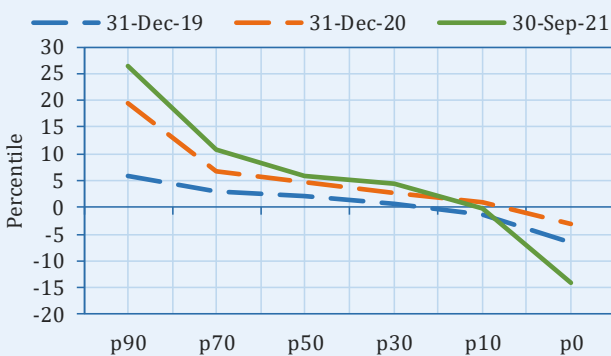
Chart 7.1.4: Percentile Distribution on Current Ratio of Companies



Source: Bloomberg

Firms maintained the same level of liquidity in terms of CR in Sep-21 as in Dec-20, though the corporate sector witnessed a significant revival in business activities and working capital requirements. The liquidity profile of these firms is however stronger than the pre-COVID-19 levels of Dec-19. This improvement bodes well for future resilience of these firms, and also reflects the effectiveness of SBP policies to ensure the adequate supply of liquidity in the market to support the business and economic activities in the wake of COVID-19 **(Chart 7.1.4)**.

Chart 7.1.5: Percentile Distribution on ICR of Companies

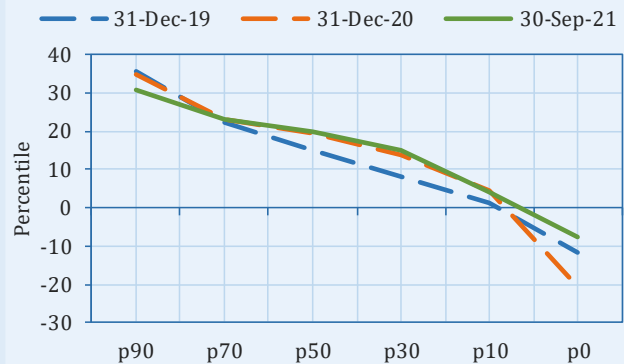


Source: Bloomberg

Top borrowing firms also improved their debt servicing capacity in terms of ICR during CY21 due to growth in earnings as well as reduced financial costs due to low interest rate which prevailed during CY20 and the first three quarters of CY21 **(Chart 7.1.5)**.

The policy rate has been increased from 7% in Sep-21 to 9.75% in Dec-21. The increase in policy rate may result in higher financial costs for businesses; however, the firms in general have reasonably strong margins which will aid them in absorbing the increase in financial cost of borrowing.

Chart 7.1.6: Percentile Distribution on Gross Margin

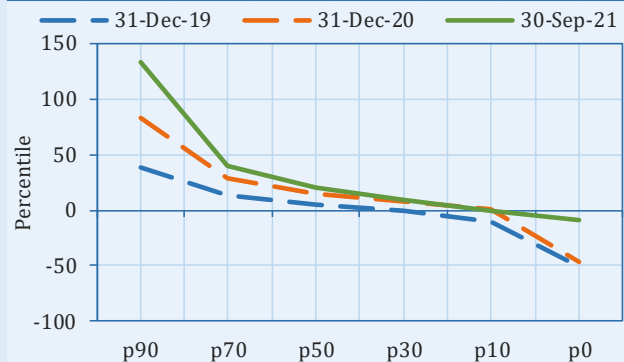


Source: Bloomberg

Core earnings of firms in terms of GM ratio more or less remained stable as the inflation and increase in global commodity prices affected the input and output pricing equally. However, depending upon the idiosyncratic dynamics of firms and their underlying sectors, the margins of some firms witnessed some change **(Chart 7.1.6)**.

In terms of market indicators, EPS of the sample firms improved as compared to both Dec-19 and Dec-20 due to high profitability of firms in CY21 **(Chart 7.1.7)**.

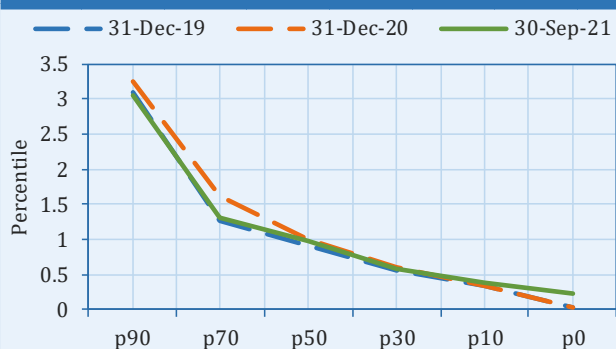
Chart 7.1.7: Percentile Distribution on Earning Per Share (EPS) of Companies



Source: Bloomberg

P/B Ratio of the sample firms remained more or less at the same level as the last two years, which shows that recent improvement in operating efficiencies and earnings have not been factored in the shares prices of the firms. Given the high profitability of listed companies in CY21, the low P/B ratio shows that there is room for appreciation in stock prices, which bodes well for investors (**Chart 7.1.8**).

Chart 7.1.8: Percentile Distribution on Price/Book (P/B) Ratio of Companies



Source: Bloomberg

Conclusion

The comparative position of ORR of top 30 borrowing groups of the banking sector shows that these groups have generally improved their credit worthiness (i.e. ORR) in CY21 as compared to CY20. The improvement in credit ratings also reflects a prudent and risk-averse approach on the part of banks to have higher exposure on large firms which have better credit worthiness. CY21 has been a year of revival of the economy with top borrowing firms reflecting improved credit ratings and overall stronger financial performance and more stable market indicators.