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

Corporate sector is a major client of bank loans, utilizing a hefty 72.5 percent of the total lending portfolio as of December 2024. The corporate sector also comprises a number of business conglomerates on which banks have taken exposure, potentially creating a credit concentration risk with systemic implication for the banking sector. To address the issue, SBP has put in place regulatory prudential limits on banks' exposure to a single borrower, borrowing group, and related party.[18] Moreover, prudential regulations also define the term 'large exposure' and prescribe an aggregate limit on large exposures. This box analyzes the repayment behavior and capacity as well as overall financial health of firms in the top borrowing groups of the banking sector on the following parameters:

a. Banks' own assessment of creditworthiness of large borrowers and borrowing groups, as captured through Obligor Risk Rating (ORR), assigned to each corporate sector borrower. The rating continuum goes from 1 to 12, with 1 to 9 denoting performing categories whereas 10 to 12 for non-performing categories.
b. Borrowers' repayment behavior in terms of any overdue payments in their loan obligations to banks.
c. Latest financial indicators of leading corporate borrowers as well as market-based indicators that show how investors value these firms.

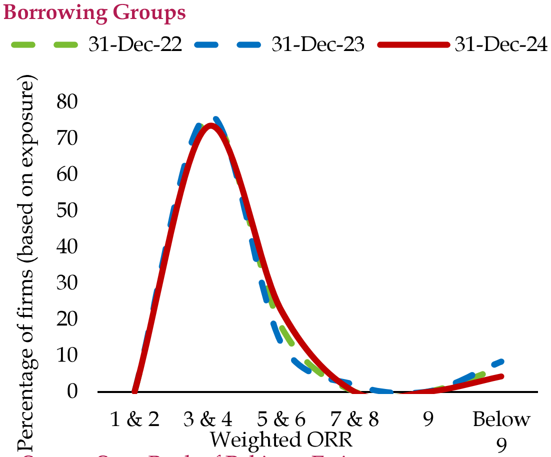
To accomplish this task, thirty (30) large borrowing groups, comprising 221 borrowers/firms, have been identified based on internal exercise conducted by SBP. This assessment considered factors/sources such as the ownership structure of the firm, regulatory returns, financial statements of the firms and information available on groups'/firms' websites etc. Further, groups with a fund-based exposure of Rs 55 billion and above are considered for this assessment, given their systemic risk implications.

Credit Worthiness of Top 30 Borrowing Groups based on their Obligor Risk Rating (ORR)

The creditworthiness of top 30 borrowing groups has been assessed based on their ORR assigned by banks. The 221 identified firms together constitute around 28.7 percent of the corporate/commercial lending portfolio of banks and DFIs at end of December 2024.[19]

Based on ORRs of different entities of the borrowing groups, overall average rating (weighted by size of loans) of each group was compiled. To assess the dynamics of credit worthiness of these groups, distributions of the weighted ORRs for last three years have been plotted. Assessment indicates that, on average, around three-fourths of the top 30 groups have at least good to medium (3 & 4) ratings. Nonetheless, major chunk of the firms in large borrowing groups, around 95 percent, has been consistently rated in performing category, viz., 1 to 9 (**Figure 7.1.1**).

Internal Credit Rating of Top 30 Borrowing Groups **Figure 7.1.1**



Source: State Bank of Pakistan Estimates

Outstanding loans to top 30 borrowing group increased by 27.2 percent (YoY) in CY24. This was largely driven by a surge in private sector credit toward the end of CY24, primarily resulting from monetary easing and banks' aggressive efforts to increase Advances-to-Deposit Ratio (ADR). The average internal credit rating profile of performing firms remained stable, although some migration was observed within performing category (ORRs 1 to 9) during CY24. Specifically, slight percentage of firms in bin (3&4) moved into lower rating bin (5&6). In terms of repayment capacity, however, the overall distribution implies that the borrowers' credit quality and repayment capacity has remained steady even in the face of low economic growth and tight financial conditions during the first half of CY24 **(Figure 7.1.1)**. It is important to note that around 64 percent of banks' corporate and commercial loan portfolio comprises of borrowers who have been rated by independent external rating agencies.

[18] Regulation R-1 of SBP Prudential Regulation for Corporate/Commercial Banking.

[19] This share was 31 percent at end of December 2023

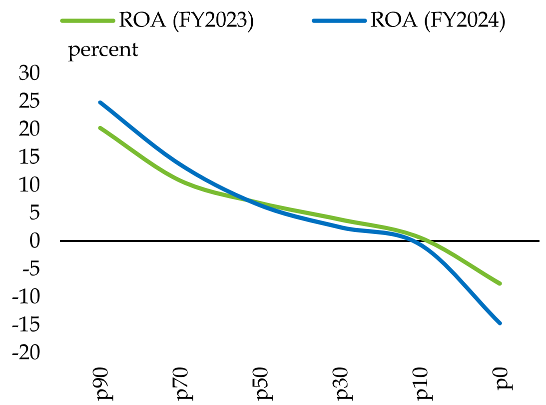
By and large, top 30 borrowing groups exhibited strong repayment capacity, except for a few groups (around 4.23 percent of total exposure) which fall under non-performing/overdue category. The non-performing borrowing groups were 8.28 percent of total exposure in prior year i.e. CY23.

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

Out of the 221 identified firms in top 30 borrowing groups, 60 firms were listed on PSX. To analyze the financial soundness of these firms and assess how they are valued by the market, an assessment of these 60 listed firms was carried out using their financials and market-based indicators on the basis of available data for the financial year ended in 2023 and 2024.[20]

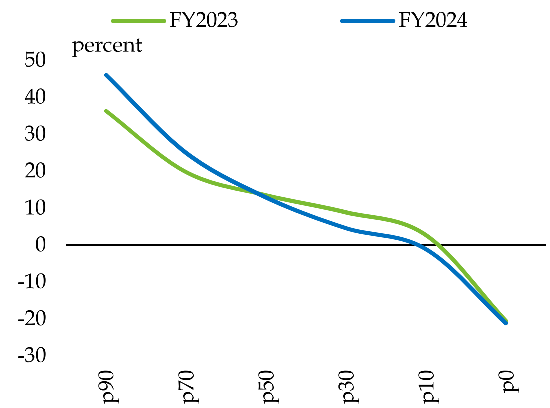
The financial year (FY) 2024[21] witnessed a slight respite in the overall stressed macroeconomic conditions, and the finance cost of the firms also declined due to monetary policy easing post May 2024; however, taxation expenses remained high leading to a mixed trend in earnings of the selected firms. On average basis, FY24 saw signs of improvement in the financial performance of the firms (**Figure 7.1.2 and Figure 7.1.3**).

Percentile Standing of Companies vis-a-vis ROA — **Figure 7.1.2**



Source: Capital Stake

Percentile Standing of Companies vis-a-vis ROE — **Figure 7.1.3**



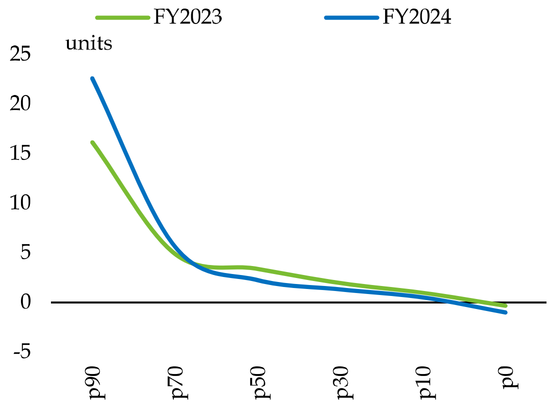
Source: Capital Stake

Similarly, the financial indicators related to repayment capacity of the firms improved primarily due to monetary easing during FY24, wherein majority of the firms in the sample demonstrated a comfortable interest coverage ratio (**Figure 7.1.4**). Sample firms faced a sluggish trend in current ratio over the year under review; however, the ratio of most of the firms remained in a comfortable zone, showing availability of ample liquidity cushions to honor their short-term financial obligations (**Figure 7.1.5**). Moreover, sample firms also showed a stable repayment behavior as there was decline in the delinquencies during the year under review.

[20] Out of these, data of 17 firms was used for interim period i.e. 9-month period ended in September 2024 at the time of analysis.Where applicable, necessary adjustments have been made.

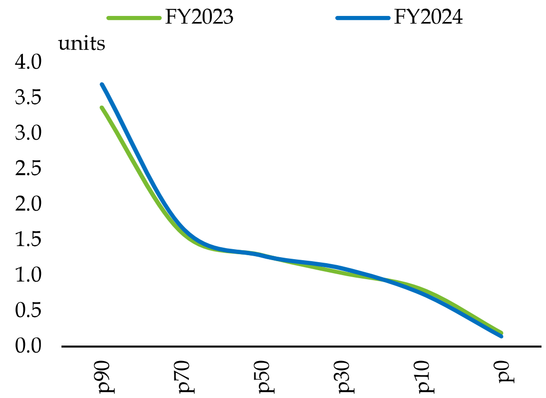
[21] FY here denotes financial year of the firm instead of usually understood fiscal year

Percentile Standing of Companies vis-a-vis Interest Coverage Ratio **Figure 7.1.4**



Source: Capital Stake

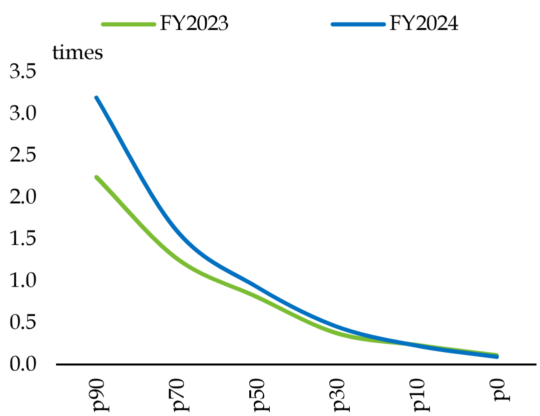
Percentile Standing of Companies vis-a-vis Current Ratio **Figure 7.1.5**



Source: Capital Stake

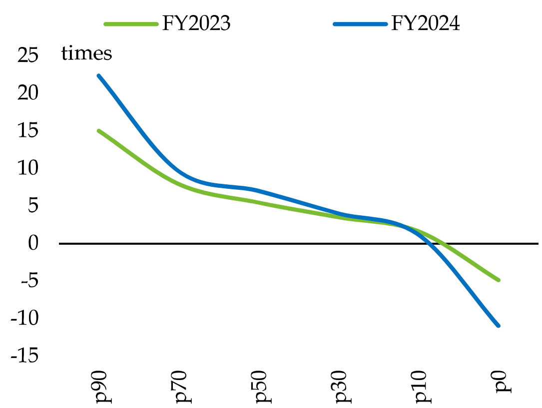
Investors in general, hold a positive sentiment about the stock/equity market, despite volatility and large movement in the market index during 2024. An analysis of market-based indicators of the selected firms shows that overall growth in price-to-book (P/B) and price-earnings (P/E) ratios of these firms was mainly driven by an increase in firms' stock prices (**Figure 7.1.6 and Figure 7.1.7**).

Percentile Standing of Companies vis-a-vis Price / Book Ratio **Figure 7.1.6**



Source: Capital Stake

Percentile Standing of Companies vis-a-vis Price / Earnings Ratio **Figure 7.1.7**



Source: Capital Stake

Conclusion

The yearly comparative position of ORRs and repayment behavior of the top 30 borrowing groups of the banking sector shows that these groups have generally maintained their creditworthiness with a good repayment behavior and bear a fair financial profile. The top borrowing firms also reflected relatively a resilient financial performance and continued to serve their financial obligations during the year under review.