RATING REPORT

Habib Bank Limited

REPORT DATE:
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RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity Rating	AAA	A-1+	AAA	A-1+
TFC	AA+		AA+	
Outlook	Negative		Negative	
Date	*June 29, 2018*		*September 22, 2017*	

COMPANY INFORMATION	
Established in 1941	**External auditors:** A. F. Ferguson & Co. Chartered Accountants
Public Limited Company	Chairman of the Board: **Mr. Sultan Ali Allana**
Key Shareholders (with stake of 5% or more):	**President & CEO:** Mr. Muhammad Aurangzeb
Aga Khan Fund for Economic Development – 51.00%	
CDC Group PLC – 5.00%	

APPLICABLE METHODOLOGY
JCR-VIS Commercial Banks Rating http://jcrvis.com.pk/docs/Meth-CommercialBanks201803.pdf

Habib Bank Limited

OVERVIEW OF THE INSTITUTION

Habib Bank Limited (HBL) was established as a privately held bank in 1941. Currently the Bank operates as a public limited company with majority shareholding held by Aga Khan Fund for Economic Development (AKFED).

HBL's branch network spans over 24 countries. In Pakistan, the Bank operates 1,703 branches (2016: 1,677) including 47 (2016: 45) Islamic banking branches, whereas the Bank has 48 branches (2016: 54) outside Pakistan including KEPZ.

Profile of Chairman

Mr. Sultan Ali Allana serves as the Chairman of the Board. Mr. Allana is a career banking professional with over 33 years of experience in retail, corporate and investment banking. He is a Director of AKFED and has oversight responsibility for AKFED's investments in Banking, Insurance, and Aviation.

Profile of CEO

Mr. Muhammad Aurangzeb spearheads the management team at HBL and he assumed the position of Chief Executive Officer on April 30, 2018. Mr. Aurangzeb possesses over 30 years of diverse local and

RATING RATIONALE

Largest commercial bank with systemic importance and diversified operations.

Habib Bank Limited (HBL) is the largest commercial bank in the country with a market share of 14.3% (2016: 14.1%) in domestic deposits at end-2017. HBL enjoys strong domestic operations and franchise with systemic importance to the domestic financial sector. The Bank through its subsidiaries and associates has a presence in the Insurance (Jubilee Life and Jubilee General), Asset Management (HBL AML) and Microfinance sectors as well. HBL also has sizeable presence outside Pakistan with 8.5% (2016: 13.4%) of the total assets of the Bank deployed overseas.

Strong board composition with increasing focus on improving compliance and governance infrastructure; innovation, financial inclusion and compliance continue to be important pillars in the Bank's overall strategy.

Overall corporate governance framework is supported by strong board composition & oversight and professional and experienced management team which has been strengthened further in 2017 and in the ongoing year. Strong focus on improving compliance is evident from reorganization (establishment of international compliance department, quality control and training unit and merger of similar nature departments) and significant strengthening of the Compliance team through induction of experienced resources. Moreover, board and management level compliance committee has been established in order to enhance governance and oversight. HBL has also embarked on a group wide business and compliance transformation program in partnership with international consultants to review and further improve its AML and CFT processes whilst embedding a strong compliance culture within local and international network. JCR-VIS believes that improvements being undertaken on the compliance front will be a source of competitive advantage for HBL.

Over the last few years, the Bank's HBL Asaan Account initiative and NISA program has also contributed significantly to enhancing reach and financial inclusion. The First MicroFinanceBank Limited also contributed to enhanced financial inclusion with number of active borrowers and active savers increasing by 38% and 56.7%, respectively, during 2017. As a medium term strategic goal, the Bank aims to almost double the number of customers over the next three years. A significant contribution to the financial inclusion initiative will come from HBLs branchless banking platform which has been re-launched in the ongoing year.

Consolidation in the international business remains a key focus area. Growth in portfolio anticipated primarily from Middle East while China operations are expected to receive a boost post receipt of an RMB clearing license in the ongoing year.

New York State Department of Financial Services (NYSDFS) followed up with enforcement actions on their report with an enhanced look back of transactions which eventually resulted in a settlement payment of $225m. Subsequently, HBL decided to surrender its banking license in New York. This impacted operations of other overseas jurisdiction requiring dollar clearing bank and other corresponding relationships. As per management, correspondent banking arrangements for all key jurisdictions are now in place. The Bank is in the process of consolidating its international operations through reducing exposure. Growth in international operations is targeted from Middle East with gradual build up in low risk financing and investment book. Last year, HBL opened its first branch in Urumqi, the largest city in the province of Xinjiang, China. With completion of satisfactory first full year operations, management is focused on obtaining an RMB license during 2018, which will facilitate in increasing business volumes. The Bank also plans to convert its representative office in Beijing into a branch.

Financing portfolio witnessed healthy growth in 2017 with improving asset quality indicators. Broad based growth in advances targeted for 2018.

Aggregate exposure to the sovereign/public sector by way of advances and investments represented 55.1%

international banking experience. He has held senior level positions in ABN AMRO Amsterdam, RBS Singapore and JP Morgan, Asia Pacific. He is a graduate of the Wharton School, University of Pennsylvania with majors in Economics and Business Administration.

(2016: 53.7%) of the total asset base at year-end 2017. In absolute terms, growth in financing portfolio was witnessed in the corporate, consumer and SME segment while agriculture, commodity and international advances declined. Given the sizeable growth in corporate advances, proportion of the same increased to around two-third of total financing portfolio. A significant portion of the increase in gross advances was against government/public sector companies. Resultantly, proportion of the same increased to 23% (2016: 16%) of overall gross advances. For 2018, broad based growth in financing portfolio is planned with particular emphasis on increasing consumer assets. Increase in consumer loan portfolio during 2017 was witnessed for all segments with personal loan and credit card products being the key growth drivers. Despite growth in the consumer portfolio, NPLs have remained around prior year level. Infection in the consumer portfolio remains well below industry norms. Overall gross infection in the advances portfolio continued its declining trend with the same being reported at 7.76% (2016: 8.84%) at year-end 2017. Given the mid-term economic scenario and policy rate regime, maintaining asset quality indicators in line with benchmarks for the assigned ratings is considered important.

Credit and market risk emanating from the investment portfolio is considered manageable.

Net investment portfolio stood at Rs. 1.34tr (2016: Rs. 1.30tr) at year-end 2017. Credit risk of the portfolio is considered low with over nine-tenths of the investment portfolio comprising exposure to government securities. With significant capital gains realized on the PIB portfolio, the investment and duration of the PIB portfolio has witnessed a noticeable decline. In the backdrop of further increase expected in benchmark rates, reduction in PIB exposure is expected to bode well from a market risk perspective.

Healthy liquidity profile as evident from a sizeable & growing customer base and cost effective domestic deposit mix. However, depositor concentration levels have increased on a timeline basis and there is room for improvement. Significant liquid assets carried on the balance sheet also support assessment of liquidity profile of the Bank.

During 2017, average domestic total deposit and current account deposit base depicted a healthy growth of 14.9% and 16.4%, respectively. Overall growth in deposits was lower at around 6% on the back of extensive de-risking and consolidation in the international business. HBL continues to dominate in terms of new to bank relationships with 1.3m new deposit customers added in 2017 taking the total customer base to over 11m worldwide. The Bank's sizeable customer base is a significant strategic advantage and is almost double that of its major private sector competitor. However, top 50 depositor concentration levels have witnessed a noticeable increase. Maintaining depositor concentration levels in line with benchmarks for the assigned ratings is considered important. Liquid assets carried on the balance sheet are sizeable while liquidity coverage ratio and net stable funding ratio are significantly above regulatory requirements. Given the increase in ADR, liquidity buffer has declined in international operations. As per management, availability of ample funding lines provides cushion against any unforeseen withdrawals. Moreover, international deposit base is targeted to depict strong growth in the ongoing year with deployment planned in high yielding sovereign bonds.

Despite a drop in equity base, capital indicators have showed significant improvement due to focused management of Risk Weighted Assets (RWAs) and are currently above JCR-VIS's benchmark for the assigned ratings. Increasing regulatory capital requirements as part of Basel 3 and D-SIB framework implementation will result in a need to further enhance capital buffers over the next 18 months.

Despite a drop in equity, capital indicators of HBL improved due to focused management of RWAs. Historically, RWAs have increased at a CAGR of 11.6% during the 10 year period (2007-2016) ending Dec 2016 with 2017 being the first year where RWAs have witnessed a decline. At end-1Q18, Tier-1 and overall CAR increased to 12.45% and 16.25%, respectively. Going forward, increasing regulatory capital requirements as part of Basel 3 (full 2.5% impact of CCB at end-2019) and D-SIB framework (2% CET-1 enhanced regulatory requirement by end-March '2019) implementation will result in a need to further enhance capital buffers over the next 18 months. Focus on management of RWAs along with higher internal capital generation vis-à-vis 2017, the capital buffers are expected to be in compliance with the benchmark for the assigned ratings.

Profitability from domestic operation remains strong. Non-recurring item (pension cost, exchange losses and consultancy & legal expenses) and international operations will continue to be a drag on overall profitability in 2018. Profitability for 2019 should receive significant jump from spread improvement, volumetric growth and absence of one-off expenses.

While profitability from domestic operations remains strong, overall profitability for 2017 was impacted by the sizeable settlement payment with respect to New York operations. Given the increase in administrative expenses and stagnant revenues, cost to income ratio has trended upwards over the last two years and is on the higher side vis-à-vis JCR-VIS benchmark for the assigned ratings. Spreads after witnessing a decline in 2017 and 1Q18 are expected to depict an uptick on a quarter on quarter basis with full year spreads for 2018 expected to be slightly higher than 2017. This along with volumetric growth in earning assets is expected to bode well for overall revenues in 2018. Fee and commission income is diversified with growth noted across all areas barring trade and investment banking income. Consumer finance and card related fee remained growth drivers while bancassurance income also remained a sizeable contributor. Given the strong focus of the new management, trade structures are being revamped and pricing has been realigned with market norms on account of which significant growth is expected in trade volumes in the ongoing year. Establishing new FI relationships for recouping remittance business is also being undertaken.

However, with impact of pension cost, exchange loss (will again be sizeable in 2Q18), absence of capital gains and higher one-off expenses, profit before tax for 2018 is expected to remain below levels recorded in 2015 and 2016. Moreover, given the consolidation of the international portfolio, revenues from the same have declined while reduction in expense base will gradually transpire. Growth momentum in profitability is expected from 2019 onwards where full year impact of spread increase, volumetric growth, absence of one-off expenses and improved profitability of international operation will be major drivers.

FINANCIAL SUMMARY *(amounts in PKR millions) – Annexure I*			
BALANCE SHEET	**2015**	**2016**	**2017**
Investments	1,236,416	1,304,723	1,335,783
Net Advances	605,636	712,133	800,689
Total Assets	2,124,910	2,392,699	2,563,059
Borrowings	314,485	333,987	395,486
Deposits & other accounts	1,558,311	1,793,370	1,899,511
Subordinated Loans	10,000	9,998	9,994
Tier-1 Equity	125,610	135,872	129,237
Net Worth	171,852	182,067	172,704
INCOME STATEMENT			
Net Spread Earned	76,761	79,318	78,864
Net Provisioning / (Reversal)	4,335	666	(399)
Non-Markup Income	32,266	25,859	29,726
Administrative expenses	45,738	50,918	56,901
Profit/ (Loss) Before Tax	57,402	52,246	26,815
Profit / (Loss) After Tax	35,470	31,820	7,064
RATIO ANALYSIS			
Market Share (Domestic Advances)	10.7%	11.3%	11.60%
Market Share (Domestic Deposits)	14.1%	14.1%	14.3%
Gross Infection	10.30%	8.84%	7.76%
Total Provisioning Coverage	92%	93%	95%
Net Infection	1.35%	1.13%	0.78%
Cost of deposits	3.20%	2.49%	2.44%
Gross Advances to Deposits Ratio	42%	42%	44%
Net NPLs to Tier-1 Capital	6.39%	5.83%	4.73%
Capital Adequacy Ratio (CAR)	15.92%	15.31%	15.79%
Spreads	3.80%	3.60%	3.29%
Efficiency	47%	51%	57%
ROAA	1.82%	1.41%	0.29%
ROAE	24.78%	20.63%	4.54%
Liquid Assets to Deposits & Borrowings	69%	67%	62%

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Habib Bank Limited
Sector	Commercial Banks
Type of Relationship	Solicited
Purpose of Rating	Entity & TFC Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
29-June-18	AAA	A-1+	Negative	Reaffirmed
22-Sep-17	AAA	A-1+	Negative	Maintained
30-Jun-17	AAA	A-1+	Stable	Reaffirmed
30-Jun-16	AAA	A-1+	Stable	Reaffirmed
30-Jun-15	AAA	A-1+	Stable	Reaffirmed
30-Jun-14	AAA	A-1+	Stable	Reaffirmed
28-Jun-13	AAA	A-1+	Stable	Reaffirmed
26-Jun-12	AAA	A-1+	Stable	Upgrade
29-Jun-12	AA+	A-1+	Stable	Reaffirmed
13-Jun-11	AA+	A-1+	Stable	Reaffirmed
29-Jun-10	AA+	A-1+	Stable	Reaffirmed

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
	RATING TYPE: TFC-1		
29-June-18	AA+	Negative	Reaffirmed
22-Sep-17	AA+	Negative	Downgrade
30-Jun-17	AAA	Stable	Reaffirmed
30-Jun-16	AAA	Stable	Reaffirmed
17-Dec-15	AAA	Stable	Final
30-Jun-15	AAA	Stable	Preliminary

Instrument Structure	Unsecured subordinated TFCs amounting to Rs. 10b. (Inclusive of Green Shoe option of Rs. 2.5b). The TFC has a tenor of 10 years.
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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