RATING REPORT

Habib Bank Limited

REPORT DATE:
June 27, 2023

RATING ANALYSTS:
Musaddeq Ahmed Khan
musaddeq@vis.com.pk

RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity Rating	AAA	A-1+	AAA	A-1+
Outlook	Stable		Stable	
Rating Action	*Reaffirmed*		*Reaffirmed*	
Date	*June 27, 2023*		*June 29, 2022*	
TFC-2 (ADT-1)	AA+		AA+	
Date	*June 27, 2023*		*June 29, 2022*	
TFC-3 (ADT-1)	AA+		AA+	
Date	*June 27, 2023*		*December 15, 2022*	

COMPANY INFORMATION	
Established in 1941	**External auditors:** KPMG Taseer Hadi & Co.
Listed Public Limited Company	**Chairman of the Board:** Mr. Sultan Ali Allana
Key Shareholders (with stake more than 5%):	**President & CEO:** Mr. Muhammad Aurangzeb
Aga Khan Fund for Economic Development – 51.00%	

APPLICABLE METHODOLOGY
VIS Financial Institution - June, 2023
https://docs.vis.com.pk/docs/FinancialInstitution.pdf
VIS Rating Scale
https://docs.vis.com.pk/docs/VISRatingScales.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 the Aga Khan Fund for Economic Development (AKFED).

Profile of Chairman

Mr. Sultan Ali Allana has served as the Chairman of the Board of Directors of HBL since February 2004. He has over 38 years of experience in the financial and banking sector. Mr. Allana also serves on the Boards of several institutions.

Profile of CEO

Mr. Muhammad Aurangzeb joined HBL on April 30, 2018 as the President & CEO of the Bank. Mr. Aurangzeb possesses an overall banking experience of over 30 years in domestic and international locations. He has held senior positions in ABN AMRO and Royal Bank of Scotland and was Chief Executive Officer – Global Corporate Bank, Asia Pacific at JP

RATING RATIONALE

Banking Sector

The economy is currently facing several challenges, including a decrease in foreign reserves, a devaluing currency, and high inflation levels. To combat rising inflation, caused by the commodity super cycle and effects of Ukraine war, the central bank has implemented stricter monetary policies, resulting in a significant increase in the policy rate. This has led to higher funding costs for banks and has the potential to impact borrowers' debt servicing ability. As a result, banks are adjusting by increasing provisions for potential loan losses and writing off non-performing loans. The economic slowdown coupled with banks more conservative stance will likely prompt slowdown in private sector lending, with investment in sovereign securities being the only venue available to banks to deploy funds. Counterbalancing this, rising interest rates should help banks maintain their margins, partially offsetting the decline in earnings and allowing for improved profitability. However, there is increased credit risk and market risk vulnerability, especially in the face of any potential interest rate or currency fluctuations, which could impact the capitalization levels of banks. Looking ahead, the medium to long-term outlook for the fiscal account is challenging because the government is struggling to expand its revenue base. Public debt accumulation is accelerating, crowding out private sector credit. This trend also increases the risk of potential sovereign debt restructuring. Given banking sector balance sheets highly skewed towards Government paper, this could lead to liquidity and profitability challenges, particularly for small and medium-sized banks in the future.

The rating assigned takes into account HBL's position in Pakistan's banking sector, its systemic significance, and the diversity of its operations.

Habib Bank Limited (HBL) maintains its position as the leading commercial bank in the country, holding the largest market share in deposits. HBL enjoys strong franchise with systemic importance to Pakistan's financial sector. The Bank through its subsidiaries and associates has a presence in the Insurance (Jubilee Life and Jubilee General), Asset Management (HBL AMC) and Microfinance (HBL Microfinance Bank) sectors as well.

HBL achieves asset growth, bolstered by strong and consistent performance in domestic lending.

As of Dec'22, HBL's asset base grew by 6.9%, while the industry saw a higher growth rate of 19.1%. There was notable growth in advances, with the Gross Advance to Deposit Ratio (ADR)[1] increasing to 47.6% (Dec'21: 41.2%) as of Dec'22. On the other hand, the ratio of liquid assets to

[1] Adjusted for SBP refinancing schemes

Morgan prior to joining HBL.	deposits and borrowings (LADB) decreased to 56.8% (Dec'21: 62.1%) as of Dec'22, and largely consistent till Mar'23, while continuing to indicate strong liquidity.

HBL achieves significant growth in Gross Advances, expands market share, and maintains favorable asset quality indicators.

HBL experienced significant growth in gross advances, mainly driven by the domestic portfolio, resulting in an increased market share from 12.1% in Dec'21 to 12.3% in Dec'22. International advances portfolio decreased by 21% in USD terms, however, given a record high exchange rate, the international portfolio grew by 1% in PKR terms. The financing mix remained unchanged, with corporate financing making up the largest portion. Top 10 funded advances made up 20.2% of the total domestic portfolio as of Dec'22 as compared to 18.1% as of Dec'21, suggesting a slight increase in the concentration. There are 6 funded exposures in excess of 10% of equity although well within maximum regulatory limits as of Dec'22. Overall these exposures are reflective of low credit risk having been taken against public sector entities (that are representative of sovereign risk) and well-established private sector companies.

The increase in non-performing loans (NPLs) can be attributed, partly, to the rise in foreign exchange rates used for the conversion of overseas NPLs, but gross infection (GI) ratio improved over the 2021-2022 period, given the base effect of higher pace of growth in advances. Certain sectors, including Wholesale & Retail Trade, Power & Energy, Oil & Gas, and Cement, witnessed a significant increase in GI. Nevertheless, HBL's asset quality indicators are favorable compared to other large banks, maintaining a low net infection rate of 0.7% and sufficient provisioning coverage as of Mar'23.

HBL's investment portfolio increased in Mar'23, primarily driven by increase in Pakistan Investment Bonds (PIBs).

HBL's investment portfolio is characterized by low credit risk, with 93.5% consisting of sovereign securities, however these expose the Bank to interest rate risk. Pakistan Investment Bonds (PIBs) made up 65.4% of investments and 29.0% of total assets. Around 66% of the PIBs portfolio is at floating rates, this will provide a much needed protection against market risk pertaining to these securities. Due to a rise in benchmark rates, the Bank incurred Mark-to-Market (MTM) losses of Rs. 70.8b on overall investment as of Mar'23, compared to Rs. 3.3b as of Dec'21. To mitigate this, currently HBL focuses on investing in Treasury Bills (T-Bills) with shorter durations and these decisions are continuously under review as per changes in policy rate and expected market conditions.

Despite a decrease in liquid assets relative to deposits and borrowings, HBL continues to maintain significant liquid reserves. The growth in deposits is primarily fueled by current deposits.

A substantial amount of liquid reserves provides strong cover to deposits and borrowings. As the Bank's ADR has gone up, its liquid assets in relation to deposits and borrowings have decreased to 58.2% (Dec'21: 62.1%) as of Mar'23. Despite this, liquidity reserves are strong.

HBL experienced slight deposit growth of 1.6% in 2022, mainly due to increase in current deposits. The growth in total deposits have slowed down significantly, as the Bank as part of its conscious strategy has moved away from hot deposits, carrying negative returns, and is focusing on current and low-cost deposits, which have grown by 20% and 17% over 2021. Nonetheless, the overall deposit composition is reflective of well-established access to low cost sources.

HBL's profitability shows growth.

As a result of monetary tightening by the State Bank of Pakistan (SBP) in 2022, benchmark rates remained high for most of the year which resulted in an increase in net markup income during 2022. Non markup income also posted strong growth, being supported by major increase in fee & commission income. HBL experienced growth in profitability, although its overall profitability indicators continue to be strained due to elevated operating expenses. The Bank efficiency ratio remains highest compared to Large banks. HBL's return on average assets (RoAA) remained lower than that of its industry peers and the median for large banks.

The short to medium term outlook for HBL's profitability is expected to improve, but it faces vulnerability primarily due to its significant holdings of PIBs and an elevated credit risk environment in terms of advances, which could result in increased provisions.

HBL's Capital Adequacy Ratio (CAR) Faces Decline amid Advances Growth, PIB and GoP Bond MTM Losses, and Exchange Rate Depreciation.

HBL's Capital Adequacy Ratio (CAR) has been declining due to the impact of FX devaluation on overseas risk weighted assets and investments, along with Mark-to-Market (MTM) losses on PIBs and GoP US Dollar Bonds. As of Mar'23, HBL's CAR was significantly lower than the median of large banks, and below the benchmarks for the assigned rating, although it is expected to recover partially within the rating horizon.

The management is undertaking a number of initiatives to reduce risk weighted assets, and improving the CAR.

Habib Bank Limited

FINANCIAL SUMMARY (amounts in PKR millions)			Appendix I
BALANCE SHEET	**Dec'21**	**Dec'22**	**Mar'23**
Total Investments	1,905,189	1,882,075	2,059,306
Gross Advances	1,463,205	1,709,421	1,701,418
Net Advances	1,384,549	1,622,607	1,606,252
Total Assets	4,074,588	4,355,097	4,642,911
Borrowings	432,262	579,005	682,581
Deposits & other accounts	3,184,261	3,234,176	3,355,209
Subordinated Loans	12,374	18,874	18,874
Tier-1 Equity	203,800	219,266	196,264
Paid Up Capital	14,669	14,669	14,669
Net Shareholder Equity (excl. surplus revaluation)	232,740	251,791	276,795
INCOME STATEMENT	**2021**	**2022**	**1Q2023**
Net Spread Earned	120,947	152,137	51,576
Net Provisioning / (Reversal)	6,353	6,456	2,680
Non-Markup Income	30,724	38,256	12,173
Operating expenses	84,608	110,475	35,204
Profit/ (Loss) Before Tax	58,974	71,555	25,342
Profit / (Loss) After Tax	34,271	30,867	15,300
RATIO ANALYSIS	**Dec'21**	**Dec'22**	**Mar'23**
Market Share (Domestic Advances)	12.1%	12.3%	NA
Market Share (Domestic Deposits)	14.1%	13.0%	NA
Non-Performing Loans (NPLs)	74,170	84,775	93,023
Gross Infection	5.1%	5.0%	5.5%
Total Provisioning Coverage (incl. general prov.)	106.0%	102.4%	102.3%
Net Infection	0.4%	0.6%	0.7%
Cost of deposits	3.58%	6.25%	NA
Gross Advances to Deposits Ratio***	41.2%	47.6%	46.3%
Net NPLs to Tier-1 Capital (adj. for general prov.)	2.4%	4.4%	5.6%
Tier 1 CAR	13.39%	12.78%	11.38%
Capital Adequacy Ratio (CAR)	17.22%	15.00%	14.21%
NIM	5.77%	6.44%	NA
Efficiency	56.7%	57.7%	57.3%
Liquid Coverage Ratio (LCR)	231%	254%	254%
Net Stable Funding Ratio (NSFR)	155%	149%	147%
ROAA	0.9%	0.7%	1.4%*
ROAE *(Net Shareholder Equity)*	15.6%	12.7%	11.6%*
Liquid Assets to Deposits & Borrowings	62.1%	56.8%	62.8%

**Annualized*
***Estimates*
****Adjusted for SBP refinancing schemes*

REGULATORY DISCLOSURES — Appendix II

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				
27-Jun-23	AAA	A-1+	Stable	Reaffirmed
29-Jun-22	AAA	A-1+	Stable	Reaffirmed
30-Jun-21	AAA	A-1+	Stable	Reaffirmed
30-Jun-20	AAA	A-1+	Stable	Reaffirmed
28-Jun-19	AAA	A-1+	Stable	Reaffirmed
31-Dec-18	AAA	A-1+	Stable	Maintained
29-June-18	AAA	A-1+	Negative	Reaffirmed
22-Sep-17	AAA	A-1+	Negative	Maintained
30-June-17	AAA	A-1+	Stable	Reaffirmed
30-June-16	AAA	A-1+	Stable	Reaffirmed
30-June-15	AAA	A-1+	Stable	Reaffirmed
30-June-14	AAA	A-1+	Stable	Reaffirmed
28-June-13	AAA	A-1+	Stable	Reaffirmed
26-June-12	AAA	A-1+	Stable	Upgrade
29-June-12	AA+	A-1+	Stable	Reaffirmed
13-June-11	AA+	A-1+	Stable	Reaffirmed
29-June-10	AA+	A-1+	Stable	Reaffirmed

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: TFC-2 (ADT-1)			
27-Jun-23	AA+	Stable	Reaffirmed
29-Jun-22	AA+	Stable	Reaffirmed
30-Jun-21	AA+	Stable	Reaffirmed
30-Jun-20	AA+	Stable	Reaffirmed
28-Jun-19	AA+	Stable	Final
31-Dec-18	AA+	Stable	Preliminary

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: TFC-3 (ADT-1)			
27-Jun-23	AA+	Stable	Reaffirmed
15-Dec-22	AA+	Stable	Final
04-Oct-22	AA+	Stable	Preliminary

Instrument Structure (Tier 1)	Privately placed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible Additional Tier-I (ADT-1) TFC amounting Rs. 12.4b.
Instrument	

Structure (Tier 1)	Privately placed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible Additional Tier-I (ADT-1) TFC amounting Rs. 6.5b.
Statement by the Rating Team	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	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Contents may be used by news media with credit to VIS.

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Risha A. Mohyeddin	Global Treasurer	**18-May-2023**
2	Mr. Tariq Masud	Chief Risk Officer	
3	Mr. Aamir Irshad	Head Corporate, Commercial and Investment Banking	
4	Mr. Rayomond Kotwal	Chief Financial Officer	