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	AAA		AA+	
ADT-1	AA+		N/A	
Outlook	Stable		Negative	
Date	*December 31, 2018*		*June 29, 2018*	

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 34 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 international banking

RATING RATIONALE

Industry Dynamics

Banking sector profitability after peaking in 2015 has continued to decline for the third consecutive year in 2018 owing to pressure on spreads (maturity of PIBs and low interest rate environment), one-off expenses & penalties (pension charges and overseas penalty) and regulatory actions (transaction tax on deposits, super tax and deposit insurance). JCR-VIS expects profitability to remain under pressure in the short-term as full impact of increase in interest rate on spreads materializes with a lag given that liabilities re-price faster than assets do. Over the medium term, balance sheet growth along with improvement in spreads, is expected to off-set higher credit cost, and translate into healthy growth in profitability. Extent of improvement in profitability will depend on timing and quantum of discount rate reversal and impact of implementation of IFRS-9 (expected implementation in 2020).

Recently, private sector credit off-take has witnessed a noticeable jump with the government relying on central bank borrowing to fund deficits. However, lower economic growth is expected to result in slowdown in overall credit off-take. Moreover, asset quality indicators are projected to depict some weakening. This is already evident from increase in NPLs of the banking sector at end-Sep'2018 vis-à-vis Dec'2017, although some increase is attributable to higher overseas NPLs. Despite sizeable growth in advances portfolio, capital adequacy ratio of commercial banks has slightly improved from 15.7% at end-Dec'2016 to 15.9% at end-Sep'2018. In the backdrop of increasing capitalization indicators, JCR-VIS expects pressure on capitalization indicators to be more pronounced for small & medium banks pursuing aggressive growth as compared to large banks.

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 around 14% in domestic deposits at end-Sep'2018. 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 are amongst the leading insurance companies in the country), Asset Management (HBL AMC is the 5th largest AMC in terms of market share) and Microfinance sectors as well.

Domestic financing portfolio witnessed strong double digit growth while international gross advances declined. Asset quality indicators continued to improve with gross infection declining from 11.9% at end-Dec'2013 to 7.1% at end-Sep'2018 while total provisioning coverage remains healthy at over 90%.

Over the last two years, growth in financing portfolio was witnessed in the corporate, consumer and SME segment while international advances have declined with proportion of the same in net advances being lower at 11% at end-9MCY18 vis-à-vis 19% at end-2016. In absolute terms, domestic gross advances portfolio increased by 15% during 9MCY18. Given the sizeable growth in corporate advances, proportion of the same increased to around two-third of total financing portfolio. In terms of sector-wise exposures, increase has been manifested in the power sector which represents around one-fifth of the gross advances portfolio. Despite growth, infection in the consumer portfolio remains well below industry norms.

Overall NPLs increased to Rs. 68.9b (2017: Rs. 67b) due to increase in overseas NPLs on account of currency depreciation while NPLs from domestic operations continued to decline. Gross infection in the advances portfolio continued its declining trend with the same being reported at 7.11% (2017: 7.76%) at end-Sep'2018. While JCR-VIS expects some increase in NPLs in the domestic portfolio, asset quality

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.

indicators are expected to remain sound on the back of adequate quality of exposures undertaken. 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. 1.16tr (2017: Rs. 1.34tr) at end-9MCY18. Credit risk of the portfolio is considered low with over nine-tenths of the investment portfolio comprising exposure to government securities. Exposure in PIBs as a percentage of total investment and domestic deposits has witnessed a noticeable decline which bodes well from a market risk perspective. Duration of PIBs is considered manageable. Given the significant volatility in interest rates, market risk management is considered important.

Healthy liquidity profile as evident from a sizeable & growing customer base and cost effective domestic deposit mix. However, depositor concentration levels continue to remain on the higher side. Significant liquid assets carried on the balance sheet also support assessment of liquidity profile of the Bank.

Average domestic deposits of HBL increased by 12% during 9MCY18 while average current account deposits grew by 15% (Rs. 80b) over 9MCY17. Overall growth in deposits was lower at around 3% during 9MCY18 on the back of extensive de-risking and consolidation in the international business. HBL continues to be the market leader in terms of new to bank relationships with total customer base of 12m worldwide. The Bank's sizeable customer base is a significant strategic advantage. However, top 50 depositor concentration levels continue to remain on the higher side. While declining on a timeline basis, liquid assets carried on the balance sheet are sizeable. Liquidity coverage ratio and net stable funding ratio at 182% and 154.87% respectively as at end-Sep'2018 are significantly above regulatory requirements.

Despite a sizeable penalty payment and significant growth in advances portfolio, capitalization indicators have improved vis-à-vis end-Sep'2017 due to conservative dividend payout and focused management of Risk Weighted Assets (RWAs). Issuance of additional Tier-1 instrument will further strengthen capitalization indicators.

Despite a sizeable settlement payment with respect to New York operations and significant growth in advances portfolio, capitalization indicators have improved vis-à-vis end-Sep'2017 due to conservative dividend payout and focused management of Risk Weighted Assets (RWAs). After declining in 2017, RWAs declined further as at end-9MCY18. This along with increase in eligible capital has translated into improvement in Tier-1 and overall CAR to 13.02% and 16.79%, respectively. Despite 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), focused management of RWAs along with higher internal capital generation vis-à-vis 2018 and issuance of ADT-1 instrument are expected to result in capitalization indicators being in compliance with the benchmark for the assigned ratings.

Profitability indicators have depicted weakening but are expected to improve over the rating horizon.

Profitability indicators have depicted weakening due to international operations and sizeable non-recurring items (remediation & pension cost, exchange losses on foreign currency borrowing and consultancy & legal expenses). In terms of core operations, declining trend in spreads and lower fee commission income (attributable to lower remittance and trade related fee) also contributed to the dip in profitability. On the administrative expenses front, excluding expenses related to remediation cost, pension charge and business transformation, normalized expense growth is in single digits. Profitability in the short-term is expected to remain under pressure due to spread compression, sizeable exchange loss in 4QCY18 and high remediation cost. Ratings incorporate JCR-VIS's expectation that profitability indicators will gradually improve in 2019

on the back of balance sheet growth & spread improvement (full impact expected from 3QCY19) and significant reduction in non-recurring expenses. From 2020 onwards, JCR-VIS expects profitability indicators to revert to normalized levels and become compliant with JCR-VIS's profitability benchmark for the assigned ratings.

Strong board composition with increasing focus on further strengthening 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 2018. 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. Other initiatives under the transformation programme included loan processing through an app, centralized account opening, digitizing all client/customer information, and using tools of data analytics to enhance customer experience

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 significant increase in number of active borrowers and active savers during 2018. 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 under the brand name – HBL Konnect.

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 2018.

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. China will remain a key focus of the Bank's overseas strategy. In 2017, HBL opened its first branch in Urumqi, the largest city in the province of Xinjiang, China. With government focusing on diversifying away from USD into RMB and HBL obtaining an RMB license during 2018, representative office in China is planned to be converted into a branch office in 2019.

Additional Tier-1 Instrument

The Instrument: HBL is in the process of issuing a privately placed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instruments amounting up to Rs. 15.0b (inclusive of Green Shoe Option of Rs. 5.0b). The issue proceeds will contribute towards the bank's additional Tier-1 (ADT-1) capital and will be utilized towards enhancement of the bank's business operations.

Priority: In terms of priority of claims, HBL's ADT-1 instrument will rank ahead of claims of ordinary shareholders but below the bank's senior creditors, including depositors, and Tier-2 TFC already issued.

Non-performance risk: Non-performance risk for ADT-1 instruments is characterized by presence of point of non-viability and lock-in-clause, issuer having full discretion on coupon payments, interest

servicing from only profits for the year and conversion feature in the event of pre-specified trigger events in terms of regulatory requirements. While the regulatory framework may not consider a missed coupon payment as a default; the credit rating methodology employed by JCR-VIS would treat such missed payments as an event of default. In normal course of business, JCR-VIS believes that chances of non-performance risk are considered remote given healthy capital buffers which will be enhanced further post issuance of ADT-1 instrument. Moreover, profitability profile is expected to remain sound. Despite existence of full coupon discretion, exercising the feature is not considered likely in normal course of business as it will hamper future fund raising ability of the Bank.

FINANCIAL SUMMARY *(amounts in PKR millions) –*		**Annexure I**		
BALANCE SHEET	**2015**	**2016**	**2017**	**9M2018***
Investments	1,236,416	1,304,723	1,335,783	1,157,476
Net Advances	605,636	712,133	800,689	906,967
Total Assets	2,124,910	2,392,699	2,563,059	2,499,729
Borrowings	314,485	333,987	395,486	239,011
Deposits & other accounts	1,558,311	1,793,370	1,899,511	1,959,001
Subordinated Loans	10,000	9,998	9,994	9,990
Tier-1 Equity	125,610	135,872	129,237	133,288
Net Worth	171,852	182,067	172,704	176,381
INCOME STATEMENT				
Net Spread Earned	76,761	79,318	78,864	57,062
Net Provisioning / (Reversal)	4,335	666	-399	1535
Non-Markup Income	32,266	25,859	29,726	12,058
Administrative expenses	45,738	50,918	56,901	51,114
Profit/ (Loss) Before Tax	57,402	52,246	26,815	15,533
Profit / (Loss) After Tax	35,470	31,820	7,064	9,015
RATIO ANALYSIS				
Market Share (Domestic Advances)	10.70%	11.20%	10.50%	11.47%
Market Share (Domestic Deposits)	14.10%	14.10%	14.30%	14.13%
Gross Infection	10.30%	8.84%	7.76%	7.11%
Total Provisioning Coverage	92%	93%	95%	92%
Net Infection	1.35%	1.13%	0.78%	0.95%
Cost of deposits	3.20%	2.49%	2.44%	2.86%
Gross Advances to Deposits Ratio	42%	42%	44%	48%
Net NPLs to Tier-1 Capital	6.39%	5.83%	4.73%	6.37%
Capital Adequacy Ratio (CAR)	15.92%	15.31%	15.79%	16.79%
Spreads	3.80%	3.60%	3.29%	3.10%
Efficiency	47%	51%	57%	75%
ROAA	1.82%	1.41%	0.29%	0.47%
ROAE	24.78%	20.63%	4.54%	7.72%

** Ratios Annualized*

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				
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-1 (Tier-2)			
31-Dec-18	AAA	Stable	Maintained
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

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: TFC-1 (ADT-1)			
31-Dec-18	AA+	Stable	Preliminary

Instrument Structure (Tier-2)	Unsecured subordinated TFCs amounting to Rs. 10b. (Inclusive of Green Shoe option of Rs. 2.5b). The TFC has a tenor of 10 years.
Instrument Structure (Tier-1)	Privately placed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instruments amounting up to Rs. 15.0b (inclusive of Green Shoe Option of Rs. 5.0b). The issue proceeds will contribute towards the bank's additional Tier-1 (ADT-1) capital and will be utilized towards enhancement of the bank's business operations.
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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