RATING REPORT

Habib Bank Limited

REPORT DATE:
July 05, 2019

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		AAA	
ADT-1 (Final)	AA+		AA+	
Outlook	Stable		Stable	
Date	*June 28, 2019*		*December 31, 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

VIS Commercial Banks Rating *https://s3-us-west-2.amazonaws.com/backupsqlvis/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 15 countries including Pakistan. In Pakistan, the Bank operates 1,697 branches (2017: 1,703) including 47 (2017: 47) Islamic banking branches and 46 branches (2017: 48) outside Pakistan including KEPZ.

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 34 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 more than 30 years in both domestic and international locations. He has held senior positions in ABN AMRO Bank and Royal Bank of Scotland and was Chief Executive Officer –

RATING RATIONALE

Industry Dynamics

Banking sector profitability after peaking in 2015 continued to decline for the third consecutive year in 2018 owing to pressure on spreads (maturity of PIBs), one-off expenses & settlement payments and regulatory actions (transaction tax on deposits, super tax and deposit insurance). VIS expects profitability to improve considerably over the next 18 months as full impact of increase in interest rate on spreads materializes with a lag given that liabilities re-price faster than assets do. Moreover, aggressive participation is expected in long-tenor bonds post 3QCY19 once further clarity over inflation outlook emerges. 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). Other key risk to profitability may emerge from implementation of treasury single account which may result in liquidity and profitability challenges for banks. The impact may be significant for select public sector and provincial government owned banks. Impact for large private sector banks is expected to be manageable given that deposits represent a smaller proportion of overall deposits and cost of funds for government is significantly higher vis-à-vis Bank's average cost of funds.

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, the government will increasingly rely on commercial banks for funding deficits post the country's entry in the IMF Programme. Resultantly, ADR ratios of banks which have increased over the last 2 years (ADR Ratio of the sector has increased from 46.6% at end-Dec'2016 to 55.8% at end-Dec'2018) are expected to decline again. Resultantly, liquidity buffers are expected to increase.

Maintaining asset quality indicators will be the biggest challenge for the banking sector where VIS expects weakening in asset quality indicators of Banks in general. Increase would be more pronounced for Banks where ADR is on the higher side and where exposure to the SME segment is sizeable. This is already evident from increase in NPLs of the banking sector at end-March 2019 vis-à-vis December 2017 (NPLs have increased by around Rs. 100b during the period), although some increase is attributable to higher overseas NPLs and non-performance by a single sugar sector group. Despite sizeable growth in advances portfolio, capital adequacy ratio of commercial banks has slightly improved from 15.8% at end-Dec'2017 to 16.1% at end-March 2019. Given the increasing profitability and conservative lending strategy expected to be pursued by most banks, capitalization indicators for most large and medium sized banks are expected to remain sound.

Largest commercial bank with systemic importance and diversified operations.

Habib Bank Limited (HBL) is the largest commercial bank in the country with market share remaining consistently over 14%. 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.

Global Corporate Bank, Asia Pacific at JP Morgan prior to joining HBL.

After increasing at a CAGR of 20% over the last 3 years, credit growth is expected to slow down in the ongoing year. However, growth momentum is projected to continue in key target segments. Asset quality indicators continued to improve in 2018. Given the challenging macro-economic outlook, maintaining asset quality indicators in line with rating benchmarks is considered important.

Major portion of the Bank's assets comprises exposure to the sovereign/public sector. Aggregate exposure to the sovereign / public sector by way of investments & advances represents around 52.9% (2017: 55.7%) of total assets. Broad based growth in financing portfolio was witnessed in 2018 with corporate, commercial and consumer portfolio recording over 15% increase vis-a-vis preceding year. Corporate segment represents around three-fifths of the domestic financing portfolio where the Bank enjoys market leadership position. Proportion of public sector/government financing increased to 26% (2017: 23%) at end-2018. The largest sectoral exposures being to the power and the textile sectors. Going forward, the corporate segment will continue to focus on deepening relationship through aggressive cross-sell while strong growth in trade volumes is targeted. In absolute terms, consumer portfolio crossed Rs. 50b and the bank aims to achieve market leadership across products. Despite growth, infection in the consumer portfolio remains well below industry norms. The commercial and retail segment increased by 20% in 2018 through enhanced penetration in the small traders segment through the flagship product- HBL Small Business Finance.

Despite higher NPLs from international portfolio (primarily a function of rupee devaluation), infection levels improved (2018: 6.6%; 2017: 7.8%) due to higher pace of decline in domestic NPLs and sizeable increase in advances portfolio. Provisioning coverage (overall) remains strong (2018: 93%; 2017: 95%). At end-1Q19, gross infection and total provisioning coverage was reported at 6.6% and 92%, respectively. Given slow-down in GDP growth in GCC region, HBL has enhanced monitoring of exposures while assets are conservatively planned to be deployed in treasury and short-term trade assets. 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 investment portfolio is considered manageable

Net investment portfolio represented around 47% of total asset base at end-Dec'2018. Investment in sovereign instruments represented 92% of the total portfolio. Resultantly, credit risk emanating from the investment portfolio is low. In absolute terms, investment in PIBs has declined during 2018; PIBs in relation to domestic deposits is on the lower side vis-à-vis peer Banks at 21.3% at end-Dec'2018. Around 43% of the PIB portfolio was classified as HTM with remaining PIB investment being primarily classified as AFS. Deficit on PIB holdings (classified as AFS) was Rs. 10.08b at end-Dec'2018. Given the reduction in PIB and equity exposure along with decline in duration of the PIB portfolio, exposure to market risk has declined on a timeline basis.

Robust 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.

HBL caters to a sizeable and growing customer base of over 11 million customers which is more than double that of its major private sector competitor. Moreover, around 1 million (2017: 1.3m) new to bank (NTB) customers were added in 2018; highest by a local bank. The bank's deposit strategy will continue to focus on enhancing deposit mix through addition of NTB customers. During 2018, overall deposit base and average domestic deposits increased by 6.3% and 10.3%, respectively. Domestic CASA was reported at 85.5% while proportion of current accounts in deposit mix increased to 37.4% (Dec'2017: 35.9%) at end-Dec'2018. However, depositor concentration levels are higher vis-à-vis VIS's benchmark for the assigned ratings. Besides improving deposit mix, overall liquidity profile is supported by sizeable liquid assets in relation to total deposits and borrowings. Liquidity coverage ratio and net stable funding ratio of 173% and

141% at end-Dec'2018 were significantly above the regulatory requirement of 100%.

Given the high ADR for international operations, liquidity buffer in terms of liquid assets are low for international operations. However, comfort is drawn from sizeable exposure to short-term trade based assets and availability of sufficient funding lines which provides cushion against any unforeseen withdrawals.

Issuance of additional Tier-1 instrument (ADT-1) will 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 recorded a meager increase at end-CY18. This along with increase in eligible capital has translated into improvement in Tier-1 and overall CAR to 12.45% and 16.38%, respectively. Despite increasing regulatory capital requirements as part of Basel III (full 2.5% impact of CCB at end-2019) and implementation of D-SIB framework, 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 remaining in compliance with the benchmark for the assigned ratings.

Profitability indicators are expected to depict improvement in the ongoing year on the back of spread improvement. However, cost to income ratio will continue to remain on the higher side vis-à-vis peer banks in 2019 and are only expected to align with rating benchmarks over the medium term.

Profitability indicators in 2018 have depicted weakening due to international operations and sizeable non-recurring items (remediation & pension cost, business transformation 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. Ratings incorporate VIS's expectation that profitability indicators will gradually improve in 2019 on the back of balance sheet growth & spread improvement and some reduction in non-recurring expenses. From 2020 onwards, VIS expects profitability indicators to revert to normalized levels and become compliant with profitability benchmark for the assigned ratings.

Enhancing digital presence and accelerating the pace of digital customer acquisition will be amongst the top priorities for 2019

During 2018, HBL's mobile and internet banking platforms were revamped and re-launched to ensure improved customer experience. Moreover, the Bank's Konnect platform, which primarily targets the unbanked and underbanked population of the country, was launched in July 2018 and the Bank has been able to onboard over 1.4 million new customers in 2018. The Bank also commenced mobile app based small scale lending program which is planned to be scaled up through broadening of product offerings, which will include credit cards.

Strong board composition & oversight with increasing focus on further strengthening compliance and governance infrastructure; innovation and financial inclusion 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 have 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 client/customer information, and using 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.

During 2018, the International Operations continued to focus on consolidation and de-risking. Non-core locations have been identified and progress has been made on exiting from the same. Growth in international operations targeted from Middle East and China

During 2018, the International Operations continued to focus on consolidation and de-risking. Non-core locations have been identified and progress has been made on exiting from the same. Exit from identified non-core markets will remain a key focus area in 2019. Growth in international operations is targeted from Middle East with gradual build up in low risk financing and investment book. Operations in 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. The Urumqi branch is expected to start RMB operations in 2019. HBL is also in the process of upgrading the Beijing Representative Office to a branch. The Beijing branch will allow HBL to play an important role in originating China business.

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 normal 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 VIS would treat such missed payments as an event of default. In normal course of business, 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	2018	1Q19
Investments	1,236,416	1,304,723	1,335,791	1,341,031	889,429
Net Advances	605,636	712,133	800,689	1,015,854	1,018,452
Total Assets	2,124,910	2,405,084	2,573,950	2,879,495	2,651,823
Borrowings	314,485	333,987	395,486	518,896	228,612
Deposits & other accounts	1,558,311	1,793,370	1,899,511	2,020,008	2,050,887
Subordinated Loans	10,000	9,998	9,994	9,990	9,988
Tier-1 Equity	125,610	135,872	129,237	134,410	135,452
Net Worth	171,852	182,067	172,639	179,049	182,692
INCOME STATEMENT					
Net Spread Earned	76,761	79,318	77,630	76,016	21,726
Net Provisioning / (Reversal)	4,335	666	88	4,640	(188)
Non-Markup Income	32,266	25,859	30,953	16,445	5,592
Administrative expenses	45,738	50,918	56,228	70,327	19,457
Profit/ (Loss) Before Tax	57,402	52,246	27,488	19,849	7,837
Profit / (Loss) After Tax	35,470	31,820	7,731	11,789	2,842
RATIO ANALYSIS					
Market Share (Domestic Advances)	10.7%	11.2%	11.4%	12.1%	12.2%
Market Share (Domestic Deposits)	14.1%	14.1%	14.3%	14.1%	14.3%
Gross Infection	10.30%	8.84%	7.76%	6.61%	6.61%
Provisioning Coverage	92%	93%	95%	93%	92%
Net Infection	1.35%	1.13%	0.78%	0.82%	0.85%
Cost of deposits	3.20%	2.49%	2.44%	3.13%	4.52%
Gross Advances to Deposits Ratio	42%	42%	44%	52%	51%
Net NPLs to Tier-1 Capital	6%	6%	5%	6%	6%
Capital Adequacy Ratio (CAR)	15.92%	15.31%	15.79%	16.38%	16.37%
Markup Spreads	3.80%	3.60%	3.29%	3.14%	3.53%
Efficiency	47%	51%	57%	78%	72%
ROAA	NA	1.4%	0.3%	0.4%	0.4%*
ROAE	NA	20.6%	5.0%	7.5%	6.9%*
Liquid Assets to Deposits & Borrowings	65%	67%	62%	56%	59%

** 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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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				
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-1 (Tier-2)			
28-Jun-19	AAA	Stable	Reaffirmed
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)			
28-Jun-19	AA+	Stable	Final
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	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.
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