RATING REPORT

Habib Bank Limited

REPORT DATE:
July 07, 2020

RATING ANALYSTS:
Talha Iqbal Chhoangalia
talha.iqbal@vis.com.pk

Muhammad Tabish
muhammad.tabish@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+
TFC	AAA		AAA	
ADT-1	AA+		AA+	
Outlook	Stable		Stable	
Date	*June 30, 2020*		*June 28, 2019*	

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).

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

RATING RATIONALE

Industry Update

As a result of the novel coronavirus outbreak, both macro and micro financial stability indicators have been impacted. Pakistan's economy, which was already undergoing a phase of adjustment, has been dented by the resultant intermittent lock downs and depressed economic activity. As of the date of this report, with new virus cases touching new peaks, the pandemic could stretch into Q2'2021, when potentially an effective vaccine is expected to be developed.

In view of weak macroeconomic environment, credit risk across the sector is considered to be heightened, beyond pre-coronavirus credit risk levels, which were more aligned with usual macroeconomic cycle-based volatility. Accordingly, there is a credit risk driven downward pressure on all bank ratings. SBP, in an effort to promote financial stability, ensure continued credit supply to the economy and maintain confidence in the banking system, has taken significant steps including allowing to defer principal payments for up to a year and also allowing other clients facing major liquidity constraints, a full restructuring of their existing loan facilities; the policy rate has been reduced by 625 basis points to 7% (Dec'19: 13.25%); capital conservation buffer (CCB) has been reduced by 100 basis points to 1.5%; the facility to apply reduced Risk Weight, for capital calculations, on SME loans has been increased to Rs. 180m (up 44%) and allowed debt burden ratio for consumer loans has been enhanced from 50% to 60%.

These measures are expected to provide short-term relief to counterparties, with several of them facing liquidity constraints. Nevertheless, at the same time, these may also delay the materialization of increased credit risk level on asset impairment ratios. The waiver in CCB should allow the banks additional room to meet financing requirements of liquidity-strained counterparties. - The adverse credit risk environment – on account of the Covid-19 outbreak – could translate in to increased provisioning burden. VIS expects differences between Banks in the way they book provisioning charges against expected NPLs. Banks with strong profitability and capital adequacy are expected to start booking provisions (in the form of general provisions) in the ongoing year while other smaller Banks will undertake provisions as they fall due as per regulatory requirement starting from last quarter of 2021.

Collectively, sector financial risk indicators have significantly strengthened since the last financial crises of 2008. In terms of capitalization, the industry boasts a CAR of 17%, ADR of 51% and about 50% of the asset base is liquid (Mar'20). These ratios are indicative of strong loss absorption buffers, while the excess liquidity available with the banks should allow them to navigate through the crisis.

While impact on profitability will vary across industry, overall profitability indicators for 2021 are expected to be impacted by the following; i) So far, the interest rate has already dropped by 625 basis points; this sharp drop in interest rates and narrowing of the interest rate corridor is expected to negatively affect banking spreads. A review of historical banking spreads in a low interest regime indicates that spread shrinkage is likely going to be ~50 basis points. However, in the near term (Q2 & Q3), the spreads may post short term improvement, as a result of faster downward re-pricing on liabilities vis-à-vis assets. This short-term spread improvement will likely keep the spreads intact for the ongoing year; ii) higher provisioning iii) in view of the reduced economic activity and lower trade volumes, fee-related income and overall ancillary income will shrink. This, along with projected spread shrinkage, will likely have an adverse impact on efficiency ratios across the industry; SBP maintains its deadline for IFRS 9 implementation at January 1 2021, with deadline for pro-forma accounts preparation being Oct'20; full provisioning impact of this is expected to be sizable.

Largest commercial bank with systemic importance and diversified operations.

Habib Bank Limited (HBL) is the largest commercial bank in the country (asset base crossed 3 trillion in the outgoing year) with market share (based on domestic deposits) 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.

After depicting strong double-digit growth in advances during 2015-2018, pace of credit growth slowed down in 2019 but has remained higher vis-à-vis peer banks. While asset quality indicators remain sound, exposure of the banking sector to credit risk remains heightened

Major portion of the Bank's assets comprises exposure to the sovereign/public sector. Aggregate exposure to the GoP by way of investments & advances represents around 50.7% (2018: 52.1%) of total assets at end-2019. After depicting strong double-digit growth in advances during 2015-2018, pace of credit growth slowed down in 2019 but remained higher vis-à-vis peer banks. Resultantly, proportion of advances in total assets has grown over the last 2 years. In line with banking sector trend, largest sectoral exposures are to the power and textile sectors. Both these sectors are under varying degrees of stress although comfort is drawn from lending to sound counterparties. Given HBL's dominant share in private sector credit, proportion of private sector financing to total gross advances stood at ~74% at end-2019. Segment-wise financing mix has largely remained unchanged with corporate financing representing the largest segment. During 2019, credit expansion was witnessed across three major segments with highest growth (in percentage terms) in consumer segment followed by retail & commercial and corporate segment. Despite growth, infection in the consumer portfolio remains well below industry norms.

Asset quality indicators remain sound while provisioning coverage has been consistently maintained on the higher side. However, exposure of the banking sector to credit risk remains heightened. Regulatory relief measures undertaken by SBP to promote financial stability, support businesses, ensure continued credit supply to the economy and maintain confidence in the financial system have been received positively and are expected to delay the impact of prevailing headwinds on portfolio asset quality indicators. Our credit impairment expectations are conservative, albeit there is a probability of deviation from expectations; downside risk is elevated, amidst an uncertain economic environment. Given the ongoing challenging operating environment and HBL's prudent risk management policy, a general provision policy is being evaluated at a portfolio level which is considered to have heightened credit risk considering the current stressed situation resulting from Covid-19 outbreak.

Credit and market risk emanating from investment portfolio is considered manageable

Net investment portfolio represented around 44% of total asset base at end-Dec'2019.

Investment in sovereign instruments represented 95% of the total portfolio. Resultantly, credit risk emanating from the investment portfolio is low. During 2019, shift in investment portfolio was witnessed with buildup in longer tenor PIBs while exposure in T-bills declined. Around 74% of the PIB portfolio at end-Dec'2019 comprised fixed rate PIBs. Surplus on PIB holdings (classified as AFS) was reported Rs. 15.9b at end-1Q'20 and is expected to increase further given reduction in benchmark rates.

While international operations incurred a sizeable loss, majority of core branches have witnessed a turnaround and return to profitability. Sizeable improvement expected in profitability profile of international operations in 2020

Overseas assets represent around one-tenth of total assets. During 2019, majority of core branches have seen a turn-around and return to profitability. Moreover, as part of a deliberate strategy, exit from 2 non-core locations was undertaken in 2019 while similar strategy is planned to continue in 2020. This along with closure of New York branch in 1Q20 is expected to improve core profitability from international operations. However, the bank incurred a loss of Rs. 13.0b (2018: Loss before tax of Rs. 12.6b) in 2019. Sizeable losses from international operations in 2019 pertained to higher legal overheads related to termination of New York operations significant currency devaluation and increased regulatory and compliance cost and extensive de-risking exercise. International strategy entails HBL taking advantage of its unique footprint, and facilitating global trade and payment flows in select growth corridors. Growth in international operations is targeted from Middle East and China. Focus on improving compliance systems, processes, governance and staffing has continued during the review period.

Robust liquidity profile

HBL caters to a sizeable and growing customer base of over 20 million customers worldwide. Moreover, around 1 million (2018: 1million) new to bank (NTB) customers were added in 2019. The bank's deposit strategy will continue to focus on enhancing deposit mix through addition of NTB customers and deepening relationships with existing customers. Ratings incorporate HBL's strong deposit mix, sizeable retail deposit base and manageable depositor concentration levels. 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 Stability Funding Ratio (NSFR) were reported at 238.7% (2019: 154.9%; 2018: 172.9%) and 165% (2019: 176.1%; 2018: 141.1%) respectively, at end-1Q'20 and are comfortably above the regulatory requirement of 100%. VIS expects liquidity pressures, if any, emanating from deferment/extension in principal as per SBP relaxation scheme to be limited given the strong liquidity buffers in place.

Sound capitalization indicators

Overall capitalization indicators are adequate with HBL's strong focus on maintaining and enhancing capital buffers as reflected by a conservative dividend payout policy, issuance of Additional Tier-1 capital and efforts to optimize risk weighted assets growth being a key rating driver. HBL's Tier-1 and overall CAR (unconsolidated basis) have improved on a timeline basis since 2017 and were reported at 13.7% (2018: 12.4%) and 17.1% (2018: 16.4%) at end-2019, respectively. Tier-1 and overall CAR ratios of the bank stand well above regulatory requirements. However, CAR (based on consolidated financials) declined to 15.3% (2018: 16.2%) on account of implementation of D-SIB buffer and resultant ineligibility of Tier-2 capital alongwith devaluation resulting in higher RWAs for international operations. In this regard, further strengthening of CAR buffers based on consolidated financial statements is considered important. HBL's net NPL in relation to Tier-1 capital depicted improvement on a timeline basis and is the lowest amongst peer banks reflecting strong asset quality and sound capitalization indicators

Profitability profile expected to improve over the rating horizon

HBL's overall profitability profile depicted improvement in 2019 driven by spread improvement, volumetric growth in earning assets, growth in fee based and forex income and significant reduction in net provisions. However, cost to income ratio was significantly on the higher side vis-à-vis rating benchmarks primarily due to elevated cost from international operations. Despite higher provisioning charges over the rating horizon, VIS expects HBL's earnings profile to improve on the back of expected capital gains and normalization of non-recurring expenses. Going forward, sizeable exposure to fixed rate PIB portfolio along with aggressive re-pricing of deposits is expected to partly offset pressure on spreads (over the medium term) due to sharp decline in interest rates (625bps since the start of the calendar year 2020). Profitability indicators are expected to align with rating benchmarks over the rating horizon.

The ongoing Covid-19 pandemic has accelerated the pace of digital transformation

HBL Konnect, launched in 2018, underpins HBL's commitment towards financial inclusion of the unbanked and under-banked segment. Through this segment the bank has already on-boarded 6.6 million (Konnect: 4.0m, Ehsas Kafalat Program: 2.6m) customers. The brand identity was refreshed in 2019 with a revamped App and introduction of new services and features, targeting the younger segment of the population. Going forward, the management expects Konnect to be serving more than 12 million customers via Konnect App and a 60,000 agent network. HBL's strategy over the last few years of enhancing digital presence and focusing on digital customer acquisition will be a source of competitive advantage for the Bank.

FINANCIAL SUMMARY *(amounts in PKR millions)*				Annexure I
BALANCE SHEET	**2017**	**2018**	**2019**	**1Q'20**
Investments	1,335,791	1,341,031	1,351,961	1,408,951
Net Advances	800,689	1,015,854	1,073,019	1,083,291
Total Assets	2,573,950	2,879,495	3,053,734	3,023,080
Borrowings	395,486	518,896	382,071	371,335
Deposits & other accounts	1,899,511	2,020,008	2,301,899	2,250,372
Subordinated Loans	9,994	9,990	22,360	22,358
Paid-up Capital	14,668	14,668	14,668	14,668
Tier-1 Equity	129,237	134,410	155,251	158,798
Net Worth	172,639	179,049	201,422	213,210
INCOME STATEMENT				
Net Spread Earned	77,630	76,016	94,626	26,202
Net Provisioning / (Reversal)	88	4,640	2,530	141
Non-Markup Income	30,953	16,445	18,759	4,628
Administrative expenses	56,228	70,327	82,709	23,254
Profit/ (Loss) Before Tax	27,488	19,849	27,099	7,042
Profit / (Loss) After Tax	7,731	11,789	15,064	3,998
RATIO ANALYSIS				
Market Share (Domestic Advances)	11.4%	12.1%	14.0%	14.0%
Market Share (Domestic Deposits)	14.3%	14.1%	14.6%	14.1%
Gross Infection	7.76%	6.61%	6.34%	6.43%
Provisioning Coverage	95%	93%	96%	96%
Net Infection	0.78%	0.82%	0.55%	0.61%
Cost of deposits	2.44%	3.13%	5.44%	6.29%
Net NPLs to Tier-1 Capital	5%	6%	4%	4%
Capital Adequacy Ratio (CAR)	15.79%	16.38%	17.07%	17.24%
Markup Spreads	3.29%	3.14%	3.53%	3.76%
Efficiency	57%	78%	72%	79%
ROAA*	0.3%	0.4%	0.5%	0.5%
ROAE*	5.0%	7.5%	8.8%	8.9%
Liquid Assets to Deposits & Borrowings	62%	58%	60%	62%

**Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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		
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-1 (Tier-2)		
30-Jun-20	AAA	Stable	Reaffirmed
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)		
30-Jun-20	AA+	Stable	Reaffirmed
28-Jun-19	AA+	Stable	Final
31-Dec-18	AA+	Stable	Preliminary

Instrument Structure (Tier 2)	Unsecured subordinated TFCs amounting to Rs. 10b. The TFC has a tenor of 10 years. Privately placed, perpetual, unsecured, subordinated, non-cumulative and contingent

Instrument Structure (Tier 1)	convertible Additional Tier-I (ADT-1) TFC amounting up to Rs. 12.4b.
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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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Rayomond Kotwal	CFO	22-June-2020
2	Mr. Irfan Ahmed Meer	Financial Controller	22-June-2020
3	Mr. Rehan Nabi Sheikh	Head – External Affairs	22-June-2020
4	Mr. Naseem Ahmed Abbasi	Head – Capital Planning	22-June-2020