RATING REPORT

Habib Bank Limited

REPORT DATE:
October 04, 2022

RATING ANALYSTS:
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Rating Category	Latest Rating	
	Long-term	**Short-term**
TFC-3 (ADT-1)	AA+	
Outlook	Stable	
Rating Action	*Preliminary*	
Date	*October 04, 2022*	

COMPANY INFORMATION	
Established in 1941	**External auditors:** KPMG Taseer Hadi & Co.
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
Applicable rating criteria: Commercial Banks - June 2020
https://docs.vis.com.pk/docs/Meth-CommercialBanks202006.pdf
Rating the Issue- November 2021
https://docs.vis.com.pk/docs/Notchingtheissue202007nov.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 36 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

RATING RATIONALE

Additional Tier-1 Instrument

The Instrument: HBL is in the process of issuing a Basel III compliant fully paid-up, privately placed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible debt instrument in the nature of Term Finance Certificates ("TFCs") amounting up to Rs. 10.0b (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 subordinated debt instruments but will rank pari passu with the earlier AT1 instrument of Rs. 12.4b issued in 2019.

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 (no coupons if the Bank is in non-compliant with MCR, CAR and LR requirements);
- discretion on interest servicing; incase a profit/mark-up payment is cancelled by HBL, it will not be classified as a default as per regulatory framework;
- conversion feature into ordinary shares 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 nonperformance 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.

The assigned rating incorporates HBL's market positioning in Pakistan's banking sector, its systemic importance and diversified operations.

Habib Bank Limited (HBL) is the largest commercial bank in the country with market share (based on domestic deposits) remaining consistently over 14%. 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 are amongst the leading insurance companies in the country), Asset Management (HBL AMC) and Microfinance

Pacific at JP Morgan prior to joining HBL.

(HBL Microfinance Bank, formerly First Microfinance Bank Limited, the second largest microfinance bank in the country) sectors as well.

The rating incorporates asset quality indicators of HBL, which compare favorably to 'Large Banks' median

On a YoY basis in 2021, HBL's NPL's remained relatively unchanged, albeit 10% uptick in NPLs was noted in HY22. The asset quality indicators of the Bank compare favorably to the 'Large Banks' median. Furthermore, the Bank's net infection at 0.6% is considered to be adequately low and provisioning coverage is considered adequate.

The rating incorporates strong liquidity profile of HBL

HBL's liquidity profile derives strength from its sizable branch network and growing branchless banking touchpoints, which translate into a strong ability to raise deposits and maintain market positioning. HBL's deposit generation ability is also evident from its cost of funding, which was in line with the 'Large Banks' median as of 2021. As is the case across the industry, HBL's liquidity profile also incorporates sizable liquid reserves in relation to deposits and borrowings.

HBL's domestic profitability depicted healthy growth, albeit overall profitability indicators remain stressed, leaving room for further improvement

In line with the industry trend, wherein average benchmark rate prevailing during 2021 was lower than 2020, HBL's NIM depicted contraction. HBL's domestic profitability depicted healthy growth, albeit overall profitability indicators remained stressed on account of HBL's international operations, leaving room for further improvement. Accordingly, HBL's RoAA remained on the lower side, trailing the industry and the 'Large Banks' median.

The short to medium term outlook on HBL's profitability is stressed mainly as NIM is likely to undergo contraction in the short term and normalize by Q4'22/Q1'23. This is mainly following the upward trajectory in benchmark rates, which should translate into an uptick in NIM. Nevertheless, given the lag in repricing of assets vis-à-vis liabilities, the NIM is likely to contract in Q3'22 and normalize subsequently. It is pertinent to mention that the growth in non-fund-based income would partially offset this impact. Furthermore, the sizable holdings of PIB portfolio will translate into MTM deficits on investments, which will impact HBL's capital buffers, as this deficit forms part of the Tier II capital.

Macroeconomic changes and deficit on investment portfolio has translated into stress on the Bank's capital adequacy

Given the continued growth in advances and a sizable depreciation in USD/PKR parity, HBL's capital adequacy has trended down since our last review. As of Dec'21, HBL's CAR stood marginally lower than the 'Large Banks' median, albeit remained compliant with benchmarks for the assigned rating. At end-1H2022, as the Bank recorded a deficit of Rs. 18.4b (net of deferred tax) on its AFS portfolio, HBL's unconsolidated CAR eligible equity was affected. As of end-June'22, HBL's CAR and Tier I CAR receded further falling below the 'Large Banks' median. The management is undertaking a number of initiatives to conserve risk weighted assets, and maintaining the CAR at similar level YoY. The proposed issuance of ADT-1 instrument will support business growth, while maintaining the CAR at the required levels.

FINANCIAL SUMMARY *(amounts in PKR millions) – Annexure I*				
BALANCE SHEET	**2019**	**2020**	**2021**	**1H22**
Investments	1,351,962	1,912,238	1,905,189	2,171,367
Net Advances	1,073,019	1,117,321	1,384,549	1,506,111
Total Assets	3,053,734	3,643,712	4,074,588	4,735,536
Borrowings	382,072	540,095	432,262	713,994
Deposits & other accounts	2,301,899	2,669,491	3,184,261	3,530,963
Subordinated Loans	22,360	22,356	12,374	12,374
Tier-1 Equity	155,251	183,378	203,800	201,278
Paid Up Capital	14,669	14,669	14,669	14,669
Net Worth	201,422	242,725	257,929	247,429
INCOME STATEMENT				
Net Spread Earned	94,626	122,052	120,947	67,675
Net Provisioning / (Reversal)	2,530	10,224	6,353	1,828
Non-Markup Income	18,759	25,743	30,724	20,002
Administrative expenses	82,709	83,152	84,608	52,341
Profit/ (Loss) Before Tax	27,099	52,994	58,974	32,416
Profit / (Loss) After Tax	15,064	31,524	34,271	11,512
RATIO ANALYSIS				
Market Share (Domestic Advances)	11.6%	12.2%	12.1%	NA
Market Share (Domestic Deposits)	14.6%	14.1%	14.1%	NA
Gross Infection	6.34%	6.32%	5.07%	5.14%
Provisioning Coverage	96%	101%	106%	103%
Net Infection	0.55%	0.74%	0.36%	0.55%
Cost of deposits	5.44%	4.49%	3.58%	NA
Gross Advances to Deposits Ratio	46.9%	40.0%	41.2%	40.0%
Net NPLs to Tier-1 Capital	3.8%	4.3%	2.4%	4.0%
Tier-1 CAR	13.7%	14.8%	13.4%	12.48%
Capital Adequacy Ratio (CAR)	17.07%	19.20%	17.22%	15.33%
Markup Spreads	3.53%	4.04%	3.56%	NA
Efficiency	72%	59%	57%	60%
ROAA	0.5%	0.9%	0.9%	0.5%
ROAE	8.8%	16.4%	15.6%	9.7%
Liquid Assets to Deposits & Borrowings	59.7%	65.0%	62.1%	62.2%

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	TFC Rating
Rating History	

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
RATING TYPE: TFC-3 (ADT-1)			
04-Oct-22	AA+	Stable	Preliminary

Instrument Structure (Tier 1)	Proposed privately placed, perpetual, unsecured, subordinated, non-cumulative and contingent convertible Additional Tier-I (ADT-1) TFC amounting Rs. 10b (inclusive of a Green Shoe Option of Rs. 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.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Imran Ahmed	Head FR, Capital Management, Strategic Investment & Cost Oversight	September 27, 2022
2			