



BANK AL HABIB LIMITED

Ratings (September 2006)

Bank AL Habib Limited (BAHL)

	New	Previous
Entity		
Long Term	AA	AA
Short Term	A1+	A1+

TFCs

Unsecured, subordinated

1 st Issue PKR 1,350mln	AA-	AA-
2 nd Issue PKR 1,500mln	AA-	-

Financial Data

PKR (mln)

	31-Dec-05	31-Dec-04
Total Assets	91,501.5	77,435.6
Equity	4,745.8	3,274.3
Net Income	1,464.1	541.0
ROA %	1.73	0.80
ROE %	36.51	18.03
Equity/ Total Assets %	5.19	4.23
SBP CAR	8.64	9.37

Analysts

Maimoon Rasheed
+92 42 5869504
maimoon@pacra.com

Shahzad Saleem
+92 42 5869504
shahzad@pacra.com

TFC Issue

Bank AL Habib issued unsecured subordinated TFC of PKR 1,350mln for a tenor of 8 years in July 2004. The profit payment is made semi-annually, based on 6-month KIBOR plus 150bps with a floor of 3.5% and a cap of 10%. Major principal redemption will be in three semi-annual installments, commencing from the 84th month of the issue. The bank is in the process of issuing its second unsecured subordinated TFC of PKR 1,500mln for a tenor of 8 years. The profit, payable semi-annually, would be based on 6-month KIBOR plus 195bps without any floor and cap. Major principal redemption will be in two equal semi-annual installments beginning 90th month after issuance. The TFC holders are exposed to a relatively higher risk, as the obligations towards the TFC holders are subordinate to those of other creditors including depositors of the bank.

Rating Rationale Assessment

- The ratings reflect BAHL's low risk appetite reflective in its very good asset quality. The commitment of the management to protect the established brand image through service quality and prudent banking practices supplements its core business strategy. Meanwhile, continuous efforts of the bank to further strengthen the risk management systems is considered a key-rating factor. At the same time, the ratings recognize the bank's ability to sustain relative performance through continuing focus on business expansion and product innovation in the fast changing dynamics of the banking sector.
- The bank, in the recent period, has adapted an aggressive network expansion strategy – 26 new branches in 2005 and 17 in the first half of 2006 with a total of 117. However, despite relatively rapid expansion in branch network, the bank recorded moderate asset growth but, at the same time, managed to maintain its system share. Bank Al Habib, with a primary focus on the niche market – trade financing particularly in SME sector – has a stable credit-to-deposit ratio at around 66% net of export refinance. The consumer portfolio, a high growth segment for most of its peers, has only a nominal proportion in BAHL's loan book. This, alongwith a relatively stable credit-to-deposit ratio, signifies the management's cautious stance towards risk. The bank's advances portfolio is dominated by working capital financing in which the proportion of trade finance is one of the highest among peers. This also translates into low credit risk. The bank attained higher share in the total import/export business of the country, which is in line with its medium-term strategy. While helping in enhancing its fee-based income, this has also facilitated credit expansion.
- The bank's performance – measured in terms of both ROA and ROE – exhibited a substantial improvement. NIMR increased in line with volume expansion and increased spreads. The bank, despite higher proportion of term deposits, was able to maintain lower cost of funds compared to most peers. Although the proportion of non-fund based income in total-net-revenue (net of capital gains) declined, it increased in absolute terms YoY mainly on the back of higher foreign trade related revenue. The bank, with increased focus on the treasury function, also achieved significantly higher income from dealing in foreign currencies. Despite rapid branch expansion during 2005, the bank, with enhanced total net revenue, has been able to curtail its higher cost-to-total net revenue ratio, which is now in line with most of peers. Despite higher specific provisioning during the year, the bottom line was further compensated by decline in effective tax rate due to 3pp reduction in statutory tax rate and positive tax adjustment relating to the prior year. During 1H06, BAHL opened its first Offshore Banking Unit (OBU) in Bahrain. Meanwhile, the bank expanded both its assets and deposit base and improvement in spreads also continued, positively impacting the profitability of the bank.
- Going forward, the management plans to continue rapid branch expansion in the near-term, before entering the consolidation phase. However, BAHL is targeting moderate growth in assets and deposits. The bank also plans to sustain low cost of funds by retaining and strengthening customer loyalty. For credit expansion, the bank's reliance would remain on trade related financing with continuing focus on the SME sector. Although the magnitude of consumer financing would remain limited, the bank is expected to launch full range of consumer products including auto loans and credit cards. This, alongwith an effort to enhance Islamic product range, is expected to help the bank in attracting and retaining customers with varied needs. The bank's brokerage house – AL Habib Capital Markets (Pvt.) Limited – started operations in December 2005 as a corporate member of Karachi Stock Exchange. As the operations expand, this will augment income while increasing operational diversity.
- Bank AL Habib continues to enjoy very good asset quality with NPLs limited to less than one percent of finances at end-June-2006. The bank while making prudential provisions takes into account the value of permissible collateralized property in most cases. BAHL, at the same time, is in the process of improving its existing risk management framework according to the SBP guidelines. The bank has already established a separate Risk Management Department. The primary focus of the department would be to achieve compliance with the guidelines under BASEL II and the related human resource has already been inducted for the purpose. To strengthen its technological platform, the bank is in the process of acquiring a new software system.
- The proportion of bank's equity in total assets, with higher profitability and increased amount of retention, has improved. The proposed TFC issue, in addition to the existing one, with relatively longer tenor, would support the bank's CAR (end Jun-06: 9.44%) for an extended period while providing room for further growth.

Background

- BAHL's sponsors are members of the Habib family – the oldest and a distinguished name in Pakistan's banking circles. They are active in the management of the bank and are backed by a team of experienced professionals most of which have been with the bank since its inception.
- The bank's main activities are short-term lending, mainly trade finance related and seasonal running finance. Its future strategy envisages growth through further expansion of branch network, while maintaining the Habib hallmark of a conservative risk profile. BAHL continues to strengthen its technological platform and human resource base.