The Pakistan Credit Rating Agency Limited

HABIB METROPOLITAN BANK LIMITED

	NEW [DEC-17]	PREVIOUS [JUNE-17]
Entity		
Long Term	AA+	AA+
Short Term	A1+	A1+
Outlook	Stable	Stable

REPORT CONTENTS

DECEMBER 2017

Assets:

- The advances to deposit ratio (ADR) remained increased slightly (Sep17: 35%, Sep16: 33%).
- Gross advances increased by an impressive 24% (Sep17: PKR 166.4bln: Sep16: PKR 134.6bln).
- The contribution of the bank's CASA declined marginally (Sep17:54%, Sep16: 58%). The bank's share in this segment remains low in comparison to its peer banks.

Funding

- The main source of HMB's funding is its deposit base, constituting around 80% of the total liabilities at end-Sep 17.

Credit Risk

- The NPL's of the bank decreased (Sep17: PKR 18.474bln, Sep16: PKR 19.135 mln) and the infection ratio simultaneously improved to 10% (Sep16: 12.6%) on the back of increased advances.

Market Risk

- HMB's investment portfolio witnessed a minor increase of ~1% (Sep17: PKR 375bln, Sep16 PKR 370bln) and constitutes 65% of the total earning assets at end-Sep17.
- HMB is gradually shifting its exposure from PIB's to T-bills on the account of reduced interest rate from PIBs.

Performance

- The bank's net interest revenue increased by ~18% owing to reduced interest expense.
- Increase in non-interest expenses (Sep17: PKR 8.117bln, Sep16: PKR 6.990bln) led to reduction in bank's profitability with the net income decreasing to PKR 3.255bln (Sep-16: 3.819bln).
- The asset yield increased marginally (end-Sep17: 6.31%, end-Sep16: 6.24%). However, the cost of funds witnessed a decrease (end-Sep17: 3.66%, end-Sep16: 4.16%). Consequently, the spread increased by 58bps (end-Sep17: 2.66%, end-Sep16: 2.08%).

Capital

- HMB's paid up capital stands at PKR 10,478mln thus safely meeting the MCR of PKR 10,000mln.
- The bank has a strong CAR (end-Sep17: 16.76%, CY16: 18.5%), with key contribution from Tier I capital (15.83%) and Tier II capital (0.93%).
- The bank's growth trend has been a factor for high CAR.

Business Strategy

- Going forward, the bank aims to target organic growth, mobilization of low-cost deposits and improvement of asset quality.
- Both avenues are areas of attention, as the bank has very low concentration of CASA and continues to have stressed asset quality.

Profile

- Habib Metropolitan Bank (Habib Metro), originally Metropolitan Bank Limited, started banking operations in 1992, and is listed on Pakistan Stock Exchange.
- During 2017, the bank opened 13 new branches. The bank has a nationwide network of 320 branches at end-Dec17.

Governance and management

- HMB's nine member Board of Directors (BoD) comprises CEO, two representatives of HBZ, three independent directors and three non-executive directors.
- The CEO, Mr. Sirajuddin Aziz, carries experience of over three decades pertaining to domestic and international banking industry.
- A professional team of senior executives assists the Chief Executive.

RATING RATIONALE

The ratings incorporate HabibMetro's association with a diversified and financially strong international bank - Habib Bank AG Zurich (HBZ). This association helps in assimilating the parent's best practices into HabibMetro, while fostering control environment with enhanced level of oversight. The ratings recognize the bank's healthy financial profile reflected in its strong CAR. The bank has experienced downtrend in profitability which will remain a challenge in days to come. With dynamic competition in the market, holding onto a sustained market share (deposits and advances) with profitable growth has become increasingly difficult. The bank's strategy envisages re-orientation of the bank towards supply chain. The bank experienced relatively high infection compared to most peers, though these are considerably covered. NPL's are high; management's efforts must translate in sustained asset quality - indeed improvement. The bank needs to diversify its deposit base.

KEY RATING DRIVERS

The ratings are dependent on the management's ability to augment its position generally in the banking industry and particularly in its market niche - trade finance. Any weakening in asset quality in turn will put pressure on the bank's profitability and risk absorption capacity.

INDUSTRY SNAPSHOT

The banking sector experienced substantial expansion in its deposit base (2016: 14%). Building on the uptick in the economy, advances also grew by a sizeable margin after a lag of many years. Given GDP growth in FY17 and other macro-economic fundamentals, credit expansion is foreseen. Hence, CAR is going to be a challenge, as profits would also suffer due to PIBs maturities.

Habib Metropolitan Bank Limited

BALANCE SHEET	30-Sep-17 9M PKR mln	31-Dec-16 Annual PKR mln	31-Dec-15 Annual PKR mln
Earning Assets			
Advances (Net of NPL)	166,375	140,020	131,589
Debt Instruments	4,674	5,791	7,156
Total Finances	171,049	145,811	138,745
Investments	370,509	308,958	274,080
Others	31,534	16,795	24,925
	573,092	**471,565**	**437,751**
Non Earning Assets			
Non-Earning Cash	41,912	37,777	33,962
Deferred Tax	3,146	2,459	1,939
Net Non-Performing Finances	806	2,812	956
Fixed Assets & Others	12,522	11,994	15,272
	58,386	**55,042**	**52,129**
TOTAL ASSETS	**631,478**	**526,606**	**489,879**
Interest Bearning Liabilities			
Deposits	474,745	430,888	403,355
Borrowings	97,902	37,205	31,463
	572,647	468,093	434,818
Non Interest Bearing Liabilities	20,239	18,843	18,234
TOTAL LIABILITIES	**592,886**	**486,936**	**453,052**
EQUITY (including revaluation surplus)	**38,591**	**39,670**	**36,828**
Total Liabilities & Equity	**631,478**	**526,606**	**489,879**

INCOME STATEMENT	30-Sep-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	24,696	33,172	36,850
Interest / Mark up Expensed	(14,309)	(21,410)	(22,466)
Net Interest / Markup revenue	**10,387**	**11,762**	**14,384**
Other Income	4,201	8,836	9,182
Total Revenue	**14,588**	**20,598**	**23,566**
Non-Interest / Non-Mark up Expensed	(8,117)	(9,420)	(8,801)
Pre-provision operating profit	6,471	11,178	14,765
Provisions	(728)	(845)	(2,226)
Pre-tax profit	5,743	10,334	12,539
Taxes	(2,488)	(4,214)	(4,883)
Net Income	**3,255**	**6,119**	**7,656**

Ratio Analysis	30-Sep-17	31-Dec-16	31-Dec-15
Performance			
ROE	11%	17%	24%
Cost-to-Total Net Revenue	56%	46%	37%
Provision Expense / Pre Provision Profit	11%	8%	15%
Capital Adequacy			
Equity/Total Assets	6%	7%	7%
Capital Adequacy Ratio as per SBP	17%	18%	18%
Funding & Liquidity			
Liquid Assets / Deposits and Borrowings	72%	74%	73%
Advances / Deposits	35%	33%	33%
CASA deposits / Total Customer Deposits	54%	57%	57%
Intermediation Efficiency			
Asset Yield	6%	7%	9%
Cost of Funds	4%	5%	6%
Spread	3%	3%	4%
Outreach			
Branches	316	307	276

The Pakistan Credit Rating Agency Limited

STANDARD RATING SCALES & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances or economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk**. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business, and economic environment.
CCC CC C	**Very high credit risk**. "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, a suspended rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

Regulatory and Supplementary Disclosure

Rated Entity

Name of Rated Entity Habib Metropolitan Bank Limited
Sector Banking
Type of Relationship Solicited

Purpose of the Rating Independent Risk Assessment
Regulatory Requirement

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
30-Dec-17	AA+	A1+	Stable	Maintain
23-Jun-17	AA+	A1+	Stable	Maintain
23-Jun-16	AA+	A1+	Stable	Maintain
25-Jun-15	AA+	A1+	Stable	Maintain
26-Jun-14	AA+	A1+	Stable	Maintain

Related Criteria and Research

Rating Methodology Bank Rating Methodology
Sector Research Banking Sector - Viewpoint | Jun-17

Rating Analysts

Faraan Taimoor
faraan.taimoor@pacra.com
(92-42-35869504)

Jhangeer Hanif
jhangeer.hanif@pacra.com
(92-42-35869504)

Rating Team Statement

Rating Procedure
Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

Rating Shopping
PACRA maintains principle of integrity in seeking rating business.
PACRA has used due care in preparation of this document. Our information has been obtained directly from the underlying entity and public sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information.

Conflict of Interest
PACRA, 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 done by them
The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest
The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA
The analysts or any of its family members do not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This is, however, not applicable on investment in securities through collective investment schemes. PACRA has established appropriate policies governing investments and trading in securities by its employees
PACRA may provide consultancy/advisory services or other services to any of its clients or to any of its clients' associated companies and associated undertakings that is being rated or has been rated by it. In such cases, PACRA has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities
PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and ii) fee mandate - signed with the payer, which can be different from the entity
PACRA ensures that the credit rating assigned to an entity or instrument should not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship

Surveillance
PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer
PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so
PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct
PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality
PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties
Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

Prohibition

PACRA reports and ratings constitute opinions, not recommendations to buy or to sell

Probability of Default (PD)

PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past