The Pakistan Credit Rating Agency Limited

Rating Report

Habib Metropolitan Bank Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2018	AA+	A1+	Stable	Maintain	-
28-Jun-2018	AA+	A1+	Stable	Maintain	-
30-Dec-2017	AA+	A1+	Stable	Maintain	-
23-Jun-2017	AA+	A1+	Stable	Maintain	-
23-Jun-2016	AA+	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

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. There has been a dip in CAR in the recent period, although it still remains strong and primarily constitutes Tier I. The bank has experienced uptrend in profitability in nine months period. With dynamic competition in the market, holding onto a sustained market share (deposits and advances) with profitable growth has become increasingly difficult. Competition has intensified in the forte of the bank: trade business. 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 decreasing, management's efforts are translated in improved asset quality. The bank needs to diversify its deposit base.

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 in the wake of rising competition. Any weakening in asset quality will in turn put pressure on the bank's profitability and risk absorption capacity.

Disclosure

Name of Rated Entity	Habib Metropolitan Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Commercial Bank(Jun-18)
Rating Analysts	Muhammad Obaid | muhammad.obaid@pacra.com | +92-42-35869504

Profile

Structure Habib Metropolitan Bank Limited (hereinafter referred as "HMBL" or "the bank") was incorporated as a public limited company, in 1992, and is listed on Pakistan Stock Exchange (PSX).

Background Bank commenced operations in 1992. The Bank has a network of over 326 branches spanning more than 98 cities and enjoys credit lines with many international banks in more than 100 different countries. The Bank serves wide range of corporate, retail, small business, agricultural, Islamic and asset financing customers.

Operations Bank provides comprehensive banking services and products. These include specialized trade finance products, besides an array of products and technologically advanced services like mobile banking, globally accepted visa card and nationwide ATM network.

Ownership

Ownership Structure HMBL is majority owned by Habib Bank AG Zurich (HBZ) (51%), rest is owned by FIs and Corporates (31%), Individuals (15%) and Directors & Associates (3%).

Stability HMBL performs succession planning session periodically and identify successors for all critical roles. In this way it provides continuity to leadership and avoids extended and costly vacancies for key position.

Business Acumen HMBL enjoys close institutional relationship with Habib Group (HG) entities. Habib family, having been involved in banking for over 75 years, is considered pioneers of introducing banking in Pakistan. Extensive experience and strong acumen of sponsors has added value to HMBL.

Financial Strength HBZ, having a network of 360 branches spanning eight countries over four continents, is owned and managed by Habib family. HBZ has four wholly owned subsidiary banks. The Group has a strong capital base (Jun18: CHF 1.28 bln) and asset base (Jun18: CHF 11.2 bln).

Governance

Board Structure HMBL's nine member Board of Directors (BoD) comprises CEO along with three independent directors and five non-executive directors including two representatives of HBZ.

Members' Profile Chairman of the board, Mohamedali Rafiq Habib, is a well-known and seasoned banker with over 32 years experience. He was appointed as Joint-President & Divisional Head (Asia) & Member of General Management of HBZ in 2011 and was appointed Group Chief Executive Officer in 2016.

Board Effectiveness The board with its active engagement with the stakeholders is well poised to govern the bank and oversee implementation of its strategy. The BoD has constituted five committees to ensure rigorous monitoring of the management's policies and bank's operations.

Financial Transparency M/s. KPMG Taseer Hadi, Chartered Accountants, expressed an unmodified conclusion vide their review report for six months period ending June18. Further, an Internal Audit Division is in place that performs continuous reviews to improve quality of HMBL's internal control environment, ensuring an effective balance in safety and performance of processes and adding value towards Bank's risk mitigation endeavors.

Management

Organizational Structure HMBL's organizational structure and lines of authority are well-defined and processes throughout the bank are largely governed by approved policies and procedures.

Management Team HMBL's senior management team comprises experienced bankers having national and international exposure. Mohsin A. Nathani, CEO, is a seasoned banker with over 25 years of banking experience in international and domestic banking industry.

Effectiveness The management committees at HMBL comprise Central Management Committee (CMC), Central Credit Committee (CCC), Asset-Liability Committee (ALCO) and IT Steering Committee. The committees facilitate smooth and efficient operations of the bank through vertical and horizontal co-ordination at various levels, while ensuring the adequacy of segregation of duties. Further, to oversee and ensure the effectiveness, an appropriately designed internal control framework is in place and is routinely tested to address top risks.

MIS HMBL continues to upgrade its core banking software, hPLUS. It offers many features including Intelligent Option Navigation, Event Monitoring, Real-Time Client Limit Monitoring, and Customer Credit Worthiness Analysis.

Risk Management Framework Prudent risk management aspects are embedded in the bank's strategy, organizational structure, processes, and systems and controls. Risk Management Department remains responsible to ensure that appropriate risk management policies are developed and implemented to mitigate the key risks to which the bank is exposed.

Business Risk

Industry Dynamics The banking industry witnessed significant expansion in the loan book. Last year and YTD (2018) both witnessed huge deployments. This is expected to slow down. New projects require gestation period and additionally crowding-out effect may take place. Rising interest rates mean profitability of the sector would take support. Yet NPLs, as a result, may also transpire. CAR is reaching the maximum requirement by December 2018 (11.9%). This will create a challenge for some of the players.

Relative Position HMBL's customer deposits as at Sep18, PKR 485 mln, decreased by 1.8% however, the portion of CASA improved. The sector witnessed a growth of 6%. Bank's share in total deposits of the banking sector also decreased from 4.1% at Dec17 to 3.9% at Sep18.

Revenues Total net revenue for the 9M improved 11.9% YoY and stands at PKR 16.3 Bln. The growth in Net Interest Income was primarily due to improved spreads (Sep18: 2.71% Dec17: 2.68%). Non-markup income remained flat as higher income from dealing in foreign currencies was offset by lower capital gains being a market phenomenon.

Performance ROE of the Bank increased 60 bps from 14.4% at Dec17 to 15% in Sep18 owing to surge in markup income. Further, during nine months period an overall specific provision net reversal of PKR 524 mln was recorded (Dec17: PKR 393 mln).

Sustainability Going forward, HMBL remains committed to protecting its shareholders' interests, while maximizing the value and service offered to its customers through a varied spectrum of financial products architected upon an advanced technological platform. Bank aims to target organic growth, mobilization of low-cost deposits, improvement of asset quality and enhancement of cost efficiency.

Financial Risk

Credit Risk The credit risk strategy encapsulates to keep the risk low by ensuring diversification in terms of geography, product mix, customer base, and by emphasizing self-liquidating lending. Recoveries against non-performing advances continued to outpace fresh charge booked against delinquent loans, as NPLs decreased from PKR 18.5 bln at Dec17 to PKR 17.7 bln at Sep18. Bank's coverage ratio stands at 94%, while the Bank's NPL ratio stands at 8.3%.

Market Risk Market risk, in terms of HMBL's exposure of investment book, now representing 64% of total earning assets as at Sep18, witnessed a dip from 67% at Dec17. Investments continued to remain concentrated in government securities (Sep18: 99%; Dec17: 99%).

Liquidity And Funding Total customer deposits decreased slightly, by 1.8%, to PKR 485 bln. However, the portion of CASA improved to 57% at Sep18 (Dec18: 55%). Advances-to-deposits ratio increased to 38.5% at Sep18 (Dec17: 33.6%).

Capitalization Bank remains adequately capitalized, with CAR for Sep18, reported at 15.13% (Dec17: 17.19%). The Bank's quarterly average Liquidity Coverage Ratio (LCR) for the three quarters ended Sep 18 is 270%, while the Bank's Net Stable Funding Ratio (NSFR) as at Sep 18 is 222%, which are both well in excess of SBP prescribed minimum requirement.

The Pakistan Credit Rating Agency Limited

Habib Metropolitan Bank Limited

BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	Annual	Annual	Annual
	PKR mln	PKR mln	PKR mln	PKR mln
Earning Assets				
Advances (Net of NPL)	194,815	172,226	140,020	131,589
Debt Instruments	7,508	7,290	5,791	7,156
Total Finances	202,323	179,516	145,811	138,745
Investments	376,056	389,506	308,958	274,080
Others	10,810	11,005	16,795	24,925
	589,189	**580,027**	**471,565**	**437,751**
Non Earning Assets				
Non-Earning Cash	51,836	43,326	37,777	33,962
Deferred Tax	4,391	2,835	2,459	1,939
Net Non-Performing Finances	956	1,934	2,812	956
Fixed Assets & Others	14,332	16,432	11,994	15,272
	71,515	**64,527**	**55,042**	**52,128**
TOTAL ASSETS	**660,705**	**644,553**	**526,606**	**489,879**
Interest Bearning Liabilities				
Deposits	509,184	518,364	430,888	403,355
Borrowings	92,019	64,379	37,205	31,463
	601,203	582,743	468,093	434,818
Non Interest Bearing Liabilities	20,904	21,312	18,843	18,234
TOTAL LIABILITIES	**622,106**	**604,056**	**486,936**	**453,051**
EQUITY (including revaluation surplus)	**38,598**	**40,498**	**39,670**	**36,827**
Total Liabilities & Equity	**660,705**	**644,553**	**526,606**	**489,879**

INCOME STATEMENT	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Interest / Mark up Earned	30,563	33,838	33,172	36,850
Interest / Mark up Expensed	(18,811)	(19,867)	(21,410)	(22,466)
Net Interest / Markup revenue	**11,752**	**13,971**	**11,762**	**14,384**
Other Income	4,574	5,682	8,836	9,182
Total Revenue	**16,326**	**19,653**	**20,598**	**23,566**
Non-Interest / Non-Mark up Expensed	(8,598)	(10,449)	(9,420)	(8,801)
Pre-provision operating profit	7,727	9,203	11,178	14,765
Provisions	(388)	(74)	(845)	(2,226)
Pre-tax profit	7,339	9,129	10,334	12,539
Taxes	(2,809)	(3,620)	(4,214)	(4,883)
Net Income	**4,531**	**5,509**	**6,119**	**7,656**

RATIO ANALYSIS	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
Performance				
ROE	15% *	14%	17%	24%
Cost-to-Total Net Revenue	53%	53%	46%	37%
Provision Expense / Pre Provision Profit	5%	1%	8%	15%
Capital Adequacy				
Equity/Total Assets	6%	6%	7%	7%
Capital Adequacy Ratio as per SBP	15%	17%	18%	18%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	69%	73%	74%	73%
Advances / Deposits	38%	34%	33%	33%
CASA deposits / Total Customer Deposits	57%	55%	57%	57%
Intermediation Efficiency				
Asset Yield	7% *	6%	7%	9%
Cost of Funds	4% *	4%	5%	6%
Spread	3% *	3%	3%	4%
Outreach				
Branches	326	320	307	277

** annualized*

Rating Scale

Credit Rating Scale & 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.

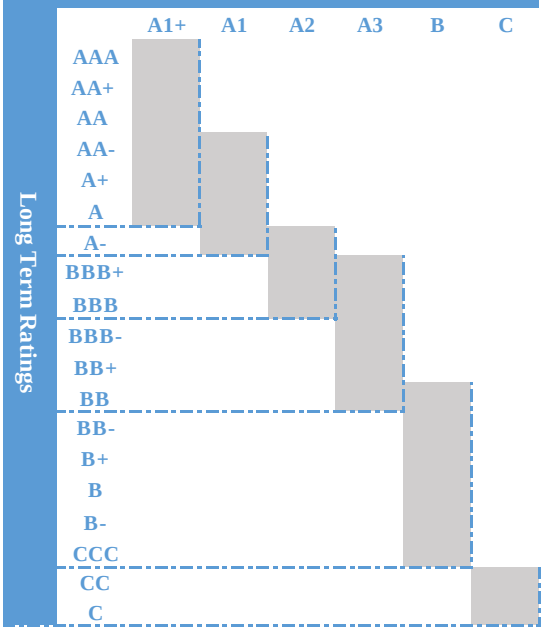
Long Term Ratings

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 and in 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.** Substantial 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.

Short Term Ratings



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'.

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. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

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, the 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, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) 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 fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is 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 | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) 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 | Chapter III | 14-(f-VII)
Proprietary Information