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-2019	AA+	A1+	Stable	Maintain	-
27-Jun-2019	AA+	A1+	Stable	Maintain	-
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	-
25-Jun-2015	AA+	A1+	Stable	Maintain	-
26-Jun-2014	AA+	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings of Habib Metropolitan Bank (HabibMetro) is vested in the brand strength of the Bank, flanked by a family of astute bankers. The Bank is also associated 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 Bank has a strong forte in the business hub of Pakistan in terms of its presence and contribution of deposits and advances. To hold asset quality is crucial in the future. The Bank grew its deposit base, wherein it enhanced its current and saving deposit. As at December 31, 2018 the CAR of the Bank has taken a hit due to mark-to-market of its investment book, however, the profitability in the recent period is higher, providing internal generation of Capital which would improve the CAR.

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	PACRA_Methodology_FI(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Commercial Bank(Jun-19)
Rating Analysts	Usama Liaquat | usama.liaquat@pacra.com | +92-42-35869504

Profile

Structure Habib Metropolitan Bank Limited was incorporated as a public limited company, in 1992, and is listed on Pakistan Stock Exchange (PSX).

Background Bank commenced its commercial-banking operations as Metropolitan Bank in October 1992; and in 2006 the Bank merged with Habib Bank AG Zurich's Pakistan operations. The merged entity was named Habib Metropolitan Bank Limited. The Bank continued to strengthen its outreach which makes the total branch network of 371 as at Sep-19.

Operations Bank provides comprehensive banking services and products. Bank has subsidiary companies, namely Habib Metropolitan Financial Service, Habib Metropolitan Modaraba Management, First Habib Modaraba and Habib Metro Modaraba.

Ownership

Ownership Structure HMBL is majority owned by Habib Bank AG Zurich (HBZ) (51%), rest is owned by FIs and Corporates (31%), Individuals (16%) and Directors & Associates (2%).

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 Habib Bank AG Zurich (HBZ), having a network of 393 branches spanning eight countries over four continents, is owned and managed by Habib family. HBZ has three wholly owned subsidiary banks: Habib Bank Zurich Plc (UK); Habib Canadian Bank; HBZ Bank Limited (S Africa). Habib Bank Zurich (Hong Kong) Ltd and HabibMetro Pakistan are also subsidiaries of HBZ. The Group has a strong capital base (Jun19: CHF 1.28 bln) and asset base (Jun19: CHF 11.2 bln).

Governance

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

Members' Profile Chairman of the board, Mr. Mohamedali R. Habib is a graduate in Business Management – Finance from Clark University, USA. He also holds a PGD in General Management from Stanford – NUS Singapore. Mr. Habib has worked in the corporate sector for over three decades, in various managerial capacities across different industries, including multinational projects. He is accompanied with well-known and seasoned professionals.

Board Effectiveness The board actively participates in strategy formulation and effectively monitors the managerial affairs of the bank. To ensure effective and independent oversight of the bank's overall operations, the Bank has constituted five committees.

Financial Transparency The external auditors of the company, KPMG Taseer Hadi & Co., Chartered Accountants, issued an unmodified audit conclusion pertaining to half yearly financial statements for Jun19.

Management

Organizational Structure HMBL's organizational structure and lines of authority are well-defined. The bank, with a largely horizontal organizational structure, has seventeen groups & divisions reporting to the CEO, except Internal Audit which reports to the Board's Audit Committee and Shariah Board which reports to the Board of Directors.

Management Team Bank's senior management team comprises experienced bankers having national and international exposure. Mr. Mohsin Ali Nathani, CEO, is a seasoned corporate banker with over 25 years of banking experience, covering Asia (East and South-East), Middle East and Levant regions.

Effectiveness The management committees at HMBL comprise Central Management Committee (CMC), Central Credit Committee (CCC), Asset-Liability Committee (ALCO), Management Compliance Committee, COSO Steering Committee and IT Steering Committee. The committees facilitate smooth and efficient operations of the bank through vertical and horizontal co-ordination at various levels.

MIS HabibMetro 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. The bank has adopted a cohesive management structure for credit, operations, liquidity and market risk.

Business Risk

Industry Dynamics Despite challenging macroeconomic environment, banking sector maintained its growth trajectory during 9MCY19, backed by decent growth in deposits (9MCY19: PKR 14,945bln; 9MCY18: 13,603bln). However, lending was largely skewed towards investments and particularly towards government instruments due to favorable interest rate dynamics (9MCY19: PKR 9,641bln; 9MCY18: 6,942bln). Meanwhile, advances witnessed a slowdown owing to subdued economic activity, cautious lending approach and monetary tightening (9MCY19: PKR 8,014bln; 9MCY18: 7,422bln). Asset quality saw some deterioration – increased NPLs, particularly in sugar and energy sectors (9MCY19: PKR 758 bln; 9MCY18: 637bln). The profitability of the banking sector improved due to increase in Net Interest Income, which translated positively in other profitability indicators. The overall risk profile of the banking sector remained satisfactory.The year 2018 was a marked year as the industry saw an expansion of ~22% in advances, although the deposit growth rate stayed in single digit. As a result the industry saw a rise in the ADR ratio from 50% to 55%. In terms of advances expansion, a predominant portion went in to energy sector followed by textile, individuals and agriculture. Corporate sector claimed the major portion of the borrowings with small amounts going into commodity, consumer and SME sectors. Profitability of the banks has taken a hit due to incremental costs and provisioning on account of NPLs. After a lapse of few years the industry NPLs have seen an accretion which is a concern going forward.

Relative Position During 9MCY19, Bank's customer deposits (PKR 554bln) increased by ~7.46% better than sector's growth of ~5.1% against deposits in CY18. HMBL retained its position in medium banks with share in total customer deposits of the sector at 4.0% (CY18: 4%).

Revenues On the gross markup income side, Bank reported markup of PKR 51bln as at Sep-19 with growth of 67% as compared to corresponding period of last year. Of this increase, income on loans and advances constitute a major chunk increasing by 113% to PKR 19.25bln (9MCY18: PKR 9.04bln) followed by investments increasing by 32% to PKR 27.39bln (9MCY18: PKR 20.81bln). Non-markup income of the Bank increased by ~28% YoY, clocking in at PKR 5.79bln (9MCY18: PKR 4.52bln) with major contributions coming in from foreign exchange income and fee & commission income.

Performance Profit before tax of the Bank increased by 18.76% over the same period of last year and was reported at PKR 8.72bln (9MCY18: PKR 7.34bln). Provisioning expense remains almost stagnant over the same period of previous year (9MCY19: PKR 295.9mln, 9MCY18: PKR 296.2mln).

Sustainability Going forward, the Bank aims to target organic growth, by adding new clients, mobilizing low-cost deposits, improving asset quality and enhancing cost efficiency.

Financial Risk

Credit Risk Net advances of the Bank constitute ~30% of the total assets at end Sep19 – increasing 14.7% YoY (9MCY19: PKR 260.11bln, CY18: PKR 226.69bln). At end Sep19, the Non-performing loan base of the Bank witnessed a decrease of PKR 242mln and was reported at PKR 17.44bln. NPL ratio has improved to 6.3% as compared to 7.3% in CY18.

Market Risk The investment portfolio showed a significant growth of 38.24% to PKR 479.24bln during 9MCY19 (CY18: PKR 346.7bln). The bank's investment portfolio constitutes 55.8% of total asset base (PKR 858.18bln) and government securities continue to dominate the overall investment book (90.3%).

Liquidity And Funding Bank's focus throughout the period under review remained on improving deposit profile and managing spreads. Total Deposits were reported at Sep19 PKR 600.9bln as against PKR 543.6bln last year – mainly led by growth in current accounts by 17.3% followed by growth in saving accounts by 13.7%.

Capitalization HMBL is a well-capitalized institution with an equity base and CAR well above the regulatory requirements. Bank's CAR on Sep19 was 13.86% (Dec18: 13.12%), which is above the regulatory requirement of 11.9%.

PKR mln

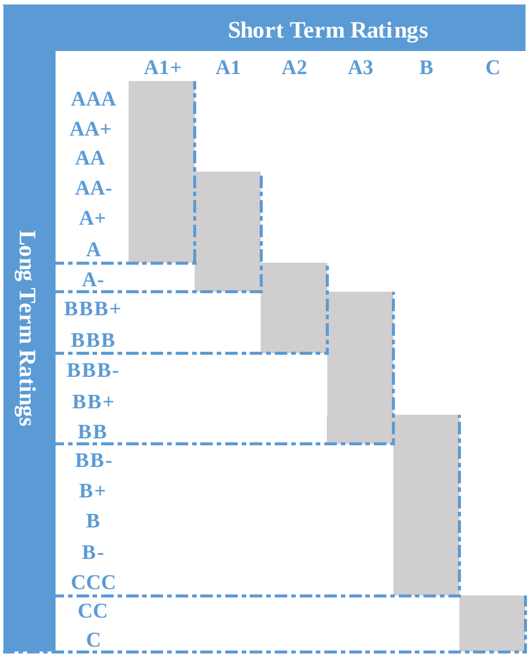
Habib Metropiltan Bank Listed Public Limited	Sep-19 9M	Dec-18 12M	Dec-17 12M	Dec-16 12M
A BALANCE SHEET				
1 Total Finances - net	268,551	235,405	179,356	145,681
2 Investments	470,290	336,831	389,506	308,958
3 Other Earning Assets	39,525	28,715	25,988	26,721
4 Non-Earning Assets	79,305	71,325	63,722	42,304
5 Non-Performing Finances-net	512	1,119	2,093	2,942
Total Assets	858,183	673,396	660,666	526,606
6 Deposits	600,898	543,578	508,104	430,888
7 Borrowings	166,958	51,347	64,039	37,205
8 Other Liabilities (Non-Interest Bearing)	49,436	41,469	48,025	18,843
Total Liabilities	817,292	636,394	620,168	486,936
Equity	40,891	37,002	40,498	39,670
B INCOME STATEMENT				
1 Mark Up Earned	51,086	42,520	33,838	33,172
2 Mark Up Expensed	(38,199)	(26,297)	(19,867)	(21,410)
3 Non Mark Up Income	5,788	6,074	5,644	8,836
Total Income	18,675	22,297	19,615	20,598
4 Non-Mark Up Expenses	(9,663)	(11,840)	(10,598)	(9,594)
5 Provisions/Write offs/Reversals	(296)	(382)	113	(671)
Pre-Tax Profit	8,716	10,074	9,129	10,334
6 Taxes	(3,708)	(3,914)	(3,620)	(4,214)
Profit After Tax	5,008	6,161	5,509	6,119
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	2.2%	2.4%	2.4%	2.3%
Non-Mark Up Expenses / Total Income	51.7%	53.1%	54.0%	46.6%
ROE	17.1%	15.9%	13.7%	16.0%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	4.8%	5.5%	6.1%	7.5%
Capital Adequacy Ratio	13.9%	13.1%	17.2%	18.1%
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	62.5%	63.8%	74.1%	73.1%
(Advances + Net Non-Performing Advances) / Deposits	43.3%	41.7%	34.3%	33.2%
CA Deposits / Deposits	30.1%	28.4%	28.1%	32.5%
SA Deposits / Deposits	31.1%	30.3%	24.8%	25.7%
4 Credit Risk				
Non-Performing Advances / Gross Advances	6.3%	7.3%	9.7%	12.4%
Non-Performing Finances-net / Equity	1.3%	3.0%	5.2%	7.4%

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.



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.

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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)
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