

Directors' Report - Consolidated

On behalf of the Directors, I am pleased to submit the Annual Consolidated Financial Statements along with the Auditors' Report for the year ended December 31, 2007.

Corporate Reporting Framework

The Board is committed to ensure that requirements of the Code of Corporate Governance set by the Securities and Exchange Commission of Pakistan and Listing Regulations are fully met. The Bank has adopted corporate governance practices and the Directors are pleased to inform the members that:

- The financial statements prepared by the management of the Bank present a true and fair view of the state of its affairs, operational results, cash flows and changes in equity.
- Proper books of accounts of the Company have been maintained.
- Appropriate accounting policies have been consistently applied in preparation of financial statements.
- The Company has followed international accounting standards (as applicable to Banks in Pakistan) in the preparation of accounts and there is no departure from the said standards.
- As a continuous process, efforts have been made to effectively implement the internal control system. Issues identified during the review process are rectified through appropriate corrective actions and by further strengthening the internal control procedures.
- There are no doubts about the Banks' ability to continue as a going concern.
- There has been no material departure from the best practices of corporate governance as detailed in the regulations.
- Risk Management, Human Resource and Audit Committees constituted by the Board are functioning efficiently in accordance with their Terms of Reference. The Board has met regularly and held five meetings in the year.

The Statement of Internal Control, Statement of Compliance, Review Report to the Members on Statement of Compliance and the Auditors' Report are attached to the Financial Statements.

Initial Public Offer

During the year, the Government of Pakistan issued an Initial Public Offer (IPO) of 5% ordinary shares with a green shoe option of 2.5% in case of over subscription. The amount as on offer was Rs. 8.1 billion, the largest IPO in Pakistan's history. The IPO was oversubscribed by 2.33 times, confirming the confidence; investors and general public have in Habib Bank Limited. Subsequent to the issue, shareholders increased from 6 to over 175,000.

Subordinated loan from International Finance Corporation (IFC)

IFC disbursed Tier 2 qualifying, 8 year subordinated loan of US \$ 50 million. The IFC loan will support and strengthen HBL's capital adequacy, diversify funding sources and support operational expansion and diversification of HBL's lending activities.

Market and Competition Review

GDP growth rate of 7% was achieved over the fiscal year 2006-2007, which was 0.4% higher than the previous year; the manufacturing and services sector were the main contributors. Foreign Direct Investment (FDI) reached \$5 billion in FY 07 and it is encouraging to note that almost all of this FDI is non-privatisation related. Inward remittances over the year were at a record high of \$5.5 billion. However, high dependence on imports combined with an increase in global oil prices have caused the trade deficit to widen; the current account deficit increased significantly. Liquidity in the market has fuelled inflation. In order to contain this phenomenon, the SBP has embarked upon a tight monetary policy, causing interest rates to increase and

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as a consequence we are seeing a reduction in credit demand; Gross Loan to Deposit Ratio has declined from over 75% in 06 to below 66% in 07 in the sector. While the banks have had to increase interest rates in line with the monetary policy, they have not been able to pass on the corresponding cost due to the inelastic demand for corporate and consumer credit; spreads for the entire industry have reduced as a consequence. Going forward, we believe that the SBP will maintain a tight grip on the money supply side and thus margins could shrink further; based on the current scenario, we believe that the growth next year may reduce from the projected 7% to 6% or so. This may have a corresponding impact on the credit growth and thus bank margins are likely to remain under pressure.

With the recent mergers of banks in Pakistan and the expected entry of renowned Islamic and International banks eyeing the Pakistan financial market, we believe that the competition for business will increase. Although large banks, such as HBL will be able to compete aggressively on the back of a country wide branch network, profitability and bottom line will remain sensitive to any margin compression.

Group's Performance Review

Over 2007 the balance sheet size increased by 16.5% (2006: 11.6%). Group's deposit base has also increased by 15.7% (2006: 6.15%). This is in line with the Group's efforts for generating funds from the retail bank and investing these in profitable ventures. The State Bank of Pakistan (SBP) now requires provision to be made on the full value without reduction of any forced sale value of collaterals held. Due to this, the Group's profit has decreased by Rs. 5.8 billion (19.6%) to Rs. 15.14 billion (2006: 18.84 billion). The details have been mentioned in note 9.5 of the Financial Statements.

Credit Rating

You would be pleased to note that JCR-VIS Credit Rating Company Limited has assigned a long term rating of "AA+" (Double A Plus) and a short-term rating of "A1+" (A One Plus) to the Bank. The ratings derive significant strength from HBL's strong franchise value and its systematic importance to the local economy as the largest private sector Bank, both in terms of deposits held by the Bank and the size of its branch network.

Future Outlook

An aggressive growth strategy is in place with the Retail Bank being the generator of stable low cost deposits. Recent developments include branch refurbishments, upgrade in technology, launching of new and re-branded deposit products and intense marketing have all had a positive effect on the deposit growth. In the event that the cost of deposits increase due to rising interest rates, SBP's tight monetary policy and intense market competition stemming from industry consolidation we could see some compression in spreads.

While the demand for private sector credit has been relatively flat, we expect it to improve later in the year as several large infrastructure investment projects are expected to come on stream. There will be a focus on developing the synergy between the Corporate and Investment Bank and a focus on developing the SME segment with its higher margins.

Revenues from Bancassurance and other services are likely to increase as the year progresses. Global Treasury has been reorganised and repositioned; this will augment earnings and enable the Group to enhance its share in the trade finance area.

On November 24th 2007, the Bank launched its credit card. While there is tough competition in the credit card market, we believe that we will be able to position the Bank to take on a lead role in the next five years;

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the credit card business will take 2-3 years to achieve profitability but has the potential to become a significant contributor to earnings in the medium term. The Consumer Bank is expected to become a major revenue generator in the years ahead.

HBL has successfully implemented anti-money laundering software and KYC procedures throughout its network; we will continue to deploy considerable financial resources towards meeting regulatory and compliance guidelines.

Implementation of Basel II procedures will continue in 2008 and will further strengthen risk management capabilities across the Bank. Significant technology upgrade has enabled that all 1,400 plus branches are online and able to service customers from any branch. The first phase of the branch refurbishment will see 170 branches (urban and rural) renovated throughout Pakistan over 2008. Over the next five years, new building projects will be undertaken in major cities to house centralised processing centers and call centers (\$ 23 million of capital expenditure relating to this has been included in the budget for 2008).

Human Resource challenges persist and the Bank continues to invest in recruiting, retaining and training high achievers and experienced professionals. The Bank is in the process of developing and implementing strategies for training staff at different levels within the bank: IFC is assisting the Bank in developing a training strategy and training programmes.

Dividend

The Directors approved payment of Cash Dividend of 20 percent (Rs. 2 per share) for payment to the shareholders entitled at close of business on March 10, 2007.

The directors proposed a cash dividend of 40% percent (Rs. 4 per share) and 10% bonus shares (1 share for

every 10 shares held) to shareholders entitled at close of business on March 14, 2008 subject to approval of the shareholders at the Annual General Meeting. As per current IAS, this will be accounted for in Quarter 1, 2008.

Value of Investments in Employee Retirement Benefits Fund

The following is the value of investments of provident, gratuity, pension and benevolent funds maintained by the Bank, based on latest audited financial statements as at December 31, 2005.

	Amount in Rs '000'
Employees' Provident Fund	6,635,911
Employees' Pension Fund	8,998,939
Employees' Gratuity Fund	600,755
Employees' Benevolent Fund – Executive and Officers	861,480
Employees' Benevolent Fund – Clerical and Non-Clerical	383,115

Earnings per Share

Basic and Diluted earnings per share have been disclosed in note no. 28.

Pattern of Shareholding

The pattern of shareholding and categories of shareholders are attached to the Financial Statements.

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Meetings of the Board

Five Board meetings were held during 2007 and were attended by the Directors as follows:

Name	Meetings during tenure	Attendance
Mr. Sultan Ali Allana	5	5
Mr. R. Zakir Mahmood	5	5
Mr. Iain Donald Cheyne	5	5
Mr. Sajid Zahid	5	5
Mr. Muhammad Ismail Qureshi	4	4
(Resigned w.e.f. December 18, 2007)		
Mr. Arif Mansur	3	2
(Passed away on August 09, 2007)		
Mr. Shaukat Hayat Durrani	4	4
(Resigned w.e.f. December 18, 2007)		
Mr. Ahmed Jawad	2	1
(Appointed on October 17, 2007)		
Mr. Mushtaq Malik	1	1
(Appointed on December 18, 2007)		

The seventh director has been nominated and will be appointed following approval from SBP.

Auditors

The present auditors M/s KPMG Taseer Hadi and Co. Chartered Accountants retire and, being eligible, offer themselves for re-appointment in the forthcoming Annual General Meeting. The Board of Directors on the suggestion of the Audit Committee recommends M/s KPMG Taseer Hadi and Co., Chartered Accountants for the appointment of next term.

Appreciation and Acknowledgement

In conclusion, I extend my thanks and appreciation to HBL shareholders, customers and employees for their persistent support and trust and we hope to continue delivering exceptional results in the future. We also express our earnest appreciation to the Government of Pakistan, State Bank of Pakistan and Ministry of Finance for their unfaltering support.

On behalf of the Board

R. Zakir Mahmood
President and Chief Executive Officer
Karachi: February 14, 2008.