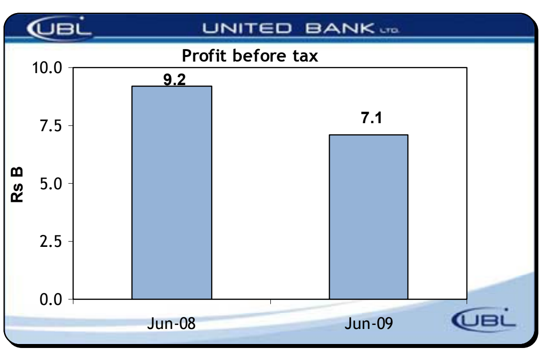
# DIRECTORS' REPORT TO THE MEMBERS

On behalf of the Board of Directors, I am pleased to present to you the consolidated financial statements of the Bank for the half-year ended June 30, 2009.

## Financial Highlights

| | (Rs. In millions) |
|---|---|
| Profit before taxation | 7,107 |
| Taxation | (2,509) |
| Profit after taxation | 4,598 |
| Share of minority interest | (7) |
| Un-appropriated profit brought forward – January 01, 2009 | 17,703 |
| Transfer from surplus on revaluation of fixed assets – Incremental depreciation | 127 |
| Profit before appropriations | 22,421 |
| Transfer to statutory reserve | (858) |
| Cash dividend paid to shareholders – 2008 | (1,012) |
| Bonus shares issued – 2008 | (1,012) |
| Un-appropriated profit carried forward – June 30, 2009 | 19,540 |
| | (Rupees) |
| Earnings per share (post bonus) | 4.13 |

## Results impacted by economic challenges




UBL posted a profit before tax of Rs. 7.1 billion for the six month period ending June 30th 2009 which is 23% lower from the same period last year due to higher provision on advances and provision required on impairment for investments. Deposits increased by 6% over December 2008 with a 17% growth in current deposits. Current and saving accounts (CASA) ratio increased to 62% at June 30, 2009 from 59% at December 31, 2008.

Profit after tax at Rs. 4.6 billion translates into diluted earnings per share of Rs. 4.13 (June 2008: 5.21). Higher provisioning has significantly impacted results as is evident from a pre-provision operating profit increase of 13% over the same period last year.

Net interest income before provisions grew by 19% on account of higher Kibor rates and a 13% increase in average advances. However, non-interest income came in 2% down at Rs 6.5 billion. Consequently, operating revenue came in higher by 12% at Rs 22.5B compared to the same period last year.

Net interest margins (NIMs) remained strong at 6.3% owing to higher interest rates and attractive returns on the investment portfolio. However, NIMs on a year on year basis were impacted by an increase in the cost of deposits as a result of SBP regulation of 5% minimum rate of return on saving deposits which came into effect in June 2008.

Net interest income after provisions came in 12% down from the same period last year at Rs 9.5 billion. Provisions are up by Rs. 3.9 billion to Rs 6.6 billion this year mainly due to higher corporate and on-going consumer portfolio provisions. It is to be noted, however, that the management has taken a prudent stance to improve coverage on our loan portfolio so as to mitigate further weakening in asset quality. The provisioning charge also includes Rs. 484M charged on account of impairment loss taken on the equities portfolio.

Non-interest income at Rs. 6.5 billion was 2% down over the same period last year. Fee income was down due to reduced investment and acquisition financing activity in the corporate sector and lower level of fees from distribution of retail financial products. Commissions on consumer loans declined by 30% owing to net attrition in the lending portfolio. Exchange income is down by 26% as volatility in the Pak rupee had contributed to significant exchange income last year.

Administrative expenses increased by only 11% over the same period last year with personnel cost contributing to nearly half of the increase. In spite of high inflationary pressures (average 1H09 CPI at 17.6%), we have managed to improve cost efficiency across the bank and to limit operating costs from increasing sharply.

Total assets have grown by Rs. 34 billion to Rs. 654 billion during the first six months of the year with investments increasing by 11% to Rs. 128 billion and deposits by 6% to Rs. 521 billion.

**Marcro-economic indicators remain fragile**

The effects of the global financial crisis continued to be felt on Pakistan's economy which grew by only 2% during 2008-09. Political instability and increased militancy in the northern areas of the country have taken its toll on the economy both in terms of direct costs of the fight against extremism as well as affecting investment inflows and investor confidence.

GDP growth came in at 2% mainly due to large scale manufacturing sector which declined by 7.7% this year as compared to a growth of 4% last year. Services sector grew by 3.6% this year compared to 6.6% last year and could not achieve the targeted growth owing to a decline of 1.2% in the finance and insurance sector as compared to the growth of 12.9% last year. Agriculture sector remained the one bright performer registering a growth of 4.7% this year as compared to 1.1% achieved last year.

Deteriorating law and order situation led to foreign direct investment declining from $3.9 billion to $2.2 billion this year and a net outflow of $451 million of portfolio investment as against a net inflow of $99 million last year. This has had a direct impact on the economic growth which has consequently affected the banking sector profitability adversely.

However, the IMF program has helped to bring some stability in key economic indicators. Foreign exchange reserves which had dropped to below $7 billion in November 2008 increased to $11.4 billion in June 2009. Current account deficit was 23% lower this year at $8.5 billion with trade deficit down to $14 billion against $16.8 billion last year. Remittances were up by 21% to $6.4 billion this year which also helped to stabilize the external account.

The tight monetary policy followed by the government has also yielded results by easing demand pressures on the economy which is evident from M2 growth which came in at 4.6% as compared to 9.3% last year. With CPI also falling to 14% in June 2009, the SBP reduced discount rate by 100 bps to 14% with further cuts expected later in the year. The lowering of interest rates should provide impetus for future growth which bodes well for the banking sector advances. Asset quality which has been adversely impacted by high borrowing rates would also be strengthened following further cuts in discount rates.

The key challenges, however, which need to be resolved in order to revive the economy and restore investor confidence in the Pakistan market remain the acute energy crisis and the increased threat of militancy and extremism. Given the government's current focus on these issues, we remain cautiously optimistic that the economic indicators will continue to improve this year.

**Deposits growth further strengthen the balance sheet**

Deposits have continued to grow and increased by 6% to Rs 521 billion despite liquidity constraints and increased competition from high yielding National Saving Schemes. The increase in deposits has come mainly from current deposits which grew by 17% to Rs 157 billion while we have shed high cost fixed deposits by 2% to Rs 187 billion. This reduction in expensive deposits has resulted in cost of deposits declining from 5.7% in March 2009 to 5.4% in June 2009. Consequently CASA for the bank has also improved from 59% to 62% in June 2009.

**Disbursement to IDPs (Internally displaced persons)**

UBL had the honour of being selected to assist the government in providing aid to approximately 268,000 families which have been displaced in the war against militants in the northern area of Pakistan. An efficient and transparent financial assistance disbursement mechanism has been devised in conjunction with NADRA to serve this purpose. Around 250 UBL branches started the process of distributing cards for disbursement of Rs 25,000 per family. To date UBL has opened approximately 285,000 accounts against which 177,000 cards have been activated and funds amounting to almost Rs, 4 billion disbursed.

**UBL Wiz Prepaid**

Moving on from the success of UBL Wallet, we have launched Pakistan's first Prepaid Debit card – UBL Wiz. The concept revolves around 'Pay now, buy later.' The prepaid debit card works on the lines of the concept of prepaid mobile phone and internet cards with the customer acquiring a specific denomination card from readily accessible locations and using it till its expiry or depletion. The funds in the VISA prepaid card are used through purchase transactions or cash withdrawals by the customer.

70k cards have been issued with a float of Rs 95 million in a short period and additional features are being introduced including ATM/Internet, card sales through all online branches and retail outlets, and specific usage cards (Hajj-Umra-Internet-Corporate-Remittance-FCY).

**Credit rating re-affirmed**

The credit rating company JCR-VIS has re-affirmed the bank's long-term entity rating at AA+ and the ratings of our four subordinated debt instruments at AA. The short-term ratings remain at A-1+ which is the highest rating denoting the greatest certainty of timely payments by a financial institution.

The re-affirmation of our ratings is based on our diversified deposit base, strong international operations and leading corporate and commercial segments in the domestic market. All ratings for UBL have been assigned a Stable outlook.

**Implementation of core banking application on schedule**

The implementation of our core banking software project Genesis is well on track against targeted milestones. The core banking application has been procured from a reputable international vendor and the transition to the new software is planned over multiple phases which is being overlooked by a dedicated project management and business teams headed by a Project Director. A Genesis Steering Committee, comprising senior management of the bank, also keeps track of progress made in achieving established milestones, as well as making sure that there is complete synergy between the project team and the rest of the business divisions.

The first phase of the front end application Customer Service Manager (CSM) which comprises complaints management, customer dashboard, alerts engine and campaign management has been successfully deployed at the City Branch and the roll out in 300 branches in Karachi and Lahore is now underway. The software offers the capability to present a consolidated position of every retail UBL customer and allows us to target products to specific customers. It will also assist in more efficient logging of customer complaints at the branches and their speedy resolution through a customizable workflow engine that keeps track of turnaround times and escalates whenever those times are exceeded. This will result in providing much better customer service at the branches and will enable Head Office to monitor the service delivery at the branches from a centralized reporting dashboard.

A sub-phase of the project is also under way, to be completed in 3 months, which will allow CSM to be used by Relationship Managers for servicing corporate / SME / Agri clients in a similar manner. Phase two of the CSM comprising consumer and corporate/SME loan origination is scheduled to be automated in end-to-end Straight Through Processing (STP) mode by the end of this year.

The back end engine of the core banking application SYMBOLS will cater to the bank's requirements with respect to consumer, agriculture, SMEs, corporate, treasury and trade finance portfolios, along with its deposit products. SYMBOLS includes complete end-to-end product lifecycle mapping, including post disbursement monitoring and control. Currently treasury operations are on the fast track with implementation expected by the end of the year. The Standard track implementation comprising migration of all other products and services other than treasury is expected by second quarter 2010. After the first 5 pilot branches, SYMBOLS will be deployed across the Pakistan branch network at a steady pace, while the implementation of SYMBOLS / CSM at UBL's overseas branches will also commence in parallel at this time.

**Launch of UBL liquidity plus fund (ULPF)**

The launch of UBL Fund Managers' most recent fund by the name of UBL Liquidity Plus Fund-ULPF added a seventh fund (sixth open ended) to our existing diverse range of funds products which is in line with our aim of offering a complete and comprehensive range of funds for our customers. UBL authorized branches across the country will provide services to customers for all product offerings. With this latest fund, UBL Fund Managers now have Rs. 21 billion assets under management.

**Looking ahead**

The earnings and growth of the banking sector has been negatively impacted by the current economic and political turmoil in the country. While there are signs of improvement in key macro economic indicators, major challenges remain. The IMF program has brought some stability but there needs to be a concerted effort by the policy makers to tackle the energy crisis which is the main impediment to industrial growth. Additionally success in the war on extremism will be key to restoring investor confidence and reviving foreign direct investment.

Despite these challenges, however, our diverse revenue and funding sources have provided us support. Our efforts to reduce funding costs by shedding expensive deposits and exercising tight operating cost controls have resulted in pre-provision operating profit growing by 13% to Rs. 13.9 billion in the first six months of the year over the same period last year. Operating revenue (net interest and non interest income) has also shown an increase of 12% in the first six months of the year.

The main challenge remains improving asset quality which has negatively impacted our bottom line. Our focus has been on securing coverage on our portfolio this quarter which is evident from the improvement in our coverage ratio. With the high provision charge taken in this quarter, we believe that provision expenses have peaked and should show a reduction in the next quarters. The declining interest rates should also ease pressure on corporate and retail borrowers which should lead to an improvement in asset quality. Going forward, we remain cautiously optimistic of improvements in this area.

***Acknowledgements***

We would like to express our sincere thanks and gratitude to our customers for their patronage and the State Bank of Pakistan and the Government of Pakistan for their continued support. We also take the opportunity to thank the shareholders for their continued trust and the staff for their dedication and commitment.

For and on behalf of the Board,

Sir Mohammed Anwar Pervez, OBE, HPk
Deputy Chairman
London

July 28, 2009