

# RATING REFLECTIONS

JCR-VIS Credit Rating Company Limited

NATIONAL EXCELLENCE, INTERNATIONAL REACH

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JCR-VIS Credit Rating Company Limited (JCR-VIS) has been rating debt instruments of New Allied Electronics Industries (Pvt.) Limited (NAEIL) since 2006. On December 11, 2008, JCR-VIS assigned 'D' rating to the three outstanding debt instruments of NAEIL on account of overdue payments on the same.

As shown in the table I, JCR-VIS had earlier downgraded the ratings of the TFC of Rs. 900m, Sukuk of Rs. 600m and Sukuk of Rs. 750m of New Allied Electronics Industries (Pvt.) Limited (NAEIL) on October 27, 2008, followed by another downgrade on November 11, 2008. JCR-VIS then assigned 'D' ratings to the above mentioned TFC and Sukuks.

While last financial accounts available pertain to the period ending June 30, 2008, and no results were released subsequently, our observations also derive input from the management.

The defaults on the debt instruments can largely be attributed to a drastic plunge in sales of NAEIL following the setting in of recessionary effects in the local economy. At the same time, the steep depreciation of the Rupee resulted in higher import costs for the company. Moreover, NAEIL being a highly leveraged entity, rising interest rates also critically affected the institution. The simultaneous occurrence of all these factors severely hampered the repayment capacity of NAEIL; however, JCR-VIS believes that a major reason behind the default on the debt instruments has also been the non-implementation of bond covenants, which were integral components of the transaction structures for investors' protection. The instruments were structured with credit enhancements built into the transaction but clauses pertaining to credit enhancements were either allowed to lapse by the trustees without intimation to bond/sukuk holders, contributing to the enhancements becoming ineffective, and also on account of default by a guarantor.

The security structures on the basis of which the ratings were assigned to the three debt instruments are described as follows:

## TFC-1

Preliminary rating was assigned to the first TFC of Rs. 900m on November 7, 2006 with a final rating on April 5, 2007. The 'A-' rating assigned to the TFC derived strength from the security structure of the transaction which included the following:

- ◆ A cash collection mechanism and a cash collection account for building up quarterly installments
- ◆ A Stand by Letter of Credit (SBLC) for one markup payment in the first year. For the later years, if the amount in the cash collection account fell below last year's levels, the SBLC was to be arranged for principal and markup payments for the entire tenor
- ◆ Mortgage deed over property having a cushion of Rs. 600m

As the collection account had fallen below last year's levels, an SBLC for the entire tenor of the TFC was required to be arranged. However, when the default occurred, the outstanding SBLC only covered one markup payment amount.

## TFC-2

Final rating of 'A-' was issued to TFC-2 of Rs. 600m on August 27, 2007. The 'A-' rating assigned to the Sukuk was based on a rolling guarantee that was to be issued by at least an 'A-' rated financial institution amounting to the next redemption amount for the tenor of the Sukuk. However, when the default occurred, the issued SBLC had expired and not been renewed.

## TFC-3

Preliminary rating was assigned to the Sukuk of Rs. 750m on December 12, 2007. Final rating was assigned on January 14, 2008. The 'A' rating assigned to the Sukuk was based on the rolling guarantee to be issued by at least an 'A+' rated financial institution amounting to the next installment (principal and markup) for the tenor of the Sukuk.

NAEIL defaulted on the markup payment that was due on December 3, 2008 and the guarantee was called on January 15, 2009 by the trustee. However, in this case, the 'A+' rated guarantor First Dawood Investment Bank Limited (not rated by JCR-VIS) failed to honor the guarantee

TABLE - I

Rating History

Rating Actions	TFC Rs. 900M	Sukuk Rs. 600M	Sukuk Rs. 750M
Apr. 5, 2007	A-/Stable		
Aug. 27, 2007		A-/Stable	
Jan. 14, 2008			A/Stable
Sep. 30, 2008	A-/Negative	A-/Negative	A/Negative
Oct. 27, 2008	BBB+/Negative	BBB+/Negative	A-/Negative
Nov. 11, 2008	BB+/Negative	BB+/Negative	BBB-/Negative
Dec. 11, 2008	D	D	D