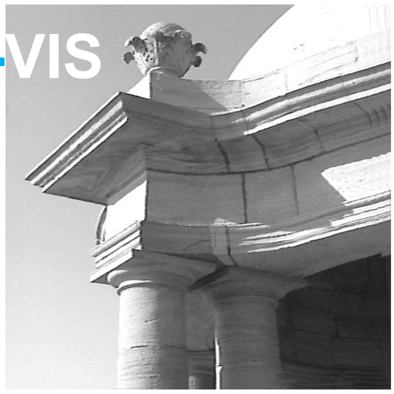
JCR-VIS



RATING THE ISSUE

Rating Criteria

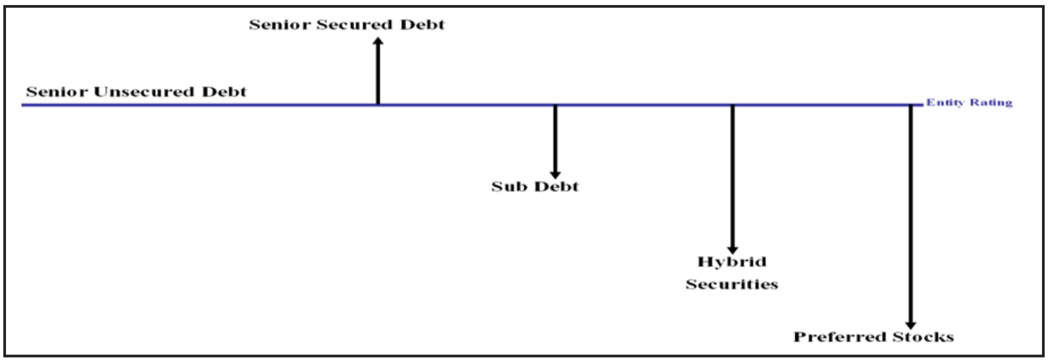
Credit ratings provide an opinion on a company's ability and willingness to meet its obligations on time. JCR-VIS Credit Rating Company Limited assigns credit ratings to both issuers and issues. These issuers may include corporations, financial institutions or sub-sovereigns. The issuer ratings take into account the business and financial risk profile of the entity as a whole. The specific factors that need to be taken into account in case of issuer rating depend on the type of issuer. In case of a corporate issuer, one of the most important factor that may need to be considered is debt service coverage ratio, whereas in case of a financial institution, quality of deposits may be amongst the most critical factor.

The issue specific rating takes into account the relative priority of claim of a particular class of debt vis-à-vis the other outstanding obligations of that particular entity. This means that issue specific rating takes into account both the probability of default on an entity level basis and the recovery prospects associated with a particular debt issue. As a general rule, the set of creditors that will be settled first in a bankruptcy scenario will be assigned the highest ratings, whereas the equity holders have residual claim on a company's assets. This essentially means that JCR-VIS will first arrive at the issuer rating, which is also the rating applicable to senior unsecured creditors and then the ratings of individual debt issues may be determined based on their specific features. Broadly speaking, the following factors must be considered before arriving at issue specific rating:

- Debt specific factors, including security and relevant legal structure;
- Relative seniority of the debt issue vis-à-vis other outstanding debt obligations of the issuing entity;
- Credit enhancement, if any.

Notching Guidelines

The notching guidelines take into account the relative positioning of various classes of debt obligations.



The above chart summarizes the notching guidelines practiced by JCR-VIS, in terms of where a particular debt issue will be placed in relation to the entity rating. It is important to recognize that as the ratings become higher, the reliance on collateral progressively becomes lower. Timeliness is the primary issue for investment grade ratings whereas the potential for ultimate recovery becomes important for lower grade ratings which have higher probability of default. In terms of ratings, this implies that there may be greater differentiation between let's say the entity and subordinated debt ratings of a non-investment grade issuer vis-à-vis an investment grade issuer. In case of an investment grade issuer, the notching down of subordinated debt is generally limited to one notch while it may be up to two notches in case of speculative grade issuers. Moreover, there may be no need to create any differentiation at all between the entity and subordinated debt rating of a 'AAA' rated issuer.

The extent of notching of subordinated/unsecured debt also depends on the quantum of secured or preferred debt carried by a company in relation to the total pool of assets that may be offered as collateral. If a company does not have sufficient assets remaining after satisfying the obligations of secured/preferred creditors, then this could put the subordinated/unsecured debt holders at a disadvantage and may warrant a larger rating differential than may otherwise be warranted.

The quality of security plays an important role in the extent of notching up of secured debt, including its current valuation, nature of charge, probability of obsolescence and the level of enforceability of securities as incorporated in the legal documentation. There may however be no differentiation in entity and secured debt ratings of issuers rated 'AA+' or 'AAA'.

Quality of collateral may range from highly liquid and readily marketable securities to specialized assets, with the ratings advantage being minimal or absent in case of latter on account of two major reasons. Firstly, in case of specialized assets, which do not have sellability or utility outside of the business of the entity, such as those that may be carried by a telecom operator or a refinery, JCR-VIS may not necessarily consider any differentiation between the entity and secured debt ratings. Secondly, the time involved in recovery may also impact the degree of notching of a secured debt instrument.

In a parent-subsidiary relationship, particularly in case of a single operating subsidiary and non-operating holding company structure where both are taken into default simultaneously, even the contractually subordinated debt of the subsidiary would have a higher claim than the senior creditors of the parent entity. This is because the parent's creditors would have a residual claim on the subsidiary's assets after all the liabilities of the subsidiary have been settled. This structural subordination may put the parent's creditors at a material disadvantage. However, certain mitigating factors exist that can limit the degree of notching, or eliminate it altogether. Upstream guarantees can position the claims of a parent on a pari passu basis with the guaranteeing subsidiary, which results in a convergence of ratings. If the parent company is directly in possession of any assets, the degree of subordination will be diluted. Moreover, ratings may also be distinct in case of parent companies that have diverse investments, since multiple income streams may provide a cushion for creditors.

Factoring in Credit Enhancements

Credit enhancement is any form of risk reduction technique that provides protection, in the form of financial support, to cover losses under stressed scenarios or that protects a particular set of creditors from the risks faced by the entity as a whole either fully or to some extent. There can be two types of credit enhancements:

- Third party guarantees
- Cash collection mechanism

In case of the former, the extent of enhancement is a function of the strength of guarantor, amount of guarantee vis-à-vis amount of debt and the timeliness of the guarantee. Moreover, a corporate guarantee carries less weight vis-à-vis a guarantee issued by a financial institution/government. If a particular security is fully secured by a third party, then the counterparty risk will be replaced by the guaranteeing entity. For instance, a debt instrument issued by an entity rated ‘BBB’ and fully guaranteed by an entity rated ‘A’ would be assigned rating of ‘A’, assuming that the guaranteeing entity is rated by JCR-VIS. If JCR-VIS does not have an outstanding opinion on the guaranteeing entity, then a shadow rating may be done, and the debt instrument would be rated accordingly.

Notching up is also possible though establishing a strong structure which gives significant additional enhancement to the debt recovery prospects. This could be achieved through credit enhancement features such as creation of a reserve or sinking fund or dedicated liquidity support.

Cash collection mechanism which can also be referred to as on-balance sheet securitization, can sometimes also result in a particular debt instrument being rated distinctly from what may be indicated by the issuer rating and notching guidelines discussed above. When captured, one specific revenue stream of the entity, backing a particular liability may result in a better credit quality vis-à-vis the entity rating. The entrapment of revenue in designated accounts however has to be viewed in context of the likely cash requirements for normal business operations. JCR-VIS recognizes that cash entrapment mechanism cannot compensate for an issuer’s ability to pay if overall entity level debt servicing capacity is considered constrained in general, since an entity that stops making payments on a particular class of debt, may stop payments on all types of debts; this may also be triggered by cross-default covenants in loan documents. If however, there is sufficient legal ring fencing, which would ensure that payments on a particular class of debt will continue even if the entity defaults on one or other liabilities, then the necessary credit enhancement may be built into the ratings of the debt instrument backed by specific cash flows.

Faheem Ahmad

President & CEO, JCR-VIS Credit Rating Company Limited
Founder, VIS Group
Chairman, Association of Credit Rating Agencies in Asia

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters Degrees in Engineering and Business Administration from USA.

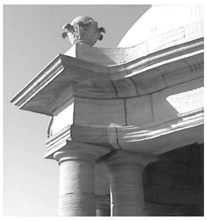
Sobia Maqbool, CFA – Director Financial Institutions / International Operations

Sobia has 10 plus years of professional experience in the field of credit ratings. At JCR-VIS, she is in charge of a multi-jurisdiction team & supervising rating assignments across a diverse range of sectors, including corporate, sub-sovereigns & financial institutions. She also provides analytical support for international assignments conducted by Islamic International Rating Agency (IIRA) for sovereign ratings & Fiduciary ratings. Sobia is a Rating Committee member of both JCR-VIS & IIRA, which is a body that considers all rating actions.
Sobia has been actively involved in research activities & development of methodologies. She has developed analytical methodologies for various market segments such as Takaful, Public Finance, Non-banking Finance Companies, Mutual Funds, Bank Loan Ratings, among others. She also provided significant contribution to the development of Fiduciary Rating System, launched from the platform of IIRA. Sobia has spoken at both local & international forums & has been facilitating training courses in both Pakistan & abroad, in areas such as Corporate Credit Analysis, Bank Risk Analysis, Insurance Risk Analysis, Financial Management and Basel Framework.

Jahangir Kothari Parade (Lady LLoyd Pier)
Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose genrosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.



Jahangir Kothari Parade

National Excellence, International Reach

JCR-VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors.

The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, JCR-VIS continues its endeavor to remain an emblem of trust.

JCR-VIS Credit Rating Company Limited

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