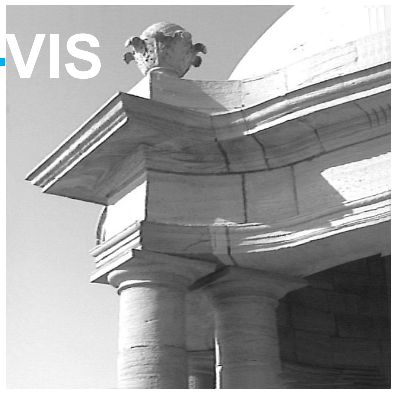
JCR-VIS



Linkages between Parent and Subsidiary companies

Rating Methodology

With the passage of time, Pakistan has witnessed the emergence of large corporations and groups, which have altered the competitive landscape in the country. These entities often have diversified interests, which are manifested through their investment in subsidiaries and associate companies. Parent entities can often have a significant degree of influence, over the credit risk profile of their subsidiaries and associate companies which may be manifested in the form of support or negative intervention.

JCR-VIS Credit Rating Company Limited (JCR-VIS)'s approach to rating subsidiaries is a bottom up approach. This starts with assigning a stand-alone rating to the parent and subsidiary in line with their respective methodologies for Corporates, Commercial Banks, Non-Banking Finance Companies (NBFCs), Insurance and Micro-Finance Institutions. The stand-alone rating takes into account factors such as the existence of a commercial relationship between the parent and subsidiary, at an arm's length.

The next step is to determine the likelihood of support that is expected from the parent. The likelihood of support has two components — willingness and ability to support. Willingness to support incorporates considerations of reputation and confidence sensitivity, strategy, operational integration as well as marginal return on required prospective investment and the role of financial regulators.

Factors such as shared name pertain more to a moral obligation rather than a legally binding requirement. The strategic importance and relative size of a subsidiary to that of the parent entity may be an important indicator of the degree of support that might be forthcoming in times of distress because an institution might not be willing to bear a dent on its own franchise when it has the ability to prevent this from happening.

Ability to support depends on the parent's own risk profile and the correlation between the parent and subsidiary's respective financial condition. In highly correlated businesses, parent and subsidiary may undergo a trough in their business cycle at the same time; thus the parent's ability to provide support may be impaired in times of contingencies.

As per the above mentioned process, the ratings of subsidiaries are based on their own standalone creditworthiness, with a potential notching to reflect parental support.

A weak entity sponsored by a strong parent usually enjoys a stronger rating than it may have on a stand-alone basis. Given that the parent has the ability to support the subsidiary in times of financial distress, there could be various outcomes ranging from ratings equalization to negligible or no support from the parent. Wider the gap,better evidence of support is required.

The degree of notching reflects an assessment of the support that might be forthcoming when needed, which in turn depends on a number of factors, including strategic importance, percentage ownership, management control, shared name, relative size and nature of parent's operations, and history of support to the subsidiary.

Rating of a strong subsidiary owned by a weak parent may be capped at the parent's level. Exceptions to this rule can occur when the subsidiary is legally ring fenced and a parent's bankruptcy may not be able to cause the bankruptcy of its subsidiary. In such a scenario, the subsidiary will be able to pay off its obligations as per its own capability before winding up and creditors will be protected to the extent of the entity's stand-alone strength, which implies that the subsidiary may be rated higher than the parent.

While the norm for "ratings lift" may be only one or two notches for subsidiaries of NBFCs since they have a cap on their leverage, it could be up to three notches for commercial banks because of their access to a larger pool of funds. In case of industrial corporates, which are further constrained in the amount of debt that they can take on their books, the rating lift provided to their subsidiaries may be considerably limited. Further analysis of intra-group debt may be warranted to determine the level of support that can be realistically built into the ratings.

The ownership of an entity by more than one parent would result in a dilution of impact of a strong parent, in case one parent defaults or is under distress. This, however, would depend on the relationship between each parent and the subsidiary.

In case of a foreign parent, the linkage between parent and subsidiary could be different from locally established entities. As foreign parent may not be subject to the same rules for bankruptcy;thus the bankruptcy of the parent would not in itself instigate bankruptcy of the subsidiary.

The creditworthiness of the foreign parent is an important factor in the subsidiary's rating to the extent of its ability and willingness to expand or squeeze the subsidiary's cash reserves. In the absence of rating assigned to the parent by an international rating agency, a shadow rating is assigned to the same in order to facilitate the analysis.

The sovereign rating of Pakistan itself also comes into play when applying notching guidelines to the rating of a company based in Pakistan, having a foreign parent. The extent of notching would also take into account the rating of the foreign parent versus the rating of Pakistan itself, which is deep investment grade currently. This implies that the rating uplift from a financially strong foreign parent could be significant.

However, given the risks in the local environment and Rupee depreciation over time, at times even financially strong foreign parents have exhibited reluctance to extend support to their local subsidiaries. This brings us to our earlier highlighted criterion whereby the marginal return on additional investment may not be justified, given the risk exposure. Sovereign boundaries impede integration and make it easier for a foreign parent to distance itself in the event of problems at the subsidiary level. In such scenarios, the rating of a subsidiary may largely reflect its stand-alone financial risk profile.

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

International Operations & Product Development

Sobia has 11 plus years of professional experience in the field of credit ratings. As Director Financial Institutions & International Operations at JCR-VIS Credit Rating Company Limited, she is in charge of a multi-jurisdiction team & supervising rating assignments across a diverse range of sectors, including sovereigns, financial institutions, among others, in addition to leading the organization's initiatives in new fields, both locally as also internationally. She also provides analytical support for international assignments conducted by Islamic International Rating Agency (IIRA) in now more than 10 jurisdictions in the region and beyond. Sobia has represented JCR-VIS at several forums, including regulatory committees, conferences and other initiatives to further the concept of 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 including Fiduciary Ratings for IFIs, Public Finance, Mutual Funds, Bank Loans, Debt Instruments, Project Finance, Securitization, Takaful, among others. Sobia has spoken at both local & international forums & has been facilitating training courses in both Pakistan & abroad. She holds an MBA degree in Finance and is also a CFA charter holder.

Maimoon Rasheed - Director

Methodology & Criteria

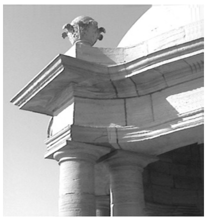
Maimoon possesses 12+ years experience in financial risk assessment with focus on credit ratings, conventional finance, and general management. He possesses management experience in the fields of financial risk modeling, asset management and brokerage. He has been actively involved in both buy and sell side capital market research.

Maimoon's overall experience comprises ratings of entities across a range of sectors including financial – Commercial banks, investment banks, asset management companies, leasing companies, modarabas, securities houses and insurance companies – and corporates in different industries. He obtained his B.S in Applied Geology from Punjab University, Lahore. He also has Masters Degrees in Business Administration with majors in Finance.

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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