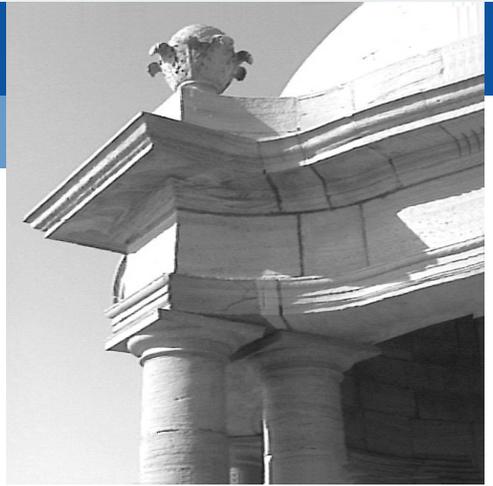


LINKAGES BETWEEN PARENT AND SUBSIDIARY COMPANIES



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.

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan’s debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan’s short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on ‘Rating Watch’ when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our ‘Criteria for Rating Watch’ for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks ‘Positive’, ‘Stable’ and ‘Negative’ qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our ‘Criteria for Rating Outlook’ for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of ‘structured’ securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for ‘structured obligation’, denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities

and not on the basis of the credit quality of the issuing entity alone.

‘p’ Rating: A ‘p’ rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A ‘p’ rating is shown with a ‘p’ subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our ‘Policy for Private Ratings’ for details. www.jcrvis.com.pk/images/policy_ratings.pdf

‘SD’ Rating: An ‘SD’ rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.



Faheem Ahmad

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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. He could be contacted at faheem@jcrvis.com.pk



Faryal Ahmad Faheem

Deputy CEO

Faryal Ahmad Faheem has been associated with JCR VIS Credit Rating Company since 2006. She has primarily been involved in rating assignments of financial institutions as well as corporate organizations besides her role in the general management of the company. She has worked extensively in the areas of in-depth financial and risk analysis of the banking as well as mutual fund industry with specific focus on management quality ratings and fund rankings. She has also been involved in the methodology development process at JCR-VIS. She holds a Master's degree in Business Administration from the Institute of Business Administration, Karachi (2005) and also a Risk and Corporate Management certification from Columbia University, USA. Faryal could be contacted at faryal.faheem@jcrvis.com.pk



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 generosity 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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