



The Pakistan Credit Rating Agency Limited

## Rating Report

### Fauji Fertilizer Company Limited

#### Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jul-2020	AA+	A1+	Stable	Maintain	-
01-Aug-2019	AA+	A1+	Stable	Maintain	-
30-Jan-2019	AA+	A1+	Stable	Maintain	-
30-Jul-2018	AA+	A1+	Stable	Upgrade	-
04-Aug-2017	AA	A1+	Stable	Maintain	-
04-Aug-2016	AA	A1+	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect the dynamic business profile and robust financial position of Fauji Fertilizer Company Limited (FFC), while incorporating the derived strength of Fauji Group. FFC is one of the largest players in the fertilizers market, in terms of its production capacity and product offtake. Its strong business footprint has enabled it to build an impeccable brand in Pakistan with "Sona" being a household name in the farming community. The production facilities are secured by uninterrupted supply of gas from Mari Field, representing inherent commercial strength of the company, in terms of sustainable business volumes. The company has continued to cherish on highest production levels and sanguine profitability. FFC is prominently placed in the fertilizer industry. Lately, Pakistan's urea market has witnessed certain key changes on the pricing front. In January 2020, the Government decided to prospectively reduce the GIDC from PKR400/bag of urea to PKR5/bag, as a way to subsidize costs incurred by farmers. Urea prices stabilized in 2QCY20, following varying price cuts by the industry players in the first quarter of CY20. The overall industry demand has largely remained stable despite the outbreak of the COVID-19 pandemic. Some fluctuation was noted in the industry's urea offtake, as depicted by an uneven Month-on-Month (MoM) trend, amid subsequent lockdowns. The industry continues to face challenges in terms of enhancement of business costs. The expected hike in costs would also be related to disallowances of input GST and proportionate business expenditure on account of sales made to persons not registered under the Sales Tax Act 1990, as enacted under sales tax and income tax laws respectively. Going forward, these enhanced business costs or any hike in gas tariffs may have to be passed on to the customers. Delay in implementation of subsidy mechanism (most notably for phosphate fertilizer) and in prevention measures against further spread of locust swarms, may put pressure on the farmers' already tightened purchasing power, potentially bearing an impact on fertilizer offtake.

The ratings take into account FFC's sizable book of diversified investments, both in the long term and short term, which has been developed to offer sustainable returns to its stakeholders. Dividend stream from these investments compliments FFC's ratings. Leveraging associated with business ventures, will require oversight and close attention.

#### Disclosure

<b>Name of Rated Entity</b>	Fauji Fertilizer Company Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-20),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria   Rating Modifier(Jun-20)
<b>Related Research</b>	Sector Study   Fertilizer(Jan-20)
<b>Rating Analysts</b>	Jibran Cheema   jibran.cheema@pacra.com   +92-42-35869504



## Profile

**Legal Structure** Fauji Fertilizer Company Limited (herein referred to as 'the company' or 'FFC') was incorporated in 1978 and is listed on the Pakistan Stock Exchange.

**Background** It was established as a joint venture between Fauji Foundation (FF) – a leading charitable trust in Pakistan and Haldor Topsoe A/S of Denmark – a world leader in catalysts. Subsequently, FF continued as the major sponsor of the company. The company has in employment a total number of 3,457 employees. Its Head Office is located in Rawalpindi.

**Operations** FFC's core business consists of manufacturing and marketing of fertilizer products, comprising mainly Urea and DAP. It is one of the largest urea manufacturers in the country having a nameplate capacity of 2,048 KT. During CY19, 2,467 KT of Urea was produced, with a capacity utilization of 122%, owing to efficiency enhancement through BMR. FFC's market is relatively concentrated in Punjab. The company also provides marketing services to its group company in the fertilizer business, i.e. Fauji Fertilizer Bin Qasim Ltd. and technical services to other chemical industries.

## Ownership

**Ownership Structure** FFC is majority owned by Fauji Foundation (44.35%); a Charitable Trust incorporated under the Charitable Endowments Act 1890. State Life Insurance holds 9.12%, whereas other institutions and general public hold 25.16% and 21.37% of the shareholding, respectively.

**Stability** Long standing stake of a renowned business conglomerate, Fauji Group, denotes a strong foothold and sustainable presence in the market.

**Business Acumen** Fauji Foundation (FF), founded in 1954, has emerged as one of the leading conglomerates of the country, with established business interests in various diversified sectors. Evolution of FFC as the largest fertilizer player in the market is an explicit demonstration of its sponsors' business acumen.

**Financial Strength** Besides holding formidable equity strength in FFC, the sponsors have an extensive investment book, comprising 2 subsidiaries, 4 associated companies and 1 joint venture of FFC, which fortifies their sound financial strength.

## Governance

**Board Structure** The Board of Directors consists of thirteen members comprising one executive director (CEO & MD) and twelve non-executive directors. Among the non-executive directors, there are seven representatives of FF.

**Members' Profile** Mr. Waqar Malik replaced Lt Gen Syed Tariq Nadeem Gilani, as the Chairman of the Board of Directors in April'20, becoming FFC's first civilian Chairman in its history. Mr. Waqar has professional experience of over three decades in corporate and business sectors, across three continents. The profile of members across the Board, is considered strong.

**Board Effectiveness** Board meetings have been convened on a quarterly basis throughout the period under review with good participation of the members. In order to keep up with the proper standards of the business, there are four sub-committees of the board; Audit Committee, HR and Remuneration Committee, System & Technology Committee and Project Diversification Committee.

**Financial Transparency** A.F Ferguson & Co., Chartered Accountants, the auditors of FFC, expressed an unmodified opinion on the financial statements of CY19.

## Management

**Organizational Structure** The company's organizational structure comprises twelve well segregated functional departments, headed by highly experienced professionals.

**Management Team** FFC's management team is a balanced blend of professionals having long association with the company. The company's CEO & MD, Lt Gen Tariq Khan, HI-(M) (Retired), joined FFC in March'18. He is also the CEO & MD of Fauji Fresh n Freeze Limited and FFC Energy Limited, wholly owned subsidiaries of FFC.

**Effectiveness** Three principal management committees are in place for ensuring operational effectiveness in the management of the company's affairs, namely; (i) Executive Committee – reviews company's operations and ensures implementation and execution of strategy, (ii) Business Strategy Committee – oversees the business development plans and prospective opportunities, & (iii) Corporate Social Responsibility Committee – enables and ensures the social responsibilities of the company.

**MIS** FFC has a state of the art IT infrastructure in place, including SAP software. The company has maintained a profound management system that enables smooth operations of business processes and provides an end to end solution for financial, logistical, distribution, inventory, plant maintenance and human capital management.

**Control Environment** Operations at the plant sites are actively monitored on a daily, monthly and yearly basis, in order to keep the company's performance sustainable.

## Business Risk

**Industry Dynamics** The production capacity of the country's fertilizer industry comprises 7.1mln MT of Urea and CAN and 1.7mln MT of DAP, NP and NPK. In CY19, an unprecedented demand for Urea was noted. This coincided with a fall in farmers' preference for DAP due to unfavorable pricing, as depicted by a decline of ~10% in its offtake, compared to CY18. In Jan'20, the Economic Coordination Committee opted to prospectively reduce the Gas Infrastructure Development Cess from PKR400/bag to PKR5/bag, as a way to subsidize costs incurred by farmers. The market players reduced the pricing with varying extents, creating a price disparity in the urea market, leading to a shift in market share of the industry players. With availability of gas not an immediate concern, certainty in the supply side mechanics is noted. On the other hand, deteriorating economic conditions in the wake of Covid-19 poses a risk to the demand within the industry. Going forward, gas tariff changes and announcement of subsidy, is expected to play a major role in dictating the industry behavior.

**Relative Position** FFC, after promptly lowering the prices of its urea products, was successful in significantly expanding its market share, taking advantage of the prevailing price disparity in the market. As at End-3MCY20, its combined market share with FFBL stood at 65% (End-CY19: 48%) for Urea and 53% for DAP (End-CY19: 46%). Subsequently, after the price reduction by competitors, the market positioning is expected to return to its equilibrium.

**Revenues** In CY19, the company was able to achieve its highest ever revenue from Sona Urea but due to the slump in the turnover of DAP, the topline failed to achieve growth during the year. The total revenue in CY19 amounted to PKR~105,783mln (CY18: PKR~108,365mln), depicting a YoY fall of 2%. Revenue in 3MCY20 clocked in at PKR~20,626mln (3MCY19: PKR~20,311mln), showcasing a meager growth of 2% compared to the corresponding period.

**Margins** Healthy gross profit margins were maintained in CY19, clocking it at 29.1% (CY18: 28.0%), in spite of challenges such as high gas tariffs and currency devaluation. Higher average borrowing rates, during CY19, resulted in a sizable finance cost of PKR~2,477mln (CY18: PKR~1,637mln). On the other hand, the company recorded its highest ever investment income of PKR~5,670mln, depicting a 115% YoY rise, due to effective utilization of funds and favorable rates of return. Consequently, the net profit margins, rose to 16.2% (CY18: 13.3%). The profit margins showed further improvement in 3MCY20. The gross margins soared to 36.3% (3MCY19: 29.4%) while the net margins clocked in at 20.7% (3MCY19: 18.2%).

**Sustainability** FFC carries a sizable book of diversified investments, with its equity portfolio comprising of entities in the banking, power, food and cement sectors, in addition to the fertilizer industry.

## Financial Risk

**Working Capital** In 3MCY20, the average debtor days of FFC rose to 51 days (CY19: 30 days, CY18: 12 days), mounting pressure on the working capital mechanics of the company. Similarly, the average inventory days stood at 31 days (CY19: 34 days, CY18: 22 days). As a result, the company's gross working capital cycle expanded to 82 days in 3MCY20 (CY19: 64 days, CY18: 35 days). The trade payable days saw a minor increase during the period under review. In accumulation, the net working capital cycle clocked in at 68 days (CY19: 53 days, CY18: 27 days).

**Coverages** The free cash flows from operations (FCFO) during CY19 amounted to PKR~18,964mln (CY18: PKR~16,590mln), increasing by 14% on a YoY basis. The trend of healthy FCFO continued in 3MCY20. The interest coverage (FCFO to Finance Cost) clocked in at 8.0x (CY19: 7.7x, CY18: 10.3x), representing a comfortable position. Similarly cash conversion efficiency (FCFO to Sales) has been part of a rising trend (3MCY20: 26.1%, CY19: 17.9%, CY18: 15.3%).

**Capitalization** The total borrowings of the company, as at End-3MCY20, stood at PKR~20,316mln, decreasing sharply from PKR~33,092mln, as at End-CY19. Leveraging mix comprises short term and long-term borrowings (including current maturity of long term borrowings) amounting to PKR~9,867mln and PKR~10,449mln, respectively. Equity amounted to PKR~35,880mln (End-CY19: PKR~35,567mln, End-CY18: PKR~33,383mln), while the gearing ratio clocked in at 36.2% as at End-3MCY20 (End-CY19: 48.2%, End-CY18: 57.1%). The leveraging levels have been part of a declining trend, since CY16.



Fauji Fertilizer Company Limited Fertilizer	Mar-20	Dec-19	Dec-18	Dec-17
	3M	12M	12M	12M

#### A BALANCE SHEET

1 Non-Current Assets	25,128	25,001	24,237	24,877
2 Investments	46,206	52,422	55,423	35,791
3 Related Party Exposure	29,172	28,492	27,069	24,154
4 Current Assets	40,535	47,475	39,761	23,809
<i>a Inventories</i>	7,001	6,795	12,932	395
<i>b Trade Receivables</i>	9,789	13,460	3,679	3,722
<b>5 Total Assets</b>	<b>141,041</b>	<b>153,390</b>	<b>146,490</b>	<b>108,631</b>
6 Current Liabilities	80,235	80,319	64,180	40,639
<i>a Trade Payables</i>	3,236	3,242	2,651	1,792
7 Borrowings	20,316	33,092	44,348	33,942
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	4,611	4,412	4,578	4,697
<b>10 Net Assets</b>	<b>35,880</b>	<b>35,567</b>	<b>33,383</b>	<b>29,352</b>
<b>11 Shareholders' Equity</b>	<b>35,880</b>	<b>35,567</b>	<b>33,383</b>	<b>29,352</b>

#### B INCOME STATEMENT

1 Sales	20,626	105,783	108,365	97,316
<i>a Cost of Good Sold</i>	(13,136)	(75,046)	(77,986)	(72,621)
<b>2 Gross Profit</b>	<b>7,490</b>	<b>30,737</b>	<b>30,379</b>	<b>24,695</b>
<i>a Operating Expenses</i>	(2,075)	(8,288)	(8,833)	(8,574)
<b>3 Operating Profit</b>	<b>5,416</b>	<b>22,449</b>	<b>21,545</b>	<b>16,121</b>
<i>a Non Operating Income or (Expense)</i>	1,157	3,782	1,774	2,091
<b>4 Profit or (Loss) before Interest and Tax</b>	<b>6,573</b>	<b>26,231</b>	<b>23,320</b>	<b>18,212</b>
<i>a Total Finance Cost</i>	(673)	(2,477)	(1,637)	(2,471)
<i>b Taxation</i>	(1,638)	(6,643)	(7,244)	(5,030)
<b>6 Net Income Or (Loss)</b>	<b>4,262</b>	<b>17,110</b>	<b>14,439</b>	<b>10,711</b>

#### C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	5,387	18,964	16,590	9,920
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	4,659	16,863	15,063	7,345
<i>c Changes in Working Capital</i>	2,965	8,074	7,803	27,362
<b>1 Net Cash provided by Operating Activities</b>	<b>7,624</b>	<b>24,937</b>	<b>22,866</b>	<b>34,707</b>
<b>2 Net Cash (Used in) or Available From Investing Activities</b>	<b>4,690</b>	<b>2,764</b>	<b>(21,108)</b>	<b>(1,779)</b>
<b>3 Net Cash (Used in) or Available From Financing Activities</b>	<b>(16,825)</b>	<b>(25,824)</b>	<b>348</b>	<b>(33,741)</b>
<b>4 Net Cash generated or (Used) during the period</b>	<b>(4,511)</b>	<b>1,877</b>	<b>2,105</b>	<b>(813)</b>

#### D RATIO ANALYSIS

<b>1 Performance</b>				
<i>a Sales Growth (for the period)</i>	-22.0%	-2.4%	11.4%	21.9%
<i>b Gross Profit Margin</i>	36.3%	29.1%	28.0%	25.4%
<i>c Net Profit Margin</i>	20.7%	16.2%	13.3%	11.0%
<i>d Cash Conversion Efficiency (EBITDA/Sales)</i>	32.2%	24.2%	18.9%	10.5%
<i>e Return on Equity (ROE)</i>	47.7%	49.6%	46.0%	37.2%
<b>2 Working Capital Management</b>				
<i>a Gross Working Capital (Average Days)</i>	82	64	35	24
<i>b Net Working Capital (Average Days)</i>	68	53	27	18
<i>c Current Ratio (Total Current Assets/Total Current Liabilities)</i>	0.5	0.6	0.6	0.6
<b>3 Coverages</b>				
<i>a EBITDA / Finance Cost</i>	9.9	10.3	12.7	4.2
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	2.0	2.0	1.9	1.1
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.7	0.8	1.1	3.0
<b>4 Capital Structure (Total Debt/Total Debt+Equity)</b>				
<i>a Total Borrowings / Total Borrowings+Equity</i>	36.2%	48.2%	57.1%	53.6%
<i>b Interest or Markup Payable (Days)</i>	84.4	99.9	68.0	28.6
<i>c Average Borrowing Rate</i>	10.1%	6.4%	4.1%	6.2%

#	Notes
D.1.a	Sales growth figure of Mar-20 is based on proration of 3MCY20 to full year CY20, hence reflecting decline.

**Credit Rating**

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<b>Very high credit quality.</b> Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
AA-	
A+	
A	<b>High credit quality.</b> Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
A-	
BBB+	
BBB	<b>Good credit quality.</b> Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BBB-	
BB+	<b>Moderate risk.</b> Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
BB	
BB-	
B+	
B	<b>High credit risk.</b> A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
B-	
CCC	<b>Very high credit risk.</b> Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
CC	
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



*\*The correlation shown is indicative and, in certain cases, may not hold.*

**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):

<p><b>Entities</b></p> <ul style="list-style-type: none"> <li>a) Broker Entity Rating</li> <li>b) Corporate Rating</li> <li>c) Financial Institution Rating</li> <li>d) Holding Company Rating</li> <li>e) Independent Power Producer Rating</li> <li>f) Microfinance Institution Rating</li> <li>g) Non-Banking Finance Companies (NBFCs) Rating</li> </ul>	<p><b>Instruments</b></p> <ul style="list-style-type: none"> <li>a) Basel III Compliant Debt Instrument Rating</li> <li>b) Debt Instrument Rating</li> <li>c) Sukuk Rating</li> </ul>
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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

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- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
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- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
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- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

### **Probability of Default**

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

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