



The Pakistan Credit Rating Agency Limited

## Rating Report

### Islamabad Feeds (Pvt.) Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Jan-2021	BBB	A2	Stable	Maintain	-
26-Aug-2020	BBB	A2	Negative	Maintain	YES
03-Sep-2019	BBB	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The global feed industry is valued at ~\$460bln, with poultry (~\$166bln) constituting ~36% of the total industry. Pakistan produces ~8mln MT of feed annually, with ~150 registered feed mills and ~200 unregistered feed mills catering to it. The industry generates an annual turnover of ~PKR 200bln to PKR 250bln from local sales. Amidst the COVID-19 pandemic, closure of restaurants/marriage halls and export avenues led to a supply glut of poultry products in local market. As a result, prices of poultry products posted a dip. Subsequently, sale of feed and recovery from farms remained under pressure. Although feed producers had sufficient inventory, liquidity crunch significantly impacted the industry players. Lately, as business avenues became operational, demand for poultry products has improved. A visible surge is also observed in feed and poultry product prices. Subsequently, sale of feed and recovery from farms has improved. This is likely to benefit the industry players, provided that the supply of poultry products remain stable. This, along with SBP's interest rate cut and deferment/restructuring option is expected to provide sufficient respite to the industry players.

The ratings reflect Islamabad Feeds (Pvt.) Ltd.'s established presence in poultry and allied chain including feed, hatcheries, broiler and layer farms. Lately, post Dr. Aslam's untimely demise, his son - Mr. Ali - has been appointed as the Group's CEO. The current sponsors have adequate acumen in poultry segment. The Company remained exposed to inherent risk in the feed industry emanating from raw material price changes and low demand amidst the COVID-19 pandemic. Lately, the increasing demand and prices of poultry products has eased some pressure off the Company. Although the Company enjoyed stable margins and profitability in FY20, sales have slowed down considerably leading to lower capacity utilization and off take. As lock down has eased and demand centres (restaurants, banquet halls etc.) have reopened, sales are expected to surge, however, remain moderate. The Company has piled up raw material inventory (maize and soybean meal), procured on cash, to manage the impact of increased cost. As a result, margins and profits are expected to benefit the Company. However, this led to stretched working capital requirement, and receivable days remaining high, which was met through short-term borrowings. The Company has an aggressively leveraged capital structure, while coverages remain stretched.

The ratings are dependent on the management's ability to prudently manage liquidity and working capital requirements. The management's ability to build profitable volumes remains critical for the ratings. Envisioned improvement in business and financial profile along with effective changes in governance framework would be beneficial. Significant deterioration in coverages and/or margins will have negative impact on the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	Islamabad Feeds (Pvt.) 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   Poultry Feed(Jan-20)
<b>Rating Analysts</b>	Faiqa Qamar   faiqa.qamar@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Islamabad Feeds (Pvt.) Limited ('Islamabad Feeds' or 'the Company') was incorporated in Aug-2008 as a Private Limited Company.

**Background** Islamabad Feeds is an established player in the poultry industry, comprising poultry farms and feed mills. The sponsors of the Company started poultry business in 1981 and integrated by setting up poultry feed mill, poultry farms and hatcheries. The Company set up its first feed mill in Rewat in 2008, which became formally operational in 2010. Second feed mill was setup in Okara in 2017.

**Operations** Islamabad Feeds is primarily engaged in the production and sale of poultry feed through its two feed mills, located in Rewat and Okara. They have combined installed capacity of 550,000 MT per annum, utilized upto 52%. The Company has also set up its poultry farms for broiler chicken, in Lahore, Multan, Okara, Muree, Hyderabad, Karachi and Attock. The bird placement capacity of these farms is around ~300,000. The Group's registered office is located in Satellite Town, Rawalpindi. The Company's sales offices are present in Lahore, Islamabad and Karachi.

## Ownership

**Ownership Structure** The Company is owned by the family of late Dr. Muhammad Aslam. Majority ownership lies with Mr. Aslam's two sons, Mr. Muhammad Ali (43.8%) and Mr. Muhammad Hassan (36.6%). The remaining stake resides among Dr. Aslam's daughters, Ms. Saleha Aslam (7.3%) and Ms. Yumna Aslam (7.3%), and his wife, Mrs. Alia Mehmood (5%).

**Stability** Ownership transition to next generation is visible, post Dr. Aslam's demise. However, the structure remains stable.

**Business Acumen** The Company is a venture of Islamabad Group, an established player with substantial presence in Pakistan's poultry and poultry feed industry. The Group has experienced multiple business cycles. The Group's flagship entity, Islamabad Feeds, has established itself as a provider of high quality poultry feed. Post Dr. Aslam's demise, the Company's succession has been mainly transferred to his sons. However, the current sponsor have limited acumen.

**Financial Strength** The Group's overall financial position and performance are strong and the Group has consolidated asset base of ~ PKR 13 bln with an equity base of ~ PKR 3.8 bln. The Group generated a turnover of ~ PKR 16 bln with a PAT of ~ PKR 58 mln in FY20.

## Governance

**Board Structure** The Company's BoD comprises one Executive Director and one Non-Executive Director from the sponsoring family. Lack of independent oversight and diversity indicate room for improvement in the governance structure.

**Members' Profile** Mr. Muhammad Ali, eldest son of Dr. Muhammad Aslam has been appointed as the Board's Chairman. He has recently completed his Bachelor's in Business Administration from the National University of Sciences and Technology, Islamabad. He has been associated with the Group for more than a year.

**Board Effectiveness** There are no sub-committees of the Board. During FY20, the Board met informally to discuss pertinent matters. Minutes of these meetings are not adequately maintained.

**Financial Transparency** The Company's external auditors, M/s Muniff Ziauddin & Co. Chartered Accountants, have expressed an unqualified opinion on the Company's financial statements for the year ended June 30, 2020. The firm has been QCR rated by ICAP and is in 'Category A' of SBP panel of auditors.

## Management

**Organizational Structure** The Company operates through Finance, Accounts, Production, Sales & Marketing, Human Resource, IT and Internal Audit division. All functional heads report to the CEO who makes strategic decisions. Thus, highlighting key man risk of management.

**Management Team** Islamabad Feeds has an experienced management team. Lately, Mr. Ali has been appointed as the Company's CEO. He has recently completed his graduation from the National University of Sciences and Technology, Islamabad. Dr. Munawwar Ali, GM Production, has an overall experience of above three decades and has been associated with the Group from the past 30 years. Mr. Muhammad Sajjad, CFO, has an overall experience of 25 years and has been associated with the Group for almost 20 years.

**Effectiveness** At Islamabad Feeds, six management committees are formally in place; namely, audit, finance, sales and recovery, production, broiler and layer farms. These committees meet informally to discuss pertinent matters and minutes are not adequately maintained.

**MIS** Customized software, installed by Sidat Hyder, is used at Group level. Standardized reports are generated as per requirement.

**Control Environment** To ensure operational efficiency, the Company has setup an internal audit function to implement the policies and procedures.

## Business Risk

**Industry Dynamics** The global feed industry is valued at ~\$460bln, with poultry (~\$166bln) constituting ~36% of the total industry. Pakistan produces ~8mln MT of feed annually, with ~150 registered feed mills and ~200 unregistered feed mills catering to it. The industry generates an annual turnover of ~PKR 200bln to PKR 250bln from local sales. Amidst the COVID-19 pandemic, closure of restaurants/marriage halls and export avenues led to a supply glut of poultry products in local market. As a result, prices of poultry products decreased. Sale of feed and recovery from farms remained under pressure. Lately, as business avenues became operational, demand for poultry products has improved. A visible surge is also observed in feed and poultry product prices. SBP's interest rate cut and deferment/restructuring option is expected to provide sufficient respite to the industry players.

**Relative Position** Islamabad Feeds has secured prominent position in the market due to its high FCR, culminating in higher demand for their product. The Company has a market share of ~6.8% in terms of revenue and ~6.8% in terms of production in the poultry feeds sector.

**Revenues** The Company mainly generates revenue by manufacturing and selling variants of poultry feed (~88%), eggs (8%) and broiler meat (4%). Around ~25% of the Company's revenue is generated by selling feed to an associated Group venture, Islamabad Farms. The Company mainly sells in the central region (~82%), followed by north region (~18%). During FY20, the Company's topline decreased to PKR 13.6 bln (FY19: PKR 14.5 bln) amidst the COVID-19 pandemic. In 1QFY21, the Company's topline stood at PKR 3.171 bln as demand and prices have risen for poultry feed and products.

**Margins** The Company's gross margin improved in FY20 to 9.5% (FY19: 7.3%) as it was able to pass on the increased raw material costs in a timely manner. In FY20, the management kept production and overhead expenses in check resulting in improved operating margin of 7.8% (FY19: 5.7%). On net level, in FY20 significant jump in finance cost to PKR 966 mln (FY19: PKR 546 mln) led to decreased net profit of PKR 37.5 mln (FY19: PKR 146 mln) and net profit margin of 0.3% (FY19: 1.04%). In 1QFY21, the Company gross margin stood at 8.6%. On operational and net levels the margins stand at 6.7% and 0.73%, respectively.

**Sustainability** Post Dr. Aslam's demise, the Company's succession has been mainly transferred to his sons. On performance end, the prevailing uncertainty amidst COVID-19 outbreak has created challenges for the industry and the Company. Sustaining operations and generating cash flows is expected to improve as prices of day old chicks, broiler chicken and eggs have risen.

## Financial Risk

**Working Capital** Islamabad Feeds working capital needs originate from financing and storing maize and soybean meal in bulk. High inventory levels resulted in higher inventory days (FY20:173 days, FY19:144 days). The Company generally receives payment from buyers upon maturity and sale of flock of birds. Receivable days increased to (FY20: 79 days, FY19: 59 days). Both higher inventory days and receivable days kept the net working capital days on the higher side (FY20: 184 days, FY19: 148 days). The Company procures raw materials on credit. Trade payable days have increased slightly (FY20: 68 days, FY19: 56 days), due to the relaxation of credit terms. Limited room exists at net trade level (FY20: 12%, FY19: 9%).

**Coverages** Interest cover is a function of free cash flows and finance cost. Free cash flows stood at PKR 1.1 bln in FY20 (FY19: PKR 844 mln). The Company's finance cost stood at PKR 966 mln in FY20 (FY19: PKR 504 mln). The increase in finance cost was due to increased short-term borrowings leading to a decrease in interest cover. Interest cover stood at 1.2x in FY20 (FY19: 1.7x). Core and total interest cover stood at 1.2x each in FY20. Moreover, debt payback increased to 1.7 in FY20 (FY19: 0.9).

**Capitalization** Islamabad Feeds has highly leveraged capital structure with debt to equity ratio at 70.2% in FY20 (FY19:69%) on the back of relatively small equity base. Short-term borrowings constituted 95.2% of total debt in FY20 (FY19: 95.1%). The Company's total debt increased to PKR 6.7 bln in FY20 (FY19: PKR 6.2 bln).



Islamabad Feeds (Pvt.) Ltd. Poultry Feed	Jun-20	Mar-20	Sep-19	Jun-19	Jun-18	Jun-17	Jun-16
	12M	9M	3M	12M	12M	12M	12M

#### A BALANCE SHEET

1 Non-Current Assets	2,397	2,351	2,489	2,492	1,991	1,939	2,051
2 Investments	-	-	-	-	-	-	-
3 Related Party Exposure	-	-	-	-	-	-	-
4 Current Assets	10,313	10,490	9,852	9,501	7,937	7,099	8,849
<i>a Inventories</i>	6,821	7,124	6,315	6,100	5,402	4,669	7,030
<i>b Trade Receivables</i>	3,089	2,841	2,820	2,792	1,933	1,905	1,219
5 Total Assets	12,710	12,841	12,341	11,993	9,928	9,038	10,900
6 Current Liabilities	2,814	2,740	2,739	2,706	2,300	963	941
<i>a Trade Payables</i>	2,540	2,506	2,506	2,531	1,894	819	719
7 Borrowings	6,762	6,798	7,163	6,136	4,912	5,434	7,454
8 Related Party Exposure	66	66	66	66	9	13	11
9 Non-Current Liabilities	176	230	230	230	140	145	157
10 Net Assets	2,893	3,006	2,143	2,855	2,567	2,483	2,336
11 Shareholders' Equity	2,893	3,008	2,889	2,855	2,567	2,483	2,336

#### B INCOME STATEMENT

1 Sales	13,626	11,508	3,836	14,544	11,826	13,718	15,219
<i>a Cost of Good Sold</i>	(12,322)	(10,384)	(3,426)	(13,480)	(11,069)	(12,811)	(14,248)
2 Gross Profit	1,304	1,124	410	1,064	756	906	972
<i>a Operating Expenses</i>	(239)	(172)	(57)	(236)	(205)	(214)	(202)
3 Operating Profit	1,066	952	353	828	551	692	770
<i>a Non Operating Income or (Expense)</i>	(11)	(4)	(2)	(2)	(11)	(15)	(2)
4 Profit or (Loss) before Interest and Tax	1,055	948	351	826	540	677	768
<i>a Total Finance Cost</i>	(966)	(733)	(246)	(504)	(375)	(474)	(607)
<i>b Taxation</i>	(51)	(63)	(21)	(73)	(81)	(59)	(37)
6 Net Income Or (Loss)	38	152	84	249	83	145	124

#### C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	1,162	1,110	430	844	623	803	930
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	235	437	243	363	240	302	314
<i>c Changes in Working Capital</i>	(746)	(1,100)	(1,123)	(682)	691	1,757	(862)
1 Net Cash provided by Operating Activities	(511)	(663)	(879)	(319)	931	2,059	(548)
2 Net Cash (Used in) or Available From Investing Activities	(120)	(85)	(60)	(187)	(289)	(87)	(133)
3 Net Cash (Used in) or Available From Financing Activities	599	662	991	414	(522)	(2,020)	675
4 Net Cash generated or (Used) during the period	(32)	(85)	51	(92)	120	(48)	(6)

#### D RATIO ANALYSIS

1 Performance							
<i>a Sales Growth (for the period)</i>	-6.3%	5.5%	5.5%	23.0%	-13.8%	-9.9%	0.0%
<i>b Gross Profit Margin</i>	9.6%	9.8%	10.7%	7.3%	6.4%	6.6%	6.4%
<i>c Net Profit Margin</i>	0.3%	1.3%	2.2%	1.7%	0.7%	1.1%	0.8%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	3.1%	0.1%	-18.1%	1.1%	11.1%	18.7%	0.4%
<i>e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/S</i>	1.3%	7.0%	11.9%	9.5%	3.4%	5.3%	5.3%
2 Working Capital Management							
<i>a Gross Working Capital (Average Days)</i>	252	224	214	204	215	202	194
<i>b Net Working Capital (Average Days)</i>	184	164	155	148	173	181	177
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	3.7	3.8	3.6	3.5	3.5	7.4	9.4
3 Coverages							
<i>a EBITDA / Finance Cost</i>	1.3	1.5	1.7	2.1	1.8	1.9	1.6
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.2	1.5	1.7	1.6	1.6	1.6	1.4
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	1.7	0.5	0.4	0.9	0.3	0.3	0.5
4 Capital Structure							
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	70.2%	69.5%	71.4%	68.5%	65.7%	68.7%	76.2%
<i>b Interest or Markup Payable (Days)</i>	57.0	64.1	63.7	80.7	52.7	48.4	53.7
<i>c Entity Average Borrowing Rate</i>	14.2%	14.3%	14.5%	9.0%	7.2%	7.3%	8.1%

**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	
CC	<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.
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)
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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)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
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- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

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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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