



The Pakistan Credit Rating Agency Limited

## Rating Report

### SGM Sugar Mills Limited

#### Report Contents

1. Rating Analysis
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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Sep-2021	BBB	A2	Stable	Upgrade	-
02-Oct-2020	BBB-	A3	Positive	Maintain	-
06-Nov-2019	BBB-	A3	Stable	Maintain	-
07-May-2019	BBB-	A3	Stable	Maintain	-
31-Dec-2018	BBB-	A3	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

Pakistan's sugar industry is the country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~65–70mln MT. The industry is trying to overcome the supply challenges. However, support price, set by considering the cost incurred by farmers, remains a constraint. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. Previously, the sales tax levied on sugar was increased to 17% (previously 8%,) charged on the PKR 60/KG price, which contributed to higher prices. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price instead of PKR 60/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 200 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21. Lately, TCP approved to import another 0.1mln MT of sugar. Going forward, despite higher input costs, higher sugar prices are expected to remain favourable for millers.

The ratings reflect improved business performance of SGM Sugar Mills Limited ('SGM' or 'the Company'). The Company was acquired by 'United Group' of Essarani family. The family has long standing experience in agriculture sector and commodity trading including trading in fertilizer and coal, operating a sugar mill (Sindh Abadgar's Sugar Mills Limited) and ethanol distillery (United Ethanol Limited). Given the size of mill and steps taken by new management, a turnaround in profitability is visible. Margins remained strong at gross level on the back of favourable sugar prices. The management's consistent attention to improve efficiencies and to assure ample supply of sugarcane supplements margins. The financial risk profile is characterized by moderate leverage and improved working capital cycle. The coverages have shown significant improvement and are at a strong position. Sponsors' commitment to provide financial support provides further comfort to the ratings.

The ratings are dependent upon optimizing capacity utilization and achieving operational efficiency consistently by the management. Deterioration in margins and/or cashflows will negatively impact the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	SGM Sugar Mills Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating(Jun-21),Criteria   Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria   Rating Modifiers(Jun-21)
<b>Related Research</b>	Sector Study   Sugar(Dec-20)
<b>Rating Analysts</b>	Shayan Farooq   shayan.farooq@pacra.com   +92-42-35869504

## Profile

**Legal Structure** SGM Sugar Mills Limited ("SGM" or "the Company") is a public unlisted company.

**Background** The Company was incorporated in September, 2007 and was formerly owned jointly by Dhabi Group (44%), Etihad Group (22%) and Mehar Family (34%). During May, 2018, United Group, represented by the Essarani Family, acquired shareholding of the Company. The Mehar Family still retains their shareholding in the Company.

**Operations** The primary business of the Company involves the sale and manufacturing of crystalline sugar along with ensuing by-products (Molasses and Bagasse). The Company has a crushing capacity of 12,000 TCD with its mill located in Ghotki, Sindh, whereas the head office is located in Karachi. During the current season, sugar marketing year (MY) 2021, the Company produced a total of 74,179 MT of sugar, crushing 755,607 MT of sugarcane while achieving a recovery rate of 9.9%.

## Ownership

**Ownership Structure** Major shareholding of the Company rests with Essarani Family (77%), through Mr. Deo Mal Essarani (16%) and his three sons – Mr. Asha Ram (29%), Mr. Mahesh Kumar (13%) and Dr. Tara Chand (20%). Remaining shareholding resides with Mehar Family, through Mr. Sardar Muhammad Baksh Khan Mehar (10%) and Mr. Sardar Ali Gohar Khan Mehar (13%).

**Stability** Ownership is stable as the Company's controlling interest now vests with one family. Each individual in the family holds a defined share in the Company.

**Business Acumen** Essarani family has been involved in agriculture sector for a significant period of time and owns entities collectively represented under 'United Group'. The Group's entities include Sindh Abadgar's Sugar Mills Limited, United Ethanol Industries Limited, Agro Trade Private Limited, and United Agro Chemicals.

**Financial Strength** The Company has adequate financial strength derived from its Group and support of sponsors. The Group had total assets worth PKR 18bln, supported by an equity base of PKR 11.5bln as of MY20. The Group posted a net profit worth PKR 920mln during MY20. Total debt as at MY20 stood at PKR 6.7bln.

## Governance

**Board Structure** Board of Directors comprises four members including the Chairman, Chief Executive Officer and two Non-Executive Director. All four members belong to Essarani Family, with no representation of Mehar Family.

**Members' Profile** Mr. Deo Mal Essarani acts as the Chairman of the Board. He has over 46 years of diversified experience and also acts as the Chairman for two other group companies - Sindh Abadgar's Sugar Mills and United Ethanol Industries Limited. Dr. Tara Chand acts as a Non-Executive Director. Mr. Chand has more than 15 years of experience in the sugar industry.

**Board Effectiveness** Low frequency of Board meetings and lack of Board committees reflects a room for improvement on effectiveness of the Board.

**Financial Transparency** M/s Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants, classified in Category 'A' by the SBP with a satisfactory QCR rating by ICAP, have been appointed as the external auditors of the Company. They have expressed an unqualified opinion on the financial statements for the year Sept, 2020.

## Management

**Organizational Structure** Highest level of authority lies with the Chief Executive, who is supported by Resident Director Mills and Chief Financial Officer. The Company has established functions for cane procurement, production, mechanical etc at mill location that report to the Resident Director. All functions at head office pertaining report to CFO.

**Management Team** Mr. Asha Ram has been appointed as CEO. However, key responsibility for managerial oversight and decision making rests with Dr. Tara Chand. Dr. Tara Chand is a medical doctor by profession and a member of Pakistan Sugar Mills Association. He is also the CEO of Sindh Abadgar's Sugar Mills Limited and United Ethanol Industries Limited. He has over fifteen years of experience in the Sugar Industry.

**Effectiveness** The Company has no management committees in place. However, meetings are conducted fortnightly to discuss business performance and organisational structure changes. All HODs and CEO are present at the meetings. In addition, further meetings are called as required.

**MIS** The Company has deployed ERP software from CosmoSoft, which is currently in a trial run.

**Control Environment** Oversight and effective management is maintained through the internal audit department which is shared on a group level. The department is headed by Mr. Ali Raza Dosani, who acts as the Group Internal Auditor. The group has expanded the internal audit department by inducting more individuals recently.

## Business Risk

**Industry Dynamics** Pakistan's sugar industry is the country's 2nd largest agro-based industry, comprising 90 mills with an annual crushing capacity estimated ~65–70mln MT. The industry is trying to overcome the supply challenges. However, support price, set by considering the cost incurred by farmers, remains a constraint. During MY21, the overall sugar production increased by 15%, YoY, to 5.6mln MT (MY20: 4.9mln MT) due to better crop availability and an increase in area under cultivation. The recent surge in local sugar prices was registered by the demand-supply gap. Previously, the sales tax levied on sugar was increased to 17% (previously 8%) charged on the PKR 60/KG price, which contributed to higher prices. In the FY21 budget, a sales tax of 17% was proposed to be levied on the market retail price instead of PKR 60/kg. However, Government has allowed not to charge sales tax on market retail price till Nov-21. Moreover, in MY21 crushing season, the Government increased the support price of sugarcane to PKR 200 per maund (previously, it was increased to PKR 190 from PKR 180 per maund). Actual realized sugarcane prices at the mill gate were even higher. To meet the local demand and curb the hike in sugar prices, the Government planned to import 0.8mln MT of sugar. Out of this, 0.3mln MT has already been imported, till Jun-21. Lately, TCP approved to import another 0.1mln MT of sugar. Going forward, despite higher input costs, higher sugar prices are expected to remain favorable for millers.

**Relative Position** Due to high number of players in industry, companies relatively have low market share. The Company had a market share of ~ 1.3% during MY21.

**Revenues** The Company's revenue stream comprises the sale of sugar and molasses. During 2QMY21, the Company posted sales worth PKR 2,586mln in comparison to PKR 1,674mln during 2QMY20. This growth is mainly supported by higher prices (2QMY21: PKR 75 per kg, 2QMY20: PKR 62 per kg) and off loading high levels of level of inventory. The Company held finished inventory worth of PKR 3,764mln during 2QMY21 (2QMY20: PKR 1,843mln).

**Margins** The Company has reduced gross margins at 24% during 2QMY21 (2QMY20: 32%) due to the increase in raw material cost for the Company. Average procurement price of the sugarcane stood at PKR 260 in 2QMY21 in comparison to PKR 220 in 2QMY20. Significant decrease in finance costs (2QMY21: PKR 181mln, 2QMY20: PKR 296mln) from interest rate cut lead the rise in net income, which rose to PKR 335mln during 2QMY21 (2QMY20: PKR 191mln). Net margin improved to 13% (2QMY20: 11%).

**Sustainability** Going forward, the management aims to improve business performance through efficient operations with no major expansion activity planned. The overall profitability is expected to improve as sugar and by-products prices are expected to remain high.

## Financial Risk

**Working Capital** The Company witnessed decline in working capital requirements during 2QMY21 on the back of lower stocks. During the nine period, inventory days stood at 148 days as compared to 256 days in 2QMY20. This was the primary reason behind lower net working capital days of 150 days (2QMY20: 284 days). Moreover, sufficient cushion for additional short-term funds is available for the Company. Short term trade leverage and short-term total leverage stood at 18% and 12%, respectively in 2QMY21 (2QMY20: 9% and 9%).

**Coverages** A significant improvement in cashflows helped the Company improve coverage ratios during 2QMY21. Improved cashflows resulted in strong coverage ratios (2QMY21: 3.7x, 2QMY20: 0.6x), owing to reduced finance costs (2QMY21: PKR 181mln, 2QMY20: PKR 296mln) from dipped interest rates. FCFO during 2QMY21 stood at ~PKR 675mln as compared to ~PKR 181mln during 2QMY20, as a result of better profitability.

**Capitalization** The Company has a highly leveraged capital structure represented by a leveraging ratio of ~68% during 2QMY21 (2QMY20: 70%). Total debt is inclined towards short term borrowing (2QMY21: PKR 3,262mln, 2QMY20: PKR 3,339mln), to fulfil working capital requirements. Long-term debt is worth PKR 2,400mln (2QMY20: PKR 2,600mln) which was obtained to pay off debt from the Company's books by the previous sponsors. Additionally, the Company expects to convert sponsors loan worth PKR 960mln (extended by Mr. Asha Ram) into equity. The figure is currently classified as advance against equity.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

SGM Sugar Mills Limited Sugar	Mar-21 6M	Sep-20 12M	Mar-20 6M	Sep-19 12M	Sep-18 12M	Sep-17 12M
<b>A BALANCE SHEET</b>						
1 Non-Current Assets	5,432	5,638	5,383	5,436	5,681	4,605
2 Investments	-	-	-	-	-	-
3 Related Party Exposure	1	-	47	-	-	-
4 Current Assets	4,389	904	4,598	1,590	291	847
<i>a Inventories</i>	3,767	414	3,753	939	-	589
<i>b Trade Receivables</i>	228	32	17	0	-	0
5 Total Assets	9,822	6,542	10,027	7,026	5,972	5,452
6 Current Liabilities	603	887	850	844	553	1,551
<i>a Trade Payables</i>	115	63	304	90	27	69
7 Borrowings	5,862	2,600	5,939	3,444	2,800	1,830
8 Related Party Exposure	-	-	11	-	-	1,208
9 Non-Current Liabilities	596	628	662	698	775	520
10 Net Assets	2,762	2,426	2,565	2,040	1,844	343
11 Shareholders' Equity	2,762	2,426	2,565	2,040	1,844	343
<b>B INCOME STATEMENT</b>						
1 Sales	2,586	5,467	1,674	3,409	3,483	2,194
<i>a Cost of Good Sold</i>	(1,954)	(4,767)	(1,143)	(2,851)	(3,360)	(2,526)
2 Gross Profit	631	700	531	559	123	(332)
<i>a Operating Expenses</i>	(75)	(86)	(62)	(92)	(219)	(152)
3 Operating Profit	556	615	468	467	(97)	(484)
<i>a Non Operating Income or (Expense)</i>	(20)	10	8	79	456	16
4 Profit or (Loss) before Interest and Tax	536	625	476	545	360	(468)
<i>a Total Finance Cost</i>	(181)	(528)	(296)	(497)	(155)	(188)
<i>b Taxation</i>	(20)	(10)	10	32	(0)	52
6 Net Income Or (Loss)	335	87	191	81	205	(604)
<b>C CASH FLOW STATEMENT</b>						
<i>a Free Cash Flows from Operations (FCFO)</i>	675	951	181	888	15	(121)
<i>b Net Cash from Operating Activities before Working Capital</i>	545	336	181	479	(723)	(166)
<i>c Changes in Working Capital</i>	(3,972)	878	-	(971)	445	(702)
1 Net Cash provided by Operating Activities	(3,428)	1,214	181	(492)	(278)	(867)
2 Net Cash (Used in) or Available From Investing Activities	29	(634)	-	(172)	(7)	(155)
3 Net Cash (Used in) or Available From Financing Activities	3,262	(544)	-	759	307	1,029
4 Net Cash generated or (Used) during the period	(137)	36	181	96	22	7
<b>D RATIO ANALYSIS</b>						
1 Performance						
<i>a Sales Growth (for the period)</i>	-5.4%	60.4%	-1.8%	-2.1%	58.8%	-10.3%
<i>b Gross Profit Margin</i>	24.4%	12.8%	31.7%	16.4%	3.5%	-15.1%
<i>c Net Profit Margin</i>	13.0%	1.6%	11.4%	2.4%	5.9%	-27.5%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working C</i>	-127.5%	33.4%	10.8%	-2.4%	13.2%	-37.5%
<i>e Return on Equity   Net Profit Margin * Asset Turnover * (T</i>	25.8%	3.9%	16.6%	4.2%	18.8%	-104.6%
2 Working Capital Management						
<i>a Gross Working Capital (Average Days)</i>	157	46	257	101	62	2
<i>b Net Working Capital (Average Days)</i>	150	41	235	94	57	-13
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	7.3	1.0	5.4	1.9	0.5	0.5
3 Coverages						
<i>a EBITDA / Finance Cost</i>	4.0	1.9	0.6	1.9	0.4	-0.5
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	2.4	1.3	0.6	1.0	0.0	0.0
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fin</i>	2.6	6.1	-11.5	7.1	-23.1	-12.1
4 Capital Structure						
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equit</i>	68.0%	51.7%	69.9%	62.8%	60.3%	89.9%
<i>b Interest or Markup Payable (Days)</i>	117.7	45.3	123.0	111.8	157.1	0.0
<i>c Entity Average Borrowing Rate</i>	8.0%	13.4%	13.0%	13.6%	5.1%	7.4%

**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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- (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.
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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)
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- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (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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