



The Pakistan Credit Rating Agency Limited

## Rating Report

### Engro Fertilizers Limited

#### Report Contents

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Jul-2021	AA	A1+	Stable	Maintain	-
29-Jul-2020	AA	A1+	Stable	Maintain	-
30-Jul-2019	AA	A1+	Stable	Maintain	-
28-Jan-2019	AA	A1+	Stable	Maintain	-
27-Jul-2018	AA	A1+	Stable	Upgrade	-
30-Dec-2017	AA-	A1+	Stable	Maintain	-
20-Apr-2017	AA-	A1+	Stable	Maintain	-
18-Nov-2016	AA-	A1+	Stable	Maintain	-
18-Nov-2015	AA-	A1+	Stable	Upgrade	-

#### Rating Rationale and Key Rating Drivers

Pakistan has an agrarian economy, thus fulfills around ~84% of its fertilizer requirement through local production while the remaining is met through imports. The country's total fertilizer production capacity sails around ~ 6.9mln MT of Urea and ~ 1.7mln MT of DAP, NP, and NPK. In 5MCY21, Urea's offtake stood at 2.2mln MT. Meanwhile, DAP's offtake stood at 423,000MT, as it is largely utilized in the Rabi Season. The industry's overall margins posted healthy growth in gross and net levels due to unchanged gas rates, low fuel cost, and interest rates. In the local market, Urea's price has slightly decreased. Last year, the GIDC rate was reduced on feed and fuel gas and the industry reduced the Urea prices. However, as per the ruling of the Supreme Court in Aug-20, the further charge of GIDC was stopped and liability was made payable in full by all manufacturers in 48 months. Moreover, the subsidy of PKR1000/50KG on DAP by GoP may bring its price down by ~25%. In the international market, prices of Urea and DAP witnessed an upward trend. Going forward, Urea's and DAP inventory is expected to be adequate.

The ratings reflect Engro Fertilizers Limited's ('EFert' or 'the Company') sound risk profile. EFert derives strength from its parent company i.e., Engro Corporation Limited ('Engro Corp'), the largest conglomerate in Pakistan. The Company's capacity utilization of both Urea and NPK remained strong, primarily attributable to continued gas supply and improved plant efficiencies, evident from highest ever production of Urea during CY20. The Company reaps benefit from the incentivized gas pricing. Lately, the Company is pursuing extension of concessionary gas till the number of days for which supply of gas was curtailed. EFert continues to increase its top-line backed by volumetric growth. The Company has also diversified its product portfolio into other agri-based products and has maintained healthy margins and profitability, over the years. Moreover, stable income from the subsidiary company from other sources provide support to the Company's bottom line. The Company has a moderately leveraged capital structure with very strong coverages and significant liquidity leading to a robust financial profile. Ratings draw comfort from sponsor's business acumen and their widespread reach. Strong governance framework adds strength to the Company's profile. The Company has received numerous corporate awards.

The ratings are dependent on the sustainability of operations and maintaining its market share. Sustainability in the performance of subsidiaries, stable dividends, and effective management of financial profile is important. Prudent management of the working capital, cash flows, and coverages are imperative for the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	Engro Fertilizers 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   Fertilizer(Jan-21)
<b>Rating Analysts</b>	Faiqa Qamar   faiqa.qamar@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Engro Fertilizers Limited ('EFert' or 'the Company') is a public listed company, incorporated in 2009.

**Background** The restructuring and demerger of EFert from Engro Chemicals Pakistan Ltd., which was formed after an employee buyout in 1991, became effective in Jan-10. Subsequently, all the fertilizer business assets and liabilities were transferred to EFert. The Company set up its first fertilizer plant (Base plant) in 1968 with a capacity of 173,000MT. In 2007, EFert undertook a urea expansion project named, EnVen that became commercially operational in 2011. EFert formed a wholly-owned subsidiary i.e., EFert Agritrade (Pvt.) Limited (EAPL), in Jul-17, to manage its business of trading and distribution of imported fertilizer. In 2019, the Company ventured into the logistics space.

**Operations** EFert is engaged in the manufacturing, purchasing, and marketing of fertilizers, seeds, and pesticides and providing agri services. Urea and DAP are sold under the brand name of Engro while NPK, MAP, and Zinc based fertilizers are sold as Zarkhez, Zorawar, and Zingro. The Company has 3 plants, out of which 2 Urea plants are located at Daharki (Base plant and EnVen) and 1 NPK plant (Zarkhez) is located at Port Qasim, Karachi. The total capacity of EFert's urea plants is 2.275mln MT (Base plant: 975,000 MT p.a and EnVen: 1,300,000 MT p.a). Zarkhez has a total capacity of 100,000MT. In CY20, the Company's total urea production witnessed a growth of ~13% (CY20: ~2.26mln MT, CY19: ~2mln MT) with a utilization level of ~99.5%. NPK witnessed a decline in production and stood at ~127,082MT (CY19: ~134,784MT) with a utilization level of ~127%.

## Ownership

**Ownership Structure** EFert is majorly owned by Engro Corporation Limited (Engro Corp) (~56%), the largest conglomerate in Pakistan. Rest of the ownership lies with general public (~19%), financial institutions (~4%), mutual funds (~3%), insurance companies (~2%) and others (~16%).

**Stability** The ownership structure of the Company is seen stable as the majority of shareholding vests with the sponsors through Engro Corp.

**Business Acumen** Engro Corp is a conglomerate with over three generations of experience in commercial and social enterprises. Currently, the Group has interests in Fertilizer, Foods, Power Generation, Technology, Financial Services, Chemical Storage, and Petrochemicals. Strong affiliation and technical track record with international JVs have added to the success of companies within the Group.

**Financial Strength** In CY20, EFert had a consolidated equity base of ~PKR ~46.7bln with an asset base of ~PKR 131.7bln. It generated a turnover of ~PKR 105.8bln and posted a PAT of ~PKR 18.1bln.

## Governance

**Board Structure** The BoD comprises eight members. There are four Non-Executive Directors, three Independent Directors, and one Executive Director.

**Members' Profile** The Company's Board is chaired by Mr. Ghias Khan. He is the President and CEO of Engro Corp and has been associated with Dawood Group for more than a decade. He has an overall experience of almost two decades. All members on the BoD have diversified experience and most have been associated with the Company's BoD for a long span of time.

**Board Effectiveness** The BoD has two committees to assist in governing the affairs of the Company. These comprise Audit Committee and People Committee. The BoD met seven times during CY20 with close to full participation, while the Audit Committee and People Committee met four times and three times, respectively.

**Financial Transparency** EFert's external auditor, A.F. Ferguson & Co, has issued an unqualified opinion on CY20's financial statements.

## Management

**Organizational Structure** The Company has a well-defined organizational structure divided into eleven departments. Five of the departments are centralized at the Group level. All functional heads report to the Company's CEO, who then reports to the BoD. However, the Head of Internal Audit and the Head of Human Resource reports administratively to the CEO and functionally to the Board's Audit and People's Committee, respectively.

**Management Team** Mr. Nadir Salar Qureshi, the CEO, has professional experience of over two decades and has been associated with the Group since Mar-17. He is aided by a team of experienced professionals.

**Effectiveness** The management is assisted by four committees i.e., Management, Pricing, Corporate HSE, and Capex Committee. Meetings of the committees are held on a periodic basis to ensure efficiency and strategic planning.

**MIS** EFert has recently undertaken adoption of a comprehensive ERP system at group level – OneSAP. It is an end-to-end system that integrates information on a single platform, unifying Group's reporting and promoting collaboration through shared data.

**Control Environment** EFert has an in-house internal audit function which is responsible for monitoring compliance, inherent and other risks associated with the operations.

## Business Risk

**Industry Dynamics** Pakistan's total fertilizer production capacity sails around ~ 6.9mln MT of Urea and ~ 1.7mln MT of DAP, NP, and NPK. In 5MCY21, Urea's offtake stood at 2.2mln MT. Meanwhile, DAP's offtake stood at 423,000MT. The industry's overall margins posted healthy growth in gross and net levels due to unchanged gas rates, low fuel cost, and interest rates. In the local market, Urea's price has slightly decreased. Last year, the GIDC rate was reduced on feed and fuel gas leading to reduced Urea prices. However, as per SC ruling in Aug-20, GIDC charge was stopped and was made payable in full by all in 48 months. Moreover, the subsidy of PKR1000/50KG on DAP by GoP may bring its price down. In the international market, prices of Urea and DAP witnessed an upward trend. Going forward, Urea's and DAP inventory is expected to be adequate.

**Relative Position** EFert is the second-largest player in the fertilizer industry with a market share of ~33% in Urea and ~18% in Phosphates (as of CY20).

**Revenues** EFert's top-line comprises sales of Urea (~84%), Speciality Fertilizer (~9%), and Others (~7%). During CY20, the Company posted a dip of ~5% in top-line, however, remained strong (CY20: ~PKR 75.1bln, CY19: ~PKR 79.2bln). The decline can be seen as an effect of lower Urea prices in CY20, despite a ~2% increase in volumes sold. During 1QCY21, the top-line increased by almost three folds and stood at ~PKR 22.9bln (1QCY20: ~PKR 8.1bln), primarily attributable to a 3.5x increase in volumetric sales.

**Margins** During CY20, the gross profit of the Company posted a dip to ~PKR 29.1bln (CY19: ~PKR 32.7bln) owing to lower Urea prices translating into the gross margin of ~39% (CY19: ~41%). Similarly, the operating margin declined to ~27% (CY19: ~31%). The bottom line is supported by dividend income from EAPL and interest income from debt instruments. Finance cost declined to ~PKR 3.3bln in CY20 (CY19: ~PKR 3.7bln) due to lower KIBOR. Thus, the net margin stood at ~22% (CY19: ~23%). During 1QCY21, the gross and operating margin increased to ~43% and ~34%, respectively, owing to improved prices of fertilizer products. Significant dividend income and lower finance cost resulted in higher net margin of ~28%.

**Sustainability** The Company continues to explore new avenues, particularly in the pesticides and Agri farming sectors. Moreover, EFert is actively evaluating alternate sources of gas with the Government to mitigate the risk of depleting reserves.

## Financial Risk

**Working Capital** In CY20, the inventory days improved to 25 days (CY19: 15 days) owing to inventory pile up. However, the receivable days remain stable (CY20: 29 days, CY19: 29 days). The trade payable days witnessed an increase to 33 days (CY19: 26 days). This elevated the net working capital days (CY20: 21 days, CY19: 17 days). In 1QCY21, the net working capital days improved to 8 days due to lower receivable days. Short-term investments provide a cushion to the borrowings.

**Coverages** In CY20, the Company's FCFO improved slightly to ~PKR 22.7bln (CY19: ~PKR 22.3bln), despite lower profitability. Moreover, the finance cost declined in CY20 due to lower KIBOR. Consequently, the interest coverage improved to 6.9x (CY19: 6x). However, the core and total coverage witnessed a minor dip to 1.7x (CY19: 1.8x) and 1.9x (CY19: 2.1x), respectively. In 1QCY21, the interest coverage witnessed a significant rise to 27.8x owing to higher profitability. Moreover, the core and total coverage followed the same course and stood at 3.6x and 3.8, respectively. Coverages are expected to remain strong, going forward.

**Capitalization** EFert has a moderately leveraged capital structure with a leveraging ratio of ~32% in 1QCY21 (CY20: ~36%, CY19: ~43%). Over the years, the Company has reduced its reliance on short-term borrowings, and currently, it is only ~1% of the total borrowings.



Engro Fertilizers Limited Fertilizer	Mar-21 3M	Dec-20 12M	Mar-20 3M	Dec-19 12M	Dec-18 12M
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#### A BALANCE SHEET

1 Non-Current Assets	69,694	70,891	70,077	71,158	72,833
2 Investments	27,027	25,075	6,969	5,502	6,335
3 Related Party Exposure	913	837	8,254	16,449	14,599
4 Current Assets	25,434	31,463	37,963	35,999	20,382
<i>a Inventories</i>	4,943	6,720	10,932	3,569	2,960
<i>b Trade Receivables</i>	2,098	2,028	4,975	10,010	2,375
5 Total Assets	123,068	128,265	123,263	129,108	114,148
6 Current Liabilities	33,763	35,875	31,098	34,863	31,211
<i>a Trade Payables</i>	4,838	6,944	6,017	6,792	4,604
7 Borrowings	20,908	23,880	29,999	32,555	31,499
8 Related Party Exposure	1,046	1,066	5,671	6,400	1,090
9 Non-Current Liabilities	21,268	22,458	12,255	12,437	7,352
10 Net Assets	46,083	44,986	44,240	42,853	42,996
11 Shareholders' Equity	46,083	44,986	44,240	42,853	42,996

#### B INCOME STATEMENT

1 Sales	22,944	75,056	8,058	79,237	66,141
<i>a Cost of Good Sold</i>	(13,116)	(45,994)	(4,751)	(46,524)	(38,232)
2 Gross Profit	9,828	29,062	3,308	32,713	27,909
<i>a Operating Expenses</i>	(2,048)	(9,168)	(1,249)	(7,971)	(7,915)
3 Operating Profit	7,781	19,893	2,059	24,742	19,995
<i>a Non Operating Income or (Expense)</i>	1,453	2,302	980	6,181	3,460
4 Profit or (Loss) before Interest and Tax	9,234	22,196	3,038	30,923	23,455
<i>a Total Finance Cost</i>	(308)	(3,278)	(1,224)	(3,688)	(2,055)
<i>b Taxation</i>	(2,488)	(2,103)	(427)	(8,673)	(4,731)
6 Net Income Or (Loss)	6,438	16,815	1,388	18,563	16,669

#### C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	8,546	22,695	3,166	22,295	21,486
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	8,684	22,396	3,128	22,912	21,612
<i>c Changes in Working Capital</i>	(2,871)	8,469	(8,931)	1,957	8,602
1 Net Cash provided by Operating Activities	5,813	30,865	(5,804)	24,869	30,215
2 Net Cash (Used in) or Available From Investing Activities	(5,636)	(8,456)	6,457	(3,030)	(15,442)
3 Net Cash (Used in) or Available From Financing Activities	(2,880)	(22,436)	(2,724)	(17,912)	(15,786)
4 Net Cash generated or (Used) during the period	(2,703)	(27)	(2,071)	3,927	(1,013)

#### D RATIO ANALYSIS

1 Performance					
<i>a Sales Growth (for the period)</i>	22.3%	-5.3%	-59.3%	19.8%	-2.7%
<i>b Gross Profit Margin</i>	42.8%	38.7%	41.0%	41.3%	42.2%
<i>c Net Profit Margin</i>	28.1%	22.4%	17.2%	23.4%	25.2%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	24.7%	41.5%	-71.6%	30.6%	45.5%
<i>e Return on Equity / Net Profit Margin * Asset Turnover * (Total Assets/SI)</i>	54.7%	37.3%	12.3%	46.0%	40.1%
2 Working Capital Management					
<i>a Gross Working Capital (Average Days)</i>	31	54	167	44	34
<i>b Net Working Capital (Average Days)</i>	8	21	94	17	10
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	0.8	0.9	1.2	1.0	0.7
3 Coverages					
<i>a EBITDA / Finance Cost</i>	28.1	7.8	3.0	8.7	12.8
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	3.6	1.7	0.9	1.8	1.7
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.7	1.3	3.7	1.7	1.9
4 Capital Structure					
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	32.2%	35.6%	40.4%	43.2%	42.3%
<i>b Interest or Markup Payable (Days)</i>	80.3	29.0	51.9	54.9	72.0
<i>c Entity Average Borrowing Rate</i>	4.7%	11.7%	16.0%	12.0%	7.2%

**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)

### **2) Conflict of Interest**

- 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.
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- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (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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- (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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- (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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