



Credit Rating Company Limited.

CORPORATE RATING METHODOLOGY

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SCOPE OF CRITERIA

VIS Credit Rating Company Limited (VIS) applies its 'Corporate Rating Methodology' to evaluate industrial and service sector non-financial corporate issuers and entities. Entity ratings assess a company's overall capacity and commitment to repay senior unsecured creditors, while debt instrument ratings additionally consider the specific structure and priority ranking of individual instruments within the capital structure, which may enhance or diminish recovery prospects compared to unsecured creditors.

Credit ratings represent professional opinions regarding a company's ability and willingness to meet payment obligations on time, with rating categories indicating the relative risk levels associated with different credit qualities. These ratings serve as risk assessment tools rather than guarantees against financial loss. They do not constitute investment advice or recommendations to buy, sell, or hold specific securities, nor do they evaluate whether an investment is appropriate for any particular investor's circumstances or objectives.

SUMMARY OF CRITERIA CHANGES

The fundamental criteria as outlined in 'Rating Methodology - Industrial Corporates' dated August 2025 remains the same with no changes to the ratings framework itself.

As markets develop and ratings universe continues to expand, VIS continues to deepen its understanding of the debt market and makes regular updates to account for changing market conditions. Sectoral Research are regularly disseminated in the Sector Updates posted in the Knowledge Center on the VIS website.

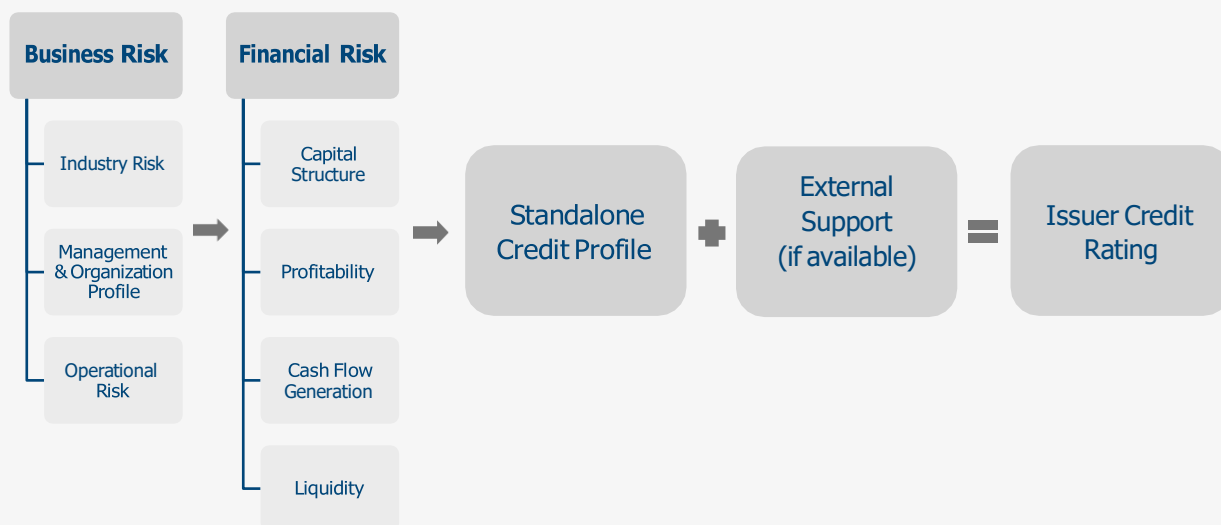
AN OVERVIEW OF RATINGS FRAMEWORK

VIS employs a comprehensive ratings framework built on two primary pillars: Business Risk and Financial Risk, each containing multiple sub-components. The rating process evaluates all areas individually before integrating these assessments into a final rating. Strengths in one area can compensate for weaknesses in another, creating a balanced evaluation approach. While certain metrics like financial ratios follow established benchmarks for each rating category, other factors require qualitative judgment, making credit rating both analytical and interpretive.

VIS has developed specific weightings for various rating factors through extensive experience, though these may evolve over time and vary by industry. For companies with five or more years of operating history, financial risk typically receives up to 60% weighting, reflecting expectations of stable operations and consistent financial performance. Conversely, newer entities receive greater emphasis on business risk assessment due to their limited track record. Business risk assessment is made at two levels: industry-wide and company-specific analysis. Industry evaluation examines cyclical patterns, competitive dynamics, capital requirements, technological disruption potential, and regulatory environment. Company-specific analysis focuses on management capabilities, organizational framework, and operational risk elements. This comprehensive review determines the entity's business model strength, market position, diversification, competitive advantages, operational systems effectiveness, and management quality.

Financial analysis encompasses historical and projected financial performance, capital structure risks, profitability levels, and cash flow adequacy for operations and debt service. Financial statements may be adjusted to provide clearer performance insights over time. Projected financials reflect management's economic outlook and undergo stress-testing across various scenarios to evaluate the company's resilience under different conditions. While historical performance indicates track record, future earnings potential primarily drives rating determinations.

Ratings also incorporate available external support, potentially enhancing the final assessment based on backing from sponsors, shareholders, affiliated entities, and the creditworthiness of supporting organizations.



**Weightages assigned according to stage of industry/entity life cycle*

RATING METHODOLOGY- STANDALONE RATINGS

Our assessment model is based on some key factors, qualitative and quantitative, which may further be broken down into sub-factors to comprehensively capture the rating drivers.

A. BUSINESS RISK ASSESSMENT

Industry risk along with operational risk and management & organizational profile of a specific company determines mainly the business risk of an entity. The business risk of a company largely dictates the extent of financial risk it can afford by affecting the level and predictability of cash flows that the companies operating in that industry are likely to generate. Higher and predictable cash flow streams will lower the business risk.

BUSINESS RISK SUB-FACTORS
Industry Risk
Management & Organization Profile
Operational Risk

A. (i) Industry Risk

Rating analysis commences with evaluating the operating environment of companies. Industry risk assessment establishes rating ceilings for individual entities within specific sectors. The governing principles for rating ceiling applications include: industry lifecycle positioning, growth trajectory assessment, margin sustainability, capital deployment flexibility, and the sector's overall risk profile relative to economic cycles. For instance, due to certain industries' maturity stage in their lifecycle, sector ratings typically cannot exceed the "A" band for instance, irrespective of how conservative individual entity financial profiles may appear. Conversely, industries with strong growth potential, healthy margins, and flexible capital deployment timing provide financial risk cushioning that can support higher ratings even when not all sector participants achieve high ratings.

INDUSTRY RISK SUB-FACTORS

Cyclical

Competition

Capital Intensity

Technology Risk

Regulatory Framework

Energy Sensitivity

Cyclical Analysis

VIS examines business dynamics to assess cyclical levels across industries. Companies are deemed highly cyclical when financial performance experiences significant fluctuations due to economic environmental changes. All industries are categorized on a High-to-Low risk spectrum for cyclical and related sub-factors.

During economic prosperity with elevated consumer confidence and income levels, cyclical industries like automotive experience increased sales, while economic downturns typically reduce sales as consumers defer major purchases. Steel manufacturers similarly prosper during economic expansion as increased construction drives steel demand, but struggle during recessions when construction activity declines.

Commodity-dependent industries face similar volatility. Oil sector companies remain vulnerable to international price fluctuations, with even industry leaders experiencing margin and profitability swings. In contrast, certain sectors demonstrate greater stability with steady demand growth and resilience during both economic expansions and contractions. Consumer goods sectors including soaps, detergents, food products, and pharmaceuticals exhibit low cyclical characteristics.

Through-the-Cycle Rating Approach

VIS employs through-the-cycle evaluation methodology. While ratings may appear conservative during economic upturns or optimistic during downturns, the assessment focuses on companies' ability to weather potential economic reversals. Long-term ratings remain stable when performance recovery can reasonably be expected following downturns, potentially avoiding rating reductions during temporary difficulties.

Financial Flexibility Considerations

Financial flexibility and liquidity represent crucial factors, particularly as cash accumulation and depletion occur rapidly in cyclical industries. Cyclical companies typically build cash reserves during boom periods to provide downside protection. Cash flow strength assessment becomes challenging due to volatility in input/output prices, volumes, and varying capital expenditure timing across cycles.

Relative cost positioning becomes a competitive advantage during downturns, as lowest-cost producers can reduce prices to breakeven levels while maintaining or gaining market share, potentially creating unsustainable losses for higher-cost competitors.

Capital Expenditure Timing

Understanding capital expenditure timing and levels proves critical in cyclical industries. Industry-wide capacity increases typically occur near cycle peaks, creating uncertainty about demand sustainability when new capacities become operational. The Pakistan cement industry exemplifies this challenge, tripling capacity from 15 million tons (2001) to 45 million tons (2009), only to face the 2008 economic crash as expanded capacity came online, resulting in years of depressed profits and debt servicing difficulties.

Competitive Risk Assessment

Industry competitive analysis examines entry barriers effectiveness, substitution risks, and growth prospects. Low entry barriers, inter-industry competition, alternative technology threats, and declining revenue prospects in early-stage industries constitute major risk elements. Pakistan's fertilizer industry exemplifies low-risk characteristics with high entry barriers, minimal substitution risk, and moderate growth potential.

Capital Intensity Impact

Capital intensity, including initial outlays and ongoing maintenance/expansion requirements, increases industry risk, particularly for long-term return horizon sectors. Financial strength and funding access become critical growth determinants. Automobile manufacturing requires substantial facility, infrastructure, and equipment investments, while the power sector demands large capital outlays, making capital intensity a high-risk factor for both sectors.

Technological Change Vulnerability

Evolving technology and consumer preferences accelerate obsolescence in certain industries, requiring continuous capital investment. This technological vulnerability appears prominently in information technology, telecommunications, and consumer durables sectors. Industry innovation rates and product obsolescence create customer expectations for new product development, requiring skilled personnel and effective innovation processes that may challenge many companies.

Regulatory Environment Analysis

Regulatory frameworks encompassing licensing, approvals, tariffs, taxation, environmental regulations, and price controls significantly affect business strategy and performance. Overly restrictive regulations may constrain growth potential, while balanced regulations provide operator safety nets enhancing financial performance. Government regulatory price controls can impact industry profitability, with the regulatory environment serving as a potential risk factor to consider. Regulatory support levels often correlate with industry economic contribution and policy maker importance assessments.

Energy Sensitivity Factors

Industry energy requirement sensitivity affects ratings, particularly for high-consumption sectors like cement and steel where energy constitutes substantial input costs. Uninterrupted energy supply along with cost and alternate sourcing analysis becomes critical for future profitability assessments in energy-intensive industries.

Company-Specific Risk Prioritization

Industry risk assessment establishes the foundation for company-specific risk factor analysis and evaluation priority determination. Highly competitive industries require market share sustainability assessments, while capital-intensive sectors emphasize sponsor financial strength and capital access capabilities.

Multi-Sector Operations

Companies operating across multiple sectors undergo separate business unit analysis, with overall industry risk assessment weighted by each unit's organizational importance. Diversification benefits beyond additive approaches receive consideration, with management's diverse operation capabilities becoming critical alongside sector-specific challenges in each participating industry.

INDUSTRY RISK	AUTOMOBILE	CEMENT	FERTILIZER	OIL & GAS-REFINERIES	PHARMA	POWER GENERATION	SUGAR	TELECOMMUNICATIONS
Cyclicalit	High	High	Low	High	Low	Low	High	Low
Competition	Low	Medium to Low	Medium to Low	Medium to Low	Low	Low	Medium to Low	Medium to Low
Capital Intensity	High	High	High	High	Medium to Low	High	Medium	High
Technology risk	Medium	Low	Low	Medium	Low	Medium	Medium	High
Regulatory framework	Medium	Medium To Low	High to Medium	High	High	High	High	High
Energy Sensitivity	Medium	High	Medium	High	Low	Medium to Low	Low	High

A. (ii) Management & Organizational Profile

Management Credibility Evaluation

Management credibility is assessed through the alignment between strategic objectives and actual performance outcomes. Consistent delivery against established business plans reflects positively on management capabilities. VIS analyzes whether strong performance results from effective management practices or occurs despite weak leadership—a distinction that becomes clearer when evaluated across multiple business cycles.

Management meetings are an integral component of the ratings exercise which allow VIS team to understand the profile of the team beyond what is reflected in numbers and plans. The assessment focuses on operational effectiveness and risk management approach, while considering management team stability and the relevance of individual credentials to their respective responsibilities.

MANAGEMENT RISK SUB-FACTORS

Organizational Structure

Management Information Systems

Internal Controls

Organizational Structure Analysis

The organizational framework reflects management philosophy and directly impacts operational efficiency and business success. Several factors can constrain ratings, including:

- Excessive dependence on a limited number of individuals
- Absence of succession planning mechanisms
- Heavy emphasis on family-based rather than professional management
- Unclear management hierarchies and reporting structures
- Excessive board interference in daily operations
- Lack of appropriate delegation practices

Effective organization building requires senior management to formulate a clear vision and communicate it throughout all organizational levels. Employee understanding of corporate objectives and both short-term and long-term strategic approaches becomes essential for sustainable business growth.

Legal Structure Impact on Ratings

The legal framework significantly influences credit assessments. Sole proprietorships and partnerships typically lack robust governance and reporting systems, resulting in higher operational risk and potentially affecting credit ratings. Key person risk becomes particularly pronounced in sole proprietorships, making succession planning analysis more critical. Given unlimited liability structures, the separation between personal and business assets requires careful evaluation, including potential set-off provisions during litigation scenarios. These factors directly impact recovery prospects for lenders, particularly relevant for investment-grade rating considerations.

Family-Owned Business Considerations

When ownership concentrates within family structures, distinguishing management control from ownership becomes crucial, particularly in identifying silent majority partners. Partnership agreements require thorough review to understand profit and loss sharing arrangements between investing and working partners, helping identify potential conflict areas. Partner withdrawal patterns over time also warrant examination.

Additional assessment factors for sole proprietorships and partnerships include:

- Operational history duration
- Educational backgrounds and work experience of controlling partners
- Financial capacity of partners to support business operations during challenging periods
- Historical performance track record across various business cycles

Due to evolving business dynamics and heightened business risk exposure, sole proprietorships and partnerships typically require more frequent rating reviews compared to other corporate structures.

Corporate Disclosure and Governance

For limited liability companies, whether publicly listed or privately held, disclosure practices beyond minimum statutory requirements provide important risk assessment insights. Voluntary adoption of governance best practices demonstrates management's commitment to objective and transparent operations.

Information Systems and Technology Assessment

Management information systems evaluation has gained increasing importance in credit rating analysis. Assessment areas include system adequacy, security protocols, disaster recovery capabilities, and business continuity planning. The degree of IT integration with core business operations helps determine operational risk levels associated with the entity.

Internal Control Framework

Internal controls serve critical functions across both public and private organizations by safeguarding against financial losses, maintaining reliable financial reporting standards, and maximizing operational effectiveness. In non-regulated industries, aggressive financial policies combined with weak internal risk management frameworks represent high-risk scenarios requiring careful evaluation.

A. (iii) Operational Risk**Market Position and Competitive Advantage**

A company's product portfolio and corresponding market shares determine its ability to influence market supply dynamics and pricing power, potentially providing competitive advantages over industry peers. VIS recognizes that substantial market shares do not automatically translate to industry dominance—in highly fragmented sectors like textiles, even large local players may lack meaningful pricing leadership capabilities.

Companies possessing competitive advantages typically achieve superior margins along with enhanced stability and pricing control. Leading brands generally command premium pricing power and generate more stable earnings through established customer loyalty. Key competitive advantage sources include:

- Entity size and scale benefits
- Product or service diversification
- Strategic geographic positioning
- Proven track record of superior service delivery or product innovation
- Efficient distribution networks
- Significant intellectual property assets

While no specific size criteria exist across different rating bands, scale becomes meaningful when it translates into tangible market advantages. Conversely, smaller companies can occasionally develop competitive advantages in specialized market niches.

Diversification Benefits

Industry diversification through varied product lines and target markets typically receives favorable assessment as it reduces operational business risk exposure. Large, well-diversified companies demonstrate greater resilience due to extensive resource bases and protective advantages including economies of scale, broader market access, expanded

customer bases, and diverse product portfolios—enabling better performance during economic downturns. Growth-stage smaller companies generally lack these protective strengths, with weak financial structures amplifying vulnerability during economic or business contractions.

Supply Chain Risk Assessment

Raw material supply and pricing risks require comprehensive evaluation, including availability analysis, market characteristics, foreign market dependencies, supplier relationship quality, and substitute availability. Companies or industries relying on foreign markets for either input procurement or sales face significant risks from access timing issues and exchange rate fluctuations.

Labor Market Considerations

While traditional labor union concerns have diminished over time, skilled labor availability has gained prominence. Technological advancement has fundamentally altered labor markets—automation and digital transformation have shifted demand from routine low-to-middle-level skills toward sophisticated analytical, technical, and managerial capabilities. This trend particularly affects industries like engineering, where widening skills gaps create automation transition challenges.

Financial Flexibility Evaluation

VIS considers financial flexibility a critical rating factor. Well-established multiple banking relationships providing access to comprehensive banking facilities at competitive rates receive favorable assessment. Inadequate working capital facilities or asset-liability mismatches typically represent negative factors, particularly for smaller companies. Short-term funding coverage ratios below 1x against liquid assets are classified as high risk.

Growth Potential Assessment

Future earnings growth potential and management's strategic plans for achieving growth objectives hold particular importance. While mature cash-generating companies may initially appear favorable, failure to sustain long-term earnings growth becomes a significant limitation. Companies lacking growth potential are considered high risk for rating purposes.

Operational Infrastructure Quality

Manufacturing businesses face additional risks related to plant and machinery quality, capital expenditure patterns, existing capacity optimization, and expansion plan execution timeliness. These factors gain heightened importance for technology-dependent operations. Failure to maintain competitive technology standards through timely upgrades can negatively impact rating assessments.

Regulatory Compliance and Legal Risk

Regulatory compliance issues receive thorough consideration in rating evaluations. Frequent non-compliance instances signal elevated operational risk, impacting ratings accordingly. Additionally, protracted legal disputes can create reputational challenges and ultimately result in substantial financial costs.

Substitute Product Competition

Substitute product availability intensifies competition and reduces profit potential. Examples include:

- Sugar versus artificial sweeteners
- Powdered milk versus fresh milk
- Traditional newspapers versus digital news platforms
- Conventional automobiles versus Electric vehicles

Substitute product presence often necessitates increased marketing expenditure to protect market share, potentially affecting operational profitability and representing high risk factors for rating purposes.

B. FINANCIAL RISK ASSESSMENT

The financial risk assessment is primarily driven by an objective analysis of the company's performance against predefined benchmarks. In undertaking this analysis, VIS not only looks at the absolute levels of ratios, we also focus on trends and compare these ratios with those of competitors. Financial ratios are also evaluated in context of a firm's business risk. A company with stable cash flows and favorable business prospects may take up added financial risk than a company having higher business risk.

B. (i) Capital Structure & Access to Capital

Financial Policy Evaluation

The financial policy of the management is assessed to determine the degree of flexibility in the capital structure of the company as compared to its business risk. Common shares provide the greatest cushion to creditors, as they do not entail any fixed obligations. Preference shares, depending upon their features, also have greater flexibility in payments vis-à-vis pure debt instruments as the dividend payments are made out of available profits, although they pose a greater strain on cash flows as compared to common equity.

FINANCIAL RISK SUB-FACTORS

Capital Structure & Access to Capital

Profitability

Cash Flow Generation

Liquidity

Capital Structure Analysis and Adjustments

While equity and debt definitions remain standardized, certain adjustments may be necessary to accurately evaluate capital structure based on instrument characteristics and intended use:

- Preference shares may be treated more like debt when they are cumulative and carry redeemable options with high exercise probability
- Convertible debt instruments maintain debt classification until conversion occurs, as interest payments remain fixed and mandatory
- Subordinated sponsor loans may qualify as quasi-equity when fully subordinated, interest-free, and repayable at company discretion
- Balance sheet adjustments include netting unprovided losses, provisions, dead investments, or loans with minimal recovery prospects
- Hidden reserves from undervalued assets not reflected in books may be recognized, though fixed asset revaluation surpluses are typically treated as illiquid unless from easily marketable assets'

- Revaluation surpluses from fixed or intangible assets are generally adjusted to determine the true leveraging levels.

Leverage Impact Analysis

Leverage enhances shareholder returns through financial magnification but simultaneously increases risk through higher fixed obligations. The assessment examines:

- Funding source analysis and associated costs
- Debt tenor alignment with financed assets
- Refinancing risk evaluation across the balance sheet
- Unencumbered asset ratios to determine additional borrowing capacity

Higher leverage levels generally increase risk profiles and require careful evaluation during rating analysis.

Profitability and Cost Structure Impact

Capital structure directly affects profitability through debt servicing costs. Unless offset by substantial gross margins, high debt service burdens negatively impact financial risk profiles. As capital structure risk increases, lenders typically demand higher compensation for their exposure, further pressuring profitability.

Access to Capital Under Stress

VIS evaluates companies' stressed capital access capabilities through several factors:

Market Experience and Options: Companies with diverse financial instrument experience and established debt/capital market relationships maintain multiple funding alternatives when specific sources become unavailable.

Market Limitations: Restricted domestic capital markets may prevent reasonable-rate access during normal periods or stress situations.

Operational Disruptions: Outstanding litigation can impair supplier and customer relationships, potentially restricting capital access temporarily.

Company Size and Financial Resilience

Large firms typically demonstrate substantial staying power, often benefiting from significant bank exposure levels that create reluctance to abandon relationships during stress periods. Small companies face greater vulnerability as committed credit facilities may be withdrawn more easily during challenging periods, regardless of previous commitments.

Investor Confidence Factor

Investor perception and confidence in company viability remains critical for maintaining capital access across all market conditions. This psychological element often determines funding availability during both normal operations and stress scenarios.

B. (ii) Profitability

Profitability Assessment and Sustainability Analysis

Sustained profitability combined with prudent earnings retention enables companies to attract external capital and navigate challenging business cycles effectively. VIS examines historical performance trends alongside current and anticipated market conditions to project future profitability trajectories, developing comprehensive assessments of whether profitability positions will remain stable, improve, or deteriorate over intermediate to long-term horizons.

Projected profitability levels undergo rigorous stress testing across multiple scenarios, including:

- Volume reductions and demand contractions
- Adverse input and output price movements
- Unfavorable exchange rate fluctuations for currency-exposed operations
- Increased financial cost burdens

Revenue Stability and Margin Enhancement

Sales stabilization and gross margin improvements typically occur as companies progress toward value-added operations, develop differentiated products or specialized market niches, achieve higher capacity utilization rates, and realize economies of scale benefits. Commodity-dependent sectors face dual risks from both pricing volatility and off-take uncertainty, as evidenced in sugar and cotton spinning industries. For companies with substantial export/import exposure or international price linkages, global supply and demand dynamics receive careful evaluation.

Profitability as Management and Asset Quality Indicator

A company's profitability performance ultimately reflects management effectiveness and underlying asset value. While absolute profitability levels remain important, the extent to which earnings translate into balance sheet strength through retained earnings carries greater significance in the rating assessment process. This earnings retention capacity demonstrates management's commitment to financial strengthening and provides the foundation for sustainable credit quality over time.

B.(iii) Cash Flow Generation

Primary Importance of Cash Flow Assessment

Cash flow analysis represents the most critical component among all credit rating factors. While profitability and cash flows typically demonstrate strong correlation, the ultimate determinant of creditworthiness is the free cash flow available for debt servicing, which enables companies to meet obligations on schedule. VIS examines current and projected debt levels alongside annual debt service requirements relative to generated cash flows to assess future risk profiles.

Multi-Level Cash Flow Evaluation

Funds Flow From Operations (FFO)

FFO analysis measures operational cash generation capacity against working capital needs, capital expenditure requirements, and debt servicing obligations. The assessment includes evaluating core revenue sensitivity to business cycles for determining cash flow forecast accuracy.

Cash Flow from Operations (CFFO)

CFFO analysis incorporates working capital fluctuation impacts and the resulting operational stress on cash generation. This metric provides insight into the company's ability to manage short-term liquidity pressures while maintaining operational effectiveness.

Free Cash Flow (FCF)

FCF evaluation assesses the company's capability to service both routine and strategic expenditures. Under going-concern assumptions, VIS evaluates internal fund generation capacity for asset modernization and maintenance, plus external funding accessibility for expansion initiatives.

Discretionary Cash Flow (DCF)

DCF analysis determines dividend-paying capacity and sustainability. Consistent dividend payment history builds investor confidence and encourages future capital contribution support. Companies demonstrating reliable dividend capacity typically maintain stronger access to external funding sources.

Core Analysis Objective

The fundamental purpose of cash flow analysis centers on determining operational fund generation sufficiency for debt service obligations and capital expenditure requirements. VIS emphasizes cash flow from operations levels and their relationship to outstanding debt positions, particularly debt service coverage ratios derived from operational cash flows.

Coverage Ratio Interpretation

High cash flow coverage ratios do not automatically indicate financial strength when resulting from reduced capital expenditure or declining debt levels. Such patterns may signal management complacency and could compromise future growth potential, requiring careful evaluation of underlying drivers.

Industry-Specific Cash Flow Characteristics

Cash flow predictability enables companies to pursue more aggressive capital structures without significantly compromising creditworthiness:

- **Oil and Gas Exploration Industry:** Cash flows depend heavily on proven reserve quantities entering production phases. Companies continuously invest substantial capital in exploration activities to build reserves. However, exploration success remains uncertain, creating volatile cash flow patterns that favor conservative debt leverage approaches.
- **Pharmaceutical Industry:** Demonstrates relatively stable demand characteristics resulting in predictable cash flow generation. This stability supports comparatively higher debt leverage capacity while maintaining acceptable credit risk profiles.

Strategic Capital Structure Alignment

Companies with stable and predictable cash flow patterns can implement more aggressive capital structures while preserving creditworthiness. The key lies in matching capital structure decisions with underlying cash flow characteristics and industry-specific operational dynamics.

B. (iv) Liquidity

Critical Importance of Liquidity

Liquidity represents a fundamental consideration in VIS ratings, as companies with strong balance sheets and competitive positions can still fail without adequate liquidity levels. Even the most financially sound enterprises require sufficient liquid resources to meet operational and financial obligations during both normal and stressed conditions.

Seasonal Industry Liquidity Patterns

Industries dependent on seasonal agricultural cycles, such as sugar and cotton spinning sectors, experience distinctive liquidity patterns. Debt leverage typically peaks during production seasons when seasonal borrowings finance inventory buildup, then declines as production cycles complete.

For such cyclical industries, VIS assesses both average liquidity positions throughout the cycle and maximum financial stress during peak production periods. Inventory marketability analysis becomes crucial—readily marketable products including sugar, wheat, raw cotton, petroleum products, diesel, and edible oils can be liquidated to generate emergency liquidity when needed.

Balance Sheet Liquidity Sources

Multiple balance sheet elements contribute to overall liquidity assessment:

- **Marketable Investments:** Securities and investments that can be readily liquidated without significant value loss provide immediate liquidity support.
- **Undrawn Credit Facilities:** Available but unutilized working capital lines offer contingent liquidity resources for operational needs.
- **Unencumbered Assets:** Assets free from collateral arrangements can more easily secure additional financing during stress periods, providing strategic liquidity flexibility.
- **Contingent Sources:** Any reliance on investment asset sales, external support arrangements, or future liquidity events receives appropriate consideration in the overall assessment.

Group Structure Liquidity Dynamics

Companies operating within business groups often access favorable borrowing terms through guarantees from stronger group entities. However, this relationship can work both ways—weaker group companies may require support from the rated entity. VIS evaluates prospective support burdens based on historical precedents and future commitment potential involving weaker associated companies, with findings appropriately reflected in rating assessments.

Entity Structure and Cyclicity Considerations

Liquidity assumes heightened importance for:

- **Cyclical Companies:** Greater exposure to business cycle volatility increases liquidity needs during downturns, making robust liquidity management essential for maintaining operations.
- **Sole Proprietorships:** These entities typically face weaker capital access compared to other corporate structures, making internal liquidity management more critical for business continuity.

Working Capital Cycle Analysis

The working capital cycle provides important liquidity insights through several key factors:

- **Trade Debtor Quality:** Assessment of customer creditworthiness and payment concentration risks that could impact cash collection timing.
- **Credit Terms Extended:** Analysis of payment terms offered to customers and their impact on cash conversion cycles.
- **Payment Track Record:** Historical collection performance evaluation, including impacts on overall cash cycle length.
- **Cash Cycle Implications:** A positive cash cycle often indicates strong market positioning where suppliers extend favorable terms while customers pay promptly, demonstrating competitive strength that VIS recognizes in rating assessments.

KEY RATIOS

CASH FLOW & COVERAGE RATIOS

- **Funds Flow from Operations (FFO):** profit before financial expenses and taxes + adjustment for impact of non-cash items – payment for financial expenses and taxes.
- **Cash Flow from Operations (CFFO):** FFO +/- changes in working capital requirements
- **Free Cash Flow (FCF):** CFFO – impact of capital expenditure undertaken and disposal of fixed assets
- **Discretionary Cash Flow (DCF):** FCF – dividends paid during the period
- **Debt Coverage Ratios:**
- $\text{FFO} / \text{Total Debt}$
- $\text{FFO} / \text{Long-term Debt}$
- **Debt Servicing Coverage Ratios:** $(\text{FFO} + \text{financial charges paid}) / (\text{Periodic principal repayment} + \text{financial charges paid})$

LIQUIDITY RATIOS

- **Current Ratio:** $\text{Current Assets} / \text{Current Liabilities}$
- **Net Working Capital:** $\text{Current Assets} - \text{Current Liabilities}$
- **Days to Sell Inventory:** $\text{Days of Raw Material Inventory Turnover} + \text{Days of WIP Inventory Turnover} + \text{Days of Finished Goods Inventory Turnover}$
- **Collection Period:** $(\text{Average Trade Debtors} / \text{Net Sales}) * 365$
- **Payable Cycle:** $[\text{Average Creditors} / (\text{Cost of Goods Manufactured} - \text{Depreciation \& Amortization})] * 365$
- **Net Cash Cycle:** $\text{Days to Sell Inventory} + \text{Collection Period} - \text{Payable Cycle}$

PROFITABILITY RATIOS

- Gross Margin: $\text{Gross Profit} / \text{Net Sales}$
- Cash Margin: $\text{Gross Profit} + \text{Depreciation \& Amortization} / \text{Net Sales}$
- Operating Profit Margin: $\text{Operating Profit} / \text{Net Sales}$
- Net Margin: $\text{Net Profit} / \text{Net Sales}$
- ROAA: $\text{Net Profit} / \text{Average Total Assets}$
- ROAE: $\text{Net Profit} / \text{Average Net Worth}$
- Effective Interest Rate: $\text{Financial Charges} / \text{Average Total Debt}$
- Effective Tax Rate: $\text{Taxation} / \text{Profit before Tax}$

CAPITALIZATION

- Gearing: $\text{Borrowings} / \text{Net Worth}$
- Debt Leverage: $\text{Total Liabilities} / \text{Net Worth}$

Note: VIS reserves the right to make appropriate adjustments to the above formulas, on a case-to-case basis, based on the results of our analysis to better reflect the rating rationale. Any such adjustments will be clearly defined.

RATING SUPPORT FACTORS

Entity ratings may be enhanced on the basis of the extent of support from sponsors / shareholders, associated companies, etc. VIS takes into account how important the company is to the group, the relative financial health of the group and any explicit or implicit support to the company being rated. VIS seeks to analyze the particular instances in which assistance was required by the company being rated and the degree of support provided by the sponsors in the past. Evaluation of the financial strength of the group then becomes important to give any benefit in credit ratings including its franchise value, access to funds and diversification element.

Any institution holding an external guarantee will be rated equivalent to the guarantor if the guarantee is explicit and provides full and timely coverage to obligations. However, in other cases where the guarantee is present but timeliness is not ensured, notching down from the guarantor is usually the practice. The ultimate sponsor / guarantor will be the government which is rated risk free or AAA where LCY rating is concerned. Details on government support are outlined in the 'Government Supported Entities' criteria.

In the event that a company / obligation is supported by two entities carrying independent credit risks, then the support provided is generally superior as compared to the situation in which only the stronger entity was supporting the company being rated. This concept arises from the viewpoint that the probability of both the supporting entities defaulting at the same time is lower than the probability of either one defaulting. Limited benefit of joint support is given to associated / group companies or companies in the same sector to ensure independent risk drivers.

Debt instruments may be notched from entity ratings on considerations of asset protection and ranking. For details on notching, please see 'Instrument Rating' criteria by VIS.

ESG FACTORS IN CREDIT RATINGS

Environmental, Social, and Governance (ESG) factors are increasingly becoming integral to credit rating methodologies as they can materially impact an issuer's creditworthiness and long-term financial stability. This integration reflects the growing recognition that traditional financial metrics alone may not capture all risks that could affect an entity's ability to service its debt obligations. Incorporating ESG enhances risk detection, improves stakeholder confidence, aligns with investor demand for sustainable finance, and fosters resilience in rated entities. This approach ensures credit opinions remain relevant in a rapidly evolving risk landscape.

Climate-related risks represent a significant component of environmental assessment, encompassing both physical risks from extreme weather events and transition risks from shifting to a low-carbon economy. These factors directly affect asset values, operational costs, and business continuity. Companies with high carbon intensity or significant exposure to climate risks may face credit rating downgrades as agencies anticipate increased compliance costs, asset impairments, or revenue volatility. For example, coal-fired power plants face stranded asset risks that can trigger multi-notch downgrades, while renewable energy companies may receive rating upgrades due to stable, long-term cash flows and regulatory support. Poor environmental practices that result in regulatory penalties or cleanup costs can negatively impact liquidity ratios and debt coverage metrics, directly influencing credit ratings.

Social considerations encompass labor relations, community impact, customer satisfaction, and supply chain management practices, with their assessment directly correlating to operational stability and financial performance. Companies experiencing significant labor disputes, product safety issues, or community opposition may face credit rating pressure due to potential revenue disruption, litigation costs, and reputational damage. Conversely, strong social performance often supports rating stability or improvement through enhanced customer loyalty, reduced regulatory scrutiny, and operational resilience. For instance, companies with poor product safety records may experience rating downgrades following major recalls or litigation settlements, while those with strong employee relations typically demonstrate lower operational risk and more predictable earnings.

Corporate governance quality represents perhaps the most established ESG component in credit analysis, with direct implications for credit ratings through its impact on strategic decision-making, risk management effectiveness, and financial reporting transparency. Weak governance structures frequently result in credit rating downgrades as agencies lose confidence in management's ability to navigate challenges and maintain financial discipline. Companies with governance failures, such as accounting irregularities or excessive executive compensation, often face immediate rating reviews and potential downgrades. Strong governance practices, including independent board oversight, transparent reporting, and effective risk management, typically support higher credit ratings by demonstrating management credibility and strategic consistency.

The integration of ESG factors into credit rating methodologies follows a materiality-based approach where these considerations directly influence traditional credit metrics and overall rating outcomes. The impact varies by sector, with utilities, mining, and manufacturing companies facing greater environmental scrutiny, while consumer-facing businesses experience heightened focus on social factors. This comprehensive approach enables VIS to better predict long-term credit performance by capturing emerging risks and opportunities that traditional financial analysis might overlook, ultimately resulting in more accurate and forward-looking credit assessments.

Incorporating ESG factors, the VIS Credit Ratings also reflect how entity's exposure to and management of environmental, social, and governance (ESG) risk factors may affect its long-term sustainability and long-term

competitiveness. In addition to evaluation of a company on key Environmental and Social risk factors, VIS ESG Ratings for entity take into consideration company's management measures relative to their aggregate ESG risks and opportunities. Management measures are generally evaluated through companies' governance structures, policies and targets, quantitative performance metrics, and relevant controversies. Detailed "ESG CORPORATE GOVERNANCE RATING METHODOLOGY", is available at our website on the following link, <https://docs.vis.com.pk/docs/ESGRatingMethodology.pdf>

THE RATING SCALE & HORIZON

Rating scale and Definitions may be accessed at (<https://docs.vis.com.pk/docs/VISRatingScales.pdf>)



NATIONAL EXCELLENCE

INTERNATIONAL REACH

Jahangir Kothari Parade (Lady Lloyd Pier) Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose generosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.

Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs). Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.

VIS Credit Rating Company Limited is committed to the protection of investors and offers a blend of local expertise and international experience to serve the domestic financial markets. With its international reach, VIS is positioned to aim for an international mark. In this regard, the global experience of our international affiliates and partners have been invaluable towards adding depth to our ongoing research endeavors, enriching us in ways, that enable us to deliver our responsibilities to the satisfaction of all investors. The edifice of the Jahangir Kothari Parade has stood proudly through the years and is a symbol of our heritage. Its 'Dome' as the most stable of building structures, exemplifies architectural perfection. Committed to excellence, VIS continues its endeavour to remain an emblem of trust.

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