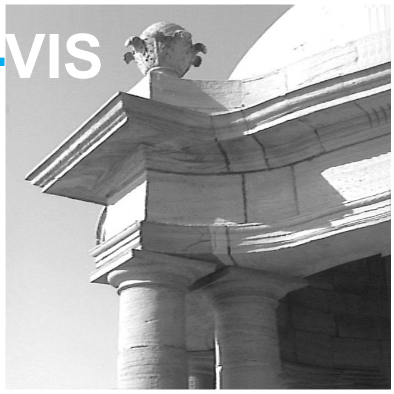
JCR-VIS



OFF-SHORE SECURITIZATION

Rating Methodology

INTRODUCTION

Securitization is a structured finance process whereby assets are transformed into securities – financial instruments that may be readily bought or sold. Securitization has evolved over the last few decades and potentially offers various advantages such as liquidity generation, diversification of funding sources, lower cost of capital, etc.

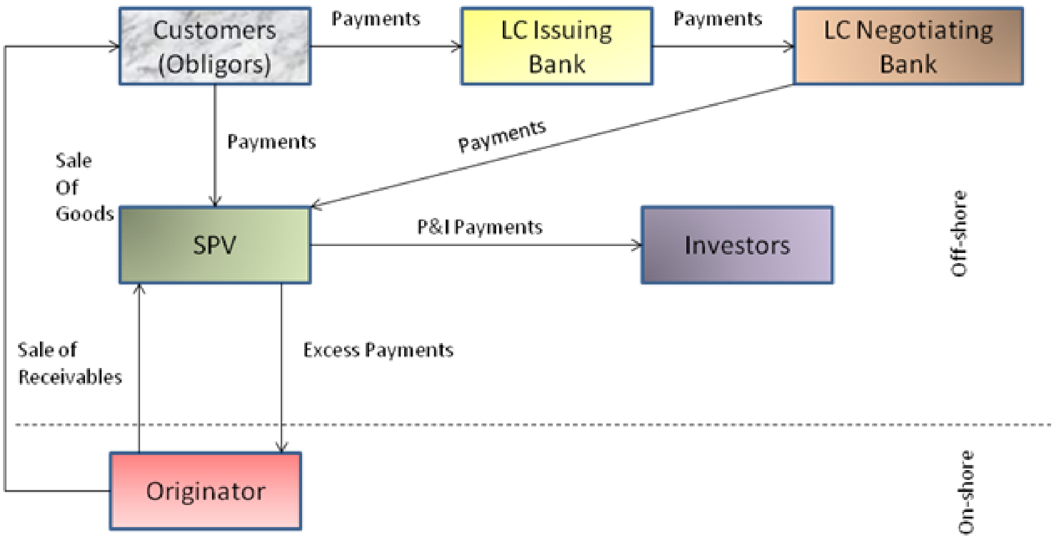
Furthermore, off-shore securitization can provide an attractive funding avenue to emerging/developing market issuers that intend to diversify financing avenues because these structures can facilitate cross border transactions and funding flow.

The main focus of this paper is to provide the basic architecture for securitization transactions and broadly, JCR-VIS' approach to rating these issues. Two distinct types of securitization transactions, discussed in this paper, are categorized as follows:

i. Off-shore Existing Trade Receivables Securitization

ii. Off-shore Future-Flow Securitization

Figure 1: Typical Securitization Transaction Flow



OFF-SHORE TRADE RECEIVABLES SECURITIZATION

Off-shore trade receivable securitizations are based on export generated receivables that may be denominated in USD or the currency of the specific country of export. These receivables are then assigned to an overseas Special Purpose Vehicle (SPV) that makes collections from the obligors. Off-shore trade receivable securitizations are backed by transactions already executed in the past and therefore there is no reliance on future performance of the entity. In view of this, it is possible that a speculative grade issuer may be able to raise funding through structures that may be rated in the investment grade.

There are, however, basic requirements of such issues like securitized trade receivables must be of a minimum critical level to justify an existing trade receivables securitization transaction. Moreover, the securitized trade receivables should be a given portion of the actual trade receivables, with sufficient downside cushion available against risk of default by customers.

As the receivables are generated off-shore, the transaction is automatically hedged against convertibility and transfer risks and more importantly exchange rate risk which means that the rating of the issue is not constrained by the country's Foreign Currency (FC) ceiling. Furthermore, in this case the obligors are also situated off-shore, where the receivables are being generated; this allows the issuer to mitigate the local macroeconomic and legal risks to an extent.

As depicted in the chart above, the existing trade receivables of the originator would be assigned to a SPV, which issues securities backed by such assigned receivables. Due to the short-term nature of trade receivables, typical pay down of such structures would occur over a short horizon. The maturity of the transaction can be extended by the use of a revolving period to make it more relevant to the needs of businesses and investors alike. In the revolving period, the collections received from receivables are used to pay interest only to the investors and the balance is used to purchase new receivables. However, longer maturities require assessing the sustainability of future receivable generation ability of the business. This may, however, not be a significant rating constraint as non-generation of receivables should trigger early amortization.

OFF-SHORE FUTURE FLOW SECURITIZATION

Off-shore future-flow securitizations are fundamentally structured in a similar fashion as existing trade receivables securitization, in that structured debt offerings that are originated by an SPV and secured by receivables due from selected international obligors. The basic difference lies in the fact that such obligations are secured by receivables to be generated in the future. A company can technically securitize any recurring source of income. Such a structure requires on-going assessment of an entity's ability to generate receivables.

The future receivables are generally sold directly or indirectly by the originating company to an off-shore trust or other issuing vehicle, which in turn issues a debt instrument. In addition, the obligors are directed to make payments directly to an off-shore collection account managed by a trustee. As the payments are made directly to the SPV, instead of the originator, transfer and convertibility risk created by the local sovereign may be limited, if not eliminated.

RATING THE TRANSACTION

As discussed above, in case of off-shore securitization transactions, future flow or existing trade receivables, the receivables are basically denominated in hard currencies that are generated abroad. These receivables automatically provide a natural hedge against the exchange rate, convertibility and transfer risks and are therefore not constrained by the Foreign Currency ceiling of the originator country. Also, as the receivables are generated off-shore and obligors are in other countries, those receivables are also, to a large extent, isolated (although not completely) from the macroeconomic and legal risks of the originating country. However, JCR-VIS believes that the transaction is still subject to a certain degree of sovereign expropriation and interference risk, in view of which, JCR-VIS believes that the transaction could attain ratings at a certain level above the sovereign FC rating, depending on transaction and sovereign specifics. The credit rating of the issue itself will be conducted by JCR-VIS' foreign partner whereas the originator will be rated by JCR-VIS.

Broadly, the differentiation in rating these transaction types stems from the fact that in a future flow securitization, ratings may invariably be linked to the credit quality of the originator. Originating companies face performance risk in future-flow securitizations because they must deliver a product or service before the creation of actual receivables and they must also continue to generate receivables even through periods of economic and/or political turmoil. Therefore, while convertibility and transfer risks are largely mitigated, as is the case in securitization of existing trade receivables, future flow securitizations are more closely related to the originating company's risk profile. The actual rating would depend on the type of goods or service generating the receivables, legal structure of the transaction and existing debt profile of the company.

In existing trade receivables securitization, the transaction rating is not linked to the underlying corporate's performance rating. Rating is decoupled from the originator's rating, and the underlying receivables characteristics and performance determine the rating.

Faheem Ahmad

President & CEO, JCR-VIS Credit Rating Company Limited
Founder, VIS Group
Chairman, Association of Credit Rating Agencies in Asia

Mr. Ahmad possesses 30+ years experience in financial risk assessment with focus on Islamic finance, venture capital and general management. He has top level management experience at international level in the fields of credit ratings, Islamic and conventional financial risk assessment modeling, industrial management and construction engineering. Mr. Ahmad is an active participant at international forums on Credit Ratings. He obtained his B.S in Civil Engineering from NED University of Engineering and Technology, Karachi. He also has Masters Degrees in Engineering and Business Administration from USA.

Sobia Maqbool, CFA – Group Head

Sobia has almost 10 years of professional experience in the field of credit ratings. As Group Head at JCR-VIS, she is in charge of a multi-jurisdiction team & supervising rating assignments across a diverse range of sectors, including corporate, sub-sovereigns & financial institutions. She also provides analytical support for international assignments conducted by Islamic International Rating Agency (IIRA) for sovereign ratings & Fiduciary ratings. Sobia is a Rating Committee member of both JCR-VIS & IIRA, which is a body that considers all rating actions.

Sobia has been actively involved in research activities & development of methodologies. She has developed analytical methodologies for various market segments such as Takaful, Public Finance, Non-banking Finance Companies, Mutual Funds, Bank Loan Ratings, among others. She also provided significant contribution to the development of Fiduciary Rating System, launched from the platform of IIRA. Sobia has spoken at both local & international forums & has been facilitating training courses in both Pakistan & abroad, in areas such as Corporate Credit Analysis, Bank Risk Analysis, Insurance Risk Analysis & Financial Management.

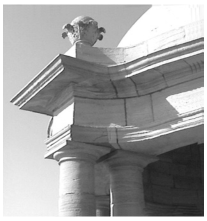
Mohammad Arsal Ayub – Assistant Manager

Arsal has been associated with JCR-VIS since mid-2013. During his tenure, he has worked on credit analysis of various industrial corporates, financial institutions and debt instruments. Arsal holds a Bachelors degree in Finance, Account & Management from the University of Nottingham.

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 genrosity 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.



Jahangir Kothari Parade

National Excellence, International Reach

JCR-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, JCR-VIS is positioned to aim for an international mark. In this regard, the global experience of our principal, Japan Credit Rating Agency, Ltd. has 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, JCR-VIS continues its endeavor to remain an emblem of trust.

JCR-VIS Credit Rating Company Limited

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