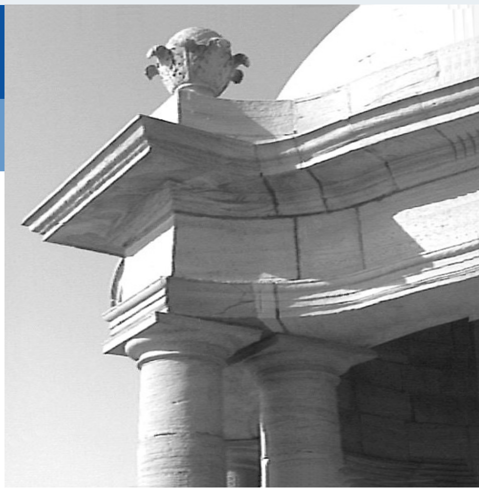


SMALL & MEDIUM ENTERPRISES

Rating Methodology

JCR-VIS Credit Rating Co Ltd. has updated its pioneering rating methodology for small medium enterprises (SMEs) in Pakistan. This pioneering effort puts JCR-VIS and Pakistan in the forefront of global research in the field of SME ratings. SME sector has grown substantially in Japan, India and Bangladesh. Some rating agencies have opted for purely quantitative approaches while others are taking into account qualitative aspects as well.

SCOPE OF METHODOLOGY

For the purpose of this methodology, JCR-VIS will classify organizations as SMEs using the same guidelines as notified by the State Bank of Pakistan in the Prudential Regulations for SMEs.

As per prudential regulations of Small Enterprise (SE), are classified as those with up to 50 Employees and Turnover up to Rs.150 million, while the Medium Enterprise (ME), are classified as those with Employees between 51-250 (Manufacturing & Services MEs), 51-100 (Trading MEs) and Turnover above Rs.150 million and up to Rs.800 million.

However, organizations currently meeting the SME guidelines but with definite plans in hand that would see them exit the SME category within the next one year would not be covered by this methodology. It should also be noted that this methodology only covers entity ratings of SMEs and does not apply to debt issuances by these SMEs.

JCR-VIS has developed the methodology for SMEs keeping in view the market demand for reliable independent credit opinions in the SME sector also, rather than only relying on the credit history of SMEs. At the same time, we are cognizant of the fact that the current level of costs of the rating exercise, as well as the detailed information and interaction requirements of a conventional corporate rating exercise would not be manageable for most SMEs.

The main challenge in developing a methodology for SMEs stemmed from the fact that the need was for a product that addressed the above-mentioned issues, i.e time and cost to the client, while still producing a highly reliable credit opinion.

After careful consideration, JCR-VIS has come to the conclusion that the relatively unsophisticated nature of business in most SMEs means that it would be possible to significantly increase the weight of historical financial indicators in the rating exercise. This departure from the scoring model traditionally used to arrive at corporate credit ratings would have a direct impact on the information requirements (for example, detailed financial projections would not be required),time required by analysts per assignment and therefore the associated costs.

RATING METHODOLOGY

The core rating methodology for SME ratings will remain the same as that used for JCR-VIS' corporate ratings, i.e the analysis of industry, business and financial risk, with the differences being more in the areas of emphasis and manner of execution. We are giving below a brief recap of the areas covered in a corporate rating exercise followed by a discussion on what variations in execution and areas of emphasis would be involved in SME ratings. The rating methodology of JCR-VIS is extensively supported by the in-house data bank of SMEs available from various resources and the analytical engine it has put in place to determine the reference ratings for SMEs.

Industry Risk

- Industry Characteristics (e.g. cyclicality, stage of product life cycle etc.)
- Industry financials (including local and global perspectives)

Business Risk

- Market Position
- Operating Efficiency
- Management Risk
- Regulatory Issues

Management & Governance Risk

- Legal Structure
- Management Track Record & Credibility
- Succession Planning
- Supervisory risk

Financial Risk

- Asset Size
- Earnings and Cash Flows
- Capital Structure
- Liquidity
- Coverages
- Payment history with lending banks.

Probably the biggest difference in the rating process would be seen in the level of interaction with the rated organization. Generally, JCRVIS' credit rating process is a highly interactive one, because while dealing with sophisticated business models our analysts want to ensure that they clearly understand the management's business plans and the relative risks attached to the various courses of action that the rated organization may opt between. The uncertainty attached to any future course of action is enhanced by the relatively longer rating horizon of three to five years for conventional medium to long-term ratings.

On the other hand, a substantial proportion of SMEs qualifying to be rated under this methodology would have comparatively simpler business models, along with a much shorter rating horizon of one year laid down by this methodology. Therefore, JCR-VIS will decide on a case-to-case basis on the level of client interaction required and its form. Initial visits to client premises, which form a key part of our corporate rating methodology will not be mandatory in the case of SME ratings. However, due to dearth of sources of information, direct interaction may be expected in cases where required with key suppliers, major customers and lenders of the rated SME, while being a rarity in corporate ratings.

In keeping with the abovementioned expected business profile of most SMEs, JCR-VIS is of the opinion that we will be able to arrive at a reasonably accurate financial risk profile of the rated organization simply through application of a quantitative model supported by limited quantitative inputs.

It would be pertinent to clarify here that the above mentioned changes are not meant in any way to produce a 'lower quality' credit opinion as compared to conventional issuer ratings and represent changes in the methodology solely based on the inherent characteristics of SMEs.

In addition to the above-mentioned changes, JCR-VIS adjusts weightage of various analytical aspects in order to ensure that they truly reflect the risk profile of the SME sector. Examples of areas where the weightage would be increased would be asset size, cash flows and liquidity.

Asset size, would also be a key determinant in arriving at the SME rating. While in the case of corporates, asset size is generally seen only as an indicator of whether a company has reached economic size (indeed too large an asset base may actually indicate uneconomic size), the possibility of diseconomies of scale in SMEs is very low due to the asset and turnover limits defined to qualify as an SME.

Apart from asset size extra emphasis will also be given to the area of liquidity, because access to capital of SME is generally not very strong and is expected to become even more constrained in times of stress. Therefore the company must have sufficient internal resources to be able to weather short-term pressures on cash flows. This change is also a factor of the rating horizon (liquidity also carries enhanced weightage while assigning short-term ratings using the corporate methodology).

The two key areas considered at the time of assessment of liquidity would be the level of the SME's cash and cash equivalents in relation to its debt and working capital management (based on an analysis of the net trade cycle and the liquidity index). Cash flows would also be analyzed, based on Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) related analysis, to develop an expectation of the SMEs ability to maintain liquidity levels over the rating horizon of JCR-VIS.

RATING HORIZON & SURVEILLANCE

The rating horizon of SME ratings is a maximum of 6 months from the date of issuance of the rating, provided that no major developments take place in the interim period that could have a material impact on the rated entities risk profile. SME ratings are a one-time exercise and are not kept under surveillance, keeping in view the expected unavailability of reliable interim data due to record keeping issues as well as to curtail costs associated with the rating exercise. However, ratings could be updated earlier if requested by the client.

DISSEMINATION

Rating dissemination of SME Ratings will not be through press releases as is the existing practice for all other kinds of ratings. However, a current rating list of publicly disclosed ratings will be maintained on our website, www.jcrvis.com.pk.

RATING SCALE & DEFINITIONS

As the horizon for SME ratings spans for a period of 6 months, JCR-VIS uses its Short term Issue/Issuer Rating Scale with a suffix (sme).

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and / or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

v

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

D

Defaulted obligations

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. He could be contacted at faheem@jcrvis.com.pk

Javed A. Callea
Advisor

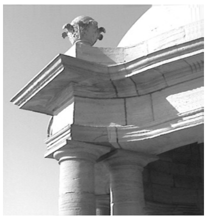
Mr. Callea is a professional in the financial sector with over 35 years of experience mostly in the financial institutions with certain exposure to service and infrastructure sectors in Pakistan. He has held the position of Chief Executive of a leasing company for 10 years. His core areas of expertise cover leasing, development financing, project management, investment & merchant banking, strategic investment management and real estate.

Major financial institutions he worked for include Pakistan Industrial Credit and Investment Corporation, State Life Insurance Corporation, Bankers Equity, Crescent Leasing Corporation and Saudi Pak Ind. & Agri. Inv. Company. He has also served as Member Finance of Water & Power Development Authority of Pakistan and as member of the Inquiry committee on stock exchange crises in 2000 commissioned by the SECP. He earned his MBA degree from the Institute of Business Administration in 1974.

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

Technical Partners Islamic International Rating Agency, Bahrain
JV Partner CRISL, Bangladesh
Member Association of Credit Rating Agencies in Asia

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