

Rating Methodology

INVESTMENT COMPANY

CRISL

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CREDIT RATING INFORMATION & SERVICES LIMITED

Nakshi Homes (4th & 5th Floor), 6/1A, Segunbagicha, Dhaka 1000, Bangladesh
Tel: 717 3700 - 1, Fax: 956 5783 Email: crisl@bdonline.com Web: www.crisibd.com

RATING METHODOLOGY

INVESTMENT COMPANY

CREDIT RATING PHILOSOPHY

CRISL follows structured rating methodologies for each sectors of the national economy and accordingly it has developed distinct methodology for investment companies. CRISL integrates analysis of an entity's recent financial and operating performance with an assessment of the firm's strategic plan. CRISL rating methodology for Investment Companies provides an analytical framework that focuses on the key operational, financial and qualitative factors. CRISL is critical in assessing the overall performance, competitive positioning and its ability to withstand challenging operating environment & portfolio concentration. CRISL rating methodology involves an in-depth analysis of several qualitative and quantitative factors. In CRISL view, the analysis of financial ratios alone (based on annual reports) would not be able to capture the entire business risks. While assigning the ratings, CRISL duly considers continuously changing factors to capture the structural changes and dynamics in the industry. For the rating of an Investment Company, CRISL also considers the revenue stream and its business operations.

CRISL RATINGS

CRISL Investment Company Ratings are the OPINIONS of CRISL on overall creditworthiness of Investment Company. CRISL's analytical framework looks at the external and internal factors that affect creditworthiness of the company and then the relationship between a parent and subsidiary/associate that ultimately affect the earning prospect. These opinions are arrived at after a systematic analysis of both quantitative and qualitative factors in the areas of the firm's operation. CRISL offers two types of ratings- Long Term and Short Term. Long term ratings are valid for maximum one year while short term rating carries a validity of maximum six months with standard minimum surveillance of six months on its expiry. Therefore, CRISL ratings are always to be read with time reference.

CRISL RATING PERSPECTIVE

Understanding the increasingly important role of ratings, consistent and uniform default definition is critical and it has significant impact on the reliability and comparability of ratings across rating agencies. A rigorous and transparent definition of default makes

the ratings assigned by a rating agency meaningful. Ratings can either indicate probability of default (PD) or Expected Loss (EL). The underlying principles guiding each of these approaches are not similar, and ratings that indicate probability of default are not directly comparable with ratings that indicate Expected Loss, especially at lower rating levels. Investors and market participants, thus, will compare only those ratings that are based on similar approaches, or make appropriate adjustments before comparison.

Considering the stage of development of rating environment in Bangladesh, CRISL adopted rating definition of "Probability of Default". Therefore, all CRISL ratings indicate the probability of default and not the EL that may arise after the default.

DEFINITION OF DEFAULT

CRISL adopted the international definition of default as being adopted by global rating agencies. Under the above definition, Default is:

- A) A missed installment (Principal and or Interest) which has not been discharged / paid as per schedule or within the grace period allowed by the regulators/ creditors.
- B) Failure to honor the corporate guarantee obligations as per contract or within the allowed grace period;
- C) The legal insolvency or bankruptcy of the issuer/ entity
- D) Restructuring of a financial obligation substantially disadvantageous to the creditors

SCOPE AND LIMITATIONS OF CRISL RATINGS

CRISL ratings are in local currency and therefore, it does not take into consideration the sovereign risks and foreign currency risk of Bangladesh Government. CRISL, being a domestic rating agency of Bangladesh, considers the government of Bangladesh as the highest pay master and all government guaranteed securities/ guarantees are considered as AAA.

RATING FRAMEWORK

CRISL's evaluation of Investment Company comprises an analysis of the following:

FINANCIAL PROFILE AND POLICIES

CRISL reviews the firm's overall financial profile and the policies it employs to maintain and grow its financial capacity. The assessment of financial fundamentals considers not only the current financial status of the company but also trends in earnings, including cash flow and profitability and asset quality. Certain financial ratios are often used in assessing investment management firms in addition to the evaluation of the entire financial profile of the institution.

The most important aspect of a firm's long-term creditworthiness is its ability to sustain profits. Consistent profitability provides not only steady and predictable cash flow to service debt requirements, but also forms capital to support growth. Profits have to cover operating expenses, debt service and credit losses, where financing operations exist, and they must also provide a source of capital for future growth. Strong and predictable earnings generate confidence among investors, which helps companies to secure continuous access to equity and to the debt market.

The principal areas of focus are in identifying the main sources of earnings, the sustainability of those earnings and the firm's cost structure. The current and cash component of those earnings are also assessed, as they may have impact on future liquidity. An investment management firm's earnings power is determined largely by the level and mix of assets held for trade, dividends from portfolio companies, and assets under management. With most revenues closely tied to the levels of assets held for sale and assets under management, profitability is sensitive to changes in market values and net sales. It is important to identify the proportion of pre-tax earnings derived from less-cyclical activities, such as fee income from management services, and their level in relation to fixed or total costs. The underlying assets that generate those earnings are also carefully assessed in terms of their quality. The qualities of those assets, particularly where principal assets are held for investment and trading, are analyzed to determine their nature, true value and marketability. It is important to ascertain the quality and quantity of its dividend income, the value and liquidity of assets held for sale, its revenue mix by assets under management and relevant growth projections, and

finally, the firm's track record. Any future projections should undergo sensitivity analysis to assess the likely impact by varying economic and market conditions.

MARKET RISK

Investment Company largely depends on the capital market for their short term investment. Therefore yield of an investment company is positively related with capital market scenario. Apart from these, the companies can also involve in capital market for long term investment though investment firms usually invest in subsidiaries and associates companies. Investment firm's investment opportunity as well as its return deviates according to the market scenario.

INVESTMENT RISK

CRISL evaluates the degree of diversification of the firm's investment opportunities. The breadth and diversification of a firm's investment contribute to the growth, reliability, and diversity of earnings. At the same time, the firm's portfolio mix influences the firm's profitability. In general, the more diversified the portfolio, the lower the risk profile. However, it is also important to assess whether diversification places undue stress on the company because of inadequate support structures, knowledge, experience or the absence of suitable market access in order to take full advantage of the expected benefits of that diversification.

POLITICAL/REGULATORY RISK

Investment companies invest in various industries and each industry abides by some rules and regulation for its operation. If there is any change in rules and regulation, it may have impact on investment opportunities and return on investment.

MANAGEMENT QUALITY & STRATEGY

As part of its assessment of management quality, CRISL looks at the organizational structure of the company, the extent to which departmental functions and responsibilities are clearly defined, and the relationship between the management team and the company's parent or shareholders. In addition, the company's strategy and investment decision-making process are analyzed along with its process for defining and implementing those strategies compared to its stated investment goals. The role of its internal support structures is an important factor for review, as is its risk management procedures and guidelines for both regulatory and internal compliance. Finally, governance issues are explored, including an assessment of how effective management is in resolving any conflicting pressures between shareholders and management. CRISL's framework involves reviewing the promoter's track record in terms of growth of the business, risk appetite, gearing policy, transparency in running the operations and their commitment and financial support to the business in distressful situation. Conservative business growth with no history of litigations or regulatory fines would be viewed favorably by CRISL over an aggressive business growth by compromising on the

business ethics. In CRISL's view, companies backed by strong institutions as a strategic investor are expected to derive higher comfort as compared with any other company which is backed by individual promoters. Success of any organization also depends, to a great extent, on the continuity of its business strategies and depth & stability in its management team.

PORTFOLIO ANALYSIS

As a measure of the portfolio quality of an investment, CRISL uses the concept of "portfolio scores". These scores are based on CRISL's estimates of risk and return associated with each exposure of the portfolio taking into account its maturity. To quantify the return on portfolio, CRISL uses its database of historical performance for various rating categories for various maturity buckets. At the outset, CRISL analyses the portfolio quality of the investment based on investment sectors. The portfolio return score is calculated by considering the weighted average return on investment of the portfolio and is compared against benchmark for various rating categories and ratings are assigned accordingly.

RETURN VOLATILITY

Investment Company's return depends on how it manages its portfolio. Efficient portfolio is yielded with higher return. However, in assigning rating, CRISL analyses the expected return and risk on the portfolio in which an investment company invests. Apart from these, to make uniformity between actual return and expected return it also analyzes the deviation of return by using sensitivity analysis through conservative approach in profit after tax calculation.

RISK MANAGEMENT & CONTROLS

An investment firm's risk appetite and its ability to control these risks are important rating considerations. CRISL assesses a company's ability to identify the various market risks that are inherent in its business, and to implement systems for reporting and managing those risks, particularly in terms of oversight and compliance.

There are various forms of risk that could impact the quality of a firm's assets and earnings. These include:

- (a) Interest risk for earnings sensitive to interest rate movements;
- (b) Credit risk for earnings that are sensitive to default;
- (c) Liquidity risk, where the absence of market liquidity could impair earnings;
- (d) Concentration risk stemming from non-diversified assets;
- (e) Extension risk associated with investments that have the potential for early pre-payment;
- (f) Derivatives risk, where speculative hedging is improperly used or understood;
- (g) Currency risk, where earnings and assets are exposed to unanticipated movements in foreign currency exchange.

(h) Contingent liability risk, where Investment Company is exposed to such risk for guarantee or the like

All these risks play an important role in the firm's ability to sustain its earnings flow, maintain its financial strength and, ultimately, to service its debt. How an investment company defines, measures, monitors and controls its risk is very important. CRISL examines the extent to which the company's risk management unit is truly independent from the trading or other revenue-producing areas of the firm as well as the effectiveness of the systems in place to manage those risks.

EARNINGS

Both trend analysis and industry comparison is conducted to determine the relative financial performance of the company. Revenue and cost structures are broken down into the separate business /product lines and contribution from different segments. Across time and industry comparison determines how well an investment company has been able to manage its risk relative to other players. Performance measures would include the pre-tax return on funds employed, volatility in revenues, efficiency and any over/under-performance relative to the broader market and the reason for such results. Performance is also evaluated relative to projections and reasons for deviations are explored further.

CRISL assesses the financial flexibility of the company. The ability of the company to rationalize costs in times of sluggish market conditions and spread fixed costs over a larger volume is critical. Costs per transaction would help indicate the flexibility in pricing available to the company. Larger companies would fare well in their ability to develop economies of scale.

SOLVENCY AND LIQUIDITY

Given the volatile nature of the capital market, an investment company needs to have an adequate level of capital to be placed with the exchange houses for margin requirement. For analyzing banker's adequacy of funds, CRISL evaluates the parameters like financial flexibility in the form of availability of various sources of funding, quality of capital, committed bank lines for alternative liquidity, average utilization of the capital placed with the exchange houses, collection period from the clients and capital needs of off-balance sheet transactions. The rating framework also evaluates capital adequacy for the current business operations and its ability to raise further funds for business expansion. In CRISL's view, strong capital levels provides necessary cushion in terms of absorbing any delay in collections from clients and losses during bad capital market. However, CRISL evaluates the company on the basis of free net worth available for the business after adjusting it for risky or ill-liquid investments. CRISL also considers the bank guarantees as a part of contingent obligations.

CRISL RATING SCALES AND DEFINITIONS

LONG TERM RATING-INVESTMENT COMPANY	
Rating	Definition
AAA Triple A (Highest Safety)	Investment Companies rated in this category are adjudged to be of best quality, offer highest safety and have highest credit quality. Risk factors are negligible and risk free, nearest to risk free Government bonds and securities. Changing economic circumstances are unlikely to have any serious impact on this category of Investment Companies.
AA+, AA, AA- (Double A) (High Safety)	Investment Companies rated in this category are adjudged to be of high quality, offer higher safety and have high credit quality. This level of rating indicates an entity with a sound credit profile and without significant problems. Risks are modest and may vary slightly from time to time because of economic conditions.
A+, A, A- Single A (Adequate Safety)	Investment Companies rated in this category are adjudged to offer adequate safety for timely repayment of financial obligations. This level of rating indicates an entity with an adequate credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.
BBB+, BBB, BBB- Triple B (Moderate Safety)	Investment Companies rated in this category are adjudged to offer moderate degree of safety for timely repayment of financial obligations. This level of rating indicates that an Investment Company is under-performing in some areas. These entities are however, considered to have the capability to overcome the above-mentioned limitations with special care and cautious operation. Risk factors are more variable in periods of economic stress than those rated in the higher categories.
BB+, BB, BB- Double B (Inadequate Safety)	Investment Companies rated in this category are adjudged to lack of key protection factors, which results in an inadequate safety. This level of rating indicates an Investment Company as below investment grade but deemed likely to meet obligations when due. Overall quality may move up or down frequently within this category.
B+, B, B- Single B (Risky)	Investment Companies rated in this category are adjudged to be with high risk. Timely repayment of financial obligations is impaired by serious problems which the entity is faced with. Whilst an entity rated in this category might be currently meeting obligations in time, continuance of this would depend upon favorable economic conditions or on some degree of external support.
CCC+, CCC, CCC- Triple C (Vulnerable)	Investment Companies rated in this category are adjudged to be with vulnerable protection factors. This rating indicates that the degree of certainty regarding timely payment of financial obligations is doubtful unless circumstances are favorable.
CC+, CC, CC- Double C (High Vulnerable)	Investment Companies rated in this category are adjudged to be with high vulnerable position. This rating indicates that the degree of certainty regarding timely payment of financial obligations is quite lower unless overall circumstances are favourable or there is possibility of high degree external support.
C (Near to Default)	Investment Companies rated in this category are adjudged to be with near to default in timely repayment of financial obligations. This type rating may be used to cover a situation where an insolvency petition has been filed or similar action has been taken, but payments on the obligation are being continued with high degree of external support.
D (Default)	Investment Companies rated in this category are adjudged to be either currently in default or expected to be in default. This level of rating indicates that the entities are unlikely to meet maturing financial obligations and calls for immediate external support of a high order.

Note: For long-term ratings, CRISL assigns + (Positive) sign to indicate that the issue is ranked at the upper-end of its generic rating category and - (Minus) sign to indicate that the issue is ranked at the bottom end of its generic rating category. Long-term ratings without any sign denote mid-levels of each group

SHORT TERM RATING – INVESTMENT COMPANY

ST-1	<p>Highest Grade</p> <p>Highest certainty of timely payment. Short-term liquidity including internal fund generation is very strong and access to alternative sources of funds is outstanding. Safety is almost like risk free Government short-term obligations.</p>
ST-2	<p>High Grade</p> <p>High certainty of timely payment. Liquidity factors are strong and supported by good fundamental protection factors. Risk factors are very small.</p>
ST-3	<p>Good Grade</p> <p>Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Although ongoing funding needs may enlarge total financing requirements, access to capital markets is good. Risk factors are small.</p>
ST-4	<p>Satisfactory Grade</p> <p>Satisfactory liquidity and other protection factors qualify issues as to investment grade. Risk factors are larger and subject to more variation.</p>
ST-5	<p>Non-Investment Grade</p> <p>Speculative investment characteristics. Liquidity is not sufficient to insure against disruption in debt service. Operating factors and market access may be subject to a high degree of variation.</p>
ST-6	<p>Default</p> <p>Entity failed to meet scheduled principal and/or interest payments.</p>