

ASSET BACKED SECURITIES (ABS)

RATING METHODOLOGY

**© COPYRIGHT AGUSTO & CO. LIMITED
ALL RIGHTS RESERVED**

The copyright of this document is reserved by Augusto & Co. Limited. No matter contained herein may be reproduced, duplicated or copied by any means whatsoever without the prior written consent of Augusto & Co. Limited. Action will be taken against companies or individuals who ignore this warning.

The circulation of this document is restricted to the subscriber to whom it has been addressed. Any unauthorised disclosure or use of the information contained herein is prohibited.

INTRODUCTION

An Agosto & Co. Asset Backed Security (ABS) Rating is an independent assessment of the creditworthiness of the asset backed security. We provide an objective opinion concerning the ability of the Issuer to meet its debt obligations in a timely manner. An Agosto & Co.'s rating is not an audit or an equity opinion but a forward-looking evaluation of the ability of the Issuer to meet its obligations as and when due. We are therefore not liable to any third party who relies on our opinion.

Our track record in providing independent ratings dates back to 1993 when we commenced risk rating on Nigerian banks. Initially, we rated all 129 banks in existence in Nigeria at that time on an unsolicited basis. In 1997, we discontinued our unsolicited ratings of banks and requested Nigerian banks to solicit an independent rating from Agosto & Co. Limited. From 1998, the scope of our rating expanded to include Discount Houses, Insurance Companies, Finance & Leasing Companies, Primary Mortgage Institutions, Asset Managers, Mutual Funds, Industrial Companies, Municipal bonds, Corporate bonds, and Financial Institution bonds.

Agusto & Co. ratings are acceptable locally and internationally. Subscribers to our rating publications include major international organisations such as International Finance Corporation, The World Bank, FMO Holland, HSBC, Standard Chartered Bank, Barclays Bank, Credit Suisse, US EXIM Bank, Bank of Japan, Reserve Bank of South Africa, European Investment Bank, Commonwealth Development Corporation, African Development bank, JP Morgan Chase, ING, BNP Paribas, Citigroup etc. as well as major reinsurance companies and insurance brokers such as Munich Re, Swiss Re, African Re, J. B. Borda, Alexander Forbes. This is in addition to all the Treasurers of Nigeria's major companies, as well as a diverse spectrum of local and foreign investors and Issuing Houses. Over the years, these institutions have relied on the high quality of our credit reports and our opinions to make important strategic decisions.

RATING OBJECTIVES

Our principal objectives in analyzing and rating an ABS are to:

- Assist the investors and other stakeholders to better understand the risk attributable to investing in the Asset backed security;
- contribute to the development of the financial markets by providing an independent risk assessment for the purpose of determining the pricing of financial instruments and;
- support the regulatory authorities in their objectiveness of achieving a sound financial system and the sustained confidence of investors in the system.

Each Rating Report contains:

- A review of the transaction structure and payment mechanisms including parties to the transaction, counterparties' creditworthiness, as well as strengths, weaknesses, and mitigating factors.

- An analysis of the underlying asset pool – The originator's sourcing process and underwriting standards, originator collection and monitoring methods, the pool characteristics, Eligibility Criteria and Collateral Description
- A Cash Flow analysis including stress test scenarios
- Analyst's comments on the Issuer's ability to meet its financial obligation
- A risk rating indicating the date of issuance and the expiry date

OUR METHODOLOGY

RATING PHILOSOPHY

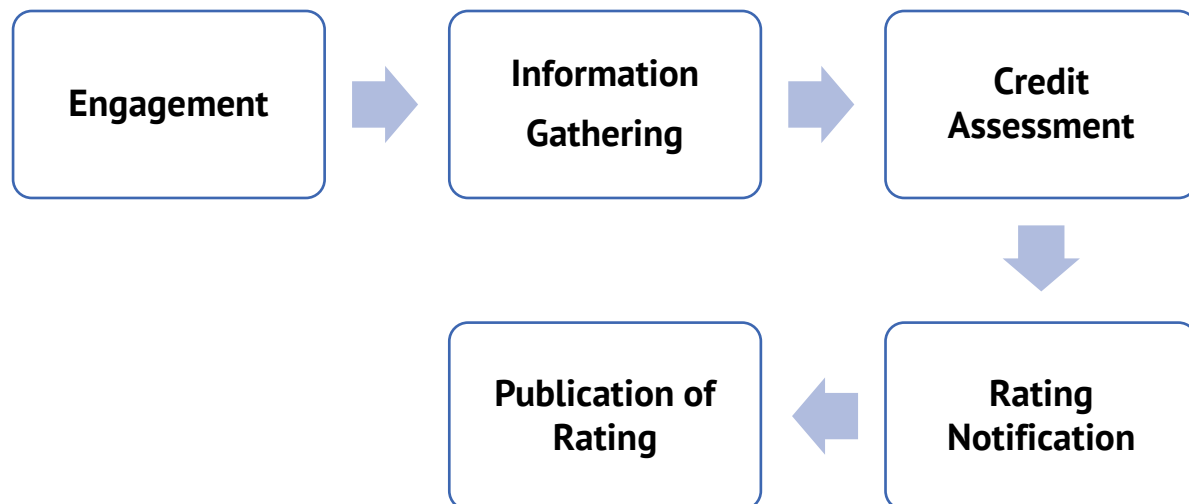
Our asset backed security ratings are based primarily on the current financials and other information provided to us by the Originator/Issuer and Servicer. This information will typically include background information on the originator, the Issuer's most recent audited financial statements and unaudited management accounts. We would also cover any other pertinent information that will enable us to obtain a fair picture of the likely performance of the underlying asset pool as well as assess the payment structure of the transaction and the adequacy and timing of the cash flow to sustain the interest and principal payments.

We however recognise that it is difficult to arrive at a meaningful rating without discussing with management and obtaining additional information that is not ordinarily available publicly. Therefore, we will seek additional information from management both historical and forward-looking, on issues, which are relevant for arriving at a fair rating for the asset backed security. We would also seek to understand the strategic factors that are likely to support future cash flow while identifying critical factors that may inhibit future cash flow.

We also recognise that changing circumstances may quickly invalidate a rating, which might have been previously valid. We will therefore review our ratings in instances where there are significant subsequent events, which may warrant a change in a previous rating. These reviews may not be based on published financial statements. Accordingly, we may rely on unaudited interim financial statements as well as other sources of information, which may or may not be publicly available for the purpose of a rating review. Therefore, a rating may be changed, suspended, or withdrawn at any time, due to changes in or unavailability of information, or other circumstances. However, such changes will be communicated to the Issuer.

All confidential information, which we obtain through this process, is used solely for the purpose of arriving at the rating and will not be published or otherwise disclosed to third parties without the prior consent of the company.

Figure. 1: Agusto & Co. Rating Process



RATING CRITERIA

To arrive at a rating, we consider both quantitative and qualitative criteria. There are the key areas which we review, including:

1. Macro-Economic and Industry Analysis

As an integral part of our macroeconomic analysis, we review macroeconomic trends over the most recent five years. We also review political issues and how they affect the economy. At the end of the analysis we:

- Prepare macro-economic projections over the next five years
- Explore alternative political scenarios
- Form an opinion on the economic outlook and its economic impact on the financial service industry as well as the mortgage and real estate sector.

Under the Industry Analysis, the key areas we review are:

- Size and strategic importance of the industry
- Regulations
- Industry characteristics
- Industry financial condition
- Key success factors
- Industry challenges and major risk areas
- Industry Outlook

At the end of our industry analysis we:

- note industry trends over the past five years
- prepare financial projections of the performance of the industry
- form an opinion over the performance of the industry over the medium term

2. Originator Analysis

Company and Management

The originator's ability and appetite for risk determines the quality of its assets and by extension, the securitized asset pool. A comprehensive review will thus be carried out of the originator's management and governance capabilities including:

- Character
- Qualification and Experience
- Breadth

Asset Quality

- Size of the originator's total loan portfolio
- Loan administration and appraisal processes
- Quality of obligors
- Geographical, Sectoral and obligor concentration
- Volume and trend of classified assets and recoveries
- Loss mitigation strategies
- Charge off process
- Collection strategies
- Repossession rates
- Foreclosure process

3. Issuer Analysis

Company and Management

Our review of the issuer's structure seeks to determine its ability to exercise timely and organized control over the activities involved in the performance of its obligations. We also carry out a thorough assessment of the issuer's governance structure, adequacy of staffing and the ability of the institution to retain its staff and ensure staff productivity. These include

- Character
- Qualification and Experience
- Breadth

Risk Management Systems

The rating examines the Issuer's risk management structure i.e. the practices and processes adopted by the Issuer to manage its business risks. This includes tools and processes used to assess and monitor the risks in its portfolio of securitized assets.

- Existence & strength of risk management
- Adequacy of risk management framework
- Portfolio size and composition
- Monitoring methods
- Collection mechanisms and strategies
- Loss mitigation strategies
- Charge off process
- Repossession rates
- Foreclosure process
- Internal Controls

4. The Issue/Asset Pool

Asset Pool Features

Agusto and Co. will carry out an in depth analysis of the securitized asset to determine any risks arising from the default on any of the assets/obligors which may potentially impair cash flows. The characteristics of the originator's asset portfolio are a direct reflection of the probability of default. Delinquency rates in the originator's portfolio are also benchmarked against that of the asset pool.

- Size of the pool
- Asset type
- Asset Classification
- Geographical, obligor, sectoral concentration
- Quality of Obligors
- Borrowers Profile
- Level of overdue loans
- Loan seasoning
- Quality of collateral
- Loan to value ratio
- Original Tenure
- Debt yield ratio
- Debt service coverage ratio
- Debt service coverage ratio stressed
- Asset pool versus Actual portfolio comparison

Transaction Structure

The transaction structure is analyzed to determine the structural features built into the transaction to highlight any inherent risks as it pertains to payments/debt service. We are particularly interested in the sustainability and adequacy of cash flows. Our ratios are thus analyzed based on projections. Agusto & Co. places significant emphasis on the issuer's liquidity policies and contingency plans to determine any risks arising from the default on any of the assets:

- Counterparties to the transaction including Servicer
- Payment structure
- Payment channels
- Adequacy and timing of cash flows
- Stressed timing and adequacy of cash flows Interest rates
- Credit Enhancement structures
- Liquidity support

Legal Issues

- Bankruptcy remoteness
- True sale
- Trust deeds
- Legal agreements
- Guarantees
- Legal assessments and Opinions

In addition to these factors, we may also use the following criteria to upgrade or downgrade the rating.

Management/Investor conflict

An ABS will be downgraded if there is open conflict between members of management of the Originator/ Issuer and/or investors and we believe that this may have (or has had) an adverse effect on the ABS financial condition.

Significant changes in ownership

Where there have been significant changes in ownership or management of Originator/ Issuer and these have created uncertainty, we may downgrade the Asset backed security until the outlook becomes clearer.

Significant changes in the nature of business

Where an Originator / Issuer changes its line(s) of business such that it has moved into areas where it does not have experience and a track record, we will downgrade such ABS unless we are satisfied that its risk profile has not altered materially.

Security characteristics

Existence of arms-length or related party guarantees (e.g. a bank, a parent company or an overseas affiliate) or stand-by credit facilities to support the company in the event of cash flow difficulties may provide additional comfort regarding payment at maturity. Accordingly, we may upgrade obligors that possess these characteristics in spite of fundamental weaknesses in the basic repayment capacity of the company.


Other factors

A rating is an opinion of the quality of risk attributable to the repayment capacity of a particular Issuer in the short term. These are affected by a variety of factors which no one can fully predict at a particular point in time. Accordingly, where any issues come to our notice that we believe will significantly affect the short-term repayment capacity of the Originator/Issuer, we will take such factors into account in arriving at a final rating or reviewing an existing rating.

Rating Definitions

Agusto & Co. rating categories conform to internationally recognizable designations for rating categories. A comparison of our rating category is shown below.

Agusto & Co. Ratings	S & P Equivalent	Moody's Equivalent	Fitch Equivalent
Aaa	AAA	Aaa	AAA
Aa	AA	Aa	AA
A	A	A	A
Bbb	BBB	Baa	BBB
Bb	BB	Ba	BB
B	B	B	B
C	C	Caa, C	C
D	D		D



Aaa

Securities rated 'Aaa' are judged to offer highest safety of timely payment of interest and principal. Though the circumstances providing this degree of safety are likely to change, such changes as can be envisaged are most unlikely to affect adversely the fundamentally strong position of such issues.

Aa

Securities rated 'Aa' are judged to offer high safety of timely payment of interest and principal. They differ in safety from 'Aaa' issues only marginally.

A

Securities rated 'A' are judged to offer adequate safety of timely payment of interest and principal; however, changes in circumstances can adversely affect such issues more than those in the higher rated categories.

Bbb

Securities rated 'Bbb' are judged to offer sufficient safety of timely payment of interest and principal for the present; however, changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal than for debentures in higher rated categories.

Bb

Securities rated 'Bb' are judged to carry inadequate safety of timely payment of interest and principal; while they are less susceptible to default than other speculative grade debentures in the immediate future, the uncertainties that the issuer faces could lead to inadequate capacity to make timely interest and principal payments.

B

Securities rated 'B' are judged to have greater susceptibility to default; while currently interest and principal payments are met, adverse business or economic conditions would lead to lack of ability or willingness to pay interest or principal.

C

Securities rated 'C' are judged to have factors present that make them vulnerable to default; timely payment of interest and principal is possible only if favourable circumstances continue.

D

Securities rated 'D' are in default and in arrears of interest or principal payments or are expected to default on maturity. Such bonds are extremely speculative and returns from these bonds may be realized only on reorganisation or liquidation.

Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from Aa to C to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign. We also assign a suffix of "sf" to denote it is a Structured Finance Rating.