



Credit Rating Information and Services Limited

Credit Rating Methodology – Small and Medium Enterprise (SME)

Concept of Credit Rating

CRISL defines credit rating as a measure of assessing the relative risk of default and the severity of default associated with a particular securities issue, issuer and/or other financial assets. It is a symbolic indication of the current opinion of the relative capability of timely servicing of the debts and obligations as per the terms of the contract. It is an independent, impartial best judged professional OPINION on the ABILITY and WILLINGNESS of a borrower to discharge its debt when due, in case of a debt instrument and assessment of net worth, external liability and earning prospects in case of a corporate Entity.

Rating agencies are perceived as impartial, professional and best-judged opinion-giving agencies in the investment process to safeguard the interest of the general investors. The rating reflects neutral and influences free professional opinion on the assessment of credit risk associated with an instrument or a corporate. The rating services provide a guideline to the investors as to the degree of certainty of payment of principal and interest in the case of the debt instrument and the degree of acceptability of the net worth and earning prospects of an entity seeking public finance.

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 ratings that indicate the probability of default. Therefore all CRISL ratings indicate the probability of default and not the EL that may arise after the default.

Scope and Limitation of Credit Rating

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

The SME ratings cover those entities which are ideally not any limited companies but rather business entities operating under sole proprietorship or partnership. However, private limited companies operating on a small scale within the range of definition by the regulator may be included in the SME rating periphery of CRISL.

The SME Credit rating report are prepared based on an audited report/ management report along with information provided by the sponsors and responsible persons of the concerned bank(s)/NBFCs regarding related documentation, procurement process, revenue, operational and financial expenses along with

related margin, risk and its hedging policy, prospect and business strategy of the entity. Since the SME-supplied financial statements carry minimum information in general, CRISL collects and collates information through physical verification and interviews key management officials of the enterprise. In the absence of any structured financial information, CRISL applies its techniques, analysts' judgment and assumption to cross-check the data supplied to draw meaningful conclusions. In the absence of a physical site visit, in some cases, CRISL conducts off-site interviews of core management personnel and concerned officials of the lending bank(s) to assess the loan repayment status and history as well as the current operational status and prospects of the enterprise. With the above, CRISL duly factors industry information along with peer group comparison of the same business.

Time Horizon

CRISL ratings are forward-looking and sustainable throughout the normal business cycle. CRISL issues normally two types of ratings – short-term and long-term. Short-term rating carries a validity of six months while a long-term rating is valid for one year. The change in the economic scenario, complexities and change in government policy may have an impact on the ratings assigned over some time. CRISL updates the rating periodically with the cooperation of the client. If the client is not willing to cooperate, CRISL withdraws the rating after due notice to the client. Therefore, the CRISL rating is to be read with time.

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) A distress exchange in which the bondholders/ creditors are offered a substitute instrument with inferior terms and conditions
- E) Restructuring of a financial obligation substantially disadvantageous to the creditors;

CRISL Rating Scale

From an entity point of view, most of the Small and Medium enterprises are not incorporated as companies under the Companies Act and operate as sole proprietorship enterprises, partnership enterprises, associations or joint ventures. However, with the above status, these Enterprises are enjoying various funded and non-funded financial facilities from the bank and non-banking financial institutions as an enterprise with valid Trade licenses, specific permission from local authorities, certification of trade bodies or other recognized authorities. The central bank has been encouraging the banks to extend financial support to small and medium enterprises, given its contribution to the national economy. CRISL

Small and Medium Enterprise rating scales have been made different from corporate rating scales to depict a clear distinction between its operations from traditional corporate entities. Considering the nature of finance CRISL offers only long-term ratings. For long-term SME Rating, CRISL uses a rating scale with the prefix “CRISL –Me” for medium enterprises and “CRISL-Se” for small, cottage and micro enterprises. The loan facilities/ exposures are enjoyed by those enterprises with the prefix ‘blr’ like the bank facilities being enjoyed by the corporate or any other organizations.

Industry Structure

CRISL recognizes the SMEs in accordance with the definition of National Industrial Policy, 2022 and the definition approved by the Bangladesh Bank’s SME and Special Programs Department or any changes thereof made from time to time. As per definition, SMEs are categorized into three broad areas: manufacturing, service and trading. The recognition criteria of Bangladesh Bank for small and medium enterprises are fixed assets (excluding land and building), number of workforce, loan limit and turnover.

Rating Methodology

The SME Rating framework is built upon two fundamental aspects of credit analysis. The first is the analysis of qualitative factors and the second is the analysis of quantitative factors. Since the SME-supplied financial statements carry minimum information in general, CRISL designs its methodology with significant weight in qualitative factors accordingly. All the factors considered by CRISL in rating may be clustered into five broad analytical risk blocks- Financial Risk, Industry Risk/Business Risk, Management Risk, Loan or Borrowing Performance, and Security Risk. Due to such an unstructured form of information as well as the weak recording system of SMEs, CRISL has developed its structured format for information collection covering the aforementioned areas of concentration. The financial position (i.e. Balance Sheet and Income Statement and Cash flow Statement) may either be collected as per an audited report or the assessment team justifies the information provided as per their reporting format that may be in the form of management reporting signed by the sponsors/promoters. The analytical rigor may differ among the SMEs due to their operational nature; however, major categorization will be in line with the definition of Bangladesh Bank. CRISL tries to convert the qualitative factors to quantitative which ultimately assist CRISL in back testing of its methodologies. To arrive at a meaningful assessment the financial statements are reshaped frequently to make the ratios and analytical factors meaningful in line with the time horizon.

INDUSTRY RISK:

SMEs are not confined to any single industry; rather, they operate across a wide range of economic sectors, serving as linkages and providing essential support through both products and services. As such, industry-specific risks may influence the performance of related SMEs. Accordingly, CRISL considers factors such as diversification scope, industry size, supply-demand gap, government policy stance, product characteristics, social relevance, and entry and exit barriers while assessing SMEs.

BUSINESS RISK:

Business risk arises primarily from changes in market conditions and operational infrastructure. In evaluating business risk, CRISL examines the sustainability of an enterprise within a dynamic market environment. Due to their relatively small scale of operations, SMEs exhibit diverse business models—such as manufacturing and marketing within a specific geographic area, providing support services to large-scale industries, trading goods through imports or local sourcing, or operating at an agro-based level.

CRISL reviews the relevant infrastructure of each client and benchmarks its standing against peers. As most SMEs function as backward linkages to the formal sector, they generally have little control over pricing and remain highly dependent on market forces. Moreover, competition is intense owing to the large number of enterprises engaged in similar businesses.

Accordingly, factors such as business size, longevity, growth relative to the industry, competitive landscape, customer base, track record, supplier relationships, business networks, and infrastructural adequacy are critical in determining an enterprise's market position. CRISL also considers additional aspects, including franchise or dealership arrangements, business outlook, level of technology adoption, and quality of services. To evaluate these parameters, CRISL conducts site visits, meets with suppliers and customers to assess relationships, and engages with promoters to understand their business plans and growth strategies.

For new SME projects, CRISL applies the same core considerations as in project finance, albeit on a smaller scale. Key parameters include project viability in light of market conditions, estimated project cost, risk of cost overruns, implementation schedule, sponsor competence, projected cash flows, project location, and availability of skilled manpower. The evaluation of these factors is essential in the rating framework for both new projects and business expansion initiatives.

MANAGEMENT RISK:

Management plays a decisive role in determining the success or failure of an enterprise. To evaluate managerial capability, CRISL examines the management team's track record, past successes and failures, strategic vision, credibility, and leadership style with regard to transparency, teamwork, delegation of authority, and succession planning. Although the assessment is largely subjective, CRISL also incorporates objective indicators wherever possible.

In practice, most SMEs are managed by one or two promoters—often family members or individuals from the same community—rather than by professional managers as in larger corporates. Consequently, enterprise performance depends heavily on the promoters' personal experience and expertise. A significant number of promoters lack formal education and are engaged in business through inheritance.

CRISL also considers the capacity of support staff in ensuring smooth business operations. Workplace conditions and the quality of employer–employee relationships are important factors in this regard. Any inefficiency in management that could lead to business failure is closely reviewed.

While lenders typically maintain strong oversight over SME borrowers, repayment willingness remains a critical factor alongside repayment ability, and this is reflected in the promoter's financial track record. In

addition, CRISL evaluates the promoters' involvement in other ventures, industry experience, succession planning, and compliance with tax obligations such as income tax and VAT.

The overall assessment of management quality is further validated through direct interviews with the promoters, management team, and key support staff.

FINANCIAL SECURITY RISK:

Although security against a loan primarily comes into play after default and influences recovery ratings, it also significantly affects a borrower's repayment behaviour during the loan tenure. In view of this, CRISL places particular emphasis on the nature and quality of collateral offered against SME loans, the extent of security coverage, and the enforceability of legal rights over such security.

In the rating evaluation process, CRISL considers various forms of loan coverage, including fixed deposit receipts (FDRs), hypothecation, guarantees, collateral, and third-party guarantees, among others.

LOAN OR BORROWING PERFORMANCE:

The review of loan and facility performance is a key consideration in the SME rating process. For this purpose, the analyst team visits the respective bank branch and engages with banking professionals to gather information on loan repayment history, reasons for payment delays, utilization of sanctioned limits, and personal deposits of the borrower.

CRISL evaluates the current loan status—whether classified or unclassified—along with the history of rescheduling or restructuring, repayment regularity, compliance with loan covenants, and overall consistency in financial dealings.

FINANCIAL RISK:

As noted earlier, SMEs are generally organized as sole proprietorships, partnerships, or—less commonly—private limited companies. Entities incorporated as companies are legally required to prepare audited financial statements annually. However, in practice, such statements often fail to present an accurate picture of the business, largely due to tax-related considerations. Moreover, the disclosures are typically too limited to draw reliable conclusions.

To address this gap, CRISL provides each rated client with a structured format to report key financial information, including financial position, working capital utilization, and cash flow movement. Bank transaction statements are also considered an important supplementary source for validating and assessing business volume. In line with these factors, CRISL assigns moderate weight to financial risk within its SME rating methodology. Financial risk is assessed under three broad categories: Leverage and Coverage, Business Performance and Profitability, and Liquidity and Fund Flow Analysis.

Under the Leverage and Coverage category, CRISL evaluates indicators such as debt-to-equity ratio, debt-to-total assets ratio, interest coverage ratio, debt service coverage ratio, the promoter's business and personal net worth, and the overall equity development trend.

Under Business Performance and Profitability, CRISL evaluates key indicators such as Return on Average Assets (ROAA), Return on Average Equity (ROAE), Operating Profit Margin (OPM), and Net Profit Margin (NPM), among others.

For Liquidity and Fund Flow Analysis, the focus is on the adequacy of funding sources to meet obligations over the next 12–24 months. The liquidity profile is assessed using measures such as the Current Ratio, Quick Ratio, Cash Conversion Cycle, utilization of sanctioned loan limits during the year, and trends in operating cash flows.

CRISL's assessment teams are responsible for forming an opinion on the entity's debt repayment capacity based on cash flow analysis. Particular emphasis is placed on future cash flow projections in relation to debt obligations. The entity's financial flexibility is also reviewed, with special attention given to its banking relationships and ability to mobilize additional funds when required.

In addition, CRISL considers the likelihood of financial support from sponsors in times of distress. For sole proprietorships and partnerships, the personal assets of the sponsor(s) are also assessed as part of the financial risk evaluation.

OTHER FACTORS:

Besides the above broad areas, CRISL also evaluates several supplementary parameters on a case-by-case basis. These include the impact of government subsidies or taxation, funding flexibility, legal and environmental issues, sudden business disruptions, risks arising from non-insurance or inadequate insurance coverage of assets, extraordinary or windfall gains and losses, as well as the implications of new monetary or fiscal policies or other significant developments within the industry.

BANK LOAN RATING

CRISL assigns Bank Loan/Facilities Ratings (BLR) to evaluate an entity's credit exposure. In cases where certain key information is unavailable, CRISL may not be able to assign a full entity rating. Instead, the assessment is limited to factors directly affecting the entity's loan repayment capacity, credit profile reliability, and associated risk factors.

RATING VALIDITY

CRISL's rating of the SMEs is valid for one year from the date of the rating assigned. However, CRISL keeps the rating under surveillance with half yearly assessment during the validity period and the rating needs renewal every year to keep the rating updated.

**CRISL SME RATING SCALE AND DEFINITION
LONG TERM RATING FOR MEDIUM ENTERPRISE**

<p align="center"><i>CRISL Me-1</i> (Highest Safety)</p>	<p>Highest Investment Grade Medium Enterprise rated in this category is 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 entities.</p>
<p align="center"><i>CRISL Me-2</i> (Higher Safety)</p>	<p>High Investment grade Medium Enterprise rated in this category is adjudged to be of high quality, offer higher safety and have high credit quality. This level of rating indicates a 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.</p>
<p align="center"><i>CRISL Me-3</i> (Adequate Safety)</p>	<p>Investment Grade Medium Enterprise rated in this category is adjudged to offer adequate safety for timely repayment of financial obligations. This level of rating indicates an enterprise with an adequate credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.</p>
<p align="center"><i>CRISL Me-4</i> (Moderate Safety)</p>	<p>Medium Enterprise rated in this category is adjudged to offer moderate degree of safety for timely repayment of financial obligations. This level of rating indicates that an enterprise may also have some under-performing areas due to economic, financial or operational environment. Risk factors are more variable in periods of economic stress than those rated in the higher categories. These Enterprises are however considered to have the capability to overcome the above-mentioned limitations.</p>
<p align="center"><i>CRISL Me-5</i> (Inadequate Safety)</p>	<p>Speculative Grade Medium Enterprise rated in this category is adjudged to lack key protection factors, which results in an inadequate safety. This level of rating indicates an Enterprise as below investment grade but deemed likely to meet obligations when due. Overall quality may move up or down frequently within this category.</p>
<p align="center"><i>CRISL Me-6</i> (Risky)</p>	<p>Medium Enterprise rated in this category is adjudged to be with high risk. Timely repayment of financial obligations is impaired by serious problems, which the SME is faced with. Whilst an Enterprise 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.</p>
<p align="center"><i>CRISL Me-7</i> (Vulnerable)</p>	<p>Non-Investment grade Medium Enterprise rated in this category is adjudged to be vulnerable and might fail to meet its repayments frequently or it may currently meeting obligations in time through creating external liabilities. Continuance of this would depend upon favorable economic conditions or on some degree of external support.</p>
<p align="center"><i>CRISL Me-8</i> (Highly Vulnerable)</p>	<p>Medium Enterprise rated in this category is adjudged to be very highly vulnerable. Entities might not have required financial flexibility to continue meeting obligations; however, continuance of timely repayment is subject to external support.</p>
<p align="center"><i>CRISL Me-9</i> (Extremely Vulnerable)</p>	<p>Medium Enterprise rated in this category is adjudged to be extremely speculative in timely repayment of financial obligations. This level of rating indicates Enterprise with very serious problems and unless external support is provided, they would be unable to meet financial obligations.</p>
<p align="center"><i>CRISL Me-10</i> (Default)</p>	<p>Default Grade Medium Enterprise rated in this category is adjudged to be either already in default or expected to be in default.</p>

**CRISL SME RATING SCALE AND DEFINITION
LONG TERM RATING FOR SMALL ENTERPRISE**

<p align="center"><i>CRISL Se-1</i> (Highest Safety)</p>	<p>Highest Investment Grade Small Enterprise rated in this category is 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 entities.</p>
<p align="center"><i>CRISL Se-2</i> (Higher Safety)</p>	<p>High Investment grade Small Enterprise rated in this category is adjudged to be of high quality, offer higher safety and have high credit quality. This level of rating indicates a 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.</p>
<p align="center"><i>CRISL Se-3</i> (Adequate Safety)</p>	<p>Investment Grade Small Enterprise rated in this category is adjudged to offer adequate safety for timely repayment of financial obligations. This level of rating indicates an enterprise with an adequate credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.</p>
<p align="center"><i>CRISL Se-4</i> (Moderate Safety)</p>	<p>Small Enterprise rated in this category is adjudged to offer moderate degree of safety for timely repayment of financial obligations. This level of rating indicates that an enterprise may also have some under-performing areas due to economic, financial or operational environment. Risk factors are more variable in periods of economic stress than those rated in the higher categories. These Enterprises are however considered to have the capability to overcome the above-mentioned limitations.</p>
<p align="center"><i>CRISL Se-5</i> (Inadequate Safety)</p>	<p>Speculative Grade Small Enterprise rated in this category is adjudged to lack key protection factors, which results in an inadequate safety. This level of rating indicates an Enterprise as below investment grade but deemed likely to meet obligations when due. Overall quality may move up or down frequently within this category.</p>
<p align="center"><i>CRISL Se-6</i> (Risky)</p>	<p>Small Enterprise rated in this category is adjudged to be with high risk. Timely repayment of financial obligations is impaired by serious problems, which the SME is faced with. Whilst an Enterprise 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.</p>
<p align="center"><i>CRISL Se-7</i> (Vulnerable)</p>	<p>Non-Investment grade Small Enterprise rated in this category is adjudged to be vulnerable and might fail to meet its repayments frequently or it may currently meeting obligations in time through creating external liabilities. Continuance of this would depend upon favorable economic conditions or on some degree of external support.</p>
<p align="center"><i>CRISL Se-8</i> (Highly Vulnerable)</p>	<p>Small Enterprise rated in this category is adjudged to be very highly vulnerable. Entities might not have required financial flexibility to continue meeting obligations; however, continuance of timely repayment is subject to external support.</p>
<p align="center"><i>CRISL Se-9</i> (Extremely Vulnerable)</p>	<p>Small Enterprise rated in this category is adjudged to be extremely speculative in timely repayment of financial obligations. This level of rating indicates Enterprise with very serious problems and unless external support is provided, they would be unable to meet financial obligations.</p>
<p align="center"><i>CRISL Se-10</i> (Default)</p>	<p>Default Grade Small Enterprise rated in this category is adjudged to be either already in default or expected to be in default.</p>

CRISL RATING SCALES AND DEFINITIONS
BANK LOAN/ FACILITY RATING SCALES AND DEFINITIONS- LONG-TERM

RATING	DEFINITION
<i>blrCRISL Se/Me-1</i> (Highest Safety)	Investment Grade Bank Loan/ Facilities enjoyed by banking clients rated in this category are adjudged to have highest credit quality, offer highest safety and carry almost no risk. Risk factors are negligible and almost nearest to risk free Government bonds and securities. Changing economic circumstances are unlikely to have any serious impact on this category of loans/ facilities.
<i>blrCRISL Se/Me-2</i> (High Safety)	Bank Loan/ Facilities enjoyed by banking clients rated in this category are adjudged to have high credit quality, offer higher safety and have high credit quality. This level of rating indicates that the loan / facilities enjoyed by an entity has sound credit profile and without any significant problem. Risks are modest and may vary slightly from time to time because of economic conditions.
<i>blrCRISL Se/Me-3</i> (Adequate Safety)	Bank Loan/ Facilities rated in this category are adjudged to carry adequate safety for timely repayment/ settlement. This level of rating indicates that the loan / facilities enjoyed by an entity have adequate and reliable credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.
<i>blrCRISL Se/Me-4</i> (Moderate Safety)	Bank Loan/ Facilities rated in this category are adjudged to offer moderate degree of safety for timely repayment /fulfilling commitments. This level of rating indicates that the client enjoying loans/ facilities under-performing in some areas. However, these clients are considered to have the capability to overcome the above-mentioned limitations. Cash flows are irregular but the same is sufficient to service the loan/ fulfill commitments. Risk factors are more variable in periods of economic stress than those rated in the higher categories.
<i>blrCRISL Se/Me-5</i> (Inadequate Safety)	Speculative/ Non investment Grade Bank Loan/ Facilities rated in this category are adjudged to lack key protection factors, which results in an inadequate safety. This level of rating indicates loans/ facilities enjoyed by a client are below investment grade. However, clients may discharge the obligation irregularly within reasonable time although they are in financial/ cash problem. These loans / facilities need strong monitoring from bankers side. There is possibility of overcoming the business situation with the support from group concerns/ owners. Overall quality may move up or down frequently within this category.
<i>blrCRISL Se/Me-6</i> (Somewhat Risk)	Bank Loan/ Facilities rated in this category are adjudged to have weak protection factors. Timely repayment of financial obligations may be impaired by problems. Whilst a Bank loan 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. Special monitoring is needed from the financial institutions to recover the installments.
<i>blrCRISL Se/Me-7</i> (Risky)	Risky Grade Bank Loan/ Facilities rated in this category are adjudged to be in vulnerable status and the clients enjoying these loans/ facilities might fail to meet its repayments frequently or it may currently meeting obligations through creating external support/liabilities. Continuance of this would depend upon favorable economic conditions or on some degree of external support. These loans / facilities need strong monitoring from bankers side for recovery.
<i>blrCRISL Se/Me-8</i> (High Risky)	Bank Loan/ Facilities rated in this category are adjudged to carry high risk. Client enjoying the loan/ facility might not have required financial flexibility to continue meeting obligations; however, continuance of timely repayment is subject to external support. These loans / facilities need strong monitoring from bankers side for recovery.
<i>blrCRISL Se/Me-9</i> (Extremely Speculative)	Bank Loan/ Facilities rated in this category are adjudged to be extremely risky in timely repayment/ fulfilling commitments. This level of rating indicates that the clients enjoying these loan/ facilities are with very serious problems and unless external support is provided, they would be unable to meet financial obligations.
<i>blrCRISL Se/Me-10</i> (Default)	Default Grade Bank Loan/ Facilities rated in this category are adjudged to be either already in default or expected to be in default.