



## The Pakistan Credit Rating Agency Limited

### Rating Report

#### Fecto Cement Limited

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#### Rating History

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action   | Rating Watch |
|--------------------|------------------|-------------------|---------|----------|--------------|
| 22-Apr-2020        | A-               | A2                | Stable  | Maintain | YES          |
| 27-Sep-2019        | A-               | A2                | Stable  | Maintain | -            |
| 30-Mar-2019        | A-               | A2                | Stable  | Maintain | -            |
| 18-Dec-2018        | A-               | A2                | Stable  | Maintain | -            |
| 07-May-2018        | A-               | A2                | Stable  | Initial  | -            |

#### Rating Rationale and Key Rating Drivers

Fecto Cement has a single manufacturing capacity, located in north region, with an annual cement capacity of 0.8mln tons. The company's market share stands at 1.7% in operational cement capacity. The Company's sales are majorly driven by local market fundamental – an industry wide phenomenon. However, Fecto exported a minuscule part to Afghanistan - viable export markets given geographical location of the company. As at end-Dec19, cement sector achieved second phase of expansion (18 mln tpa). Augmented supply side along with slow local demand resulted in depressed cement prices (especially in north region) where players remained unable to pass on high manufacturing costs. Cement sector's local capacity utilization recorded dip to 65% in 1HFY20 (FY19: 68%). This will be further impacted amid COVID-19 outbreak and country wide lock down being observed. The likelihood of impact is considered high where quantum is directly correlated with tenure of lock down. Curtailed key policy rate will provide much needed breathing space to the sector. During 1HFY20, profitability and margins witnessed significant downward trend attributable to the severe competitive environment in the north region. High capacity utilization and exports to Afghanistan in times of slow local demand are some positives. Rating watch incorporates deteriorating performance of the company in the last few quarters. The company has announced green-field expansion, since some time, modalities are yet to be finalized. It has taken time for the project to start. With the new market conditions, the delay in the finalization of the project financing and other related matters, it is unlikely that the project will start over the short horizon. Currently, the company is operating on deleveraged structure. Given current business profile, any acquisition of long term finance will be a rating critical factor.

The ratings are dependent on improvement of company's business volumes and margins. The company's improved business performance in current stretched economic scenario – challenges on demand front - remains vital for ratings.

#### Disclosure

|                              |  |
|------------------------------|--|
| <b>Name of Rated Entity</b>  | Fecto Cement Limited   |
| <b>Type of Relationship</b>  | Solicited  |
| <b>Purpose of the Rating</b> | Entity Rating  |
| <b>Applicable Criteria</b>   | Methodology   Corporate Ratings(Jun-19),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria   Rating Modifier(Jun-19) |
| <b>Related Research</b>      | Sector Study   Cement(Mar-20)  |
| <b>Rating Analysts</b>       | Sehar Fatima   sehar.fatima@pacra.com   +92-42-35869504  |

## Profile

**Legal Structure** Fecto Cement Ltd is a listed Company. Its shares are traded on Pakistan Stock Exchange Limited (PSX). The Company's shares are quoted under the Cement Sector.

**Background** Incepted in 1981, Fecto Cement Limited (FECTO) is part of the Fecto group. The group is diversified into import, export and trading of electrical wires, cables, home appliances and automobiles and later, expanded to industrial sectors by establishing a cement plant, sugar mills, tractor plant as well as paper sack and hardboard manufacturing units. Fecto Cement Limited is headquartered in Karachi, Pakistan and the cement plant is established near Islamabad. The quality standards of the company are ISO 9001:2000.

**Operations** Fecto Cement Limited is engaged in manufacturing, marketing and selling cement and clinker.

## Ownership

**Ownership Structure** Fecto Group hold majority stake (75%) through Mr. Yasin; rest is widely spread among FIs and general public.

**Stability** The shareholding has lately been transferred to Mr. Yasin Fecto by his siblings. The company's ownership structure is not expected to change in foreseeable future.

**Business Acumen** The business acumen of the sponsor is considered adequate on account of long term association with cement sector.

**Financial Strength** The financial strength of the group is considered adequate.

## Governance

**Board Structure** The overall control of the company vests in seven member board of directors (BoD), including the CEO. The BoD comprises three independent directors.

**Members' Profile** Fecto's board members carry necessary technical stature which is required for effective decision making.

**Board Effectiveness** The board meeting minutes are formally maintained and the attendance is considered adequate. High attendance of the members was observed during the meetings held in FY19.

**Financial Transparency** M/s. Rahman Sarfaraz Rahim Iqbal Chartered Accountant conducted the external audit services for fecto. They're in 'A' category of SBP list of external auditors and has a QCR rating. They have expressed unqualified opinion on the financial statements for the year ended 30th June, 2019.

## Management

**Organizational Structure** Fecto Cement has a lean organizational structure with the company's operations grouped under eight key functions. These include 1) Procurement, 2) Production, 3) Sales & Marketing, 4) Information Technology, 5) Finance, 6) Corporate Affairs, 7) Human Resource, and 8) Internal Audit.

**Management Team** The CEO, Mr. Yasin Fecto, is a son of Mr. Ghulam Muhammad Fecto and is associated with the company since 1990s. Mr. Yasin holds a master's degree and has experience of cement and packaging sectors. The CEO is supported by a team of experienced individuals having long association with the company.

**Effectiveness** There is an Audit and HR & Remuneration committee reporting directly to the Board.

**MIS** The company has core operating software; modules include financial, purchase, inventory, sales and payroll; reports generated are considered of adequate frequency.

**Control Environment** The Company is currently operating with one line; plant is of European technology. Accredited with ISO 9001: 2008 and ISO 14001: 2004 certifications, Fecto Cement deploys good technology to ensure production of quality cement

## Business Risk

**Industry Dynamics** Cement industry is divided into North and South region – majority (76%) operational capacity exists in North region. Industry has completed phase II of capacity expansion of around 18mln tons per annum. Till end-Aug19, local cement dispatches deteriorated significantly amid muted local demand. Afterwards, PSDP disbursements stimulated activity whereby local dispatches picked up pace. During 8MFY20, north region witnessed 16% growth in local dispatches where exports recorded curtailment of 3%. Exports to Afghanistan inched up, if sustained will provide breathing space to the north region. South region witnessed uptrend in export dispatches which is correlated with longevity of export window available through sea. Industry dynamics significantly shifted attributable to augmentation in supply side which resulted in depressed prices; situation has become real challenging for players operating in north region. Low cement prices and high energy and fuel costs have resulted in erosion of profitability. Furthermore, high finance costs amplified the effect on financial matrix of cement players (especially in north region). Currently, long term leveraging of industry is moderate (28% as at end-Dec19) whilst total leveraging stands at 55%. Recent decrease in policy rate will provide little cushion to stressed fundamentals. Going forward, restoration of cement prices and margins is crucial for the sector as no huge infrastructural project is on the horizon and Coronavirus outbreak has negatively impacted economies around the globe. Post management of Covid-19 crises, local dispatches may take time to pick up pace whilst ambiguity prevails on conditions related to export market.

**Relative Position** At end-Dec19, Fecto Cement's market share is 1.7% categorizing Fecto as a small player. With capacity to produce 780,000 tons of clinker per annum.

**Revenues** During 1QFY20, turnover was recorded at PKR 0.89bln a significant dip of 20% YOY (1QFY19: PKR 1.1bln, FY19 PKR 4.7bln). In line with the industry trend, local dispatches of the company decreased slightly during FY19 owing to slowdown in public and private development projects, whereas export dispatches increased marginally. Given the difference in retention prices between local and export market, proportion of local sales is projected to remain high. Cost of sales amounted to PKR 886mln during 1QFY20, mainly comprising energy cost, raw materials consumed, salaries & wages, and packing materials. Gross profit decreased to PKR 12mln during 1QFY20 due to lower sales and extensive deterioration of the margin as the company was unable to pass on the impact of higher prices for coal and electricity attributable to severe competition in north region. During 1QFY20, operating costs were recorded at PKR 95mln (1QFY19: PKR 116mln). Hence, Company made loss in 1QFY20 of PKR 53mln (FY18: PKR 442mln, 1QFY18: PKR 228mln; FY17: PKR 761mln). In 1QFY20, Fecto exported to Afghanistan and Sales contribution remained positive on accounts of inched up demand (1QFY20: 17%; 1QFY19: 8%). Capacity utilization (clinker) stand at 74% YTD – Sep (YTD- Sept 18: 77%).

**Margins** During FY19, Fecto's margins deteriorated (Gross: FY19: 12.5%, FY18: 21%, Operating: FY19: 26%, FY18: 11%, PBIT: FY19: 3%, FY18: 12%, EBITDA: FY19: 4.8%, FY18: 13%). During 1H FY20, there was a massive dip in gross margins to stand at 1% (1H FY19: 43%) operating declined to 9% (1QFY19: 38%), whilst PBIT declined to 8% (1QFY19: 42%). Whilst, EBITDA margin remained largely stable at 6% (1QFY19: 6%). This is due to the surge in the prices of fuel, energy and instability in cement prices in north region.

**Sustainability** Going forward, the company has planned and announced (in 2017) a green field expansion in Malakand agency in KPK of 1.8mln tpa. The estimated cost of the project is PKR 18bln with a debt to equity ratio of 80:20. The equity portion of PKR 3.6mln will include majority portion of preference shares. However, there has been a delay and the management is not seeing finalization of modalities over the short horizon. Rating watch incorporates issues regarding quarry and deteriorating performance of the company in the last few quarters.

## Financial Risk

**Working Capital** During 1QFY20, Fecto's working capital requirements represented by net cash cycle (net working capital days) – a function of inventory, receivables and payable - increased to 128days (end-Jun19: 90days; end- Sep18: 86days, end-Jun18: 81days) which is considered high. The liquidity profile as evident by the Current ratio witnessed slight uptick (1QFY20: 5.2x; 1QFY19: 4.2x; FY19: 7.4x).

**Coverages** During 1H FY20, FCFO and EBITDA becomes negative PKR 75mln and PKR 54mln respectively. In FY19, FCFO and EBITDA declined to PKR 84mln PKR 227mln (FY18: PKR 426mln, FY18: PKR 656mln) respectively mainly due to sharp decline profitability. Going forward, prudent management of business affairs remains vital.

**Capitalization** Over the last few years, the company has been operating on a deleveraged structure. Going forward, the management is not planning to acquire long term finance in medium term. Given the current business profile, acquisition of long term finance will be a rating negative factor. In 1QFY20 and FY19, Company made an investment of PKR 318mln and PKR 320mln for associated company Frontier Paper Products (Private) Limited.



The Pakistan Credit Rating Agency Limited

Financial Summary

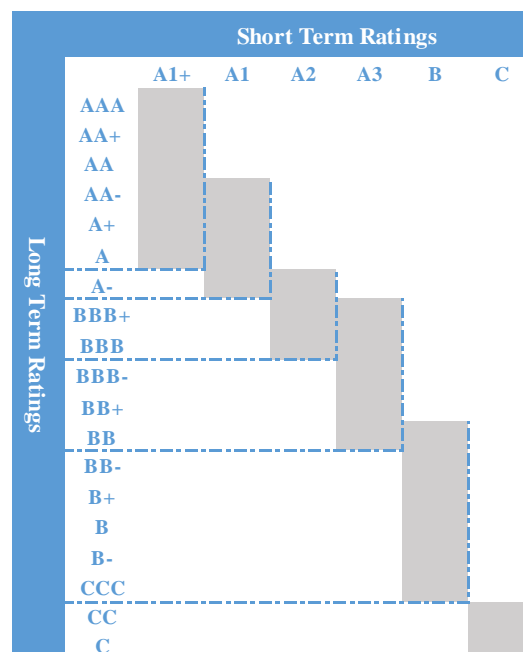
PKR mln

| Fecto Cement Ltd<br>Infrastructure   Cement                         | Dec-19<br>6M | Jun-19<br>12M | Jun-18<br>12M | Jun-17<br>12M |
|---|--------------|---------------|---------------|---------------|
| <b>A BALANCE SHEET</b>  |              |               |               |               |
| 1 Non-Current Assets  | 1,902        | 1,966         | 1,846         | 1,850         |
| 2 Investments   | 320          | 320           | -             | -             |
| 3 Related Party Exposure  | 270          | 229           | 207           | 102           |
| 4 Current Assets  | 2,604        | 2,552         | 3,177         | 2,869         |
| a Inventories   | 1,265        | 1,258         | 1,329         | 1,277         |
| b Trade Receivables   | 28           | 68            | 75            | 16            |
| 5 Total Assets  | 5,095        | 5,067         | 5,230         | 4,821         |
| 6 Current Liabilities   | 651          | 336           | 663           | 549           |
| a Trade Payables  | 351          | 51            | 353           | 169           |
| 7 Borrowings  | 165          | 43            | 15            | -             |
| 8 Related Party Exposure  | -            | -             | -             | -             |
| 9 Non-Current Liabilities   | 273          | 356           | 342           | 378           |
| 10 Net Assets   | 4,007        | 4,332         | 4,210         | 3,894         |
| 11 Shareholders' Equity   | 4,007        | 4,332         | 4,210         | 3,894         |
| <b>B INCOME STATEMENT</b>   |              |               |               |               |
| 1 Sales   | 1,915        | 4,740         | 4,903         | 5,131         |
| a Cost of Good Sold   | (2,109)      | (4,146)       | (3,875)       | (3,574)       |
| 2 Gross Profit  | (194)        | 594           | 1,027         | 1,557         |
| a Operating Expenses  | (184)        | (494)         | (491)         | (413)         |
| 3 Operating Profit  | (378)        | 101           | 536           | 1,143         |
| a Non Operating Income or (Expense)                                 | 27           | 35            | 67            | (50)          |
| 4 Profit or (Loss) before Interest and Tax                          | (351)        | 136           | 603           | 1,093         |
| a Total Finance Cost  | (4)          | (5)           | (3)           | (1)           |
| b Taxation  | 56           | (41)          | (158)         | (331)         |
| 6 Net Income Or (Loss)  | (300)        | 89            | 442           | 761           |
| <b>C CASH FLOW STATEMENT</b>  |              |               |               |               |
| a Free Cash Flows from Operations (FCFO)                            | (351)        | 84            | 390           | 721           |
| b Net Cash from Operating Activities before Working Capital Changes | (355)        | 79            | 387           | 719           |
| c Changes in Working Capital  | 225          | (94)          | (100)         | (256)         |
| 1 Net Cash provided by Operating Activities                         | (131)        | (15)          | 287           | 463           |
| 2 Net Cash (Used in) or Available From Investing Activities         | (13)         | (173)         | (194)         | (171)         |
| 3 Net Cash (Used in) or Available From Financing Activities         | 97           | (121)         | (95)          | (164)         |
| 4 Net Cash generated or (Used) during the period                    | (46)         | (308)         | (1)           | 128           |
| <b>D RATIO ANALYSIS</b>   |              |               |               |               |
| 1 Performance   |              |               |               |               |
| a Sales Growth (for the period)                                     | -19.2%       | -3.3%         | -4.4%         | 2.0%          |
| b Gross Profit Margin   | -10.1%       | 12.5%         | 21.0%         | 30.3%         |
| c Net Profit Margin   | -15.6%       | 1.9%          | 9.0%          | 14.8%         |
| d Cash Conversion Efficiency (EBITDA/Sales)                         | -16.6%       | 4.8%          | 12.7%         | 23.5%         |
| e Return on Equity (ROE)  | -14.4%       | 2.1%          | 10.9%         | 21.3%         |
| 2 Working Capital Management  |              |               |               |               |
| a Gross Working Capital (Average Days)                              | 125          | 105           | 100           | 79            |
| b Net Working Capital (Average Days)                                | 106          | 90            | 81            | 72            |
| c Current Ratio (Total Current Assets/Total Current Liabilities)    | 4.0          | 7.6           | 4.8           | 5.2           |
| 3 Coverages   |              |               |               |               |
| a EBITDA / Finance Cost   | -119.3       | 70.8          | 525.9         | 601906.5      |
| b FCFO / Finance Cost+CMLTB+Excess STB                              | -49.9        | 7.0           | 330.6         | 360407.5      |
| c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)  | -0.1         | 0.5           | 0.0           | 0.0           |
| 4 Capital Structure (Total Debt/Total Debt+Equity)                  |              |               |               |               |

## Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

| Long Term Ratings |   | Short Term Ratings |  |
|-------------------|---|--------------------|--|
| AAA               | <b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments  | A1+                | The highest capacity for timely repayment.   |
| AA+               | <b>Very high credit quality.</b> Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.   | A1                 | A strong capacity for timely repayment.  |
| AA                |   | A2                 | A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.   |
| AA-               |   | A3                 | An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions. |
| A+                | <b>High credit quality.</b> Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.  | B                  | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.                   |
| A                 |   | C                  | An inadequate capacity to ensure timely repayment.   |
| A-                |   |                    |  |
| BBB+              | <b>Good credit quality.</b> Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.   |                    |  |
| BBB               |   |                    |  |
| BBB-              |   |                    |  |
| BB+               | <b>Moderate risk.</b> Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.                           |                    |  |
| BB                |   |                    |  |
| BB-               |   |                    |  |
| B+                | <b>High credit risk.</b> A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.  |                    |  |
| B                 |   |                    |  |
| B-                |   |                    |  |
| CCC               | <b>Very high credit risk.</b> Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default. |                    |  |
| CC                |   |                    |  |
| C                 |   |                    |  |
| D                 | Obligations are currently in default.   |                    |  |



|  |  |   |   |  |
|--|--|---|---|--|
| <b>Outlook (Stable, Positive, Negative, Developing)</b> Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'. | <b>Rating Watch</b> Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion. | <b>Suspension</b> It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn. | <b>Withdrawn</b> A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information. | <b>Harmonization</b> A change in rating due to revision in applicable methodology or underlying scale. |
|--|--|---|---|--|

**Disclaimer:** PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

### **2) Conflict of Interest**

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

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- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA’s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
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- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

### **Probability of Default**

(22) PACRA’s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA’s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA’s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

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