



The Pakistan Credit Rating Agency Limited

## Rating Report

### H.A.R Fibres (Pvt.) Limited

#### Report Contents

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Mar-2024	BBB-	A2	Stable	Maintain	-
29-Mar-2023	BBB-	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

Pakistan's spinning industry is highly fragmented and consists of ~368 dedicated spinning units with an estimated size of ~PKR 775bln and ~13.4mln number of spindles installed as of FY23 according to an economic survey of Pakistan. The projected cotton production estimate is revised and projected to be ~11.5mln bales and currently, the production has reached upto ~8.26mln bales, surpassing FY23 total production of ~4.91mln bales. During FY24, better local raw cotton yield is expected to supplement the industry for import substitution. Pakistan's requirement for imported cotton has increased from ~3.5mln bales to ~4mln bales for the ongoing year. The recent hike in energy tariffs further elevated the challenges for the industry. Overall, the industry's cashflow, thus liquidity remains stretched. Consequently, the industry's overall outlook is on the Watch.

The ratings of H.A.R Fibres (Pvt) Limited ('H.A.R Fibres' or 'the Company') demonstrate an adequate position within the spinning segment of the textile industry. Engaged in the production of carded yarn in three blends - Cotton, Polyester cotton, and Viscose (Coarse: 1s – 20s), the Company sources ~70% of its cotton from the United States, Brazil, and Africa, with the remaining

~30% is sourced locally, from Punjab and Sindh. H.A.R Fibres primarily generated revenue from a single segment, that experienced a significant YoY decrease of ~51.8%, attributed to reduced demand both domestically and internationally. On a comparative basis, business margins remain on the lower side. However, the materialization of enhancement in efficiency parameters, i.e. installation of 1000 rotors and increase in spindles to ~30,232, are expected to improve the overall business profile by reducing the cost per spindle leading to enhanced margins.

On the financial risk front, the liquidity profile is stretched in FY23, reflecting relatively low coverage for the Company's financial obligations. Additionally, the Company's capital structure is highly leveraged, with capital needs arising from financing inventories and trade receivables. However, the borrowing cushion remains positive. Moreover, Sponsor's acumen to manage through challenging times bodes well for the ratings.

The ratings are dependent upon the management's ability to improve margins, profitability, and financial profile of the Company. This includes keeping the debt levels manageable and improving the business profile of the Company, going forward. Improvement in the governance framework remains important for the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	H.A.R Fibres (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating(Jul-23),Methodology   Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology   Rating Modifiers(Apr-23)
<b>Related Research</b>	Sector Study   Spinning(Sep-23)
<b>Rating Analysts</b>	Faiqa Qamar   faiqa.qamar@pacra.com   +92-42-35869504

## Profile

**Legal Structure** H.A.R Fibres (Private) Limited ('H.A.R Fibres' or 'The Company') was established under section 16 of the Companies Act, 2017.

**Background** Founded in 2018, H.A.R Fibres is a significant venture of the renowned "Shahid Family," esteemed for its long-standing presence and credibility in the yarn trading industry in Faisalabad, Pakistan. This rich familial legacy provides H.A.R Fibres with a solid foundation and extensive industry knowledge to navigate the complexities of the textile sector.

**Operations** H.A.R Fibres specializes in yarn manufacturing and distribution, headquartered near Faisalabad's Clock Tower. Its manufacturing plant in Mohalla Mughalpura, Naya Lahore, houses approximately 20,232 spindles, ensuring operational efficiency and accessibility to key resources and markets.

## Ownership

**Ownership Structure** Mr. Shahid Mehmood Sheikh possesses ~40% stake in the Company. While the remaining ownership is distributed among his sons: Mr. Haroon Shahid (~20%), Mr. Faizan Shahid (~20%), and Mr. Adan Shahid (~20%). The ownership structure of the Company is outlined in the accompanying table.

**Stability** The Company inherits the technical and business expertise from the first generation to the second generation of the Shahid family, combining the guidance and knowledge of the initial leaders with the emerging leadership of the new generation. However, as of now, there has been no official announcement of a succession plan.

**Business Acumen** H.A.R Fibres is a family-owned Private Company. Apart from H.A.R Fibres, the sponsoring family is engaged and is involved in real estate. The sponsors have vast experience and knowledge of various aspects of the textile value chain. Mr Shahid Mehmood Sheikh has been in the yarn trading business for the last 46 years and is enjoying a good reputation in the business community.

**Financial Strength** For more than two decades, the sponsoring family has participated in diverse business ventures, highlighting the adequate financial strength of the sponsors.

## Governance

**Board Structure** The four-member Board of Directors, also the Sponsors, holds the overall control of the Company.

**Members' Profile** All the Board members are qualified in different disciplines and carry ample experience in textile as well as other industries. Mr. Shahid Mehmood Sheikh, Chairman of the BoD, has been in the yarn trading business for the last 46 years and enjoys a good reputation in the business community.

**Board Effectiveness** The dominance of sponsors on the Board poses a challenge as it lacks independence. The absence of a structured system for recording Board minutes highlights a need for improvement in the overall governance framework.

**Financial Transparency** Zahid Jamil & Co, the external auditors of the Company, are a QCR-rated firm and hold a listing under category "B" by the State Bank of Pakistan. They have provided an unqualified opinion on the financial statements of the Company for the fiscal year ending on June 30, 2023.

## Management

**Organizational Structure** The Company's organizational framework comprises three primary departments: i) Finance, Admin & Marketing, ii) Purchase, and iii) Production. Each department is headed by a respective head, who reports to the Executive Directors, overseeing the operations. They then report to the CEO.

**Management Team** Mr. Haroon Shahid boasts a decade of experience in the Textile Manufacturing Industry, coupled with two decades of expertise in yarn trading. Similarly, Mr. Faizan Shahid possesses a decade of experience in Textile Manufacturing and 15 years of proficiency in yarn trading.

**Effectiveness** The Company has no management committees. The Sponsor's close involvement in day to day affairs of the business bodes well for the effectiveness of the Company.

**MIS** The Company has built an in-house oracle to cater to the business needs. The senior management monitors the business performance through certain Key MIS reports.

**Control Environment** Production is completely order driven, there is a rigorous quality check done on the end product by the QC department. The Company has obtained ISO 9001 certification.

## Business Risk

**Industry Dynamics** Pakistan's spinning industry comprises ~368 spinning units with an estimated value of ~PKR 775bln and ~13.4mln installed spindles as of FY23, as per a Pakistan economic survey. Cotton production estimates for FY24 are revised upwards to ~11.5mln bales, with current production reaching ~8.26mln bales, surpassing FY23's total of ~4.91mln bales. Better local raw cotton yield is anticipated to aid import substitution. Pakistan's demand for imported cotton has risen from ~3.5mln bales to ~4mln bales this year. Elevated energy tariffs and the availability of locally sourced raw cotton pose significant challenges for the industry, warranting a cautious outlook.

**Relative Position** H.A.R Fibres with its operational spindle count of 20,232, occupying 0.15% of the market share in terms of operational capacity is categorized as a relatively small player in Pakistan's spinning sector.

**Revenues** FY23's revenue amounted to ~PKR 693mln, a YoY decrease of ~51.8% (FY22 ~PKR 1,438mln). During 1HFY24, the topline fell to ~PKR 496mln from ~PKR 676mln in the corresponding previous period. The Company lacks a brand-specific customer base, distributing its entire output in Faisalabad through sales brokers. H.A.R Fibres faces a notable customer concentration risk, relying solely on local yarn sales. Despite a projected ~126.6% surge in Pakistan's cotton production, strengthening spinning companies' revenue, global demand and competition remain pivotal factors.

**Margins** During FY23, production costs aligned with declining sales, with cost of goods sold at ~PKR 632mln (down from ~PKR 1,318mln during FY22) due to lower raw material costs. Despite a capacity utilization drop to ~67.5%, energy costs rose due to increased tariffs. Gross profit for the year was ~PKR 61mln, a ~49% decrease (FY22: ~PKR 120mln), with a margin of ~8.7% (slightly up from ~8.4% during FY22). 1HFY24 saw a gross profit margin improvement to ~9.6%. Operating profit dropped to ~PKR 30mln, with a margin of ~4.4% (down from ~5.3% during FY22). Challenges like rising power costs and global economic slowdowns pose threats to spinning sector margins.

**Sustainability** Going forward, in line with the improving business environment, the Company is planning to start a BMR, which will add 1,000 rotors to existing capacity. The total cost of CAPEX is estimated to be ~PKR 100mln, which will entirely be funded from equity. BMR is expected to bring in efficiency gains, lowering cost per spindle, and will consequently improve margins.

## Financial Risk

**Working Capital** In FY23, the Company's working capital requirement surged to ~355 days from ~72 days in FY22, driven by a rise in inventory days to ~497 days from ~91 days in FY22 due to reduced demand. However, net working capital days improved to ~222 days in 1HFY24. Short-term total leverage dropped to ~20.8% in FY23 from ~47.6% in FY22, reflected in trade assets of ~PKR 1,397mln in FY23 compared to ~PKR 742mln in FY22, alongside short-term borrowings of ~PKR 40mln in FY23, up from ~PKR 22mln in FY22. Short-term total leverage improved to ~29.2% in 1HFY24. Additionally, short-term trade leverage decreased to ~22.4% in FY23 from ~49% in FY22 but improved to ~30.3% in 1HFY24.

**Coverages** The Company's cash flows from operations declined, totaling ~PKR 38mln in FY23, down from ~PKR 79mln in FY22, attributed to lower EBITDA, resulting in relatively low coverage for the Company's financial obligations. Moreover, in FY23, the total debt payback period increased to ~15.3 years from ~6.8 years in FY22. Additionally, the Liquid Cover Ratio for FY23 dropped to ~0.9 times compared to ~3.6 times in FY22. However, there was an improvement in the Liquid Cover Ratio in 1HFY24, reaching ~1.8 times.

**Capitalization** In FY23, the Company's leverage slightly improved to ~76.2% from ~79.2% in FY22, attributed to an expanded equity base of ~PKR 171mln (FY23) compared to ~PKR 148mln (FY22). Total borrowings decreased to ~PKR 170mln (FY23) from ~PKR 231mln (FY22), with short-term borrowings comprising ~17% of the total. The rise in short-term borrowings is linked to a loan obtained under Import Musawamah Pledge from Bank Al-Falah Limited.



H.A.R Fibres (Pvt.) Limited Spinning	Dec-23 6M	Jun-23 12M	Jun-22 12M	Jun-21 12M
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**A BALANCE SHEET**

1 Non-Current Assets	368	383	211	225
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,278	1,461	825	492
<i>a Inventories</i>	937	1,090	469	251
<i>b Trade Receivables</i>	73	76	170	141
<b>5 Total Assets</b>	<b>1,647</b>	<b>1,844</b>	<b>1,036</b>	<b>717</b>
6 Current Liabilities	899	1,117	410	245
<i>a Trade Payables</i>	462	507	280	187
7 Borrowings	125	170	134	119
8 Related Party Exposure	429	380	332	236
9 Non-Current Liabilities	3	6	12	13
<b>10 Net Assets</b>	<b>191</b>	<b>171</b>	<b>148</b>	<b>104</b>
<b>11 Shareholders' Equity</b>	<b>191</b>	<b>171</b>	<b>148</b>	<b>104</b>

**B INCOME STATEMENT**

1 Sales	496	693	1,438	994
<i>a Cost of Good Sold</i>	(448)	(632)	(1,318)	(910)
<b>2 Gross Profit</b>	<b>48</b>	<b>61</b>	<b>120</b>	<b>84</b>
<i>a Operating Expenses</i>	(13)	(30)	(44)	(35)
<b>3 Operating Profit</b>	<b>35</b>	<b>30</b>	<b>77</b>	<b>50</b>
<i>a Non Operating Income or (Expense)</i>	(4)	18	(14)	50
<b>4 Profit or (Loss) before Interest and Tax</b>	<b>31</b>	<b>48</b>	<b>63</b>	<b>100</b>
<i>a Total Finance Cost</i>	(8)	(22)	(2)	(1)
<i>b Taxation</i>	(3)	(2)	(17)	(30)
<b>6 Net Income Or (Loss)</b>	<b>19</b>	<b>24</b>	<b>43</b>	<b>70</b>

**C CASH FLOW STATEMENT**

<i>a Free Cash Flows from Operations (FCFO)</i>	34	38	79	56
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	34	16	77	55
<i>c Changes in Working Capital</i>	(105)	76	(136)	(144)
<b>1 Net Cash provided by Operating Activities</b>	<b>(71)</b>	<b>92</b>	<b>(59)</b>	<b>(89)</b>
<b>2 Net Cash (Used in) or Available From Investing Activities</b>	<b>-</b>	<b>(197)</b>	<b>(7)</b>	<b>(17)</b>
<b>3 Net Cash (Used in) or Available From Financing Activities</b>	<b>49</b>	<b>103</b>	<b>102</b>	<b>121</b>
<b>4 Net Cash generated or (Used) during the period</b>	<b>(22)</b>	<b>(2)</b>	<b>36</b>	<b>14</b>

**D RATIO ANALYSIS**

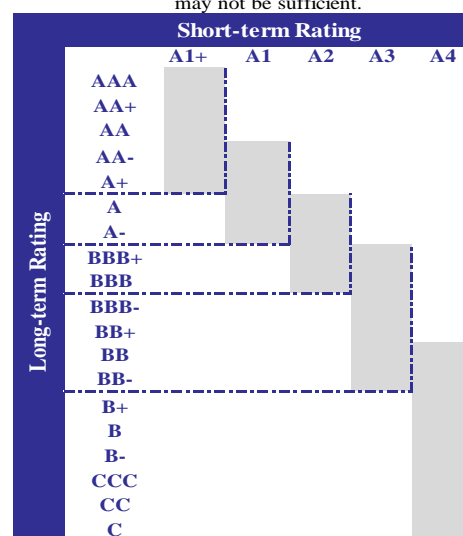
<b>1 Performance</b>				
<i>a Sales Growth (for the period)</i>	43.3%	-51.8%	44.6%	95.9%
<i>b Gross Profit Margin</i>	9.6%	8.7%	8.4%	8.5%
<i>c Net Profit Margin</i>	3.9%	3.4%	3.0%	7.0%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	-14.4%	16.4%	-4.0%	-8.9%
<i>e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/</i>	21.3%	14.9%	34.3%	119.6%
<b>2 Working Capital Management</b>				
<i>a Gross Working Capital (Average Days)</i>	400	562	131	108
<i>b Net Working Capital (Average Days)</i>	222	355	72	51
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	1.4	1.3	2.0	2.0
<b>3 Coverages</b>				
<i>a EBITDA / Finance Cost</i>	17.8	12.6	1012.4	N/A
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.1	0.5	2.4	N/A
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	8.7	15.3	5.6	6.3
<b>4 Capital Structure</b>				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	74.4%	76.2%	76.0%	77.3%
<i>b Interest or Markup Payable (Days)</i>	0.0	0.0	0.0	N/A
<i>c Entity Average Borrowing Rate</i>	0.7%	0.8%	0.0%	0.0%

### Credit Rating

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.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
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.
AA-	
A+	
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.
A-	
BBB+	
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-	
BB+	
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-	
B+	
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-	
CCC	
CC	<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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



\*The correlation shown is indicative and, in certain cases, may not hold.

**Outlook (Stable, Positive, Negative, Developing)** 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'.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. 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 rating outlook of the respective opinion.

**Suspension** 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.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults, or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):  
 a) Broker Entity Rating  
 b) Corporate Rating  
 c) Debt Instrument Rating  
 d) Financial Institution Rating  
 e) Holding Company Rating  
 f) Independent Power Producer Rating  
 g) Microfinance Institution Rating  
 h) Non-Banking Finance Companies Rating

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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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- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (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)

### **Conduct of Business**

- (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 | Clause 11-(A)(p).
- (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)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

### **Independence & Conflict of interest**

- (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)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

### **Monitoring and review**

- (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 | 17-(a)
- (19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)

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