



The Pakistan Credit Rating Agency Limited

## Rating Report

### Pakistan Services Limited

#### Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

#### Rating History

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook    | Action    | Rating Watch |
|--------------------|------------------|-------------------|------------|-----------|--------------|
| 24-Mar-2021        | A                | A1                | Negative   | Maintain  | YES          |
| 24-Mar-2020        | A                | A1                | Negative   | Downgrade | YES          |
| 20-Nov-2019        | A+               | A1                | Developing | Maintain  | YES          |
| 21-May-2019        | A+               | A1                | Stable     | Maintain  | -            |
| 19-Nov-2018        | A+               | A1                | Stable     | Maintain  | -            |
| 29-Mar-2018        | A+               | A1                | Stable     | Maintain  | -            |
| 18-Aug-2017        | A+               | A1                | Stable     | Initial   | -            |

#### Rating Rationale and Key Rating Drivers

Pakistan Services Limited's (The Company) has a leading position in the hospitality industry. Hospitality and tourism industry was affected due to outbreak of Covid-19 with associated lockdown and travel restrictions around the globe. Pandemic situation is still underway as third wave is around reflecting uncertainty in the industry. Overall hotels and hospitality industry dynamics started improvement, restrictions were softened and economic activity resumed. Hotel industry is allowed to operate under specific SOPs, which led the Company to achieve limited profitability in 2QFY21 and came back to operating profit level at the half year close. Challenges persists like low occupancy rate and reduction in average daily room rate. As a response to address the challenges, the Company managed to achieve alignment of its cash flows and payables by deferring long term debt which will eventually ease out liquidity pressure for near future. Furthermore, management decision to dispose of non-core assets will supplement the future liquidity position. Capital structure of the Company reflects leveraging with large asset base but on the other hand coverages are weak due to lower cashflows and higher debt servicing cost. Alignment of long-term loan is alleviating this pressure. Financial support from sponsors remains imperative.

Ratings are dependent on effective implementation of envisaged strategy to improve cashflows while maintaining modest leveraging and strengthening coverages. Any significant delay in commencement of new projects and/or further deterioration in margins coupled with low occupancy rate leading to weak coverages and pressure on liquidity, will have a negative impact on ratings. Meanwhile, maintaining sufficient cushion for debt repayment remains crucial. Outlook on the entity is negative while rating watch maintained. In this respect, removal of material uncertainty related to going concern as documented by the external auditors is important.

#### Disclosure

|                              |  |
|------------------------------|--|
| <b>Name of Rated Entity</b>  | Pakistan Services Limited  |
| <b>Type of Relationship</b>  | Solicited  |
| <b>Purpose of the Rating</b> | Entity Rating  |
| <b>Applicable Criteria</b>   | Methodology   Corporate Ratings(Jun-20),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria   Rating Modifier(Jun-20) |
| <b>Related Research</b>      | Sector Study   Hotel & Retail Industry(Jun-20)   |
| <b>Rating Analysts</b>       | Kanwal Ejaz   kanwal.ejaz@pacra.com   +92-42-35869504  |

## Profile

**Legal Structure** Pakistan Services Limited (the Company) is a public limited company, quoted on the Pakistan Stock Exchange.

**Background** The Company was incorporated in 1958 by the Government of Pakistan and Pakistan International Airlines, with four hotels in Karachi, Lahore, Rawalpindi and Peshawar. The hotels were managed by InterContinental Hotels & Resorts up until 1985, after which they took an exit from Pakistan. Subsequently, Hashoo Group successfully bid for the hotels in the same year and commenced operations under the brand 'Pearl Continental Hotels'.

**Operations** Pakistan Services Limited (PSL) operates six luxury hotels with 1,526 total rooms in all major cities i.e. Karachi, Lahore, Rawalpindi, Peshawar, Bhurban and Muzafarabad under 'Pearl Continental'.

## Ownership

**Ownership Structure** Majority stake in Pakistan Services Limited is owned & controlled by foreign companies. The remaining shareholding is held through local associated companies and directors.

**Stability** Ownership structure of the Company is stable as there is limited free-float and no ownership changes are expected.

**Business Acumen** Hashoo Group was established in 1960 by Sadruddin Hashwani, Chairman of the Group. The Group penetrated the hospitality industry by setting up its first hotel in 1978 and the second in 1981 under the brand 'Holiday Inn'. In the following years, the Group acquired Pakistan Services Limited and gained franchise rights for Marriott Hotels by Marriott International. The sponsor have considerable expertise in hospitality sector.

**Financial Strength** The Company's financial strength is derived from the support of its Group. The Group has business ventures spread across various industries, both, locally and internationally. The Group activities encompass hospitality, oil & gas exploration and production, information technology, minerals, pharmaceuticals, real estate and commodity trading. In addition to operating Pearl Continental through Pakistan Services Limited, the Group operates two Marriott Hotels (Islamabad and Karachi) and one property of Pearl Continental located in Gwadar and a chain of budget hotels under Hotel One (Pvt.) Limited through Hashwani Hotels Limited.

## Governance

**Board Structure** The Company's Board comprises nine members. Three are Executive Directors, three are Non-Executive Directors and three are Independent Directors.

**Members' Profile** Mr. Sadruddin Hashwani, Chairman of the board, possesses more than four decades of experience in hospitality sector. Other Board members also have well diversified and extensive profiles. They include professional accountants, lawyers and experienced individuals from hospitality industry.

**Board Effectiveness** The board has formed four committees namely; i) Audit Committee ii) Human Resource Committee iii) Nomination Committee and iv) Risk management Committee to comply with the code of corporate governance. During the FY20, four board meetings were held in which attendance of the board members remained adequate. The Company maintains board meeting minutes in a proper manner.

**Financial Transparency** KPMG Taseer Hadi & Co. is the external auditor of the Company. The auditor has given an unqualified opinion on the financial statements for year ended June 30th, 2020.

## Management

**Organizational Structure** The Company has a well-defined organizational structure. The highest level of authority lies with the Chief Executive who is aided by the Vice Chairman.

**Management Team** Mr. Murtaza Hashwani is the CEO of the Company. He is a graduate from Santa Monica University, USA, and carries experience of over 2 decades managing hospitality, oil & gas and pharmaceutical sectors. Mr. Tahir Mahmood, has replaced Mr. Javed Iqbal as the Company's CFO, is an experienced professional having association with Hashoo group from last 13 years. Other members of management tier are all seasoned professionals with relevant experience.

**Effectiveness** In order to ensure efficient operations, the Company relies on constructing and implementing strict budgets. Moreover, to devise future strategies while evaluating current performance, various reports on a frequent basis are submitted to the top management.

**MIS** The Company has implemented 'Opera', an integrated, cloud-based, management system designed specifically for the hospitality industry by Oracle.

**Control Environment** The Company has formed an efficient internal audit department, which reports to the Audit committee of the board. The department works primarily in three dimensions i) Assurance, ii) Consulting and (iii) Investigation.

## Business Risk

**Industry Dynamics** Improvement in infrastructure, coupled with improving security conditions, led to growth in Pakistan's hospitality sector in past few years. Additionally, progression of China Pakistan Economic Corridor (CPEC) boosted the industry. The luxury hotels space in Pakistan is largely dominated by a few major players as barriers to entry exist due to the capital intensive nature of the business. However, slowdown in Pakistan's economic growth from FY19, geopolitical tensions and global outbreak of Covid-19 pandemic are further expected to dampen the demand for luxury hotels and affect all players in the industry

**Relative Position** Pakistan Services Limited, operating under the brand 'Pearl Continental', is the leading 5 star brand in the country with 1,526 rooms, followed by Serena Hotels, Avani Hotels and Marriott Hotels, respectively.

**Revenues** The Company generates its revenue from four sources, namely, rooms (largest contributor), food & beverage, other related services and shop license fee. During FY20, the Company posted revenues worth PKR 8,130mln (FY19: PKR 10,138mln). However, improvement in occupancy rates is unlikely to be sustainable amid current situation of Covid-19.

**Margins** During FY20, the Company witnessed a decline in gross profit margin, which decreased to 33.1% (FY19: 40.1%). Gross profit margin decreased on the back of lower revenue YoY. Impact of lower revenue combined with higher operating expenses. The Company has recorded a net loss of PKR 1,744mln during FY20. However the pace of decline has now slowed during 2QFY21 as operating profits turned positive to PKR 252mln as compared to operating loss of PKR 42mln in 1QFY21. PSL has posted net loss of PKR 300mln in IHFY21.

**Sustainability** Going forward, improvement in profitability and margins would be critical at a time when occupancy rates are expected to experience a significant drop due to current situation of Covid-19.

## Financial Risk

**Working Capital** During FY20, the Company was not able to maintain a strong position on its working capital management with net working capital cycle at -28days (FY19: -6days). However, during 1HFY21, the Company's net working capital cycle further decreased to -46days. Materialization of initiatives to improve cashflows is critical for the Company, in order to eliminate asset liability mismatch.

**Coverages** During IHFY21, the Company's free cashflows from operations reached to PKR 676mln (FY20: 895mln, FY19: PKR 1,525mln). The interest coverage ratio fell to 1.2x (FY19: 2x) and debt coverage ratio to 0.2x in IHFY21 (FY20: 0.1x, FY19: 0.3x).

**Capitalization** Total borrowings during IHFY21 clocked in at PKR 17,184mln (FY20: 16,974mln, FY19: PKR 15,825mln). Leveraging ratio during 1HFY20 clocked in at ~33% remaining almost stagnant.



The Pakistan Credit Rating Agency Limited

Financial Summary  
PKR mln

| Pakistan Services Limited<br>Hospitality | Dec-20<br>6M | Jun-20<br>12M | Jun-19<br>12M | Jun-18<br>12M |
|--|--------------|---------------|---------------|---------------|
|--|--------------|---------------|---------------|---------------|

#### A BALANCE SHEET

|                           |        |        |        |        |
|---------------------------|--------|--------|--------|--------|
| 1 Non-Current Assets      | 43,443 | 43,773 | 42,582 | 41,495 |
| 2 Investments             | 6,604  | 7,660  | 4,525  | 3,183  |
| 3 Related Party Exposure  | 3,714  | 2,404  | 4,514  | 3,083  |
| 4 Current Assets          | 1,956  | 1,672  | 2,435  | 2,778  |
| a Inventories             | 66     | 69     | 86     | 86     |
| b Trade Receivables       | 335    | 195    | 543    | 705    |
| 5 Total Assets            | 55,717 | 55,509 | 54,056 | 50,540 |
| 6 Current Liabilities     | 3,016  | 2,559  | 2,323  | 2,188  |
| a Trade Payables          | 1,372  | 945    | 463    | 549    |
| 7 Borrowings              | 17,184 | 16,974 | 15,603 | 11,557 |
| 8 Related Party Exposure  | -      | 45     | 21     | 15     |
| 9 Non-Current Liabilities | 891    | 1,005  | 1,204  | 939    |
| 10 Net Assets             | 34,626 | 34,925 | 34,905 | 35,840 |
| 11 Shareholders' Equity   | 34,626 | 34,925 | 34,905 | 35,840 |

#### B INCOME STATEMENT

|  |         |         |         |         |
|--|---------|---------|---------|---------|
| 1 Sales                                    | 3,255   | 8,130   | 10,138  | 10,527  |
| a Cost of Good Sold                        | (2,264) | (5,439) | (6,068) | (5,647) |
| 2 Gross Profit                             | 992     | 2,691   | 4,070   | 4,880   |
| a Operating Expenses                       | (1,004) | (2,901) | (3,230) | (3,268) |
| 3 Operating Profit                         | (12)    | (210)   | 840     | 1,612   |
| a Non Operating Income or (Expense)        | 342     | 95      | (55)    | 1       |
| 4 Profit or (Loss) before Interest and Tax | 330     | (116)   | 785     | 1,613   |
| a Total Finance Cost                       | (697)   | (1,728) | (1,154) | (726)   |
| b Taxation                                 | 68      | 99      | (494)   | (392)   |
| 6 Net Income Or (Loss)                     | (300)   | (1,744) | (863)   | 496     |

#### C CASH FLOW STATEMENT

|   |       |         |         |         |
|---|-------|---------|---------|---------|
| a Free Cash Flows from Operations (FCFO)                            | 676   | 895     | 1,525   | 2,014   |
| b Net Cash from Operating Activities before Working Capital Changes | 500   | (1,053) | 162     | 1,385   |
| c Changes in Working Capital  | (244) | 930     | (117)   | 134     |
| 1 Net Cash provided by Operating Activities                         | 256   | (123)   | 44      | 1,518   |
| 2 Net Cash (Used in) or Available From Investing Activities         | 66    | (79)    | (5,035) | (3,894) |
| 3 Net Cash (Used in) or Available From Financing Activities         | (283) | (1,023) | 3,965   | 3,373   |
| 4 Net Cash generated or (Used) during the period                    | 38    | (1,225) | (1,026) | 997     |

#### D RATIO ANALYSIS

|   |        |        |       |       |
|---|--------|--------|-------|-------|
| 1 Performance   |        |        |       |       |
| a Sales Growth (for the period)   | -19.9% | -19.8% | -3.7% | 7.3%  |
| b Gross Profit Margin   | 30.5%  | 33.1%  | 40.1% | 46.4% |
| c Net Profit Margin   | -9.2%  | -21.5% | -8.5% | 4.7%  |
| d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)                          | 13.3%  | 22.5%  | 13.9% | 20.4% |
| e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity) ] | -1.7%  | -5.1%  | -2.6% | 1.5%  |
| 2 Working Capital Management  |        |        |       |       |
| a Gross Working Capital (Average Days)  | 19     | 20     | 26    | 28    |
| b Net Working Capital (Average Days)  | -46    | -12    | 7     | 9     |
| c Current Ratio (Current Assets / Current Liabilities)  | 0.6    | 0.7    | 1.0   | 1.3   |
| 3 Coverages   |        |        |       |       |
| a EBITDA / Finance Cost   | 1.4    | 0.7    | 2.0   | 4.4   |
| b FCFO / Finance Cost+CMLTB+Excess STB  | 0.2    | 0.1    | 0.4   | 1.0   |
| c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)                              | 63.0   | -19.1  | 30.9  | 7.7   |
| 4 Capital Structure   |        |        |       |       |
| a Total Borrowings / (Total Borrowings+Shareholders' Equity)                                    | 33.2%  | 32.8%  | 30.9% | 24.4% |
| b Interest or Markup Payable (Days)   | 0.0    | 0.0    | 130.7 | 141.1 |
| c Entity Average Borrowing Rate   | 7.6%   | 12.6%  | 7.8%  | 6.2%  |

**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+   | <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     | <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   | <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.   |

| 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):

|  |   |
|--|---|
| <p><b>Entities</b></p> <ul style="list-style-type: none"> <li>a) Broker Entity Rating</li> <li>b) Corporate Rating</li> <li>c) Financial Institution Rating</li> <li>d) Holding Company Rating</li> <li>e) Independent Power Producer Rating</li> <li>f) Microfinance Institution Rating</li> <li>g) Non-Banking Finance Companies (NBFCs) Rating</li> </ul> | <p><b>Instruments</b></p> <ul style="list-style-type: none"> <li>a) Basel III Compliant Debt Instrument Rating</li> <li>b) Debt Instrument Rating</li> <li>c) Sukuk Rating</li> </ul> |
|--|---|

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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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- (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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### **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 | 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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