

The Pakistan Credit Rating Agency



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Rating Modifiers Criteria

Methodology

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Summary

This criterion explains PACRA’s rating modifiers, which provide additional information regarding the likelihood of change in direction of underlying ratings. It is important to note that rating modifiers are not necessarily precursors to rating changes. In cases where actual developments deviate from PACRA’s expectations or remedial actions are taken, rating changes may not follow those indicated by the rating modifiers. Likewise, rating changes may occur without the rating modifier indicating the same in certain cases.

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Introduction

PACRA's Credit Ratings reflect forward-looking opinions on the creditworthiness of an underlying entity or instrument. More specifically, a rating depicts the relative ability of an entity or instrument to honor its financial obligations. The primary factor captured on PACRA's rating scale is the relative expectation of credit risk or credit quality (where AAA-ratings capture the highest credit quality and C-ratings capture the highest credit risk). Furthermore, PACRA's management quality ratings reflect both the standalone performance and relative standing of an entity within a specific sector.

Rating modifiers are refinements about a rating opinion that PACRA may use. Rating modifiers address the likelihood of change in the direction of underlying ratings. A rating modifier is annexed to any assigned rating from PACRA's rating scales. A rating modifier, does not mean that a rating change is inevitable, and rating changes may just as well occur without the rating modifier indicating the same.

Rating modifiers are based on a through-the-cycle approach, rather than on a point-in-time basis. Thus, they are not applicable to opinions based on actual or past performance. As a result, rating modifiers accompany all PACRA opinions with the exception of Performance Rankings and Capital Preservation.

PACRA has two types of rating modifiers: Rating Outlook (Outlook) and Rating Watch (RW).

Rating Outlook

Rating outlook indicates the likely direction of a rating or opinion over the intermediate term in response to changing trends in economic, sectoral, technological, applicable regulations and standards, and/or fundamental business/financial conditions. It is not necessarily always a precursor to a rating change.

PACRA reviews all its ratings on a biannual basis. As part of this process, the latest status of the rating outlook is also updated. PACRA assigns one of the following four outlook categories:

1. **Positive:** Indicates the likelihood that a rating may be upgraded.
2. **Negative:** Indicates the likelihood that a rating may be downgraded.
3. **Stable:** Indicates that a rating is not likely to change.
4. **Developing:** It is used for situations in which there are conflicting elements or future events that are significant in nature but are unclear with regards to their potential impact on the rating or opinion.

The following points should be considered while interpreting an outlook:

- An outlook merely indicates PACRA's view that the rating could be changed if the scenario upon which the rating is based does not transpire and future developments are in line with PACRA's expectations. Rating outlook is unique to each rating opinion. A very highly rated entity may have a negative outlook associated with the assigned rating, while an entity with a low rating may have a positive outlook. Thus, the outlook must always be considered relative to the underlying opinion, rather than in isolation.
- An outlook reflects PACRA's view regarding the trends and risks affecting the intermediate rating prospects. As such, it isn't necessary for companies within a given industry/peer group to have the same outlook. However, this could be the case if a material event affects the entire industry.
- If an outlook translates into a rating change and an outlook is then assigned to the changed rating, such an outlook is a new outlook yet to be translated.

- It is extremely rare for a rating to be downgraded and assigned a positive outlook, or upgraded and assigned a negative outlook, though it may occur.

Moreover, the rating outlooks "Positive", "Negative", or "Developing" do not imply that any potential change would be of only one rating notch as a rating change could be of one or several notches depending on the circumstances. There might also be no change in the rating and PACRA may simply revert the outlook to 'Stable' if the original fundamentals are restored.

Rating Watch

Rating watch alerts the users to the possibility of a rating change subsequent to or in anticipation of a material identifiable event whose impact on a rating remains unclear/undetermined. Examples of such likely events include, but are not limited to, the following:

1. Change in ownership by way of merger/demerger/acquisition;
2. Operating developments;
3. Major economic, technological, or financial event;
4. Recapitalization;
5. Regulatory action.

Rating watch is assigned if the impact of above-mentioned events on rating cannot be accurately assessed at a given time and additional information is necessary to fully ascertain this. Alternatively, a rating watch is also assigned in cases where the rating implications of an event are clear, however, a specific triggering event (shareholder approval or regulatory approval) is awaited to enable a decisive rating action.

Rating watch 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. PACRA will generally publish updates to identify, as and when required, its most current assessment of the situation.

Rating watch does not imply that any potential change would be only one notch; it could be one notch or several notches, depending on the situation. Similarly, it is possible that there might be no change in the rating. PACRA may simply remove the rating from "Rating Watch" if the original fundamentals are restored or reached again, or update the rating with the appropriate action at the time of resolution of the key events triggering the rating watch.

OUTLOOK (STABLE, POSITIVE, NEGATIVE, DEVELOPING)

Indicates the potential 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 the foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.