



The Pakistan Credit Rating Agency Limited

## Rating Report

### Khas Textile Mills (Pvt.) Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Aug-2023	BBB-	A2	Stable	Maintain	-
23-Aug-2022	BBB-	A2	Stable	Upgrade	-
23-Aug-2021	BB+	A3	Stable	Maintain	-
28-Aug-2020	BB+	A3	Stable	Maintain	-
29-Aug-2019	BB+	A3	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect the small yet adequate business profile of Khas Textile Mills (Pvt.) Limited. The company manufactures various types of cotton rings and open-end yarn. The company's association with the Khas Group exhibits the good financial muscle of the sponsoring family. The group has a forte in diverse sectors; including textile, aluminum, poultry, socks, knitwear, and import of building hardware. Over the last few years, the company's topline portrayed an improving trend with sales mix largely from the local market. During FY22, the enhanced production capacity exacerbated sales volume attributable to higher demand for textile products. The repercussions were reflected in the form of a manifold increase in the bottom line (FY22: PKR 230mln; FY21: PKR 41mln). The margins posted a healthy increase owing to an incline in the revenue base. The free cash flows from operations were recorded as historically high. The borrowing book remained dominated by short-term borrowing. The financial risk profile improved due to an increase in coverage. During 1HFY23, the growth of the topline was in line with small spinning players. The operating expenses recorded an increase and net profitability declined sizably. Margins and coverage were affected while borrowings remained skewed towards the short-term borrowings reflecting high working capital requirements. The management is concerting efforts to prudently manage its cashflows. Further, the management is planning to overcome the challenge emanating from high markup by availing Export Finance Scheme. It shall assist in curtailing markup expenses as well as improve the flow of cashflows. The management is currently seeing good capacity utilization levels in July and August. The order book is tilted towards shorter tenure to manage any unforeseen challenges. During FY23, textile exports were valued at \$16.5 billion compared to \$19.33 billion, reflecting a dip of 15% YoY – the declining trend has been witnessed by the start of FY23. The exports tumbled attributable to high energy costs, shortage of cotton, and uncertainty in the foreign exchange rate. The suppressed demand pattern exhibited by export avenues was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments witnessed a decline of 13% YoY. The basic textiles including raw cotton, cotton yarn, and cotton cloth posted a drop of 21% YoY. During the month of June 2023, cotton yarn exports increased by 7% MoM. The value-added exports reported a volumetric increase of 16% on a MoM basis.

Strengthening governance practices will have a positive impact on the ratings. Any deterioration in debt coverages leading to higher financial risk or substantial losses will have a negative impact on ratings.

#### Disclosure

<b>Name of Rated Entity</b>	Khas Textile Mills (Pvt.) Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Rating(Jun-22),Methodology   Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology   Rating Modifiers(Jun-22)
<b>Related Research</b>	Sector Study   Spinning(Sep-22)
<b>Rating Analysts</b>	Sehar Fatima   sehar.fatima@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Khas Textile Mills (Pvt.) Limited (Khas Textile) was incorporated in 2001 as a private limited Company.

**Background** The company is engaged in the manufacturing of yarn. In 2006, the company went through a major transformation and started manufacturing cotton rings and open-end yarn. Since its incorporation, over the years, Khas Textile has increased its production capacity.

**Operations** The company currently operates 19,200 spindles and 864 rotors and has a purpose built manufacturing facility located in the industrial hub – Nooriabad. The company has a captive electricity generation capacity of 3.5 Megawatt against the requirement of 3.2 Megawatt. The company has a backup line connection with HESCO.

## Ownership

**Ownership Structure** The company is entirely owned by the sponsoring family, which includes Mr. Haji Ashfaq Ahmed and his wife (20%), his two sons (i) Khurram Ashfaq (40%) and (ii) Noman Ashfaq (40%) individually and through their respective families.

**Stability** The shareholding between different members of the family is clearly distributed. However, no formal succession plan has been documented.

**Business Acumen** The Chairman, Mr. Ashfaq Ahmed has over 45 years of experience in diverse sectors including textile, aluminum, poultry, socks and knitwear, and import of building hardware. Mr. Khurram Ashfaq, managing director, of the Company, has over 23 years of experience in the textile sector. Apart from spinning, the sponsors also have a forte in the diverse sectors.

**Financial Strength** Khas Group of Industries has five companies operating in different sectors. Apart from a presence in diverse sectors; sponsors also have a joint venture, with the KAI-largest aluminum manufacturer, in Bangladesh. The sponsors have a reasonable net worth and have demonstrated their commitment to support the company if needed.

## Governance

**Board Structure** The company has a five-member board. Three of the members are executive directors and two are non-executive directors. All directors have been affiliated with the company since its inception.

**Members' Profile** Mr. Ashfaq Ahmed, Chairman of the board, has over 45 years of experience in diverse industries including Textile.

**Board Effectiveness** The engagement of the directors in day to day running of the business bodes well with the effectiveness of strategic oversight. However, there are no committees formed by the board.

**Financial Transparency** Rahman, Sarfaraz, Rahim, Iqbal, Rafiq & Co. Chartered Accountants are the external auditors of the company. The auditors have expressed an opinion on the company's financial statements for the year ending June 30, 2022.

## Management

**Organizational Structure** The company has a well-defined organizational structure. There are five main departments; (i) Production, (ii) Power House, (iii) Finance, (iv) Factory Admin, and (v) Human Resources. All the heads of the department report to the CFO. Overall, the group management oversees all the operations of the company. There are clearly delimited reporting lines as well as segregation of duties between top-tier management.

**Management Team** Mr. Khurram Ashfaq, managing director, is responsible for overseeing all matters related to Khas Textile. Other members of the Company's top-tier management are also comprised of seasoned professionals and have been associated with the company for a considerable amount of time.

**Effectiveness** There are no formal management committees; however, key management members meet on regular basis to resolve and proactively address operational issues, if any, eventually ensuring a smooth flow of operations.

**MIS** The company is currently operating SAP-BI-8.82 which has been customized by Abacus Consulting (Pvt.) Limited according to the Company's needs. The operational modules include (i) Payable, (ii) Receivable, (iii) Inventory, (iv) Procurement, (v) Order Management, (vi) General Ledger, (vii) Fixed Assets, and (viii) Cash Management. The reports are generated and reviewed regularly by the top management.

**Control Environment** The company has an updated technological infrastructure in all its manufacturing and support functions, to ensure quality and cost-effectiveness. The company has an internal audit department in place.

## Business Risk

**Industry Dynamics** During FY23, textile exports were valued at \$16.5 billion compared to \$19.33 billion, reflecting a dip of 15% YoY – the declining trend has been witnessed by the start of FY23. The exports tumbled attributable to high energy costs, shortage of cotton, and uncertainty in the foreign exchange rate. The suppressed demand pattern exhibited by export avenues was also a challenge. During FY23, value-added products such as knitwear, bedwear, towels, and ready-made garments witnessed a decline of 13% YoY. The basic textiles including raw cotton, cotton yarn, and cotton cloth posted a drop of 21% YoY. During the month of June 2023, cotton yarn exports increased by 7% MoM. The value-added exports reported a volumetric increase of 16% on a MoM basis. Knitwear and readymade garments witnessed an incline at 18% and 19% respectively. During the month of July 2023, textile exports were valued at \$2 billion compared to \$2.3 billion, reflecting a slump of 12.6% on a MoM basis. Further analysis reveals an overall decline of 8.6% YoY.

**Relative Position** With 19,200 spindles and 864 rotors, the company's share in the spinning sector of the textile industry is minimal. In terms of margins, the company falls in the lower tier of the spinning sector.

**Revenues** A predominant portion of the topline is vested with local sales. While a minimum portion is derived from export sales. During FY22, the company's revenue base portrayed an increase to PKR 4.9bln (FY21: PKR 3.5bln) comprising the sale of yarn (99% )and wastage (1%). Locally, the company sells to several suppliers. The local sales reflected a growth of 40% on a YoY basis standing at PKR 4.5bln. During 1HFY23, the company's topline clocked at PKR 1.1bln. Export sales constituted 8% of the revenue base to stand at PKR 90mln. The local sales were recorded at PKR 1bln.

**Margins** During FY22, the gross margin and operating profit margin improved to 11.4% (FY21: 9.9% ) and 9.3% (FY21: 7.5%) attributable to a sizeable increase in sales. The finance cost inclined to PKR 125mln (FY21: 114mln). Despite this increase, the company was able to achieve a net profitability of PKR 230mln (FY21: PKR 41mln). During 1HFY23, the gross margin inched down to 10%. The operating profit margin went down to 6.4% whereas the operating expenses clocked at PKR 40mln. The company's bottom line was reported at PKR 13mln.

**Sustainability** The management is currently seeing good capacity utilization levels in the months of July and August. The purchase orders are tilted towards shorter tenure to manage any unforeseen challenges. Further, the management is planning to overcome the challenges emanating from high markup by availing Export Finance Scheme. The export finance scheme shall assist in curtailing markup expenses as well as improve the flow of cashflows. The efficient utilization of the additional capacity remains vital in the upcoming years.

## Financial Risk

**Working Capital** At end-Jun'22, the company's net cash cycle days improved to 98 days (end-Jun'21: 128 days) due to a decrease in inventory days recorded at 40 days (end-Jun'21: 69 days). The short-term trade leverage inched up to 38.7% (end-Jun'21: 36%). At end-Dec22, the net working capital days portrayed a sizeable increase at 270 days primarily due to an increase in inventory days standing at 117 days. The company's trade assets clocked at PKR 1.9bln.

**Coverages** At end-Jun'22, the free cash flows from operations recorded a sizeable improvement at PKR 644mln (end-Jun'21: PKR 292mln). This increase has reflected an improvement in interest coverage (end-Jun'22: 5.2x; end-Jun'21: 2.6x) and core operating coverage (end-Jun'22: 1x; end-Jun'21: 1.4x). The debt payback also improved to 1.8 years (end-Jun'21: 7.5 years). At end-Dec22, the interest coverage and core operating coverage were recorded at 0.6x and 0.2x.

**Capitalization** The company has a moderately leveraged capital structure. At end-Jun'22, the leveraging decreased to 44.2% (end-Jun'21: 57.1%). The equity base of the company enhanced to PKR 2.3bln (end-Jun'21: PKR 1.5bln). The total borrowings increased to PKR 1.8bln (end-Jun'21: PKR 1bln). The mix tilted toward short-term borrowings. At end-Dec22, the company's leveraging inched up to 46.6%. The short-term borrowings displayed an increase standing at PKR 1.3bln.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Khas Textile Mills Limited Textile	Dec-22 6M	Jun-22 12M	Jun-21 12M	Jun-20 12M
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#### A BALANCE SHEET

1 Non-Current Assets	2,470	2,528	2,254	1,781
2 Investments	156	46	1	8
3 Related Party Exposure	101	112	65	50
4 Current Assets	2,626	1,936	1,484	1,681
<i>a Inventories</i>	1,572	518	572	776
<i>b Trade Receivables</i>	706	1,165	704	667
5 Total Assets	5,353	4,621	3,804	3,519
6 Current Liabilities	847	354	142	187
<i>a Trade Payables</i>	469	188	88	122
7 Borrowings	2,038	1,826	1,018	1,395
8 Related Party Exposure	-	-	1,071	1,035
9 Non-Current Liabilities	136	140	1	1
10 Net Assets	2,333	2,302	1,572	901
11 Shareholders' Equity	2,333	2,302	1,572	901

#### B INCOME STATEMENT

1 Sales	1,118	4,994	3,581	2,548
<i>a Cost of Good Sold</i>	(1,006)	(4,427)	(3,228)	(2,336)
2 Gross Profit	111	567	354	212
<i>a Operating Expenses</i>	(40)	(104)	(85)	(48)
3 Operating Profit	72	464	269	164
<i>a Non Operating Income or (Expense)</i>	2	(12)	(63)	2
4 Profit or (Loss) before Interest and Tax	74	452	206	167
<i>a Total Finance Cost</i>	(47)	(125)	(114)	(136)
<i>b Taxation</i>	(14)	(96)	(52)	(28)
6 Net Income Or (Loss)	13	230	41	2

#### C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	27	644	292	173
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	27	527	292	173
<i>c Changes in Working Capital</i>	-	(365)	114	(648)
1 Net Cash provided by Operating Activities	27	162	407	(474)
2 Net Cash (Used in) or Available From Investing Activities	-	(490)	(69)	(51)
3 Net Cash (Used in) or Available From Financing Activities	-	351	(330)	505
4 Net Cash generated or (Used) during the period	27	23	8	(21)

#### D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	-55.2%	39.4%	40.6%	-23.2%
<i>b Gross Profit Margin</i>	10.0%	11.4%	9.9%	8.3%
<i>c Net Profit Margin</i>	1.2%	4.6%	1.1%	0.1%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	2.4%	5.6%	11.4%	-18.6%
<i>e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sh</i>	1.1%	11.9%	3.3%	0.2%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	323	108	139	163
<i>b Net Working Capital (Average Days)</i>	270	98	128	137
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	3.1	5.5	10.4	9.0
3 Coverages				
<i>a EBITDA / Finance Cost</i>	0.6	5.3	2.9	1.6
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.2	1.0	1.4	0.9
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	-17.3	1.8	7.5	36.1
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	46.6%	44.2%	57.1%	73.0%
<i>b Interest or Markup Payable (Days)</i>	98.3	73.7	0.0	0.0
<i>c Entity Average Borrowing Rate</i>	4.3%	5.8%	4.9%	6.4%

### 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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### **Rating Team Statements**

(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

### **Restrictions**

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (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 | 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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