



## The Pakistan Credit Rating Agency Limited

### Rating Report

#### Islamabad Feeds (Pvt.) Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Aug-2020	BBB	A2	Negative	Maintain	YES
03-Sep-2019	BBB	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The global feed industry can be valued at around ~\$460bln, with poultry (~\$166bln) constituting ~36% of the total industry. Pakistan has installed poultry feed production capacity of ~ 8mln MT/year with a total of ~150 registered feed mills and ~200 unregistered feed mills catering to it. The industry generates an estimated annual revenue of ~ PKR 100bln from local sales to poultry farms. Lately, due to Covid-19 outbreak, restaurants, marriage halls and other public places have been closed. This, along with no exports of poultry products, have led to supply glut in local market. Prices of poultry products posted a dip, despite being an essential food item, due to lower demand with many poultry farms becoming non-operational. Subsequently, sale of feed and recovery from farms is expected to remain under pressure. Although feed producers have sufficient inventory and oversupply has reduced slightly, lower sales and liquidity crunch are expected to significantly impact the industry. Recent SBP measures will provide some respite in the short-time. However, prolonged closure of key revenue generating channels will affect sales in the entire poultry chain.

The ratings reflect Islamabad Feeds established poultry in the poultry industry with its sponsors and associates having presence in other poultry segments including hatchery, broiler and layer farms. The Company remains exposed to inherent risks in the feed industry emanating from raw material price changes and lately low demand due to COVID-19 outbreak. Although the Company enjoyed good margins and profitability in 3QFY20, sales have slowed down considerably in the 4QFY20 subsequent to lock down leading to lower capacity utilization and off take. This trend is expected to continue until lock down eases and demand centres (restaurants, banquet halls etc.) reopen. The Company piled up raw material inventory, procured on cash, in anticipation of higher prices. This led to stretched working capital requirement, with receivable days also high, met through short-term borrowings. The Company had an aggressive leveraged capital structure, while coverages remain stretched. The ratings have been put on "Rating Watch" as COVID-19 outbreak and lock down has adversely impacted industry prospects and created uncertainty. PACRA will monitor the prevailing situation and update the ratings accordingly.

The ratings are dependent on the management's ability to prudently manage liquidity and working capital requirements. The management's ability to build profitable volumes remains critical for the ratings. Envisioned improvement in business and financial profile along with effective changes in governance framework would be beneficial. Significant deterioration in coverages and/or margins will have negative impact on the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	Islamabad Feeds (Pvt.) 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   Poultry Feed(Jan-20)
<b>Rating Analysts</b>	Faiqa Qamar   faiqa.qamar@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Islamabad Feeds (Pvt.) Limited ('Islamabad Feeds' or 'the Company') was incorporated as a Private Limited Company in Pakistan, in Aug 2008.

**Background** Islamabad Feeds is an established player in the poultry industry, comprising poultry farms and feed mills. The sponsors of the Company started poultry business in 1981 and integrated by setting up poultry feed mill, poultry farms and hatcheries. The Company set up its first feed mill in Rewat in 2008, which became formally operational in 2010. Second feed mill was setup in Okara in 2017.

**Operations** Islamabad Feeds is primarily engaged in the production and sale of poultry feed through its two feed mills, located in Rewat and Okara. Units I and II have combined installed capacity of 550,000 MT per annum, utilized upto 52%. The Company has also set up its poultry farms, for broiler chicken, in Lahore, Multan, Okara, Muree, Hyderabad, Karachi and Attock. The bird placement capacity of these farms is around 300,000. The Group's registered office is located in Satellite Town, Rawalpindi. To manage operations, the Company sales offices are present in Lahore, Islamabad and Karachi.

## Ownership

**Ownership Structure** Majority ownership of Islamabad Feeds resides with Dr. Muhammad Aslam (99%). His wife owns the remaining share (1%).

**Stability** Ownership structure of the business is seen as stable as no changes in ownership are expected. The second generation is gradually being inducted in the business. However, transition to next generation remains to be seen.

**Business Acumen** The Company is a venture of Islamabad Group which has an established presence in Pakistan's poultry and poultry feed industry. The Group's flagship entity, Islamabad Feeds, has grown to become one of the Country's leading feed mills catering to its clients in the poultry industry.

**Financial Strength** The sponsors have high net worth and their willingness to support the business bodes well for the Company.

## Governance

**Board Structure** Islamabad Feeds BoD comprises one Executive Director and one Non-Executive Director belonging to the sponsoring family. Small size of the Board and absence of independent oversight indicates significant room for improvement in the Company's governance framework.

**Members' Profile** The Board's Chairman, Dr. Muhammad Aslam, is a Doctor of Veterinary Medicine and has an overall experience of over four decades in poultry and integrated businesses. He is the Chairman of Pakistan Poultry Association and also a member of Punjab Poultry Board. Mrs Aalia Mehmood, the Non-Executive Director, has an overall experience of above three decades in the field of education. She has been associated with the Company's Board for 12 years.

**Board Effectiveness** There are no sub-committees of the Board. During FY19, the Board met informally to discuss pertinent matters. Minutes of these meetings are maintained. However, these are not in detail.

**Financial Transparency** Islamabad Feeds external auditors, M/s Muniff Ziauddin & Co. Chartered Accountants, have expressed an unqualified opinion on the Company's financial statements for the year ended June 30, 2019. The firm has been QCR rated by ICAP and is in 'Category A' of SBP panel of auditors.

## Management

**Organizational Structure** The Company operates through Finance, Accounts, Production, Sales & Marketing, Human Resource, IT and Internal Audit division. Both feed mills are monitored by their respective Managers, who reports to the GM Production. All Departmental Heads report to the Company's CEO, enabling him to make the key strategic decisions. The key person risk exists but is mitigated by engagement of a larger team.

**Management Team** Islamabad Feeds has an experienced & professional management. The Company's CEO, Dr. Muhammad Aslam, is a Doctor of Veterinary Medicine and has an overall experience of over four decades in poultry and integrated businesses. Dr. Munawwar Ali, GM Production, has an overall experience of above three decades and has been associated with the Group from past 30 years. Mr. Muhammad Sajjad, CFO, has an overall experience of 25 years and has been associated with the Group from almost 20 years.

**Effectiveness** At Islamabad Feeds, six management committees are formally in place; namely, audit, finance, sales and recovery, production, broiler farms and layer farms. These committees meet informally to discuss pertinent matters and minutes are maintained. However, these are not in detail.

**MIS** Sidat Hyder has installed Oracle as an enterprise resource software, customized as per the industry needs for the Company. This enables the senior management to monitor and generate reports about inventory, sales, receivables and payables side. These reports are generated on daily, weekly and monthly basis.

**Control Environment** To ensure operational efficiency, the Company has setup an internal audit function to implement the policies and procedures. This function conducts regular pre and post audits to monitor the policies and procedures implemented at Islamabad Feeds.

## Business Risk

**Industry Dynamics** The global feed industry can be valued at around ~\$460bln, with poultry (~\$166bln) constituting ~36% of the total industry. Pakistan produces ~8mlnMT of feed annually with a total of ~150 registered feed mills, and ~200 unregistered feed mills catering to it. This industry directly drives its demand from poultry – chicken and eggs – feed consumption. Lately, due to Covid-19 outbreak, marriage halls/restaurants have been closed. This, along with no exports of poultry products, have led to supply glut in local market. Prices of poultry products have posted a dip despite being an essential food item due to lower demand with many poultry farms becoming non-operational. Subsequently, sale of feed and recovery from farms is expected to remain under pressure.

**Relative Position** Islamabad Feeds has secured prominent position in the market due to its high FCR, culminating in higher demand for their product. The Company is ranked among the first tier players of poultry feed industry

**Revenues** The Company generated revenue by manufacturing and selling variants of poultry feed (87%), Broiler (6%) and Eggs (7%). Islamabad Feed generates (82%) of its revenue from the country's central region and remaining (18%) from country's northern region in FY19. Moreover, the Company generated 20-25% of revenue by selling feed to associated company – Islamabad Farms. During 9MFY19, the Company's top line stood at PKR11.5 bln (FY19:PKR14.5 bln).

**Margins** The gross margin of the Company improved 9MFY20: 9.8% (FY19: 7.3%) as the Company was able to pass on the increased raw cost in a timely manner. However, the input cost raw material (soybean meal), increased due to rupee depreciation. The management kept the production and overheads expenses under control resulting in better operating margins 9MFY20: 8.3% (FY19: 5.7%). Higher finance cost (9MFY20: PKR 733mln, FY19: PKR 501mln) narrowed net profit margin to (9MFY20: 1.3%, FY19: 1.7%).

**Sustainability** The prevailing lockdown and uncertainty amidst COVID-19 outbreak has created challenges for the industry and the Company. Sustaining operations and generating cash flows will be tough in current environment as demand remains low. The situation may worsen if lockdown prolongs for a significant time.

## Financial Risk

**Working Capital** Islamabad Feeds working capital needs originates from financing and storing maize and soybean meal in bulk. High inventory levels resulted in higher inventory days (9MFY20:157 days, FY19:144 days). The Company generally receives payment from buyers upon maturity and sale of flock of birds. Receivable days increased to (9MFY20: 67 days, FY19: 59 days). Both higher inventory days and receivable days kept the net working capital days on the higher side (9MFY20: 164 days, FY19: 148 days). The Company procures raw materials on credit. Trade payable days has increased slightly (9MFY20: 60 days, FY19: 56 days), due to the relaxation of credit terms. Adequate room exists at net trade level (9MFY20: 12%, FY19: 8%).

**Coverages** In 9MFY20, the interest cover slightly decline to 1.5x (FY19: 1.7x). This decline was mainly due to the higher finance cost (9MFY20: PKR 733 mln, FY19: PKR 501mln) despite the increase in free cash flows from operations (6MFY20: PKR 1,110mln, FY19 PKR 844mln). In 9MFY20, the Company's core and total coverage ratios have slightly decline to 1.5x (Core and Total Coverage: FY19: 1.6x). The Company has deferred/restructured its debt to create room in cashflows and coverages, which were otherwise getting strained.

**Capitalization** Islamabad Feeds has highly leveraged capital structure with debt to equity ratio at 70% in 9MFY20 (FY19:69%) on the back of relatively small equity base. The Company's total debt increased PKR 6.8bn in 9MFY19 (FY19: PKR 6.2bln). During 9MFY19, the Company's total debt comprises mainly of Short-Term Borrowings (PKR 6.6bln) to procure Maize, Soybean meal and other raw materials in bulk. The Company has availed SBP provided measures to defer and restructure its debt obligations but overall leveraging remains the same.



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR mln

Islamabad Feeds (Pvt.) Ltd. Poultry Feed	Mar-20 9M	Jun-19 12M	Jun-18 12M	Jun-17 12M
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#### A BALANCE SHEET

1 Non-Current Assets	2,351	2,492	1,991	1,939
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	10,490	9,501	7,937	7,099
a Inventories	7,124	6,100	5,402	4,669
b Trade Receivables	2,841	2,792	1,933	1,905
5 Total Assets	12,841	11,993	9,928	9,038
6 Current Liabilities	2,740	2,706	2,300	963
a Trade Payables	2,506	2,531	1,894	819
7 Borrowings	6,798	6,136	4,912	5,434
8 Related Party Exposure	66	66	9	13
9 Non-Current Liabilities	230	230	140	145
10 Net Assets	3,007	2,855	2,567	2,483
11 Shareholders' Equity	3,008	2,855	2,567	2,483

#### B INCOME STATEMENT

1 Sales	11,508	14,544	11,826	13,718
a Cost of Good Sold	(10,384)	(13,480)	(11,069)	(12,811)
2 Gross Profit	1,124	1,064	756	906
a Operating Expenses	(172)	(236)	(205)	(214)
3 Operating Profit	952	828	551	692
a Non Operating Income or (Expense)	(4)	(2)	(11)	(15)
4 Profit or (Loss) before Interest and Tax	948	826	540	677
a Total Finance Cost	(733)	(504)	(375)	(474)
b Taxation	(63)	(73)	(81)	(59)
6 Net Income Or (Loss)	152	249	83	145

#### C CASH FLOW STATEMENT

a Free Cash Flows from Operations (FCFO)	1,110	844	623	803
b Net Cash from Operating Activities before Working Capital Changes	437	363	240	302
c Changes in Working Capital	(1,100)	(682)	691	1,757
1 Net Cash provided by Operating Activities	(663)	(319)	931	2,059
2 Net Cash (Used in) or Available From Investing Activities	(85)	(187)	(289)	(87)
3 Net Cash (Used in) or Available From Financing Activities	662	414	(522)	(2,020)
4 Net Cash generated or (Used) during the period	(85)	(92)	120	(48)

#### D RATIO ANALYSIS

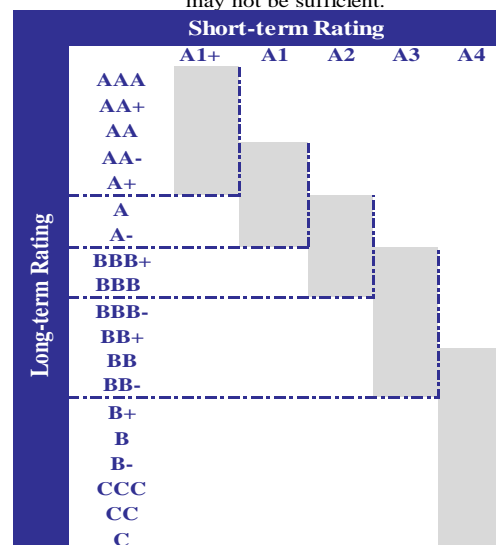
1 Performance				
a Sales Growth (for the period)	5.5%	23.0%	-13.8%	-9.9%
b Gross Profit Margin	9.8%	7.3%	6.4%	6.6%
c Net Profit Margin	1.3%	1.7%	0.7%	1.1%
d Cash Conversion Efficiency (EBITDA/Sales)	9.8%	7.2%	5.6%	6.5%
e Return on Equity (ROE)	6.9%	9.2%	3.3%	6.0%
2 Working Capital Management				
a Gross Working Capital (Average Days)	224	204	215	202
b Net Working Capital (Average Days)	164	148	173	181
c Current Ratio (Total Current Assets/Total Current Liabilities)	3.8	3.5	3.5	7.4
3 Coverages				
a EBITDA / Finance Cost	1.5	2.1	1.8	1.9
b FCFO / Finance Cost+CMLTB+Excess STB	1.5	1.6	1.6	1.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.5	0.9	0.3	0.3
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	69.5%	68.5%	65.7%	68.7%
b Interest or Markup Payable (Days)	64.1	80.7	52.7	48.4
c Average Borrowing Rate	14.8%	9.0%	7.2%	7.3%

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

Scale	Short-term Rating Definition
<b>A1+</b>	The highest capacity for timely repayment.
<b>A1</b>	A strong capacity for timely repayment.
<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>A4</b>	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):

#### Entities

- Broker Entity Rating
- Corporate Rating
- Financial Institution Rating
- Holding Company Rating
- Independent Power Producer Rating
- Microfinance Institution Rating
- Non-Banking Finance Companies (NBFCs) Rating

#### Instruments

- Basel III Compliant Debt Instrument Rating
- Debt Instrument Rating
- Sukuk 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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- (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)
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- (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)
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- (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)

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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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