



The Pakistan Credit Rating Agency Limited

## Rating Report

### Sapphire Fibres Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
13-Nov-2023	A+	A1	Stable	Maintain	-
23-Nov-2022	A+	A1	Stable	Maintain	-
23-Nov-2021	A+	A1	Stable	Maintain	-
23-Nov-2020	A+	A1	Stable	Maintain	-
23-Nov-2019	A+	A1	Stable	Maintain	-
24-May-2019	A+	A1	Stable	Maintain	-
23-Nov-2018	A+	A1	Stable	Maintain	-
29-May-2018	A+	A1	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect the recognizable business profile of Sapphire Fibres Limited (the Company) established from its presence in the broader value chain; enabling it to manage volatility in the textile industry. The Company enjoys a competitive edge in its respective market by the presence of a value-addition segment. The Company's core product range is segregated into three segments; Spinning, Knitting, and Denim. The Company's overall spinning capacity was enhanced to 104,496 spindles in FY23. The business profile, mainly emanating from a sizable contribution of the Spinning segment posted a noticeable growth over the years. However, the volumetric analysis signifies a largely sustained pattern whereas the benefit is largely derived from Rupee devaluation in FY23. The sheer quantum of the revenue base is large whilst the management captures attractive margins from the value-addition segment. A major chunk of the exports comprise the sale of Yarn followed by Fabric and Garments. The Company achieved geographical diversification through an established customer base and product differentiation during the last few years. Locally, the Company sells to several big players in the textile industry. As per management accounts, the Company's topline was recorded at PKR 12.2bln during 1QFY24 (FY23: PKR 46.4bln) while it achieved a net profitability of PKR 716mln in 1QFY24 (FY23: PKR 5.1bln). During FY23, the margins remained in a comfortable range despite the challenges witnessed in the import of raw materials. On the strategic side, the investments are meticulously worked out and rigorously followed which adds to the financial strength. The adequate coverages exhibit sufficient cash flows to meet the outstanding debt obligations. The Company portrays a robust financial risk profile as evidenced by less leveraging and an improved Capital structure. Management of the working capital cycle remains essential, going forward. Ratings incorporate the association of the company with the well-established Sapphire Group which enjoys a distinguishing presence in several sectors. 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.

The ratings are dependent on sustaining the business profile of the Company by maintaining profitability and margins achieved from core textile operations. At the same time, the sustainability of non-core income and prudent management of surplus funds is important. The sustainability of coverages would remain critical to avoid any drag on the financial profile.

#### Disclosure

<b>Name of Rated Entity</b>	Sapphire Fibres 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   Composite and Garments(Dec-22)
<b>Rating Analysts</b>	Uswa Sikandar   uswa.sikandar@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Sapphire Fibres Limited (Sapphire Fibres) is a listed, public limited concern established in 1979.

**Background** Sapphire Fibres is the flagship Company of Sapphire Group. Mr. Mohammad Abdullah, Ex-Chairman of the Group, founded Sapphire Group in 1969 and is succeeded by his sons, Mr. Shahid Abdullah, Mr. Nadeem Abdullah, Mr. Amer Abdullah, and Mr. Yousaf Abdullah.

**Operations** Sapphire Fibres is a vertically integrated composite textile unit engaged in the production of yarn, knitwear, and denim fabric. The Company has six manufacturing facilities in and around Lahore as well as captive power plants. The Company currently operates with 104,496 spindles.

## Ownership

**Ownership Structure** The company's major stake (67.5%) is vested with the Sponsoring Family through Individuals (13.7%) and Group companies (53.8%). While the remaining stake is held by the General Public (26%) and Others (6.5%).

**Stability** The presence of a Group holding company, Sapphire Holdings (Pvt.) Limited, as well as formal documentation capturing the family ownership structure bodes well for the stability of the company.

**Business Acumen** The Abdullah family has more than 50 years of experience in the textile industry with full knowledge of the internal workings of textile mills as well as a special knack for the formulation of policies and strategic planning.

**Financial Strength** The Sapphire Group has one of the largest vertically integrated textile set-ups in Pakistan with more than 30 production units. It also has interests in diversified sectors including Power, Dairy, Cement, and Investment companies.

## Governance

**Board Structure** Overall control vests in a nine-member board of directors including the Chairman and CEO. The board is chaired by Mr. Yousaf Abdullah. The Board is dominated by the Sponsoring Group. However, the non-executive role of some family members and the presence of three independent directors makes the overall governance structure strong. All the board members are seasoned professionals. The board meets on a regular basis for strategic planning and to foresee any future challenges faced by the business.

**Members' Profile** Mr. Amer Abdullah has ceased to be the Chairman of the Board as of September 23, 2021, and Mr. Yousaf Abdullah has been appointed as the Chairman of the board. He became director in various companies of Sapphire Group in 1995.

**Board Effectiveness** Attendance of members in board meetings remained strong while the minutes of meetings were well documented. Two committees - Audit, and Human Resource & Remuneration - are in place to assist the board on relevant matters. Both committees are chaired by Independent directors.

**Financial Transparency** M/s. Shinewing Hameed Chaudhri & Co. - in category "B" on the SBP panel of auditors - is the external auditor of the Company. The auditor gave an unqualified opinion on the company's financial statements for the period ended June 30th, 2023. The company has an Internal Audit function which is co-sourced.

## Management

**Organizational Structure** The company's overall operations are segregated into eight broad functional divisions which are further categorized into various sub-divisions to ensure a smooth flow of operations with a large number of senior executives reporting directly to the CEO.

**Management Team** The management team comprises qualified and experienced professionals, led by the CEO - Mr. Shahid Abdullah - who possesses rich textile industry experience and has been associated with the Company since its inception. He is currently serving as the CEO of Sapphire Electric Company Limited. He is assisted by the COO, Mr. Shayan Abdullah.

**Effectiveness** The management tier ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations while the implementation of the system covers the integration of business processes, and optimizing resources using synchronization and planning.

**MIS** The company has implemented an Oracle-based ERP - Oracle E-business suite - to cater to the large-scale and diversified operations. Regular updates to the software aid the management in timely decision-making.

**Control Environment** The company's monthly MIS reports which comprise comprehensive segment and unit-wise performance reports are reviewed formally by the CEO along with monthly accounts.

## Business Risk

**Industry Dynamics** During FY23, the 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** During FY23, Sapphire Fibres contributed a healthy share of the country's total textile exports. It is one of the largest specialized yarn manufacturing and marketing companies in Pakistan.

**Revenues** During FY23, the Company's topline recorded an increase of 6.4% to stand at PKR 46.4bln (FY22: PKR 43.6bln). Exports constituted 83.6% of the Company's topline in FY23 standing at PKR 38.8bln (FY22: PKR 38.2bln). The majority of the company's exports are to Asia, Europe, America, Australia, and Africa. Geographically, the concentration of the revenues is moderately diversified. The company also witnessed a sizeable improvement in local sales to stand at PKR 10bln (FY22: PKR 7.5bln). During 1QFY24, the revenue base of the company clocked at PKR 12.2bln.

**Margins** The company's gross margin went down on a YoY basis (FY23: 19.2%, FY22: 23.6%). The same translated into operating margins which improved to 13.9% (FY22: 17.9%). Net margin, however, declined to 11% (FY22: 14.2%) which is in line with the industry trend. During 1QFY24, the company's gross margin and net margin were recorded at 13.9% and 5.8% respectively.

**Sustainability** Regular Balancing, Modernization, and Replacement (BMR) in spinning and weaving segments in FY23 had a positive impact on overall productivity. Dividend income from the Company's trading portfolio continues to supplement the bottom line.

## Financial Risk

**Working Capital** The company's working capital needs emanate from financing inventories and trade receivables for which the company relies on both internal cash flows as well as short-term borrowings (STBs). As of end-Jun23, the company's net working capital days displayed an incline to stand at 140 days (end-Jun22: 119 days) due to an increase in the trade receivable days (end-Jun23: 49 days; end-Jun22: days). As of end-Sep23, the company's working capital cycle inclined to 154 days.

**Coverages** During FY23, the company prudently managed its free cashflows clocking at PKR 6.9bln (end-Jun22: PKR 8bln). Despite, an increase in finance cost, the interest coverage for the period remained at a comfortable range of 3.9x (end-Jun22: 5.4x) while core debt coverage inched down to 2.3x (end-Jun22: 3.1x). The company's debt payback reflected that the company is generating enough cash to meet its debt obligations. As of end-Sep23, the free cash flows from operations clocked at PKR 1.1bln.

**Capitalization** The company has a moderately leveraged capital structure. At end-Jun23, the Equity base of the company enhanced to PKR 27.7bln (end-Jun22: PKR 23.3bln) reflecting a growth of 18.5%. The Borrowing book reflected a downward trend to stand at PKR 14.9bln (end-Jun22: 17.6bln). Out of which, the short-term borrowings constitute 59.4% standing at PKR 8.8bln (end-Jun22: PKR 10.9bln). Due to this, the total leveraging registered a decrease to stand at 35% (end-Jun22: 43.1%). As of end-Sep23, the company's leveraging went up to 38.9%.



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Financial Summary  
PKR mln

Sapphire Fibres Limited Spinning	Sep-23 3M	Jun-23 12M	Jun-22 12M	Jun-21 12M
<b>A BALANCE SHEET</b>				
1 Non-Current Assets	15,142	15,215	14,695	12,896
2 Investments	4,640	4,303	5,298	6,854
3 Related Party Exposure	5,907	5,444	4,966	4,682
4 Current Assets	29,511	26,193	23,942	16,427
<i>a Inventories</i>	18,905	14,503	14,344	11,352
<i>b Trade Receivables</i>	5,231	7,447	5,077	2,728
5 Total Assets	55,200	51,156	48,900	40,860
6 Current Liabilities	7,113	7,879	7,329	4,315
<i>a Trade Payables</i>	2,248	2,450	3,372	1,724
7 Borrowings	18,416	14,926	17,685	17,161
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	686	642	517	468
10 Net Assets	28,985	27,709	23,369	18,915
11 Shareholders' Equity	28,985	27,709	23,369	18,915
<b>B INCOME STATEMENT</b>				
1 Sales	12,279	46,447	43,638	27,531
<i>a Cost of Good Sold</i>	(10,570)	(37,530)	(33,350)	(23,591)
2 Gross Profit	1,709	8,917	10,288	3,941
<i>a Operating Expenses</i>	(671)	(2,477)	(2,494)	(1,429)
3 Operating Profit	1,038	6,439	7,794	2,512
<i>a Non Operating Income or (Expense)</i>	691	1,639	932	1,125
4 Profit or (Loss) before Interest and Tax	1,729	8,079	8,726	3,637
<i>a Total Finance Cost</i>	(671)	(1,984)	(1,672)	(963)
<i>b Taxation</i>	(341)	(974)	(849)	(400)
6 Net Income Or (Loss)	717	5,121	6,205	2,274
<b>C CASH FLOW STATEMENT</b>				
<i>a Free Cash Flows from Operations (FCFO)</i>	1,134	6,971	8,091	3,144
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	487	5,109	6,490	2,191
<i>c Changes in Working Capital</i>	(4,200)	(2,295)	(5,452)	(3,487)
1 Net Cash provided by Operating Activities	(3,713)	2,814	1,038	(1,296)
2 Net Cash (Used in) or Available From Investing Activities	397	475	(1,359)	(682)
3 Net Cash (Used in) or Available From Financing Activities	3,490	(2,975)	302	1,975
4 Net Cash generated or (Used) during the period	174	314	(18)	(4)
<b>D RATIO ANALYSIS</b>				
<b>1 Performance</b>				
<i>a Sales Growth (for the period)</i>	5.7%	6.4%	58.5%	0.0%
<i>b Gross Profit Margin</i>	13.9%	19.2%	23.6%	14.3%
<i>c Net Profit Margin</i>	5.8%	11.0%	14.2%	8.3%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	-25.0%	10.1%	6.0%	-1.2%
<i>e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sl</i>	10.1%	20.1%	29.3%	12.0%
<b>2 Working Capital Management</b>				
<i>a Gross Working Capital (Average Days)</i>	171	163	140	187
<i>b Net Working Capital (Average Days)</i>	154	140	119	164
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	4.1	3.3	3.3	3.8
<b>3 Coverages</b>				
<i>a EBITDA / Finance Cost</i>	2.3	4.4	6.0	4.3
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	1.3	2.3	3.1	1.7
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	2.8	1.2	1.0	2.7
<b>4 Capital Structure</b>				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	38.9%	35.0%	43.1%	47.6%
<i>b Interest or Markup Payable (Days)</i>	57.7	73.2	61.4	86.8
<i>c Entity Average Borrowing Rate</i>	13.9%	10.4%	7.6%	4.8%

### 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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- (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).
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- (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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- (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)
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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 | 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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