



The Pakistan Credit Rating Agency Limited

## Rating Report

### Zahidjee Textile Mills Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Nov-2022	A	A1	Stable	Upgrade	-
25-Oct-2021	A	A2	Stable	Upgrade	-
29-Oct-2020	A-	A2	Positive	Maintain	-
30-Oct-2019	A-	A2	Positive	Maintain	-
30-Apr-2019	A-	A2	Stable	Maintain	-
28-Dec-2018	A-	A2	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The rating upgrade incorporates Zahidjee Textile's improved business and financial risk. The business risk profile is supported by the Company's established track record of operating in spinning and weaving segments. Continuous BMR activities have led to significant growth in operations in recent years. During FY22, the Company increased its spinning capacity to 133,344 spindles from 93,024 spindles financed through a mixture of internal and external sources for the manufacturing of finer count. The operating performance of the Company witnessed a sizable improvement in FY22. The revenue base recorded a healthy increase and stood at PKR 27.9bln (FY21: PKR 16.6bln). The Company's sales volume was enhanced attributable to an increase in local sales and better yarn prices. Improved financial risk profile attributable to a decrease in leveraging and an increase in coverage. The debt structure is skewed towards long-term borrowings. Further, room to borrow displayed improvement along with reduced debt payback. Going forward, improved performance was recorded in recent quarters along with sustaining financial risk profile and efficient utilization of enhanced capacity. During FY22, Pakistan's textile exports surged to \$19.3bln (recording a growth of 26%). Exports grew owing to increased volumetric growth of (16% YoY) in the value-added segment, a steep rise in global demand, and record-high cotton prices. Under the value-added category, the knitwear segment remained the top performer by posting 34% YoY growth in exports to \$5.1 billion in FY22 due to a sharp rise in global demand, especially in the US and European countries. Floods have added another challenge, especially pertaining to the availability of the cotton crop.

The Company's financial risk profile remains strong, characterized by sufficient cash flows and, in turn, strong coverages, driven by augmented profitability. Ratings are also underpinned by a moderately low leveraged capital structure, growth in the equity base, and a good corporate governance framework.

#### Disclosure

<b>Name of Rated Entity</b>	Zahidjee Textile Mills 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   Composite and Garments(Dec-21)
<b>Rating Analysts</b>	Sehar Fatima   sehar.fatima@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Zahidjee Textile Mills Limited ("Zahidjee Textile" or "the Company") is a listed, public limited concern incorporated in 1990.

**Background** The Company was established in 1990 when Mr. Muhammad Sharif, Ex-Chairman of the Company, purchased a sick spinning concern in Faisalabad and renamed it Zahidjee Textile Mills Limited. Gradually, the Company had been expanded by setting up additional spindles where a weaving unit was also established.

**Operations** The Company is primarily engaged in the production and sale of cotton and blended (Polycotton) yarns, greige fabric, processed fabric, and captive power generation with an installed capacity of ~25MW. Production facilities are situated at three different locations in Faisalabad.

## Ownership

**Ownership Structure** The majority stake (96.28%) in Zahidjee Textile is held by the Zahid family through Mr. Muhammad Zahid (21.28%) and Mr. Ahmad Zahid (75%), while the remaining (3.72%) stake lies with joint-stock companies and the general public.

**Stability** Though there is no formal succession plan, it is decided that Mr. Ahmad Zahid will be the successor. Going forward, this is expected to reflect in the pattern of shareholding with a further increase in Mr. Ahmad Zahid's stake, while Mr. Zahid will remain the vital shareholder with a majority interest vested.

**Business Acumen** The Zahid family has over four decades of experience in textile manufacturing and trading. In addition, the family has an interest in investment banking.

**Financial Strength** The Zahid family also owns Zahidjee Towers (Pvt.) Limited along with several real estate properties at prime locations in Lahore and Faisalabad. The sponsor has shown a willingness and ability to support the business if the need arises.

## Governance

**Board Structure** Zahidjee Textile's Board of Directors comprises seven members and is Chaired by Mr. Ahmad Zahid. The Board comprises four members of the sponsor family and three independent members. There are two committees in place i) Audit Committee ii) and Human Resource Committee to assist the Board on relevant matters.

**Members' Profile** Mr. Muhammad Sharif – Ex-Chairman and founder of the Company who had over five decades of experience in yarn trading resigned from the Company in Jun-21. The independent directors possess multiple years of experience in the textile, chemicals, and electronic appliances sectors, bringing diversity to the existing skill set Board. Board has appointed Mr. Ahmed Zahid as a new Chairman effective from July 6, 2021.

**Board Effectiveness** Board meetings have full attendance of directors, boding well for the Board's effectiveness. Meanwhile, the quality of discussion disclosed in meeting minutes has room for improvement.

**Financial Transparency** RSM Avais Hyder Liaquat Nauman Chartered Accountants is the external auditor of the Company, placed in category "B" on the State Bank's panel of auditors. The auditor gave an opinion on the company's financial statements for the year ending June 30, 2022. The board has also set up an internal audit function with the Head of Internal Audit reporting directly to the Board Audit Committee.

## Management

**Organizational Structure** Zahidjee Textile has a lean organizational structure, divided into various departments reporting to the COO - Ms. Ayesha Shehryar, and the CFO - Mr. Mudassar Ramzan.

**Management Team** The Ex-CEO – Mr. Muhammad Zahid has overall thirty-five years of experience in the textile sector and is actively involved in day-to-day decision-making in the Company while Mr. Zahid's daughter, Ms. Ayesha Shehryar, is the Chief Operating Officer. The management team constitutes well-experienced, seasoned individuals. The management tier ensures effective delegation of functional responsibility across various departments, facilitating a smooth flow of operations.

**Effectiveness** While there are formal management committees, all Unit Heads report to the CEO daily to discuss day-to-day developments and issues. The Company maintains adequate IT infrastructure and related controls.

**MIS** Zahidjee Textile deployed an Oracle-based ERP solution – Oracle EBS in 2012. This allows the company to streamline the flow of information from dispersed operations, enabling proactive management, avoidance of disruptions, and timely decision-making.

**Control Environment** Daily reports regarding the Company's performance are submitted to higher management. Through MIS, the Company is also able to monitor working capital management and exposure to related parties with automated limits and periodic reviews.

## Business Risk

**Industry Dynamics** During FY22, Pakistan's textile exports surged to \$19.3bln (recording a growth of 26%). Exports grew owing to increased volumetric growth of (16% YoY) in the value-added segment, a steep rise in global demand, and record-high cotton prices. Under the value-added category, the knitwear segment remained the top performer by posting 34% YoY growth in exports to \$5.1 billion in FY22 due to a sharp rise in global demand, especially in the US and European countries. Other value-added segments such as ready-made garments, bed wear, and towel posted YoY growth of 29%, 19%, and 19% to \$3.9 billion, \$3.3 billion, and \$1.1 billion respectively. However, a slowdown is expected in textile demand amid burgeoning inflationary pressures in the exporting destinations, especially in the US and European countries.

**Relative Position** Zahidjee Textile is one of the exporters of greige fabric in Pakistan and holds a ~1% share in the country's exports. The Company's size of installed capacity has increased manifold over the last few years.

**Revenues** The sales revenue of the Company for FY22 has enhanced manifold to PKR 27.9bln (FY21: PKR 16.6bln), recording a growth of 68% owing to the increased operational efficiencies and strong local demand resulting in volumetric growth in yarn sales. The Company's top line is dominated by yarn (75.6%), followed by fabrics (24.4%), whereas the same mix is expected to continue in the future. It is pertinent to mention that the Company's 15% (FY21: 13%) revenues are being generated from export sales.

**Margins** The Company's gross margin increased to 20.2% during FY22 (FY21: 14.3%) on the back of controlled input costs. The Company was largely able to maintain its distribution cost and administration expenses as reflected in the operating margin (FY22: 18%; FY21: 12.6%). Dependency on debt finance has forced the Company to bear increased finance costs (FY22: PKR 636mln; FY21: PKR 283mln) attributable to higher interest rates. Despite enhanced financed costs, the Company was able to secure sizable improvement in the net profitability (FY22: PKR 3.9bln; FY21: PKR 1.5bln). The net margin was reported as 14.2% (FY21: 9.4%).

**Sustainability** The Company incurred BMR in FY20, aimed at reducing power costs, and is currently in the process of upgrading its weaving segment through the replacement of old looms. These measures assisted the Company in achieving improved efficiency. The Company has enhanced the total production capacity to 133,344 spindles through the installation of new spindles.

## Financial Risk

**Working Capital** The company meets its working capital requirements through a mix of internal generation and short-term borrowings (STBs). The net working capital days improved during the period (FY22: 80 days, FY21: 94 days) attributable to a decrease in inventory days (FY22: 46 days, FY21: 64 days). The short-term trade leverage enhanced to 47.2% (FY21: 42%) attributable to an increase in trade assets of the company.

**Coverages** The free cash flows from operations recorded sizable growth to PKR 5.3bln (FY21: PKR 2bln) reflecting an increase in interest coverage to 8.7x (FY21: 7.7x). Despite an increase in finance cost, the debt coverage also enhanced to 5.3x (FY21: 4.4x). The company's debt payback also improved to 1 year (FY21: 1.5 years) reflecting that the company is generating enough cash to meet its obligations.

**Capitalization** The company has a moderately leveraged capital structure. At end-Jun22, the equity base of the company recorded growth of 90% to stand at PKR 14.6bln (FY21: PKR 7.7bln). The total borrowings of the company reflected an increase to stand at PKR 8.7bln (FY21: 4.9bln) out of which short-term borrowing constitutes 45% while the leveraging of the company inched down to 37.4% (FY21: 38.8%).



Zahidjee Textile Mills Limited ##	Jun-22 12M	Jun-21 12M	Jun-20 12M	Jun-19 12M
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**A BALANCE SHEET**

1 Non-Current Assets	14,390	8,152	6,618	6,089
2 Investments	125	123	57	73
3 Related Party Exposure	6	384	360	360
4 Current Assets	12,250	5,946	5,386	4,623
a Inventories	4,094	2,936	2,927	2,604
b Trade Receivables	4,313	2,001	1,729	1,231
<b>5 Total Assets</b>	<b>26,772</b>	<b>14,604</b>	<b>12,421</b>	<b>11,146</b>
6 Current Liabilities	1,933	1,334	1,143	643
a Trade Payables	595	537	466	182
7 Borrowings	8,756	4,964	4,156	3,944
8 Related Party Exposure	6	162	173	249
9 Non-Current Liabilities	1,386	421	481	395
<b>10 Net Assets</b>	<b>14,691</b>	<b>7,723</b>	<b>6,467</b>	<b>5,915</b>
<b>11 Shareholders' Equity</b>	<b>14,691</b>	<b>7,845</b>	<b>6,467</b>	<b>5,915</b>

**B INCOME STATEMENT**

1 Sales	27,936	16,615	13,902	13,445
a Cost of Good Sold	(22,304)	(14,233)	(12,226)	(11,983)
<b>2 Gross Profit</b>	<b>5,632</b>	<b>2,381</b>	<b>1,677</b>	<b>1,462</b>
a Operating Expenses	(601)	(280)	(277)	(247)
<b>3 Operating Profit</b>	<b>5,031</b>	<b>2,101</b>	<b>1,399</b>	<b>1,215</b>
a Non Operating Income or (Expense)	(123)	(98)	(76)	(82)
<b>4 Profit or (Loss) before Interest and Tax</b>	<b>4,908</b>	<b>2,003</b>	<b>1,323</b>	<b>1,133</b>
a Total Finance Cost	(636)	(283)	(329)	(389)
b Taxation	(295)	(162)	(296)	37
<b>6 Net Income Or (Loss)</b>	<b>3,978</b>	<b>1,559</b>	<b>697</b>	<b>782</b>

**C CASH FLOW STATEMENT**

a Free Cash Flows from Operations (FCFO)	5,342	2,073	1,655	1,666
b Net Cash from Operating Activities before Working Capital Changes	4,751	1,625	1,303	1,305
c Changes in Working Capital	(3,111)	(355)	(261)	(199)
<b>1 Net Cash provided by Operating Activities</b>	<b>1,640</b>	<b>1,270</b>	<b>1,042</b>	<b>1,106</b>
<b>2 Net Cash (Used in) or Available From Investing Activities</b>	<b>(2,718)</b>	<b>(1,942)</b>	<b>(1,034)</b>	<b>(451)</b>
<b>3 Net Cash (Used in) or Available From Financing Activities</b>	<b>3,466</b>	<b>533</b>	<b>(27)</b>	<b>(596)</b>
<b>4 Net Cash generated or (Used) during the period</b>	<b>2,388</b>	<b>(139)</b>	<b>(20)</b>	<b>59</b>

**D RATIO ANALYSIS**

<b>1 Performance</b>				
a Sales Growth (for the period)	68.1%	19.5%	3.4%	30.2%
b Gross Profit Margin	20.2%	14.3%	12.1%	10.9%
c Net Profit Margin	14.2%	9.4%	5.0%	5.8%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	8.0%	10.3%	10.0%	10.9%
e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Sl	35.3%	21.8%	11.3%	14.1%
<b>2 Working Capital Management</b>				
a Gross Working Capital (Average Days)	87	105	111	106
b Net Working Capital (Average Days)	80	94	103	95
c Current Ratio (Current Assets / Current Liabilities)	6.3	4.5	4.7	7.2
<b>3 Coverages</b>				
a EBITDA / Finance Cost	9.2	8.3	5.8	4.6
b FCFO / Finance Cost+CMLTB+Excess STB	5.3	4.4	3.1	3.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.0	1.5	1.1	1.0
<b>4 Capital Structure</b>				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	37.4%	38.8%	40.1%	41.5%
b Interest or Markup Payable (Days)	69.9	99.0	68.3	79.7
c Entity Average Borrowing Rate	8.2%	6.1%	7.2%	7.7%

**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)

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- 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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- (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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- (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
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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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- (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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