Ratings

Series 2014 A	HR BBB+ (G)
Outlook	Stable

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Definition

The issuer or issue with this rating provides moderate safety for timely payment of debt obligations. Maintains moderate credit risk on a global scale, with weakness in the ability to pay in adverse economic scenarios.

Rule 17g-7 Information Disclosure Form

The Rating Action Commentary (RAC) associated with this disclosure form is an integral part of the form.

1. **Symbol, Number, or Score in the Rating Scale used by HR Ratings as required by Paragraph (a)(1)(ii)(A) of Rule 17g-7:**

Entity/Instrument	Rating Action	Rating Type	Rating Code
Series 2014 A	Ratified	Long Term Rating	HR BBB+ (G) / Stable Outlook

2. **Version of the Procedure or Methodology used to determine the credit rating as required by Paragraph (a)(1)(ii)(B) of Rule 17g-7:**

The rating assigned by HR Ratings to the entity is based in accordance with the following methodologies established by the rating agency:

- Charter Schools Credit Risk Evaluation, February 2015
  https://www.hrratings.com/docs/metodologia/New%20Charter%20Schools%20Methodology%20R.pdf

3. **Main assumptions and principles used in constructing the procedures and methodologies to determine the credit rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7:**

Principles:

The bonds rated are considered as a general obligation of the entity. Therefore, the methodology mentioned before is based on the evaluation of the credit quality of the whole entity. The rating process consists of two basic components:

- Determination of the Initial Rating or Quantitative analysis:

  HR Ratings makes a quantitative analysis of audited financial statements that provides insight of the financial administration of the entity. Taking in consideration the historical analysis and guidance given by the entity of the projected financial statements, HR Ratings projects, for the next five years, the financial statements in a base and a stress scenario. In order to validate guidance given by the entity, it is compared with historical data and guidance given in past years.

  Another important concept in the Charter Schools methodology is the projection of enrollment which HR Ratings makes considering also guidance given based on historical information, expansion plans, demand and competition. Enrollment determines the federal and state recourse that the school receives.

  Once projections are made, our model calculates the Free Cash Flow (FCF), which is the core concept in order to calculate the four metrics that determine the initial rating. These four metrics are: i) Debt Service Coverage Ratio ("DSCR"), ii) DSCR with cash, iii) Years of Payment and iv) "MALC". The model calculates a weighted average between these metrics and between years in both base and stress scenarios, then these two numbers are weighted to obtain one that is associated to a rating.

- Qualitative Adjustments to the initial rating:

  Based on a qualitative analysis that takes in consideration various factors that could have an impact on the entity´s credit risk, the initial rating may have a multi-notch adjustment. These factors are:

a) Management and future debt instrument issuance: HR Ratings takes in consideration the strength and diversity of the management team and the board of directors by analyzing each member's experience and field of expertise. On the other hand, the analysis takes into account a responsible policy of debt issuance.

b) Demographic trends and competition: The demand factor is key to determine enrollment that defines most of the income that the school receives. Demographic trends in the areas where the school is located are key to determining demand, as well as the competition that the school faces with their counterparts.

c) Academic performance and other services: One of the main qualitative risks is the revocation of the charter, this can be a result of poor academic performance. The student grades and other measurements of academic performance are obtained by public sources from a third party.

d) State regulation and legislation: Another risk of revocation of the charter comes from any change in the state regulation and legislation, this could also lead to an adjustment in the initial rating.

4. Potential limitations of the credit rating as required by Paragraph (a)(1)(ii)(D) of Rule 17g-7

- HR Ratings does not validate, guarantee or certify the accuracy, correctness or completeness of any information and is not responsible for any errors or omissions or for results obtained from the use of such information.
- Ratings and/or opinions assigned by HR Ratings are based on an analysis of the creditworthiness of an entity, issue or issuer, and do not necessarily imply a statistical likelihood of default.
- The credit ratings do not opine on the liquidity of the issuer´s securities or stock.
- The credit ratings do not consider the possible loss severity on an obligation default.
- The credit ratings are not an opinion of the market value of any issuer´s securities or stock, or the possibility that this value suffer a deterioration.

5. Information on the uncertainty of the credit rating as required by Paragraph (a)(1)(ii)(E) of Rule 17g-7

The Analysis Committee noted no material limitations on the reliability, accuracy and quality on the data relied on in determining the credit rating.

The Analysis Committee noted no lack of information on the scope of historical data that would have better informed any credit rating listed in this disclosure form.

6. Use of third party due diligence services as required by Paragraph (a)(1)(ii)(F) of Rule 17g-7

HR Ratings did not consider third-party due diligence information for the rating.

7. Use of servicer or remittance reports to conduct surveillance of the credit rating as required by Paragraph (a)(1)(ii)(G) of Rule 17g-7

HR Ratings did not use Servicer or Remittance Reports.

8. Description of types of data about any obligor, issue, security or money market instrument relied upon for determining credit rating as required by Paragraph (a)(1)(ii)(H) of Rule 17g-7

Among the main information used for the rating is:

- Audited financial statements (FY20-FY22)
- Projections provided by the school administration of the financial statements.
- Historical and projected data of enrollment by grade and by campus.
- Information obtained from the school management of future strategies of enrollment, financial administration, expansion plans and improvement in academic performance.
- Public information related to state legislation, academic performance and demographic trends and competition.

9. Overall assessment of quality of information available and considered in determining credit rating as required by Paragraph (a)(1)(ii)(I) of Rule 17g-7

The quality of the information provided by the entity is considered to be consistent with the quality observed in ratings that use a similar methodology.

10. Information relating to conflicts of interest as required by Paragraph (a)(1)(ii)(J) of Rule 17g-7

The rating was solicited by the entity or issuer, or on its behalf, and therefore, HR Ratings has received the corresponding fees for the provision of its rating services. The following information can be found on our website https://www.hrratings.com/: (i) The internal procedures for the monitoring and surveillance of our ratings and the periodicity with which they are formally updated, (ii) the criteria used by HR Ratings for the withdrawal or suspension of the maintenance of a rating, (iii) the procedure and process of voting on our Analysis Committee, and (iv) the rating scales and their definitions.
The rating and/or opinions assigned are issued on behalf of HR Ratings, not of its management or technical staff, and do not constitute an investment recommendation to buy, sell, or hold any instrument nor to perform any business, investment or other operation. The assigned ratings and/or opinions issued may be subject to updates at any time, in accordance with HR Ratings' methodologies.

11. Explanation or measure of potential volatility to the credit rating as required by Paragraph (a)(1)(ii)(K) of Rule17g-7

1. Factors that are reasonably likely to lead to a change in the credit rating:

   - **Revocation or non-renewal of the academy's charter:** One of the main qualitative risks is the revocation of the charter as a result of different reasons. The most important would be a considerable deterioration of students' academic performance. This would result in the suspension of operations of the charter and very likely in the default of their obligations.
   - **Inability to meet enrollment and ADA targets:** If the School is not able to follow their expansion plans and this results in the inability to reach the enrollment projections incorporated in our base or stress scenario, the main rating metrics would be impacted. This as enrollment is vital to determine the federal and state funding that the school receives.
   - **Changes in state funding levels, or statutory changes in state open-enrollment charter School funding:** In line with the above, if the state or federal funds are in lower levels derived from a lower enrollment, it would affect the funding the School receives. Similarly, if there's a modification in the criteria that determines the levels of funding that the charter schools receive may result in the deterioration of rating metrics.
   - **Changes in the strategy of debt structure:** In order to elaborate financial projections HR Ratings makes some assumptions of the debt issuance policy of the entity taking into consideration guidance given by the school. Levels of debt are essential to determine the credit rating of the entity, therefore if levels of debt issuance changes from what HR Ratings expected in either scenario, the rating metrics would be impacted.
   - **Integration Risk.** If the School is unable to efficiently integrate the two new campuses in 2024, FCF generation could come under pressure.

2. The magnitude of the change that could occur under different market conditions determined by HR Ratings to be relevant to the rating:

   - **Lower dynamism in existing campuses and lower enrollment.** The School's revenue depends on the dynamism presented in the existing campuses, as well as on the reported enrollment. If the Company is not able meet the forecasted enrollment levels, this could produce lower than expected revenue. If this is reflected in an enrollment 2022-2027 CAGR below 9.9%, it could have a moderate negative impact on the rating.
   - **Accountability Rating by the Texas Education Agency (TEA).** This accountability rating considers the students' performance and achievements, schools' growth, closing performance gaps and postsecondary readiness. For the last ten consecutive years the School has earned this rating by meeting the standards required. It is important to mention that if for three consecutive years a school is given a substandard rating (i.e., an "Improvement Required" Accountability Rating), the state of Texas revokes school's charter. This would result in the suspension of operations of the charter and a strong negative impact on the rating.

   NOTE: The Credit Analysis Committee must convene to review and discuss the changes that could occur under different market conditions. All the ratings issued by HR Ratings must be approved by the Credit Analysis Committee in accordance with the applicable methodology and the information available at the time. However, the magnitude of a potential change in the rating that could reasonably occur as a result of the impact of the factors listed above are characterized by the following summary chart:

Rating change impact	Number of notches
Minimum	(0-1)
Moderate	(2 - 3)
Strong	>3

12. <u>Historical performance and expected probability of default and expected loss in event of default as required by Paragraph (a)(1)(ii)(L) of Rule 17g-7</u>

For historical performance of each rating listed in the disclosure form, click on the link in the ratings table presented on Page 1.

Our credit ratings need to be understood as rankings of the relative creditworthiness of different entities or credits. Creditworthiness takes into consideration both the ability and willingness to meet debt obligations in the manner prescribed in the relevant documentation. Default refers to the noncompliance of previously agreed obligations. As our ratings measure relative creditworthiness, they do not necessarily reflect any specific statistical probability of default. However, HR Ratings provides to the market participants the default rate for historical default and loss statistics for the class or subclass of the credit rating. Although the default rate is not the expected probability of default or loss given default, we consider it the ratio that could be interpreted by market participants as such. The default rate for each of the asset classes in which HR Ratings provides ratings and for each rating category is publicly available for each calendar year at: https://www.hrratings.com/regulatory_disclosure/transition_matrix.xhtml

13. <u>Assumptions made by HR Ratings in determining announced credit ratings and examples of how assumptions impact the rating as required by Paragraph (a)(1)(ii)(M) of Rule 17g-7</u>

1. Assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on the credit rating if proven false or inaccurate:

   - HR Ratings bases its ratings and/or opinions on information obtained from sources that are believed to be accurate and reliable. The assumption is that the information provided is reliable and credible, however, does not validate, guarantee or certify the accuracy, correctness or completeness of any information and is not responsible for any errors or omissions or for results obtained from the use of such information.

- Our estimates consider a 2022-2027 revenue CAGR of 14.1% mainly driven by an increase in enrollment as well as inorganic growth in 2024.
- State Legislation: We assume that the legislation that allows Charter Schools to operate will not have any change that could generate trouble in the operation of the school or to the revocation of the charter.
- Regarding profitability at the operating level, we expect that during 2022 EBITDA margin will reach 23.0% by 2027, compared to the 21.8% EBITDA margin observed in 2022.
- We forecast the Company would register a FCF of US$17.8m in 2027, compared to US$6.9m in 2022.
- The Company would report US$106.9m of gross debt and US$75.6m of net debt in 2027.
- Regarding maintenance capex, we are considering 100% of depreciation figures for the forecasted period (2022-2027).
- The school will be able to maintain the academic performance required by the regulation to keep the charter license once the TEA accounting tests return to regular appliance.

2. Analysis, using specific examples, of how each of the assumptions identified in the preceding paragraph impacts the credit rating:

- As for revenue growth, this would be mainly driven by the increase in enrollment (9.9% 2022-2027 CAGR) as two new campuses (Arlington and Grand Prairie) are incorporated in our forecasted figures. If TBP's results reflect a 2022-2027 revenue CAGR below 14.1%, it could result in a rating downgrade.

- In case the legislation that allows the operation of charter schools undergoes any change, this could lead to operational difficulties for the school or the revocation of the charter.
- In terms of EBITDA generation, we expect an EBITDA CAGR for the 2022-2027 period of 15.3%, largely driven by sustained revenue growth and operating expenses growth based on inflation and the expected increase in enrollment. A lower EBITDA CAGR for the 2022-2027 period and an average EBITDA margin below 20% could result in a lower rating.
- We anticipate FCF growth mainly driven by EBITDA generation. It is important to mention that we expect working capital requirements given the expected revenue growth for the forecasted period. If the Company is not able to offset these requirements with a higher EBITDA generation, the rating could be negatively impacted.
- Regarding debt, we incorporate the obligatory amortization of the bonds Series 2020 and 2014 A. Additionally, in 2024, we consider that the Institute will draw down US$15m from its line of credit to partially fund the investment in PP&E as part of the incorporation of Arlington and Grand Prairie campuses. For 2023 we expect the amortization of the line of credit for US$55m.
- If the maintenance capex figures, are higher than expected for the forecasted period, the generation of FCF would be negatively impacted and could lead to a lower rating.
- It the Company is not able to maintain the academic performance required by the regulation, this would result in the suspension of operations of the charter and very likely in the default of their obligations.

14. Representations, warranties and enforcement mechanisms available to investors as required by Paragraph (a)(1)(ii)(N) of Rule 17g-7

The reporting of representations, warranties, and enforcement mechanisms does not apply to any of the credit ratings listed in this disclosure form.

**HR Ratings LLC. (HR Ratings), is a HR Ratings de México, S.A. de C.V. subsidiary, a Credit Rating Agency registered by the Securities and Exchange Commission (SEC) of the United States as an NRSRO for this type of rating. HR Ratings' recognition as an NRSRO is limited to the ones described in section 3 (a) (62) (A) and (B) subsection (i), (iii) and (v) of the US Securities Exchange Act of 1934.*

Credit Rating Attestation

I, Heinz Cederborg, Corporates / ABS Director have the responsibility for this rating action and, to the best of my knowledge:

- No part of the credit rating was influenced by any other business activities;
- The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated; and
- The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument

Mexico City, December 21, 2022

/s/ Heinz Cederborg, Corporates / ABS Director
HR Ratings de México, S.A. de C.V.

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The rating was solicited by the entity or issuer, or on its behalf, and therefore, HR Ratings has received the corresponding fees for the rating services provided. The following information can be found on our website at www.hrratings.com: (i) The internal procedures for the monitoring and surveillance of our ratings and the periodicity with which they are formally updated, (ii) the criteria used by HR Ratings for the withdrawal or suspension of the maintenance of a rating, (iii) the procedure and process of voting on our Analysis Committee, and (iv) the rating scales and their definitions.

The ratings and/or opinions of HR Ratings de México S.A. de C.V. (HR Ratings) are opinions regarding the credit quality and/or the asset management capacity, or relative to the performance of the tasks aimed at the fulfillment of the corporate purpose, by issuing companies and other entities or sectors, and are based on exclusively in the characteristics of the entity, issue and/or operation, regardless of any business activity between HR Ratings and the entity or issuer. The ratings and/or opinions granted are issued on behalf of HR Ratings and not of its management or technical personnel and do not constitute recommendations to buy, sell or maintain any instrument, or to carry out any type of business, investment or operation, and may be subject to updates at any time, in accordance with the HR Ratings classification methodologies, in terms of the provisions of article 7, section II and/or III, as appropriate, of the “General provisions applicable to the issuers of securities and other participants in the stock market”.

HR Ratings bases its ratings and/or opinions on information obtained from sources that are believed to be accurate and reliable. HR Ratings, however, does not validate, guarantee or certify the accuracy, correctness or completeness of any information and is not responsible for any errors or omissions or for results obtained from the use of such information. Most issuers of debt securities rated by HR Ratings have paid a fee for the credit rating based on the amount and type of debt issued. The degree of creditworthiness of an issue or issuer, opinions regarding asset manager quality or ratings related to an entity’s performance of its business purpose are subject to change, which can produce a rating upgrade or downgrade, without implying any responsibility for HR Ratings. The ratings issued by HR Ratings are assigned in an ethical manner, in accordance with healthy market practices and in compliance with applicable regulations found on the www.hrratings.com rating agency webpage. There Code of Conduct, HR Ratings’ rating methodologies, rating criteria and current ratings can also be found on the website.

Ratings and/or opinions assigned by HR Ratings are based on an analysis of the creditworthiness of an entity, issue or issuer, and do not necessarily imply a statistical likelihood of default, HR Ratings defines as the inability or unwillingness to satisfy the contractually stipulated payment terms of an obligation, such that creditors and/or bondholders are forced to take action in order to recover their investment or to restructure the debt due to a situation of stress faced by the debtor. Without disregard to the aforementioned point, in order to validate our ratings, our methodologies consider stress scenarios as a complement to the analysis derived from a base case scenario. The rating fee that HR Ratings receives from issuers generally ranges from US$1,000 to US$1,000,000 (or the foreign currency equivalent) per issue. In some instances, HR Ratings will rate all or some of the issues of a particular issuer for an annual fee. It is estimated that the annual fees range from US$5,000 to US$2,000,000 (or the foreign currency equivalent).