Generic Ratings Navigator Companion

For Companies not Covered by Sector-Specific Navigators

Special Report

Navigator for Corporates is a graphical peer comparator that forms part of a series of similar tools being introduced across Ind-Ra.

Information on the formal rating criteria that underlie Ind-Ra's corporate ratings can be found in Ind-Ra's Corporate Rating Methodology Master Criteria, dated 4 January 2017

Sector Navigators provide guidance for applying the concepts of the Corporate Rating Criteria to the issuers in the sector the Navigator covers. The Navigator Companion Report provides an additional description of the key rating factors for companies that are assessed using the Generic Navigator.

Rating horizon is defined as a period ranging between 5-10 years and remains independent of the tenure of debt obligations.

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Generic Sectors: This report presents the key peer comparator elements observed, or expected for companies which do not fall into any of the sector-specific Navigators.

The Sector Risk Profile defines and groups companies operating in the sector into a "natural rating territory". For the Generic Navigator, this is based on Ind-Ra's view of the inherent risk profile of the corporate sector as a whole. After assessing the Management and Corporate Governance, this Navigator examines four generic sector-specific factors for given rating levels. Finally, three Financial Profile factors help capture financial attributes commensurate with particular rating categories.

Sector Risk Profile

As the Generic Navigator applies to a wide range of companies, the Sector Risk range of 'IND A+' to 'IND B-' reflects the spectrum of ratings observed for most corporate sectors. The 'IND AA' rating category is generally only applicable to sectors with highly defensive characteristics such as pharmaceuticals, utilities and oil and gas producers for which sector-specific Navigators will exist. However, each sub-factor will be defined up to the 'IND AA' category to differentiate the stronger entities from the rest by capturing company-specific traits which may result in a higher rating.

Sector-Specific Key Factors

Generic Approach: As the Generic Navigator applies across numerous sectors, Business Profile factors focus on defining the broad risk characteristics of the issuer's sector as well as the relative strength of the issuer within its sector rather than providing the more detailed analysis found in sector-specific Navigators.

Sector Competitive Intensity: This indicates the structural risks of the issuer's sector based on the industry's organisation, its relative position in the value chain, its relative bargaining power with suppliers and customers as well as possible threats from new entrants.

Sector Trend: This factor assesses the long-term growth potential of the issuer's sector, its predictability and the susceptibility to short-term demand shocks. Declining industries are generally not consistent with investment-grade ratings. Sectors facing threats from substitutes with low switching costs are generally more difficult to predict.

Market Position and Diversification: These factors indicate an issuer's ability to withstand competitive pressures, which can include, for example, its position in key markets, its level of product dominance, and its ability to influence price. Maintaining a high level of operating performance often depends on product diversity, geographical spread of sales, diversification of major customers and suppliers, and the comparative cost position.

Financial Profile Key Factors

Profitability: The analysis focuses on the stability of earnings and cash flows from the issuer's major business lines. Sustainable operating cash flow supports the issuer's ability to service debt and finance its operations and capital expansion without reliance on external funding.

Financial Structure and Flexibility: These factors use an array of predominantly cash-based metrics to measure the level of capitalisation of an issuer and other flexibility measures such as liquidity and exposure to foreign-exchange movements.

Management and Corporate Governance

See Appendix I

Limitations

This report outlines the indicative factors observed or extrapolated for rated issuers. Ratio levels refer to the mid-point of a through-the-cycle range, and actual observations are likely to vary from these. Certain sub-sectors may contain a small number of observations overall, or at any given rating category. Where no observations exist, guidelines for a category are extrapolated based on Ind-Ra's judgment. The relative importance of factors will vary substantially over time both for a given issuer and between issuers, based on the significance agreed upon by the rating committee. The factors give a high-level overview and are neither exhaustive in scope nor uniformly applicable. Additional factors will influence ratings particularly where group relationships constrain or enhance a rating level.

Sector-Specific Key Factors

Sector Competitive Intensity

This Key Factor measures the structural risks of the issuer's sector based on the industry's organisation, its relative position in the value chain, its relative bargaining power with suppliers and customers as well as possible threats from new entrants.

The Structure of the Sector

A large number of non-differentiated players of similar size are more conducive to price competition than an oligopolistic industry.

The Presence of Barriers to Entry and Exit

Easy entry and low cost of exiting mean that in good times the number of competitors will increase; the new entrants are being attracted by favorable market conditions and knowing that in case of a downturn they can easily reduce their exposure. As a result, the benefit of the strong market positions will be eaten away by the increased competition, especially if there is little benefit of being an incumbent.

Value Chain

The relative power in the value chain defines how much pricing power a sector has in relation to its suppliers and customers. The best theoretical case is a monopolistic sector with numerous small suppliers and customers. This sector would be able to absorb most profits generated by the value chain. Conversely, a fragmented sector selling undifferentiated products to a small number of large customers and depending on a few suppliers would most likely make no profit beyond the minimum necessary for its survival.

Related Criteria

Corporate Rating Methodology Master Criteria (January 2017)

Figure 1

Sector Competitive Intensity: Sub-Factors

Category	Industry structure	Barriers to entry/exit	Relative power in the value chain
IND AA	Oligopolistic industry.	Very high barriers to entry; Emergence of significant new entrants in the rating horizon close to impossible	Dominant position in the value chain with suppliers and customers significantly more dispersed; Retains most of the value added in the chain
IND A	Reduced number of competitors with clear leader	Time and significant financial commitment required to enter the industry meaningfully	Stronger bargaining power than suppliers and customers
IND BBB	Larger number of competitors with some track record of price discipline in downturns	Moderate barriers to entry; Incumbents are generally strongly established but successful entrants have emerged over time	Balanced relative bargaining power with suppliers and customers
IND BB	Highly competitive industry with a large number of players and aggressive competitive behavior	No barrier to entry/exit; number of industry players follow the cycle	Supplier and/or customer more concentrated with significant bargaining power
IND B	Fragmented industry, participant landscape in aggressively disruptive phase with numerous company failures anticipated	No barriers to entry/exit and industry displays a high and/or rapidly accelerating attrition rate of market players	Weakest position in a value chain, where the weakness of this position in itself exercises a downward pressure on company's growth prospects

Source: Ind-Ra

Sector Trend

This factor assesses the long-term growth potential of the issuer's sector and its predictability, its susceptibility to short-term demand shocks and the level of threats from substitutes.

Long-Term Growth Potential

This factor measures the sustainability of the business and implicitly, the potential for increase in competition and margins. Declining industries are generally not consistent with investment-grade ratings.

Volatility of Demand

This factor measures the steadiness of demand. Volatility can be caused either due to the volatility of growth in the economy or due to the nature of product being non-essential or discretionary

Threat of Substitutes

The substitute available to fulfill the need of the existing product can be of a different quality or available at a different price point. Furthermore, exit barriers or switching may be important factors affecting substitution. Threats from substitutes with low switching costs will have an impact on the sector's pricing power and make long-term trends more difficult to predict.

Figure 2
Sector Trend: Sub-Factors

Category	Long-Term growth potential	Volatility of demand	Threats of substitutes
IND AA	Strong long-term potential with gradual, steady growth	Highly stable demand even in economic downturns	No substitute; Product is a must-have for customers.
IND A	Strong long-term potential with more volatile growth or very stable industry with moderate but predictable growth over the rating horizon	Generally stable, somewhat more sensitive to economic cycles	Substitutes exist but are of lower fundamental quality
IND BBB	Mature industry; Traditional markets may be under some pressure but opportunities arise in new markets	Demand volatility in line with economic cycles.	Facing substitutes of comparable quality but switching costs are significant
IND BB	Limited growth potential either due to substitute products or slow shift in consumer preferences	Demand volatility exacerbates economic cycles. Highly cyclical and difficult to predict.	Facing substitutes of comparable quality with modest switching costs. Facing substitutes with better fundamental characteristics or imminent technological change risk. Modest switching costs
IND B	Stagnant growth or declining industry	Highly cyclical and facing a sharp, near-term and secular decline in prospects	Product line fundamentally uncompetitive, sustained only by legacy customer base, itself in rapid decline

Source: Ind-Ra

Company's Market Position

Once the relative attractiveness of the company's sector has been assessed in the two key factors above, Ind-Ra analyses the factors which indicate an issuer's ability to withstand competitive pressures. This can include, for example, its position in key markets, its level of product dominance, its ability to influence price and its operating efficiency.

Market Share

Market share has several advantages including economies of scale, power to set market practices, better bargaining power with suppliers and ability to hire better quality of management. As such, the leader has a higher ability to withstand headwinds due to its size and dominance than other players in the industry.

Competitive Advantage

A company having a competitive advantage in terms of cost, technology or brand is less vulnerable to competitive pressures. Such entities are generally the last ones to be impacted by the industry cycles.

Operating Efficiency

Operating efficiency is measured in terms of return on capital employed compared to industry average.

Figure 3

Company's Market Positions: Sub-Factors

Category	Market share	Competitive advantage	Operating efficiency
IND AA	Market leader in most of its segments	Strong competitive advantages in cost, technology or brand which cannot be replicated by competitors in the rating horizon	Best in class return on invested capital
IND A	Top-three player in most markets or leader in a well-defined and protected niche	Strong competitive advantages but more at risk from competitors.	Higher than average return on invested capital
IND BBB	Top-five player in most markets or leader in a niche with some threats of substitution within the industry	Some competitive advantages with reasonably good sustainability	Return on invested capital in line with industry average
IND BB	Predominantly second-tier player	No or very modest competitive advantages with questionable sustainability	Lower than average return on invested capital
IND B	Extremely small and or undifferentiated player	Weak/disadvantageous competitive position	Poor return on invested capital; expected to remain materially below the cost of capital

Source: Ind-Ra

Diversification

Maintaining a stable operating performance often depends on product diversity, geographical spread of sales, diversification of major customers and suppliers. These elements are captured in the form of geographic and product diversification.

Geographic Diversification

Geographic diversification analyses a couple of related points- the extent of any entity's concentration or reliance on one/few regions and its balance between growth and mature markets.

Product/End Market Diversification

Presence in different business lines, which do not have a high performance correlation, limits the impact of a slowdown in a particular segment on the entity's overall performance. A single-product entity, on the other side, is completely dependent on the dynamics of that sector.

Figure 4

Diversification: Sub-Factors

Category	Geographic diversification	Product/end market diversification
IND AA	Ideal balance between mature and growth markets; No reliance on any single region; Strong exports	Well-balanced exposure to five or more business lines or markets with different sensitivity to the economic cycle
IND A	Strong diversification but balance between emerging and growth markets could be better	Well-balanced exposure to at least three business lines or markets with different sensitivity to the economic cycle
IND BBB	Some geographical diversification but imbalance between growth and mature markets	Exposure to at least three business lines or markets but with some performance correlation or balanced exposure to two business lines or markets with different sensitivity to the economic cycle
IND BB	Concentrated in one region.	Majorly focused on one business line/end-market or two correlated business lines/ end-markets
IND B	Concentrated in a disadvantaged region.	Product line in a declining stage

Source: Ind-Ra

Financial Key Factors

The quantitative aspect of Ind-Ra's corporate ratings focuses on an issuer's financial profile and its ability to service its obligations using a combination of internal and external resources. The sustainability of these credit-protection measures is evaluated over a period of time, using both actual historical numbers but more importantly Ind-Ra's forecasts to determine the strength of an issuer's debt servicing capacity and funding ability.

Financial metrics can alleviate only some of the pressures from the Sector Risk Profile and Business Profile characteristics, and do not enable the company to completely insulate itself. Conversely, a company with a strong business profile may be burdened by high leverage, which may exert strong downward pressure on its rating levels.

Due to the wide range of companies the Generic Navigator applies to, the metrics level consistent with each rating category described below is based on the observed median figures for the whole universe of non-financial corporates.

The Financial Key Factors are:

- Profitability, which provides a bridge between the qualitative Business Profile Factors and the mainly quantitative Financial Key Factors, is normally strongly correlated with the attractiveness of the sector and the company's market position in that sector.
- Financial Structure - essentially the level of leverage on the company's balance sheet
- Financial Flexibility includes other important aspects such as Liquidity, FX Exposure and Financial Discipline.

The definition of the credit metrics is included in the *Corporate Rating Methodology* Criteria Report, dated 4 January 2017 and the Special Report *Cash Flow Measures in corporate Analysis* dated 4 April 2016.

Profitability

A range of both cash flow and income statement-based metrics is used to assess profitability.

Return on sales ratios such as FFO and EBITDAR margins are combined with metrics factoring in capital intensity (EBIT margin) and financial policy (FCF margin). Given the importance of stability of profit generation, a qualitative Sub-Factor on Volatility of Profitability has been included as well.

Figure 5

Profitability: Sub-Factors

Mid-Points	FFO margin (%)	EBITDAR margin (%)	EBIT margin (%)	FCF margin (%)	Volatility of profitability
IND AA	10.0	15.0	12.0	5.0	Volatility of profits viewed as a positive outlier for the industry
IND A	7.0	13.0	9.5	2.0	Lower volatility of profits than industry average
IND BBB	5.0	11.0	7.5	Positive	Volatility of profits in line with industry average
IND BB	3.0	6.0	5.0	Neutral to negative (within -1%)	Higher volatility of profits than industry average
IND B	1.0	3.0	3.0	Negative FCF margin, with limited/no flexibility on spending reduction and funding gaps.	Volatility of profits viewed as a negative outlier for the industry

Source: Ind-Ra

Financial Structure

Ind-Ra bases its analysis on both net and gross leverage ratios. While the main focus is on FFO-based leverage and ratios, Ind-Ra also assesses EBITDA-based metrics, which are typically close to each other. Gross leverage is a key ratio, as cash can dwindle rapidly when companies are in financial stress, for example due to substantial cash outflows from working capital. However, net leverage is also relevant for companies holding a high level of cash for prudential reasons beyond what is needed for operational purposes.

The net debt/(CFO-capex) ratio has been added as a measure of leverage based on discretionary cash flows post interest costs and investment requirements but before dividends distribution. When assessing an issuer in an expansionary phase, it may be relevant to only deduct from CFO a standardised capex figure, reflecting maintenance and improvement of existing assets rather than the total amount of investments.

Figure 6
Financial Structure: Sub-Factors

Mid-points	Lease-Adj FFO net leverage (x)	Lease adjusted gross debt/EBITDAR (x)	Net debt/(CFO-capex) (x)
IND AA	1.0	1.5	2.0
IND A	2.5	3.0	3.0
IND BBB	3.5	3.5	4.5
IND BB	4.0	4.5	6.0
IND B	5.5	6.0	>6 or negative (CFO-Capex)

Source: Ind-Ra

Financial Flexibility

Financial flexibility allows an issuer to meet its debt service obligations and manage periods of volatility without eroding credit quality.

Financial Discipline

The more conservatively capitalised an issuer, the greater its financial flexibility. In general, a commitment to maintaining debt within a certain range allows an issuer to cope better with the effect of unexpected events. This is reflected in the Financial Discipline Sub-Factor.

Liquidity

Other factors that contribute to financial flexibility are the ability to revise plans for capital spending, strong banking relationships, the degree of access to a range of debt and equity markets, committed, long-dated bank lines and the proportion of short-term debt in the capital structure. These issues are incorporated in the Liquidity Sub-Factor. Once liquidity reaches a certain level, it is generally not a source of rating differentiation, hence the identical definition for the ‘IND A’ and ‘IND AA’ rating categories.

FFO Fixed Charge Coverage and EBITDAR Gross Interest Coverage

Fixed charge coverage ratios are a central measure of the financial flexibility of an entity, which compares the operational cash-generating ability of an issuer (after tax) to its financing costs. Many factors influence coverage ratios – including general funding costs, the mix of fixed-rate versus floating-rate funding, the use of zero-coupon debt, and so on. For this reason, the coverage ratios should be considered alongside the appropriate leverage ratios.

FX Exposure

Foreign exchange exposure can also impact Financial Flexibility. Some companies may have a natural currency hedge (oil and gas), or an acceptable unhedged exposure in pegged currency regimes, given the type of products they sell and their own cost base. For other companies, there may be a material mismatch between the currency borrowed and the currency in which they have internal cash resources. Where there is a mismatch, Ind-Ra will assess the company‘s approach and management of that exposure.

Debt-Equity

Debt-equity ratio is often an indicator of an entity's flexibility to borrow from the banking system.

Figure 7

Financial Flexibility: Sub-Factors

Mid-Points	Financial discipline	Liquidity	FFO fixed charge cover (x)	EBITDAR/ (gross interest + rents) (x)	FX exposure	Debt-Equity ratio (x)
IND AA	Publicly announced conservative financial policy; Track record of strict compliance	Very comfortable liquidity with no need to use external funding in the next 24 months or more; Well-spread maturity schedule of debt; Diversified sources of funding; One year liquidity ratio above 1.25x	6.5	7.0	Negligible unhedged forex exposure.	0.3
IND A	Clear commitment to maintain a conservative policy with only modest deviations allowed	Very comfortable liquidity; Well-spread debt maturity schedule; Diversified sources of funding; One year liquidity ratio above 1.25x	3.0	3.5	Unhedged forex exposure within 10% of EBITDA	0.6
IND BBB	Financial policies less conservative than peers' but generally applied consistently	One-year liquidity ratio above 1.25x; Well-spread maturity schedule of debt but funding may be less diversified	2.25	2.5	Unhedged forex exposure within 20% of EBITDA	1.0
IND BB	Financial policies in place but flexibility in applying it could lead it to temporarily exceed downgrade guidelines.	Liquidity ratio around 1.0x; Less smooth debt maturity or concentrated funding	1.75	2.0	Unhedged forex exposure within 40% of EBITDA.	1.4
IND B	No financial policy or track record of ignoring it; Opportunistic behavior.	Liquidity ratio below 1x; Overly reliant on one funding source	1.5	1.5	Unhedged forex exposure higher than 40% of EBITDA.	>1.4

Note: Liquidity score is defined as: available cash + undrawn portion of committed facilities + free cash flow (if positive)/debt maturities + FCF (if negative)
Source: Ind-Ra

Appendix I: Management and Corporate Governance

Figure 8

Management and Corporate Governance: Sub-Factors

Category	Management strategy	Governance structure	Group structure	Financial transparency
IND AA	Consistent and robust strategy and very strong track record in implementation	No record of governance failing; Strong management team, experienced board with presence of independent directors and functional heads	Transparent group structure; Related party transactions, if any, are insignificant and have an economic rationale.	High-quality and timely financial reporting
IND A	Coherent strategy and good track record in implementation	Good governance track record Experienced board exercising effective check and balances	Group structure shows some complexity but mitigated by transparent reporting. Related party transactions have an economic rationale.	Good quality and timely financial reporting
IND BBB	Strategy may include opportunistic/aggressive elements but soundly implemented	Adequate governance track record	Some group complexity; No significant related-party transactions without appropriate economic rationale	Average financial reporting without significant failing
IND BB	Strategy lacks consistency/coherence and/or weakness in implementation	Inadequate governance structure; Very high Key-man risk	Complex group structure or non-transparent ownership structure; Presence of significant related-party transactions	Financial reporting is appropriate but with some failings (e.g., lack of interim or segment analysis)
IND B	Lack of adequate strategic planning and implementation	Poor governance structure; Significant instances of governance failing	Highly complex group with large and opaque related-party transactions or opaque ownership structure	Defective financial reporting; Aggressive accounting policies

Source: Ind-Ra

Management and Corporate Governance

The company-specific Management and Corporate Governance Factor is composed of four Sub-Factors: Management Strategy, Corporate Governance, Group Structure and Financial Transparency.

Sub-Factors

Management Strategy

Ind-Ra considers management‘s track record in terms of its ability to create a healthy business mix, maintain operating efficiency, and strengthen its market position. Financial performance over time notably provides a useful measure of the management’s ability to execute its operational and financial strategies.

Corporate goals are evaluated centering upon track record and future strategy. Risk tolerance and consistency are important elements in the assessment. The historical mode of financing acquisitions and internal expansion provides insight into management‘s risk tolerance.

Governance Structure, Group Structure and Financial Transparency

The three other Sub-factors address different aspects of the general issue of corporate governance. The purpose of addressing Governance Structure is to assess the way effective power within an issuer is distributed.

Elements considered are notably the presence of effective controls for ensuring sound policies, an effective and independent board of directors, succession plan, talent bench, management compensation, related-party transactions, integrity of the accounting and audit process and key-man risk.

Corporate Governance operates as an asymmetric consideration. Where it is deemed adequate or strong, it typically has little or no impact on the issuer's credit ratings, i.e. it is not an incremental positive in the rating calculus. Where a deficiency which may diminish lenders' protection is observed, the consideration may have a negative impact on the rating assigned. Ind-Ra's approach to evaluating corporate governance is described in the Criteria Report *Evaluating Corporate Governance* dated 4 April 2016.

The Corporate Governance Sub-Factor focuses on the structural aspects of governance, in particular board of directors characteristics.

Group Structure and Financial Transparency assess how easy it is for investors to be in a position to assess an issuer's financial condition and fundamental risks. These aspects are somewhat linked to Corporate Governance as high-quality and timely financial reporting is generally considered by Ind-Ra to be indicative of robust governance. Likewise, publishing intentionally inaccurate or misleading accounting statements is symptomatic of deeper flaws in an issuer's governance framework. The public exposure of techniques that subvert the spirit of accepted accounting standards or, worse yet, are designed to mask fraudulent activity can undermine investor confidence.