Introducing Ratings Navigator for Corporates

Special Report

Navigator for Corporates is a graphical peer comparator that forms part of a series of similar tools being introduced across India Ratings and Research (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.

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

Analysts
Khushbu Lakhotia
+91 33 4030 2508
khushbu.lakhotia@indiaratings.co.in

Abhishek Bhattacharya
+91 22 4000 1786
abhishek.bhattacharya@indiaratings.co.in

Ratings Navigator is a visual representation of an issuer's key credit features against sector expectations for a given rating category. It articulates an issuer's key strengths and weaknesses in a standardised format showing how issuers stack up against the expected traits of their sector and compare with individual rated peers on each of the factors. Navigator is not a scoring model or otherwise an input into the rating process

Purpose of the Navigator

Improved Transparency: The Ratings Navigator is designed to provide transparency for the key drivers of non-financial corporate issuer ratings, and visually communicate an issuer's key strengths and weaknesses in a standardised format

Not a New Methodology: The Ratings Navigator does not affect rating criteria, nor introduce a new analytical approach, nor is it a quantitative model; it is a graphical peer comparator tool.

Standalone Approach: Ind-Ra factors in the relationship between parents and their subsidiaries in assigning Long-Term Issuer Ratings and debt issue ratings. The Rating Navigator does not specifically address these issues, but focuses on the standalone credit profile of the issuer.

Sector-Level Navigators: Ind-Ra aims to publish one Rating Navigator for each major corporate sector and a Generic Navigator applicable to issuers not covered by other Navigators.

Structure of Navigator

Key Factors: Each navigator includes a sector-risk profile, five business profile and three financial profile factors. Each key factor is captured on the navigator as a three-notch wide range rather than a notch-specific assessment as the latter would be artificially precise.

The Sector-Risk Profile: This risk profile, identifying typical upper boundaries for credit ratings, does not simply replicate the range of existing ratings within the sector but highlights that not all sectors are conducive to issuers rated in high rating categories. For example, a sector in which companies are selling discretionary goods in a highly competitive environment with no particular niche or barriers to entry is unlikely to have ratings in the highest investment grade categories.

Management and Corporate Governance: This first key factor in the business profile is common to all sectors and includes an assessment of the Management Strategy, the structure and quality of corporate governance, risks related to the group structure and the degree of financial transparency (see pages 6-7).

Four Sector-Specific Key Factors: These assess the strength of the business profile of the issuer in its sector. These individual factors help position the issuer within the ranges provided under the sector risk profile and may occasionally take the issuer outside this range of ratings because of company-specific factors.

Three Financial Key Factors: These are headed profitability, financial structure and financial flexibility. Although these high level factors are common to all sectors, the choice of individual ratios and their mid-points per rating category vary substantially from sector to sector.

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 among 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.

Sample Navigator Snapshot

- Page 1 summarises the factor-level profile of the issuer, relative to peers, together with key drivers, rating sensitivities and issuer data, including rating history and peer ratings;
- Page 2 provides the sub-factor-level detail for the chosen issuer on a fuller range of measures

How do the Factors and Sub-Factors Work

ABC Limited (page 1)

Corporates Rating Navigator

Sector	**Generic**

Rating/Outlook

Current Rating	**IND AA-/Negative**

Rating History

Date	Rating/Outlook	Action
17 Sep 2018	IND AA-/Negative	Affirmation; Outlook revision
19 Nov 2017	IND AA-/Stable	Upgrade

Bar Chart Legend:

Vertical Bars = Range of Rating Factor

Bar Colors =Relative Importance

- Higher Importance
- Moderate Importance
- Lower Importance

Positive Outlook

Negative Outlook

Analysts

Primary Analyst
Khushbu Lakhotia
+91 33 4030 2508
Khushbu.lakhotia@indiaratings.co.in

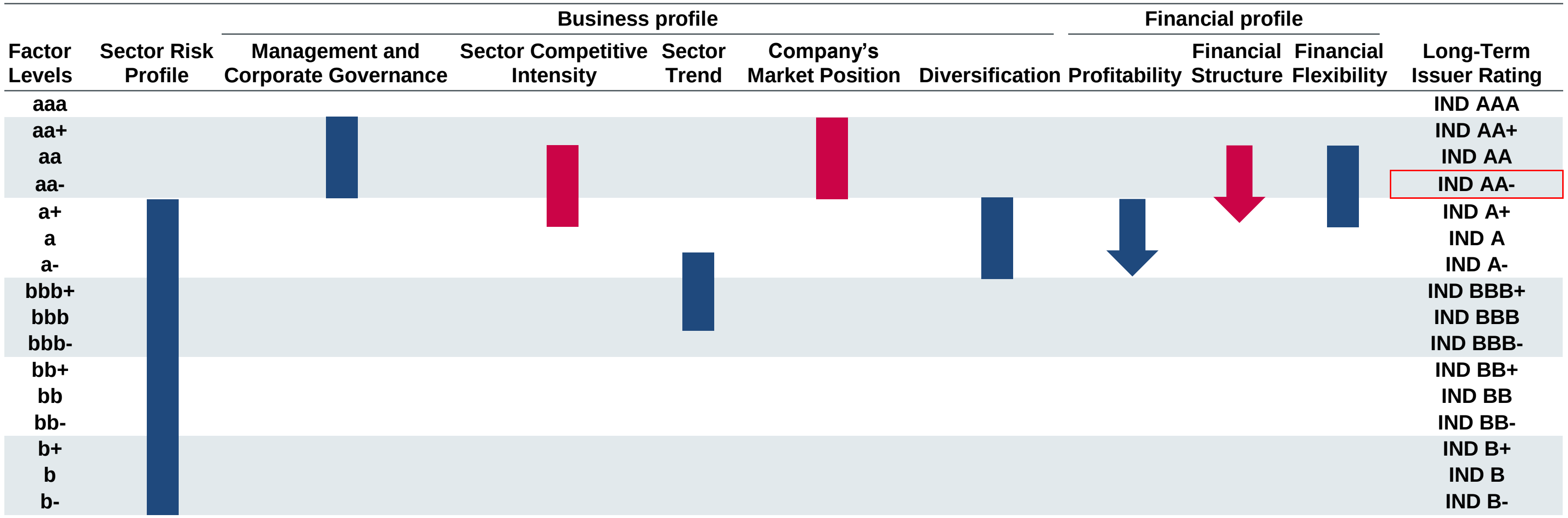
Secondary Analyst
Ashoo Mishra
+91 22 4000 1700
Ashoo.mishra@indiaratings.co.in

Relevant Criteria and References

Introducing Rating Navigator

Generic: Rating Navigator Companion

Corporate Rating Methodology



Drivers & Sensitivities

Deterioration in operating performance in FY18	ABC's EBITDA margin declined to 5.2% in FY18 (FY17: 9.8%) due to a decline in margins in some segments .
Deterioration in leverage	ABC's net leverage (net debt/EBITDA) weakened to 1x in FY18 (FY17: 0.6x), due to a rise in debt to INR214 million (INR119 million) and a fall in profitability.
Revenue diversification to continue	ABC continues to consistently grow in the segments. Ind-Ra expects ABC to continue registering double-digit revenue growth in FY19, while maintaining a dominant position.
Continued market dominance	ABC's business continues to be its cash cow with flattish revenue but robust EBITDA generation and minimal incremental working capital requirements.
Strong liquidity position	Cash/equivalents increased to INR11 billion at end-FY18 (FY17: INR5 billion). Ind-Ra expects the company to report positive free cash flow in FY19-FY20.
Negative rating sensitivity	Net adjusted leverage sustaining above 1.5x in FY19 and beyond could lead to a negative rating action.
Positive rating sensitivity	The Outlook would be revised to Stable on net adjusted leverage reducing below 1.5x on a sustained basis.

ABC Limited (page 2)

Management and Corporate Governance

	Management Strategy	aa	Consistent and robust strategy and very strong track record in implementation
aa+	Governance Structure	aa	No record of governance failing; Strong management team, experienced board with presence of independent directors and functional heads
aa	Group Structure	aa	Transparent group structure; Related party transactions, if any, are insignificant and have an economic rationale.
aa-	Financial Transparency	aa	High-quality and timely financial reporting

Sector Competitive Intensity

aa	Industry Structure	aa	Oligopolistic industry.
aa-	Barriers to Entry/Exit	aa	Very high barriers to entry; Emergence of significant new entrants in the rating horizon close to impossible.
a+	Relative Power in Value Chain	a	Stronger bargaining power than suppliers and customers

Sector Trend

a-	Long-Term Growth Potential	bbb	Mature industry; Traditional markets may be under some pressure but opportunities arise in new markets
bbb+	Volatility of Demand	a	Generally stable, somewhat more sensitive to economic cycles
bbb	Threat of Substitutes	bbb	Facing substitutes of comparable quality but switching costs are significant

Company's Market Position

aa+	Market Share	aa	Market leader in most of its segments
aa	Competitive Advantage	aa	Strong competitive advantages in cost, technology or brand which cannot be replicated by competitors in the rating horizon
aa-	Operating Efficiency	aa	Best in class return on invested capital

Key Factors and their Sub-Factors

The navigator snapshot summarises overall factors in a graphical display. Each factor can be further divided into sub-factors. The second page of the Ratings Navigator clearly lists the division of each factor into its component sub-factors and the assessment of each sub-factor at the rating category level.

The breakdown in Figure 1 shows two assessments, side-by-side. The left-most column 'Overall Factor Assessment' shows the three-notch band assessment of each factor. The columns further to the right then break down the sub-factors, with the title of each sub-factor, followed by the selected description appropriate for each sub-factor and its corresponding rating category.

Note that the banding for Sector-Risk extends from low 'b' to the sector cap, as it ultimately reflects a form of ceiling or magnet upon the upper limit of a rating, without presenting a floor to the rating.

The definition of sector-Specific and Financial Sub-factors observed for each rating category is available in the companion report published for each sector navigator. We recommend users to consult this companion report as context when reviewing navigators for multiple entities.

Figure 1

Sector Trend

Overall factor assessment	Sub-Factors	Category	Sub-factor selected description
A-			
BBB+	Long-term growth potential	BBB	Mature industry. Traditional markets may be under some pressure but opportunities arise in new markets.
BBB	Volatility of demand	BBB	Demand volatility in line with economic cycles
BBB-	Threat of substitutes	BBB	Facing substitutes of comparable quality but switching costs are significant
BB+			

Source: Ind-Ra

Not all factors or sub-factors have an option to select from all rating categories, acknowledging the lack of observations for some sectors at the highest rating levels. While sub-factors common to all sectors such as corporate governance or liquidity are defined for the whole range of rating categories, i.e. from 'aa' to 'b', sector-specific sub-factors are defined only for rating categories within the upper boundary of the relevant Sector Risk Profile.

The sub-factor assessment is made at the simple rating category level (i.e. 'bbb', 'bb' without + or – modifiers). In contrast, after blending, the three-notch range for the Overall Factor Assessment can straddle rating categories. For example, if the assessment is border-line investment grade, a mid-point of 'bb+' (ie a range of 'bb' to 'bbb−') or 'bbb−' (a range of 'bb+' to 'bbb') could be indicated

The Overall Factor Assessment balances each sub-factor's strengths, weaknesses and relative influence in the particular case under consideration. The factor's three-notch mid-point is not expected to be a mathematical average of the sub-factors, although in some instances (if they all have equal relative importance) this may be the case. However, it may happen that one sub-factor is of overriding importance in the Overall Factor Assessment.

For example, in Figure 4 below, weak financial transparency is weighing down heavily on the overall assessment for the management and corporate governance factor. The resulting three-notch band centred on 'bb−' is significantly lower than a simple mathematical average of the sub-factors, which would have yielded a result of 'bb+'.

Figure 2

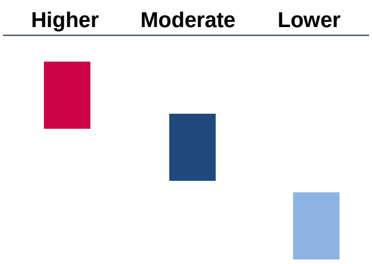
Management and Corporate Governance

BBB-	Management strategy	BBB	Strategy may include opportunistic/aggressive elements but soundly implemented
BB+	Governance structure	BBB	Adequate governance track record
BB	Group structure	BB	Complex group structure or non- transparent ownership structure; Presence of significant related party transactions
BB-	Financial transparency	BB	Financial reporting is appropriate but with some failings (e.g., lack of interim or segment analysis)
B+			

Source: Ind-Ra

Figure 3

Relative Importance



Source: Ind-Ra

Relative Importance

All factors are deemed to be of importance in determining the rating, but the relative importance indicator shows which factors are exerting greater or lesser influence on the final rating at the time of the analysis. The relative importance for each factor can be 'higher', 'moderate' or 'lower' and is reflected in the colour of the bar representing that particular factor on the graph: red, dark blue and light blue, respectively (see sidebar).

Those selected as 'higher' indicate the factors which hold high significant in determining the overall rating. The Ratings Navigator does not employ any explicit factor weightings, primarily because the importance or significance of risk elements can shift quite rapidly over time and/or differ markedly across issuers at the same time. Furthermore, too much science applied to weightings would imply a mathematical scoring approach, fundamentally at odds with the way in which our rating opinions are determined. For example, an issuer with extremely high leverage may see its financial structure and financial flexibility key factors input as 'higher' and every other factor input as 'lower' as they play a very limited role in the rating outcome.

Relative to rating sensitivities quoted in rating research, it would seem intuitive that changes to factors which play a greater role in the rating outcome would typically drive rating changes and so ought to be closely aligned to rating sensitivities. There may, however, be instances where a higher-influence factor is considered very unlikely to change and may therefore be less prominent in the triggers for a potential rating change.

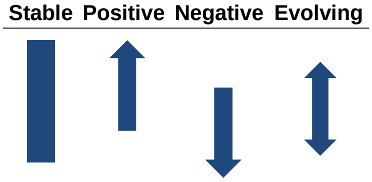
Each rating factor assessment provides three key pieces of information:

- the overall factor assessment - depicted as a three-notch range across the rating scale;
- the relative importance of the factor in the credit analysis; and
- the outlook for the factor using directional arrows.

Similarly, a moderate influence factor may be significantly more likely to change and may therefore be more prominent in the rating sensitivities. The likelihood a specific factor could lead to a rating change will be a combination of the factor's absolute rating level, its relative importance and the speed at which it is changing.

Relative importance means relative to other rating factors for the same entity – not relative to other issuers. Clearly, if peers are very similar in terms of metrics and business mode, it is likely the relative influence of the various factors will be similar. Issuers in the same peer group with differences in business and financial profiles will usually be mapped differently – even if the rating is the same – to reflect that different factors will play a greater or lesser role in the rating profile.

Figure 4
Factor Outlook



Source: Ind-Ra

The Outlook of the Factor

An indication of the outlook for each factor is provided by using arrows to denote 'positive', 'negative', 'stable' or 'evolving' trend. If the outlook for the rating of the issuer is 'positive' for example, one would expect at least one of the rating factors to show a 'positive' outlook. As the factors should be assessed with a through-the-cycle perspective, most outlooks are expected to be set at 'stable', but especially for the faster-moving financial ratios, non-stable outlooks can still be justified to denote a clear expected directional trend for a particular factor over the next 12-24 months.

The assessment of quantitative financial metrics for an issuer against the reference metrics for its rating category will be made using the entity's financial profile under Ind-Ra's rating case over the next one to two years rather than any past years' historical average. However, if the projected improvement (deterioration) is viewed as particularly uncertain, the positioning of the assessment may be made based on the current year's level and reflect the projected improvement (deterioration) by a positive (negative) outlook for the factor.

For example, a leverage reduction based on yet-to-be-finalised asset sales may be reflected by assessing the financial structure key factor in line with the current credit metrics but with a positive outlook to show the expectation of improvement. Should the asset sales be already completed, the assessment could already be done on the basis of the expected lower leverage with a stable outlook.

Individual Factor Considerations

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.

Figure 5

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

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 the characteristics of the directors in the board.

Group Structure and Financial Transparency determine investors' ability 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.

Sector-Specific Business Profile Factors

Each companion report to the sector navigators will detail the other four sector-specific business profile factors, their importance in helping to assess risk profiles in the sector and the corresponding rating category. These will cover a broad range of qualitative business risks, tailored to the industry fundamentals for each sector. Business risk factors are tailored at the factor and sub-factor levels for each industry. Given this customisation, business risk factors are not always directly comparable across sectors assessments.

The overall factors will differ between sectors, and columns will not be directly comparable, even where their titles are similar – 'Diversification' in one sector may have a materially different set of features compared to another.

Financial Profile Factors

Financial Profile key factors, in contrast, have all been grouped under the three headings Financial Flexibility, Financial Structure and Profitability and Cash Flows. The tables below show common sub-factors, drawing standard ratios from the Corporate Rating Methodology.

Sector navigators may have additional ratios, where more common measurements do not help to differentiate issuer ratings (such as for real estate); these ratios may be omitted.

Where ratios are given, these mid-points per rating category vary substantially from sector to sector, reflecting sectors' and companies' different risk profiles and characteristics.

Figure 6

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	(Ratio)	(Ratio)	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	(Ratio)	(Ratio)	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	(Ratio)	(Ratio)	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	(Ratio)	(Ratio)	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	(Ratio)	(Ratio)	Unhedged forex exposure above 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

Figure 7

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	(Ratio)	(Ratio)	(Ratio)
IND A	(Ratio)	(Ratio)	(Ratio)
IND BBB	(Ratio)	(Ratio)	(Ratio)
IND BB	(Ratio)	(Ratio)	(Ratio)
IND B	(Ratio)	(Ratio)	(Ratio)

Source: Ind-Ra

Figure 8

Profitability: Sub-Factors

Mid-Points	FFO margin (%)	EBITDAR margin (%)	EBIT margin (%)	FCF margin (%)	Volatility of profitability
IND AA	(Ratio)	(Ratio)	(Ratio)	(Ratio)	Volatility of profits viewed as a positive outlier for the industry
IND A	(Ratio)	(Ratio)	(Ratio)	(Ratio)	Lower volatility of profits than industry average
IND BBB	(Ratio)	(Ratio)	(Ratio)	(Ratio)	Volatility of profits in line with industry average
IND BB	(Ratio)	(Ratio)	(Ratio)	(Ratio)	Higher volatility of profits than industry average
IND B	(Ratio)	(Ratio)	(Ratio)	(Ratio)	Volatility of profits viewed as a negative outlier for the industry

Source: Ind-Ra