Revenue Supported Rating Criteria

Master Criteria

Scope

This report presents India Ratings and Research's (Ind-Ra) master criteria for assigning credit ratings to revenue-supported obligations and entities in the public finance sector (public sector entities of central and state governments, central government special purpose vehicles, among others). The report discusses the key qualitative and quantitative factors that influence a borrower's expected ability to meet financial obligations in full and on schedule. This report merges the following existing criteria:

- School Rating Criteria
- Rating Criteria for Colleges and Universities
- Non-Profit Institutions Rating Criteria
- Non-Profit Hospitals and Health Systems Rating Criteria
- Revenue-Supported Rating Criteria

This report also describes the operating and financial factors India Ratings and Research (Ind-Ra) considers in rating certain non-profit institutions (institutions, or societies, associations, organisations, trusts or institutions registered under the Societies Registration Act, 1860; the Indian Trusts Act, 1882; the Charitable & Religious Trusts Act, 1920 or as a charitable company under Section 8 (old Section 25 of the companies Act, 1956) of the Companies Act, 2013 are considered as Voluntary organisations/Non-governmental organisations. In addition, there are informal groups working at grassroots level without being registered under any legislation but may also be considered as part of voluntary sectors). Most of these institutions are not created for profit maximisation and are generally exempted from paying income tax under Income Tax act. Not all rating factors outlined in this report may apply to an individual rating or rating action. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action.

Some ancillaries' services of these institutions are provided by other companies having the same ownership/control. These entities provide services only to select identified institutions. Ind-Ra while assigning ratings to not-for-profit institutions takes a consolidated view of these entities. Most of for-profit schools and colleges are also rated under this criteria.

Five Categories of Focus: The criteria are organised into five broad categories of analytical focus: governance and management; operational profile; financial profile, debt profile and liquidity. While the report describes Ind-Ra's general approach for assigning revenue-supported ratings, not all the credit factors discussed may pertain to every rating situation.

Extremely Diverse Borrowers: Public finance borrowers that issue revenue-supported debt represent an extremely diverse set of organisations that include municipal enterprises, educational and cultural institutions, non-profit hospitals, and utilities. Even among entities of similar size, scope, and purpose, these businesses are predominantly localised enterprises, each of whose creditworthiness is tightly linked to local demographic, economic, and/or competitive characteristics.

Credit Factors Will Vary: As a result of the diversity among borrowers, the degree to which certain credit factors are emphasised – especially non-financial factors – will vary depending on the levels of credit stability and competitiveness observed within the sector and for individual borrowers. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action. This report highlights the credit factors reviewed by Ind-Ra that are most common across revenue-supported borrowers.

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Broad Spectrum of Credits: Central and state government entities (including special purpose vehicles), charitable/voluntary organisations, private foundations, co-operative societies and cultural institutions, are typical examples of non-profit institutions covered by this criteria.

Role of Essentiality: Institutions providing income generation and critical services, including physical, mental, and social care, would be deemed strongest in terms of essentiality. Many social service providers are fairly small; serve a client base consisting of at-risk individuals with significant, fairly expensive, acute care needs; and depend on a single contract from just a handful of referral agencies for the bulk of their revenues.

Conversely, many of these institutions do not serve as critical a societal need as a human service provider yet offer robust income, educational or cultural support to a large section of society. As a result, these institutions may demonstrate a strong track record of demand-driven funding support that compensates for the less critical, less immediate need served. Co-operative societies, including milk co-operatives are playing a major role in improving income generation activities in rural areas. These co-operatives receive funding support from their respective state governments/central government.

Other Considerations: An institution's mission, market position vis-à-vis competitors, programs and services quality, and leadership play an integral role in the analysis of a non-profit institution. In addition, depending on business model, fundraising and investment may also be important factors.

Variations from Criteria

Ind-Ra's criteria are designed to be used in conjunction with experienced analytical judgment exercised through a committee process. The combination of transparent criteria, analytical judgment applied on an instrument-by-instrument or issuer-by-issuer basis and full disclosure through a rating action commentary (RAC), strengthens Ind-Ra's rating process while assisting market participants in understanding the analysis used in the ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific instrument or entity. Such adjustments are called variations. All variations will be disclosed in the respective RACs, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature, or other factor relevant to the assignment of a rating and the methodology applied to it are both included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular instrument or entity.

Governance and Management

An organisation's financial position and operating performance are highly influenced by the strategic direction and management oversight exercised by the organisation's board of directors/trustees. Moreover, the effectiveness of the executive management team is critical to the success and long-term viability of any organisation. Yet, the evaluation of governance and management quality is the most subjective part of Ind-Ra rating analysis.

For this reason, a meeting with key board members and/or senior management is valuable, particularly for new credit ratings. For larger organisations, key senior management is considered to be the CEO, CFO, and the chief operating officer. The purpose of the meeting is to develop an understanding of the organisation's mission, philosophy, and strategic goals. Ultimately, a borrower's ability to meet its financial commitments is driven by the business strategy adopted and pursued in the markets it serves. Ind-Ra will attempt to assess the soundness of the business strategy through an analysis of historical performance relative to projections, the competitive landscape and payer dynamic, and the regulatory environment.

If a new capital project is being undertaken, Ind-Ra will inquire as to the genesis of the project, the depth of the planning process, expected funding sources for capital investments and how the board and management have interacted to identify all risks in the project to minimise the probability for unsuccessful execution.

Throughout its credit analysis, Ind-Ra will focus on management best practices and assess the effectiveness of operational tools (e.g. management information systems) in measuring and evaluating performance and efficiency. Management practices are one of the leading qualitative factors that Ind-Ra evaluates.

Operating Profile

Ind-Ra rating methodology includes a review of the operating characteristics of a borrower. Measured in a variety of ways depending on the borrower's sector, Ind-Ra's operations review may include assessments of business strategy, operational effectiveness, competitive position and environment, and capital planning and management processes. Ind-Ra views favourably those organisations that demonstrate stability in their performance level over time.

Business Strategy

To assess business strategy, Ind-Ra examines an organisation's position and ability to meet the needs of its constituents. While Ind-Ra reviews historical market position trends in the context of current industry characteristics, close attention is paid to the flexibility an organisation retains to deal with potential changes in its competitive or operating landscape.

Ind-Ra looks to overall trends in demand and financial metrics to judge the effectiveness of an organisation's business strategy. As part of the analysis, Ind-Ra reviews the institutionalised processes that facilitate effective strategic planning, with an emphasis on aspects that provide operating flexibility to adjust for variations in demand. Even within the same industry, Ind-Ra recognises that no single business strategy is appropriate for all organisations. The plan should fit the mission of the borrower, the needs of its customers and other constituents, and its specific marketplace.

Competitive Profile

In sectors where marketplace competition is a potential rating concern, an organisation's position relative to its peers is a major area of analytical focus. In such cases, Ind-Ra analysis may include reviews of market share trends, rate competitiveness, industry reputation, geographic coverage or footprint, and product differentiation. Aspirations to achieve higher industry standing or ranking, support service area economic development, or significantly change market share concentration are evaluated in conjunction with the practical realities of the organisation's current competencies and ability to secure additional resources to fund such initiatives.

Regulatory Issues

Some sectors such as education are highly regulated. Ind-Ra thus combines a review of the current and expected regulatory climate with an assessment of the organisation's ability to maintain stable operations in the face of regulatory change. Ind-Ra may review responses to prior regulatory mandates, identifying financial and operational effects. Ind-Ra examines the potential for future regulatory initiatives and assesses whether the organisation, through its systems, practices, and resources, will have the ability to manage potential downside risks.

Relationship with Government

For certain public finance credits that are an enterprise or component unit of a government, the rating of the revenue-backed security may be tied to or influenced by the credit quality of the government. In addition to sharing common management and service area characteristics, there are situations where significant legal or operational connections may exist between the two (for example where credit agreements cross-default or if one fund is drawing upon the cash of the other). In these cases the revenue-supported rating may be closely tied to the government's long-term rating. Ind-Ra details any direct relationship between the government's credit quality and related revenue-supported securities within the appropriate rating action commentary.

Operational Effectiveness

Figure 1
Attributes: Operating Profile

Stronger attributes	• Provider of an essential service; institution tends to be a leader in its respective market, supported by an experienced, forward-looking management team
Midrange attributes	• Provider of a product or service that is competitive with other institutions, though not market leading could face demand variability overtime; management is less seasoned and more reactionary
Weaker attributes	• Provider of a product or service in low demand than that its of primary competitors; management experience could be lacking, particularly in articulating a more focused message necessary to build a more stable demand

Source: Ind-Ra

Trends in Activity Data Highlight Program and/or Service Demand

Given the reliance of most of these institutions on demand-driven revenues, unbudgeted variance in activity could be a credit concern, particularly if the increase or decrease in activity is unexpected, has a material adverse financial impact, and, from a budgetary perspective, cannot be managed. Generally, stable to upward trending activity data are viewed favourably; a one-year decrease or increase is not considered a trend but should be explained by the institution's management.

To gauge overall trends in demand for such institution's programs and/or services, Ind-Ra reviews five years of activity data. Depending on the type of institution, the data could highlight an institution's utilisation trends (e.g. admissions or memberships) or overall support for its mission (e.g. grant funding or contributions).

As discussed, certain well-endowed institutions derive the vast majority of their operating revenue from the annual receipt of investment income. For many of these institutions, demand-based operating revenues have little, if any, meaningful bearing on financial performance. While in these situations Ind-Ra may weigh more heavily its analysis of the balance sheet (*see Financial Profile, page 8*) as part of the overall rating process, activity-based data are still reviewed. Positive or negative trends in the data may signal a fundamental change in the actual or perceived quality of an institution's programs and/or services or in its overall competitive position. Such changes or shifts could potentially complicate an endowment-dependent institution's future ability to maintain or build balance sheet resources in the absence of financial market gains.

Market Position and Track Record Correlated with Financial Strength

An institution's operating history supported by an effective mission/vision statement, and its longstanding identification with a certain cause of purpose. Across many activities, there is a strong relationship between length of operating history and financial strength, largely a function of the time needed to grow core revenue streams and cultivate a donor base necessary for effective fundraising.

In light of this industry characteristic and as part of its evaluation of activity-based data, Ind-Ra discusses with an institution its history, marketing and pricing strategy, admission process (national, state or local levels of admissions), overarching mission, and the tactical implementation of its various components. Ind-Ra analysis also incorporates a review of the competitive environment and an assessment of an institution's track record in responding to developing opportunities and threats.

Another important factor is the geographical location of the institution, the proximity of competing and similar institutions and the socioeconomic profile of the main catchment area. Institutions located at major cities are likely to receive more applicants and recruiters than those located at non-metro location. These factors give an indication of potential flexibility to raise tuition fees in light of the students' financial position and competition from nearby institutions.

Educational Institutions Specific Metrics – Demand Flexibility

Applications, Acceptance and Enrolments

When analysing enrolment and, in particular, to determine enrolment trends, Ind-Ra generally reviews at least five years of enrolment data. The agency considers growing or stable headcount enrolment positively. A one-year decline in enrolment should be explained by the institution's management, but Ind-Ra does not consider it the start of a trend. Significant enrolment volatility indicates a higher risk. Smaller institutions are generally considered more vulnerable as a smaller absolute change can be more impactful.

Headcount gives an indication of the overall demand for the institution. Historically, a shift to more part-time students would have signalled less annual revenue for the institution; however, with the advent of the internet and the spread of life-long learning, many students are pursing part-time college courses. As a result, an institution's administration must always be aware of the needs of its students and proactively change course offerings and formats in response. When analysing enrolment data, Ind-Ra is careful to review the institution's particular mission, its dependence on each component of enrolment, and its strategic plan for maintaining enrolment in the long term.

The trend in the number of students applying to an institution is an indicator of student demand. Acceptance rates (the number of students accepted into a programme or institution, divided by the number of students submitting applications for entrance into the programme or institution) demonstrate an institution's ability to control future enrolment. Institutions that accept 75% or more of the applications have less flexibility should they suffer a decline in applications. While acceptance rates are important, Ind-Ra observes that in education streams where students are allocated colleges by state regulator (common to engineering and medical courses), high acceptance rate is not a credit negative factor.

Enrolment rates (the number of students who choose to enrol in a programme divided by the number of students accepted into a programme) is indicative of the institution's relative position among its competitors. Comparative enrolment rates are most informative when used to compare institutions with similar degrees, programmes, student quality and markets. Comparisons among institutions serving different needs or markets are not appropriate. Private universities do not have a cap on the number of students they can enrol; hence, capacity utilisation is a redundant indicator for private universities. Capacity utilisation of private universities is calculated on the basis of capacity created by private universities.

Tuition Fees

Tuition fee levels are a significant factor for students and parents choosing an institution. Competitiveness is most effectively measured through a comparison of tuition fees among peer institutions. The proportion of foreign students to total students is also important, as foreign students usually pay the full unsubsidised fees.

Campus Life and Institution's Facilities

As the cost of attending an institution is a significant factor determining choices, students and parents invest a substantial amount of time in researching and visiting campuses. In addition to the institution's reputation, students and parents consider such factors as the aesthetic appearance of the campus and the availability of quality student facilities. Ind-Ra assesses the institution's response to these needs by discussing with management the short and long-term plans for the campus.

The agency carries out a review of the institution's longer-term plans for additional buildings and major repairs, and strategic plans for the future, to assess management's readiness to allocate resources for these purposes. Deferral of maintenance expenditure to balance an operating budget is a concern.

For institutions that provide campus housing, not only must current housing be properly maintained, but new or renovated housing must be comparable to off-campus housing. Overall, Ind-Ra believes that universities with management that regularly reviews the need for change, in terms of both education and quality of campus life, are better positioned to manage enrolment and have more flexibility to adjust to change.

Co-operative Specific Operational Metrics

Key rating factors related to operational profile of co-operative societies include business strategy, manufactured products portfolio and/or services offered by them, market position, geographical reach, product brand recognition, price flexibility, competition and regulatory environment.

Hospital Specific Operational Metrics

A hospital's ability to meet its financial obligations is often driven by the business strategy it pursues in the markets it serves. Assessing the organisation, service area, and facilities are key credit factors.

Service Area

Market characteristics and market share are the key ingredients emphasised in the rating process. Management that is able to formulate specific growth strategies based on this information is viewed favourably. On the other hand, deteriorating socioeconomic factors have the potential to lead to unfavourable shifts in payer mix and can negatively affect the rating.

Market share is a primary credit factor and is evaluated both in terms of the absolute level and its movement over time. Higher shares are viewed more favourably than lower shares, but positive trends in share that are observed over a multiyear period are generally better than a higher but declining market share trends. Trends and levels in individual services are also reviewed to identify potential strengths and weaknesses in subspecialties. Demonstrated growth in market share for service lines that have been targeted for investment is viewed positively, especially if utilisation growth occurs in high volume and/or high margin services.

Higher market share, in addition to indicating substantial success in executing overall strategy, can signify that a hospital has a relatively large amount of leverage in negotiating pricing with commercial insurers. A dominant market share is viewed very positively in the rating process, as it could insulate itself from the impact of an economic downturn in comparison to other health providers with smaller market share.

Operational Effectiveness

Successfully meeting financial commitments is predicated on effectively conducting the daily activities of running a hospital or health system. Maintaining a facility that is conducive to physician referrals, efficiently processing patients, ensuring that supplies and personnel are sourced and deployed, providing high-quality and appropriate care, and maximising collections for services rendered are all critical aspects of hospital operations. Ind-Ra analysis seeks to identify processes that continually improve the effectiveness of major operational functions, with particular focus on management's ability to assess operational constraints and inefficiencies, monitor progress, and maximise financial and strategic results.

Utilisation

Ind-Ra considers several indicators when evaluating hospital utilisation trends, from broad measures of patient activity such as inpatient discharges or total outpatient visits, to specific service or ancillary activity that may disproportionately influence profitability. A declining trend may indicate market share loss to a competitor, or deteriorating demographics and is generally viewed negatively. However, increasing trends are viewed positively.

Volume changes for individual services, such as surgeries, emergency room cases, clinic visits can yield insights into competitive developments in the service area, the relative success of investments in selected product lines, and shifts in technology or regulation. Ind-Ra examines these factors in conjunction with occupancy ratios to determine what credit impact they may have, if any.

Average length of stay (ALOS) measured in conjunction with case mix index is a direct reflection of case management practices. Unless patient acuity is increasing, a rising ALOS suggests problems with patient throughput and the excessive expenditure of resources in providing care. Effective ALOS management increases a provider's effective capacity and lends credit strength.

Payer Mix

The composition of a hospital's sources of payment for services provided usually reflects the service area's socioeconomics and has a high correlation with a hospital's financial performance. There is a broad range of payment rates and terms among the various payer groups. Ind-Ra reviews trends in payer composition as well as the profitability and collection cycle for each. Payment rates for commercial insurers are usually high, so a higher proportion of commercial payers is viewed positively in the rating process. High concentration of revenue from a single commercial payer can be viewed negatively unless governed by a long-term agreement providing attractive rates.

High concentrations of governmental payers can have both positive and negative effects on credit ratings. While an agreement with the government on both providing in- and out-patient services has a positive impact on revenue, unprofitable payment rates or significantly delayed payment realisation under these programs would affect the credit ratings. Similarly, certain specialty reimbursement programs such as disproportionate share, graduate medical education, and indirect medical education can make hospitals vulnerable to budgetary pressures and policy-driven payment-rate changes.

Fundraising

Contributed Funds Provide Operating and Capital Support

Institutional development, commonly referred to as fundraising, provides an important resource for many of not-for-profit institutions. While charitable organisations are in the business of collecting donor's contributions earmarked for a specific cause, contributions to other institutions provide an important source of budgetary flexibility and, over time, help build financial resources and finance necessary capital improvements.

Contributions to an institution come from a variety of sources, including board members, patrons, and other non-affiliated foundations and corporations. State and central government grants are also periodically allocated to certain institutions to support operations, facility development, or both. Ind-Ra typically requests information on the professional background of the board and other key supporters to assess giving potential. As the presence of an affluent board alone does not translate into actual giving, the board's track record of giving adequate financial support is reviewed.

Figure 2

Attributes: Fundraising

Stronger attributes	• Long-standing fundraising culture, perpetuated by an identifiable mission and supported by mature, well-developed infrastructure to effectively solicit donor contributions; annual fund and capital campaign giving tends to be robust
Midrange attributes	• Established fundraising culture, supported by basic infrastructure needed to solicit donor contributions; giving tends to be adequate, though largely associated with specific projects or purposes
Weaker attributes	• Lacklustre fundraising culture, possibly as a result of the organisation's service line, highlighted by a spotty track record of development activities; generally no infrastructure in place to support effective fundraising, with most donations solicited on an ad hoc basis

Source: Ind-Ra

Gifts and contributions are typically made to an institution on an unrestricted basis in the form of a one-time or annually recurring donation or are restricted to a specific purpose. Unsecured loans from family, friends and trustees/society members are a common form of revenue for such institutions. Outside of annual giving, which for some institutions could represent a sizable percentage of operating revenues, unrestricted gifts to most of these institutions are fairly limited, as donors generally prefer to lend their support to specific, identifiable projects or initiatives. Still, restricted giving enhances financial flexibility, as it enables an institution to free up funds it would have otherwise dedicated to a cause now being supported and funded by a donor.

Financial Profile

Quantitative Assessment of Factors Informs Rating Process

Financial metrics contribute significantly to rating determinations. With inputs derived from audited financial statements and other supporting financial documents, Ind-Ra calculates and evaluates quantitative assessments of revenue diversity, operating performance, balance sheet resources, and debt burden, as well as the historical trends of such measures. Expectations for future financial performance and, ultimately, the credit rating are informed by assessments of those factors. As long as a borrower's underlying strategic position remains sound, a certain amount of variability in financial performance should not affect the rating on the bonds.

Ind-Ra analyses both the revenue and expense sections of the statement of activities to determine concentration of revenues and flexibility of expenses. Significant changes in revenues or expenses from one year to another should be explained by management. For most institutions, the ability to at least annually cover operating expenditures and debt-carrying charges from operating revenues has positive implications for its long-term financial position.

Solid financial performance generally correlates to higher rating levels, as a rating reflects the institution's ability to make full and timely payments of principal and interest. Ind-Ra analyses trends based on five years of historical financial data, and assesses the sustainability of current results. Analysis focuses on the audited balance sheet and the audited income statement. Ind-Ra views favourably institutions that consistently generate positive operating results.

Income Statement

Ind-Ra analyses both the revenue and expense sections of the income statement to determine concentration of revenue and flexibility of expenses. Institutions deriving revenue from a wide variety of sources are less susceptible to fluctuations resulting from funding reductions or changes in demand for a particular programme.

Significant changes in revenue or expenses from one year to another should be explained by management. An ability to generate revenue above expenditure annually is essential for maintaining or improving an institution's long-term financial position and for providing adequate debt-service coverage.

Revenue Diversity

Stability of Demand-Based Revenues May Offset Concentration Concerns

Depending on the institution's mission and mix of offerings, an institution's revenue base can range from extremely diverse to extremely limited. As part of its analysis, Ind-Ra discusses with management the composition and historical stability of key revenue streams and projections for future funding levels. For some institutions, a seemingly concentrated revenue base may, in fact, be more diverse when the primary sources of those funds are revealed. For example, the income statement of a research organisation may indicate grants and contracts represent 95% of total operating revenues. However, when the pool of grants and contracts is analysed, no one granting agency may have a significant contribution to the total.

Diversity of Revenues Affords Flexibility; Sources of Diversification Analysed
Operating Profile

Generally, keeping other things same, the more diverse an institution's funding mix, the higher its credit rating. This stems principally from the increased financial flexibility afforded by the presence of multiple revenue sources that are often uncorrelated.

Ind-Ra recognises that sources of diversification often have their own associated risks, and these risks are considered in the rating process. In addition, while revenue concentration may increase an institution's vulnerability, management's ability to closely manage the drivers of that key revenue stream, such as a research institute carefully complying with the requirements of a central funding grant, may help mitigate the dependency risk. Regardless of the concentration of revenue, the ability of an institution to articulate a well-reasoned strategy for managing pending changes in its funding environment is viewed favourably in the rating process.

Figure 3

Select Operating Performance Metrics

Diversity of revenues	Concentration in any one revenue source could be a concern but may be mitigated by a history of stability
Volatility of revenue	A revenue source that contributes at least 25% of revenues is reviewed for changes that have affected its consistency

Note: Both revenues and expenses are reviewed usually for five years, to determine the consistency of the institution's financial performance
Source: Ind-Ra

Expenditure Flexibility Key to Operating Stability

Given the potential impact that unexpected changes in funding could have on an institution's ability to achieve budgetary balance, Ind-Ra reviews an institution's expenditure flexibility, notably its ability to hold constant or even decrease its total operating budget during times of revenue weakness. Integral to this analysis is an assessment of significant expenditures. In general, most institutions are adept at managing variable expenses, including those directly tied to their provision of programs and/or services, and demonstrate a willingness to pare down their offerings in response to less favourable economic conditions or reimbursement levels.

Importantly, Ind-Ra recognises that certain institutions perform mission-critical activities, such as electricity distribution; food grain supplies; provisions of irrigations; highly subsidised public transport such as state transport buses and publicly funded metro rail, critical hospital care, regardless of the negative financial impact. As part of its expenditure analysis, Ind-Ra discusses with management its long-term strategy for cost containment related to such mission-critical offerings and attempts to ascertain what control, if any, management may have in maximising future revenues or reimbursement. Ind-Ra also seeks to understand whether the failure of a mission-critical program or service to achieve certain financial benchmarks over time will result in its cancellation or restructure. In general, an institution's ability to identify specific triggers that may cause it to exit an unprofitable business line and articulate an overall strategy for managing loss-generating, mission-critical activities is viewed favourably in the rating process.

Although most institutions maintain a fairly lean and flexible operating budget, costs associated with staff salaries and related benefits are generally fixed and, depending on the organisation, often significant. While Ind-Ra notes that institutions with an ability to temporarily reduce headcount and/or freeze salaries during a period of financial weakness are often better able to achieve larger expenditure reductions, these actions have implications, particularly as related to a client or patron's view of quality. Less favourable views of quality could result in weakening demand for an institution's programs and/or services and its ability to fundraise.

Operating Margin

Fiscal Balance Achieved Through Revenue and Expenditure Match

The operating margin measures an institution's ability to generate revenue from its core operations sufficient to meet annual expenditures, fund routine maintenance, and service financial obligations. While Ind-Ra recognises margins may vary from year to year, over a five-year period the expectation is for at least a break-even level of performance. By generating a consistent margin at or above a break-even level, an institution is less reliant on its unrestricted reserves for operating support and can generally service debt from net available income. Most of government entities providing social/public goods either earn marginal profit or are in losses and are funded by the upper tier government.

Figure 4

Attributes Box: Operating Margin

Stronger attributes	• Consistent track record of strong positive operating performance supported by a diverse revenue base and solid resource levels; exposure to non-marketable, illiquid securities tempered by operating strengths and availability of other, more liquid funds
Midrange attributes	• Consistent track record of moderate operating performance, although years of slight deficits are not uncommon; and adequate to healthy resource levels; modest exposure to nonmarketable securities, with a more limited ability to manage the illiquidity issues accompanying these investments
Weaker attributes	• Generally negative, fairly volatile operating performance and adequate to fairly weak resource levels; extremely limited financial capacity to manage the risks associated with any exposure to nonmarketable asset classes

Source: Ind-Ra

Adjustments to Operating Margin Enhance Analysis

Ind-Ra omits the non-core items like profit or losses on sale of capital assets - land and other assets including operating assets - and income or expenditure unrelated to the core business activities while computing the operating margin for an institution.

Debt Profile

The level and structure of a borrower's debt strongly affect Ind-Ra's overall assessment of creditworthiness. The purpose of a planned financing, the total amount of debt outstanding, and various characteristics of a borrower's debt structure are all components of Ind-Ra's review. Ind-Ra's approach may also consider the likely consequence of debt market fluctuations and a borrower's ability to meet obligations under such stressed conditions.

Purpose

Ind-Ra debt profile analysis begins with a review of the rationale to issue debt. For new money issues, Ind-Ra seeks to determine if planned capital investments are justified by capacity constraints, projected market growth, or competitive opportunities. In addition to Ind-Ra's own research and analysis, Ind-Ra considers a borrower's methods for monitoring industry growth patterns and their relative market position, if appropriate. Ind-Ra looks favourably on organisations that soundly demonstrate a need for their CIP by employing a variety of techniques to assess service area dynamics.

A borrower's ability to service planned debt from existing operations is viewed favourably. Alternatively, if debt repayment depends on the incremental revenue to be generated by new capital assets, the evaluation of project completion risk and feasibility becomes an important aspect of Ind-Ra analysis. For debt issued to refinance or restructure existing obligations, Ind-Ra analysis focuses on the rationale for the issuance and the options available to the borrower for that purpose.

Magnitude

Ind-Ra evaluates the actual and expected amount of debt outstanding by comparing debt and debt service levels to a comparable group of borrowers and examining future debt service requirements in relation to historical and expected revenue streams and the borrower's overall cost structure. Ratios relevant to the sector capture the financial flexibility afforded by an organisation's assets and operations relative to outstanding and expected long-term debt.

The inability to meet periodic debt service requirements with operating cash flows is viewed negatively. However, in certain cases, these concerns may be mitigated when a borrower's non-operating revenues (or those of an affiliate or other related entity that support the borrower) show a long and stable history or its liquid assets are several times greater than debt obligations (particularly for the higher education and healthcare sectors).

Investment-grade ratings (higher than "IND BBB-") generally require coverage of debt service by earnings before capital costs, with higher ratings correlating strongly with higher coverage ratios. However, the presence of extraordinary pricing flexibility or available liquidity can mitigate occasional deficiencies in coverage.

Structure

The characteristics of a borrower's debt instruments and capital structure have a strong bearing on Ind-Ra assessment of creditworthiness. The establishment and composition of the obligated entity or entities, the nature of the security pledge, interest rate mechanisms, demand features, performance covenants, and principal amortisation are all components of Ind-Ra's review.

A high proportion of fixed-rate debt is viewed positively by Ind-Ra. Moreover, fixed-rate debts with amortising principal within the expected life of the assets financed provide the most stable debt configuration.

Ind-Ra examines the ability of borrowers that use variable-rate debt to manage interest rate and liquidity risk. Factors that can mitigate the risks involved, such as large cash reserves, are also considered.

To determine if a borrower can manage its variable-rate and short-term debt exposure at its given rating level, Ind-Ra may perform stress tests to determine the resilience of a borrower's financial metrics (e.g. cash flow and liquidity adequacy), compared with its peer group. Typically, borrowers rated 'IND A' or higher have greater financial flexibility, including market access, to manage the various risks associated with variable-rate debt than their lower rated counterparts.

Legal Provisions

Ind-Ra analyses several legal factors, which may include indenture provisions such as security pledges, rate covenants, events of default, additional bonds tests, and reserve requirements. While Ind-Ra believes bond covenants are clearly important to overall investor security, the degree to which they influence ratings varies. Operating performance will have a greater effect on the rating than legal provisions for most highly rated borrowers. However, legal provisions become increasingly important as a borrower moves down the rating scale.

Indirect Risks and Contingent Liabilities

In looking at an issuer's debt obligations, Ind-Ra examines not only liabilities directly incurred and payable by the issuer but also outstanding debt for which the issuer may in the future have an obligation. Examples include moral obligations, where the issuer may support but is not legally obligated to support – the debt upon failure of the primary security, and needs of related governmental entities that may require financial resources of the rated issuer. Such obligations are monitored but typically excluded from direct debt calculations unless the issuer's resources have been relied on to cover the obligation during the past three years.

Planning Documents Facilitate Assessment of Debt Portfolio and Future Needs

When assessing financial leverage, Ind-Ra reviews an institution's existing level of debt and future plans for debt issuance. For this reason, Ind-Ra prefers to see that an institution has a capital improvement plan with a documented process for assessing capital projects, a time horizon for completion, and anticipated sources of funding. Typically, capital plans cover a period of at least five years and are subject to periodic review. As part of its analysis of pro forma leverage and future debt capacity, Ind-Ra may incorporate a planned borrowing into certain debt ratios to the extent sufficient detail relating to the financing is available.

As current and proposed debt structure is an important consideration, Ind-Ra evaluates an institution's debt policy outlining parameters for incurring leverage and any related documents.

Debt and Debt Service Coverage

When assessing leverage, Ind-Ra considers existing debt and plans for debt issuance. The agency prefers to see that the institution has a capital improvement plan with a documented process for assessing capital projects, a reasonable time horizon for funding the projects and the funding sources. The plan should cover at least three subsequent years and be reviewed periodically.

When reviewing an institution's level of debt, Ind-Ra calculates ratios that reflect the institution's debt burden and ability to repay the debt. Debt-service coverage is measured through both annual revenue and EBITDA. The stronger the coverage, the more likely the institution will make timely debt-service payments. In addition to the ability to pay debt service from annual net revenue, Ind-Ra also reviews available funds to debt.

While most of the institutions rated under this criteria have regular inflows (revenue), education institutions inflows are lumpy in nature. Ind-Ra examines whether fee inflow to institutions is quarterly, half-yearly, or annually and whether the available funds distort the liquidity position of institutions at the end of a fiscal year. Ind-Ra gives more importance to the cash flow during the year and ascertains whether cash flows are significant enough to honour debt service commitments. Ind-Ra believes despite cyclicality in revenue, institutions with strong brand and better financial management will have significant cushion available to them at the end of a fiscal year.

Ind-Ra also assesses an institution's pension liabilities, evaluating any present deficit, future needs and the nature and flexibility of the funding schemes, both the schemes specific to the institution and the nationwide pension funding systems.

Balance Sheet Resources and Liquidity

Financial Cushion Provides Buffer

In analysing an institution's resource base, Ind-Ra examines the magnitude of financial assets and the liquidity of these holdings. In general, the size of an institution's resource base correlates strongly with its fundraising track record and its ability to annually operate at or above the break-even level.

For institutions with significant resources, the largest component of their investment portfolio tends to be financial assets held for the long term. These assets include endowment funds and other funds that function similarly to endowment assets although with fewer restrictions as to use. In addition to long-term investments, well-endowed institutions may also maintain sizable short- and intermediate-term cash and investment pools to support short-term working capital needs and variable-rate demand programs. Generally, these investments tend to be highly liquid and available on demand, with minimal notice.

To gauge the magnitude of an institution's resource base, Ind-Ra calculates available funds, or total cash and investments not permanently restricted. This balance is then compared to operating expenditures and financial leverage as measures of financial flexibility. As part of its analysis of balance sheet resources, Ind-Ra reviews investment performance from the close of the most recent audited fiscal year and considers the potential impact that financial market movement may have had on available fund metrics derived from those audited financial statements.

Available funds for debt service provide an indication of how long the institution could fund debt service from existing cash and investments. As available funds represent the accumulation of surplus revenue over many years, comparing available funds to maximum debt service provides a measure of assurance that debt will be repaid in a timely manner in the event of a financial disruption for any one year. Ind-Ra reviews available funds to total debt as this provides a measure of assurance that all debt would be repaid in a timely manner if it all had to be retired immediately.

Balance Sheet Resources Not Necessarily a Proxy for Liquidity

Figure 5

Attributes: Financial Flexibility

Stronger attributes	Track record of strong/solid operating performance, supported by a diverse revenue base, and solid resource levels and availability of other, more liquid funds.
Midrange attributes	Moderate operating performance supported by stable, enrolment-related revenues, and adequate to healthy resource levels and limited availability of other, more liquid funds.
Weaker attributes	Weak/negative operating performance supported by variable, enrolment-related revenues, and adequate to fairly weak resource levels; extremely limited financial capacity to manage the risks associated and extremely limited availability of other, more liquid funds.

Source: Ind-Ra

Ind-Ra acknowledges that many institutions invest sizable shares of their long-term investment portfolios in alternative asset classes. Held with a long-term investment horizon, alternative investments provide the opportunity for enhanced returns although are generally illiquid, not immediately accessible, and sometimes require subsequent commitments of capital. Given these characteristics of alternative assets, which maybe significant (in excess of 50% or more of an institution's total investment holdings), available funds no longer provide a sufficient proxy for liquid resources. Consequently, Ind-Ra will also calculate an adjusted available funds metric that attempts to distil the core available funds calculation discussed above into its most liquid, most accessible components. In the adjusted calculation, Ind-Ra typically includes traditional equity and fixed-income investments as well as central and state government-backed securities, mutual funds, unencumbered cash and all cash and cash equivalents. Private equity and real estate are the most common alternative investments stripped out of the adjusted metric.

Ind-Ra also evaluates the liquidity profile of an organisation. The liquidity Indicators, classified as Superior, Adequate, Stretched and Poor, appear as a subsection in the rating action commentaries (RACs) with the associated rationale. Liquidity forms a critical component of Ind-Ra's analysis and focuses on liquidity sustainability, entity's ability to generate operational cash flows to meet its outflows, the availability of cash, unutilised limits and access to markets for raising funds.

Figure 6

Select Measures of Liquidity and Leverage

Available funds	• Includes cash and investments that are not permanently restricted. Available funds provide a measure of balance sheet resources
Adjusted available funds	• Includes cash and investments that are not permanently restricted; excludes financial assets deemed as alternative investments per the audited financial statements
Debt service coverage	• Measures an institution's ability to service debt from net available income.
Debt burden	• Measures total debt as a percentage of EBITDA. Ind-Ra considers a debt burden equal to or greater than 4x as high.

Source: Ind-Ra

While adjusted available funds may suggest a much weaker level of financial flexibility for some institutions, Ind-Ra recognises that this calculation is conservative, as it gives no credit to holdings, which, while not immediately available, will likely have a value at the end of their investment horizon. Moreover, these investments are rarely intended as a source of near-term liquidity or working capital. For these reasons, Ind-Ra will continue to calculate available funds and adjusted available funds as measures to assess total resources and liquid resources, respectively.

While analysing liquidity position of an institution, Ind-Ra examines receivable and payable days, cash conversion cycle and working capital utilisation.

Peer Comparisons

Comparative Analysis Highlights Similarities and Contrasts Among Like Credits

Lack of standardisation of demand and financial data is a major bottleneck for a robust comparison among institutions having a similar mission and mix of programmatic and service offerings, comparisons across unrelated non-profit business lines will be less meaningful. As an example, the credit drivers of a voluntary institute engaged in social development differ from the drivers of a research institute, meaning that certain demand and financial metrics will not translate to both entities. Consequently, Ind-Ra generally conducts its peer analysis for institutions among credits at a given rating level having similar attributes.

In cases where Ind-Ra does not maintain ratings on a critical mass of similar credits or in situations where the metrics do not consistently align with or support a rating recommendation, Ind-Ra may expand the universe of comparable institutions. The expanded universe could include median values for dissimilar institutions at the proposed rating level or, in the case of situations on the margin, institutions rated above or below the proposed rating level. In most cases, this analysis helps bolster the rating recommendation and highlights important contrasts.

Importantly, Ind-Ra notes that the ranges over which demand and financial metrics vary can be broad, and overlap among rating categories for certain metrics is inevitable. Moreover, ratings are forward looking and imply expectations for the future rather than being solely based on what previously occurred. Nevertheless, improvement or deterioration in an institution's demand and/or financial metrics is an important rating driver, with such improvement or deterioration relative to medians and peers a potential source of positive or negative rating pressure. Other intangible, qualitative variables, such as the strength of management, also play an integral role in the analysis.

Financial Metrics

Ratios Remain a Valuable Analytical Tool

Financial results correlate reasonably well with credit ratings. The Appendix A details the core factors discussed as part of this sector-specific criteria report and provides examples of typical characteristics exhibited across the ratings spectrum.

Median financial ratios will vary over time because ratings allow for a certain amount of performance variability and cyclicality, and no absolute floors or ceilings are prescribed for individual metrics to qualify for a particular rating level. Strong performance in one metric may or may not compensate for poor performance in another, depending on the metrics involved and other circumstances of the borrower. Also, qualitative factors and expectations for future performance often result in ratings for borrowers that may have one or several metrics that diverge from published medians.

Appendix A

Figure 7
Key Financial Ratios

Ratio	Calculation	Significance
Capital structure and cash flow		
Debt service coverage ratio	EBITDA/annual debt service	Indicates the net revenue available to meet annual debt service requirements
Interest coverage ratio	EBITDA/interest payments	Indicates the net revenue available to meet interest service requirements
Annual debt service as % of total revenue	Annual debt service/total revenues	Indicates the relative burden of debt service relative to total revenues. Higher percentages indicate less room for operating profitability variance
Debt to EBITDA	Total debt/EBITDA	Indicates the size of debt compared to the EBITDA
Debt to income	Total debt/income	Indicates the size of debt compared to the total income
Net debt to EBITDA	(Total debt – Unrestricted cash and investments)/EBITDA	Indicates the size of net debt compared to the EBITDA
Liquidity		
Cash to debt	Unrestricted cash and investments/total debt	Indicates financial flexibility and cushion against decline in operating profitability
Collection period (days)	Receivables [a] X 365/total income	Indicates days to recover the collection from raised invoices
Cash conversion cycle [b]	Receivables days + inventory days – payables days	Measures the liquidity risk associated with current assets and how fast an entity can convert its current assets into cash
Profitability		
Operating margin	Total operating revenue-total operating expenses/total operating revenue	Provides an indication of a borrower's profitability from core operations
EBITDA margin	EBITDA/total operating revenue + non-operating revenue	Provides an indication of cash flow from operating and non-operating (primarily investment income) which is available for the payment of debt service
Personnel costs as % of total operating revenues	Salaries, wages, benefits, and professional fees/total operating revenue	Provides an indication of how efficient labour is being used

[a] Most of the institutions prepare income and expenditures statements. Hence, profit after tax is nothing but current balance for these institutions.
In the previous version of School Rating Criteria and Rating Criteria for Colleges and Universities, current balance before interest and depreciation (CBBID) was used which is replaced by EBITDA now.
[b] Generally, inventory level is nil for the educational institutions
NCLT is applicable to some of entities which are rated under this criteria
Source: Ind-Ra

Appendix B

Operational Metrics – School Specific

Figure 8

Attributes: Enrolment

Stronger attributes	Demonstrated enrolment stability over a full business cycle, fuelled by highly effective competitive strategies; pipeline of prospective students is robust.
Midrange attributes	Enrolment trends, while generally stable, are prone to some fluctuation due to quality; competitive strategies effective at maintaining stable demand over time.
Weaker attributes	Volatile trends in student headcount; well-articulated vision and mission lacking; less effective competitive strategies enabling competitors to cherry pick prospective students.

Source: Ind-Ra

Figure 9

Attributes: Demand

Stronger attributes	National or regional draw for students within an affluent market area; any competitive threats are generally muted by a track record of highly favourable academic performance indicators, which also create considerable tuition pricing flexibility.
Midrange attributes	Generally stable local market serves as a primary feeder for the school; academic performance indicators are generally in line or slightly ahead of those competitors; more limited tuition pricing flexibility, particularly when local economic conditions deteriorate.
Weaker attributes	Highly concentrated, local draw in a demographically and economically challenged service area; academic performance indicators may be equal or below those of competition; extremely limited pricing flexibility.

Source: Ind-Ra

Figure 10

Attributes: Admissions

Stronger attributes	Consistently high enrolment rates, indicative of the school's first choice status among prospective students, and highly competitive admissions process, which provides a school considerable flexibility to shape the profile of incoming classes.
Midrange attributes	Stable enrolment rates, which may be high or low, depending on market dynamics; admissions process is somewhat competitive, although acceptance rates tend to be fairly high, limiting enrolment flexibility.
Weaker attributes	Variable enrolment rates, which are usually low; non-competitive admissions process, with generally no ability to shape the profile of an incoming class; heavy tuition discounting to attract students is often a necessity.

Source: Ind-Ra

Figure 11

Indicators of Student Demand

Indicators	Use of indicators in the rating process
Number of applicants	Stable to growing numbers reflect continued interest in the institution.
Acceptance rate	In general, the higher the acceptance rate, the less flexibility the institution has to increase future enrolment. However, for schools offering unique, targeted programs, higher acceptance rates are more common, as only qualified students apply.
Enrolment rate	The higher the enrolment rate, the greater the likelihood that the institution is the student's first choice.
Reputation of/publicity for school	A history of a positive reputation is desired. Recent negative publicity can have an adverse effect on enrolment and future fundraising.

Source: Ind-Ra

Colleges and University Specific Metrics – Demand Flexibility

Applications, Acceptance and Enrolments

Figure 12

Attributes Box No. 1

Stronger attributes	Consistently high enrolment rates (number of enrolments divided by the total accepted students), indicative of the institution's first choice status among prospective students, and highly competitive admissions process, which provides an institution with flexibility to shape the profile of incoming classes
Midrange attributes	Stable enrolment rates, which may be high or low, depending upon market dynamics; admissions process is somewhat competitive, although acceptance rates tend to be fairly high, limiting enrolment flexibility.
Weaker attributes	Variable enrolment rates, which are usually low; non-competitive admissions process, with generally no ability to shape the profile of an incoming class; heavy tuition discounting to attract students is often a necessity.

Source: Ind-Ra

Hospital Specific Metrics – Operational Profile

Figure 13

Service Area Characteristics

Indicator	Significance
Socioeconomic	A diversified economy with low unemployment, above-average household income, and population growth factors indicates a greater likelihood of steady demand for and affordability of services.
Market share	A higher market share is indicative of patient demand and improved negotiating position with payers.
Certificate of need requirement	Certificate of need requirements require regulatory approval for certain capital expenditures that reduces sharp changes in competitive environment.

Source: Ind-Ra

Co-operative Societies Specific Metrics – Operational Profile

Figure 14

Attributes: Demand

Stronger attributes	A higher market share is indicative of products demand and growth of manufactured products; superior supply chain management and market delivery systems; any competitive threats are generally muted by prominent brands for all products; reasonable pricing flexibility
Midrange attributes	Generally stable local market and local brands of manufactured products; developing supply chain management and market delivery systems; limited pricing flexibility
Weaker attributes	Very low market share is indicative of low product demand due to unknown brand; unorganised supply chain management and market delivery systems; extremely limited pricing flexibility

Source: Ind-Ra