Textiles Sector

Ratings Navigator Companion

Special Report

Navigator for Corporates is a graphical peer comparator that forms part of a series of similar tools used by 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 20 April 2020.

Sector Navigators provide guidance for applying the concepts of the Corporate Rating Criteria to the issuers in the sector the Navigator covers.

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Sector and Subsectors: This report presents the key peer-comparator elements observed or expected for textile manufacturers. The report covers companies across all textile production sub-sectors, such as spinning, weaving and garmenting, and includes vertically-integrated producers, as well as small players with no integration. The report is also applicable to home textiles and advance textiles.

Key Factors: The navigator examines sector-risk profile; five business profiles, including management and corporate governance; and three financial profile factors. After assessing the sector-risk profile and management and corporate governance, the navigator examines key business profile factors and key financial profile factors.

Sector Risk Profile

Rating Range: The risk profile of the textile sector ranges up to the 'A' rating category, reflecting the sector's exposure to volatile raw material prices; discretionary nature of demand; seasonality of raw material supplies; high working capital requirements; dependence on fiscal incentives and high maintenance capital expenditure.

Sector-Specific Key Factors

Diversification: Diversification of procurement, production, product and geographical sales reflects an issuer's ability to absorb temporary shocks over time. Counterparty diversification is critical as well due to the typical, high customer concentration and high dependencies on channel sales with limited data to assess counterparty credit risks.

Scale and Market Position: A large scale and strong market position in key product segments enables economies of scale on the procurement of critical raw material inputs and wider distribution of fixed costs. A strong market position demonstrates an issuer's ability to adapt and either grow or defend market share.

Value-Chain Dominance: Vertical integration with presence in more than one node of the value chain enables a high and/or a stable operating margin. Similarly, a high mix of value-added products (VAPs) is typically associated with integration in to customer processes, which improves customer stickiness, leading to high realisations.

Earnings Visibility: The risk of evolving fashion trends is unique to this sector. A high percentage of contracted manufacturing, reach and channel, branded products and overall turnaround time mitigates the risk. The efficient use of assets and automation, which reduces dependency on labour and proper upkeep of assets or modernisation will not only ensure minimum disruption to production but is also key to maintaining competitive cost positioning.

Financial Profile Key Factors

Financial Profile: Financial metrics are the ratios encompassing mid-point leverage and coverage ratios, and measures of profitability and cash flows.

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.

Sector Risk Profile

While the sector participants are rated in a wide range of 'IND AA-' to 'IND B' category, the "natural rating territory" is 'IND A' and below. At one end of the spectrum are integrated players with large-scale investment and turnover, while at the other end, there are small-to-mid players, in the spinning or weaving segments, with modest investment and turnover. Typically, large players are likely to have more stable market and customer bases, whereas small players would be more vulnerable to competition and raw material price volatility even when the demand is stable. Large players are also at an advantage to address export market demand, which may need designated capacities and turnaround of large-scale orders in tight timelines. Large investment-grade textile companies tend to be strong marketers, typically having leading market shares in specific categories. These companies enjoy generally high margins and steady operating cash flow generation. The strongest companies offset the sector's inherent weaknesses with strong liquidity; low operating costs; high VAP mix; wide diversification in terms of product, geographical and end-sector exposure, and varying degrees of vertical integration.

Low-rated companies will typically exhibit several of the following characteristics: production of a single product; no control on key inputs; single-plant operations; high operating costs; weak liquidity and/or high absolute debt levels; more commoditised product mix or reliance on individual market segments.

Raw Material Price Risk: India's textile industry is characterised by volatile raw material prices. Price risk also emanates from the volatility in crude prices, seasonality of cotton availability and regulatory control of the minimum support prices for raw cotton and low pricing flexibility of end products due to stiff competition.

Highly-Fragmented Industry: The industry is highly fragmented due to low-entry barriers and easy availability of raw material and labour, leading to a large unorganised sector participant and only a few large players. Since the sector relies on exports, it is vulnerable to a slowdown in the global markets and international competition.

Global and Local Competition: The Indian textile industry faces tight competition from local players as well as from companies in Vietnam, Sri Lanka, Bangladesh and China, which have cost advantages (labour, power, taxes) as well as a favourable duty structure on exports. Quality, consistency and order turnaround time are the key parameters of competitive advantages.

Fiscal Incentives: Policy changes can impact the sector's risk profile on various business and financial parameters. The continuity of state and central incentives is instrumental in determining the level of capex activity in the sector. Changes in the government's export policy and incentives schemes may impact the earnings profile of exporters as export incentives account for 2%-7% of their revenue.

Other Regulatory Risks: The government has historically imposed bans or put in place volume restrictions on cotton/cotton-product exports to protect the domestic industry. The compliance to pollution norms and labour laws is another dimension of regulatory control. Global regulation also influences the business of domestic textiles. For instance, China's building of strategic cotton reserves supported global cotton prices in FY13-FY19.

Debt-intensive Operations: Textile operations are working-capital intensive due to the long inventory period and high debtor days. Capex projects are typically financed under state and central incentives schemes, which lead to an elevated leverage on the balance sheet. Given the sector's high debt, any volatility in EBITDA could lead to huge swings in leverage and also

Applicable Criteria

Corporate Rating Methodology Master Criteria (January 2017) impact liquidity, especially amid an ongoing capex project.

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

Diversification

Diversification of textile companies is determined by two parameters – the company's prime raw material (cotton and synthetic) and its product mix (commodity and VAP). Business risks are different for cotton and synthetic textiles. Cotton is exposed to seasonality risk, vagaries of nature and government regulation in terms of setting minimum support prices for farmers to control domestic availability via imposing restrictions on exports. Synthetic fibres can be polyester, acrylic or nylon, all of which are driven by crude oil prices, and are available round-the-year while there is a strong supplier concentration.

Ind-Ra takes a positive note of the companies which are diversified into cotton and synthetic textiles, or have the flexibility to switch, to an extent, their primary raw material. Such companies are buffered against the adverse market conditions of one raw material, and gain from the substitution effect, if prices of a particular raw material rise. This is largely applicable for spinning companies.

Product diversification into VAP and higher-margin technical textiles is also viewed favourably by the agency. Technical textiles are made from chemicals and are less affected by cotton and crude price cycles. A diversification into businesses other than textiles, which mitigate the volatility risks of the sector, is also viewed favourably.

Geographical Diversification

A broad geographical presence helps protect a textile producer from a downturn in an individual country or a region. Product and geographical diversification taken together help moderate the impact of price cyclicality or forex movements on a company's financial performance. This is particularly applicable for home textiles, fabrics and branded apparel sub-sectors in terms of their sales networks.

Counterparty Diversification

Counterparty diversification is important as it distances the issuer from idiosyncratic risks relating to its counterparties and therefore, risk posed to receivables. High concentration also impairs a company's bargaining power and its ability to pass on the input cost fluctuations in a timely manner. The agency evaluates the creditworthiness of the counterparties, basis their outstanding credit ratings and/or market feedback. The agency will also evaluate trends in aging, provisioning and write-off of receivables.

Operational Diversification

Operational diversification is described as the number of textile plants and processing facilities that a textile company operates. A consideration of a company's operational diversification incorporates the aspects of its scale, geographical/product diversification, operational flexibility and the impact of event risks. Companies with multiple operating facilities are less affected by event risks such as fires and explosions than companies with single-plant operations. In assessing this factor, Ind-Ra undertakes a simple count of the number of plant locations.

Figure 1
Diversification

Category	Product diversification	Geographical sales diversification	Counterparty concentration	Plant locations
IND AA	Significant fibre/product diversification	Significant geographic diversification	Substantially low concentration to top customers and clientele of high creditworthiness	High (numerous plants and mill)
IND A	Good fibre/product diversification	Good geographic diversification	Low concentration to top customers and clientele of high creditworthiness	Medium (several plants and mills)
IND BBB	Limited fibre diversification	Limited diversification	Moderate concentration to top customers and clientele of moderate creditworthiness	Low (two to three plant and mills)
IND BB and below	No diversification	No diversification	High concentration to top customers and clientele of low creditworthiness	Single plant

Source: Ind-Ra

Scale and Market Position

Scale: Scale is measured in capacity (volumes) or EBITDA, rather than in revenue, as the textile industry's commodity prices are volatile. Thus, scale here implies a critical mass that enables supplier-bargaining power (cotton procurement vertical integration), diversification and a variety of offerings at different price points. An issuer's scale also enables economies of scale for total fixed costs and reduces total costs per unit.

Although a smaller scale does not limit a company's ability to operate efficiently and profitably, a larger scale is often associated with other favourable characteristics such as the company's business diversification - product range or geographical diversification - and multi-channel offerings. An issuer's annual EBITDA is used as an absolute scale measure, and when assigning it, Ind-Ra will consider not just the current year's metrics but historical and expected levels too.

Large scale operators will have a relative higher flexibility to manage through an economic downturn than mid-to-small players, by improving its productivity via cost-efficient programmes; currency, commodity or interest rate hedging, and by changing their product mix, in addition to reducing capex and dividends to preserve cash. Lower - rated entities are typically smaller and less diversified in terms of sales channels, geography and product range, or may be burdened by high debt.

Market Share: Assessment of an issuer's market share is not only reflective of its current level of size and scale, but also a track record of the trajectory of the market captured. Typically, entities with strong market share and differentiated products tend to have stronger pricing power. Product development projects with customers; sustained spending on innovation and research and development are few of the indicators the agency relies on for market share defensibility. Analysts compare the percentage topline of the issuer to the aggregate relevant sub-sector topline in relevant geographies to assess market share.

Reach and Channels: This criterion is primarily applicable for branded fabric and apparel segment. An established distribution network capable of accessing different channels results in a competitive edge. Distribution channels established over time enables an issuer's resilience to revenues with wider counterparty base. For branded apparel and retail, this indicates access to physical and online formats. Within the physical channels, there could be diverse formats in terms of exclusive branded outlets, multi-brand outlets and large format retail stores.

Figure 2
Scale and Market Position

Category	Market share	Scale (EBITDA; INR million)	Reach and channels
IND AA	Top-three player in most markets	Above INR2,000	Large scale distribution network and more than three channels of sale
IND A	Top-five player in most markets or leader in a niche with some threats of substitution within industry	INR500-2,000	Large scale of distribution network and less than three channels of sales
IND BBB	Moderate market position	INR200-500	Moderate scale of distribution network and single channel of sales
IND BB and below	Predominantly second-tier player, marginal player	<INR200	Modest distribution network and single channel of sales

Source: Ind-Ra

Value-Chain Dominance

Vertical Integration: The Indian textile sector has a long line of nodes in its value chain, including the production of fibres, spinning, weaving and garmenting. Integration in more than one node of the value-chain enables costs control, ensures consistent supplies of required raw material inputs and also helps maintain consistency and quality control. Issuers present in only one part of the value chain may remain vulnerable to external shocks. For example, if yarn prices decline, spinners would face larger inventory losses than an integrated company using yarn for captive consumption to produce a higher-value added fabric or garment.

The integration assessment is primarily applicable to the spinning, fabric and home textiles sub-sectors. Apparel manufacturers are not expected to have a high level of integration due to the asset-light nature of their business model. The integration element is measured using the percentage costs controlled by the issuer due to captive supplies.

Value Addition: Textile companies engaged in the manufacturing of VAPs, which also require a certain level of integration, have higher and less volatile margins than those involved in commoditised products. For instance, spinners manufacturing finer-quality yarns, measured by counts, are less vulnerable to raw material price changes as end-product higher realisations are less elastic to raw material price movements, in the short-run. VAPs also offer the possibility of a strong degree of integration with customers. The tailoring of products to meet specific end-customer needs can make it more difficult for these customers to easily switch suppliers and adds stability to producer earnings. Value-addition is measured by benchmarking an issuer's gross margins against the long-term sub-sector gross margins.

Raw Material Sourcing & Inventory Management: Raw material is the largest cost variant for textile players. In the cotton industry, profitability is determined by the efficiency and timing of cotton buying and inventory management. Unlike synthetic fibre, which is available across the year, cotton is a seasonal product and the season ranges from October to March. Procuring good quality fibre (cotton) during the season is important to ensure consistent quality and to benefit from bulk purchases.

However, cotton prices can be volatile and companies that stock up cotton are exposed to the risk of inventory losses should its price fall after procurement. Ind-Ra relies on assessing the historical track record of managing the inventory risk along with near-term strategies.

For synthetic players, raw material prices are correlated to the demand-supply situation; crude oil prices; movements of dollar/rupee, and the prices of cotton and chemical substitutes. For companies importing synthetic fibre, forex risks on unhedged imports can be significant. Supplier concentration in this segment is high with only a handful of players in upstream operations.

For apparel and garment players, inventory management is vital as the orders have a fixed delivery schedule and raw materials account for a lion's share of the overall cost. A majority of the sector participants are small-to-moderate in scale, may not be backward integrated, and would have high inventory in the form of both fabric and finished inventory.

The analyst's assessment of these parameters involves discussion with the issuer's management on supply diversification; proximity to raw material source availability; track record of relationships with suppliers and a comparison to the historical gross-margin volatility benchmark. The analyst will adjust the historical gross margin draw-down to reflect the risk mitigation strategies put in place.

Figure 3

Sub-Factors of Value Chain Dominance

Category	Integration	Value-addition	Raw material sourcing and inventory management policy
IND AA	Very high degree of vertical integration	Present across the value chain with substantially high mix of value-added sales	Very strong track record and diversified sources of raw material procurement, supply chain management, balanced inventory holding policy
IND A	High degree of vertical integration	High mix of value-added sales	Strong track record and diversified sources of raw material procurement, supply chain management, balanced inventory holding policy
IND BBB	Limited integration	Moderate mix of value-added sales	Moderate track record and diversification of raw material procurement, supply chain management, aggressive inventory holding period or high spot procurement policy
IND BB and below	No integration	Commodity pure-play	Low track record and scale of operation supporting efficient procurement, supply chain management, very high inventory holding period or very high spot procurement policy

Source: Ind-Ra

Earnings Visibility

Contracted Sales: The order-backed manufacturing reduces inventory risk, which is high in the fashion industry, due to fast-changing customer tastes and preferences. Companies with higher proportion of contracted sales provide revenue visibility and stability to margins due to periodic resetting of prices. Sector participants frequently participate in customers' product-development efforts that turns into a contracted sale, and sometimes even into dedicated facilities. Textile companies often have close relationships with particular customers, and these relationships can be a source of stability in an economic downturn. Moreover, companies supplying to international brands require a long lead time for new vendor approval, thereby creating an entry barrier for new players.

Own-Established Branded Sales: This criterion is applicable for branded fabric and apparel segment. Branded products sales have less demand elasticity to price and tend to garner higher realisations than unbranded goods. A high-rated entity is expected to have several brands diversified into domestic and international brands and brands with different price points. This can help in addressing the changing customer preferences or spending patterns, which could be a downtrade or an uptrade. The impact of a brand value is best assessed by the volume growth trends and realisations compared within similar products categories.

Asset Life, Automation and Use of Latest Technology: The agency believes a higher mix of new machinery and latest technology will enable production with limited disruption and ensure prompt deliveries. The use of latest technology also enables a company's ability to meet changing customer requirements. Although automation increases asset intensity, it will reduce the burden of labour management. Indian textile industry is the second-largest employer after agriculture. Spinning, weaving and garments are labour-intensive operations albeit operations at fully integrated home-textiles companies are less labour intensive. The agency will rely on the management's information on the ageing of plants, use gross asset turnover ratio and employee-to-sales ratios to assess the efficient use of assets and technology.

Figure 4
Sub-Factors of Earnings Visibility

Category	Percentage of contracted sales	Branded sales mix	Age of machines and use of modern technology
IND AA	Very high proportion of contracted with strong counterparties	Substantially high mix of branded sales and above average price points	Very high mix of sales coming from assets aging less than seven years; high asset turns and very high level of automation
IND A	High proportion with strong counterparties	High mix of branded sales and at above average price points	High mix of sales coming from assets aging less than seven years; high asset turns and high level of automation
IND BBB	Moderate proportion of contracted sales	Moderate mix of branded sales and industry average price points	Moderate mix of sales coming from assets aging less than seven years; moderate asset turns and moderate level of automation
IND BB and below	Limited order back production	Negligible branded sales mix and or lower than industry average price points	Low level of automation; low asset turns and high mix of sales from assets aging more than seven years

Source: Ind-Ra

Financial Risk Profile

In addition to sector risks and company-specific traits, ratings are also affected by issuer's current and projected financial profiles. Ind-Ra's master criteria report Corporate Rating Methodology describes a variety of credit metrics that can be used to assess ratings. These metrics apply to most corporate issuers, but certain measures are especially relevant to textile sector, as explained below.

The textile sector's operating margins tend to be volatile with a fair amount of dependency on fiscal incentives. Operations are working capital- and asset-intensive depending on the sub-sector. Working capital cycle is influenced by inventory holding, credit period given to customers and outstanding fiscal incentives. Sector participants tend to incur a high amount of maintenance and growth capital expenditure.

It is important to stress that strong financial metrics can alleviate only some of the pressure from the weakness in business profile, but may not enable a company to completely insulate itself from the key sector risks discussed above. Similarly, a company with a strong business, however, a weak financial and liquidity profile may exert downward pressure on its rating level.

Profitability and Cash Flow

Profitability

Profitability levels and trends serve a number of analytical functions. They can be an indicator of several operational factors. For example, a consistently high profitability margin can indicate a low operating cost structure or value-addition, while a declining margin over time may indicate rising competition. In addition, profitability levels and trends set the pattern for cash flow dynamics. Textile companies with consistently-higher profitability levels are better positioned to invest in growth without jeopardising their financial profiles.

The key cost elements for textile manufacturers are raw material inputs including fibres and chemicals, a large part of which is met domestically. Other key cost elements are labour and power. A competitive-cost position is fundamental to a company's robust financial performance and cash generation through the business cycle. This gives the company the flexibility to pare debt or, if necessary, to continue to invest in their businesses through cyclical downturns, thus defending their market positions.

Textile products realisations are primarily market driven by input prices, supply-demand equation and competition. Although large companies may be trendsetters in the domestic markets, the pricing power varies depending on the geography of operations, given the presence of large clusters in unorganised market. The sector is exposed to international competition where domestic players have constrained pricing power due to differential duty structures.

Similar to companies in other cyclical and commodity industries, textile players rely on low production costs for their long-term competitiveness. Low-cost producers generate higher cash flows/profit margins than marginal producers at all price levels and have positive cash flows from operations for longer periods during cyclical downturns. Moreover, low-cost producers may maintain production volumes during downturns when the high-cost producers may reduce production volumes or not operate. Cost position is an important factor in differentiating between companies as domestic producers are the price takers for finished goods and profitability will be highly dependent on the cost position. For instance, in FY20, when the cotton prices surged substantially, the yarn prices did rise for a substantial period of time. While the pricing power and value-additions were mentioned as part of the business profile assessments, Ind-Ra will evaluate the cost structures and its overall impact on profitability under the financial parameter.

An issuer's RoCE is an important metric for this sector to measure its capital-allocations decisions. The metric help the agency measure the management decision making in choosing among various options, including investment in value-chain, integration, working capital management, asset-light or asset-heavy business models. The agency views RoCE to be a better metric than capacity utilisation for analytical purposes as practical capacity utilisation substantially differs with products. For instance, a spindle can produce 200 grams-350 grams of a commodity yarn in a shift-day while a value-added yarn production from the same spindle could have a significantly lower output. Also, normal maintenance shut-down for spinners may vary in 7%-10%. For the Indian textile industry, capacity utilisation has to be considered along with value-addition, as it impacts the volume output.

An analyst will not only measure the numerical ratio but also the trend of the ratios over the last five years and the projections for the next two years. A downward-trend would make the analyst select a rating level lower than the current rating. The trend in the ratio, rather than the average of the past five years, is to be assessed to ward off the impact of any one-off gains.

Figure 5

Profitability: Sub-Factors

Mid-points	FFO margin (%)	EBIT margin (%)	FCF margin (%)	RoCE
IND AA	10	12	5	>14%
IND A	7	9	2	>12% to 14%
IND BBB	5	6	Positive	Positive spread over average of cost of capital
IND BB and below	3	4	Neutral to negative	Lower than average cost of capital

Source: Ind-Ra

In addition to the analysis of a textile company's ability to generate profits and cash flow, Ind-Ra assesses cash outflow-related actions, including investment programmes, acquisitions and shareholder-friendly actions (i.e. dividends and/or share buybacks), which can leave companies with negative FCF, thus leading to external borrowings.

Higher investment-grade companies would generally be expected to fund capex from internal sources or borrowings to an extent that they maintain a comfortable financial profile viz. have a clear strategy of maximum leverage. Lower-rated entities would typically experience periods of negative FCF during downturns, thereby relying on borrowings without a defined strategy of maximum leverage. The agency gives some allowance to companies going through high capex phases, where the underlying projects are likely to produce long-term benefits either by improving cost profile or by strengthening the business profile.

Financial Structure

Ind-Ra bases its analysis on both net and gross leverage ratios. FFO-based leverage and EBITDA-based leverage are the key metrics assessed. The focus is on cash-based leverage ratios rather than debt-to-equity ratio. Gross leverage (total debt/EBITDA) is a key ratio, as cash can dwindle rapidly when companies are in financial stress due to, for example, substantial cash outflows from working capital or location of cash could be different from the location needing liquidity. However, net leverage (net debt/EBITDA) is also relevant for companies holding a high level of cash for prudential reasons beyond what is needed for operational purposes.

The net debt/(cash flow from operations (CFO) - capex) ratio measures leverage on the basis of discretionary cash flows after interest costs and investment requirements but before the distribution of dividends. When assessing an issuer in a strong expansionary phase, it may be relevant to only deduct from CFO a standardised capex figure, reflecting the maintenance and improvement of existing assets rather than the total amount of investment spending.

Figure 6

Financial Structure: Sub-Factors

Mid-points	FFO gross leverage (x)	Total adjusted net debt/ operating EBITDA (x)	Net debt/(CFO-capex) (x)
IND AA	2	1.5	2
IND A	3	2.5	3
IND BBB	4	3	4.5
IND BB and below	5	4.5	>6.0 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. The more conservatively capitalised an issuer, the greater its financial flexibility.

Financial Discipline

In general, a commitment to maintaining debt within a certain range allows an issuer to cope better with the effect of unexpected events. In the textile sector, a large portion of the defaults have happened due to companies' large-sized capex programmes. For the same reason, an analyst will measure the capital expenditure programme over annual cash flow generation when assigning a rating. Based on textile sector studies, Ind-Ra deems capex programmes over 70% of an issuer's annual EBITDA of a normal year to be an aggressive strategy.

Liquidity

Other factors that contribute to financial flexibility are a company's 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 Cover and EBITDA Gross Interest Cover

Fixed-charge coverage ratios are a central measure of an entity's liquidity, which compares the operational cash-generating ability of an issuer (after tax) to its financing costs including non-cancellable operating lease rentals, preference dividends, etc. 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, Ind-Ra believes coverage ratios should be considered alongside the appropriate leverage ratios.

Forex Exposure

Foreign exchange exposure can also impact an issuer's financial flexibility. Some companies may have a benefit of natural hedge, considering both the current and capital account exposures, and hence an acceptable amount of unhedged net exposure. Textiles is an export-oriented sector and the industry participants benefit from a gradual currency depreciation. However, to ward-off the impact of the wild variation in the currency rates, the agency expects the high-rated issuers to substantially cover their forex exposure through financial derivatives. Hence, wherever there is a material unhedged forex exposures, Ind-Ra will assess the issuer's track record in managing forex volatility risk, measuring the forex charges as a percentage of sales or unhedged exposure as a percentage of the annual EBITDA.

Debt-Equity Ratio

Debt-equity ratio is 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)	FX exposure	EBITDA/gross interest (x)	Debt-equity (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	Unhedged forex exposure within 10% of EBITDA	7	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	Unhedged forex exposure within 20% of EBITDA	4	0.6
IND BBB	Financial policies less conservative than those of 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	Unhedged forex exposure within 40% of EBITDA	3	1
IND BB	Financial policies in place but flexibility in applying it could lead to temporarily exceeding downgrade guidelines	Liquidity ratio around 1.0x; less smooth debt maturity or concentrated funding	1.75	Unhedged forex exposure higher than 40% EBITDA	2	1.4
IND B	No financial policy or track record of ignoring it; opportunistic behaviour	Liquidity ratio below 1.0x; overly reliant on one funding source	1.5	High unhedged forex exposure	1.5	>1.4

Note: Liquidity score is defined as: available cash + undrawn portion of committed facilities + FCF (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

Ind-Ra's company-specific Management and Corporate Governance Factor is composed of:

1. Management strategy
2. Corporate governance
3. Group structure
4. Financial transparency

Sub-Factors

Management Strategy

Ind-Ra considers a management's track record in terms of its ability to create a healthy business mix, maintain operating efficiency, and strengthen its market position. The issuer's 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 centring upon the issuer's 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 valuable insight in to a management's risk tolerance.

Governance Structure, Group Structure and Financial Transparency

The purpose of addressing governance structure is to assess the way effective power within an issuer is distributed. Notable elements considered are the presence of effective controls for ensuring sound policies; an effective and independent board of directors; a succession plan; talent bench; management compensation; related-party transactions; integrity of the accounting and audit process, and key-man risk.

The corporate governance sub-factor focuses on the structural aspects of governance, in particular, the characteristics of the board of directors. 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. However, 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 group structure and financial transparency sub-factor 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 ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings and Research has been compensated for the provision of the ratings.