

Interpreting the Sector Credit Factor Reports for Corporates

Special Report

Sector-Level Guidance: India Ratings' Sector Credit Factors (SCFs) are designed to enable issuers and investors to understand the building blocks used when rating companies in a particular sector. They highlight the key rating factors most frequently applied in major corporate sub-sectors, while still recognising the potential for the unique characteristics of a company and sector to affect ratings.

Rating Category Indications: Each SCF report's page 2 Building Blocks chart identifies industry- and company-specific risk profiles per rating category most commonly observed for that sector. The mid-point financial ratios quoted are indicative of the range relevant to that rating category.

Factors Unweighted: The weighting between qualitative and quantitative factors varies substantially over time, despite the linear appearance of the building blocks diagram. That said, as a general guideline, where one factor is significantly weaker than the others, the downside risks of this weakest element tend to attract a greater weight in the analysis.

Publications: To date, India Ratings has published 7 SCFs.

Figure 1

SCF Reports Published

Rating Indian Automotive Manufacturers
Rating Indian Automotive Supply Companies
Rating Indian Construction Companies
Rating Indian Cement Producers
Rating Indian Telecoms Companies
Rating Indian Mining Companies
Rating Indian Steel Producers

Source: India Ratings

Complementing India Ratings Criteria: The sector credit factors should be read in conjunction with India Ratings' master criteria *Corporate Rating Methodology* which details the overarching approach to rating corporates and which includes a list of the main financial ratios used. The principal rating factors are listed in Figure 2 below. Reports on sector-specific credit factors complement the master criteria report, but employ a greater focus on how criteria are applied at the sub-sector level.

Related Research

[Corporate Rating Methodology
\(September 2012\)](#)

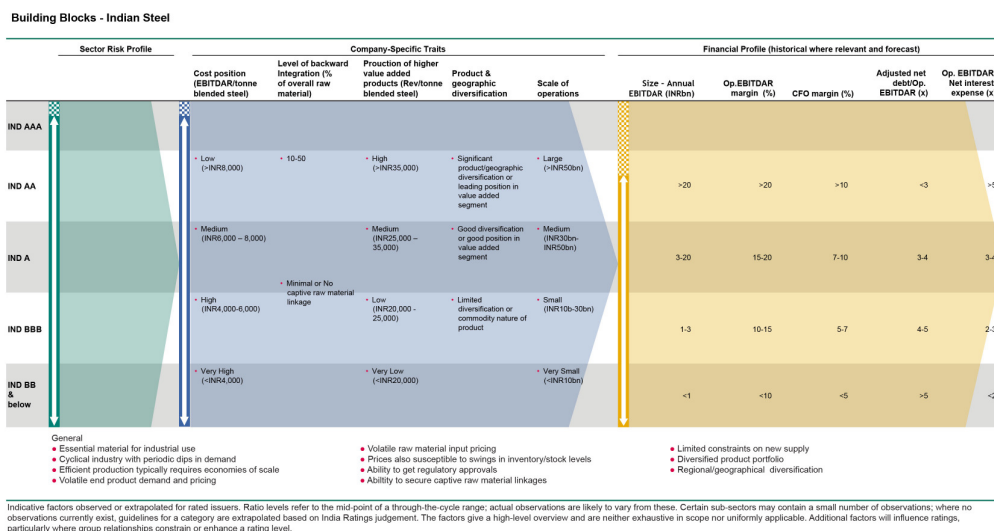
Figure 2
Master Criteria Rating Factors versus Sector Credit Factors

Corporate Rating Methodology – rating factors	SCF Building Blocks Diagram – credit factors
Industry profile and operating environment	Sector risk profile
Company profile	Company-specific traits
Financial profile	Financial profile
Management strategy and corporate governance, ownership, support and group factors	Other

Source: India Ratings

Understanding the Building Blocks Template

The solid vertical arrowed segments denote the range of rating categories typically consistent with, in turn, the sector risk profile, company-specific traits, and the company financial profile. A chequered box denotes the potential to be rated at a higher rating level, albeit in relatively rare cases.



Sector Risk Profile (Green)

India Ratings generally approaches the analysis sequentially by starting with sector risk. This will typically set a range of rating categories where most observations for this sector are found. Sectors that have the capacity to offer the lowest levels of business risk, such as integrated steel producers, will identify multiple rating categories. Sectors with typically high risks will start the process with a lower number of likely rating categories.

Company-Specific Traits (Blue)

Company level traits may very rarely offer the potential to enhance the final rating of that company beyond that indicated in the first column's sector risk profile. For example, being a single, dominant player in a higher risk sector may confer modest additional benefit beyond the rating profile observed for the rest of the sector.

Financial Profile (Mustard)

The financial profile column may equally indicate a higher range of ratings and thus some potential further rating uplift, albeit in very rare circumstances. Much more frequently, weak financials can drag a company well below the rating suggested by the first two columns.

Other Factors

Finally, this column may have an overriding enhancement or detrimental feature, which can also affect the end-result credit rating, or other criteria usually used for that sector.

Sector Risk Profile

The sector risk profile provides a starting point for rating a company in a given sector. In highlighting general sector characteristics, India Ratings has identified key attributes consistent with particular rating categories. A company's overall risk profile cannot become completely detached from these typical ranges for ratings in the sector risk profile column.

The rating parameters in this column do not simply replicate the spectrum of existing company ratings within the sector; they place the inherent risks of the sector into broad rating categories. The characteristics of a cyclical sector that sells highly discretionary goods to consumers, and is part of a competitive market with no particular niche and no barriers to entry, is unlikely to sit comfortably in the higher investment grade categories such as 'IND AA' and above.

Where relevant, India Ratings also lists sub-sector attributes and where such risk profiles sit within the rating spectrum. Where sector attributes are not allocated to a specific rating category, these are listed under the *General* heading at the bottom of the building blocks graphic.

Industry Risk

"India Ratings determines an issuer's rating within the context of each issuer's industry fundamentals. Industries that are in decline, highly competitive, capital intensive, cyclical or volatile are inherently riskier than stable industries with few competitors, high barriers to entry, national dominance, and predictable demand levels.

Major industry developments are considered in relation to their likely effect on future performance. The inherent riskiness and/or cyclicity of an industry may result in a ceiling for ratings within that industry. Therefore, an issuer in such an industry is unlikely to receive the highest rating possible ('IND AAA') despite having a very conservative financial profile.

Equally, reflecting differences in financial and management profile, not all issuers in low-risk industries can expect high ratings. Instead, many credit issues are weighed in conjunction with the risk characteristics of the industry, to arrive at a balanced evaluation of credit quality."

Source: India Ratings' *Corporate Rating Methodology*

Business risk is not looked at in a vacuum. To provide maximum clarity and avoid overly theoretical bands, representative financial profiles are assumed in defining the sector risk profile in some industries.

Company-Specific Traits

Company-specific traits and financial measures further refine the rating to specific rating levels whether within or outside the "natural" rating territory defined under the sector risk profile.

Turning to this company traits column, specifics of the company (sometimes overlapping with the previous column) may help to place further limits as to the appropriate rating. Single-product companies are unlikely to reach the upper end of the rating range.

Diversification in terms of product or geography may help to pitch a rating at or above the sector risk profile, if the bulk of sector players represented in the column do not typically have a mix of product or geographical diversification to lower their individual risk profiles.

Equally, size may be a company-specific characteristic that secures market dominance or price control, or economies of scale unrepresented in the previous column. The size of the company also often denotes diversification in terms of product or geography, or local dominance.

- India Ratings believes most industries carry a fundamental range of rating possibilities linked to their business risk.
- The sector risk profile is thus the first credit factor to be assessed.

Definitions

- A **rating category** includes all three ratings (eg, 'IND BBB-', 'IND BBB' and 'IND BBB+').
- A **rating level** is the notch-specific level within the rating category (eg, 'IND A+' within the 'A' rating category).

- This second set of credit factors addresses the position of an individual company within a sector.
- These individual factors help position the issuer within the ranges provided for sector risk.
- The cumulative effect of company-specific factors may occasionally take the issuer outside the range of categories identified for general sector risk.

Figure 3

Illustrative Table: Company-Specific Traits

	Diversification and scale of operation	Complexity of product offerings	Technical capability	Customer concentration	Market position
IND AA	Large companies with well balanced revenues from end-user segments	Portfolio of technology-oriented offerings across product categories/function alities	Product development focus through in-house R&D or JVs providing access to technology	Sole supplier status or group links with large manufacturers Low; top 5 customers contributing < 50% revenues	Market leadership in most offerings
IND A	Large Companies with presence across end-market segments	High value, technology-oriented products	Product development focus through in-house R&D or JVs providing access to technology	Sole supplier status or group links with large manufacturers Low; top 5 customers contributing < 50% revenues	Strong Position in key products
IND BBB	Medium-sized companies with limited diversification	Simpler components/parts	Product differentiation with average technical capability	Medium; top 5 customers contributing between 50%-70% revenues	Leadership position in small segments; moderate position in key segments
IND BB and below	Small companies supplying to niche segments	Simple process-oriented offerings	low levels of technology	High; top 5 customers contributing >70% revenues	Low barriers to entry

Source: India Ratings' report *Rating Indian Automotive Suppliers*

In turn, individual factors are defined in greater detail in the report's commentary with some linked to financial metrics.

Company Profile

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

Size may be a factor if it confers major advantages in terms of operating efficiency, economies of scale, financial flexibility, and competitive position. Size may not, however, always support higher ratings. For example, in commodity industries, size is not as important as cost position, since the ability of one participant to influence price in a global commodity is usually not significant."

Source: India Ratings' *Corporate Rating Methodology*

Financial Profile

The financial profile column lists indicative financial metrics, based on those contained in the *Corporate Rating Methodology* used in assessing the financial strength of a representative company in the sector.

As the third column in the diagram, this rating factor should not be used as a "read-across" that a company can be afforded a high rating purely because it has upper-level financial metrics yet a lower-tier sector risk profile and lower-bracket company-specific traits. However, it can be assumed that healthy financial metrics may indicate some uplift compared with the read-across

from the previous two columns' lower reference points.

Equally, weak financial metrics may be offset in part for companies cited within the upper end of the previous two columns, and may be assigned a higher rating because stability and predictability of operational performance is assured, and therefore slightly higher leverage is acceptable compared with other sector participants without the same lower business risk profile.

Mid-point median ratios relate to the category rather than notch-specific levels. The danger in providing guideline financial metrics is that users view this column as ultimately defining the rating. Clearly, this is not the case. Financial metrics can alleviate only some of the pressures from the sector risk profile and company traits, and do not enable the company to completely detach itself — even where, for example, financial leverage levels are very low (or even potentially in a net cash position).

Similarly, India Ratings does not offer financial metrics for points on the rating scale where business risk would reduce to negligible the chances of a final rating actually being assigned at a particular level. For example, many well-run technology companies typically have significant cash resources to carry them through a sudden drop in volumes. Consequently, this sector's upper risk profile would be representative of net cash technology companies. Conversely, net cash (lease-adjusted leveraged basis) asset-intensive shipping companies are not the norm when considering the sector risk profile.

India Ratings also does not rate to a snapshot year-end metric. Instead, the sustainability of these credit-protection measures is evaluated over a period of time — using both historical data and India Ratings' near-term forecasts. Consequently, the indicative medians quoted are multi-year medians rather than single-year metrics. This approach is consistent with India Ratings' "rating through the cycle" approach (see below), which in a recession focuses on the "exit point" — the profile after the company exits the cycle.

Other Factors

This final column acknowledges that other rating factors may override the cumulative effect of the previous types of credit factors. Management or governance failures may reduce the rating level. External support from a parent company or state may lift the rating.

Inter-Relationship of Factors

Precisely because there are so many combinations of different factors, and some may weigh more heavily in some sectors than others — and all will weigh more or less heavily at different points over time — India Ratings does not set out to weight these columns' different attributes. There is no standard formula to link these inputs into an exact rating. For example, a poor liquidity financial metric will often completely override the benefits of all the previous columns, and result in a low credit rating. Similarly, a high FCF margin and low leverage may be "the last hurrah" of an expiring industry, disposing of stock in a fire sale.

- Financial credit factors complete the assessment, and often have a significant impact on refining the final rating judgement.
- "Weakest link" analyses are often most critically affected by the financial factors, eg liquidity weaknesses.

ALL CREDIT RATINGS ASSIGNED BY INDIA RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://WWW.INDIARATINGS.CO.IN/UNDERSTANDINGCREDITRATINGS.JSP](http://www.indiaratings.co.in/understandingcreditratings.jsp) IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE [WWW.INDIARATINGS.CO.IN](http://www.indiaratings.co.in). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. INDIA RATINGS' CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE.

Copyright © 2012 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, India Ratings & Research (India Ratings) relies on factual information it receives from issuers and underwriters and from other sources India Ratings believes to be credible. India Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of India Ratings factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of India Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information India Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to India Ratings and to the market in offering documents and other reports. In issuing its ratings India Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind. A rating provided by India Ratings is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that India Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of India Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. India Ratings is not engaged in the offer or sale of any security. All India Ratings reports have shared authorship. Individuals identified in a India ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a rating by India Ratings is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of India Ratings. India Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. India Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. The assignment, publication, or dissemination of a rating by India Ratings shall not constitute a consent by India Ratings to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of United Kingdom, or the securities laws of any particular jurisdiction including India. Due to the relative efficiency of electronic publishing and distribution, India Ratings research may be available to electronic subscribers up to three days earlier than to print subscribers.