

Corporate Rating Methodology

Master Criteria

This report updates and replaces the version published on 4 January 2017.

Scope

Issuer Ratings: An Issuer Rating (IR) is an assessment of an issuer's relative vulnerability to default on financial obligations, and is intended to be comparable across industry groups. Issuers may often carry both Long-Term and Short-Term IRs. Since both types of IRs are based on an issuer's fundamental credit characteristics, a relationship exists between them (see Figure 3 and Related Criteria "Short-Term Ratings Criteria for Non-Financial Corporates"). These criteria apply to both new ratings and the monitoring of existing ratings.

The criteria apply to all corporate sector entities, including manufacturing, services and trading companies.

This Master Criteria identifies factors that are considered by India Ratings in assigning ratings to a particular entity or debt instrument. Not all rating factors in these criteria may apply to each individual rating or rating action.

Corporates consist of a broad universe of entities, and additional reports including those specific to a sector, a class of liability, a particular form of cross-sector risk or a particular form of corporate structure provide additional background to the application of this Master Criteria report, and are available at indiaratings.co.in.

Instrument Ratings: The rating of an individual debt security can be different from the IR depending on the security's priority among claims, and other aspects of the capital structure.

Key Rating Drivers

Qualitative and Quantitative Factors: India Ratings and Research's (Ind-Ra) corporate ratings reflect both qualitative and quantitative factors encompassing the business and financial risks of fixed-income issuers and their individual debt issues.

Figure 1

Key Rating Factors

- | | |
|----------------------------------|-------------------------------|
| • Industry risk | • Financial profile |
| • Business profile | ○ Cash flow and profitability |
| • Management strategy/governance | ○ Capital structure |
| • Group structure | ○ Financial flexibility |

Source: Ind-Ra

Historical and Projected Profile: Ind-Ra's analysis typically covers at least one economic cycle of the issuer under review. The analysis should cover at least three years of operating history and financial data, as well as the agency's forecasts of future performance. These are used in a comparative analysis, through which the agency reviews the strength of an issuer's business and financial risk profile relative to that of others in its industry and/or rating category peer group.

Weighting of Factors Varies: The weighting between individual and aggregate qualitative and quantitative factors varies between entities in a sector as well as over time. As a general guideline, where one factor is significantly weaker than others, this weakest element tends to attract a greater weight in the analysis.

Related Research

- [Parent and Subsidiary Rating Linkage \(April 2019\)](#)
- [Short Term Ratings Criteria for Non-Financial Corporates \(April 2020\)](#)
- [Treatment of Hybrids in Non-Financial Corporate and REIT Credit Analysis \(January 2019\)](#)
- [Cash Flow Measures in Corporate Analysis \(April 2016\)](#)
- [How Ind-Ra Uses Commodity Prices in its Projections \(April 2016\)](#)
- [Investor Caution Required for India Corporate Perpetual Securities \(September 2012\)](#)
- [Treatment of Non-Recourse Debt \(September 2012\)](#)
- [Rating Indian Cement Producers \(September 2012\)](#)
- [Rating Indian Mining Companies \(September 2012\)](#)
- [Rating Indian Telecom Companies \(September 2012\)](#)
- [Ratings Navigator for Corporates \(October 2018\)](#)
- [Generic Ratings Navigator Companion \(October 2018\)](#)
- [Ratings Navigator Companion Construction Sector \(November 2018\)](#)
- [Ratings Navigator Companion Steel Sector \(November 2018\)](#)

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Rating Approach

The Corporate Rating Criteria provides an umbrella framework which guides our ratings for corporate issuers at the level at which the diversity and dynamism of the corporate sector can be captured on a common basis. Corporate issuers with high investment-grade ratings are expected to demonstrate strong financial and operational flexibility. Individual rated corporates will however fall in multiple industry categories, some of which are quite small in size and with idiosyncratic characteristics,

Starting from the range of rating categories most appropriate for a corporate's sector risk profile, the analysis of business, financial characteristics of the issuer, the most appropriate peer group and, historical and forecast comparative perspectives, enables rating committees to narrow down the rating outcome to a notch-specific level. Corporate issuers with high investment-grade ratings are expected to demonstrate strong financial and operational flexibility. Ratings may be capped in industries or sectors that possess greater volatility in credit metric performance than others over normal cycles.

Ratings Navigators

Sector Navigators provide guidance for the application of the concepts of the Corporate Rating Criteria to the issuers in the sector the specific Navigator covers. The Generic Navigator can be used if no appropriate sector Navigator exists. Certain issuers may straddle several sectors, in which case Ind-Ra may choose to prepare one Navigator for each relevant sector or when one sector is dominant, focus on this most relevant sector. More details on Ratings Navigators can be found on our website. The list of factors looked at in the Navigators is not exhaustive and Ind-Ra includes a Rating Derivation section which explains the positioning of the issuer's rating against its peers and/or the Navigator thresholds and describes additional considerations impacting the rating not included in the Navigator.

An issuer's IR would normally be expected to lie within the three-notch band centred on any reasonable combination of the mid-points of the Navigator's Key Factors. Where this is not the case, the difference will be fully explained by the other factors described in the Rating Derivation. Navigators are not expected to be used when issuers fall under the remit of separate sector-specific criteria (investment holding companies in particular) or where the factors in the Navigator would not adequately reflect the risk profile of the issuer due to specific characteristics (e.g. with an issuer in several sectors of which none is dominant). Furthermore, at present Navigators may not be used at the lower end of the rating scale, where ratings are largely driven by financial profile and lesser by business profile.

For some important industries, where sector-specific Navigators are absent, Ind-Ra has published Sector Credit Factors (SCF), which are used as guidance in the assessment.

Industry Profile

Ind-Ra 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. Ind-Ra explores the possible risks and opportunities on the industry profile resulting from social, demographic, regulatory and technological changes. The agency considers the effects of geographical diversification and trends in industry expansion or consolidation required to maintain a competitive position. Industry overcapacity is a key issue, because it creates pricing pressure and, thus, can erode profitability. Also important are the stage of an industry's life cycle and the growth or maturity of product segments, which determine the need for expansion and additional capital spending.

While sectors differ greatly (and issuers can often combine a variety of sectors in their operations), major industry developments are considered in relation to their likely effect on performance. The Navigators' sector risk profile, wherever available, provides a typical rating range for the issuers in a variety of industries. However, the upper boundary of the range is not a hard rating cap for issuers in the industry, but an issuer rated higher than the boundary would be expected to be a clear positive outlier on most financial and business characteristics. It is unlikely that any issuer would be rated on a standalone basis more than a couple of notches above the upper boundary of the rating range of the relevant industry, despite having a very conservative financial profile.

Business 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.

Key rating factors related to the business profile cover a broad range of qualitative business risks, tailored to the industry fundamentals for each sector. Commonly observed or expected elements for a number of key corporate industries are included in our relevant Ratings Navigators to provide guidance for the application of the concepts of the Corporate Rating Criteria.

Management Strategy and Corporate Governance

Management Strategy

Ind-Ra's consideration of management strategy focuses on operating strategy, risk tolerance, financial policies and corporate governance. Ind-Ra considers management's track record in terms of its ability to create a healthy business mix, maintain operating efficiency, and strengthen its market position. Financial performance over time provides a useful measure of management's ability to execute its operational and financial strategies.

Corporate goals are evaluated, centring upon two main factors – strategy and track record. Key factors considered are the mix of debt and equity in funding growth, the issuer's ability to support higher levels of debt, and the funding requirement of new assets. The historical mode of financing acquisitions and internal expansion provides insight into management's risk tolerance.

SCF Reports

SCFs describe observations of how criteria factors from the master Corporate Rating Methodology have been applied to specific sectors including median summaries and are not criteria.

Corporate governance

India Ratings generally focuses on the following governance characteristics: governance structure, group structure and financial transparency.

Elements considered are notably the presence of effective controls for ensuring sound policies and procedures in boardroom effectiveness, board independence, management compensation, related-party transactions, and integrity of accounting and audit.

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

Corporate governance operates as an asymmetric consideration. Where it is deemed adequate or strong, it typically has little or no impact on the issuer's credit ratings, i.e. it is not an incremental positive in the rating calculus. Where a deficiency which may diminish bondholder protection is observed, the consideration may have a negative impact on the rating assigned. Refer to Ind-Ra's master criteria on Evaluating Corporate Governance in this regard.

Ownership, Support and Group Factors

Group Structure

Ind-Ra also considers the relationship between parents and their subsidiaries in assigning issuer and debt issue ratings. In most cases, separate issuers of debt within a corporate group are typically assigned separate IRs. The criteria report "Parent and Subsidiary Rating Linkage – Approach to Rating Entities within a Corporate Group Structure" explains Ind-Ra's linkage framework reflecting the multi-faceted relationships between group entities. These include legal jurisdiction, corporate structures, company by-laws, loan documentation, the degree of integration between the entities, and the strategic importance of each subsidiary.

Where the rated entity is the holding company of the group, analysis of the group structure determines the degree of connectivity that exists. Ind-Ra analyses the credit quality of material operating entities and their contribution (upstreaming dividends, parental access and control of subsidiaries' cash flows) to the holding company or relevant rated entities.

Where the rated entity is a developer of projects being executed in Special Purpose Vehicles (SPVs), Ind Ra consolidates the debt of such SPVs if the debt is with recourse to the parent. If not, the relationship is assessed using PSL criteria and if necessary expected cash flow support is factored into the cash flows of the company. See the special report on "Treatment of non-recourse debt".

Where a consolidated approach is not taken – because of material minority interests or other considerations – Ind-Ra typically considers the sustainability and predictability of its income streams (including cash pooling within the group, and conditional dividends being upstreamed) used to service its debt, including the credit qualities of relevant entities and their contribution to the group's financial profile.

Financial Profile

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

India Ratings' financial analysis emphasises cash flow measures of earnings, coverage and leverage. Sustainability of cash flow from operations provides an issuer with both internal debt-servicing resources and a stronger likelihood of achieving and retaining access to external sources of funding.

India Ratings regards the analysis of trends in a number of ratios as more relevant than any individual ratio, which represents only one performance measure at a single point in time. India Ratings' approach attributes substantially more weight to cash-flow measures than equity-based ratios such as debt-to-equity and debt-to-capital. The latter rely on book valuations which do not always reflect current market values or the ability of the asset base to generate cash flow to service debt.

Those credit metrics with the greatest relevance are still not used in a determinate fashion to assign ratings, as the same ratio (if relevant) should be expected to vary among these different sectors. For example, an industry with low earnings volatility can tolerate higher leverage for a given credit rating than an industry with high earnings volatility. In the Ratings Navigator Reports and Sector Credit Factor series of reports, Ind-Ra has published observations of financial ratios per rating category for various sectors.

Cash Flow and Profitability

Key elements in determining an issuer's overall financial health are profits and cash flow, which affect the maintenance of operating facilities, internal growth and expansion, access to capital, and the ability to withstand downturns in the business environment.

Ind-Ra's analysis focuses on the stability of earnings and continuing 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 the reliance on external funding.

While earnings form the basis for cash flow, adjustments must be made for such items as non-cash provisions and contingency reserves, asset write-downs with no effect on cash, and one-time charges.

Capital Structure

Ind-Ra analyses capital structure to determine an issuer's level of dependence on external financing. Several factors are considered to assess the credit implications of an issuer's financial leverage, including the nature of its business environment and the principal funds flows from operations (see Figure 6: Definitions of Cash Flow Measures and Financial Ratios). Because industries differ significantly in their need for capital and their capacity to support high debt levels, the financial leverage in an issuer's capital structure is considered in the context of industry norms.

As part of this process, an issuer's level of debt is typically adjusted, where applicable, for a range of off-balance-sheet liabilities by adding these to the total on-balance-sheet debt level.

As part of this process, an issuer's level of debt is typically adjusted, where applicable, for a range of off-balance-sheet liabilities by adding these to the total on-balance-sheet debt level. Such items include the following:

- borrowings of partly owned companies or unconsolidated subsidiaries that may involve claims on the parent issuer;
- disclosed debt associated with receivables securitisations, if there is recourse to the issuer
- in cases where material amounts of debt are described as non-recourse to the rated entity, Ind-Ra typically forms a view on the economic incentives behind the non-recourse status before excluding the debt (and associated cash flows) in its calculations;
- operating lease obligations. Refer the criteria *Operating Leases: Implications for Lessee's Credit* in this regard

In situations where specific liabilities are excluded from the debt calculation, Ind-Ra may also exclude any related cash flow, income or assets. Where appropriate, the issuer's history in supporting off-balance-sheet investments with additional funds will also be a factor in determining the appropriateness of including or excluding these amounts from total debt in the absence of a formal guarantee or commitment.

Preferred stock issues with fixed dividend payments or redemption dates may be considered as quasi-debt instruments, and may be granted a degree of "equity credit" of 50% or 100%, depending on their terms. As Ind-Ra's corporate analysis is heavily cash flow-oriented, the level of equity credit which is granted only affects the quantum of debt in adjusted leverage ratios, and 100% of the coupons on hybrid instruments continue to be incorporated in coverage ratios used to measure the issuer's debt-servicing ability. This reflects Ind-Ra's view that hybrids predominantly offer protection to senior creditors by reducing loss given default, rather than decreasing default likelihood. For details of Ind-Ra's approach to equity credit for these hybrid instruments, see the criteria report "Treatment of Hybrids in Non-Financial Corporate and REIT Credit Analysis".

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. In general, a commitment to maintaining debt within a certain range allows an issuer to cope better with the effect of unexpected events on the balance sheet.

Other factors that contribute to financial flexibility are the ability to redeploy assets and revise plans for capital spending, strong banking relationships, and the degree of access to a range of debt and equity markets. Committed, long-dated bank lines provide additional support. A large proportion of short-term debt in the capital structure can indicate reduced financial flexibility, except in cases where overall gross leverage is very modest — as is the case for a small number of very highly-rated issuers whose very moderate debt burdens are predominantly based on Commercial Paper funding with liquidity back-up. Refer to "Short Term Ratings Criteria for Non-Financial Corporates" for Ind-Ra's methodology for calculation of sufficient CP back-up coverage for corporates.

Contingent Liabilities and Pensions

Financial flexibility can also be diminished by significant contingent obligations such as guarantees, collateral requirements for derivative exposures, and legal liabilities. Each of these can cause substantial drains on cash flow, which can severely reduce or even eliminate financial flexibility.

In incorporating pension risks into its analysis, Ind-Ra's key focus is on the cash flow implications of pension obligations over the rating horizon. If the issuer has a defined benefits plan for employees, and actuarial valuation of investments made under the plan reveal that there is a shortfall between market value of investments and quantum of defined benefits, then the unfunded portion will have to be added to the debt for the purpose of analysis. Similarly if there is a shortfall in the provision for gratuity, the same would also be treated as debt for computation of adjusted leverage ratios.

Accounting

Ind-Ra's rating process is not and does not include an audit of an issuer's financial statements. The issuer's choice of major accounting policies may inform Ind-Ra's opinion on the extent to which an issuer's financial statements reflect its financial performance. Relevant areas include consolidation principles, valuation policies, inventory-costing methods, depreciation methods, income recognition and reserving practices, and treatment of off-balance-sheet items. As part of its rating analyses, Ind-Ra will restate figures, where necessary, to enhance the comparability of financial information across issuers.

Because different accounting systems can affect an issuer's assets, liabilities and reported income, Ind-Ra may on occasion make adjustments as appropriate to increase comparability with other companies in the peer group. Such adjustments include those made for revenue recognition, asset values, leased property, contingency reserves, and treatment of tax and off-balance-sheet liabilities. The general principal Ind-Ra applies in its adjustments is to get back to measurements of cash: cash balances, cash flow, and cash needs.

Ind-Ra's analysts typically use audited accounts that are prepared according to local generally accepted accounting principles or international financial reporting. If such statements are not available, Ind-Ra will use other statements provided, and published management comments to make appropriate adjustments for comparative analysis, if appropriate and provided the quality of the auditors or other reviewing parties employed – and disclosure – is adequate.

Data adjustments performed by India Ratings, while standardised as far as possible, will still contain differences between issuers, and for the same issuer over time, generated by differences in accounting framework, issuer financial and accounting policy choices, audit advice to issuers.

The standardised financial adjustments performed by India Ratings' analysts typically require varying levels of ancillary disclosure and/or subjective estimates. Such ancillary disclosure may be insufficient, either in absolute terms, or reliably over the course of an issuer's ongoing disclosure, for India Ratings to apply standardised adjustments. India Ratings works with audited and unaudited financial statements, issuer projections and India Ratings-prepared projections, all of which represent aggregated data points embedding varying degrees of approximation.

In preparing the agency's forecasts, India Ratings further aggregates a number of financial data points to produce summary projections that are comparable with those derived from historical statements. These projections thus unavoidably contain further informational compression through aggregation

Forward-Looking Through-the-Cycle Approach

Forecasting Model (COMFORT)

Corporate forecasting is facilitated by the Corporate Monitoring and Forecasting Model (COMFORT). COMFORT is a forecasting model with balance sheet, profit and loss and cash flow statement used to project the key ratios in the corporate ratings criteria under a number of scenarios as set out in the criteria.

The model does not employ any statistical modelling techniques, nor are any standard forecast assumptions applied. Its primary purpose is to support India Ratings' rating analysis by ensuring the key ratios are projected in a consistent fashion to generate issuer-specific financial forecasts in line with India Ratings' methodologies for use in rating committees. The COMFORT model may however not be used for issuers such as investment holding companies or when India Ratings needs to make significant adjustments to the balance sheet structure (for example, when a large portion of the business needs to be deconsolidated or partially de-consolidated), in which case forecasts will be produced using a bespoke approach.

Ratings Case and Stress Scenarios

India Ratings evaluates the risks of rated entities and structures under a variety of scenarios to ensure rating stability. Scenarios are developed based on potential risks an issuer may encounter through both ratings and stress cases. The ratings case is defined as a set of conservative projections which form the basis of the assessment of the issuer.

Ratings-case projections are developed with a three- to five-year time horizon which, combined with typically at least the last three years of operating history and financial data, constitute one typical economic cycle of the issuer under review. India Ratings believes this represents a reasonable time frame for forecasts beyond which projections are less meaningful.

A stress case, defined as a scenario that may cause the rating to be downgraded by at least one notch, is also undertaken. The ratings-case and stress-case forecasts help to determine the amount of headroom in a company's credit ratings and inform the appropriateness of a change in rating Outlook.

Financial projections are based on the issuer's current and historical operating and financial performances, its strategic orientation and analysis of wider industry trends.

Through-the-Cycle Approach

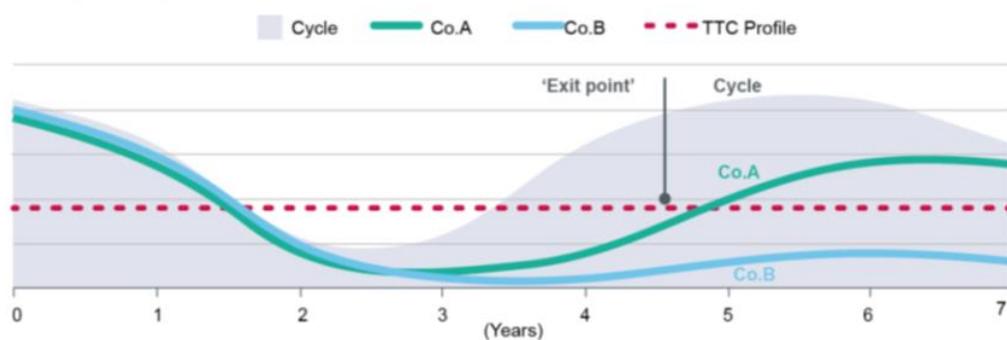
In rating cyclical companies, India Ratings' forecasts take a view on credit-protection measures and profitability "through-the-cycle". The primary challenge in rating a cyclical issuer is deciding when a fundamental shift in financial policy or a structural change in the operating environment has occurred that would necessitate a rating change.

The "Rating Through-the-Cycle" chart below illustrates two highly stylised examples. Company A suffers through the recession, but is forecast to regain its through-the-cycle profile, represented by the dotted line, by the "exit point" 18 to 24 months after the recession trough. The dotted line represents (quantitative and qualitative) parameters consistent with a particular rating level.

Company B, on the other hand, suffers more significantly during the recession, and is unable to respond as effectively. This may be because of lower rebased ongoing cash-flow expectations, or the assumption of significant new leverage to offset cash shortfalls during the recession. It may alternatively, or additionally, be the result of a fundamental shift in the business model, risks during the recession, or transformational changes in market demand. Company B will typically see its rating lowered to match a lower credit profile, which would be represented, in a stylised manner, by a parallel but lower dotted line illustrating the through-the-cycle profile of a lower rating.

Figure 2

Rating Through the Cycle



Source: Fitch Ratings Ltd

Application of Commodity prices

In assessing commodity companies' prices for credit rating, India Ratings projects future operational performance and financial profiles using various assumptions including market-based forward-price indications for the near term, and a "mid-cycle commodity price" for the medium-term profile. For oil and gas companies, this is called a price deck. Both the market-based and mid-cycle prices used by India Ratings are conservative in nature and typically below consensus levels during periods of rising prices. Conversely, they may remain above market prices during severe market downturns where the current market prices are influenced by distorting short-term factors.

India Ratings' market-based and mid-cycle price estimates are not meant to be price forecasts. Rather, they are intended to reflect a corridor of future price levels for modelling and rating purposes, and for evaluating future commodity price expectations from a debtholder's perspective. In developing its forward-price assumptions India Ratings takes account of industry supply and demand fundamentals, marginal producer cost levels and investment flows, among other factors.

Project Risk

In analysing capital expenditure within a corporate structure, Ind-Ra analyses its impact on both the financial and business risks of the issuer. The impact on the capital structure of the company and the risks associated with the cash flow generation after the expansion in the overall context of the business environment is analysed. The expansion may be for producing more of the existing product or for new ones or in fields unrelated to the existing lines of business. It may be implemented in several phases spread over several years and may be funded with no borrowings or entirely through external borrowings. In analysing the associated risks of these different scenarios, Ind-Ra focuses on the cash flow impact of these projects and its impact on the ability to service debt.

Corporates Short-Term Ratings

The time horizon of short-term ratings does not explicitly relate to the 12 months immediately following a given date. Instead, it relates to the continual liquidity profile of the rated entity that would be expected to endure over the time horizon of the long-term IR, typically one economic cycle. This approach places less emphasis on favourable or unfavourable features of the liquidity profile when they are considered temporary.

Short-term ratings are assigned to obligations whose initial maturity is viewed as short term based on market convention. This means up to 12 months for corporates. Short-term ratings are linked to long-term ratings according to India Ratings' rating correspondence table as liquidity and near-term concerns are part of the long-term credit profile review.

Ind-Ra's initial view on the Short-Term rating generally considers the issuer's long-term ratings based on the mapping in the Rating Correspondence Table (Figure 3). Where the long-term IR can link to either of two short-term ratings, the short-term rating may be clarified by means of a detailed review of the liquidity position, stability, and contingency programmes used to manage liquidity based on any criteria relevant to that sector. Where an issuer demonstrates strong, specific liquidity related features with no major deficiencies, the higher of the two short-term ratings may be assigned.

Figure 3

Rating Correspondence

Long-Term IR	Short-Term IR
IND AAA	IND A1+
IND AA+	IND A1+
IND AA	IND A1+
IND AA-	IND A1+
IND A+	IND A1+ or IND A1
IND A	IND A1
IND A	IND A1 or IND A2+
IND BBB+	IND A2+ or IND A2
IND BBB	IND A2 or IND A3+
IND BBB-	IND A3
IND BB+ to IND BB-	IND A4+
IND B+ to IND B-	IND A4
IND C	IND A4
IND D	IND D

Source: Ind-Ra

More information on Ind-Ra's approach for analysis of short-term ratings is contained in the criteria "Short-Term Ratings Criteria for Non-Financial Corporates".

Limitations of Corporate Methodology

This Corporate Rating Methodology is a Master Criteria used in rating non-financial corporates. Since non-financial corporates consist of a broad universe of entities, additional reports – including those specific to a sector, to a class of liability, to a particular form of cross-sector risk, or to a particular form of corporate structure – provide additional background to the application of this Master Criteria piece. This Master Criteria identifies factors that are considered by Ind-Ra in assigning ratings to a particular entity or debt instrument within the scope of the Master Criteria. Not all rating factors in these criteria may apply to each individual rating or rating action. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action.

1. General Limitations

In common with other IRs, general limitations relevant to the issuer credit rating scale include:

- the ratings do not predict a specific percentage of default likelihood over any given time period;
- the ratings do not opine on the market value of any issuer’s securities or stock, or the likelihood that this value may change;
- the ratings do not opine on the liquidity of the issuer’s securities or stock;
- the ratings do not opine on the possible loss severity on an obligation should an issuer default;
- the ratings do not opine on the suitability of an issuer as a counterparty to trade credit

The ratings do not opine on any quality related to an issuer’s business, operational or financial profile other than the agency’s opinion on its relative vulnerability to default.

2. Treatment of Event Risk

“Event Risk” is a term used to describe the risk of a typically unforeseen event which, until the event is explicit and defined, is excluded from existing ratings. Event risks can be externally triggered – a change in law, a natural disaster, a hostile takeover bid from another entity – or internally triggered, such as a change in policy on capital structure, a major acquisition, or a strategic restructuring.

Merger & acquisition risk is statistically the single most common event risk, and can serve as an example of how event risk may be included or excluded from ratings.

Figure 4

Event Risk Example – Treating Merger & Acquisition Risk in Ratings

Event	Rating incorporation
Company announces opportunistic acquisition, against previously declared strategy of organic growth.	Event excluded from prior rating. Event typically generates a rating review based on materiality and impact, depending on funding mix and cost.
Company announces opportunistic acquisition, in line with previously declared intent to undertake sizeable debt-funded acquisitions over three years in the company’s current sector.	Event largely included in prior rating. Event nonetheless generates a rating review to ensure parameters of current acquisition consistent with expectations already incorporated in the rating.
Company announces intention to expand through acquisitions. No clear indication of cost or anticipated funding mix.	Event excluded from prior rating. Event typically generates a rating review which will adjust the issuer’s Outlook or make a change in the rating, depending on Ind-Ra’s assessment of likely targets, bid sizes, valuations, the company’s track record in funding mixes and leverage flexibility.

Source: Ind-Ra

3. Factors Affecting Information Usage by Ind-Ra

The primary source of information behind ratings remains the public information disclosed by the issuer, including its audited financial statements, strategic objectives, and investor presentations. Other information reviewed includes peer group data, sector and regulatory analyses, and forward-looking assumptions on the issuer or its industry. Ind-Ra, in common with other credit rating agencies, has no power to compel information disclosure by rated entities, nor would it seek any such power.

The exact composition of data-points required to assign and maintain ratings will vary over time. Amongst other factors, this variation reflects that:

- the operational and financial profiles of rated issuers evolve constantly and this evolution may require greater or lesser emphasis on specific information elements in the rating calculus;
- different and fresh challenges from macroeconomic, financing or other environmental factors will arise for rated issuers over time, which in turn each require greater or lesser emphasis on specific information elements;
- Ind-Ra's own rating criteria will evolve over time, and with them, the relative emphasis placed on specific information elements

Ind-Ra's own rating criteria will evolve over time, and with them, the relative emphasis placed on specific information elements.

The level, quality and relevance of direct participation itself, however, vary between all issuers, and also vary for each individual issuer over time. Information flow may dip or lapse entirely (for example at a time of financial stress for the rated entity, or in advance of a corporate merger or restructuring), irrespective of the nature of the relationship between Ind-Ra and the rated entity. Where the aggregate information level falls below an acceptable level for any reason, Ind-Ra will in accordance with its corporate governance criteria take appropriate rating actions, including migrating the ratings to issuer non-cooperative as prescribed in SEBI's guidelines. The minimum information requirements for the ratings are provided on our website.

Rating Assumption Sensitivity

Ratings are sensitive to assumptions about the following factors: industry risk, operating environment, company profile, management strategy/governance, group structure, cash flow and earnings, capital structure and financial flexibility.

India Ratings' opinions are forward looking and include India Ratings' views of future performance. Non-financial corporate ratings are subject to positive or negative adjustment based on actual or projected financial and operational performance. The list below includes a non-exhaustive list of the primary sensitivities that can influence the ratings and/or Outlook.

Industry Risk

Changes in long-term growth prospects, competitive intensity and volatility of the relevant industry resulting from social, demographic, regulatory and technological developments.

Business Risk

Developments in an issuer's ability to withstand competitive pressures as shown in its position in key markets, its diversification, its level of product dominance, its ability to influence price and its operating efficiency.

Financial Risk

Changes in an issuer's financial profile either due to the impact of operational developments, the issuer's management financial policy or the availability of funding in a case of market disruption potentially leading to liquidity pressures.

Limitations of Corporate Rating Criteria

Ratings, including Rating Watches and Outlooks, assigned by India Ratings are subject to the limitations specified in India Ratings' Ratings Definitions and available at <https://www.indiaratings.co.in/rating-definitions>

Variations from Criteria

India Ratings' 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 a transaction-by-transaction or issuer-by-issuer basis, and full disclosure via rating commentary strengthens India Ratings' rating process while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective Rating Action Commentaries, 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 modifications to address factors specific to the particular transaction or entity.

Appendix I: Guide to Credit Metrics

Ind-Ra uses a variety of quantitative measures of cash flow, earnings, leverage and coverage to assess credit risk. The following sections summarise the key credit metrics used to analyse credit default risk. While it has many limitations, the measure based on operating EBITDA is still the most commonly used measure globally of segmental cash flow, and is thus used frequently in Ind-Ra's commentary.

However, given the limitations of EBITDA as a pure measure of cash flow, Ind-Ra also utilises a number of other measures for the purpose of assessing debt-servicing ability. These include funds flow from operations (FFO), cash flow from operations (CFO) and free cash flow (FCF), together with leverage and coverage ratios based on those measures – which are more relevant to debt-servicing ability and, therefore, to default risk than EBITDA-based ratios.

The following definitions are only an introduction to the cash flow measures and credit metrics used by Ind-Ra in its analysis. Detailed definitions and sample calculations are provided in the report "Cash Flow Measures in Corporate Analysis". Specific industries may have industry-accepted definitions and practices that differ from the terms described below. These are highlighted in other sector-specific reports.

Figure 5

Definitions of Cash Flow Measures

	Revenues
–	Operating expenditure
+	Depreciation and amortisation
+	Long-term rentals
=	Operating EBITDAR
–	Cash interest paid, net of interest received
–	Cash tax paid
+	Associate dividends ^b
–	Long-term rentals ^a
+/-	Other changes before FFO ^c
=	Funds flow from operations (FFO)
+/-	Working capital
=	Cash flow from operations (CFO)
+/-	Non-operational cash flow
–	Capital expenditure
–	Dividends paid
=	Free cash flow (FCF)
+	Receipts from asset disposals
–	Business acquisitions
+	Business divestments
+/-	Exceptional and other cash flow items
=	Net cash in/outflow
+/-	Equity issuance/(buyback)
+/-	Foreign exchange movement
+/-	Other items affecting cash flow ^d
=	Change in net debt
	Opening net debt
+/-	Change in net debt
	Closing net debt

^a Analyst estimate of long-term rentals

^b May be excluded from FFO and CFO as non-operational or non-recurring

^c Implied balancing item to reconcile operating EBITDAR with funds flow from operations

^d Implied balancing item to reconcile free cash flow with change in net debt

Source: Ind-Ra

Figure 6

Definitions of Cash Flow Measures and Financial Ratios

Cash flow measures

Funds flow from operations

Post-interest and tax, pre-working capital

FFO is the fundamental measure of the firm's cash flow after meeting operating expenses, including taxes and interest. FFO is measured after cash payments for taxes, interest and preferred dividends but before inflows or outflows related to working capital. Ind-Ra's computation subtracts or adds back an amount to exclude non-core or non-operational cash inflow or outflow. FFO offers one measure of an issuer's operational cash-generating ability before reinvestment and before the volatility of working capital. When used in interest coverage and leverage ratios, net interest paid is added back to the numerator.

Cash flow from operations

Post-interest, tax and working capital

CFO represents the cash flow available from core operations after all payments for ongoing operational requirements, interest, preference dividends and tax. CFO is also measured before reinvestment in the business through capital expenditure, before receipts from asset disposals, before any acquisitions or business divestment, and before the servicing of equity with dividends or the buyback or issuance of equity.

Free cash flow

Post-interest, tax, working capital, capital expenditures and dividends

FCF is the third key cash flow measure in the chain. It measures an issuer's cash from operations after capital expenditure, non-recurring or non-operational expenditure, and dividends. It also measures the cash flow generated before account is taken of business acquisitions, business divestments, and any decision by the issuer to issue or buy back equity, or make a special dividend.

Operating EBITDA and EBITDAR

Operating EBITDA is a widely used measure of an issuer's unleveraged, untaxed cash-generating capacity from operating activities. Ind-Ra usually excludes extraordinary items, such as asset write-downs and restructurings, in calculating operating EBITDA — unless an issuer has recurring one-time charges which indicate the items are not unusual in nature.

The use of operating EBITDA plus gross rental expense (EBITDAR, including operating lease payments) improves comparability across industries (e.g. retail and manufacturing) that exhibit different average levels of lease financing and within industries (e.g. airlines) where some companies use lease financing more than others.

Working capital

India Ratings calculates the change in working capital through the annual swings in trade receivables, trade inventory, trade payables and any other relevant working-capital item. It also includes analytical adjustments that affect working capital.

Short-term liquidity measures

CFO or FFO to debt service

This measures cash generation (CFO or FFO) relative to short-term debt service of gross interest expense and debt due within one year.

FCF + available cash + committed facilities/ debt service

This measures FCF, plus period-end available cash and period-end undrawn headroom under committed bank facilities (see above) relative to short-term debt service of gross interest expense and debt due within one year.

Committed bank facilities

In a corporate analysis – and particularly for financial ratios – sources of liquidity include headroom, or undrawn funds, under committed bank facilities relevant for the period. The bank facilities for which (i) the banks are under a contractual commitment to lend to a company and which (ii) have more than one year until maturity; and for which (iii) Ind-Ra believes that the relevant bank will lend such amounts to the company after taking into account a breach of covenant by the company or other considerations, can be included as a source of liquidity.

Coverage ratios

Debt and net debt

Debt represents total debt or gross debt, while net debt is total debt minus (freely available/unrestricted) cash and equivalents on the balance sheet. Ind-Ra evaluates various debt measures on both a gross and net debt basis. Distinctions are also made between total interest and net interest expense. The following definitions include only gross interest and gross debt to illustrate the concepts. For a detailed explanation of net debt and net interest calculations, see the report "Cash Flow Measures in Corporate Analysis".

Gross interest and net interest expense

This is a central measure of the financial flexibility of an entity. It compares the operational cash-generating ability of an issuer (after tax) to its financing costs. Many factors influence coverage, including the mix of fixed-rate versus floating-rate funding, and the use of zero-coupon or payment-in-kind (PIK) debt. For this reason, the coverage ratios should be considered alongside the appropriate leverage ratios.

FFO interest coverage

FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.

This is a measure of the ability of an issuer to meet debt service obligations, both interest and principal, from organic cash generation, after capital expenditure – and assuming the servicing of equity capital. This indicates the entity's reliance upon either refinancing in the debt or equity markets or upon conservation of cash achieved through reducing common dividends or capital expenditure or by other means.

FFO fixed-charge coverage

FFO plus gross interest plus preferred dividends plus rental payments divided by gross interest plus preferred dividends plus rental payments

This measure of financial flexibility is of particular relevance for entities that have material levels of lease financing. It is important to note that this ratio inherently produces a more conservative result than an interest cover calculation (i.e. coverage ratios on debt-funded and lease-funded capital structure are not directly comparable), as the entirety of the rental expenditure (i.e. the equivalent of interest and principal amortisation) is included in both the numerator and denominator.

FCF debt-service coverage

FCF plus gross interest plus preferred dividends divided by gross interest PLUS preferred dividends plus prior-year's debt maturities due in one year or less.

This is a measure of the ability of an issuer to meet debt service obligations, both interest and principal, from organic cash generation, after capital expenditure – and assuming the servicing of equity capital. This indicates the entity's reliance upon either refinancing in the debt or equity markets or upon conservation of cash achieved through reducing common dividends or capital expenditure or by other means.

Source: Ind-Ra

Figure 6

Definitions of Cash Flow Measures and Financial Ratios (cont.)

Leverage measures

FFO adjusted leverage

Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock DIVIDED by FFO plus gross interest paid plus preferred dividends plus rental expense.

This ratio is a measure of the debt burden of an entity relative to its cash-generating ability. This measure uses a lease-adjusted debt equivalent, and takes account of equity credit deducted from hybrid debt securities that may display equity-like features. Ind-Ra capitalises operating leases as the net present value of future obligations where appropriate and when sufficient information is available. Otherwise, leases are capitalised as a multiple of rents,

Total adjusted debt/operating EBITDAR

Total balance sheet debt adjusted for equity credit and off-balance-sheet debt divided by operating EBITDAR. Leverage adjusted for unfunded retirement benefits/gratuity/pensions

This ratio is a measure of debt burden relative to the operating profits a company generates. This measure uses a lease-adjusted debt equivalent, and takes account of equity credit deducted from hybrid debt securities that may display equity-like features.

Ind-Ra will adjust debt for the unfunded portion of defined benefits plan as disclosed under contingent liabilities and if it is material. Adjustment to debt will also be made in case of any shortfall in the provision for gratuity.

Source: Ind-Ra

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