RATING CRITERIA FOR CORPORATE

The criteria report contains all the factors affecting the creditworthiness of an issuer company operating as corporate house. While assessing the creditworthiness of the issuer, the following are the main factors that are analyzed into detail by WASO.

1. Business Risk Analysis
2. Financial Analysis
3. Management Evaluation
4. Geographical Analysis
5. Regulatory and Competitive Environment
6. Fundamental Analysis

These are explained as under:

I. Business Risk Analysis

Business risk analysis aims at analyzing the industry risk, market position of the company, operating efficiency and legal position of the company.

1. **Industry Risk:** WASO evaluates the industry risk by taking into consideration various factors like strength of the industry prospect, nature and basis of competition, demand and supply position, structure of industry, pattern of business cycle etc. How the industry players are competing with each other on the basis of price, product quality, distribution capabilities etc are also analyzed. Industries with stable growth in demand and flexibility in the timing of capital outlays are in a stronger position and therefore enjoy better credit rating.

2. **Market Position of the Company**: WASO evaluate the market standing of a company taking into account:
   i. Percentage of market share
   ii. Marketing infrastructure
   iii. Competitive advantages
   iv. Selling and distribution channel
   v. Diversity of products
   vi. Customers base
   vii. Research and development projects undertaken to identify obsolete products
   viii. Quality Improvement programs. etc.

3. **Operating Efficiency:** Favorable locational advantages, management and labor relationships, cost structure, availability of raw-material, labor, compliance to pollution control programs, level of capital employed and technological advantages etc. affect the operating efficiency of every issuer company and hence the credit rating.
4. **Size of Business:** The size of business of a company is a relevant factor in the rating decision. Smaller companies are more prone to risk due to business cycle changes as compared to larger companies. Smaller companies operations are limited in terms of product, geographical area and number of customers. Whereas large companies enjoy the benefits of diversification owing to wide

range of products, customers spread over larger geographical area. Thus, business analysis covers all the important factors related to the business operations over an issuer company under credit assessment.

II. Financial Analysis

Financial analysis aims at determining the financial strength of the issuer company through ratio analysis, cash flow analysis and study of the existing capital structure. This includes an analysis of four important factors namely:

a. Accounting quality

b. Earnings potential/profitability

c. Cash flows analysis

d. Financial flexibility

Financial analysis aims at determining the financial strength of the issuer company through quantitative means such as ratio analysis. Both past and current performance is evaluated to comment the future performance of a company. The areas considered are explained as follows.

a. **Accounting Quality:** As WASO relies on the audited financial statements, the analysis of statements begins with the study of accounting quality. For the purpose, qualification of auditors, overstatement/ understatement of profits, methods adopted for recognising income, valuation of stock and charging depreciation on fixed assets are studied.

b. **Earnings Potential/Profitability:** Profits indicate company's ability to meet its fixed interest obligation in time. A business with stable earnings can withstand any adverse conditions and also generate capital resources internally. Profitability ratios like operating profit and net profit ratios to sales are calculated and compared with last 5 years figures or compared with the similar other companies carrying on same business. As a rating is a forward-looking exercise, more emphasis is laid on the future rather than the past earning capacity of the issuer.

c. **Cash Flow Analysis:** Cash flow analysis is undertaken in relation to debt and fixed and working capital requirements of the company. It indicates the usage of cash for different purposes and the extent of cash available for meeting fixed interest obligations. Cash flows analysis facilitates credit rating of a company as it better indicates the issuer's debt servicing capability compared to reported earnings.

d. **Financial Flexibility:** Existing Capital structure of a company is studied to find the debt/equity ratio, alternative means of financing used to raise funds, ability to raise funds, asset deployment potential etc. The future debt claims on the issuer's as well as the issuer's ability to raise capital is determined in order to find issuer's financial flexibility.

III. Management Evaluation

Any company's performance is significantly affected by the management goals, plans and strategies, capacity to overcome unfavorable conditions, staff's own experience and skills, planning and control system etc. Rating exercise requires evaluation of the management strengths and weak- nesses.

IV. Geographical Analysis

Geographical analysis is undertaken to determine the locational advantages enjoyed by the issuer company. An issuer company having its business spread over large geographical area enjoys the benefits of diversification and hence gets better credit rating. A company located in backward area may enjoy subsidies from government thus enjoying the benefit of lower cost of operation. Thus geographical analysis is undertaken to determine the locational advantages enjoyed by the issuer company.

V. Regulatory and Competitive Environment

WASO evaluate structure and regulatory frame- work of the financial system in which it works. While assigning the rating symbols, WASO evaluate the impact of regulation/ deregulation on the issuer company. More importantly WASO benchmark the company against a benchmark of domestic, regional and international competitors. WASO creates annual and quarterly industry wide benchmarks, that allows comparison of the issuer with the its peer and identify possible red flags and areas for further discussion with the company management.

VI. Fundamental Analysis

Fundamental analysis includes an analysis of liquidity management, profitability and financial position, interest and tax rates sensitivity of the company. This includes an analysis of liquidity management, profitability and financial position, interest and tax rates sensitivity of the company.

1. Liquidity management involves study of capital structure, availability of liquid assets corresponding to financing commitments and maturing deposits, matching of assets and liabilities.
2. Profitability and financial position covers aspects like past profits, funds deployment, revenues on non-fund based activities, addition to reserves.
3. Interest and tax sensitivity reflects sensitivity of company following the changes in interest rates and changes in tax law.