



Rating Criteria for Commercial Paper

Executive Summary

Commercial papers (CP) are financial instruments with a maturity of up to one year. For Indian corporations, CP issuance are a common way to borrow money and are viewed as a substitute for bank loans. RBI regulations control CP concerns. Brickwork Ratings (BWR) assigns ratings for CP issues on a short-term scale but links the short-term ratings to the long-term ratings of the issuer. Short-term debt is usually rolled over, while long-term debt is expected to be repaid out of the internal accruals of the business. Before issuing any short-term rating, BWR assigns a long-term rating for the underlying credit quality of the issuer. The short-term rating is then arrived at based on an analysis of the liquidity risk the company faces with reference to the cash inflows, as well as cash outflows, seasonality and back-up facilities, wherever applicable from the banks, as well as support from the parent, where applicable.

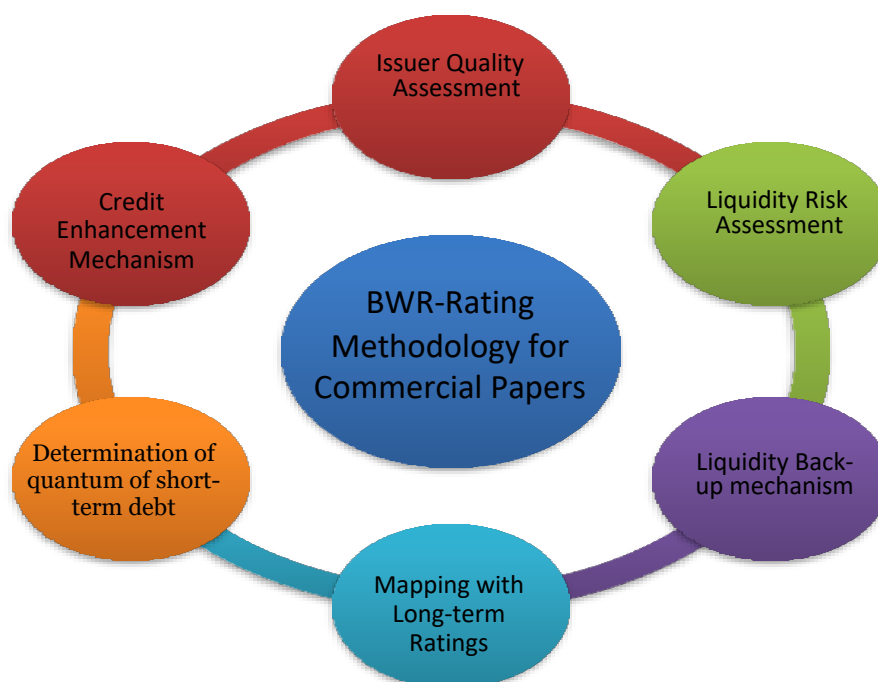
A Credit Rating Agency (CRA) must assign a minimum credit rating of A3 in order to issue CPs, in accordance with the rating symbol and standards set by SEBI. CPs are broadly categorized into secured and unsecured segments. Secured CPs may have a back-up of working capital (WC) facilities, which are earmarked to the extent of the CPs issued, providing additional liquidity support.

BWR Ratings employs a mapping framework to illustrate the connection between Short-term ratings and long-term ratings. However, based on the type of entities being rated, their liquidity profiles and available credit enhancement, BWR may assign a different rating from the suggested mapping. CPs are ongoing programs and therefore require a long-term view. Additionally, refinancing risk or issuers' access to other sources of funds play a critical role while assigning a short-term rating.

Scope of the Criteria

The document is an assessment of the qualitative and quantitative parameters considered by BWR to arrive at the rating of a CP. These parameters involve the assessment of the track record and issuer credit quality, liquidity assessment and liquidity back-up mechanism, wherever applicable, along with the determination of the quantum of short-term debt and credit enhancement mechanism. Furthermore, the risks are primarily defined in broad risk parameters of Business, Industry, Financial and Management risks on which the entity's ability to generate cash and service its debt obligations are ascertained to arrive at a long-term rating to map with the short-term scales.

Risk Assessment and Methodology



BWR evaluates the following key parameters when rating the Commercial Paper:

- a) Issuer quality assessment based on its long-term rating
- b) Liquidity risk assessment
- c) Assessment of Liquidity Back-up mechanism wherever applicable
- d) Mapping of Long-term ratings with Short-term ratings scales
- e) Determination of quantum of short-term debt
- f) Credit enhancement mechanism, if any

The criteria and methodology are captured below:

Approach & Methodology

1. Issuer Quality Assessment

BWR assessment typically includes assessing the business risk, industry risk, management risk and financial risk. These primary risks are covered and incorporated in the BWR general rating criteria.

2. Assessment of Liquidity Risk

The overall liquidity risk of the issuer is examined. Based on the cash flow statements, financial projections and additional information, provided by the issuer and the adequacy of future cash flow as against the debt servicing capability, the BWR analyst team will analyse the following:

- a. Adequacy of future cash inflows and outflows for the next one year
- b. Historical behaviour to understand any seasonality, Inventory turnover and Receivables turnover ratios and comfort factors such as support from the parent, if any.
- c. Maturity profile of the issuer’s assets and liabilities.
- d. Overall liquidity position of the issuer, including financial flexibility and other options

3. Assessment of Liquidity Back-up Mechanism

BWR examines issuers’ liquidity back-up mechanisms such as bank lines for working capital, revolving credit facilities, drawing power available against unutilised bank lines, investments in liquid mutual funds and cash or encumbrance free fixed deposits in banks, as well as the financial flexibility of the issuer. This reduces the chances of a default in the repayment of the CP. The quality of the liquidity back-up mechanism and covenants/restrictions affecting the issuer's ability to access the facility are also looked at to assess the refinancing risk associated with CPs/STD.

4. Mapping Long-term ratings with Short-term Scales

Typically, the short-term ratings are linked to the long-term ratings as per the table below. Short-term debt can be rolled over and hence BWR internally assigns a long-term rating which is then mapped/converted to a short-term rating. However, based on the situation and type of entities being rated, BWR may assign a different rating from the typically suggested mapping. BWR uses the modifier '+' from A1 to A4.

Long-term Rating	Short-term Rating
BWR AAA	BWR A1+
BWR AA+	BWR A1+
BWR AA	BWR A1+
BWR AA-	BWR A1+
BWR A+	BWR A1+/BWR A1
BWR A	BWR A1/BWR A2+
BWR A-	BWR A1/BWR A2+
BWR BBB+	BWR A2+/BWR A2
BWR BBB	BWR A2/BWR A3+/BWR A3
BWR BBB-	BWR A2/BWR A3+/BWR A3
BWR BB+ to BWR BB-	BWR A4+
BWR B+ to BWR C-	BWR A4

5. Determining the Quantum of Short-term Debt

BWR considers the quantum of short-term debt, as provided in the projections by the company, as well as information on the liquidity back-up for the commercial paper. In respect of projects, BWR examines whether the requirement of working capital has been adequately covered in the long-term loans sanctioned for the project. Such a requirement of the working capital for the period of the project construction has to be factored into the long-term debt.

6. Commercial Paper Ratings for IPO Financiers

NBFCs finance investors for their investments in IPOs/FPOs. In turn, the NBFCs fund these through Commercial Paper (CP) issuances that are of a very short tenor (7-14 days), to match the duration of the IPO process. Depending on the size of the IPO and investor interest in the IPO, CP issuances can be much larger than the normal borrowings of the NBFC for their regular activities. However, the rating of the CPs is typically the same as the other CP issues of the issuer. In addition to the factors looked at for rating regular CP issuances, the rating of CPs for IPO financing also factors the structure of the transaction, which includes the control of the NBFC over the funds and/or securities throughout the process and lien marking on share applicant ASBA account by lenders etc. The level of over-subscription expected in the IPO determines the margin taken from the clients. This in turn ensures that the structure is self-liquidating, wherein the amount refunded post the allocation of securities adequately covers the amount funded by the lender and interest thereon, thereby making the product low risk in spite of the high quantum.

7. Credit Enhancement Mechanism

BWR examines any credit enhancement option where either a parent, multi-national corporation or bank provides a guarantee for the commercial paper of the corporation or backstop facilities while assigning the CP rating. Commercial banks also provide standby credit facilities against the CPs which, in certain cases, can lead to credit enhancement of the corporate entities.

Conclusion

BWR analyses an entity by assessing the impact of each of the above-mentioned risks and attributes, along with the financial projections/cash flow over the next 12 months or the tenor of the facility (maturity less than one year) to arrive at the overall assessment of the credit quality. While the methodology involves analyses of various risks associated with the regulatory aspects, financial, industry, operational and business risk, the market position and liquidity position, the final rating may include additional factors as required to arrive at the entity's overall credit assessment.

The previous version of this document can be found in

<https://www.brickworkratings.com/download/Criteria-CommercialPaper-June2022.pdf>

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