Rating Criteria for Short-term Debt

Brickwork Ratings (BWR) assigns ratings to short-term debt instruments, having maturity up to one year, issued by corporates. These instruments include money market instruments such as Commercial Paper (CP) and bank facilities such as Short-term loans, Bank Guarantees (BGs), Letters of Credit (LCs), Packing credit and Bill discounting. While short-term debt may be rolled over, long-term debt is expected to be repaid out of the internal accruals of the business. BWR assesses the long-term credit profile of the issuer, arrives at the long-term rating and maps the short-term ratings with the long-term rating. The short-term rating so arrived at, among other variables, factors in the analysis of the company's liquidity profile and financial flexibility.

Scope of the Criteria:

The document provides a brief analysis of the attributes considered by BWR while arriving at an entity's short-term rating. The scope of this document is to capture the important aspects of various risks associated with the Company's creditworthiness, while arriving at the long-term rating of entities, framework for mapping with the short-term ratings and analysis of the entity's liquidity and refinancing risk. This criteria covers short-term debt instruments issued by corporates.

Risk Assessment and Rating Methodology:

BWR analyses an entity's credit quality based on the qualitative and quantitative risks likely to affect the sustainability of its operations, operating efficiencies, financial position, debt servicing ability, cash flow generation, profitability and market position. In general, these risks are broadly classified in BWR's rating criteria as business risks, industry risks, regulatory risks, financial risks and management risks. These risks help assess the long-term credit risk profile of the underlying entity. Furthermore, BWR considers the issuer's liquidity profile, funding available for short-term liquidity mismatch situations, unused banks limits, monthly cash flow generation as against debt servicing requirements and financial flexibility towards the refinancing of the instruments. Furthermore, the aspects related to arriving at the long-term rating are defined in BWR's general rating criteria. Various factors considered to arrive at the short-term rating are as follows:

Business Risk:

Business risk includes the demand-supply position, intensity of competition, competitive position, scale of operations, capital infusion, location advantage, operational efficiencies, and market position. Industry risk refers to the prospects and outlook for the industry, regulatory aspects, and entry and exit barriers of the industry.

Industry Risk:

BWR assesses the industry risk for an entity based on the industry in which the issuer operates. Industry risk is identified through factors such as the demographic presence, dependence on the global market, competitive landscape, capital-intensiveness, nature of industry and barriers to entry. BWR assesses the impact of technological challenges, resource availability, demand-supply scenario, price trends, product substitution availability, investment plans of the major players in the industry, industry-wide financial position, gross margins and availability of substitutes to arrive at the rating of the entity.

Regulatory Risk:

Regulatory risk will be assessed when the entity has a high dependence on government initiatives for growth and cost competitiveness, and operates in a highly regulated environment; examples of the same include the anti-dumping duty, government regulation, regulatory approvals for project/capex implementation, price control or fixation by a regulatory authority and access to raw material, etc.

Liquidity Risk:

Liquidity Risk assessment is one of the major factors considered while rating the short-term debt instrument. BWR assesses the liquidity position by evaluating the company's debt repayment profile and other committed cash outflows, vis-a-vis its business cash flow projections, cash/unencumbered fixed deposits in a bank, working capital utilisation, unutilised banking limits, tied-up debt and other sources such as private equity infusion. Additional standby liquidity via lines of credit with the issuer from banks/ financial institutions to cover the size of the CP/ short-term facility are also considered. If the company's liquidity position is inadequate, it will impact its long- and short-term ratings. BWR shall also assess the maximum permissible short-term debt for the underlying entity. The company's periodic cash flow is examined to determine the company's liquidity as against the repayment of its short-term debt obligations or current liabilities.

Financial Flexibility:

Financial flexibility denotes other sources of liquidity available with the company and the ones that can be potentially brought in as and when required during the normal course of operations. In the case of a higher reliance on fresh borrowings, the issuer's ability to raise funds and refinance its current debt is critically assessed. Following are critical parameters:

1. **Infusion from parent or group company:**

   Funding support from a strong parent or group company helps an entity finance its operations in the stress scenario and service its debt obligations during its early stages of operation when internal cash flow generation is not enough to meet fixed obligations. BWR analyses the demonstrated track record of liquidity infusion, as well as the commitment/undertaking to bring fresh funds to support liquidity by the parent/group company. The financial strength of a parent company can be reflected from its experienced management/promoters, credit quality, business performance, past track record and liquidity profile.

2. **Liquid and back-up lines of credit from banks:**

   Short-term debt raised from banks creates back-up facilities for the issuer, thereby reducing the chances of default in repayment. BWR analyses the variation in the drawing power and extent of working capital utilisation to ascertain the nature of cushion available to the entity. Liquidity back-ups are pertinent in short-term capital market instruments to avoid the risk of default on account of any unexpected event in the CP market and/or temporary disruptions in the cash flows of the rated issuer.

3. **Adequacy of cash flows:**
   BWR assesses the entity's adequacy of future cash flows to meet its short-term debt servicing requirements. These can be seen through emphasis on liquidity and cash flow related parameters such as trends in the overall liquidity position, free cash flow, retained cash flow, cash flow surplus/gap and committed bank facilities, and level of utilisation. Month-on-month cash generation as against operational and debt servicing requirements over the next one to two years is being assessed.

4. **Credit enhancement:**
   Credit enhancement could be in the form of a Standby Letter Of Credit (SBLC) provided by banks, or unconditional and irrevocable guarantees for a CP issuance. In such instances, where an SBLC is provided from a bank for an entity's CP issue, whereby the rating of the SBLC provider is expected to be reflected in the rating of the instrument, BWR assesses the credit profile of the SBLC provider, defined payment mechanism and operational risks that may arise towards the timely transfer of the funds, legal enforceability of the SBLC covering the entire amount with irrevocable and unconditional in nature of guarantees. Such instruments may carry a "CE" suffix in parenthesis in the rating of an instrument which is based on an explicit third-party credit enhancement.

Mapping Long-term Ratings with Short-term Scales

Typically, the short-term ratings are linked to long-term ratings, as per the table shown below. However, based on the type of entities being rated, their liquidity profiles and available credit enhancement, BWR may assign a different rating from the typically suggested mapping. BWR uses modifiers '+' from A1 to A4. When multiple short-term ratings overlap to a particular long-term rating, BWR focuses on the current liquidity position to a large extent to assess whether the higher or lower of the overlapping short-term ratings should be assigned.

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 A4
BWR B+ to BWR C-	BWR A4

Management and Corporate Governance:

A strong, dedicated and highly experienced management helps the organisation achieve its profitability and operating efficiency targets, and drives the company's financial and liquidity position. BWR assesses the consistency of performance demonstrated by the management and the quality of corporate governance adopted by the entity as also the performance of other group concerns. Red flags, if any, highlighted by internal or external stakeholders/ the auditor, would negatively reflect in the rating. The financial flexibility of the management, tested by the empirical evidence of successfully supporting the group companies/manufacturing units, past track record of successfully running companies and the quality of corporate governance practices followed by the company are factored in while assessing the company's overall credit profile.

Conclusion:

BWR analyses an entity by assessing the impact of each of the above-mentioned risks and attributes, along with financial projections over the next couple of years or the life of the facility, to arrive at the overall assessment of a company's credit quality. While the methodology comprises the comprehensive analyses of various risks associated with the regulatory aspects; financial, industry, operational and business risk; and the market position to arrive at the long-term rating, the short-term rating will be mapped with the entity's long-term rating.

The previous version of this document can be found in
www.brickworkratings.com/download/Criteria-ShortTermDebt.pdf

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