

Rating Criteria –Cotton Textile Industry

Executive summary

The cotton textile industry is a key component of India's manufacturing sector, spanning the entire value chain from ginning and spinning to fabric production, processing, and garment manufacturing. Cotton is India's premier commercial crop, often known as "White Gold" due to its significant contribution to agricultural exports and rural employment. The industry is highly fragmented, working-capital intensive, and exposed to fluctuations in cotton prices and global trade dynamics. Consequently, an entity's credit profile is influenced by its position in the value chain, degree of integration, operational efficiency, and ability to manage raw material and market-related risks.

Cotton is the primary raw material for the industry, and India is among the world's largest cotton producers, providing a strong domestic sourcing base. Cotton is a major economic driver, providing employment to millions of farmers and textile workers. Cultivated as a kharif crop, cotton is sown from April to June and harvested between October and December. It thrives in warm temperatures with adequate moisture and nutrient-rich black cotton soil. Cotton cultivation is concentrated in major producing states such as Gujarat, Maharashtra, and Telangana, and remains dependent on monsoon conditions, crop yields, and fibre quality. The seasonal nature of cotton production necessitates effective procurement and inventory management strategies. The industry has strong linkages with global markets through exports of cotton, yarn, fabrics, and garments, while imports of specialized cotton varieties support premium textile manufacturing. As a result, textile companies are exposed to international demand trends, trade policies, foreign exchange movements, and global cotton price volatility.

BWR's assessment of the sector focuses on raw material availability, value-chain integration, operational competitiveness, market diversification, and the ability to withstand cyclical fluctuations in commodity prices and demand conditions.

Scope of the criteria

The scope of this document is to outline the key risk parameters considered while assigning credit ratings to cotton textile companies. BWR applies a holistic approach that evaluates the interplay between four primary risk pillars, namely Industry Risk, Business Risk, Financial Risk, and Management Risks.

In addition, Environmental, Social, and Governance (ESG) considerations are increasingly integrated into the assessment, given their growing importance in determining long-term competitiveness and stakeholder perception.

BWR has an established rating criterion for manufacturing companies, under which this document forms part of the broader sector-specific criteria applicable to various industries within the manufacturing sector. The detailed criteria for manufacturing companies are available on the BWR website:

www.brickworkratings.com.

A. Industry risk:**Nature of industry**

The cotton textile industry operates in a cyclical environment, with profitability and growth influenced by fluctuations in raw cotton prices, global trade dynamics, export demand and prevailing economic conditions. Since cotton is the primary raw material, changes in crop output, weather patterns and commodity market trends have a direct bearing on industry performance.

Spinning segment:

The yarn manufacturing business is characterized by significant cyclicality due to its dependence on cotton price movements, export markets, and demand from downstream weaving and knitting sectors. Product differentiation is relatively limited in standard yarn categories, making the segment highly competitive and sensitive to changes in global textile demand and supply conditions.

Fabric and garment segments:

The performance of weaving, processing, and garment manufacturing units is largely driven by consumer spending patterns, retail demand, and economic sentiment in domestic and international markets. Demand for apparel and home textiles is susceptible to shifts in consumer preferences, seasonal purchasing trends, and changes in sourcing strategies adopted by global brands and retailers.

Foreign exchange risk:

Cotton textile companies with significant export revenues and imports of raw materials, machinery or other inputs are exposed to fluctuations in foreign exchange rates. Movements in currency markets can influence revenue realizations, input costs, profitability and overall cash flows.

To manage this exposure, many textile manufacturers adopt prudent foreign exchange risk management practices, including natural hedging strategies and the utilization of foreign currency-denominated working capital facilities. Aligning foreign currency borrowings with export receivables helps reduce currency mismatch risks and partially offsets the impact of adverse exchange rate movements on operating performance.

Regulatory risk:

The performance and competitiveness of cotton textile companies are significantly influenced by the policy and regulatory framework governing the sector. BWR assesses the extent to which spinning and textile units benefit from ongoing government support measures, including interest subvention schemes, capital subsidies, tax concessions, and other fiscal incentives provided by the Central and State Governments. Such measures can strengthen the financial position of mills, particularly small and medium-sized players, by lowering financing costs and supporting capacity expansion.

Given the export-oriented nature of the cotton textile industry, BWR also evaluates the impact of international trade policies, including Free Trade Agreements (FTAs), import and export duty structures, tariff regimes in key destination markets and export promotion schemes such as duty drawbacks and rebate programs. These factors play a crucial role in determining the global competitiveness of Indian yarn and textile manufacturers. Additionally, government interventions in the cotton value chain, including the announcement of Minimum Support Prices (MSP) for raw cotton and procurement policies, can influence raw material availability, procurement costs, and overall profitability across the industry.

International and domestic demand and supply:

Raw material procurement costs are largely influenced by prevailing demand supply conditions in the cotton market and the pricing trends of cotton, yarn and downstream textile products. Cotton spinning mills are particularly exposed to fluctuations in raw cotton prices, as fibre constitutes the largest component of production cost. Integrated textile enterprises with operations spanning cotton procurement, spinning, weaving/knitting processing and garment manufacturing generally enjoy cost advantages through internal sourcing, reduced transportation expenses, improved supply-chain coordination and assured availability of raw materials. Effective inventory planning and strategic stocking during the harvest season also help textile manufacturers mitigate the impact of raw material price volatility and ensure uninterrupted operations. Cotton prices are inherently cyclical and are driven by domestic and global production levels, consumption

trends, weather conditions, government policies and international trade dynamics. In years of favourable monsoons and higher crop output, an oversupply situation may exert downward pressure on cotton prices, whereas lower production or supply disruptions can lead to sharp price increases. Consequently, cotton textile companies must adopt prudent procurement and inventory management strategies to safeguard margins against fluctuations in raw material costs.

External environmental impact:

Cotton is an agriculture-based raw material, making the performance of the cotton textile industry closely dependent on the availability, quality, and pricing of cotton. Rating analysis therefore considers domestic and global cotton production trends, acreage under cultivation, monsoon patterns, crop yields, and fibre quality. Adverse weather conditions such as deficient or erratic rainfall, prolonged dry spells during crop development, and unseasonal precipitation during harvesting can adversely affect cotton output and fibre quality, leading to supply disruptions and volatility in raw material costs. Cotton-growing regions with high dependence on rainfall are particularly susceptible to climatic uncertainties, which can influence the operating environment for textile manufacturers.

The industry also faces risks arising from pest infestations, particularly the pink bollworm, which has affected cotton productivity in several major cotton-producing states. The emergence of pest resistance to certain genetically modified cotton varieties has increased crop protection costs and reduced yield efficiencies for farmers, potentially impacting the availability and cost of quality cotton for textile mills. Ongoing efforts to improve pest management practices, adopt advanced seed technologies and enhance crop resilience are important factors in ensuring sustainable cotton production and supporting the long-term stability of the cotton textile value chain.

B. Business Risk:

Market position and scale of operation:

BWR evaluates the market position of cotton textile companies based on product diversification, manufacturing scale, customer profile, value-added offerings, and operational flexibility across different textile segments. Companies with a diversified product portfolio encompassing cotton yarn, blended yarn, fabrics, and garments demonstrate stronger resilience to withstand industry cyclicalities and fluctuations in raw material prices than entities concentrated in a single product category.

The ability to manufacture value-added products such as dyed yarn, compact yarn, specialty fabrics, finished garments enhances pricing power, improves customer retention and supports margin stability. A broad range of fabric varieties, designs, colours and finishes enables textile manufacturers to establish long-term relationships with domestic brands, garment exporters and international retailers.

In the fabric and apparel segments, product differentiation, design capabilities, responsiveness to fashion trends and the ability to offer customized solutions are key competitive strengths. Companies with a diverse product mix and strong market reach are generally better placed to adapt to changing consumer preferences and demand patterns. While profitability in textile manufacturing is often volume-driven, larger players derive decisive competitive advantage from economies of scale including optimized procurement, lower per-unit operating costs, stronger bargaining power and enhanced capacity utilization.

BWR also assesses the installed production capacities of textile companies and their ability to expand operations in a timely manner to capitalize on favorable market conditions. Large-scale operations facilitate operational efficiencies, support future value addition initiatives, and enhance competitiveness across spinning, weaving, processing, and garmenting activities.

Level of value chain integration:

BWR views integrated textile manufacturers more favorably than standalone entities due to their superior ability to manage costs, protect margins, and control product quality throughout the production cycle.

- **Standalone spinning or weaving mills:** These entities are generally exposed to greater earnings volatility arising from fluctuations in cotton prices, changing demand conditions, and limited pricing flexibility. Their profitability is often vulnerable to imbalances within individual segments of the textile value chain.

- **Integrated textile companies (Spinning → Fabric → Garments):** Integrated players command superior value across multiple stages of production, translating into robust margin stability and stronger operational control. Such companies typically enjoy better quality management, lower logistics costs, improved supply-chain efficiency, and reduced exposure to disruptions in any single segment of the value chain. Their diversified revenue streams and broader market presence also strengthen resilience during industry downturns

Operational efficiency:

Raw cotton constitutes the principal raw material for spinning mills and represents the largest share of production costs in the cotton textile value chain. The sector's profitability is therefore highly sensitive to fluctuations in cotton prices, which are influenced by factors such as acreage under cultivation, monsoon conditions, pest infestations, crop yields, and overall market supply-demand dynamics. Variations in cotton prices directly affect operating margins, making efficient procurement and inventory management critical determinants of competitiveness. The ability of a company to secure quality cotton at optimal prices depends on its proximity to cotton-growing regions, sourcing practices and inventory strategy.

Over the years, rising costs of Bt cotton seeds, fertilizers, pesticides and other farm inputs have increased cultivation expenses for cotton growers. This has exerted pressure on farm-level profitability, particularly in low rain-fed regions, thereby influencing cotton production economics and long-term supply dynamics.

Cotton processing and procurement risk:

In the spinning segment, raw cotton undergoes a series of processes including cleaning, carding, combing, and drafting before being converted into yarn. Given the dependence on agricultural output, the availability, quality and cost of cotton remain exposed to weather-related uncertainties and crop performance. Consequently, the effectiveness of a company's procurement strategy and its ability to manage raw material price risk are key factors influencing operational stability and profitability.

Power cost and energy efficiency:

Power is one of the most significant operating expenses in the cotton textile industry. For spinning mills, energy costs generally account for a meaningful portion of total operating expenditure, while uninterrupted power supply is essential for maintaining productivity and ensuring consistent yarn quality. Similarly, weaving, processing and fabric manufacturing operations are highly dependent on reliable power availability. To enhance cost competitiveness, several large textile manufacturers invest in captive power generation facilities, including renewable energy sources such as wind and solar power. Companies that demonstrate superior energy efficiency, operate captive generation assets or benefit from concessional power tariffs offered by state governments are generally better positioned to withstand increases in electricity costs and maintain stable operating margins.

Labour availability and automation:

Labour remains an important component across the cotton textile value chain, particularly in cotton harvesting and certain manufacturing processes. In India, cotton picking continues to be predominantly manual due to the availability of relatively low-cost labour and the limited adoption of mechanized harvesting. While manual harvesting helps preserve fibre quality, it also exposes the sector to labour availability and wage inflation risks.

Within manufacturing operations, however, increasing automation and modernization have gradually reduced labour intensity. Government initiatives such as the Technology Upgradation Fund Scheme (TUFS) have encouraged investments in modern machinery and advanced production technologies. As a result, productivity levels have improved, dependence on manual labour has declined, and companies have become better positioned to address rising wage costs and labour shortages while maintaining product quality and operational efficiency.

Diversity of operations:

Strong and long-standing relationships with established garment manufacturers, fabric producers, global sourcing houses and retail brands contribute to business stability and sustained export growth. A diversified export presence across multiple international markets helps cotton textile companies mitigate risks arising from region-specific economic downturns, trade restrictions, currency volatility or geopolitical developments.

The product mix is an important consideration, with an evaluation of the proportion of pure cotton yarn, blended yarn varieties, and specialized value-added products such as combed, compact, slub and premium-count yarns. Companies with a well-diversified product portfolio, particularly those catering to higher-value and blended yarn segments, generally benefit from improved margin resilience, lower earnings volatility, and stronger market positioning.

Inventory management:

Quality cotton arrives during the harvest season and mills have to procure and build inventories during this period to secure raw material availability throughout the lean season. Raw cotton inventory management is critical for spinning mills to ensure uninterrupted production and protect profitability from volatility in fibre prices. The ability to maintain sufficient stock levels enables manufacturers to sustain operations, meet committed orders, and mitigate risks arising from supply shortages or sharp increases in cotton prices. In contrast, fabric manufacturers are generally less exposed to raw material price fluctuations, as production is largely undertaken against confirmed orders, with selling prices typically aligned to prevailing input costs.

Innovation:

Continuous investment in advanced spinning technology and modern production systems is a key differentiator in the cotton textile sector. Modernized spinning mills achieve higher productivity, improved yarn quality, lower wastage and more efficient utilization of raw cotton, thereby enhancing overall operating efficiency and profitability. However, modernization requires substantial capital expenditure, limiting regular technology upgrades primarily to financially strong players with access to adequate funding and healthy cash flows. Several state governments have introduced capital subsidies and other fiscal incentives to encourage investment in modern textile manufacturing facilities.

Despite significant progress, the technological sophistication of India's textile industry continues to lag behind that of leading textile-producing countries like China. Consequently, companies that consistently invest in technology upgrades, automation, and process improvements are better positioned to maintain cost competitiveness, improve product quality, and strengthen their presence in export markets. Positive consideration is accorded to investments that facilitate value addition, enhance operational efficiencies, reduce dependence on manual labour, and support the production of specialized or premium textile products. Such initiatives not only improve profitability but also strengthen the long-term sustainability and global competitiveness of textile manufacturers.

From a broader industry perspective, adoption of improved agricultural practices, superior seed varieties, mechanisation, and efficient farming techniques can enhance cotton yields and quality, ensuring a more reliable supply of raw material to textile mills. Higher farm productivity can improve farmer incomes while promoting sustainable cultivation practices through more efficient use of water and other natural resources.

C. Financial risk:

Financial risk assessment in the cotton textile industry involves evaluating the company's financial performance, capital structure, liquidity profile and ability to meet its debt obligations. The industry is inherently cyclical, with earnings and cash flows influenced by fluctuations in raw cotton prices, yarn and fabric realizations, export demand, foreign exchange movements and changes in global textile trade dynamics. Profitability serves as a key indicator of financial strength, reflecting the company's ability to manage raw material costs, optimize capacity utilization and maintain operating efficiencies across different phases of the industry cycle. Strategic integration across the textile value chain such as expansion from spinning into weaving, processing, garmenting or technical textiles can enhance value addition, diversify revenue streams and support margin stability over the long term.

Some of the ratios considered by BWR when evaluating profitability and return ratios are:

Ratio	Method of Computation
PAT Margin	$\frac{\text{Profit After Tax}}{\text{Revenue}}$
Operating Margin	$\frac{\text{Operating Income}}{\text{Revenue}}$
Return on Capital Employed (ROCE)	$\frac{\text{EBIT}}{\text{Capital Employed}}$
Net Cash Accruals /Total Debt	$\frac{\text{PAT} + \text{Dep.} - \text{Dividend}}{\text{Total Debt}}$

The company's capital structure is assessed to determine the level of leverage and its impact on overall financial risk. Given the cyclical nature of the textile sector, companies with moderate leverage, strong debt protection metrics and prudent financial policies are viewed more favorably. A low net debt-to-EBITDA ratio and adequate interest coverage provide financial flexibility during periods of margin compression or weak demand. As cotton textile companies are exposed to volatility in raw material prices and export markets, excessive financial leverage can significantly amplify earnings volatility and weaken debt-servicing capacity during downturns. Consequently, lenders and investors generally expect textile companies to maintain conservative leverage levels and sufficient financial buffers.

Some of the ratios considered by BWR when evaluating leverage and coverage ratios include:

Ratio	Method of Computation
Interest service coverage ratio (ISCR)	$\frac{\text{EBITDA}}{\text{Interest \& Finance Charges}}$
Debt service coverage ratio (DSCR)	$\frac{\text{PAT} + \text{Dep.} + \text{Interest Exp.}}{\text{Interest Exp.} + \text{Principal Repayment}}$

Liquidity and working capital are of significant importance in the cotton textile industry, given the substantial funds tied up in raw material procurement, production processes and customer credit. Textile manufacturers are required to maintain adequate stocks of cotton, yarn, fabric and other inputs to ensure smooth operations and mitigate supply and price volatility risks. In addition, the industry often operates with extended receivable cycles, particularly in export markets and dealings with large institutional customers.

Some of the ratios considered by BWR when evaluating liquidity ratios include:

Ratio	Method of Computation
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Quick Ratio	$\frac{\text{Total Current Assets} - \text{Total Inventory}}{\text{Total Current Liabilities}}$
Working Capital Cycle	Debtor days + Inventory Days – Payable Days

BWR evaluates the effectiveness of working capital management through factors such as inventory turnover, receivables realization period, payable management, net working capital intensity and the overall operating cycle. Efficient procurement planning, inventory optimization and timely collection of receivables are key determinants of liquidity strength. The ability to generate sustainable operating cash flows across business

cycles, maintain adequate cash and liquid investments, and preserve sufficient cushion in sanctioned working capital limits supports financial flexibility. Access to diversified funding sources and strong banking relationships further enhances an entity's ability to withstand fluctuations in raw material prices, demand conditions and export market dynamics.

Financial flexibility is another important consideration, reflecting the company's ability to access additional capital during periods of stress or to fund expansion initiatives. Textile companies often require capital for capacity additions, modernization, technology upgrades and sustainability related investments. Companies with established banking relationships, access to capital markets and support from promoters or group entities are generally better positioned to withstand cyclical downturns and pursue growth opportunities.

Other key evaluation metrics include the input-output ratio (measuring conversion efficiency from raw cotton to finished yarn/fabric), which directly dictates process wastage and the realization per unit, which indicates the entity's value-addition capabilities and market positioning.

Additionally, cotton textile companies are exposed to foreign currency risk due to imports of raw materials, machinery and chemicals, as well as exports of yarn, fabric and garments. Adverse movements in exchange rates can impact profitability, working capital requirements and debt servicing ability. The effectiveness of hedging policies and foreign exchange risk management practices therefore forms an important part of the financial risk assessment. Furthermore, the ability to monetize non-core assets, unlock value from investments or raise liquidity through asset-backed financing provides an additional cushion during periods of financial stress.

D. Management and corporate governance

BWR's assessment of management risk in the cotton textile industry focuses on the ability of the management team and the governance structure to sustain business performance across varying market conditions. Since the industry is characterized by fluctuations in cotton prices, changing demand patterns, evolving trade policies and intense competition, the quality of management is a key determinant of a company's long-term stability and credit profile. BWR evaluates the management's experience in the textile sector, its strategic vision and its demonstrated ability to navigate industry cycles. Particular importance is placed on decision-making related to raw material procurement, inventory planning, capacity utilization and market diversification. Effective management of cotton procurement and inventory levels is critical, as inappropriate stocking decisions can adversely affect margins and liquidity during periods of price volatility.

The management's operational capabilities are assessed through its track record in improving productivity, controlling costs, maintaining product quality and strengthening customer relationships. Companies that have successfully diversified their product portfolio, expanded into higher value-added textile segments or broadened their geographic presence generally exhibit greater resilience to industry-specific challenges.

BWR also reviews the management's approach to growth and capital allocation. Expansion projects, modernization initiatives and diversification plans are assessed based on their strategic rationale, execution capability and funding structure. Companies that demonstrate disciplined financial management and decisively balance growth ambitions with financial prudence are accorded higher credit consideration.

Corporate governance assessment encompasses the effectiveness of board oversight, transparency of financial reporting, internal control systems and adherence to regulatory requirements. A well-functioning governance framework enhances accountability, supports prudent risk management and strengthens stakeholder confidence. The quality and independence of the board, the robustness of audit and compliance mechanisms, and the transparency of related-party transactions are important considerations in this evaluation.

In addition, the ability of management to respond proactively to external developments including changes in export demand, foreign exchange movements, sustainability requirements and technological advancements is a key factor in determining business resilience. The presence of a structured succession plan and clearly defined organizational responsibilities further strengthens the management risk profile by reducing dependence on a single promoter or key executive.

Environmental, social and governance:

In addition to the risks discussed above, BWR believes that Environmental, Social and Governance (ESG) factors are increasingly significant in the cotton textile industry due to evolving sustainability standards and stricter regulatory requirements.

Environmental considerations include sustainable sourcing of cotton, efficient utilisation of water and energy, reduction of emissions, responsible management of textile waste, adoption of eco-friendly production processes and compliance with environmental norms across manufacturing operations. Social considerations cover employee welfare, occupational health and safety, fair labour practices, skill development initiatives and responsible engagement with suppliers and local communities. Governance considerations encompass adherence to statutory and environmental regulations, ethical business practices, transparency in disclosures, robust internal controls and effective risk management frameworks.

Textile companies that systematically embed ESG principles into their operational and strategic decision-making processes are distinctively in an advantageous position in strengthening relationships with customers, global brands and investors, which enhances market competitiveness and support long-term business sustainability. On the other hand, inadequate management of ESG-related risks may lead to regulatory actions, loss of business opportunities, reputational challenges and adverse financial consequences.

Group or parent support: In cases where the cotton textile company is part of a larger group, the willingness and ability of the parent or affiliate companies to provide financial, operational or strategic support is examined. The strength of such linkages enhances overall management credibility.

Conclusion

BWR evaluates cotton textile entities through a comprehensive assessment of industry characteristics, operational capabilities, financial performance and management effectiveness. While the industry benefits from the increasing domestic consumption, export opportunities and value-added product segments, it remains exposed to risks arising from raw material price volatility, fluctuations in global demand, foreign exchange movements and changing trade policies. Companies with integrated operations, diversified product portfolios, established customer relationships, efficient manufacturing processes, technological advancement and prudent financial management are generally better positioned to withstand industry cycles and maintain a stable credit profile.

This is the first criterion document, so no prior version or reference link exists.

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