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## Rating Criteria for Manufacturing Companies

Brickwork Ratings' framework for assessing the credit quality of manufacturing companies covers evaluation of Business Risk, Financial Risk, Management Risk and Project Risk, where applicable. Each of these broad risk factors are subdivided into various parameters, which may be different for different types of industries. BWR process for establishing the credit-worthiness of any company, typically considers the following steps:

- Establishment of the “stand-alone” credit characteristics of the company concerned (i.e. without factoring in any credit – or debit – for the company's membership of or ownership by a larger economic group or parent).
- Peer group comparison.
- Comparison of the rating and the assessment of individual risk factors previously assigned to peers.
- Determination of the company's overall strategic importance to its parent or economic group. The “stand-alone” rating may – in some circumstances – then be adjusted to reflect its importance to the group and the credit quality of the group as a whole.

### 1. Industry Risk & Business Risk Analysis:

Business Risk analysis is an assessment of the sustainability and stability of a company's cash flows. Any industry comprises a number of market segments that will exhibit relatively better or worse characteristics than the industry as a whole. BWR takes into consideration the particular segments of the market or industry in which the entity operates. For assessing this risk, BWR considers applicable factors like Evaluation of the Industry environment, Scale of operations and level of integration, Market position and customer concentration, Technology & R & D efforts, Operational efficiency and Manpower.

**Evaluation of the Industry Environment** may consider the following aspects:

- Intensity of competition
- Relative profitability of the industry
- Market size and Demand-supply situation
- Barriers to entry and ease of exit
- Market growth potential
- Regulatory regime
- Vulnerability to imports and threat of substitute products / services
- Industry Outlook

BWR may consider some of other factors like the size of the industry, growth prospects, competition, and susceptibility to technological change, the importance of the industry to the economy, government policies, entry barriers, profitability, consumer preferences, regulatory risk and cyclicity. These are the various external factors inherent for all the entities in a particular industry.

**Scale of Operations and Level of Integration of the Operations:** BWR assesses the economies of scale and operational flexibility available to a manufacturer in various stages in its production process which would influence the cost of production.

**Market Position and Customer Concentration:** BWR evaluates applicable factors like market share trends, distribution network, product differentiation, ability of the company to sell its products profitably, pricing flexibility and relationships with key customers and the customer concentration. In respect of companies that are in research and development of software, biotechnology, life sciences etc., the companies could be in a strong market position due to the patents and royalties that they receive on their products. The assessment of intellectual property rights in such companies assumes greater importance to understand the market position of such companies.

**Technology and R & D:** Technology oriented businesses provide significant entry barriers, especially to the unorganised businesses. Companies with strong technology and ongoing investment in R&D, to meet consumer preferences have an edge over the competition. Brickwork looks at the technology adoption as well as the way the company is poised for use of technology in its day to day operation. If IT systems are designed well, the manufacturing company's productivity can go up, due to enhanced processes in all these sectors.

**Operational Efficiency:** BWR evaluates the efficiency with which the operations of a company are run and its ability to sustain its activities competitively. In this context, the Operating Risk is assessed. Companies that operate with high fixed cost in terms of investment in plant and machinery are subject to higher operating risk. Inventory management, access to and procurement of raw materials, price volatility of key inputs, quality control, production planning and control, capacity utilization and level of flexibility of operations, operational strategy for diverse and widespread operations, Commodity management etc. are other factors. Companies that have sustainable raw material advantage in terms of location, higher productivity due to state of art technology and effective commodity risk management hedging policies will score over others.

Manpower plays a critical factor in the present operating environment. Effective HR process management can result in a strong competitive advantage. The company's ability to attract and retain qualified and experienced manpower and policies for training and upgrading the employees' skills are analysed. Attrition levels vis a vis industry levels, past track record of the company in labour management and diversity of skill sets in the company are also other factors that may be considered.

## **2. Financial Risk Analysis:**

BWR's financial risk analysis includes the company's current financial position, its financial risk profile and the sustainability and adequacy of the issuer's cash flows in relation to its debt servicing obligations. Accounting quality, financial flexibility and Contingent liabilities are other factors. The financial ratios that Brickwork considers are profitability ratios, Interest coverage ratios, Debt Equity ratio, DSCR, Current Ratio etc. Brickwork looks at the financial flexibility of the company in the market. Some companies with higher debt but better standing in the financial market are able to borrow money more easily. The diversification in resource mobilization is of vital importance for companies. BWR may also consider bank loan covenants and other restrictions.

### **3. Management Risk Analysis:**

Management evaluation involves understanding the Organisational structure, management philosophy and vision, strengths and weakness of key members of management and depth and stability of top management. Management strategies are a material determinant in differentiating firms and in establishing a company's business profile. The assessment also encompasses financial policies, corporate goals, strategies and plans for both regulated and diversified large businesses.

The assessment of management is based on such factors as tenure, industry experience & understanding and knowledge of customers and their needs. Management's ability and willingness to develop workable strategies to address system needs, execute reasonable and effective long-term plans and be proactive in leading its company into the future are assessed. Key financial policy considerations include management's ability to achieve cost-effective operations and commitment to credit quality.

BWR evaluates how the management operates the business, their experience in the similar line of activity and their visibility with the suppliers and customers. Track record of the management, branding for the various products that are sold, policies or strategies adopted by the entity, involvement of the promoters in the day to day operations of the business, supplier / customer network to run the operations of the business are other factors considered.

### **4. Project Risk Analysis:**

In the case of companies implementing new projects, the associated risks are evaluated viz., techno economic viability, size and relation of the project to the company's existing business, expected cash flows of the project, demand for the new products funding risks, track record of the company in implementing such projects, time and cost overruns etc.

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#### **Disclaimer:**

*It must be clearly understood that a Rating opinion is based on various factors/aspects which includes application of certain Rating criteria. The particular criteria applied depends on a number of factors, inter alia, sector/Industry, historical performance, cyclical trends, prevailing economic condition, group support etc. Rating opinions factor many assumptions and the application of any particular criteria or a set of criteria may be full or partial depending upon peculiarity of each case. Application of any Rating criteria should not therefore be considered as rendering finality or completeness to a Rating assessment. A reference to criteria needs to be perceived in broad terms, only as an aid to a rating decision.*