Credit Rating

Ratings, usually expressed in alphabetical or alphanumeric symbols, are a simple and easily understood tool enabling the investor to differentiate between debt instruments on the basis of their underlying credit quality. **The credit rating is thus a symbolic indicator of the current opinion of the relative capability of the issuer to service its debt obligation in a timely fashion, with specific reference to the instrument being rated. It is focused on communicating to the investors, the relative ranking of the default loss probability for a given fixed income investment, in comparison with other rated instruments.**

A rating is specific to a debt instrument and is intended as a grade, an analysis of the credit risk associated with the particular instrument. It is based upon the relative capability and willingness of the issuer of the instrument to service the debt obligations (both principal and interest) as per the terms of the contract. Thus a rating is neither a general-purpose evaluation of the issuer, nor an overall assessment of the credit risk likely to be involved in all the debts contracted or to be contracted by such entity.

The primary objective of rating is to provide guidance to investors/creditors in determining a credit risk associated with a debt instrument/credit obligation. It does not amount to a recommendation to buy, hold or sell an instrument, as it does not take into consideration factors such as market prices, personal risks preferences and other considerations, which may influence an investment decision. The rating process is itself based on certain 'givens'. The agency, for instance, does not perform an audit. Instead, it is required to rely on information provided by the issuer and collected by analysts from different sources, including interactions in person with various entities. Consequently, the agency does not guarantee the completeness or accuracy of the information on which the rating is based. To quote "In determining a rating, both quantitative and qualitative analysis are employed. The judgment is qualitative in nature and the role of the quantitative analysis is to help make the best possible overall qualitative judgment because, ultimately, a rating is an opinion. " Standard & Poor.

Rating Framework

Industry characteristics: This is the most important factor in the credit risk assessment. It is a key determinant of the level and volatility in earnings of any business. Other factors remaining the same, industry risk determines the cap for ratings. Some of the factors that are analyzed include:

- Demand factors
- State of competition
- Drivers & potential
- Existing & expected capacities
- Nature of product
- Intensity of competition
- Nature of demand - seasonal, cyclical
- Entry barriers for new entrants
- Exit barriers
- Threat of substitutes

For credit risk evaluation, stable businesses (low industry risk) with lower level of cash generation are viewed more positively compared to businesses with higher cash generation potential but relatively higher degree of volatility (higher industry risk). It needs to be mentioned that with the opening up of the Indian economy, it is also critical to establish international competitiveness both at the industry and the unit level.

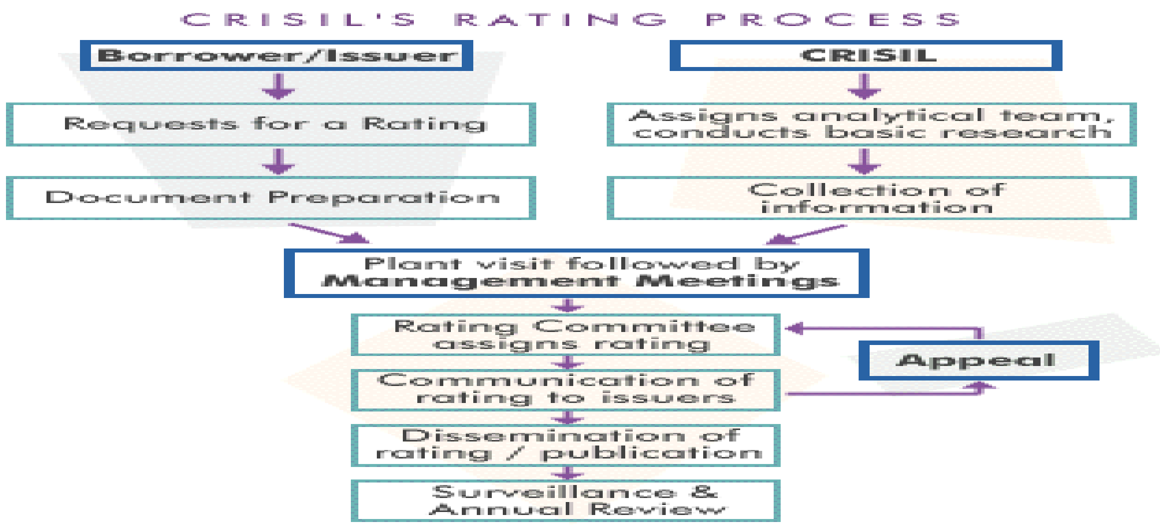
Market position: All the factors influencing the relative competitive position of the issuer are examined in detail. Some of these factors include positioning of the products, perceived quality of products or brand equity, proximity to the markets, distribution network and relationship with the customers. In markets where competitiveness is largely determined by costs, the market position is determined by the unit's operational efficiency. The result of these factors is reflected in the ability of the issuer to maintain /improve its market share and command differential in pricing. It may be mentioned that the issuers, whose market share is declining, generally do not get favourable long-term ratings.

Operational efficiency: In a competitive market, it is critical for any business unit to control its costs at all levels. Cost of production to a large extent is influenced by location of the production unit, access to raw materials, scale of operations, quality of technology, level of integration, experience, ability to use resources efficiently. A comparison with the peers is done to determine the relative efficiency of the unit. Some of the indicators for measuring production efficiency are: resource productivity (both assets and manpower), material usage (or input-output ratios) and energy consumption. Collection efficiency and inventory levels are important indicators of both the market position and operational efficiency.

New project risks: The scale and nature of new projects can significantly influence the risk profile of any issuer. The main risks from the new projects are: Time and cost overruns, even non-completion in an extreme case, during construction phase; financing tie-up; operational risks; and market risk. Besides clearly establishing the rationale of new projects, the protective factors that are assessed include: track record of the management in project implementation, experience and quality of the project implementation team, experience and track record of technology supplier, implementation schedule, status of the project, project cost comparisons, financing arrangements, tie-up of raw material sources, composition of operations team and market outlook and plans.

Financial flexibility: While the primary source for servicing obligations is the cash generated from operations, an assessment is also made of the ability of the issuer to draw on other sources, both internal (secondary cash flows) and external, during periods of stress.These sources include: availability of liquid investments, unutilized lines of credit, financial strength of group companies, market reputation, relationship with financial institutions and banks, investor’s perceptions and experience of tapping funds from different sources. Generally financial flexibility factor facilitates determination of the relative strength within a rating category (i.e., + or - prefix with the rating) and has a greater bearing on the short-term ratings.

Past and projected financial performance: Evaluation of profitability measures like ROCE, RONW, Gross Margins, leverage structure with emphasis on total debt as a % of net worth, long term debt as a % of net worth, interest coverage ratio, Evaluation of the existing financial position is also important for determining the sources of secondary cash flows and claims that may have to be serviced in future. Number of assumptions based on the future outlook of the business is made to draw projections of financial statements. Invariably, the financial projections are carried out for a number of scenarios incorporating a range of possibilities in the set of assumptions for the key cash flow drivers. A few important drivers are expectations of growth, selling prices, input costs, working capital requirements, value of currencies



Management Meeting:

- Topics discussed during management meeting are wide-ranging, including competitive position, strategies, financial policies, historical performance, and near and long-term financial & business outlook. Equal importance is placed on discussing the issuers business risk profile and strategies, in addition to reviewing financial data.
- Management's financial projections are a valuable tool in the rating process as they indicate management's plan for the future, how management assesses the company's challenges, and how they plan to deal with problems
- Rating process from the initial management meeting to the assignment of the rating normally takes three to four weeks

Rating Committee and Assignment of the Rating

- This is the only aspect of the process in which the issuer does not participate directly.
- Rating is a composite assessment of all key factors with the key issues getting greater attention from the Rating Committee. CRISIL offers an opportunity to the companies to be evaluated on a confidential basis. The rating process ensures complete confidentiality of information that is provided by the company.

Advice to Issuer

- When the committee has made its determination, the rating decision is first communicated to the issuer, subsequent to which the reasons or rationale supporting the rating is forwarded. It is important that the issuer understands the critical factors that the committee focused on in determining the rating. In the event that the issuer disagrees with the rating outcome, it has the opportunity to appeal the decision for which additional facts/data need to be submitted to the analyst and be put up once again before the Rating Committee. Issuers appealing a rating decision must provide new/ additional information which is material to the appeal and specifically addresses the concerns expressed in the rating rationale. Upon submission of additional information, the Rating Committee is reconvened. At this stage the rating may or may not change. The client has a right to reject the rating and the whole exercise is kept confidential.

Publication

- Once a final rating is assigned with the acceptance of the issuer, it is disseminated to CRISIL's subscriber clientele, as well as local and international news media.

Surveillance and Annual Review

- After a rating has been assigned, CRISIL monitors the on-going performance of the issuer and the economic environment in which it operates. Surveillance also enables analysts to stay abreast of current developments, discuss potential problem areas, and be appraised of any changes in issuer's plan. The primary analyst maintains periodic contact with the issuer and ensures financial and other information are shared with CRISIL on a timely basis.
- All ratings are under continuous surveillance and even where there is no obvious reason to change

the rating, CRISIL has a policy of conducting a formal annual review which involves a meeting with the issuer. These review meetings focus on developments over the period since the last meeting, and outlook for the coming year and incremental data is sought from the issuer.

- In some instances, a credit rating may be placed on "Rating Watch". A Rating Watch listing highlights an emerging situation which may materially affect the profile of a rated entity and can be designated positive, developing, or with negative implications.