



Rating Criteria for Manufacturing Companies

Introduction and Framework Overview

ACER Credit Rating Private Limited (ACER), a SEBI-registered credit rating agency, is committed to delivering independent and transparent opinions on issuer and credit ratings. ACER credit insights aim to empower investors, lenders, and businesses with opinions on ratings. With a clear vision to support India's economic growth story, ACER upholds the highest ethical and analytical standards, combining deep domain expertise, advanced analytics, and rigorous processes to ensure every rating is objective and insightful.

The Company reserves the right to amend this policy from time to time in accordance with the applicable regulations, circulars, and directives issued by the Securities and Exchange Board of India. This rating criteria will be reviewed annually.

The criteria is designed to evaluate both intrinsic strengths and vulnerabilities of companies, along with the external environment in which they operate. For companies undertaking new projects, a separate Project Risk analysis is integrated into the overall assessment.

Rating Framework Structure

ACER's credit rating framework for manufacturing entities is built upon four fundamental pillars to reflect relative importance in overall credit assessment. The framework evaluates both intrinsic strengths and vulnerabilities of companies while considering external environmental factors. The four pillars are:

- **Ratio Analysis** - Quantitative financial performance assessment
- **Business Parameters** - Industry dynamics and competitive positioning
- **Management Quality** - Leadership capabilities and corporate governance
- **Legal and ESG Parameters** - Regulatory compliance and sustainability factors

Each pillar comprises various sub-parameters evaluated to arrive at an aggregated understanding. These insights are combined using assigned weightages to determine the final credit rating.

Pillar I: Ratio Analysis

This pillar focuses on assessing quantitative financial performance and position through detailed analysis of various financial ratios against peer performance and internal targets.

1. Profitability Ratios (Excluding Extraordinary/Exceptional Items)

- **EBITDA Margin**: Evaluates operational efficiency by measuring operating profit relative to sales, reflecting management's ability to control fixed costs and optimize resources, and indicating operational excellence and scale economics realisation.



- **Net Profit Margin:** Assesses overall profitability after all expenses, providing a comprehensive measurement that incorporates profit quality and sustainability factors.
 - **Return on Assets (ROA):** Measures profit generation efficiency relative to total assets, indicating asset utilization effectiveness and capital productivity.
 - **Return on Capital Employed (ROCE):** Evaluates returns relative to capital employed, indicating management effectiveness in generating profits from invested capital.
2. **Leverage/Solvency Ratios** These ratios measure reliance on debt financing and capacity to meet long-term obligations, which are crucial for assessing financial structure and viability.
- **Debt to Adjusted TNW Ratio:** Assesses debt levels relative to tangible net worth, indicating leverage intensity and the adequacy of the equity cushion.
 - **Debt to EBITDA Ratio:** Measures debt relative to earnings capacity (Earnings Before Interest, Taxes, Depreciation, and Amortization), indicating debt servicing ability and financial sustainability.
 - **Total Outside Liabilities/Adjusted TNW (TOL/Adjusted TNW):** Evaluates total external obligations relative to net worth, providing a comprehensive leverage assessment.
 - **Interest Coverage Ratio:** Assesses the ability to service interest obligations, indicating debt servicing security and financial resilience.
 - **Contingent Liabilities/TNW:** Evaluates off-balance-sheet obligations relative to net worth, assessing additional commitments that could impact the financial position.
3. **Liquidity Ratios** These ratios evaluate a company's capacity to meet short-term obligations and effectively manage working capital.
- **Current Ratio:** Measures current assets relative to current liabilities, indicating the capacity to cover short-term obligations.
 - **Quick Ratio:** Evaluates liquid assets (excluding inventory) relative to current liabilities, providing a more conservative liquidity assessment.
 - **Cash Conversion Cycle Ratio (Days):** Measures the time required to convert working capital investments into cash, indicating efficiency.
 - **Total Income/Interest Expense:** Assesses income generation relative to interest costs, indicating debt servicing capacity.
4. **Efficiency Ratios** These ratios measure the effectiveness of asset utilization and operational management capabilities.
- **Inventory Turnover Ratio (TIMES):** Evaluates inventory management effectiveness through turnover frequency.
 - **Trade Receivables Turnover Ratio (Days):** Measures the average collection period, indicating customer credit management.
 - **Average Fund-Based Working Capital Limit Utilization:** Measures credit facility usage patterns over 12 months.



5. Operating Cash Flow (OCF) Ratios These ratios assess cash generated from core operations, reflecting the internal cash-generating strength of the entity.

- **CFO/Interest:** Measures operating cash flow relative to interest.
- **CFO/CPLTD:** Evaluates repayment capacity relative to cash flow.
- **DSCR:** Evaluates repayment capacity relative to cash accruals

6. Foreign Exchange Risk Metrics

- **Hedging Coverage Ratio:** Measures the extent to which foreign exchange exposure is protected by hedging instruments.

7. Equity Ratios

- **PE Ratio (Price-to-Earnings Ratio):** A valuation ratio of a company's current share price compared to its per-share earnings.
- **Shareholding Pattern Growth (FII, Pledged):** Assesses the changes in ownership held by Foreign Institutional Investors (FIIs), and shares that have been pledged as collateral.
- **8. Insolvency Probability Ratios**
- **Ohlson Score Model Ratio:** predictive model used to assess the likelihood of financial distress or bankruptcy.

Pillar II: Business Parameters

This pillar evaluates inherent business risks and strengths, encompassing the industry environment, market position, and operational efficiencies.

1. Market Position and Revenue Analysis

- **Order Book Size (Number of Times of Revenue):** Provides insight into future revenue visibility and operational stability by assessing the company's order backlog.
- **Market Share of Entity in Top 3 Key Segments:** Indicates competitive strength and market penetration across primary business areas.
- **Size of the Entity:** Assesses overall scale and market presence, contributing to competitive positioning and operational resilience.
- **Functional/Constitutional Status:** Evaluates the legal and organizational structure, affecting governance requirements and operational flexibility.
- **Company Revenue Growth Analysis:** Analyses revenue growth trends over the past three years and assesses the quality of revenue streams, indicating market acceptance and business expansion capabilities.
- **Profit Margin Trend Analysis:** Evaluates growth trends in Gross, Operating, and Net profit margins over three years, reflecting cost control and the sustainability of pricing power.

2. Innovation and Technology Management

- **New Product Introduction/Revenue Visibility:** Evaluates the company's capabilities in introducing new products, which indicates innovation and market adaptability with sustained revenue visibility.



- **Intellectual Property Rights, Patents & Royalties:** Assesses the company's intellectual property rights, patents, and potential for royalty income, indicating competitive advantages.
- **Disruptive Technological Risk:** Evaluates susceptibility to technological obsolescence, new substitute products, or fundamental industry changes.

3. Supply Chain and Operational Risk

- **Supply Chain Concentration:** Evaluates the concentration of purchases from the top three suppliers, supplier dependency, and the costs associated with switching suppliers.
- **Customer-Supplier Dynamics:** Assesses the switching costs for the top three customers and suppliers, which impacts bargaining power and pricing flexibility.
- **Off-take Arrangements:** Assesses the security of sales arrangements and customer commitments, providing revenue visibility.
- **Commodity Risk:** Assesses exposure to commodity price volatility and hedging effectiveness.

4. Operational Excellence and Risk Management

- **Implementation Risk:** Addresses potential challenges, delays, or cost overruns during project execution, considering management track record and planning effectiveness.
- **Funding Risk:** Assesses the certainty and adequacy of funding sources for operational requirements and growth initiatives.
- **Project Sustainance:** Evaluates the ultimate viability through revenue generation capability, cost management, and cash flow adequacy.
- **TEV Study:** Reviews techno-economic viability study findings, confirming project rationale and assumption robustness.
- **Loan Lifecycle Tenor vs Cashflow Generation:** Matches debt obligations with cash generation patterns over project lifecycles.

5. Market Dynamics and Competitive Analysis

- **Cyclicality Analysis:** Determines the business's susceptibility to economic cycles, which can impact demand and revenue stability.
- **Brand Power Pricing Ability:** Assesses the power of the company's brand and its ability to command premium pricing, indicating competitive differentiation.
- **Economic Cycle Resilience:** Assesses the business model's inherent stability across various economic conditions.
- **Interest Rate Sensitivity:** Management of interest rate risk, crucial for profitability stability.
- **Collection Efficiency:** Measures the effectiveness of collection efforts, directly impacting cash flows and asset quality.
- **Geographic/Product Diversification:** Indicates diversification across regions and product offerings, providing risk mitigation.

6. Performance Benchmarking

- **Trend Analysis with Peer-to-Peer Companies:** Comprehensive comparison across multiple performance dimensions, including revenue growth, profitability resilience, and competitive positioning.



- **Company Profitability Resilience:** Evaluates performance under different economic scenarios (Base, Optimistic, Pessimistic).
- **Leverage Ratios Comparison:** Benchmarks debt servicing capacity and capitalization against industry peers.
- **Liquidity and Cash Flow Ratios Comparison:** Evaluates liquidity position and cash generation relative to sector peers.

Pillar III: Management Quality Assessment

This pillar assesses the quality, experience, integrity, and strategic vision of promoters and the management team, along with corporate governance practices.

1. Promoter Excellence and Leadership

- **Relevant Experience of Promoters:** Assesses the relevant experience of promoters in related businesses, indicating their industry knowledge and depth of capability.
- **Board Size and Independence:** Evaluates board composition, independence levels, and governance effectiveness.
- **Quality of Promoters:** A comprehensive evaluation considering market reputation, integrity, credibility, and succession planning effectiveness.
- **Ownership of the Entity:** Assesses ownership structure and concentration, affecting governance dynamics and decision-making processes.
- **Resourcefulness and Transparency:** Examines the promoters' ability to raise funds at competitive costs and their transparency in business dealings.
- **Group & Parent Support:** The influence of being part of a larger corporate group, including potential for extraordinary support.

2. Financial Planning and Governance

- **Reliability of Management Financial Forecast:** Assesses the accuracy and realism of management's financial projections based on historical performance.
- **Migration in External Rating:** Changes in ratings from external agencies, reflecting shifts in credit profile and market perception.
- **Management Track Record:** Evaluates historical performance in project execution, strategic initiatives, and crisis management.

Pillar IV: Legal and ESG Parameters

This pillar evaluates the entity's adherence to legal and regulatory requirements, alongside its environmental, social, and governance practices.

1. Corporate Governance Framework

- **Non-Executive Directors Attendance and Tenure:** Reflects the engagement and stability of non-executive directors in board governance.
- **Community & CSR Activities:** Reviews community engagement and Corporate Social Responsibility initiatives relative to company size.
- **Whistleblower Policies and Tracking:** Assesses the existence and effectiveness of ethics reporting systems and mechanisms.



The above is a vital forward looking variable in the overall rating framework.

2. Legal and Regulatory Compliance

- **Anti-corruption Framework:** Evaluates measures against bribery, fraud, and other illegal practices, tracking violation patterns.
- **Litigation Exposure:** Assesses pending lawsuits, recovery proceedings, and potential contingent liabilities relative to company size and revenue.
- **Settlement History:** Reviews track record in resolving legal disputes through arbitration, lawsuits, or tribunals.
- **Insurance Coverage:** Evaluates adequacy of insurance protection relative to operational risks and net worth.
- **Regulatory Compliance:** Assesses adherence to manufacturing-specific regulations, environmental standards, and safety requirements.

3. Environmental and Social Responsibility

- **Data Breach Management:** Evaluates preparedness for and response to security incidents, including recovery capabilities and third-party risk management.
- **Regulatory Barriers:** Assesses licensing requirements and regulatory constraints that may affect operational flexibility.
- **Change in Statutory Auditors:** Reviews patterns in auditor changes, which may indicate governance or compliance issues.
- **Regulatory Clearances:** Evaluates the status of required approvals and permits for ongoing operations.

Project Risk Analysis Framework

For companies implementing significant capital projects, ACER evaluates associated risks that are factored into the overall rating. The project's nature and size relative to existing operations are critical risk indicators.

- **Nature of Project Type:** Requires a clear strategic rationale for greenfield, brownfield, diversification, or expansion initiatives, with synergies commensurate with firm size.
- **Loan Lifecycle:** Expected operational life and cash generation capability relative to loan duration.

Criteria Excellence and Market Leadership

ACER maintains commitment to analytical excellence through systematic processes, quality controls, and continuous improvement, ensuring consistent, accurate, and reliable credit assessments. The criteria reflect dedication to providing credit ratings that serve investors, lenders, and stakeholders with reliable, comprehensive, and forward-looking credit risk assessments for manufacturing sector entities.

This comprehensive framework incorporates established practices in financial analysis, business assessment, and risk evaluation while maintaining analytical sophistication appropriate for manufacturing sector complexities and stakeholder requirements.