Vadilal Industries Limited

December 27, 2019

Ratings

Facilities	Amount (Rs. Crore)	Ratings[1]	Rating Action
Long-term Bank Facilities	112.58	**CARE BBB (Triple B); Under credit watch with negative implications**	**Continues on credit watch with negative implications**
Short-term Bank Facilities	16.72	**CARE A3+ (A Three Plus); Under credit watch with negative implications**	**Continues on credit watch with negative implications**
Total Facilities	**129.30 (Rupees One Hundred Twenty Nine crore and Thirty lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings of the bank facilities of Vadilal Industries Limited (VIL) continue to remain 'under credit watch with negative implications' owing to lack of clarity about future leadership of the company on the back of heightened differences among the promoters of VIL which had led to significant delays in publication of its quarterly results on the stock exchange for Q4FY19 and Q1FY20 and which could impact the performance of the company going forward. The ratings take cognizance of the fact that quarterly results for Q2FY20 were published without any delay on the stock exchange apart from appointment of new statutory auditor (due to vacancy created on account of resignation of its erstwhile statutory auditor before expiry of their tenure of appointment citing concerns over the management not completing/initiating enquires/ investigations into various matters, as mentioned in auditor's report for the year ended March 31, 2019 as disclaimer of opinion) and appointment of a law firm and CA firm to conduct independent enquiry/examination on the matters referred under "Basis for Disclaimer of Opinion" of the said auditor's report. CARE will take a view on the ratings of VIL post outcome of the independent enquiry/examination as above along with resolution of differences amongst the promoters and clarity on future leadership of the company.

The ratings of the bank facilities of VIL continue to derive strength from the vast experience of the promoters of VIL, its long-standing track record with established operations in ice-cream business, more than a century old presence of the 'Vadilal' brand in the domestic ice-cream market supported by its strong marketing and distribution network, growing scale of operations backed by expansion in geographical reach both in domestic and export markets along with regular introduction of new flavours/variants in its product basket. The ratings also take cognizance of the management's articulation about deferment of large size debt funded capital expenditure plan which is expected to improve the leverage of the company in coming years. Further, ratings derive strength from improvement in the financial performance of VIL during FY19 (refers to the period from April 1 to March 31) & H1FY20.

The above strengths are, however, tempered on account of capital intensive nature of business resulting in relatively high leverage, susceptibility of profitability to volatile raw material prices, seasonality associated with the business and high competition in the ice-cream segment from the organized as well as unorganized segments. The ratings are also constrained due to heightened differences amongst the promoters of VIL leading to recurring instances of delay in publication of its financial results on the stock exchange in recent past, resignation of two independent directors raising concerns over the corporate governance in the company, disclaimer of opinion given by the erstwhile statutory auditor of the company in their audit report for FY19 followed by their resignation in November 2019 before expiry of the tenure of their appointment.

Rating Sensitivities

Positive factors

- Resolution of differences among promoter group and clarity on future leadership
- Growth in scale of operations along-with greater geographical diversification
- PBILDT margin above 14% on a sustained basis by managing volatility associated with raw material prices
- Improvement in capital structure marked by overall gearing below 1.00x on sustained basis

Negative factors

- Inordinate delay in resolution of differences among the promoters
- Any materially negative outcome from the on-going investigation being conducted on the basis of allegations by promoters on one another

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

- PBILDT margin below 10% on a sustained basis
- Any significant debt-funded capex which could result in weakening of its debt coverage indicators (deterioration of TD/GCA beyond 5x)

Detailed description of the key rating drivers
Key Rating Strengths
Experienced promoters
VIL was promoted by Mr. Vadilal Gandhi who started ice-cream business in 1907. Currently, the operations of VIL are managed by the third and fourth-generations of the family i.e. Mr. Rajesh Gandhi, Director, Mr. Devanshu Gandhi, Director and Mr. Kalpit Gandhi, Director and CFO (Son of Mr. Rajesh Gandhi). While Mr. Rajesh Gandhi looks after the overall operations of the company, Mr. Devanshu Gandhi looks after the sales, marketing and distribution functions. Apart from the finance function, Mr. Kalpit Gandhi looks after the plant operations on day to day basis.

Long standing track record with an over century-old brand 'Vadilal'
The brand 'Vadilal' has been enjoying a well-known legacy for more than a century in the domestic ice-cream and frozen dessert business. The brand has healthy market share in the states like Gujarat, Rajasthan, UP and Haryana. The product portfolio of VIL's ice-cream and frozen dessert includes more than 150 flavors and varieties in different forms like cups, candies, cones, kulfis, tubs, large packs, etc. Apart from ice-cream and frozen dessert, VIL also ventured into processed food business under the brand 'Quick Treat'. Further, the revenue stream is also well diversified geographically as VIL earns nearly 70%-75% of its ice-cream revenue from the states of Gujarat, Rajasthan, Uttar Pradesh and Haryana; whereas balance comes from other states.

Strong marketing and distribution network
VIL has (through VEL) has marketing presence in 23 states of India with the support of 63 C&F agents, over 1,200 distributors, more than 55,000 retailers and 290 distribution vehicles. It also offers a wide range of ice-cream and frozen desserts through nearly 300 SKUs (Stock Keeping Units) in leading modern trade outlets like Reliance Fresh, More, Hyper City, D-Mart, Food Bazaar and Star Bazaar, etc. Furthermore, VIL mainly exports its processed food product, frozen dessert and ice-cream to 45 countries across four continents, the key markets include USA, South-East Asian and European countries. During FY19, VIL registered 30% y-o-y growth in export sales.

Volume backed consistent growth in scale of operations and improvement in profitability during FY19 and H1FY20 along with steady demand outlook for ice-cream industry
The total operating income (TOI) of VIL which registered a compounded annual growth rate (CAGR) of nearly 9% on a consolidated basis during last three years ended FY19, grew by 4% during FY19 on y-o-y basis alongwith improvement in PBILDT margin by 467 bps on y-o-y basis to 14.26% on the back of increase in the sales volume in export market of its overall range of products coupled with largely stable sales realization and procurement of majority of its raw material requirement [especially skimmed milk powder (SMP)] during winter period at a relatively low cost during the said period. Further, as per the published results for H1FY20, TOI increased by 12% on y-o-y basis to Rs.410.66 crore along-with improvement in PBILDT margin by 321 bps on y-o-y basis to 22.48% on the back of volume growth and procurement of SMP at relatively low price. The growth in the sales volume was supported by geographical expansion coupled with continuous introduction of new products/flavors. Moreover, the ice-cream consumption is likely to exhibit steady growth due to changing lifestyle, growing urbanization and rise in disposable income.

Improvement in debt-coverage indicators during FY19 & H1FY20
The debt coverage indicators i.e. total debt/ GCA and interest coverage improved to 3.15 times & 5.84 times respectively during FY19 compared with 4.93 times & 3.46 times during FY18. Its interest coverage improved further to 12.18 times during H1FY20 mainly due to seasonality effect & improved profitability.

Key Rating Weaknesses
Heightened differences among the promoter group leading to instances of delay in publication of financial results on the stock exchange in recent past, resignation of some independent directors & lack of clarity about future leadership of the company
VIL published its financial results on the stock exchange for the year and quarter ended March 31, 2019 & quarter ended June 30, 2019 on August 24, 2019 post multiple instances of postponement of meetings of its Board of Directors. As communicated by the management of the company, the reason for delay in publication of its results was because of some ongoing dispute amongst the brothers in the promoter group. Because of the same, publication of results of VIL for Q2FY19 was also delayed earlier. Amidst this dispute among the promoters, in July 2019, two independent directors of VIL & VEL resigned from the Board citing hostile atmosphere in the board meetings making it impossible for them to add any value in the interest of the company. Accordingly, upon reduction of strength of independent directors, Mr. Rajesh

Gandhi also had to step down from the post of Chairman and Mr. Vijay Shah, an independent director of the company was appointed as Chairman with immediate effect to comply with the SEBI regulation of Section 17(1) of Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015. However, Mr. Rajesh Gandhi continues to be a director of the company and a part of the Board. Further, in March 2019, the board could not re-appoint Mr. Rajesh Gandhi and Mr. Devanshu Gandhi as Managing Directors of the company and resolved to look for professional management. On December 15, 2019, Mr. Yogesh Bhatt and Mr. Anil Patil have been appointed as Interim Chief Executive Officers (CEOs) of the company till the time company appoints a Managing Director.
In view of the on-going heightened differences between the promoters leading to lack of clarity on future leadership, the operational performance of the company, its essential capex plans and its market image are likely to have negative impact in short to medium term.

Disclaimer of opinion by statutory auditor in their audit report of the company for FY19 and their subsequent resignation before expiry of their tenure of appointment
The statutory auditor of VIL issued disclaimer of opinion in the audit report to the financial statements for the year ended March 31, 2019. As per the audit report, the promoter directors of the company have made various allegations and counter allegations on each other primarily relating to the operations and management of the company on a wide range of matters including potential personal expenses claimed as official expenses, funds management, dissemination of price sensitive information, demand for re-examination of books of account of past periods, legitimacy of salaries paid to relatives of the promoter directors, payments made to a vendor without services being received and independence of Independent Directors, amongst others. However, on July 22, 2019, the promoter directors have jointly communicated to the board about withdrawal of all the allegations made on each other except for the allegation with respect to claiming of personal expenses as business expenses of Rs.23.00 lakh by Rajesh Gandhi during FY15-FY19 and Rs.25.33 lakhs by Devanshu Gandhi during FY18-FY19. The statutory auditor of VIL resigned on November 15, 2019 citing concerns over the management not completing/initiating enquires/ investigations into various matters, as mentioned in the said audit report. On December 15, 2019 the Committee of Independent Directors of VIL have appointed a Law firm and a CA firm to conduct an independent enquiry/examination on the matters stated in the audit report and have also appointed a new statutory auditor w.e.f from December 13, 2019.

Relatively high leverage due to high capital intensity of the business; albeit expected improvement in leverage on account of deferment of its previously planned large-sized debt funded capital expenditure plans
Ice-cream manufacturing and distribution industry is capital intensive in nature requiring investment in production facilities, innovative products in terms of flavours and packaging, as well as marketing assets like cold storage chain, deep freezers, refrigeration equipped delivery vehicles, push card, etc. During last four years ended FY19, VIL on consolidated basis had incurred capital expenditure of around Rs.103 crore which was funded through term debt of Rs.81 crore and balance through internal accruals. Also, the seasonality associated with the business leads to high working capital utilization as on balance sheet dates. Consequently, despite improvement, the leverage of the company has continued to remain relatively high marked by an overall gearing of 1.18 times as on March 31, 2019 (1.54 times as on March 31, 2018).
In order to expand its footprints in Northern and Eastern regions of India, VIL had plans to establish new production facility in East India. Along with that the company also had plans to establish cold storage facilities near its Bareilly plant in Uttar Pradesh. The envisaged cost for these two projects was around Rs.70 crore which the company was planning to fund through term loan of Rs.49 crore and remaining through internal accruals. The execution of these two projects was expected to be spread over FY19 and FY20. However, as articulated by the company management, the said capex plans have been deferred by the company. Hence, the leverage is expected to gradually improve going forward.

Susceptibility of profitability to volatile raw material prices such as Skimmed Milk Powder (SMP) due to its linkages with international markets
The major raw materials for manufacturing of ice-cream are SMP, milk, butter and cream, which VIL procures from local dairies near its manufacturing units. The prices of key raw materials have increased gradually over the years given the rising demand and constrained supply scenario. Also, each financial year during the period from November to January, the raw material prices are at their lowest due to dynamics of dairy industry. The company focuses on procuring their entire requirement for the upcoming summer season during this period to avail the benefit of better quality raw material at lower prices. Globally, SMP prices had declined substantially from April 2014 mainly due to weak demand from one of the largest importer i.e. China along with abolition of three decade old milk production quota system within European Union (EU) countries resulting in enhanced supply. Thus, as an effect of quota abolition, the global prices of SMP remained weak on the back of oversupply. However, during FY19, post announcement of various subsidies by Government of Gujarat, Government of Maharashtra and Central Government on export of SMP, its prices have shown an increasing trend. However, in domestic market the production of milk and milk products are increasing leading to sufficient supply which is expected to keep the prices under check. Further, during FY19, VIL also earned nearly 17% of net sales from export whereas the company has no imports on the other side. Hence, VIL is exposed to adverse

fluctuation in foreign currency exchange rates. However, the company generally enters into forward cover to mitigate the forex risk to some extent.

Seasonality of demand as well as challenges arising from changing consumer tastes and preferences
The sales of VIL are normally concentrated over the summer months, reflecting the seasonality of the business. Hence, the working capital intensity is at its peak level in the last quarter of the financial year as it has to accumulate raw material inventory for meeting the demand in the upcoming summer season. The business is also susceptible to changing tastes of consumers requiring investments in fixed assets leading to highly capital intensive operations.

High competition in the ice-cream segment from the organized as well as un-organized markets
Indian ice-cream market is largely dominated by un-organized players with innumerable small and seasonal companies doing the business. Further, there are large number of big and medium-sized ice-cream companies in India which leads to a highly competitive environment. Although, there is a huge opportunity for industry players since India is one of the fastest growing countries in ice-cream production and consumption due to its large population and growing per capita income; however, VIL faces high competition from various other established brands like Amul, Havmor, Kwality Walls, Cream Bell, Mother Dairy, Top 'N' Town, Dinshaw's, etc in its various key markets. In addition, Vadilal faces competition from unorganized ice-cream manufactures at local level.

Liquidity: Adequate
VIL's liquidity continued to remain adequate as indicated from the modest average working capital utilisation of around 44% during the twelve month period ended June 2019. However, the utilisation levels remain high during peak season i.e. from October to March largely due to higher inventory requirement on the back of relatively cheaper procurement of raw materials to ensure smooth functioning of operations during the upcoming summer season. Furthermore, operating cycle of the company largely remained stable at 58 days for FY19. Current ratio continued to remain moderate at 0.99 times as on March 31, 2019 mainly due to high amount of current portion of long term debt. As articulated by the company's management, the company has made prepayment of debt amounting to around Rs.9.28 crore pertaining to FY20 during April 2019 to July 2019 out of its operating cash accruals during this period.

Analytical Approach: Consolidated
CARE had previously taken a 'combined' analytical view of VIL (Consolidated) and Vadilal Enterprises Ltd (VEL; an associate company of VIL which is separately listed); however this approach has now been changed in line with change in CARE's rating criteria whereby 'listed' companies won't be assessed on 'combined' analytical approach.
Consequently, CARE has now considered only the consolidated financials of VIL for its rating approach due to its strong managerial and operational linkages with its subsidiaries as they are either the marketing arms for the products manufactured by VIL in various geographies outside India or in related diversification. List of entities getting consolidated in VIL is placed at Annexure-3.

Applicable Criteria
Criteria on assigning Outlook and Credit Watch to Credit Ratings
Criteria for Short Term Instruments
CARE's Policy on Default Recognition
CARE's methodology for manufacturing companies
Financial ratios – Non-Financial Sector
Rating Methodology: Consolidation and Factoring Linkages in Ratings

About the Company
Ahmedabad-based VIL, which was incorporated in 1982, is engaged in manufacturing and distribution of ice-cream under the brand "Vadilal". The brand is named after Mr. Vadilal Gandhi who started ice-cream business in 1907. VIL has two manufacturing facilities for ice-cream, with combined capacity of 350,000 liters per day at Pundhra in Gujarat and Bareilly in Uttar Pradesh as on March 31, 2019. VIL also diversified into the processed food segment in 1991 and has one manufacturing facility for processed food with capacity of 46,200 MTPA at Dharampur in Gujarat. The product portfolio of VIL's ice-cream and frozen dessert includes more than 150 flavors and varieties in different forms like cups, candies, cones, kulfis, tubs, large packs, etc. Apart from ice-cream and frozen dessert, VIL also ventured into processed food business under the brand 'Quick Treat' and product portfolio includes frozen vegetables, ready-to-eat frozen snacks, Indian bread and curries, paneer and flavored milk. On a standalone basis, during FY19, VIL earned around 90% of gross sales from sale of Ice-cream and remaining 10% from processed food segment. Processed foods are mainly exported (nearly 75%).
Furthermore, VIL has also started export of ice-cream mainly to USA through its wholly owned subsidiary, Vadial Industries (Inc), USA and to United Arab Emirates (UAE) through its wholly owned subsidiary Vadilal Gulf (FZE). VIL also

provides foreign exchange consultancy services (mainly money changing service) as it is an RBI approved authorized dealer.

(Rs.Crore)

Brief Financials - VIL (Consolidated)	FY18 (A)	FY19 (A)
Total operating income	552.19	576.69
PBILDT	52.95	82.22
PAT	15.66	33.36
Overall gearing (times)	1.54	1.18
PBILDT Interest coverage (times)	3.46	5.84

A: Audited

Further, as per the published consolidated financial results for H1FY20, VIL earned a total operating income of Rs.410.66 crore and PAT of Rs.60.48 crore as against total operating income of Rs.367.60 crore and PAT of Rs.42.33 crore during H1FY19.

Status of non-cooperation with previous CRA: Rating assigned by CRISIL to the fixed deposit instrument of the company continued to remain under 'Issuer not cooperating' category vide its press release dated December 18, 2019 in absence of requisite information.

Any other information: Not Applicable

Rating History (Last three years): Please refer Annexure-2

Annexure-1: Details of Facilities

Name of the Bank Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	48.13	CARE BBB (Under Credit watch with Negative Implications)
Non-fund-based - LT-Bank Guarantees	-	-	-	5.30	CARE BBB (Under Credit watch with Negative Implications)
Non-fund-based - ST-Letter of credit	-	-	-	7.18	CARE A3+ (Under Credit watch with Negative Implications)
Fund-based - LT-Term Loan	-	-	February 2025	59.15	CARE BBB (Under Credit watch with Negative Implications)
Fund-based - ST-EPC/PSC	-	-	-	9.54	CARE A3+ (Under Credit watch with Negative Implications)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Cash Credit	LT	48.13	CARE BBB (Under Credit watch with Negative Implications)	1)CARE BBB (Under Credit watch with Negative Implications) (26-Sep-19) 2)CARE BBB (Under Credit watch with Negative Implications) (22-Aug-19) 3)CARE BBB+ (Under Credit watch with Developing Implications) (10-Jun-19)	1)CARE BBB+; Stable (12-Sep-18)	1)CARE BBB+; Stable (28-Aug-17)	1)CARE BBB (21-Sep-16)
2.	Non-fund-based - LT-Bank Guarantees	LT	5.30	CARE BBB (Under Credit watch with Negative Implications)	1)CARE BBB (Under Credit watch with Negative Implications) (26-Sep-19) 2)CARE BBB (Under Credit watch with Negative Implications) (22-Aug-19) 3)CARE BBB+ (Under Credit watch with Developing Implications) (10-Jun-19)	1)CARE BBB+; Stable (12-Sep-18)	1)CARE BBB+; Stable (28-Aug-17)	1)CARE BBB (21-Sep-16)
3.	Non-fund-based - ST-Letter of credit	ST	7.18	CARE A3+ (Under Credit watch with Negative Implications)	1)CARE A3+ (Under Credit watch with Negative Implications) (26-Sep-19) 2)CARE A3+ (Under Credit watch with Negative Implications) (22-Aug-19) 3)CARE A2 (Under Credit watch with Developing Implications) (10-Jun-19)	1)CARE A2 (12-Sep-18)	1)CARE A2 (28-Aug-17)	1)CARE A3+ (21-Sep-16)

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
4.	Fund-based - LT-Term Loan	LT	59.15	CARE BBB (Under Credit watch with Negative Implications)	1)CARE BBB (Under Credit watch with Negative Implications) (26-Sep-19) 2)CARE BBB (Under Credit watch with Negative Implications) (22-Aug-19) 3)CARE BBB+ (Under Credit watch with Developing Implications) (10-Jun-19)	1)CARE BBB+; Stable (12-Sep-18)	1)CARE BBB+; Stable (28-Aug-17)	1)CARE BBB (21-Sep-16)
5.	Fund-based - ST-EPC/PSC	ST	9.54	CARE A3+ (Under Credit watch with Negative Implications)	1)CARE A3+ (Under Credit watch with Negative Implications) (26-Sep-19) 2)CARE A3+ (Under Credit watch with Negative Implications) (22-Aug-19) 3)CARE A2 (Under Credit watch with Developing Implications) (10-Jun-19)	1)CARE A2 (12-Sep-18)	1)CARE A2 (28-Aug-17)	1)CARE A3+ (21-Sep-16)

Annexure-3: List of entities getting consolidated in VIL

Sr. No.	Name of the Entity	Subsidiary / Associate / Joint Venture	% Shareholding by VIL as on March 31, 2019
1.	Vadilal Industries (USA) Inc	Subsidiary	100.00
2.	Vadilal Industries Pty Ltd.	Subsidiary	100.00
3.	Vadilal Gulf (FZE)	Subsidiary	100.00
4.	Vadilal Cold Storage	Subsidiary	98.00

Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

Contact Us

Media Contact
Mr. Mradul Mishra
Contact No.: +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Mr. Hardik Shah
Contact No.: +91-79-4026 5620
Email ID – hardik.shah@careratings.com

Relationship Contact
Mr. Deepak Prajapati
Contact No.: +91-79-4026 5656
Email ID – deepak.prajapati@careratings.com

About CARE Ratings:

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Disclaimer

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Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

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