Rating Methodology – Project-Stage Companies

[In supersession of "Rating Methodology for Project-Stage Companies" – issued in February 2020]

Background

Project implementation encompasses different types of projects undertaken, e.g., Infrastructure (Road, Power, Port, etc.), Urban infrastructure (Irrigation, Metro Rail, Stadium, etc.) and Industrial projects (setting up facilities for manufacturing different goods, viz., Cement, Fertiliser, Consumable food and drink, Chemicals, Automobiles, etc.). CARE has developed separate rating methodologies for different types of projects under sub-sectors of Infrastructure separately and also for Urban Infrastructure Projects (refer our website www.careratings.com). This paper explains broader aspects considered while rating Project-stage companies in the industrial sector.

CARE Ratings has a standard methodology for the rating of companies belonging to the manufacturing sector. Furthermore, CARE Ratings has also developed methodologies specific to various industries within the manufacturing sector. For operational companies, the sector-specific methodologies are applicable. This methodology describes various factors that are considered by CARE Ratings while evaluating project-stage manufacturing companies. This is not an exhaustive description of all factors that are considered, but this methodology explains the qualitative and quantitative factors that are important for rating such project-stage companies.

This methodology is applied to the project-stage manufacturing companies. The operational cash flows from such project assets are expected to service its debt obligations. The ratings get constrained due to inherent risk associated with construction, funding and stabilization. So, these ratings are generally not placed at the higher end of rating scale.

Rating methodology:

The various risks which are assessed when the entity is under project implementation phase are as under:

I. Promoter and Management Risk

- Financial strength of the promoter group: The promoter group having strong financial and credit profile is viewed positively as it is expected to support the project in timely way during construction and also at the stabilization stage.
- Operational linkage with promoter: If there are direct forward or backward linkages of the project with the existing operations of promoter entities, it underscores importance of the project for the promoter entity and hence considered positively.
- Experience of executing similar project in past: Experience in similar sector adds to the comfort; however, any unrelated diversification is examined from long-term strategic perspective and support by the promoter group.

- Key management team: Project execution team with relevant sector expertise provides comfort for smooth implementation. CARE Ratings looks into details of key management team.

II. Construction risk

- Physical Status of project: The status of land acquisition, availability of resources like water, power, arrangements for pollution control are looked into. The construction status and progress is driven by mobilization of adequate manpower and machinery for the same. Any cost and time overruns are viewed negatively.
- Status of Statutory clearances: The availability of all statutory clearances or advanced stage of the same is viewed positively.
- EPC Contractor: The relevant track record of contractors and also favourable credit profile provide comfort on timely execution of the project.

III. Financial risk:

- Reasonableness of project cost with respect to benchmarks is taken in consideration. CARE relies on viability reports prepared by third parties, wherever available.
- Extent of financial closure, tie-up of funds: The projects with full or substantial financial closure are seen positively.
- Visibility with respect to timely infusion of equity: The status of equity already infused and resource raising capability of the promoters to fund required balance equity in timely manner is considered. Sometimes, equity is proposed to be raised through capital market. Due to uncertainties of capital markets, tie up of equity is viewed with caution till it is actually raised.
- Project leverage: proposed funding mix: CARE Ratings looks into these to see whether the same are comparable to similar other projects; wherever available.
- Project DSCR: The projects which are able to generate sufficient operational cash flow to service its debt obligations comfortably are seen positively. CARE Ratings considers stressed DSCR after considering negative deviations with respect to various assumptions underlying the project cash inflows.

IV Industry risk

- Demand Supply position: The market or industry data are examined to assess revenue visibility post completion of the project to the extent possible. The nature of the product to be manufactured and extent of competition for the same is analysed.

- Technology: CARE relies on third-party reports wherever available for technological assessment. A long-standing commercially proven technology minimizes the risk of stabilization, whereas new technologies which are yet to be commercially proven increase the risk of project stabilization and operations.

V Business Risk

- Location: Geographical location of the project is taken into consideration. Proximity to raw material or market, existing facilities of the promoter group company with which forward or backward linkages are proposed, provides comfort.
- The ability of the company to stabilize operations and generate envisaged realisations / cash flows is considered in the post project implementation period.

The rating process is ultimately an assessment of the fundamentals and the probabilities of change in the fundamentals. The rating, however, does not factor any force majeure events that may lead to cash flow mismatches. The rating determination is a matter of experience and holistic judgement of the Rating Committee, based on the relevant quantitative and qualitative factors affecting the credit quality of the issuer.

[Reviewed in January 2021. Next review due in January2022]

CARE Ratings Limited
4th Floor, Godrej Coliseum, Somaiya Hospital Road,
Off Eastern Express Highway, Sion (East), Mumbai - 400 022.
Tel: +91-22-6754 3456, Fax: +91-22- 6754 3457, E-mail: care@careratings.com