



Credit Rating Information and Services Limited

Credit Rating Methodology – Readymade Garments (RMG)

Meaning of Credit Rating

CRISL defines credit rating as a measure of assessing the relative risk of default and the severity of default associated particular securities issue, issuer and/or other financial assets. It is a symbolic indication of the current opinion of the relative capability of timely servicing of the debts and obligations as per the terms of the contract. It is an independent, impartial best judged professional OPINION on the ABILITY and WILLINGNESS of a borrower to discharge its debt when due, in case of a debt instrument and assessment of net worth, external liability and earning prospects in case of a corporate Entity.

Rating agencies are perceived as impartial, professional and best judged opinion giving agencies in the investment process to safeguard the interest of the general investors. The rating reflects neutral and influences free professional opinion on the assessment of credit risk associated with an instrument or a corporate. The rating services provide a guideline to the investors as to the degree of certainty of payment of principal and interest in case of the debt instrument and the degree of acceptability of the net worth and earning prospects of an entity seeking public finance.

CRISL follows the standard definition of ratings in line with the global rating agencies. It follows a ten notch scale with AAA being the highest while the lowest rating D reflects default in discharging its liabilities in time. With the addition of plus (+) and minus (-) signs before the scale, the 10 notch scale reflects 26 positions. These plus and minus signs indicate the position of each rating in the scale. The rating scales along with the definition are enclosed at the end of the report.

Scope and Limitation of Credit Rating

CRISL ratings are in local currency and therefore, it does not take into consideration the sovereign risks and foreign currency risk of Bangladesh. CRISL being a domestic rating agency of Bangladesh considers the government of Bangladesh as the highest paymaster and all government-guaranteed securities are considered as AAA.

CRISL issues to types of rating for the manufacturing corporate namely Entity Rating and debt instruments. Entity rating reflects the ability and willingness of an entity to discharge its debt obligation when due. It also reflects earning prospects and an increase in share holder's value in the long run. The debt instrument rating reflects the inherent features and structures and extent of credit enhancement compared to unsecured creditors. It also reflects all associated risks that may affect the instrument throughout its life.

The RMG Credit rating report has been prepared based on audited report/ management report along with information provided by the sponsors and responsible persons of the Banks/NBFIs regarding related documentation, procurement process, revenue, operational and financial expenses along with related margin, risk and its hedging policy, prospect and business strategy of the entity. Visited information has been collected through verbal discussion with the client as well as responsible persons of the Banks. Visited information is taken into consideration as reported data cannot always be justified thoroughly by the bank's current account statement and loan account statement but industry information and

information available with CRISL are also a factor. CRISL carried limitations in the form of documentation, shortage reporting deadline and partial co-operation by the clients. CRISL places its opinion keeping under consideration the above limitation of scope.

Time Horizon

CRISL ratings are forward-looking and sustainable throughout the normal business cycle. CRISL issues normally two types of ratings – short term and long term. Short term rating carries the validity of six months while the long term rating is valid for one year. The change in the economic scenario, complexities and change in government policy may have an impact on the ratings assigned over a period of time. CRISL updates the rating periodically with the cooperation of the client. If the client is not willing to cooperate, CRISL withdraws the rating after due notice to the client. Therefore, CRISL rating is to be read with the time.

Definition of Default

CRISL adopted the international definition of default as being adopted by global rating agencies. Under the above definition, Default is:

- A) A missed installment (Principal and or Interest) which has not been discharged / paid as per schedule or within the grace period allowed by the regulators/ creditors.
- B) Failure to honor the corporate guarantee obligations as per contract or within the allowed grace period;
- C) The legal insolvency or bankruptcy of the issuer/ entity
- D) A distress exchange in which the bondholders/ creditors are offered a substitute instrument with inferior terms and conditions
- E) Restructuring of a financial obligation substantially disadvantageous to the creditors;

Industry Structure

Bangladesh has established itself as a trusted global hub for apparel sourcing, with more than 150 countries importing ready-made garments (RMG) from the country. Its 40 years of experience in the industry, competitive pricing, low-cost workforce, strong backward linkages, quality assurance, and commitment have positioned Bangladesh as the world's second-largest RMG exporter after China. The sector employs over 4.5 million people—approximately 2.7 million women and 1.8 million men—and contributes 10–12% to the national GDP, making it the single largest contributor.

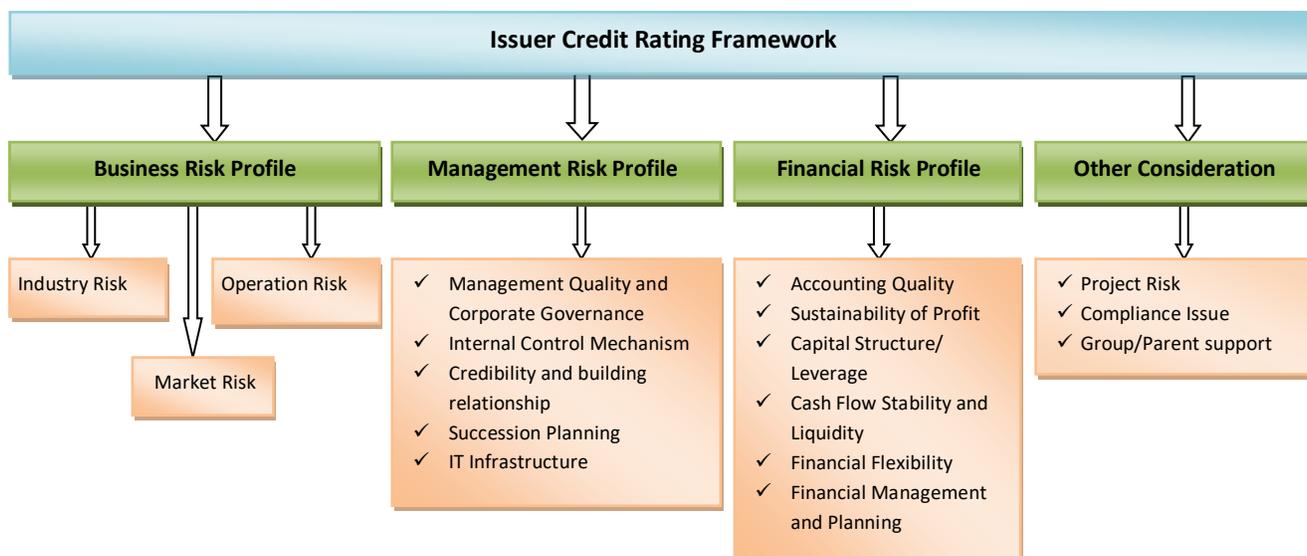
Sustainability has become a hallmark of the industry. Bangladesh now has 249 LEED-certified green factories accredited by the US Green Building Council (USGBC), including 105 Platinum, 132 Gold, and 12 Silver. Among the world's top 100 highest-rated LEED-certified factories, 68 are located in Bangladesh, while another 500 factories are in the pipeline for certification. Furthermore, landmark initiatives such as the Accord on Fire and Building Safety, the Alliance for Bangladesh Worker Safety, and the RMG Sustainability Council have transformed the industry into one of the most transparent and compliant in terms of workplace safety and value-chain responsibility.

Entrepreneurs seeking to establish an RMG business in Bangladesh must obtain approvals and licenses from relevant authorities under various Acts and rules. These include permits from the Ministry of Land, Ministry of Power, Ministry of Environment and Forests, and Ministry of Labor and Employment to ensure compliance with environmental and labor regulations. Additional approvals from bodies such as the Ministry of Commerce, BGMEA, BKMEA, National Board of Revenue, and Bangladesh Bank are also required.

Over the past 41 years (1983–84 to 2024–25), Bangladesh’s RMG export sector has maintained a strong Compound Annual Growth Rate (CAGR) of 19%. The industry’s forward linkage is broadly divided into two segments: knit and woven. During the last 32 years, knit exports have achieved a CAGR of 15.6%, while woven exports grew at 8.75%. In FY2024–25, the knitwear segment posted a 9.73% year-on-year growth, and the woven segment grew by 7.82%. Notably, around 73% of Bangladesh’s RMG exports last fiscal year were cotton-based, highlighting the sector’s heavy reliance on this raw material.

Rating Methodology

To ensure meaningful ratings, CRISL evaluates a wide range of qualitative and quantitative factors through rigorous analysis. To minimize bias, qualitative aspects are often translated into quantitative measures, which also facilitate back-testing of methodologies. The quantitative assessment covers historical and projected financials, profitability levels, capacity utilization, capital expenditure requirements, cash flow adequacy, debt-servicing capacity, free cash flow, and time-series analysis. For consistency, financial statements are recast to align ratios and analytical indicators with the relevant time horizon. Ultimately, CRISL’s rating framework groups all considered factors into four broad analytical risk categories: Business Risk Profile, Management Risk Profile, Financial Risk Profile, and Other Considerations.



A. Business Risk Profile

a) Industry Risk

1. Regulatory Framework

The regulatory framework has a direct impact on the RMG industry and to the firms operating under the industry. The regulatory framework of the industry in most cases are dictated by the government industrial policy, annual budgetary framework and measures including tax holidays, cash incentives, labor laws, environmental compliance issues and even by the import policy of the government. In countries like Bangladesh, these policies are very unstable. There are instances that many good industrial units fell sick due to a change of government policy allowing the import of the products at a cheaper price without due protection to the industries. The regulatory environment of the country sometimes also been influenced by external factors such as RMG buyers' requirements from abroad through compliance issues, price issues, WTO Commitment of the government, etc.

2. Size, Age and Contribution of the Industry

The size of the industry on the economy and the size of the companies operating under the industry play an important role in analyzing long term and long term viability. Bangladesh's ready-made garments (RMG) industry is the second largest in the world (\$39.35 billion export in FY2024-25), accounting for more than 80% of the country's export revenue. Large companies have greater tenacity and staying power due to their extensive resource base and stronger shields resulting to enjoys broader market access, larger market share in the global and local level, strong marketing network, franchise value through compliance and quality delivery within the scheduled time frame which ultimately assist the company's long term viability.

3. Industrial Cyclical

Cyclical companies are manufacturing units, whose sales volumes fluctuate with macroeconomic conditions, requiring varying levels of resources across different phases of the cycle. In its analytical framework, CRISL takes into account both the peaks and troughs of these cycles, assigning appropriate weight to each stage to ensure ratings remain consistent through the cycle. As a result, CRISL's ratings are inherently forward-looking. Typically, firms in cyclical industries build cash reserves and maintain buffers during boom periods to ensure smooth operations during downturns.

4. Growth Potentials

The growth potential of a firm vis a vis its industrial growth plays an important role in CRISL analytical rating framework. The industry life cycle such as the introductory stage, growth stage, maturity stage and sunset stage, all deserves a weightage in the analysis. However, the above potential is always reviewed in the context of future risk potentials. Again the matured industries

are not over risk-weighted because of maturity rather the factors such as business stability get due to priority vis a vis its other peripheral factors.

5. Vulnerability

The vulnerability of the RMG industry through controllable and uncontrollable factors is acknowledged in the analytical framework of CRISL. Also, the degree of sensitivity of demand to the economic cycle, changes in government policies such as import policy, industrial policy, tariff policy, etc are the key elements to be considered in rating an industrial unit. The volatility of prices of raw material may also create a vulnerable situation for the industries. The political influence on the trade unions affecting labor-intensive industries such as garments is susceptible to vulnerability.

6. Entry/Exit barrier

Strong restriction on the new entrant in the industry protects the interest of the existing companies and ultimately poses a threat to survival or profitable operation. However, CRISL considers that the strong prohibition factors such as huge capital outlay, creation of franchise value, and brand image of the products needing time, Government restriction, distribution network, etc. Entry/Exist barriers of this industry are comparatively easy but significant capital investment is to be required for composite knit and woven garments.

7. Competitive intensity

As the RMG manufacturing units, this industry is highly fragmented in price but more specific in quality delivery with a scheduled time frame. For the trading industry, the sectors are restricted to the pricing ability and maintain a moderate level of quality. While given the low cost of production and sufficient availability of raw material, knit garments factories are enjoying sizable support from local yarn and fabric companies. But for woven manufacturing and export, Bangladeshi garments preferred buyer choice for raw materials.

b) Market Risk

1. Size and age of the Business

The size and age of the organization play an important role in deciding on the competitiveness of a company. The size of an organization assists in achieving economy of scale, determining economic order size, cost efficiency and thereby lowering the unit cost of production. The size of an organization also justifies the research expenditure (which are minimum in most of the Bangladeshi companies) and capital intensive equipment and effective distribution channel. However, the size of an organization does not always speak for the advantages mentioned above. In a highly fragmented industry like RMG, price leadership goes with the quality of product with the compliant factory and not by the size of the organization. Again the age of the business is also an important factor to have an understanding of the foundation of the entity. Generally, CRISL gives mentionable weight age to an entity having long business operations compared to a new entrant.

2. Diversification- Products, Brands, Customer profile/Sales channels and geographies

In highly competitive RMG industries having a frequent change in technology, product diversity and scope of switchover to other alternative products with small or no cost is considered to be a favorable point in the overall rating process. In the rating process, diversity is considered to be a mitigating factor against concentration risk. CRISL duly factors the companies having more product lines are always preferred to the companies dependent on a single product or product line.

- **Products/ Segments**

Major RMG products that are being exported include Trousers, T-shirts and knitted shirts, Sweaters, Shirts and Blouses. Among these major products, Trousers, T-shirts and knitted shirts, Sweaters, Shirts and Blouses recorded YoY 8.85%, 10.51%, 6%, 3.82% and 6.40% growth.

A wide product portfolio, which caters to demand across target markets, seasons and end-user categories, is a credit positive for an apparel entity as it minimizes the seasonality and volatility in sales. The ability to alter its product mix by interpreting the market trends plays an important role in determining its market positioning and helping it maintain its market share and customer loyalty, in an intensely competitive scenario.

- **Brands**

CRISL evaluates brand diversification for RMG companies by examining the contribution of the largest brand(s) to the entity's overall sales mix. An entity with a wide range of brands but without any brand of significant scale may indicate a weak market presence, leaving it exposed to intense competition from fragmented or unbranded segments. Conversely, CRISL views a well-diversified brand portfolio—comprising several brands with strong recall value and meaningful market share—as a positive factor in the rating assessment. Major global garment buyers include H&M, Wal-Mart, Li & Fung, Adidas, Levi's, VF Asia, Nike, GAP, Tesco, C&A, Target, ASDA, Next, Zara, Puma, among others.

To evaluate brand strength, CRISL analyzes revenue growth trends in both volume and value terms. These growth patterns are reviewed alongside profitability levels and compared with industry peers. Volatile sales performance coupled with low profitability indicates relatively weaker brand strength, while consistent sales growth supported by stable or improving profit margins signifies relatively stronger brand strength.

- **Customer profile/ Sales channels**

CRISL duly considers the entity's ability to source orders directly from customers as a positive factor, as it reflects the manufacturer's capability to deliver products promptly and maintain consistent quality. Direct sourcing also enhances the opportunity to secure repeat orders, unlike orders received through buying houses, where the discretion to place purchase orders rests with the intermediary.

A diversified sales channel—comprising both direct customers and buying houses—and a broad customer base are viewed as positive attributes in the rating assessment. Such diversification safeguards the manufacturer against adverse developments affecting any single major customer, as dependence on one buyer can significantly impact sales if demand declines. High sales concentration with a single large or geographically limited customer also constrains market diversification. Furthermore, customer concentration may lead to receivables concentration, where any financial weakness of the major customer could adversely affect the manufacturer’s receivable position.

CRISL also evaluates customer satisfaction to assess an organization’s market sustainability and growth prospects. This assessment includes factors such as the average duration of customer relationships, frequency of repeat orders, and product rejection rates.

- **Geographies**

CRISL also considers the concentration risk towards a particular export market. Exports to a diversified set of countries can protect against adverse outcomes like trade regulations (such as import duty or import restriction) or a decline in demand or reductions/removals of export incentives for exports to a particular country. The Government of Bangladesh offers 4% incentive facilities for the non-traditional market and 1% for traditional markets.

3. Market Competition

To survive in the competition, the cost efficiency in the production and quality of products at competitive prices is essential. Presently competitive advantages are being created through sound infrastructure build-up and supply chain which are given due weight in the analytical process.

C) Operational Risk

1. Production Facilities

Plant facilities, technology and plant location are the major contributory part in analyzing the production facilities in the manufacturing entity. The location of an export-oriented company in the export processing zone or near to that or access to easy communication is considered to be advantageous while the location of a company requiring heavy raw material or selling heavy products on the port side or riverside involving cost-effective transportation is considered to be a positive factor. Buyers are getting preference for green field garments factory to place more orders than non-compliant factory and CRISL is the due preference for a rating decision. Excess to low-cost utility facilities such as gas, water, and electricity is given due weight age.

Whether a particular factory has sufficient power support or a shortage of electric support? Whether diesel-based or gas-based generators are properly working and its cost efficiency? To smooth the production facilities, whether required gas pressure is available or not? Whether Effluent Treatment

Plant (ETP), Water Treatment Plant (WTP), and Boiler are properly functional or occasional running? Whether such facilities are structurally covered or maintain properly? CRISL considers all the factors connected with utility and cost-efficiency. In Bangladesh, per unit cost of utility (especially gas and electricity) are increasing trends and how the entity is managing the production cost? This factor is duly considered at the time of rating.

2. Scale and Capacity Utilization Level

For garments-manufacturing entities, large capacities offer flexibility to supply larger orders (while retaining the flexibility to supply smaller orders) across multiple products, hence improving the ability to deal directly (rather than dealing through buying houses/aggregators) with large reputed domestic and international customers. Large-scale operations are also characterized by more diversified operations in terms of the customer base as well as geographies, which could be difficult to achieve at a smaller scale. However, given the labor intensity of the sector, large units can also face challenges related to manpower issues, such as strikes, labor unrest, etc. In considering the fact, CRISL also considers whether the entity follows the timelines for product delivery and penalties for delayed deliveries.

3. Level of Integration with Research and Development

The entities which have strong backward and forward integration into fabric manufacturing carry better weight age in rating rather than only produce in-house RMG product with outsourcing backward and forward integration. Backward integration largely depends on manufacturing yarn through spinning mills, weaving, and knitting, dyeing for fabrics manufacturing and forward integration are supported by washing and accessories industries.

With backward and forward integrated operations, an entity can capture a larger share of the value addition, leading to higher profitability. Also, the captive availability of fabric/yarn can also provide better control over the quality, apart from savings in other costs such as transportation, packing, and sales commissions.

CRISL examines the entity's ability to develop new products to serve changing needs or to acquire new domain knowledge. There is limited factory available in Bangladesh, who has performing actively for R&D activities. CRISL also studies the quality of the R&D activities, annual R&D spend, and the adequacy of the company's R&D facilities.

4. Performance Efficiency

CRISL evaluates performance efficiency by analyzing key performance indicators (KPIs) against attainable standards and actual achievements. It also assesses the reasons behind any significant deviations. The major KPIs considered include Worker Efficiency (%), Worker Absenteeism (%), Worker Turnover (%), Monthly Order Frequency, Non-Productive Hours (average per day), Defect Rate (%), Defective Hour per Unit (DHU), Wastage (%), Machine Efficiency (%), Man-to-Machine Ratio (%), Cut-to-Ship Ratio (%), and Short Shipment (%), among others.

CRISL reviews these indicators to identify bottlenecks related to manpower, machinery, and materials, and communicates with management to understand how sustainable performance is being ensured. These KPIs are interrelated and collectively influence both operational and financial efficiency. For instance, high worker absenteeism or turnover generally leads to reduced efficiency, resulting in increased wastage and defect rates.

CRISL also seeks to determine the underlying causes of performance variances through professional skepticism and analytical judgment, assessing management's corrective measures and their effectiveness in achieving desired performance outcomes.

5. Availability of Raw Materials

The availability of raw material either from the local market or export market plays an important role in the rating process. In case of local supply, the supply chain, sufficiency in terms of quality, no of suppliers, seasonality, price fluctuation, lead time and the case of import, additional factors such as import policy, the government duty structure, import restrictions, cash incentive considerations all plays important role in the CRISL analytical process.

6. Cost Structure

Cost structure plays an important role in industrial production. CRISL classifies the cost into direct material, direct labor and overhead. Again cost accumulation and its allocation to various products through job order costing system, or process cost system is reviewed to arrive at a meaningful cost-efficiency analysis. Product-wise contribution margin cost inefficiency arising out of unplanned expenditure, peer comparison cost, labor availability, labor sensitivity, cost components, direct cost as a percentage of overall cost, all are reviewed in the rating process.

A detailed cost structure analysis is also done. The RMG industry is raw material and labor-intensive with the fabric (raw material) cost accounting for ~60 to 65% of the total revenues and other manufacturing expenses (like general and administrative expenses, selling and distribution cost are accounted for ~20 to 25%. All the above costs, together, account for ~85-90% of the total revenues. Given the cost-intensive nature of the industry, the ability to control the costs at all levels becomes critical for the overall profitability of the entity.

7. Credit Controls

Credit control policies and their effectiveness play an important role in the liquidity management of the manufacturing companies. It is more particularly important when a company has been manufacturing for the local market. In order to maintain a cash operating cycle to order for raw materials, payment of labour and factory operation, the companies require cash constantly from the business cycle. In the case of export-oriented manufacturing companies, the Status of payment terms of the export LC vis avis back to back LCs needs review to assess the funding mismatch.

8. Inventory Management

The RMG industry is working capital intensive, primarily on account of the high inventory levels. The inventory levels for the entities involved in apparel manufacturing are on account of the long manufacturing cycle, which involves multiple processing stages, starting from order-backed fabric stocking, processing and stitching to finished apparels in transit to port/customers or awaiting shipment, pending the completion of the entire lot size.

Inventory management plays a vital role in the working capital management of manufacturing companies. Excess inventory increases the holding cost and thus increase the working capital need while inadequate inventory leads to production stop or excess production cost. CRISL reviews inventory planning, supply chain management, lead time, economic order quantity etc in addition to the risk of getting the finished products out of fashion, risk of expiry date etc.

B. Management Risk Profile

1. Management Quality and Corporate Governance

Corporate governance is a blend of law, regulations, enforcement and appropriate voluntary practice by the organizations that permit a corporate to attract capital, perform efficiently and generate long-term economic value for its shareholders while respecting the interest of its stakeholders and society as a whole. The specific areas covered are the composition of the Board, the formation of Committees, transparency in disclosure of relevant, reliable financial and operational information, information on ownership and control and information on internal processing of management. Experience of the promoter and management in the line of business, the risk appetite of the promoter/ management and risk mitigation plans, entity's policies on leveraging, leveraging, interest risks and currency risks, entities plans on new projects, acquisitions and expansions are the key factors to be considered.

Although the Memorandum of Association of the company contains a large number of objectives, the company normally pursues one or two main objectives based on which the MISSION and VISION Statements are prepared to determine the corporate goals. Companies operating based on certain corporate goals as reflected in operating activities.

2. Internal Control Mechanism

Adequacy of the internal control systems to the size of the business is closely examined. The existence of proper accounting records and control systems adds credence to the accounting numbers. Management information systems commensurate with the size and nature of business enable the management to stay tuned to the current business environment and take timely, judicious decisions. Existence of Internal Audit Department and duly submitted to internal audit report to management and course of action undertaken as per audit observation are all factors for rating consideration.

3. Credibility and building relationship

Credibility, to a great extent, may be reflected in its franchise value and public perception in the market. However, to identify the willingness of the company to discharge liability in time, CRISL philosophy is to see the corporate environment prevailing in the organization vis a vis the strategy

being followed to achieve the corporate goals through managing its diversified business. Besides, corporate policy to the management of conflict of interest, handling inter-company transfer pricing, and inter-company transactions also reflect the credibility of the organization and its system. In addition to the above, the banking relationship plays an important role to judge the credibility of an entity. CRISL carefully looks into all the exposures of the entity enjoyed from the bank/FIs along with the length of the relationship. CRISL also reviews the utilization limit of credit facilities. Besides, the personal deposit of the key sponsors, if there is any, are also taken into consideration. While reviewing the credit facilities, CRISL also looks into the present status of the same along with past performance.

4. Succession Planning

The succession plan is the key indicator of a corporate philosophy that an organization is a going concern, and it has an unlimited life as well as its viability will not be affected by the departure of any individual professional. To reduce the dependency on single/few individuals, a succession plan in a corporate reflects the management idea of business management continuity and its succession. CRISL, while reviewing the management philosophy, takes into consideration the above factor. Besides, through the succession plan, the visibility of family management vs professional management becomes more prominent.

5. IT Infrastructure

The extent of Information technology and communication infrastructure installation and the extent of its use in the production and product management, cost management, inventory management, human resource management play an important role in managing an organization. CRISL reviews the process with due importance to the above factors to ascertain the competitiveness in both local and international market. CRISL also consider the facilities associated with in-house software or ERP along with backup facilities of data.

C. Financial Risk Profile

Every business decision ultimately leads to a financial decision. While the financial risks are the outcome of the business risk and activities, CRISL reviews the same from the perspective of short-term and long term financial planning and projections vis a vis financial flexibility to meet emergency financial need. CRISL generally reviews the audit reports to ascertain as to its reliability from various perspectives. However, in many cases CRISL reviews the financial statements from the view point of cash flow trend, management reports, peer analysis based on quantitative production/activity reports. Quality of audit and auditors comfort level, audit qualification, management report of the auditors, application of international accounting standards in accounting plays an important role in CRISL financial analysis.

1. Accounting Quality

CRISL relies on a company's audited financial statements to analyze its financial performance during the rating process. In some cases, if audited report are not provided by the client, CRISL also consider the management report. The financial ratios and statements used by CRISL to analyze a company's financial performance are derived from the audited financial statements. CRISL consider the some key areas like overstatement or understatement of profits, method of income recognition and depreciation, inventory valuation policies, off-balance-sheet items/contingent liabilities and similar factors, etc. Consequently, CRISL commences its financial risk analysis by assessing the company's accounting quality.

Wherever required, analytical adjustments are made and the company's financial statements are recast to reflect an accurate picture of its true financial position. This is essential for an accurate assessment of the company's financial performance vis-à-vis its peers. The rating will be adversely impacted if the entity cannot provide acceptable reasons for a material qualified opinion since the reliability of the financial statements will be questioned.

2. Sustainability of Profit

CRISL evaluate sustainability of profit in consideration of year on year financial indicators like Return on Average Assets (ROAA), Return on Average Equity (ROAE), Net Profit Margin (%), and Operating profit to Operating Assets (X)

Although the absolute profitability figures such as Earning (profit) before Tax, interest, depreciation and Amortization (EBITDA), Return on equity, return in investment, cash incentive etc, CRISL puts due weight to profitability indicators, profitability trend vis a vis industry norms, position of a particular company in the peer. CRISL also takes note of the growth plans of the entity and its likely impact on the financial position in future.

3. Capital Structure/Leverage

The funding structure of an organization may have an impact on its cash flow and mismatch is cash generation. CRISL places due to importance on the financing pattern of long term and short term assets vis a vis the short term and long term debts. For example, if the long term investment in machinery is financed by a working capital loan or short term finance it may seriously affect the cash flow of the company. The companies having excessive short term debts may face cash shortage in meeting its obligations in the volatile economy. Besides, the dependence of the company on financial intermediaries such as leasing companies for short term funds may also face liquidity problems in the economic volatile situation. CRISL also ties up the asset life with its financing pattern. Any machinery purchased through lease must not have any repayments after the machinery life is exhausted.

CRISL evaluated the performance of leverage or capital structure by consideration of debt to equity, debt to total assets, and debt to EBITDA, debt service coverage ratio, interest coverage ratio, cash flow coverage ratio, and operating cash flow to finance debt.

The capital structure of an organization varies from industry to industry. Capital intensive industries require high leverage while the labor-intensive industries work at low leverage. CRISL identifies industrial norms in respect of debt equity ratio, coverage ratios, overall gearing ratio, interest coverage ratio, debt servicing coverage ratio to measure the degree of leverage. CRISL also reviews the off-balance sheet assets and liability items such as guarantees, LCS together with BB LCS to ascertain its leverage.

Entities that pursue an aggressive financial policy, including heavy reliance on debt financing, are likely to be more vulnerable to downturns than entities that have a lesser degree of financial leverage in their business.

As detailed earlier, the fixed capital intensity is driven by the business model adopted by the entity, whereas the working capital intensity is generally high, thereby keeping the funding requirements high. As a result, the overall leverage can vary from player to player. For entities with in-house manufacturing, the Central (under TUFS) and the state governments provide various incentives such as capital as well as interest subsidies on the bank term loans for setting up of the manufacturing units, thereby reducing the cost of debt funding.

Any history of past defaults in meeting interest and principal repayment obligations reduces the comfort level for the entity's future debt-servicing capability. CRISL factors in the entity's ability to honor its debt obligations even during periods of cyclical stress.

4. Cash Flow Stability and Liquidity

The cash flow of a company plays a very important part in CRISL assessment procedure. CRISL in many cases reads the Financial Statements with due emphasis to cash flow. Stable cash flow provides the comfort of judging the capability of the company to discharge its liabilities while free cash flow predicts the company's ability to go for expansion or loan repayment capacity or business growth.

Liquidity measures an entity's capacity to meet its short-term cash obligations using both internal and external resources. Internal resources include cash flow from operations, unencumbered cash and cash equivalents on the balance sheet, expected cash inflows, and proceeds from the monetization of physical or financial assets. External resources comprise undrawn credit lines and equity capital.

Short-term obligations cover both committed and contingent cash outflows, such as debt-servicing requirements, working capital needs, capital expenditures, other investment commitments, dividend payments, and share buybacks, as well as unexpected demands arising from events like litigation penalties.

CRISL also assesses liquidity through key financial indicators, including the current ratio, quick ratio, inventory turnover days, receivable turnover days, payable turnover days, and asset turnover days, among others. A higher cushion between available resources—particularly internal resources—and short-term obligations indicates a stronger liquidity profile.

Also, for liquidity assessment, CRISL compares fund-based working capital limit utilization with sanctioned fund-based working capital limits or drawing power, whichever is lower and assesses the cushion available in working capital limits. Since drawing power is also driven by inventory valuation (higher valuation leading to higher drawing power), hence it is also seen with the realizable value of inventory, especially for the old unsold stock from season leftovers, as detailed earlier.

In addition to inventory-holding requirements, the level of working capital for an apparel entity is also driven by the receivables position. Apart from the overall receivables position, the receivable aging analysis (its comparison with eligibility for drawing power) and receivable concentration towards a few entities are also analyzed to assess the quality of receivables. For export receivables, credit risk mitigates such as the Letter of Credit (LC) or the export credit risk insurance is also taken as comfort factors.

5. Financial Flexibility

Liquidity is the key to judge the short term financial flexibility of a company. Besides the franchise value of the company to borrow quick fund from the market, relationship with the financial institutions, level of financial limits allowed by the banks and its utilization level, perception of the financial institutions for funding projects under the company, cash operating cycle, etc provides wider coverage to the CRISL analysis. CRISL also considers the primary security (Whether securities are fully pledged/hypothecated/ cash coverage or not capable to provide security), collateral (whither registered mortgage with prime location or without prime location). Besides, CRISL also considers the personal guarantee with high net worth. An entity's financial flexibility (or the lack thereof) is reflected in its ability to access the capital or the money markets at a short notice, attract diverse and marquee investors and enjoy the confidence of banks, financial institutions, and intermediaries. Strong financial flexibility allows an entity to raise fresh borrowings or refinance existing ones in quick time, whenever required.

6. Financial Management and Planning

CRISL rating analysis places weight on the quality of financial management. Managing Finance through the budgetary control system, management of cost-efficiency through the installation of the appropriate cost accounting system, product costing, use of accounting information by the management, IT base financial management system, quality of the manpower and their qualification, etc all are taken into consideration while ascertaining the extent of financial management.

D. Other Consideration

1. Project Risk

To ascertain project risks, CRISL endeavors to understand the entity's rationale for undertaking new investments. The risk profile could be different, depending on whether the new project is a case of related diversification or an unrelated diversification. The following issues are considered at the time of rating:

- Track record of the management in project implementation;
- Experience and quality of the project implementation team;
- Extent to which the capital cost is competitive;
- Financing arrangements in place;
- Demand outlook;
- Competitive environment; and
- Marketing arrangement and plans.

2. Compliance Issue

Compliance in RMG manufacturing is a key requirement for most of the reputed global garments buyers. Those who are compliance factory are getting higher rating compared to non compliant factory. Both social and environmental compliances are the key as social compliance is a legal requirement that takes into account minimum labor standards, occupational safety measures and environmental concern. Minimum factory worker wages, canteen and child care facilities, structural, fire, electrical and environmental compliance standard are due weight age at the time of rating. Now a day, compliance to standard is more important a factor to achieve a garments export order than the product quality. CRISL also review the relevant compliance report provided by Accord, Alliance, Sedex, Wrap, Gots, BSCI and others. If any observation taken by compliance authority then what course of action are undertaken by the management are duly consider.

3. Group/ Parent Support

If the rated entity is a part of a larger business group (the Group), then overall business operation and financial health are getting duly weight age. In consideration of group health, CRISL consider the overall Group assets, liability, net worth, turnover, net profit, leverage structure, cash flow, support of Group companies in case of funding need extent of inter- company cash movement gets highest weight age in judging the liquidity position of a company. If the strength of the Group is greater, or the issuer rating could be capped by the Group rating, if the Group is assessed to have a weaker credit profile than the rated entity itself. CRISL also consider how much the funding flexibilities are getting to the entity?

A weak subsidiary of a strong business group may be able to get a rating notched upward from its standalone company rating. The notch upward is awarded if the company meets the criteria that indicate the likelihood of receiving group support in a distress scenario. In contrast, the rating of a strong subsidiary of a weak business group may be capped by the rating of the Group.

**CRISL RATING SCALES AND DEFINITIONS
LONG-TERM RATINGS OF CORPORATE**

RATING	DEFINITION
AAA Triple A (Highest Safety)	Investment Grade Entity rated in this category is adjudged to be of best quality, offer highest safety and have highest credit quality. Risk factors are negligible and risk free, nearest to risk free Government bonds and securities. Changing economic circumstances are unlikely to have any serious impact on this category of companies.
AA+, AA, AA- (Double A) (High Safety)	Entity rated in this category is adjudged to be of high quality, offer higher safety and have high credit quality. This level of rating indicates a corporate entity with a sound credit profile and without significant problems. Risks are modest and may vary slightly from time to time because of economic conditions.
A+, A, A- Single A (Adequate Safety)	Entity rated in this category is adjudged to offer adequate safety for timely repayment of financial obligations. This level of rating indicates a corporate entity with an adequate credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.
BBB+, BBB, BBB- Triple B (Moderate Safety)	Entity rated in this category is adjudged to offer moderate degree of safety for timely repayment of financial obligations. This level of rating indicates that a company is under-performing in some areas. Risk factors are more variable in periods of economic stress than those rated in the higher categories. These entities are however considered to have the capability to overcome the above-mentioned limitations.
BB+, BB, BB- Double B (Inadequate Safety)	Speculative Grade Entity rated in this category is adjudged to lack key protection factors, which results in an inadequate safety. This level of rating indicates a company as below investment grade but deemed likely to meet obligations when due. Overall quality may move up or down frequently within this category.
B+, B, B- Single B (Risky)	Entity rated in this category is adjudged to be with high risk. Timely repayment of financial obligations is impaired by serious problems which the entity is faced with. Whilst an entity rated in this category might be currently meeting obligations in time through creating external liabilities.
CCC+, CCC, CCC- Triple C (Vulnerable)	Entity rated in this category is adjudged to be vulnerable and might fail to meet its repayments frequently or it may currently meeting obligations in time through creating external liabilities. Continuance of this would depend upon favorable economic conditions or on some degree of external support.
CC+, CC, CC- Double C (High Vulnerable)	Entity rated in this category is adjudged to be very highly vulnerable. Entity might not have required financial flexibility to continue meeting obligations; however, continuance of timely repayment is subject to external support.
C+, C, C- Single C (Extremely Speculative)	Entity rated in this category is adjudged to be with extremely speculative in timely repayment of financial obligations. This level of rating indicates entities with very serious problems and unless external support is provided, they would be unable to meet financial obligations.
D (Default)	Default Grade Entity rated in this category is adjudged to be either already in default or expected to be in default.

Note: For long-term ratings, CRISL assigns + (Positive) sign to indicate that the issue is ranked at the upper-end of its generic rating category and - (Minus) sign to indicate that the issue is ranked at the bottom end of its generic rating category. Long-term ratings without any sign denote mid-levels of each group.

SHORT-TERM RATINGS OF CORPORATE

ST-1	Highest Grade Highest certainty of timely payment. Short-term liquidity including internal fund generation is very strong and access to alternative sources of funds is outstanding. Safety is almost like risk free Government short-term obligations.
ST-2	High Grade High certainty of timely payment. Liquidity factors are strong and supported by good fundamental protection factors. Risk factors are very small.
ST-3	Good Grade Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Although ongoing funding needs may enlarge total financing requirements, access to capital markets is good. Risk factors are small.
ST-4	Moderate Grade Moderate liquidity and other protection factors qualify an entity to be in investment grade. Risk factors are larger and subject to more variation.
ST-5	Non-Investment/Speculative Grade Speculative investment characteristics. Liquidity is not sufficient to ensure discharging debt obligations. Operating factors and market access may be subject to a high degree of variation.
ST-6	Default Entity is in default or is likely to default in discharging its short-term obligations. Market access for liquidity and external support is uncertain.

**CRISL RATING SCALES AND DEFINITIONS
BANK LOAN/ FACILITY RATING SCALES AND DEFINITIONS- LONG-TERM**

RATING	DEFINITION
<i>blr AAA</i> (<i>blr Triple A</i>) (Highest Safety)	Investment Grade Bank Loan/ Facilities enjoyed by banking clients rated in this category are adjudged to have highest credit quality, offer highest safety and carry almost no risk. Risk factors are negligible and almost nearest to risk free Government bonds and securities. Changing economic circumstances are unlikely to have any serious impact on this category of loans/ facilities.
<i>blr AA+, blr AA, blr AA-</i> (Double A) (High Safety)	Bank Loan/ Facilities enjoyed by banking clients rated in this category are adjudged to have high credit quality, offer higher safety and have high credit quality. This level of rating indicates that the loan / facilities enjoyed by an entity has sound credit profile and without any significant problem. Risks are modest and may vary slightly from time to time because of economic conditions.
<i>blr A+, blr A, blr A-</i> Single A (Adequate Safety)	Bank Loan/ Facilities rated in this category are adjudged to carry adequate safety for timely repayment/ settlement. This level of rating indicates that the loan / facilities enjoyed by an entity have adequate and reliable credit profile. Risk factors are more variable and greater in periods of economic stress than those rated in the higher categories.
<i>blr BBB+, blr BBB, blr BBB-</i> Triple B (Moderate Safety)	Bank Loan/ Facilities rated in this category are adjudged to offer moderate degree of safety for timely repayment /fulfilling commitments. This level of rating indicates that the client enjoying loans/ facilities under-performing in some areas. However, these clients are considered to have the capability to overcome the above-mentioned limitations. Cash flows are irregular but the same is sufficient to service the loan/ fulfill commitments. Risk factors are more variable in periods of economic stress than those rated in the higher categories.
<i>blr BB+, blr BB, blr BB-</i> Duble B (Inadequate Safety)	Speculative/ Non investment Grade Bank Loan/ Facilities rated in this category are adjudged to lack key protection factors, which results in an inadequate safety. This level of rating indicates loans/ facilities enjoyed by a client are below investment grade. However, clients may discharge the obligation irregularly within reasonable time although they are in financial/ cash problem. These loans / facilities need strong monitoring from bankers side. There is possibility of overcoming the business situation with the support from group concerns/ owners. Overall quality may move up or down frequently within this category.
<i>blr B+, blr B, blr B-</i> Single B (Somewhat Risk)	Bank Loan/ Facilities rated in this category are adjudged to have weak protection factors. Timely repayment of financial obligations may be impaired by problems. Whilst a Bank loan rated in this category might be currently meeting obligations in time, continuance of this would depend upon favorable economic conditions or on some degree of external support. Special monitoring is needed from the financial institutions to recover the installments.
<i>blr CCC+, blr CCC, blr CCC-</i> Triple C (Risky)	Risky Grade Bank Loan/ Facilities rated in this category are adjudged to be in vulnerable status and the clients enjoying these loans/ facilities might fail to meet its repayments frequently or it may currently meeting obligations through creating external support/liabilities. Continuance of this would depend upon favorable economic conditions or on some degree of external support. These loans / facilities need strong monitoring from bankers side for recovery.
<i>blr CC+, blr CC, blr CC-</i> Double C (High Risky)	Bank Loan/ Facilities rated in this category are adjudged to carry high risk. Client enjoying the loan/ facility might not have required financial flexibility to continue meeting obligations; however, continuance of timely repayment is subject to external support. These loans / facilities need strong monitoring from bankers side for recovery.
<i>blr C+, blr C, blr C-</i> (Extremely Speculative)	Bank Loan/ Facilities rated in this category are adjudged to be extremely risky in timely repayment/ fulfilling commitments. This level of rating indicates that the clients enjoying these loan/ facilities are with very serious problems and unless external support is provided, they would be unable to meet financial obligations.
<i>blr D</i> (Default)	Default Grade Entities rated in this category are adjudged to be either already in default or expected to be in default.

SHORT-TERM RATINGS

<i>blr ST-1</i>	Highest Grade Highest certainty of timely payment. Short-term liquidity including internal fund generation is very strong and access to alternative sources of funds is outstanding, Safety is almost like risk free Government short-term obligations.
<i>blr ST-2</i>	High Grade High certainty of timely payment. Liquidity factors are strong and supported by good fundamental protection factors. Risk factors are very small.
<i>blr ST-3</i>	Good Grade Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Although ongoing funding needs may enlarge total financing requirements, access to capital markets is good. Risk factors are small.
<i>blr ST-4</i>	Satisfactory Grade Satisfactory liquidity and other protection factors qualify issues as to invest grade. Risk factors are larger and subject to more variation.
<i>blr ST-5</i>	Non-Investment Grade Speculative investment characteristics. Liquidity is not sufficient to insure against disruption in debt service. Operating factors and market access may be subject to a high degree of variation.
<i>blr ST-6</i>	Default Institution failed to meet financial obligations