

## ICRA LANKA'S POLICY ON RATING OUTLOOK AND RATING WATCH

### Overview

ICRA Lanka's credit ratings are forward-looking opinions on the relative credit risk associated with the rated issuers/debt instrument as represented by an appropriate symbol on the relevant rating scale. While the rating, being a forward-looking opinion, incorporates an assessment of future performance and events, there could be situations where the rating might have to be considered for a revision following the possibility of the performance to differ from initial expectations or the occurrence of an unanticipated event. In such situations, ICRA Lanka may change the rating outlook (to "Positive" or "Negative") or place the ratings on "Watch" when, in our opinion, the possibility of a rating change might have increased. However, a "Positive" or a "Negative" outlook or "Watch" is not necessarily a precursor to a rating change. ICRA Lanka may consider changing the rating even if the outlook might be "Stable" or the rating might not be placed on "Watch", if the credit situation warrants so.

### What is a Rating Outlook and what does it convey?

A rating outlook indicates ICRA Lanka's view on the expected direction of the rating movement in the near to medium term (typically six months to two years). The rating outlooks assigned by ICRA Lanka fall into four categories: Stable, Positive, Negative, No Outlook.

- A "Stable" outlook indicates a low likelihood of rating change in the near to medium term
- A "Positive" outlook indicates that the rating is likely to be upgraded in the near to medium term
- A "Negative" outlook indicates that the rating is likely to be downgraded in the near to medium term

A "Positive" or a "Negative" rating outlook reflects business, financial or other trends that are taking shape but have not yet reached the level or the certainty that would trigger a rating action—in the direction conveyed by the outlook. In some cases, a change in rating outlook to "Positive" or "Negative" could also be event-induced when the implications of the event, while being less certain, are expected to play out over the near to medium term. Example, a change in regulation that increases the threat of imports, whose impact on the rated entity is less ascertainable immediately and is likely to manifest over the near to medium term. However, a "Positive" or a "Negative" outlook does not imply that the rating would necessarily be upgraded or downgraded in the future. All that the rating outlook points to, without being a necessary precursor to a rating change, is the likely direction in which the ratings may move in the near to medium term. This additional information may help investors distinguish among rated entities or debt instruments having the same ratings but different rating outlooks.

ICRA Lanka assigns a rating outlook only to long-term ratings at or above B-; and other equivalent ratings on the medium-term rating scale. ICRA Lanka does not assign any outlook to securitization transaction ratings, where the rating symbol has the suffix 'SO' in parenthesis. Also, ICRA Lanka's short-term ratings and the ratings that are placed on "Watch" (as described in the next section), do

not carry a rating outlook. It is also possible that not all instruments issued by the rated entity have the same outlook designation. For instance, the rating of a bond programme of an entity might have a “Negative” outlook, while one of its other bond programmes whose rating might be based on a guarantee from a stronger third-party might have a “Stable” outlook, as the credit risk of these instruments might have different drivers.

### **What is a Rating Watch and what does it convey?**

A rating watch indicates ICRA Lanka’s view on the expected direction of the rating movement in the short term and becomes applicable when there is an event, the credit implications of which are either unclear or not fully ascertainable immediately. Such events include a proposed change in ownership control, a merger, a demerger, an acquisition, a sudden regulatory development, a force majeure event, proposed equity infusion, proposed refinancing, proposed asset monetization, material deviation in performance vis-à-vis expectations and so on. ICRA Lanka utilizes the period for which a rating remains on “Watch” to monitor the ongoing developments and gather additional information to assess whether and to what extent the existing rating may have to be revised. A rating may also be placed on "Watch" where the rating implications of the event might already be clear, but where a triggering event (e.g. a shareholder or a regulatory approval) might be awaited. The final rating action is taken when the awaited milestone is reached. A rating may also be placed on "Watch" if there is a methodology change whose implications on the rating might be in the process of being evaluated.

ICRA designates the ratings placed on “Watch” in the following three ways:

- “Watch with Positive Implications”, which indicates that once the credit uncertainty gets resolved, the rating is more likely to be upgraded
- “Watch with Negative Implications”, which indicates that once the credit uncertainty gets resolved, the rating is more likely to be downgraded
- “Watch with Developing Implications”, which indicates that the likely direction of the rating change is unascertainable based on the available information

Similar to rating outlooks, a rating placed on “Watch” does not imply that the rating would necessarily be upgraded or downgraded in the future; nor is placing any rating on watch necessarily a precursor to a rating change. A rating watch, unlike a rating outlook, is applicable to all debt instruments regardless of the rating level, including instruments rated on the short-term scale. A rating watch is also applicable for securitization transaction ratings. The "Watch" designation is applicable at the instrument level and not at the entity level. This implies that depending on the certainty around the extent of the rating change, there could be some situations whereby ICRA Lanka places only a specific debt instrument, say the long-term instrument, on watch, without concomitantly placing the other debt instrument, say the short-term instrument, too.

### **Points of Difference between Rating Outlook and Rating Watch**

- A rating watch is expected to be resolved in a relatively shorter time frame as compared with a rating outlook, although this might not necessarily be the case.

- A change in rating outlook generally reflects the expectation that some trends are taking shape in the economy, industry, or business that could lead to a rating change. Placing a rating on “Watch” is generally event driven, as mentioned above.
- While rating outlooks (other than “Stable”) could also be event-induced, but in such situations, all the information about the event might be fully known, unlike a rating watch. However, the implications of the event are not ascertainable immediately and are expected to be evident only over the near to medium term.

### General Attributes: Rating Watch versus Rating Outlook

	Rating Outlook	Rating Watch
<b>Applicability</b>	Applicable for long-term ratings at or above [ICRA]B- and other equivalent ratings on the medium-term rating scale; not applicable for securitization transaction ratings; Ratings on “Watch” do not carry a rating outlook	Applicable for all debt instruments regardless of the rating level; and including those instruments that are rated on the short-term scale; a “Watch” is also applicable for securitization transaction ratings
<b>Trigger</b>	Can be event based but generally based on expected change in business, financial or other trends	Mostly event based
<b>Impact of event</b>	When change in rating outlook is event-based: The contours of the event are known, but the implications of the event are expected to take shape over a period of time	Contours / impact of the event are unascertainable immediately
<b>Severity of rating change</b>	Generally limited / gradual	Can be severe
<b>Time horizon of rating change</b>	Near to medium term (typically, 6 months to 2 years)	Uncertain, dependent on completion process of the event or the achievement of trigger milestone