

Credit Appraisal Process

Religare Invesco Credit Appraisal Process for Fixed Income Investments

We often hold grudge against banks and other lending institutions for their excessive paperwork, countless queries and resultant long delays ahead of any loan sanction, such as, home loan, auto loan, education loan, business loan or personal loan.

But only if we could think from the lenders' or bank's perspective; for whom the surety of timely recovery of not only the entire amount loaned (principal) but also interest thereon is as crucial as our need for timely approval of loan. To mitigate any risk of potential default by the borrower, banks usually adopt critical surveillance measures and administer series of checks and controls to gauge the credibility of the borrower.

Similarly, the asset managers too put in extra efforts to ensure that the money they lend to various business entities – Public, Private or Government, through purchase of their bonds or debt securities, is repayable fully and on time with interest thereon.

It is thus imperative for the asset managers to avoid being blindly lured by high yields offered by some of the debt securities and instead apply utmost prudence and administer thorough checks and controls to ensure that the borrower is worthy of credit. For if the borrower defaults on payments, then let alone the high yields, even recovery of principal sum can be a nightmare.

The fixed income fund managers are thus required to strike the right balance between the risk and the return appetite of every scheme that they manage through astute selection of debt securities. To assist our fixed income team systematize and streamline the selection process for debt securities, Religare Invesco Asset Management has developed a proprietary **Credit Appraisal Process** to mitigate the risk of potential credit defaults and also to determine the maximum exposure or the investment limit that the AMC can take in a given debt issuance at a given point in time.

Diving into Religare Invesco's Credit Appraisal Process

Religare Invesco's proprietary Credit Appraisal Process is designed to uphold the 4 pillars of its investment strategy, namely, **Safety** – of the principal invested, **Credit Risk** – to ensure minimal or negligible risk of credit default, **Liquidity** – to ensure adequate funds at all times and **Yield** – to endeavor for superior yields reflective of the present rate environment.

Following a disciplined investment process, the credit analysts at Religare Invesco Asset Management first assess the overall macro-economic health, followed by a detailed review of the key economic, regulatory and market factors that influence various

industries operating in the economy. The analysts' then get down to brass tacks these industries in the present economic and business environment to assess a number of related parameters, such as –

- Effect of present business environment on the industry
- Impact of economic downturn, if any, on the industry's pricing power
- Extent of Government regulations on the industry
- Competitive intensity and market potential of the industry
- Entry barriers
- News flows related to the industry etc.

Taking cue from the assessment of various industries and their future outlook, the analysts then delve in further to evaluate the financial as well as the non-financial health of select companies within each industry. To assess the financial wellness of select companies, the analysts evaluate the company's –

- Profitability & gauge its Earnings Visibility
- Capital & Net Worth
- Financial leverage (debt) on books
- Quality of its assets
- Cash Flow and Liquidity comfort
- Efficiency of its business operations and other parameters.

For the evaluation of non-financial parameters, the analysts study the company's –

- Management quality
- Reputation and track record
- Parentage
- Availability of financial support from the Parent or Government
- Business strength and weaknesses
- Business diversification
- Outlook of the industry in which the company operates to gauge its impact on the operations of the company.

Each of these assessed parameters, at the Industry level and at the Company level, both financial and non-financial, are assigned an internal credit score based on their relative positioning in the given economic scenario. *These credit scores convey the business strength and the outlook of the company thus analyzed.*

A weighted average of these scores is then arrived at for every company and these weighted average scores form the basis to assign an *internal credit rating* to every company.

Religare Invesco Asset Management assigns its own internal credit rating to every company assessed by its fixed income team. These credit ratings range from A1 to E2 (See Table) and forms the basis to select the right bonds for the portfolio.

	Internal Rating	Credit Quality	Credit Risk
Investment Grade	A1	Superior	Negligible
	A2	Very High	Extremely Low
	B1	High	Very Low
	B2	Moderate	Low
	C1	Satisfactory	Moderate
	C2	Fair	High
Non-Investment Grade	D1	Possible servicing delay	High
	D2	Likely servicing delay	High
	E1	Possible default	High
	E2	Likely default	High

Optimum Borrowing Limit

The Credit Appraisal Process also facilitates in determining the debt servicing ability (Optimum Borrowing Limit) of every company. Optimum Borrowing Limit is the fixed income team's judgment on how much a company should be borrowing at a given point in time as determined by the credit appraisal process based on the company's financial health, business operations and future outlook.

Religare Invesco AMC Investment Limit

Based on the internal credit ratings and optimum borrowing limits determined by the credit appraisal process, the credit analysts finally

determine the maximum exposure or the investment limit that Religare Invesco Asset Management Company (AMC) can take in a particular company at a given point in time.

Periodic Review

The business environment in which companies operate today is fairly dynamic. Thus, to ensure that the credit process is not being run on obsolete data, the data is reviewed and updated periodically.

Also, to ensure additional checks on the outcome of the credit process, especially where the analysts unearth concerns that can impact the credit worthiness of a specific company, the members of the fixed income team may even consider a site visit or management meet of the concerned entity to corroborate ground realities. These meets are over and above the regular meetings with the corporate management teams to fathom the existing and prospective business structures and operations and the resultant impact on the corporate earnings and balance sheets.

In nutshell

Religare Invesco Asset Management is probably one of the few AMCs in the country today to have its own exclusive **credit appraisal process** designed in-house. This process not only facilitates the fixed income team in knocking out the unsuited borrowers but also helps them in identifying those worthy of credit, way ahead of the competition.

The process gives Religare Invesco Asset Management's fixed income investment team added ammunition in its research arsenal and assists in taking self-supporting views on the borrowing prowess of various business entities, independent of the external rating agencies.

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