Criteria for Short Term Instruments

RATINGS AFRICA
A subsidiary of CARE Ratings Limited, India

Background:

The framework of CareEdge Africa (CRAF) rating methodology essentially consists of analyzing the operational and financial characteristics of the entity being rated. Besides quantitative factors, qualitative aspects like assessment of management capabilities play a very important role in arriving at the rating for an instrument. The relative importance of qualitative and quantitative components of the analysis varies with the type of entity. Rating determination is a matter of experienced and holistic judgment, based on the relevant quantitative and qualitative factors impacting the credit quality of the entity.

Rating Criteria for Short Term Instruments:

CRAF's approach for rating a short term debt instrument is similar to the one followed for assessing credit risk for long term instruments. Though the time horizon of a short term instrument is up to one year, the time horizon for arriving at the rating normally extends beyond this period since the attempt is to arrive at ratings which do not change frequently.

Assessing liquidity and financial flexibility of the entity gains more prominence while arriving at short term ratings apart from its basic fundamental credit analysis.

- **Liquidity:**
  Analyzing liquidity is crucial for arriving at the short term rating. This involves analyzing the cash flows, working capital management and examining the availability of any unencumbered liquid investments or unutilized lines of credit from banks. The entity's cash-flows are examined to assess the liquid sources for repaying short term debt. The assumptions underlying the cash flow projections are analyzed to make a realistic assessment of short term liquidity. Examination of asset-liability maturity (ALM) profile becomes important for assessing the liquidity position of companies in the financial sector. Please refer to CRAF's criteria on Liquidity Analysis of Non-financial Sector entities on our website www.careratingsafrica.com for more insights on this aspect.

- **Financial flexibility:**
  Financial flexibility refers to alternative sources of liquidity available to the entity as and when required. While low level of leverage provides basic flexibility to raise additional borrowings, alternative sources of liquidity can be:
  a) General line of credit from strong parent or group company.
  b) Strong group profile which could implicitly mean the possibility of group support in times of stress. It may be noted that high levels of pledged shareholding of promoters could, however, affect the entity's financial flexibility, and may even affect its own liquidity position and ability to raise fresh funds.
  c) Implementing large projects usually involves periods of strain on the entity's liquidity position. CRAF analyses factors like financial closure, stage of the project, draw-down schedule of funds and the various milestones of implementation of capital expenditure programme. In this context, flexibility to defer capital expenditure or implement project in phases eases the strain on liquidity of the entity and thus provides comfort in terms of financial flexibility

Short Term – Long Term Link:

Even though weighed by short term factors which may tend to skew the short term rating, the long term credit quality assumes a pervasive role in determining such short term ratings. An entity with favorable long term fundamentals will find it much easier to fulfil its short term commitments on account of its strong operating cash flows and its ability to leverage upon its strengths to refinance, if required. This implicitly establishes a link between long term and short term ratings. Moreover, many of the short term instruments tend to get 'rolled over', and though short term by design, they virtually behave like long term instruments. In the eventuality of the entity not being able to rollover the short term instrument, it may have to leverage its long term rating to get funds in the absence of any other short term funding sources. Thus, an entity's long term credit quality cannot be ignored while assigning short term ratings.

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CRAF (AFRICA) PRIVATE LIMITED

Corporate Office: 5th FLOOR, MTML SQUARE, 63, CYBER CITY, EBENE MAURITIUS

CIN: 127054 I BRN: C14127054 I FSC License No.: CR14000001

Connect:

Locations: Ebene

Saurav Chatterjee

Director & Chief Executive Officer

+ 230 5862 6551

+ 230 5955 3060

Vidhyasagar Lingesan, CFA, FRM

Chief Rating Officer

+ 230 5273 1406

+ 230 5955 3060

Naveen Kumar Dhondy

Rating Head

+ 230 5955 3060

About:

CareEdge is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics and CRAF (Africa) Private Limited (CRAF) is the first credit rating agency to be licensed by the Financial Services Commission of Mauritius in May 2015. It is also recognized by Bank of Mauritius as External Credit Assessment Institution (ECAI) from May 2016. CRAF is also licensed by Capital Markets Authority of Kenya to operate as a Credit Rating Agency in Kenya. CRAF intends to expand across other geographies in Africa with Mauritius as its hub of operations. With an equitable position in the Mauritius capital market, CRAF (Africa) Private Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.

CRAF's shareholders are CRAF Limited, African Development Bank, MCB Equity Fund and SBM (NFC) Holdings Limited.

CRAF gets its technical support in the areas such as rating systems and procedures, methodologies, etc. from CRAF Limited on an ongoing basis. CRAF Limited, with an established track record of rating companies over almost three decades, follows a robust and transparent rating process that leverages its domain and analytical expertise backed by the methodologies congruent with the international best practices.

CRAF's Rating Committee consist of full-time members comprising of Senior Rating officials from CRAF Limited and a panel of experienced professionals from Mauritius and African Development Bank.

CRAF has had a pivotal role to play in developing bank debt and capital market instruments including MMIs, corporate bonds and structured credit.