



Lanka Rating Agency Limited



Rating Modifiers Criteria Methodology

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Summary

This criterion explains LRA’s rating modifiers, which provide additional information regarding the likelihood of change in direction of underlying ratings. It is important to note that rating modifiers are not necessarily precursors to rating changes. In cases where actual developments deviate from LRA’s expectations, rating changes may not follow those indicated by the rating modifiers. Likewise, rating changes may occur without the rating modifier indicating the same in certain cases.

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1. Introduction

1.1 Ratings reflect a forward-looking opinion on the creditworthiness of an underlying entity or instrument; more specifically, it covers the relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

1.2 Rating modifiers are refinements about a rating opinion that LRA may use. Rating modifiers address the likelihood of change in the direction of underlying ratings. These are annexed after assigning the rating from the rating scale. A rating modifier, however, does not mean that a rating change is inevitable, and rating changes may just as well occur without the rating modifier indicating the same.

1.3 Rating modifiers are based on a through-the-cycle approach, rather than on a point-in-time basis. Thus, they are not applicable to opinions based on actual or past performance. As a result, rating modifiers accompany all LRA opinions with the exception of Stability Ratings.

1.4 LRA has two types of rating modifiers – Rating Outlook (Outlook) and Rating Watch (RW).

2. Rating Outlook

2.1 Rating outlook indicates the likely direction of a rating over the intermediate term in response to changing trends in economic and/or fundamental business/financial conditions. It is not necessarily always a precursor to a rating change.

2.2 LRA updates all its ratings on an annual basis. Hence, the annual review would also update the latest status of the outlook. Rating outlook indicates the likely direction of a change in the rating upon the translation of the rating outlook:

- **Positive:** Indicates the likelihood that a rating may be upgraded.
- **Negative:** Indicates the likelihood that a rating may be downgraded.
- **Stable:** Indicates that a rating is not likely to change.
- **Developing:** “developing” outlook is used for situations in which there are conflicting elements or future events that are significant in nature but are unclear with regards to their potential impact on the rating.

2.3 The following points should be considered while interpreting an outlook:

- An outlook merely indicates LRA’s view that the rating could be changed if the scenario upon which the rating is based does not transpire and future developments are in line with LRA expectations. Rating outlook is unique to each rating opinion. A very highly rated entity may have a negative outlook associated with the assigned rating, while an entity with a low rating may have a positive outlook. Thus, the outlook must always be considered relative to the underlying rating, rather than in isolation.
- An outlook reflects LRA’s view regarding the trends and risks affecting the intermediate rating prospects. As such, it isn’t necessary for companies within a given industry peer group to have the same outlooks. However, this could be the case if a material event affects the entire industry.
- If an outlook translates into a rating change and an outlook is then assigned to the changed rating, such an outlook is a new outlook yet to be translated.
- It is extremely rare for a rating to be downgraded and assigned a positive outlook, or upgraded and assigned a negative outlook, though it may occur.

2.4 A rating outlook – ‘Positive’, ‘Negative’ or ‘Developing’ – does not imply that any potential change would be only one notch; it could be one notch or several notches, depending on the situation. Also, there

might be no change in the rating. LRA may simply revert the outlook to ‘Stable’ if original fundamentals are restored or reached again.

3. Rating Watch

3.1 Rating watch alerts the users to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event, the rating implications of which remain unclear/undetermined. Examples of such likely events include, but are not limited to, the following:

- Change in ownership by way of merger/demerger/acquisition,
- Operating development,
- Major economic or financial event
- Recapitalization,
- Regulatory action.

3.2 A rating watch is assigned if the rating impact of above-mentioned events cannot be accurately assessed at a given time and additional information is necessary to fully ascertain this. Alternatively, a rating watch is also assigned in cases where the rating implications of an event are clear, however, a specific triggering event (shareholder approval or regulatory approval) is awaited to enable a decisive rating action.

3.3 Rating watch does not mean that a rating change is inevitable. A watch should be resolved within the foreseeable future but may continue if underlying circumstances are not settled. LRA will generally publish updates to identify, as and when required, its most current assessment of the situation.

3.4 Rating watch does not imply that any potential change would be only one notch; it could be one notch or several notches, depending on the situation. Similarly, it is possible that there might be no change in the rating. LRA may simply remove the rating from “Rating Watch” if the original fundamentals are restored or reached again or update the rating with the appropriate action at the time of resolution of the key events triggering the rating watch.

OUTLOOK (STABLE, POSITIVE, NEGATIVE, DEVELOPING)	RATING WATCH
Indicates the potential direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.	Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within the foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.