

## Airline Methodology

WCRCL publishes rating methodologies to give issuers and investors' insight into the rationale behind WCRCL's rating opinions. In general terms, WCRCL ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. WCRCL ratings assess an issuer's ability to make timely payments on outstanding obligations (whether principal, interest, preferred share dividends or distributions) with respect to the terms of an obligation.

WCRCL rating methodologies include consideration of historical and expected business and financial risk factors as well as industry-specific issues, regional nuances and other subjective factors and intangible considerations. Our approach incorporates a combination of both quantitative and qualitative factors.

WCRCL operates with a stable rating philosophy; in other words, WCRCL strives to factor the impact of a cyclical economic environment into its ratings wherever possible, which minimizes rating changes due to economic cycles. Rating revisions do occur, however, when more structural changes, either positive or negative, have occurred, or appear likely to occur in the near future.

WCRCL's assessment of the probability of default is a function of (1) Business Risk Parameter (BRP) analysis by assessing each of the fundamental and additional BRP for a specific issuer; (2) the Financial Risk Parameter (FRP), determined by assessing each of the primary and additional FRP analysis. The two components, BRP and FRP analysis, are combined to determine the issuer rating; in most cases the BRP will have greater weight than the FRP in determining the issuer rating. Assessing risk parameters, WCRCL performs issuer's BRP and FRP analysis against the issuer's peers in the same industry.

### *Business Risk Parameter (BRP) Analysis*

Business Risk Parameter analysis may categories into: A) Industry risk analysis, B) Regulatory framework, C) Sovereign Risk analysis, D) Company Specific risk analysis, and E) additional BRPs.

A) Industry Risk: The airline industry cover transportation of passengers by plane and includes both scheduled and chartered airlines, including budget, feeder and regional airlines, may also engage in the transportation of cargo. The airline industry bear few common features; i.e. (1) high to moderate competition intensity arising from low barriers to entry. Despite the high capital costs, barriers to entry can be relatively low given the availability of lease financing and outsourcing of most support services; (2) business cyclicity in line with the overall economy with infrequent economic crises; (3) high costs, including fixed costs, such as capital and labor, as well as variable costs, such as fuel; and

B) Regulatory Framework: The Airlines industry is locally regulated by Civil Aviation Authority Bangladesh (CAAB) and internationally regulated by International Civil Aviation Organization (ICAO). The regulatory authority focused on safety, maintenance, hours of operation per month for personnel and restrictions on routes, landing rights and slots, noting that these regulations could vary by country and legal jurisdiction. Any airlines ignoring safety may hurt severely in lawsuit settlement costs, losing reputation and even increase future insurance rates.

C) Sovereign Risk: The issuer rating in Airline industry may, in some cases, be constrained by the sovereign rating; may sets a maximum rating for the issuer. If the issuer operates in multiple lower-rated countries and a substantial amount of its business is conducted in a lower-rated country, WCRCL may reflect this risk by downwardly adjusting its issuer rating. Such risks relate with government policies and other country risk factors, such as safety and environmental regulation, airport infrastructure, the air traffic control system, and labor law. Bilateral agreements with other countries restrict the number of flights between countries.

D) Company Specific risk: Industry risk analysis and Sovereign Risk analysis sets the stage for company-specific risk analysis may divided into: a) Diversification and Market share (market competitiveness), b) Route Network, c) Operating Cost efficiency, d) Customer Service and e) Management Assessment.

a) *Diversification and Market share (market competitiveness)*: An airline's diversity principally based on (globally or regionally) the geographic distribution of its flight operations, the mix of types of passengers it carries, and the revenue and income contribution from non-passenger services. Industry leaders who are diversified well, focusing on relatively attractive markets, with operating cost advantages.

b) *Route Network*: Route network can be analyzed in different aspects; i.e. profitable routes with growth potential, Access to key cities of markets served, High flight frequency at favorable time slots along with landing slots.

c) *Operating Cost efficiency*: The standard measure of airline operating costs is Load factor, Flight Kilometer, operating expense (after depreciation) per available seat mile/kilometer. Since many costs are fixed operating cost tends to be higher for airlines flying short flights. A comparison of its operating cost per available seat mile with those of its peer airlines to be more useful than unadjusted operating cost per available seat mile. Higher costs are clearly less favorable, but performance relative to competitors is more important in our analysis than absolute levels.

d) *Customer Service*: This risk parameter analyze brand recognition, reputation for quality service, customer loyalty etc.

e) *Management Assessment*: WCRCL emphasize while evaluating management efficiency on how management strategize for growth potentiality, handles labor & staff relations and future prediction for economic cyclicalilty. Management efficiency also reflects on operating or cost efficiency and financial performance.

E) Additional BRPs: Additional Business Risk parameters may include- *Fuel Hedge*, given the energy intensive characteristics of the industry, hedging for fuel pricing may consider as positive factors which affect operating cost volatility; *Currency Sensitivity*, companies having sensitive to currency, may hedging can have an impact on stability.

### **Financial Risk Parameter (FRP) Analysis**

WCRCL opinion on Financial Risk Parameters (FRP) are primarily based on future prediction or forward looking performance evaluation, a subjective but critical consideration. We focus on Accounting Standards and Characteristics (off balance sheet & on balance sheet items), Financial policies, Profitability and cash flow adequacy, Liquidity position, Capital Structure and Coverage regarding debt service. This part can be converging with our Financial Risk Analysis of Corporate Rating Methodology.

Financial analysis aims at determining the financial strength of the issuer company through quantitative means such as ratio analysis. Both past and current performance is evaluated to comment the future performance of a company. The areas considered are explained as follows-

a) Accounting Quality: As WASO relies on the audited financial statements; the analysis of statements begins with the study of accounting quality. For the purpose, qualification of auditors, overstatement/ understatement of profits, methods adopted for recognizing income, valuation of stock and charging depreciation on fixed assets are studied.

b) Earnings Potential/Profitability: Profits indicate company's ability to meet its fixed interest obligation in time. A business with stable earnings can withstand any adverse conditions and also generate capital resources internally. Profitability ratios like operating profit and net profit ratios to sales are calculated and compared with last 5 years figures or compared with the similar other companies carrying on same business. Since, rating is forward-looking exercise, more emphasis is laid on the future rather than the past earning capacity of the issuer.

c) Cash Flow Analysis: Cash flow analysis is undertaken in relation to debt and fixed and working capital requirements of the company. It indicates the usage of cash for different purposes and the extent of cash available for meeting fixed interest obligations. Cash flows analysis facilitates credit rating of a company as it better indicates the issuer's debt servicing capability compared to reported earnings.

d) Financial Flexibility: Existing Capital structure of a company is studied to find the debt/equity ratio, alternative means of financing used to raise funds, ability to raise funds, asset deployment potential etc. The future debt claims on the issuer's as well as the issuer's ability to raise capital is determined in order to find issuer's financial flexibility.

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