ACRA

Principles of Assessing Industry Factors in the Rating Analysis of Non-financial Corporations

Passenger Transportation

This document is part of the Methodology for Assigning Credit Ratings to Non-financial Corporations under the International Scale (hereinafter, the Methodology) and describes the specifics in conducting rating analyses of the operational and financial profiles of passenger transportation companies.

The document provides lists of indicators used, factor weights, assessment score boundaries for quantitative factors, and the principles of assessing qualitative factors for companies in the industry.

1 Industry Companies

The assessment approaches described in this document are applicable to companies whose core business is the provision of passenger and cargo transportation services. However, passenger transportation accounts for the majority of revenue for the companies in the industry.

2 Rating Factor Structure

Creditworthiness analyses of rated entities in the passenger transportation industry are based on assessing eight indicator blocks, which are combined in two profiles and have their own weights totaling 100%.

The weights presented in Table 1 are base weights, i.e., they may change depending on the assessment scores derived for factor blocks (see Subsection 4.1.3 of the Methodology for a description of the floating weights concept).

Table 1. Scorecard for the passenger transportation sector

Profile	Factors	Factor weighting	Sub-factors
Operational profile	Business profile	30%	Operating and regulatory environment
			Market position
	Financial policy and corporate governance	10%	Financial policy
			Corporate governance
Financial profile	Size	15%	Revenue (USD bln)
			Passenger-distance (bln passenger km)
	Profitability	10%	Funds from operations (FFO) before fixed charges and taxes
			Return on assets (ROA)
	Leverage	15%	Adjusted gross debt to FFO before fixed charges
			Total debt to equity
			Qualitative leverage assessment
	Coverage	10%	FFO before fixed charges to fixed charges
	Liquidity	5%	Liquidity ratio
			Qualitative liquidity assessment
	Cash flow	5%	Free cash flow (FCF) margin
			Qualitative assessment of FCF stability

Source: ACRA

3 Operational Profile

The following describes the basic factors in the rating analysis of the operational profile, the degree of their influence when determining the credit rating of a non-financial corporation, and assessment specifics.

To assess operational profile qualitative indicators for rated entities in the passenger transportation industry, ACRA uses a set of characteristics specific to the industry that translate into a qualitative assessment category. Operational profile indicator weights are shown in Table 4.

3.1. Business Profile

The business profile assessment takes into account the operating and regulatory environment, as well as a company's market position. The passenger transportation industry depends on the level of economic development in its regions of presence and generally exhibits low competition. Companies in the industry use different models of owning transportation infrastructure and assets. In addition, companies in the industry can be both natural monopolists in the domestic market, and competitive players in the international market. The business profile is assessed taking into account the following subfactors subject to qualitative assessment.

3.1.1. Operating and regulatory environment

Under this subfactor, ACRA analyzes the rated entity's operating and regulatory environment. The companies in the industry perform an important social function. Passenger transportation is subject to regulation, and regulation mechanisms in various countries may differ. Regulatory authorities may award a monopolistic position in the domestic market to a particular company or open the transportation network to competitive players. Regulation of tariffs for cargo transportation and ticket prices for passenger transportation may allow a company to maintain a high level of profitability or make it dependent on subsidies. In addition, regulation may impose certain restrictions on operations of companies in the industry. For example, they may be forced to assume infrastructure support costs.

The qualitative assessment category for the operating and regulatory environment is determined according to Table 2.

Table 2. Qualitative assessment of the operating and regulatory environment

Assessment category	Main features
I	Regulation allows the company to maintain a high level of profitability; the company can set its own prices; no competition from other players; regulatory risk is absent; regulation is transparent and, historically, has been predictable (no legislative changes worsening the position of the companies in the industry for more than five years)
II	Regulation allows the company to maintain a reasonable level of profitability; market pricing mechanism; minimal competition from other players; regulation is transparent and is stable and predictable (no legislative changes worsening the position of the companies in the industry for more than five years)
III	Regulation does not affect the company's operations or financial activities; market-driven pricing mechanism; operates in a competitive market; moderate competition from other players; regulation is affected by non-economic factors (decisions may be politically motivated), precedents for unpredictable changes in regulation (cases legislative changes worsening the position of companies in the industry over the last three years), attested cases of unpredictable changes in regulation (during the last three years there were cases of legislative changes worsening the position of the companies in the industry)
IV	Regulation allows the company to maintain a minimal level of profitability; operates in a market with serious regulatory restrictions (the regulator may impose additional obligations on the company); competition from other players is significant; regulation is non-transparent and affected by non-economic factors (many decisions depend on the political situation in the country, there are examples of introducing inconsistent and difficult-to-predict legislative changes)
V	Regulation is absent or unpredictable or adverse changes for the industry are introduced via legislation; operates in a market with serious regulatory restrictions (the regulator may impose additional obligations on the company that keep it from being operationally profitable)

Source: ACRA

3.1.2. Market position

The market position assessment is an integral part of assessing the creditworthiness of rated entities in the industry. Companies that are market monopolists are generally able to maintain a high level of profitability and creditworthiness.

A reduction in the market share of a company, in turn, may result from either structural changes or competition from new players, the occurrence of which may subsequently lead to a decline in margins in the industry.

The companies in the industry mostly operate national transportation networks, so the economic and social dynamics in the region of operation have a significant impact on their operating performance and growth potential.

The qualitative assessment category for the market position is determined according to Table 3.

Table 3. Qualitative assessment of the market position

Assessment category	Main features
I	Monopolist in the market in one country (or a market leader in several countries); risk of new players entering the market is minimal; main region of presence exhibits high economic development (well-diversified and stable economy)
II	Market leader in one country with a share of more than 60% (or a market player in several countries); risk of new players entering the market is insignificant; main region of presence exhibits high economic development (diversified and predictable economic environment)
III	Regional market player in one country with a share of 30–50%; risk of new players entering the market is moderate; main region of presence exhibits medium economic development (concentration on heavy industry, potentially vulnerable to fluctuations in demand, and consequently, an economic environment that is difficult to predict)
IV	Regional market player in one country with a share of 10–30%; risk of new players entering the market is high; main region of presence exhibits low economic development (poorly diversified economy)
V	Regional market player in one country with a share of less than 10%; risk of new players entering the market is very high; main region of presence exhibits low (or very low) economic development (total absence of economic diversification)

Source: ACRA

3.2. Financial Policy and Corporate Governance

To assess the financial policy and corporate governance of rated entities in the industry, ACRA uses a common set of characteristics that translate into a qualitative assessment category for all industries (for a general description of the concept of corporate governance qualitative assessment, see Section 5 of the Methodology). The assessment of financial policy and corporate governance is carried out according to Table 4.

4 Financial Profile

The following describes the basic factors in the rating analysis of the financial profile, the degree of their influence when determining the credit rating of a non-financial corporation, and assessment specifics.

To assess qualitative indicators in the financial profile of rated entities in the industry, ACRA uses a common set of characteristics that translate into a qualitative assessment category for all economy sectors (for a general description of qualitative assessment of financial profile indicators, see Section 6 of the Methodology).

Quantitative indicators in the financial profile are assessed in points on the basis of being part of a particular range and qualitative indicators, on the basis of qualitative assessment categories according to Table 5.

4.1. Size

To assess the business scale of companies in the industry, ACRA uses the size of their revenue and passenger-distance, which are important in assessing the creditworthiness of rated entities. The volume of revenues of a company reflects the size of its customer base and allows ACRA to assess how the scale of the company's operations impacts cost management. Companies with high levels of revenue and passenger-distance exhibit greater efficiency in procurement or investment in new technologies. In addition, ACRA analyzes overall revenue volatility: the companies whose indicators exhibit stable growth rates are generally assessed above those whose revenue stagnates or does not exhibit high growth rates.

Passenger-distance allows ACRA to compare companies not only based on the number of passengers transported, but also taking into account transportation distance, which ensures the comparability of companies from different segments.

4.2. Profitability

To assess profitability, ACRA uses FFO before fixed charges and taxes. This allows ACRA to correctly conduct a comparative analysis of companies using their own infrastructure and assets with those that rent them.

Return on assets (ROA), in turn, allows ACRA to assess how efficiently a company administers its assets. Taking into account the high capital intensity of the industry and the need to maintain high asset utilization, this indicator measures a company's ability to obtain substantial ROA.

4.3. Leverage

To assess the leverage, ACRA uses the ratio of adjusted total debt [1] to FFO before fixed charges. The second indicator used is the ratio of gross debt to equity. Qualitative characteristics are also used to assess leverage.

4.4. Coverage

To assess coverage, ACRA uses an indicator calculated as the ratio of FFO before fixed charges to fixed charges. This allows ACRA to more accurately conduct a comparative analysis of companies using their own infrastructure and assets with those that rent them.

4.5. Liquidity

In order to assess liquidity, ACRA uses the short-term liquidity ratio and qualitative characteristics.

4.6. Cash Flow

To assess the cash flow, ACRA uses the FCF margin indicator, as well as the qualitative assessment of FCF stability.

If a company owns its transportation infrastructure and/or assets, it needs to maintain a sufficient level of capital expenditures and fund them with operating cash flow. Dividend payouts made by the company are analyzed separately. Amid high capital costs, high dividend payouts can exert significant pressure on FCF.

[1] Given the currently established practice of assessing the cost of renting infrastructure and assets, ACRA uses a multiplier of operating lease capitalization equal to 4x to adjust the size of debt.

Table 4. Operational profile factors

Factors	Sub-factors	Sub-factor weighting	Sub-factor score				
			5	4	3	2	1
Business profile	Operating and regulatory environment	50%	V	IV	III	II	I
	Market position	50%	V	IV	III	II	I
Financial policy and corporate governance	Financial policy	50%	V	IV	III	II	I
	Corporate governance	50%	V	IV	III	II	I

Source: ACRA

Table 5. Financial profile factors

Factors	Sub-factors	Sub-factor weighting	Sub-factor score				
			5	4	3	2	1
Size	Revenue (USD bln)	70%	[0;1)	[1;5)	[5;10)	[10;30)	[30; ∞)
	Passenger-distance (bln passenger km)	30%	[0; 2)	[2; 5)	[5; 20)	[20; 60)	[60; ∞)
Profitability	FFO before fixed charges and taxes	70%	(−∞; 5%)	[5%; 10%)	[10%; 20%)	[20%; 30%)	[30%; ∞)
	ROA	30%	(−∞; 0%)	[0%; 3%)	[3%; 10%)	[10%; 20%)	[20%; ∞)
Leverage	Adjusted gross debt to FFO before fixed charges	40%	(8; ∞)	(5; 8]	(3; 5]	(1; 3]	[0; 1]
	Total debt of the company to equity	40%	(1.5; ∞)	(1.0; 1.5]	(0.8; 1.0]	(0.5; 0.8]	[0; 0.5]
	Qualitative leverage assessment	20%	V	IV	III	II	I
Coverage	FFO before fixed charges to fixed charges	100%	(−∞; 1)	[1; 3)	[3; 6)	[6; 10)	[10; ∞)
Liquidity	Liquidity ratio	50%	(−∞; 0.8)	[0.8; 1)	[1; 1.25)	[1.25; 1.5)	[1.5; ∞)
	Qualitative liquidity assessment	50%	V	IV	III	II	I
Cash flow	FCF margin	50%	(−∞; −10%)	[−10%; 0%)	[0%; 5%)	[5%; 10%)	[10%; ∞)
	Qualitative assessment of FCF stability	50%	V	IV	III	II	I

Source: ACRA

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