



FINANCIAL REVIEW

Date: Thursday, 3 March 2005
Page Number: 15
Edition: First
Supplement: Special Reports

Market: National
Circulation: 85,746
Published: MON TO SAT
Editorial: [email the editor](mailto:email_the_editor)
Item No: P5197471

Size: 200.26 sq. cm.

Rating the companies the big agencies miss

The big rating agencies have no interest outside the top 100 firms, leaving a niche for others, writes **Tracy Lee**.

Brisbane-based Rapid Ratings may not be as recognisable as Standard & Poor's or Moody's but according to managing director Patrick Caragata, it rates more companies and has a knack of getting it right more often.

Launched in 2000, the Brisbane-based ratings house now rates about 15,000 companies out of a possible universe of 37,000.

Mr Caragata says his company rates all the listed companies in Australia.

By comparison, Moody's Australia managing director Brian Cahill says his company rates about 100.

But the business models of the two companies reflects a different approach and a different clientele.

At Moody's, Cahill says that securitised products or the rating of bonds or other debt instruments makes up about one-third of his business.

"There is a broad trend for companies and banks to use capital

markets and bond markets more broadly as a funding source," he says.

In Australia, securitised products have only really been sold in the past 10 years and because it is a newer development in Australia compared with the UK and US markets, Cahill expects that this will continue to be a good source of revenue for his ratings house.

Together with Standard & Poor's and the French-owned Fitch Ratings, Moody's have this part of the market sewn up. But this is not where alternative ratings houses such as

'We've had Ford and General Motors at sub-invest grade for years.'

Rapid Ratings and Sydney-based Corporate Scorecard are looking to compete.

"Our type of rating agency is different, we don't get paid by second parties who issue debt in the market," says Rapid Ratings' Caragata.

"For example, if a BHP or a Coles Myer want to issue debt in the Australian market [as a way of raising capital] they call an S&P or a Moody's to rate the security that is being issued. Those are not our clients."

"Our clients are typically third parties like investment funds, private equity funds, brokers, financial planning groups or large creditors. Third parties that want us to rate a second party either using financials of listed companies or the [provided] financials of unlisted companies."

The creditworthiness of a bond or any security of indebtedness is independently assessed by the credit rating agency.

It measures the probability of the timely repayment of principal and interest of a bond. Generally, a higher credit rating would lead to a more favourable effect on the marketability of a bond.

For example, triple A (AAA)



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ratings are the highest and triple B ratings (or Baa) are the lowest investment grades. Anything below triple B is commonly known as a junk bond.

A similar process is used to rate companies but the ratings symbols differ between agencies.

But since the collapse of blue chip companies such as Enron in the United States and HIH in Australia, credit rating agencies have faced increased scrutiny.

“S&P and Moody’s downgraded Enron to sub-investment grade five days before the company went bust, but we had them at sub-invest four years in a row prior to their bankruptcy,” said Caragata.

He claims that his company’s

approach allows Rapid Ratings to produce better long-term signalling of a company’s status, giving clients an early warning system of potential risk in the market.

“We give more realistic ratings in the market, other ratings out there lag a company’s performance by up to one to three years.

Rapid Ratings uses 62 financial ratios which carry different weightings, depending on which industry sector the company inhabits. According to Caragata, this is what gives his company the edge in the market.

“There is nothing in the ratings of major ratings companies that is not already in the share price,” he says.

“We’ve had Ford and General

Motors on sub-invest (grade) for years.”

But he concedes that the more conservative approach of the incumbents is needed.

Ratings by the big three houses have gained such prominence in the market that downgrades can significantly jeopardise a company’s access to capital.

Also, for the more established houses, their reports are somewhat hostage to a company’s willingness to divulge information. They argue that their role is to make an opinion on any new information regarding a company once that information has been made public.





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Options

- Ratings by Moody's and S&P have gained huge prominence.
- However, since major corporate collapses went undetected, they have been under scrutiny.
- Smaller agencies tend to serve funds, brokers and big creditors.

