COATES ENGINEERING GROUP LIMITED

Financial Health Rating (FHR):	**32, High Risk**
Core Health Score (CHS):	28, Poor Health

Estimated Probability of Default (EPD):	2.27%
Financial Period:	March 31, 2015 (YE 2015)

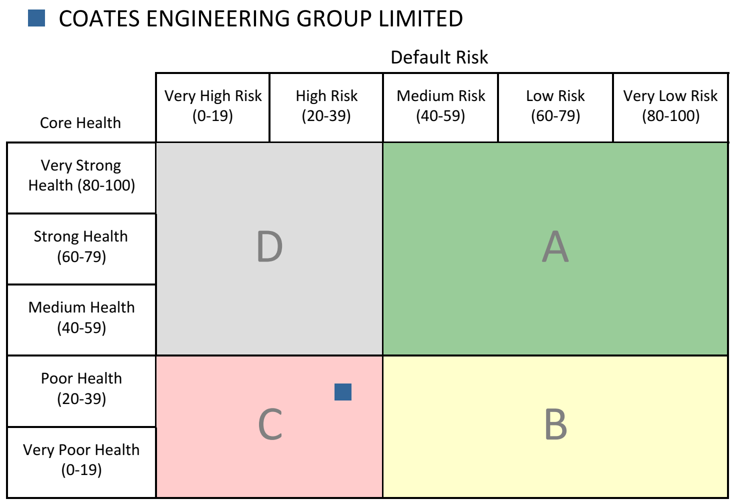
High default risk, with poor Core Health.

Quadrant C: These companies demonstrate poor to very poor Core Health (suggesting the need for efficiency improvements) combined with a high to very high risk of default over the next year.

Dialogue Context:

Companies which fall into Quadrant C should be able to discuss their plan to deliver significant improvement/relief in some or all of the areas discussed in this report within a reasonable time frame.

Figure 1: Risk Quadrant Analysis



Section 1: Priority Items for Financial Review

Table 1 below presents the prioritized review items and recommended questions based on our analysis of the financial statements ending 03/31/2015.

Table 1: Prioritized Items of Concern for Discussion

Items of Concern (4)	
1. Cash Ratio: The company's cash balance (£78,847) is very low given its current liabilities (£4,460,181). Are you comfortable with this cash availability?	See Page 2
2. Profit Margins: Both the company's operating profit margin (0.3%) and net profit margin (0.7%) are positive. What margins do you expect to produce for the coming fiscal year?	See Page 3
3. Interest Coverage: The interest coverage ratio was 0.69x, meaning the company was unable to fully cover its interest (£51,967) with operating profit (£36,093). Do you expect your interest obligation to change materially over the next year, and do you expect to cover this through operating profit?	See Page 4
4. Working Capital: The company's Current Ratio is 0.99x, and this is down on last period (1x). What is your target Current Ratio and will you reach this level of working capital in the next 12 months?	See Page 5

Table 2: Strengths and General Items for Discussion

Notable Strengths (1)	
5. Leverage: The company has a low level of debt at £937,130, which is 12% of total assets. Do you expect to maintain this level of leverage for the next 12 months?	See Page 6

Section 2: Discussion Points and Supporting Information

Discussion Point 1 (Concern):

Cash Ratio: The company's cash balance (£78,847) is very low given its current liabilities (£4,460,181). Are you comfortable with this cash availability?

Extended Discussion

The Cash Ratio has decreased from 4.6% to 1.8% in the most recent period. This is because cash has decreased from £171,804 to £78,847 while current liabilities has increased from £3,725,531 to £4,460,181. This cash balance seems very low.

- Are you comfortable with this level of cash and do you foresee any trouble having enough cash to meet your obligations over the next 12 months?
- Do you have access to additional cash if the need arises?
- What are the main components to your current liability balance and are there any components which you do not expect to result in a cash payable which might mitigate any concern?

Education: Why is this important?

A Cash Ratio reflects the extent to which a company can cover liabilities due this year with current cash on hand. Any shortfall in cash will need to be made up by accounts receivable collections or alternative sources of funding such as additional capital or asset sales.

Typically companies prefer to maintain a Cash Ratio which ranges between 15% and 30%.

Education: Other factors to be aware of

1. Credit Facility: A company may have low cash balances because it manages working capital with a revolving credit facility or some other access to capital. This will certainly ease liquidity strains while the facility is in place, however it is important to ask when this facility matures, as companies with a low FHR or even low Core Health may have problems renewing the access to funding.

2. Marketable Securities or other liquid Assets: Some companies will invest excess cash into short term highly liquid securities. This might legitimately explain a low Cash Ratio.

3. Non-cash Payables: Some companies have high levels of non-cash liabilities, such as deferred revenue, which lead to an overstatement of current liabilities as a reflection of expected cash obligation. These companies would not need to maintain as high a Cash Ratio given their lower forecast short term obligations.

Discussion Point 2 (Concern):

Profit Margins: Both the company's operating profit margin (0.3%) and net profit margin (0.7%) are positive. What margins do you expect to produce for the coming fiscal year?

Extended Discussion

The company's operating profit (£36,093) and net profit (£86,978) lead to margins of 0.3% and 0.7% respectively.

- What are your target margins for the next coming year?
- Are there any aspects of your business which are underperforming or putting downward pressure on these margins?

Education: Why is this important?

Profit margins provide information on how effectively a company is deploying its resources to generate a return for stakeholders. Extended periods of non-profitable activity will force management into increasingly risky behavior to try and rectify the situation.

Operating profit (or loss) is the return generated after core business expenses are paid. An operating margin is the operating profit as a percentage of revenues. A company needs to generate sufficient operating profit to pay for non-operating expenses, like cost of debt (interest). After a company has paid all of its expense, the result is net profit (or loss), which can be used to calculate the net margin (net profit / revenues).

Ideally both margins are positive, and increasing year on year. Any material decline in margin should be discussed.

While target margins vary across industries, performance is typically considered strong when the operating margin is greater than 10% and the net margin is greater than 5%.

Education: Other factors to be aware of

1. Material Events: One time events can affect margins. Margins should be considered with the event excluded to better estimate future performance, however the event should also be separately address to ensure it will not be recurring.

2. EBITDA and Non-Cash Items: Some companies have high levels of depreciation or other non-cash items. It is reasonable for a company to re-present margins with these non-cash items excluded. Using Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) to produce an EBITDA margin which shows a positive return is a valid demonstration of better performance.

Discussion Point 3 (Concern):

Interest Coverage: The interest coverage ratio was 0.69x, meaning the company was unable to fully cover its interest (£51,967) with operating profit (£36,093). Do you expect your interest obligation to change materially over the next year, and do you expect to cover this through operating profit?

Extended Discussion

The company's interest coverage is 0.69x, so the company was unable to fully meet its interest obligations with operating profit. However, interest expense has decreased from £56,650 to £51,967 since the prior year end.

- What do you expect next year's interest obligations to be?
- Do you expect to generate operating profits in excess of these obligations?
- If no, how will you manage your working capital to ensure the obligations can be serviced without affecting normal operations?

Education: Why is this important?

The interest coverage ratio (Operating Profit / Interest Expense) identifies the comfort with which a company is generating profit to satisfy its interest obligations. This is important because when a company cannot generate enough profit to cover its interest obligations it often needs to dip into capital, which is not sustainable over the long term. Furthermore, while many of the company's internal expenses can be managed (even if this causes discomfort), interest expenses are a legally enforceable external obligations, and are in many cases are considerably less flexible.

An interest coverage ratio greater than 1 is acceptable, and greater than 2 is strong.

Education: Other factors to be aware of

1. Non-cash expenses: If a company has significant non-cash expenses (such as depreciation or amortization) then their interest coverage ratio may not present a fair representation of their ability to service interest expenses. It would be a legitimate response for a company to show that their Cash From Operations was sufficient to pay interest expenses, or that their EBITDA was sufficient to pay interest expenses.

Discussion Point 4 (Concern):

Working Capital: The company's Current Ratio is 0.99x, and this is down on last period (1x). What is your target Current Ratio and will you reach this level of working capital in the next 12 months?

Extended Discussion

The Current Ratio has decreased from 1x to 0.99x in the most recent period. This is because current assets has increased from £3,734,770 to £4,394,512 while current liabilities has increased from £3,725,531 to £4,460,181.

- Do you have access to additional working capital funds if necessary?
- Are there any material non-cash items that are affecting this Current Ratio?
- What is your preferred Current Ratio and what do you expect your Current Ratio will be in the next 12 months?

Education: Why is this important?

Working capital is the relationship between a company's current assets (short term assets) and current liabilities (short term debts and obligations). An excess of working capital allows a company flexibility to react to changes in the market.

The Current Ratio (Current Assets divided by Current Liabilities) is a common measure of working capital.

A Current Ratio above 1 means the company has more current assets than current liabilities, and is typically an important threshold. This signals positive working capital, and suggests the company will likely meet its short term obligation. A Current Ratio of less than 1 signals negative working capital and suggests the company will not meet its short term obligations without sourcing additional capital/funds.

A Current Ratio above 2 or 3 means a company has significant security (an asset buffer), although any higher and the company is probably inefficiently using its resources.

Education: Other factors to be aware of

1. Non-Cash Items: If a company has a significant level of non-cash items, then the Current Ratio might not be a good indicator or Working Capital.

Discussion Point 5 (Strength):

Leverage: The company has a low level of debt at £937,130, which is 12% of total assets. Do you expect to maintain this level of leverage for the next 12 months?

Extended Discussion

The company's debt level is £937,130 and has increased from £707,604. This is a relatively low level of leverage at 12% of total assets.

- Who are the debtholders?
- Are you at risk of breaching any covenants?
- When does the debt mature?

Education: Why is this important?

Leverage indicates the extent of debt that is used to fund the company's operations. Utilizing debt as a funding source is an efficient way to support operations, however debt has two drawbacks compared to equity investments: 1) Payments on debt are pre-determined, so you still need to pay interest when times are tough, 2) At the maturity of the deal you need to return the capital to the investor, even if you still need it for your operations.

Mature companies will be attracted to the predictability of a debt repayment schedule and the tax benefit of interest expenses. A younger, growth-stage company might struggle with the constraints of debt repayment requirements, preferring flexibility to react as needed to establish themselves in the marketplace.

Leverage can be measured by total debt divided by total assets. The burden of meeting debt obligations increases with this ratio. An Assets Leverage ratio greater than 40% is significant enough that meeting debt repayments and maturities is likely to affect company strategy.

Education: Other factors to be aware of

1. Relationships with Debtholders: Not all debt is equal. If the capital has been provided by a related party (a group with a vested interest in the company's success) then this obligation is different to a bank loan, in which the bank's priority is a return on its investment. Close relationships with debt holders can mitigate the risk of high leverage.

2. Maturity Schedule: Debt which has a long maturity (or no set due date) provides greater flexibility than debt which has a close maturity date. Obviously, long maturities shorten every year, but that provides time for the company to prepare strategies and for business investments to mature. Identifying that a debt is not due for at least 5 years, for example, would reduce the risk implied by a high leverage ratio.

Section 3: Glossary

Rapid Ratings' Risk Analysis Terms

Financial Health Rating (FHR)	Rapid Ratings' primary risk indicator. The FHR is a score between 0 (worst) and 100 (best) which measures default risk in the next 12 months. The score covers five risk categories: Very High Risk 0-19, High Risk 20- 39, Medium Risk 40-59, Low Risk 60-79, Very Low Risk 80-100.
Estimated Probability of Default (EPD%)	The estimated probability that a company will default on an interest payment or file for bankruptcy within 12 months.
Core Health Score (CHS)	Rapid Ratings' measurement of efficiency and long term sustainability, and a fundamental input into the FHR. The score covers five health categories: Very Poor Health 0-19, Poor Health 20-39, Medium Health 40- 59, Strong Health 60-79, Very Strong Health 80-100.
Financial Period	The balance date for the trailing twelve month financial period on which the rating analysis has been conducted.

Financial Terms

Abnormal Item	An abnormal item is an operating gain or loss which is classified as abnormal because either a) it is unlikely to occur again, or b) its magnitude. The most common examples are restructuring and acquisition costs and asset impairment charges.
Current Assets	Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.
Current Liabilities	Current liabilities is used principally to designate obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities. The liquidation of this debt or obligation should be expected to occur within 12 months.
Current Ratio	Current Assets divided by Current Liabilities. A higher ratio suggests greater capacity to meet near term payment obligations. It is a measure of Working Capital.
Tangible Net Worth	Assets (not including financial assets) that lack physical substance. Intangible assets include goodwill, patents, copyrights, trademarks, trade names, organization costs, capitalized development costs, software, franchises, licenses, property rights, core deposit intangibles (banks), and intangible portion of prepaid pensions.
Working Capital	Current Assets minus Current Liabilities. This is the capital a company has available to meet ongoing business costs and to take advantage of opportunities that arise.

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Rating Scale Explanation

FHR Range	Average EPD (%)	Risk Category
95-100	<0.001	Very Low Risk
90-94	0.001	
85-89	0.002	
80-84	0.005	
75-79	0.01	Low Risk
70-74	0.02	
65-69	0.04	
60-64	0.08	
55-59	0.14	Medium Risk
50-54	0.24	
45-49	0.42	
40-44	0.73	
35-39	1.28	High Risk
30-34	2.31	
25-29	4.35	
20-24	8.71	
0-19	>11.40	Very High Risk

Core Health Score (CHS)	Core Health Category
80-100	Very Strong Health
60-79	Strong Health
40-59	Medium Health
20-39	Poor Health
0-19	Very Poor Health

Rapid Ratings' financial health rating scale defines a range of performance from worst practice at 0 to best practice at 100. The scale is separated into 20 vintiles of 5 point each, and with four vintiles per quintile. The quintiles are our main risk assessment categories, notably very low risk from 80-100, low risk from 60-79, medium risk from 40-59, high risk from 20-39 and very high risk from 0-19.While the Rapid Ratings scale appears to be linear, this is not really the case. Owing to the way the statistical distributions underlying the models for each sector have been constructed, and the sector specific-weights for each variable, companies make non-linear movements over time on Rapid Ratings' scale.

	Very High Risk (FHR 0-19)	High Risk (FHR 20-39)	Medium Risk (FHR 40-59)	Low Risk (FHR 60-79)	Very Low Risk (FHR 80-100)
Very Strong Health (CHS 80-100)	**Quadrant D** –These companies have medium or better Core Health, however challenges remain in the short-term given their elevated level of default risk.		**Quadrant A** – Companies in this quadrant demonstrate levels of operational efficiency likely to be sustainable over the medium-term combined with an acceptable to very low level of default risk over the next 12 months.		
Strong Health (CHS 60-79)					
Medium Health (CHS 40-59)					
Poor Health (CHS 20-39)	**Quadrant C** – These companies demonstrate poor to very poor Core Health (suggesting the need for improved efficiency), and a high to very high risk of default within the next 12 months.		**Quadrant B** – While default is unlikely in the short-term, the level of Core Health suggests a need for efficiency improvements in order to reach medium-term sustainability.		
Very Poor Health (CHS 0-19)					