



Rating of Entities based on Group Support

Executive Summary:

Group support refers to the likelihood that a Group company or a related entity (often within a corporate group) will provide financial assistance to its subsidiary or affiliate in times of need. A group of companies normally comprises i) common promoters, ii) significant cross- holdings, iii) a high level of operational as well as financial linkages, and sometimes, iv) a shared name or logo. These entities may have common procurement, marketing, name sharing and branding strategies at the centralised level, from an operational perspective.

The overall credit strength of a group depends on the collective financial stability and integrated operations of the entities it comprises, as cash can flow seamlessly among these entities and there can be a high possibility of cross collateral agreements with banks/lenders or corporate guarantees. Therefore, while assessing an entity/entities forming a part of a large group, Brickwork Ratings (BWR), based on several such factors expects the group to provide support to its entities in times of financial distress.

A group may offer support to an entity as implicit support, which is normally assessed based on empirical evidence and financial strength, or the said support can be explicit. Both these kinds of support reflect the expectation that the group will step in to support a subsidiary or group entity in the event of a financial difficulty and meet its debt obligations.

- **Implicit support:** Implicit support from a group company is an economic factor that can influence an entity's credit rating. The extent of group support depends on the entity's relation with the group (nature of business and commonality with other businesses, size of entity, integration with group, etc.), ranging from the entity being a non-core, non-strategic investment to a fully integrated part of the group. This Criteria covers the support based on the implicit support factors impacting an entity's credit rating.
- **Explicit support:** On the other hand, Explicit support usually involves some form of formal agreement or guarantee (explicit articulation of support through comfort letter or other forms of written support, articulation of support by board/promoter, etc.) that ties the entity's financial standing to the group's financial ability to provide support in times of distress. The explicit support in the form committed financial support via guarantees/deeds/or any other explicit agreement will be rated under the credit enhancement methodology (refer to the CE rating criteria on BWR website).

Scope of the Criteria:

The criteria in this document is are mainly applicable to large groups that have multiple/same sector operations with a relatively complex holding structure. These groups generally have favourable financial conditions and/or have the ability to raise/mobilise funds from capital markets / other sources.

The said criteria may not be applicable to homogenous groups with a common promoter and family-owned business, and those promoters that may be operating one or two entities.

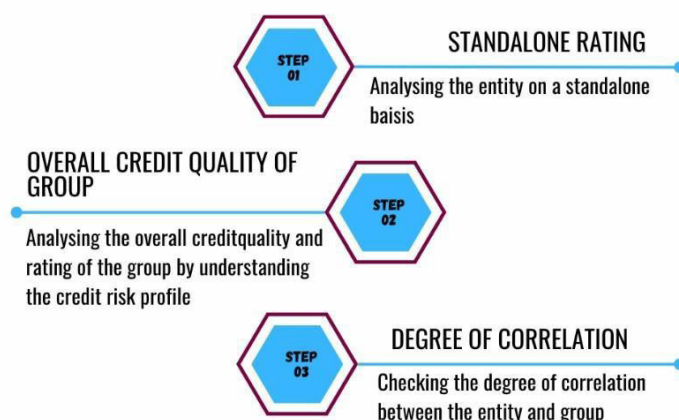
The methodology adopted by BWR usually involves determining the standalone rating of the entity initially and then the extent of notching up based on the implicit support or linkage with the group, and the group’s overall credit quality.

Implicit support reflects the expectation that a flagship company of the group will step- in to support a subsidiary or group entity in the event of a financial difficulty and meet the shortfall in its debt obligations.

Implicit support from a group company, which is mainly assessed based on past track record, is an important factor that can impact an entity’s credit rating. (For other factors refer to the support parameters in the below section)

Risk assessment and Rating Criteria:

The rating approach involves a sequence of processes such as the following:



BWR first determines a stand-alone credit rating for the entity based on the standalone credit rating. Subsequently, the assessment of the credit risk of the group (credit rating based on the consolidated financial) is done after evaluating business and financial risks, its competitive strengths, likely cash flows. BWR then assesses factors such as the degree of integration between the entity and group, extent and likelihood of support from the group, promoter control over decision making and operations, flow of cash within group companies and moral obligation on the group to support the entity.

A judgment is made based on several factors, on the extent of support the group would provide in the event of financial stress. In general, these factors reflect the importance of the subsidiary to the group and the nature of the financial and business linkages between them.

BWR will choose to notch-up only if the below mentioned linkages are strong; in case of weak linkages the entity may not receive any notch upgrade. The notch-up would be capped to the consolidated group; this is to effectively reflect the ultimate group risk emanating from exposure towards multiple entities at each individual entity rating level. Generally, in case of Group support, the extent of notch-up is limited as compared to the Parent support notch-up. Since in the group support the entity may/may-not be directly owned or have an identifiable parent hence the in Group support, the entity may receive limited notch upgrades.

The following parameters are generally adopted to determine the extent of notching of a group entity's rating:

1. Business linkages, strategic importance and economic significance:

The relevance of the entity to the group, extent of shareholding by promoters/group and economic incentives to the group are examined. The relative contribution of the entity towards the consolidated turnover and profits of the group, commonality in business activities, ownership/extent of shareholding, geographical presence, and criticality and economic relevance of the entity to the group are considered. The following parameters are part of economic importance:

- a) Degree of integration between the Entity and Group: BWR considers business linkages between the entity and group in addition to the extent to which the group is critically dependent on the rated entity for operations and business stability. If the group's business is significantly impacted by disruptions in the operation of the rated entity, then the group would likely extend support in a distress situation. Overall, higher criticality of the rated company to the group's operations or closer business linkages between the group and the entity, such as similar lines of business with a different geographical presence, generally results in a higher notch-up from the entity's standalone rating.
- b) Extent and likelihood of support from the Group: An entity that holds a high strategic importance to a group may draw financial support from the group company as and when required.
- c) Management control over decision making and operations: This refers to the level of influence or authority that the management has over the strategic decisions, day-to-day operations, and overall direction of the entity being rated. It is a critical factor when notching up an entity's standalone rating based on group support. A high level of control typically indicates a higher likelihood that the group company will intervene to support the entity in case of distress.
- d) Cash fungibility within the group companies: The flow of cash refers to the movement of financial resources (such as funds, liquidity, or capital) between companies within the same corporate group. This includes intra-group loans, financial transfers, capital injections, and dividend payments. A strong, seamless flow of cash between group companies can indicate that a company is likely to receive group support in times of need, which can lead to an upward adjustment in its standalone rating.

2. Moral Obligations: The parameters listed below define the moral obligations of a group to assist an entity.

a) **Reputational Risk and Group Cohesion:**

The failure of a subsidiary can have significant reputational consequences for the group, particularly if the subsidiary is seen as a "core" part of the brand. A moral obligation to avoid reputational harm may lead the group for support. The group's ability to maintain market confidence in the entire group could be at risk if a subsidiary is allowed to fail, especially in industries with strong investor scrutiny.

b) **Strength of Corporate Governance and Ethical Considerations:**

A morally responsible group might believe it is in its own long-term interests to support subsidiaries during downturns rather than allowing them to fail, which might be viewed as short-sighted or damaging in the long run. If a large shareholder (e.g., a government, pension fund, or major institutional investor) expects the group to act in the interest of the subsidiary's stakeholders, this could create a moral obligation for the group to provide support, even if it's not legally required.

c) Commonality of Resources:

One of the key factors that can justify a notch-up is the commonality of resources between the company and the corporate group. This refers to the degree to which the subsidiary relies on shared resources—financial, operational, or organizational, that are integrated within the group. The more interconnected the resources, the more likely it is that the subsidiary will benefit from group support, leading to a higher (or "notched-up") rating.

Conclusion:

While assessing an entity, BWR analyses in depth the entity's standalone financial and business risks, in addition to the group's consolidated financial and business strength, degree of correlation between the entity and group, economic relevance to the group and support extended to it financially or through other factors associated with the group company. Hence, the final rating involves an assessment of the ability and willingness of providing group support to various group entities and vice versa.

The previous version of this document can be found in

<https://www.brickworkratings.com/download/Criteria-GroupSupport-Sept2021.pdf>

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