



## Ratings of Entities based on Parent Support

### **Executive Summary:**

Brickwork Ratings (BWR) analyses an entity's credit profile based on qualitative and quantitative risks that are likely to affect sustainability of its operations, financial position and debt servicing ability to meet its debt obligations on its own. BWR assesses the entity on a standalone basis and subsequently the rating is notched up based on implicit or expected support from the parent.

However, the notch-up criteria are applicable only for certain situations, where entities are backed by higher rated identifiable parent or joint venture partners. The extent of the support is based on the linkages that can be broadly classified as legal linkages, operational and financial linkages, and strategic linkages, and often help the entity in various ways such as through a shared name and common management, loans from the parent, equity contribution, an extended credit period and advances.

The scope of this criteria document is to cover, the methodology for parental support that does not factor in the committed financial support in the form of corporate guarantees (which will be rated under the credit enhancement methodology, refer to the BWR website), but implicit support that would (expectedly) come in during a distressed situation or whenever the need arises.

The assumption for the aforesaid support from parents is based on the higher or superior credit profile of the parent (based on the consolidated financials) than that of the entity.

### **Notch-up Approach:**

The assumption for the parent's support is based on the parent's superior credit profile (derived from consolidated financials) compared to that of the subsidiary, with any upward adjustment to the subsidiary's rating being limited to the parent's rating.

In determining the final rating of the entity, BWR will evaluate: a) the entity's standalone rating without any support, b) the consolidated rating of the parent, considering all current and future obligations, and c) the extent of any rating adjustment, which will depend on the strength of the linkages between the entity and the parent. These linkages are typically classified as Strong, Moderate, Weak.

## **Parent Support Rating Methodology:**

Implicit support from a parent company is an economic and financial linkage that can impact and most likely notch up the credit rating of subsidiaries based on the standalone rating. The extent of parent support depends on the entity's relation with the parent. The methodology below determines the range/extend of implicit support by the parent, from an expectation of very little or no help at one end to ratings equalization at the other.

- BWR follows a 'bottom-up' approach that first determines a stand-alone credit rating for the entity. Subsequently, the relationship and linkage with the parent is considered (refer assessing linkage section below).
- A judgment is made based on a number of factors as to what extent the parent would provide support in the event of financial stress.
- In general, these factors reflect the importance of the subsidiary to the parent and nature of linkages between them. Once these factors have been assessed, the number of notches up by which the standalone rating should be improved is determined.

The notch-up criteria are majorly based on the quantitative/qualitative parameters, and gap between parents' and entities rating. Besides other criteria, the following should necessarily be factored in for notching up:

- Parent companies' image and reputation background, rating history and activities/performance/operational synergy/common activities, and track record of past ratings.
- Economic importance of subsidiary that can lead to the external pressure (by lenders and Govt.) to transfer funds and support in case of distress.
- Parent companies being considered for providing support should have capacity to support without material dilution in its strength post supporting.
- Established brand value, reputation and overall performance for the last three years, of the parent company. This implies that the notching up will be restricted for outright new companies.
- Parental support should be visible from the entity's past track record and financials. One such parameter for visibility is the entity's satisfactory rating, which should be close to the parent's rating, thereby validating that there is already a support ongoing basis, and the entity is being kept in good shape.

Broad parameters for assessing linkages can be summarized as below:

- **Legal Linkages:** Legal linkages in terms of cross default provisions, cross guarantees, enforceable put option.
- **Operating Linkages:** Common brand name/logo, common management, treasury, inter-company transactions, common supply chain, backward/forward integration and interdependence for key business transactions.
- **Financial Linkages:** Loans and advances from parent or extended suppliers' period to fund the

subsidiary's operations, or any other form of tangible support.

- Strategic Linkages: the criticality of subsidiary's operations/market for the parent in terms of long- term growth, notwithstanding the subsidiary's standalone scale or vintage

However, the assessment of some of the key factors is inherently subjective, for example, the strategic relation importance of a subsidiary, and is likely to vary over time with the economic cycle and as the general view of the reliability of implicit support changes.

The criteria defined in this document are applicable to subsidiaries that have significant shareholding from a clearly identifiable parent. In the case of JVs of two or more partners holding equal stake, the support is attributed to the partner that explicitly backs most of the JV's debt.

BWR assesses the JV agreement, overall control and strength of the JV partners (synergies and default implication on JV partner if subsidiary defaults), before considering the support from either of the JV partners.

The final rating of a subsidiary is a function of three key parameters:

- a. Determination of standalone rating of the subsidiary
- b. Determination of the parent's rating (on the consolidated financials), considering its overall credit profile
- c. Extend of Notch up, based on the linkage (strategic, business and financial) with parent

#### **a. Subsidiary's Standalone Rating**

This involves an assessment of the subsidiary's ability to sustain its operations and meet its debt obligations from its own cash accruals without depending on support from the parent, and further analyzing if the implicit support from Parent is required. While analyzing the parent company support, BWR considers the following:

- Economic and strategic importance of a subsidiary to its parent. A subsidiary's economic and strategic importance to its parent is analysed by checking the criticality of its operations for the parent and the overall contribution of the consolidated income and profits towards the parent company.
- The other strong link between a subsidiary and the parent company is the relation between suppliers, customers, contractors and lenders, among others. The impact of any disruption in the subsidiary's operations on the parent is a key element in assessing the strategic importance to the parent.
- The parent support received by a subsidiary in the past and its willingness to support the subsidiary in the case of exigencies or distress situations in future.
- Cash flow fungibility from the parent company is seen positively, unless explicitly restricted under relevant agreements.
- The presence of a cross-default clause in the underlying debt is seen as an important factor in assessing the notch up for parent support by BWR. Similarly, sharing a common brand/logo implies a significant reputation risk for the parent and therefore, a higher propensity to support the subsidiary's debt servicing.

**b. Parent's Rating**

The strength of the parent and its ability and willingness to extend support to the subsidiary, if the need arises, is evaluated. A parent company's strong credit profile (rating based on the consolidated financials) could result in notching up the rating of its subsidiary. BWR also assesses the parent company on its ability to extend support to its subsidiary and the timing of support.

**c. Extent of Notch-up:**

BWR may notch up, depending on the assessment of implicit support available from the parent (based on the above-mentioned parameters the linkage between Parent and subsidiary is established).

- **Strong Linkage:** If the company has strong linkages with the parent, BWR may adjust the rating one notch lower than the parent rating or up to the parent rating itself. This is applicable if three or more out of the four parameters of linkage are met.
- **Medium Linkage:** If two or more out of the four parameters of linkage are met, the rating might be notched down by 2 to 3 notches from the parent rating.
- **Weak Linkage:** If only one of the four linkage parameters is met, the rating could either not be upgraded at all or could be upgraded by just one notch, depending on the stake the parent holds in the company
- In the case of SPVs that have been set-up by holding companies for executing infrastructure projects and the debt of SPVs is structured with a limited recourse to the parent due to the inherent risk involved, BWR may or may not notch up the SPV's rating depending on the kind of support available to the said SPV.

**Conclusion**

While assessing an entity, BWR analyses the entity's standalone financial and business risks, in addition to the parent support extended to it financially or through other factors associated with the parent company. Hence, the final rating involves an assessment of the ability, willingness and timeliness of parent support available with subsidiary companies.

The previous version of this document can be found in

<https://www.brickworkratings.com/download/Criteria-ParentSupport-Sep2021.pdf>

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