CareEdge
GLOBAL RATINGS
A subsidiary of CARE Ratings Limited

CareEdge Global
Consolidation Methodology

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A. Introduction

A company may conduct its business activities under a single entity or through separate entities established as subsidiaries, associates, joint ventures (JVs), or group entities due to operational, legal, taxation, or regulatory considerations. These entities may operate in a similar line of business, having financial linkages with the parent or amongst each other, or may engage in diverse businesses with limited or no overlap or financial connections. Furthermore, each entity's strategic importance and reputational significance within the group may vary.

The standalone business and financial profile provide valuable insights into the various risks to which an entity is exposed. However, analysing the standalone profile alone may not always be sufficient, especially when financial interlinkages among group entities or businesses are closely interlinked. This makes analysis of consolidated business and financial risks imperative for assessing the credit risk profile of an entity.

The consolidated business profile offers an overview of the business strength of the overall group, which drives the sustainability of the market position and, thereby, the stability in earnings and cash flows. The consolidated financials provide a holistic representation of the parent's and its subsidiaries' financial position as a single economic unit and consider both the financial resources available and the group's obligations in totality. In certain cases, such as subsidiaries being ring-fenced, we may make appropriate analytical adjustments to factor restrictions in support.

B. Scope

This methodology encompasses CareEdge Global’s risk-based analytical approach to consolidation, including the factors considered when rating a parent entity, holding companies, and group entities. It delineates CareEdge Global’s strategy for assessing an entity’s credit risk profile on a consolidated basis, considering its connections with subsidiaries, associates, joint ventures (JV), or group entities.

C. Approach

A parent entity can be categorised as:

1. **Parent entity which has substantial business operations:**

   Such entities are often a group's flagship or core entity in a specific industry segment. The parent entity generally has a substantial portion of the group's business operations and often contributes to a large share of the overall group’s revenue, profits and asset base. Over time, an entity would expand its operations through organic or inorganic routes and operate through various subsidiaries. The subsidiaries could be set up with multiple motives as highlighted below:

   - Operating as a backward/forward integration to the parent
   - An extension of the parent’s business in different regions/ geographies
   - A trading/marketing arm for the parent’s products and services

- Diversification
- Legal or tax-saving motives

2. Parent entity, which is established as the holding company:

Such companies typically do not possess significant business in their standalone operations; instead, they function as holding companies for various subsidiaries engaged in similar or different sectors. For instance, a corporate group or promoter entity may maintain distinct holding companies for its various business verticals, with different subsidiaries operating independently under each holding company.

In both the above-mentioned cases, a standalone view of the parent may not be sufficient to capture the risk presented by the subsidiaries. Hence, CareEdge Global typically takes a consolidated view of the parent and its subsidiaries while assigning rating to the parent company in such cases.

The extent and strength of business and financial linkages between the parent and subsidiaries determine the extent of support that will be factored into the subsidiary's rating. However, it may be mentioned that the entities are consolidated from an accounting point of view, irrespective of the strength of linkages. CareEdge Global also examines restrictions, if any, on the flow of funds between the parent and subsidiary due to reasons like foreign exchange regulations if the subsidiary or the parent is based outside the domicile of a subsidiary or the parent, restrictive covenants in loan documents, etc.

D. Consolidation of entities with non-controlling stakes and JVs

There can be certain entities which are not linked to the parent by control or majority ownership and, hence, are not consolidated as per the reported financials. Still, there could be explicit credit support such as a guarantee or a shortfall undertaking, etc., extended for the majority of the debt of such entities by the parent or any of the other entities which have been consolidated as per reported financials. Besides, there could be entities that are not linked by ownership, but cross-default clauses exist in the loan terms of such entities with other entities that are consolidated.

Furthermore, a parent may have certain associates or JVs, which are not consolidated line by line but only share of profit or loss and investments are considered in reported consolidated financials, but to whom the parent is expected to extend unhindered support for meeting their obligations. In all such situations, CareEdge Global makes suitable adjustments in the reported consolidated financials to duly factor in the impact of debt of such supported entities and likely financial support for debt servicing, capex, and loss funding, if any.

E. Limited consolidation or exceptions from full consolidation

There are exceptions for full consolidation in certain situations. Such as:

1. **A subsidiary operating in a completely different business segment than the parent, including a subsidiary of a non-financial sector entity operating in the financial sector:**
   In this scenario, the extent of support that the subsidiary requires is assessed, and the same is adjusted from the parent's net worth.

2. **A subsidiary is of the nature of a special-purpose vehicle:**
   In this scenario, although the cashflows are ringfenced, we factor in support from the parent in the form of the equity portion of project cost and estimated cost overrun.

   In such cases, while the subsidiaries are not consolidated for accounting purposes, the investments are tested for impairment. The above approach is called the Limited Consolidation Approach, wherein the committed support in the form of projected equity investments or debt/advances to be provided to the subsidiaries will be factored into the analysis.

   In cases where the parent has explicitly spelt out / committed the extent of support (either through written communication or as indicated in the discussions with the management) that it will provide to its group entities, CareEdge Global will adopt a limited consolidation approach.

   Furthermore, CareEdge Global does not consolidate the group entities if it is not of strategic importance to the parent, or if it provides minimal economic incentive for the parent to provide support, or if the parent is insulated due to its stated posture of non-support and track record of non-support to such group entities, provided there are no legal obligations, such as guarantees extended by the parent. In such scenarios, the parent’s credit risk profile is assessed independently without factoring in the debt and losses of any of such related entities. However, the value of investments is assessed in a manner like any other equity investment, including testing the investment for any impairment in value.

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