Chilean Equity Rating Criteria

Sector-Specific

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This report updates and replaces *Equity Rating Criteria in Chile*, dated Aug. 1, 2018.

Scope

This report describes the methodology that Fitch Ratings uses to rate stock instruments issued or to be issued and/or traded on Chilean stock markets. The ratings assigned to these instruments are national scale ratings and, therefore, are not comparable across countries. Equity ratings arose in response to regulatory requirements. However, they evolved to become a market practice, as such requirements are no longer applicable.

Stocks referred to in this report include, but are not limited to, common shares issued by financial and non-financial entities. This methodology does not apply to preferred stock or shares issued outside the framework of a public offering by private funds or other investment vehicles.

By assigning equity ratings, Fitch provides investors with an independent opinion about the issuer's creditworthiness and the liquidity risk inherent in its shares. The purpose of Fitch's equity ratings is to estimate the liquidity risk an investor assumes when acquiring a particular share, with the intention of measuring in a reasonable period how easy or difficult it will be to sell the instrument.

Key Rating Drivers

Complement to Corporate Rating Criteria: This report provides an overview of elements to be assessed in the share rating process, which should be complemented with analytical considerations related to the issuer's rating. Therefore, this report should be read jointly with Fitch Ratings' global criteria reports.

Creditworthiness and Market Liquidity Risk: Fitch assigns national scale equity ratings based on two kinds of analysis: issuer creditworthiness and market liquidity risk. The combination results in the determination of an entity's equity rating.

Equity Ratings: The purpose of a stock rating is not to assess the risk of default on such shares, as they do not fall into default because they do not have specific payment commitments. Rather, it assesses the issuer's likelihood of continuing to operate. Conceptually, equity ratings indicate that the greater the issuer's creditworthiness, the greater the likelihood that its shares will continue to trade throughout the business cycle.

Liquidity Analysis Based on Historical Data: The analysis includes an assessment of the historical stock market behavior of the share in market presence, free float and volume traded, as well as the relationship between the movements of the share and the intrinsic financial condition of the company and its industry.

Related Criteria

Insurance Rating Criteria (April 2021)
Corporate Rating Criteria (December 2020)
National Scale Rating Criteria (December 2020)
Bank Rating Criteria (February 2020)
Non-Bank Financial Institutions Rating Criteria (February 2020)

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Limitations

Equity ratings reflect risks related to the issuer's creditworthiness and the stock's market liquidity. However, they do not address the risk of losses with stock prices and other market conditions, nor do they consider the adequacy of the market price of a security. In no case does the analysis result in a recommendation to buy or sell a security. Fitch does not make its own stock price estimates nor does it use projections of stock prices in determining liquidity risk.

Sources of Information

The information to carry out risk analysis and assign ratings is obtained from the issuer, industry data and other relevant sources. As to the specific analysis of the share's liquidity, Fitch obtains from market sources the data necessary to calculate the relevant stock market indicators described below.

Fitch's analysis typically covers five years of operational history and financial data. The information to assess the issuer's creditworthiness is requested by Fitch from the issuer. Once Fitch has received the information, it conducts its analysis based on the methodologies mentioned above. Fitch does not audit or verify the information received from the issuer or its representatives.

For securities without historical stock market information, such as an initial share offering, or with insufficient information, Fitch bases its analysis on the issuer's credit rating. When the security has completed approximately one year of stock market transactions, equity liquidity is incorporated into the analysis.

Issuer Creditworthiness

Fitch expresses the issuer's creditworthiness in the long-term national scale rating assigned publicly or privately or in a private credit opinion. These are derived according to the methodologies for non-financial and financial companies, depending on the entity.

The purpose of the credit analysis is to assess the likelihood of an entity meeting its financial obligations; e.g. the probability of default. The entity's operational and financial profiles, its overall credit rating and the issuer's long-term rating are good approximations of the riskiness of a company's cash generation capacity.

Fitch assesses qualitative and quantitative variables to measure an issuer's operational and financial risks and determine its credit profile, following the concepts contained in Fitch's global rating methodologies for financial and non-financial companies. For a detailed analysis of the factors Fitch assesses to rate an issuer, please refer to the global methodologies listed in *Related Criteria* on page 1.

Market Liquidity Risk

To assess stock market liquidity, Fitch performs an ex-post analysis, which is dynamic and based on monitoring certain market indicators that measure the share's liquidity. Fitch assesses these variables in the context of the country's stock market. Elements in the analysis may mitigate lower liquidity, such as the series of a particular share giving greater rights than another series. The relative importance of each risk factor may vary. Typically, indicators that point to a low level of liquidity will usually restrict the stock's rating to the lowest range of the scale.

A security's liquidity is measured by the recent evolution of certain stock market indicators, fundamentally the presence of the security in the market. The share's trading history, the percentage of free float and the evolution of its market capitalization and daily trading volume also influence the assessment of the share's liquidity.

Although the rating depends on stock liquidity indicators' recent performance, an analysis of the record of the assessed indicators is essential to determine a rating and maintaining it through the cycle.

The elements that Fitch considers in the analysis of stock market liquidity are described below.

Market Presence

Stock market presence is the main measure Fitch considers in determining market liquidity. In Chile, adjusted presence is measured as the number of days that an instrument has transactions of relevant amounts (defined by the regulator as daily transactions of at least 1,000 Unidades de Fomento) within the last 180 working days. This indicator provides a measure of the days on which a share registered relevant transactions, which is a good approximation of the number of days during which an investor would have the possibility to exit. Companies with relevant transactions almost every day have a high stock market presence, which could result in high liquidity.

Free Float

Fitch analyzes the floating percentage of shares in the market, which refers to shares authorized to be listed that are not held by majority or long-term shareholders. The higher this percentage is, the more liquid the share is likely to be.

Market Capitalization

Market capitalization reflects the market value of a public company at a particular date, calculated by multiplying the stock price by the number of shares outstanding. This variable generates a relative scale that ranks companies according to market size. Changes in stock market capitalization reflect the trend and volatility of market value.

Volumes Traded

This indicator reflects the value of transactions of a stock, defined by the number of traded securities in a period multiplied by the price of each transaction. The total traded volume of an issuer is compared with the overall market's total traded volume. The average daily traded volume is determined by the stock market presence and market capitalization, and reflects the monetary value of average daily volume of transactions for a security in a certain period.

Rating Scale

Stock ratings reflect the risks inherent to the issuer's credit rating and an instrument's stock market liquidity. However, ratings do not address the risk of losses associated with price changes and other market conditions, nor do they consider the appropriateness of prices to their market value. Ratings assigned on a national scale are not comparable across countries.

According to Article 91 of the Law No. 18,045, stocks in Chile are rated First Class, Second Class or without sufficient information, in accordance with the issuer's creditworthiness, the shares' characteristics and information about the issuer and its securities. Fitch defines the following rating scale for issuers/shareholders that submit sufficient information:

First Class Level 1(cl): Stocks that have excellent creditworthiness and stock market liquidity. Typically, companies assigned an Equity Rating of Level 1(cl) have the largest relative market capitalization in the Chilean market, a free float above 30%, a market presence of 100% on a sustainable basis and a credit rating of 'AA–(cl)' or above.

First Class Level 2(cl): Stocks that have very good creditworthiness and stock market liquidity. Typically, companies assigned an equity rating in Level 2(cl) have above-average market capitalization, a free float around 30% or above, a market presence higher than 80% on a sustainable basis, and a credit rating higher than 'A–(cl)'.

First Class Level 3(cl): These stocks that have an appropriate combination of creditworthiness and stock market liquidity. Typically, companies assigned an Equity Rating of Level 3(cl) have a credit rating of 'BBB+(cl)' or lower, regardless of market liquidity. Additionally, companies with a credit rating of 'A–(cl)' or higher can be assigned a Level 3(cl) if they have weaker liquidity ratios, such as lower sustained market presence, low relative market capitalization or low free float.

First Class Level 4(cl): These stocks have an acceptable combination of creditworthiness and stock market liquidity. Shares in Level 4 correspond to companies with a creditworthiness level 'BBB+(cl)' or lower, and/or very low market presence of less than 20%, and/or low float of under 20%, and/or small relative market capitalization. Additionally, shares conducting an IPO or those that have recently begun trading and have insufficient trading history are rated Level 4.

Second Class Level 5(cl): Stocks that, independently of their market liquidity, present a downward trend in its credit profile and have a non-investmen- grade credit rating.

Fitch will allocate a Category E(cl) rating to companies that do not submit sufficient information to assess their creditworthiness.

Additional Considerations: A few companies may have two classes of stock, e.g. voting and non-voting, or preference and non-preference. Typically, the non-voting/non-preference class of stock, often called B shares, will have stronger liquidity characteristics than the voting/preference shares, often called A shares. In these cases, the B shares will be assigned an equity rating based on the above criteria and definitions. The voting/preference A shares, despite lower liquidity metrics, may be, but are not always, rated up to the B shares' level if Fitch views the voting/preference A shares as having higher intrinsic value/attractiveness, adding to the shares' marketability in what could otherwise seem to be a less liquid market for the shares.