# Corporates Exceeding the Country Ceiling Rating Criteria

Sector-Specific

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This report updates and replaces *Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria*, dated 8 January 2021.

## Related Criteria

Country Ceilings Criteria (July 2020)
Corporate Rating Criteria (October 2022)

## Analysts

Johnny da Silva
+1 212 908 0367
johnny.dasilva@fitchratings.com

Nitin Soni
+66 6796 7235
nitin.soni@fitchratings.com

Rachel Chin
+44 20 3530 1629
rachel.chin@fitchratings.com

## Scope

This report outlines the considerations that may allow the ratings of a corporate issuer to exceed a Country Ceiling. A sovereign may prevent private-sector corporations from converting local currency (LC) to any foreign currency (FC) under a stress scenario, or may not allow the transfer of FC abroad to service FC debt obligations. This is known as transfer and convertibility (T&C) risk and is reflected in the Country Ceiling. These criteria apply globally to new ratings and the monitoring of existing corporate ratings.

## Key Rating Drivers

**Relative Importance of Key Rating Drivers**: When an issuer's LC Issuer Default Rating (IDR) is above the Country Ceiling of the relevant country, the primary driver of the FC IDR will be the Country Ceiling, which serves as a cap or limit on its FC IDR. When the LC IDR is at or below the applicable Country Ceiling, the LC IDR will be the primary driver of the FC IDR as it acts as a cap on the FC IDR.

Determining if the FC IDR can exceed the Country Ceiling requires two steps: firstly, we determine the applicable Country Ceiling; then, provided the LC IDR is higher than the applicable Country Ceiling, we assess whether the FC IDR can exceed it.

**Applicable Country Ceiling:** The country from which the issuer's cash flow originates defines the applicable Country Ceiling, regardless of where the company is headquartered or legally constituted. When dealing with multinational corporations with assets, operating facilities and cash flow generation in multiple countries, the approach to decide the applicable Country Ceiling is detailed on page 2.

**Exceeding the Country Ceiling:** Considerations when determining whether a corporate's FC IDR may exceed the applicable Country Ceiling are as follows:

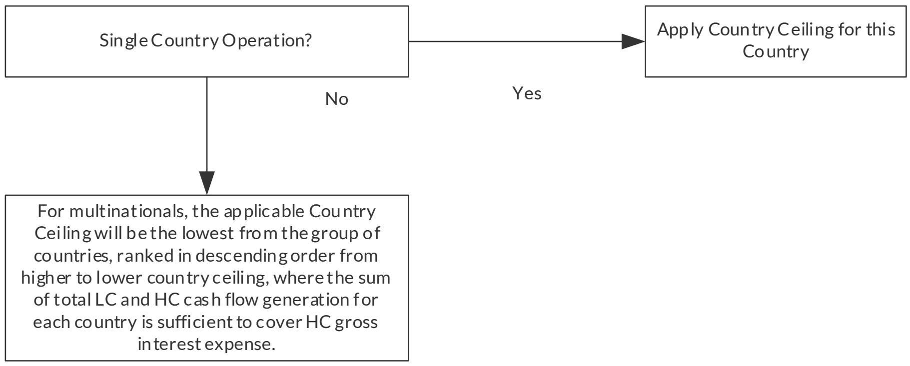
- **Offshore Structural Enhancements:** Debt issues that incorporate credit enhancement and mitigate T&C risks can be rated above the Country Ceiling, often by trapping FC cash flows offshore. This results in sufficient hard-currency (HC) debt-service coverage or debt-service reserves to allow the company to withstand a T&C event.
- **Strong Corporate Entities:** Corporates that are shielded from T&C constraints may also be rated above the Country Ceiling, considering substantial export earnings, foreign assets and offshore production. Support from foreign parents, or strategic partners providing financial support through foreign exchange can also allow the Country Ceiling to be exceeded.
- **Preferential Treatment by the Sovereign:** Issuers that benefit (or previously benefitted) from exemption from T&C constraints may be rated above the Country Ceiling.

## Applicable Country Ceiling

Using the flow chart on the next page, Fitch determines which Country Ceiling to apply to a particular corporate issuer.

We provide examples of how to determine the applicable Country Ceiling for multi-nationals on pages 4 and 5.

### Simplified Group Structure Diagram




Source: Fitch Ratings

If a certain country has restrictions in directing cash flows to the holding company, that country should be excluded from the list of countries used in assessing the applicable Country Ceiling.

Fitch's proxy for cash flow generation for determining the applicable Country Ceiling is earnings before interest, taxes, depreciation and amortisation (EBITDA). When a detailed split of EBITDA by country of origin is not available, Fitch may use the split of assets and revenues per country and the typical profit margin by type of business as a proxy.

Hard currency is defined by Fitch as being from a highly developed economy commonly used as a reserve. Fitch considers the following currencies, which are included in the IMF's COFER publications, as reserves: Australian dollar, Canadian dollar, Chinese renminbi, euro, Japanese yen, Swiss franc, UK pound and US dollar.

The rigour with which the applicable country ceiling is analysed is a matter of practicality, and can be the first step in an iterative process. We will undertake sufficient analysis to allow us to estimate the applicable ceiling and the allowable uplift, understanding that if we determine that the applicable country ceiling caps, or limits, the FC IDR below the LC IDR then we may need to deepen our analysis to be sufficiently informed to assign a final FC IDR. We may also determine that we do not need to form a firm view on the ceiling of all applicable countries to apply the criteria.

For example, where we determine that HC cash flow generation from a few countries with high ceilings is sufficient to support a FC IDR equal to the LC IDR, we may not form a view on the ceilings of other countries generating a small proportion of an entity's cash flows. Likewise, where a high proportion of cash flows is generated from HC EBITDA and the LC IDR is low, Fitch may use an internally generated assessment as a proxy for the Country Ceiling. A rating committee will determine whether the depth of analysis done to determine the applicable ceiling is sufficient to support the rating being assigned.

Once the applicable Country Ceiling is determined, the next step is to compare it to the LC IDR. If the LC IDR is lower than, or equal to the applicable Country Ceiling, then the FC IDR is equal to the LC IDR. If the LC IDR is higher than the applicable Country Ceiling, Fitch uses the following framework to determine whether any notching of the FC IDR above the Country Ceiling is appropriate.

## Framework for Notching Above the Country Ceiling

The effectiveness of financial structures, or incentives that limit a sovereign's capacity or willingness to impede an issuer's external debt service are considered by Fitch as key elements that may allow an issuer's FC IDR to be rated above the applicable Country Ceiling.

Although a balance-of-payments crisis and the controls imposed as a result could last longer than six to 18 months, Fitch believes that the duration – or the interruption of private-sector debt service associated with it – will be short. With this in mind, Fitch assesses the adequacy of offshore cash reserves and cash-generation ability when rating an entity above the Country Ceiling.

If cash abroad (including future cash generation and available committed lines) covers at least 12 months of HC external debt service (including debt amortisation and interest), then a rating above the Country Ceiling is possible. Likewise, should the coverage of HC external debt service fall short of 12 months' coverage, but other factors strongly mitigate T&C risks, Fitch could still rate a company above the Country Ceiling.

Factors that may allow an issuer's FC IDR to be rated above the applicable Country Ceiling are as follows.

### Offshore Structural Enhancements

HC external debt service in excess of 18 months could warrant more than one-notch uplift from the Country Ceiling. As most sovereign crises do not usually last beyond two to three years, Fitch could go three notches above the Country Ceiling if HC external debt service of 1.5x or higher is maintained for a minimum period of two years on a forward-looking, rolling basis. Fitch will look at the trend and thresholds do not need to be exactly met each year.

Fitch monitors the size of assets and cash flows held offshore over time. The quality and liquidity of offshore funds are likewise critical, with cash and cash equivalents held in highly rated financial institutions (investment-grade or at least three notches above the applicable Country Ceiling) and high-credit-quality instruments.

Many companies with ratings above the Country Ceiling are exporters with FC-denominated income streams, which are captured and retained offshore. From a practical perspective, these could be used to service external debt. FC trapped and held abroad is often an important driver of ratings above the Country Ceiling.

Despite the risks of government interference with FC cash flows, Fitch believes governments acknowledge the importance of a balance between appropriating an exporter's HC and allowing it to maintain sufficient HC to meet obligations and to avoid damaging the country's export capacity. As a result, Fitch discounts export EBITDA by 50% when assessing the capacity of an issuer to service its HC debt through the imposition of foreign currency exchange controls.

Fitch considers changes to laws and regulations that allow or prohibit companies from maintaining adequate funds offshore, i.e. surrender requirements. Often, lower-rated sovereigns require exporters to surrender or repatriate export proceeds within a certain period, e.g. within 180 days of export.

After factoring in a payment lag of 30 to 40 days, this provides a four- to five-month cash cushion that could be used for debt service in a crisis. Some foreign companies, as a result of transfer pricing rules, can permanently keep a certain percentage of gross export proceeds abroad and do the same with proceeds from any overseas asset sales.

### Country Ceiling Uplift Guide, Exports and Offshore Operations

| Notch uplift guidance above the applicable country ceiling | Debt-service coverage ratio:<br>(50% of HC EBITDA from exports<br>+ offshore operating EBITDA<br>+ offshore readily available cash and qualifying collateral<br>+ offshore committed undrawn credit facilities and liquidity facilities)<br>/ HC external debt service (x) | Minimum number of years maintaining HC external debt service |
|---|---|---|
| + 1 | 1.0-1.5 | 1 year |
| + 2 | >1.5 | 18 months |
| + 3 | > 1.5 | 2 years |

Note: Upward notches of more than three are possible in limited circumstances. The HC external debt-service coverage should be maintained throughout the rating-case forecast period.
Source: Fitch Ratings

As summarised in the table above, Fitch's core approach is to assess the issuer's ability to service HC external debt, which includes interest and debt amortisation (excluding short-term trade finance) from recurring HC and LC cash flow generation or available liquidity, which the company can choose not to re-route to the country or countries where the Country Ceiling is applicable. This typically includes:

- HC export EBITDA: 50% from the applicable Country Ceiling country or countries,
- Offshore HC and LC EBITDA generation from subsidiaries or operations in all countries, excluding the country from the applicable Country Ceiling, provided that the Country Ceiling rating of the countries where the operations are located is (at the minimum) in the same rating category or up to three notches lower than the applicable Country Ceiling;
- Assets offshore, especially HC liquid assets defined by Fitch as readily available cash (for example, as a result of rules allowing exporters to maintain cash balances offshore) that are available for HC external debt service. Fitch may consider readily marketable collateral assets with resilient valuation as well as readily available cash deposited regularly in accounts of financial institutions rated investment-grade or at least three notches above the applicable Country Ceiling; and
- Committed credit lines and committed liquidity lines in HC from highly rated international banks that are available to pay FC debt offshore, especially credit lines without a meaningful material adverse change clause that enable corporations to withdraw committed facilities in FC in the event of a sovereign crisis or other risk events.

When dealing with multinationals that have debt allocated in different countries (regardless of the currency), Fitch also includes the debt service of those countries (both HC and LC) that are used in the calculation of the HC debt-service coverage when applying the framework to notch above the Country Ceiling.

### Support from Foreign Owner/Partner

A strong foreign owner or a strategic partner that could be relied on as a source of HC foreign exchange and other financial support in the absence of a formal guarantee may allow an issuer FC IDR to be rated above the applicable Country Ceiling.

### Preferential Treatment by the Sovereign

A record of historical preferential treatment by the sovereign, including exemption from past T&C constraints, exemption from surrender requirements for export proceeds, and favourable tax treatment.

### No Limit on Notching Above the Applicable Country Ceiling

Fitch does not impose a limit on notches above the Country Ceiling, as the risk mitigation could in some cases be sufficient to warrant a rating that is multiple notches above the Country Ceiling.

More than three notches uplift above the Country Ceiling is reserved for credits with a strong, supportive foreign parent and/or substantial multinational operations ensuring the company has clear financing sources outside the purview of the sovereign or sovereigns of the applicable Country Ceiling or Ceilings. Such substantial risk mitigation can occur, for example, in the case of a company with a highly rated foreign parent deemed very likely to support its subsidiary's debt-service obligations. See *Parent and Subsidiary Linkage Rating Criteria* for further details.

However, any uplift of the FC IDR would still be limited to the LC IDR of the issuer as the LC IDR acts as a cap to the FC IDR.

## Examples of Multinational's Applicable Country Ceiling and Notching Above the Country Ceiling

Each example assumes HC gross interest expense is 25, the Country Ceiling is equal to the sovereign rating, and the entity is domiciled in a 'B' rated sovereign with fully owned subsidiaries in the other countries.

In all the examples below, we assume that the issuer has HC export EBITDA. This is a component of the HC EBITDA figure and the total EBITDA figure that is used to determine the applicable Country Ceiling. For simplicity, the actual HC export EBITDA figure is not provided for the purposes of calculating the debt-service coverage ratio.

### Example 1

| Country Ceiling | LC EBITDA | HC EBITDA | Total EBITDA |
|---|---|---|---|
| BBB+ | 10 | 10 | 20 |
| BBB | 15 | 15 | 30 |
| BB | 10 | 15 | 25 |
| BB- | 5 | 20 | 25 |

Source: Fitch Ratings

The applicable Country Ceiling is 'BBB' as total LC and HC EBITDA from country 'BBB+' and country 'BBB' are enough to cover the HC gross interest expense of 25. The applicable Country Ceiling is set at the lower level of these two countries, i.e. 'BBB'.

When calculating the debt-service coverage ratio to assess whether to notch above the Country Ceiling relative to the HC external debt service, only the HC and LC (10 + 10) of EBITDA generated in the 'BBB+' country, the LC and HC (10 + 15) of EBITDA generated in the 'BB' country and 50% of HC EBITDA from exports (figure not provided) in the 'BBB' country can be considered.

The LC and HC EBITDA generation in the 'BB-' country cannot be included as it comes from a country whose rating is more than three notches away from the 'BBB' applicable Country Ceiling.

### Example 2

| Country Ceiling | LC EBITDA | HC EBITDA | Total EBITDA |
|---|---|---|---|
| BBB | 10 | 10 | 20 |
| BB | 5 | 10 | 15 |
| B+ | 15 | 20 | 35 |
| B | 20 | 10 | 30 |

Source: Fitch Ratings

The applicable Country Ceiling is 'BB' as total LC and HC EBITDA from country 'BBB' and country 'BB' are enough to cover the HC gross interest expense of 25. The applicable Country Ceiling is set at the lower level of these two countries, i.e. 'BB'.

When calculating the debt-service coverage ratio to assess whether to notch above the Country Ceiling relative to the HC external debt service, all LC and HC EBITDA from the 'BBB', 'B+' and 'B' countries as well as the 50% of HC EBITDA from exports (figure not provided) from the 'BB' country can be considered.

### Example 3

| Country Ceiling | LC EBITDA | HC EBITDA | Total EBITDA |
|---|---|---|---|
| BBB | 10 | 10 | 20 |
| BB | 10 | 10 | 20 |
| BB– | 10 | 10 | 20 |
| B | 10 | 10 | 20 |
| B– | 10 | 10 | 20 |

Source: Fitch Ratings

The applicable Country Ceiling is 'BB' as total LC and HC EBITDA from country 'BBB' and country 'BB' are enough to cover the HC gross interest expense of 25. The applicable Country Ceiling is set at the lower level of these two countries, i.e. 'BB'.

When calculating the debt-service coverage ratio to assess whether to notch above the Country Ceiling relative to the HC external debt service, all LC and FC EBITDA from the 'BBB', 'BB-' and 'B' countries as well as 50% of the HC EBITDA from exports (figure not provided) from the 'BB' country can be considered. The LC and HC EBITDA generation in the 'B-' country cannot be included as it comes from a country with a rating more than three notches away from the 'BB' Country Ceiling.

## Rating Assumption Sensitivity

Below is a non-exhaustive list of the primary sensitivities that can influence the applicable Country Ceiling, or the assessment of whether the FC IDR of an issuer is capped by a Country Ceiling.

### Applicable Country Ceiling

- Changes in the Sovereign Rating or the Country Ceiling of the country or countries where operations take place, including the country that is determined to be the applicable country for the Country Ceiling; and
- When dealing with multinationals, changes in LC and FC cash flow from a country that is one of the countries used to determine the applicable Country Ceiling can lead to a change in the applicable Country Ceiling.

### Assessment of Whether the FC IDR Is Capped by the Country Ceiling

- Changes in HC interest expenses and/or in cash flow generation in the various countries of operations can result in a different applicable Country Ceiling; and
- Changes in EBITDA generated by exports from the applicable Country Ceiling country or countries, in EBITDA from subsidiaries or operations in countries that did not determine the applicable Country Ceiling, in offshore readily available cash or available committed credit lines, and in the HC debt-service burden can lead to a change in the number of notches applied above the Country Ceiling.

## Information and Limitations

### Limitations

The assessment of an issuer's ability to limit its T&C risk is part of the qualitative assessment within Fitch's analysis of an issuer. Guidelines included in these criteria will be extrapolated based on Fitch's judgment, and may be limited by access to specific information by the issuer and historical events related to sovereign defaults and expectations of behaviour.

Ratings, including Rating Watches and Outlooks, are subject to the limitations specified in Fitch's Ratings Definitions, available at https://www.fitchratings.com/site/definitions.

### Data Sources

Key assumptions underlying these criteria are developed by the analysis of historical precedents of foreign exchange transfer and convertibility controls imposed by governments and their impact on the ability of corporates to service their FC commitments.

For rating entities under these criteria, Fitch uses historical and projected data for HC external debt service, EBITDA, revenue, or asset breakdown by country, EBITDA from exports, offshore operating EBITDA, offshore readily available cash, and offshore committed undrawn credit facilities.

Please refer to the *Corporate Rating Criteria* for further detail on data sources and information usage in the rating process.

## Criteria Disclosure

The following elements are included in Fitch's rating action commentary and issuer research reports:

- The applicable Country Ceiling when it is exceeded;
- The split of assets and revenues by country, combined with the typical profit margin by type of business, is used as a proxy; when a detailed split of EBITDA by country of origin is not available for determining the applicable Country Ceiling of a multinational;

- When an uplift above the Country Ceiling is based on the coverage of HC external debt service in the rating horizon on a rolling basis. Fitch will disclose when the thresholds are not met in any particular year, but are sufficiently strong on average to allow the notch uplift; and
- When more than a three-notch uplift above the Country Ceiling has been allowed because a strong, supportive foreign parent and substantial multinational operations ensure that the company has clear financing sources outside the purview of the applicable Country Ceiling or Ceilings.

## Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgment exercised through committees. The combination of transparent criteria, analytical judgment applied transaction-by-transaction or on an issuer-by-issuer basis, and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature, or other factor relevant to the assignment of a rating and the methodology applied to it are both included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

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