Crisil
Ratings

Crisil Ratings criteria for rating holding companies

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1 Executive summary

Promoters typically route their equity investments in listed operating companies through holding companies, which have minimal business operations of their own and hence derive their value from the cash flows of operating companies. Holding companies may raise debt on the strength of their investments in operating companies to fund further investments in, and advance loans to, operating companies; the debt is usually refinanced on maturity. Crisil Ratings, therefore, considers the holding company's refinancing ability as the primary criterion driving its credit rating. Refinancing ability is assessed based on the cover provided by the market value of shareholdings in listed operating companies, and on the credit risk profiles of the operating companies. The management quality of promoters is also considered while assessing the refinancing ability of the holding company, as high-quality promoter groups will have easier access to funds due to their market reputation.

Subsequently, in April 2022, the RBI issued a guidance note (GN) to the credit rating agencies (CRAs) on assigning 'CE' ratings for bank loan facilities. This was followed by a set of FAQs on 'CE' ratings for bank loan facilities that the RBI shared with CRAs in July 2022.The GN and FAQs have laid down broad principles based on which 'CE' Ratings shall not be assigned on the basis of credit enhancement derived through pledging of shares. Accordingly, Crisil Ratings has modified the criteria and will not assign 'CE' ratings, for bank loan facilities, on the basis of credit enhancement derived through pledging of shares. However, for capital market facilities, Crisil Ratings may consider pledge of shares as a valid supporting structure for assigning 'CE' ratings[1].

2 Scope of criteria

This article[2] details Crisil Ratings methodology in rating debt raised by a holding company on the strength of its shareholding in listed operating companies. It outlines the cover requirements for each rating category, and the links between the rating of the holding company and those of its operating companies. The document also covers Crisil Ratings' approach to financial ratios used for analysing holding companies, including adjustments it carries to the reported metrics in the financial statements.

3 Methodology

Crisil Ratings on holding companies are driven primarily by the companies' refinancing ability. Refinancing ability is, in turn, assessed based on:

- Cover available from the market value of shareholdings in listed operating companies
- Management quality of promoter group
- Credit risk profiles of the operating companies

[1] Ratings with 'CE' suffix can be assigned for capital market instrument only in cases where the enhancement (in terms of pledge of shares) is being provided by a third-party. Hence, any instrument backed by pledge of shares of the subsidiaries/associate companies (owned by the issuer itself) will not qualify for a 'CE' rating

[2]The previous version of this article can be accessed here: https://www.crisilratings.com/content/dam/crisilrating/criteria-and-methodology/criteria-for-holding-companies/archive/criteria-for-holding-companies-june-2023.pdf

4 Cover available from listed shares

The available cover is the market value of listed shares held by the holding company as a multiple of the debt being raised—drives a holding company's refinancing ability. The more sizeable the available cover the greater would be the lenders' willingness to refinance the debt.

$$\textbf{Cover available} = \frac{\text{Market value of listed shares}}{\text{Total debt cap}}$$

In rating a holding company, Crisil Ratings analyses the available cover with respect to minimum requirements as calibrated for each rating category. The cover required for each rating category has the following constituents:

- Base cover: corresponding to the rating
- Alpha cover: to account for prevalent market conditions, and
- Beta cover: to account for stock-specific volatility

For a holding company to be assigned a particular rating, the market value of the listed shares held by it should provide a cover equal to the sum of the base cover for the rating category, the alpha cover, and the beta cover.

For a holding company rated 'Crisil BBB', for instance:

The available cover (market value of listed shares held / quantum of debt raised) = the cover required for the BBB rating = the base cover for the BBB rating + alpha cover + beta cover

4.1.1 Base cover

Crisil Ratings has calibrated the base cover requirement for each rating category based on analyses of the peak drops in market capitalisation of around a thousand listed and rated entities in India over the last decade. The base cover required increases as one moves up the rating scale, to provide greater cushion against a drop, if any, in share price. The base cover is also differentiated based on the tenure of the transaction as historically, share price drops within a year have been less steep than, say, over a span of two years. In calibrating the base cover requirement for each rating category, Crisil Ratings also factors in the typical collateral cover stipulated by lenders.

4.1.2 Alpha cover

The mean reversion theory of asset price movements states that asset prices may converge to a long-term mean equilibrium. If the short-term price, therefore, exceeds the longer-term average, there is a greater likelihood of a decline in price over the short term and vice versa. Crisil Ratings accounts for this market risk associated with equities as an asset class, by adding a safety factor to the base cover requirement. The safety factor, called alpha cover, is based on the prevailing state of the equity markets—whether agitated, neutral, or depressed—and is gauged by comparing the short-term price movements of the NIFTY 50 Index with longer-term price movements. The base cover requirements may be adjusted upwards if the markets are in an agitated state, or downwards if the markets are in a downturn.

4.1.3 Beta cover

The share prices of different companies respond differently to the market movement of equities as an asset class. In financial parlance, the responsiveness is denoted by beta (β), which measures the volatility of a stock with respect to market movements. Crisil Ratings adjusts cover requirements to account for the degree of responsiveness of the stock to market trends. If the beta of the holding company's shareholdings is high—indicating a high degree of volatility with respect to market movements—Crisil Ratings adds additional cover to the base and alpha covers to factor in the likelihood of a steeper drop in share price, in the event of a downturn in the equity markets.

4.2 Management quality of promoter group

Refinancing ability of the holding company also depends on the management quality of the promoter group. Crisil Ratings considers the investment philosophy, financial policies, and risk appetite of the promoter group while evaluating the management quality.

High quality promoter groups with strong market reputation may have better access to funds and enjoy high refinancing ability. Crisil Ratings may rate holding companies of such promoter groups higher than the rating as per the cover available, considering their high refinancing ability.

4.3 Links with the credit risk profiles of operating companies

Holding companies do not have business operations of their own, and hence, derive their value from the cash flows of operating companies. Any stress in operating companies will constrain the holding company’s cash flows and even the market value of its shareholdings, thus limiting its ability to refinance and service debt. Crisil Ratings, therefore, also links the holding company’s rating to the credit risk profiles of its operating companies. Irrespective of the cover available and the management quality, the holding company’s rating is anchored around the rating corresponding to the average credit risk profile of the operating companies, weighted by the market value of the holdings in these operating companies.

4.4 Liquidity, other considerations

As holding companies do not have business operations of their own and depend on upstream cash flows from underlying operating companies, liquidity in the form of cash balance or steady stream of cash inflows may be limited. Financial flexibility of the holding company to raise funds when required therefore determines availability of liquidity for the entity. This is factored through the cover available in the form of shareholdings in its listed operating companies.

Crisil Ratings also considers the repayment profile of the debt raised by the holding company. While the principal is usually refinanced, interest payments may be met from available cash flows. In such cases, Crisil Ratings evaluates the adequacy of the available cash flows in servicing interest on the debt.

Crisil Ratings deviates from the cover requirements only in exceptional circumstances. For instance, Crisil Ratings may consider lowering the cover requirement if the holding company receives cash flows from its holdings in unlisted operating companies, or if there is a clearly laid-out plan to infuse funds into the holding company. In some cases, the cover may be calculated based on the debt cap stipulated by the management, rather than on the actual debt raised.

5 Surveillance

Once a holding company’s rating is published, the rating is placed under continuous surveillance. Crisil Ratings monitors the available cover based on the market value of holdings in operating companies. Equity prices are highly volatile and may rise or fall over the short term, driven by market sentiment. Crisil Ratings takes into account whether the change in available cover is secular and driven by a structural shift affecting the fundamental performance of the operating companies, rather than by short-term market sentiment while reviewing its ratings on such instruments.

6 Conclusion

Crisil Ratings rates debt raised by a holding company based on its refinancing ability which is, in turn, determined by the cover available from the market value of its shareholdings in listed operated companies, management quality of the promoter group, and by the credit risk profiles of these operating companies. The cover requirements for a particular rating include a base cover corresponding to the rating, an alpha cover to account for market risks, and a beta cover to account for stock-specific volatility. The final rating of the holding company is also linked to the average credit risk profiles of its listed operating companies, weighted by the market value of its holdings in these companies. For bank loan facilities, Crisil Ratings does not consider debt backed by pledge of shares as valid supporting structure for assigning 'CE' Ratings. However, for capital market facilities, Crisil Ratings may consider pledge of shares as valid supporting structure for assigning 'CE' ratings.

About Crisil Ratings Limited (A subsidiadry of Crisil Limited, a company of S&P Global Company)

Crisil Ratings pioneered the concept of credit rating in India in 1987. With a tradition of independence, analytical rigour and innovation, we set the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 35,000 large and mid-scale corporates and financial institutions. We have also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and infrastructure investment trusts (InvITs). Crisil Ratings Limited ("Crisil Ratings") is a wholly-owned subsidiary of Crisil Limited ("Crisil"). Crisil Ratings Limited is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI").

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Large and highly respected firms partner with us for the most reliable opinions on risk in India, and for uncovering powerful insights and turning risks into opportunities globally. We are integral to multiplying their opportunities and success.

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