Investment Holdings and Conglomerates

Rating Criteria

Scope of the Criteria

Lianhe Ratings Global Limited ("Lianhe Global") applies the investment holdings and conglomerates criteria to investment holding companies which primarily act as financial investors holding equity stakes in a number of private or publicly traded companies. The criteria also describe Lianhe Global's general approach for assessing credit profiles of conglomerates which usually hold controlling stakes (typically wholly or majority-owned) in several main operating subsidiaries across various businesses.

Investment holding companies mainly focus on capital gains and dividends with the ultimate intention to dispose of invested entities. Controls are limited, operational integrations are normally non-existent, and funding is managed separately. On the other hand, conglomerates tend to control their invested subsidiaries and integrate them at least within each business line, and apply a more centralised approach in funding management. Conglomerates' investments are generally not for capital gains.

Lianhe Global uses the criteria corresponding to a company's main business activities and key risk features and may employ other criteria to complement the analysis. Furthermore, the criteria do not represent a comprehensive coverage but only address key rating factors.

Rating Approach and Key Credit Factors for Investment Holding Companies

The following diagram shows Lianhe Global's general approach in assessing an investment holding company's standalone credit profile and the likelihood of external support that the entity will receive in case of need, i.e. to sustain the company's viability. We incorporate the availability of external support into the assessment of a company's standalone credit strength to assign a credit rating to the entity.

The assessment analysis of an investment holding company's standalone creditworthiness is assessing the probability of the entity that will default or need to receive external support to avoid a default. We use a combination of qualitative and quantitative analysis to assess four key credit factors: investment strategy and risk appetite, governance and management, portfolio quality and diversity, and financial structure and flexibility.

The analysis usually focuses on the evaluation of non-consolidated financials of an investment holding company, availability and predictability of investment income and liquidity, and asset portfolio valuation and volatility. However, credit profiles of invested entities may also be taken into consideration shall strong credit linkage between the investment holding company and its major investments is perceived. For example, the investment holding company significantly relies on certain invested entities for cash flow streams. In addition, ratings assigned are based on our forward-looking expectations. We assess an investment holding company's historical operational and financial performance as well as its strategy and business model to arrive at a forward-looking view of its credit profile.

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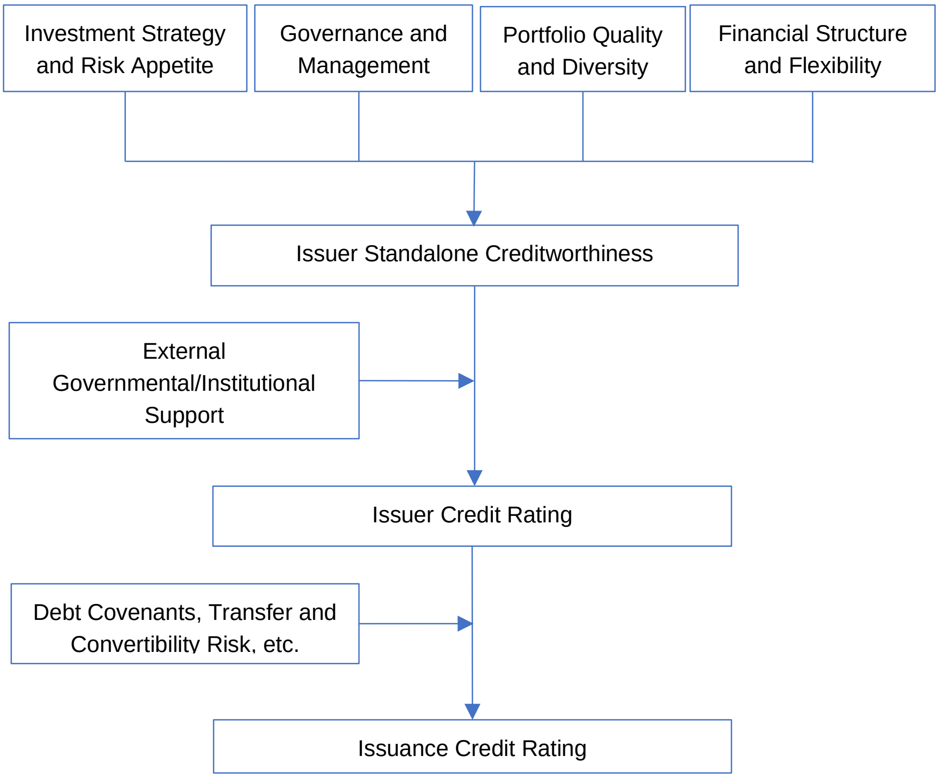
The rating framework for investment holding companies:



Key Credit Factor	Sub Factor
Investment Strategy and Risk Appetite	Investment Strategy and Execution
	Risk Appetite and Track Record
Governance and Management	Corporate Structure and Governance
	Management Quality
Portfolio Quality and Diversity	Asset Concentration
	Geographic Diversity
	Business Diversity
	Asset Quality and Valuation
Financial Structure and Flexibility	Financial Policy
	Debt Servicing Capability
	Liquidity and Funding

Investment Strategy and Risk Appetite

A clearly-defined, transparent and consistent investment strategy, along with successful execution of such strategy through the consistent adherence to the strategy with minimal deviation, helps to establish a long-term insight for the business and credit profiles of an investment holding company. Also, a balanced risk appetite, well-established risk assessment framework and proven track record are crucial to the investment holding company's credit profile.

Investment Strategy and Execution

Investment strategies and business objectives give an investment holding company a guideline and direction from where to start and where the organisation is going, while successful execution turns strategic objectives into performance. The objective setting should be clearly-defined, measurable, achievable and transparent. A strong commitment to a publicly communicated strategy will be preferred. Also, the execution of the strategies and objectives will be considered by examining the adherence to the strategies, as well as the extent and frequency of the investment decision which deviates from the strategies.

Risk Appetite and Track Record

A sound risk management framework should be able to identify the risk universe and quantify specific and aggregate risk exposure, as well as potential loss. Similarly, a well-established risk mitigation mechanism should be able to ensure the risk levels remain at an optimal threshold. Risk policies and governance clearly define and segregate duties and assign authority to employees, committees and the board for approval and execution of various risk limits and exceptions to limits.

As a whole, an investment holding company's attitude to investment risks, risk assessment framework and investment decision-making process will be assessed. An investment holding company should implement monitoring systems for its risk exposures and losses. Also, the company should be able to maintain a track record of achieving the stated targets consistently.

Governance and Management

Prudent governance and professional management are essential for the achievement of an investment holding company's business and financial objectives and ensuring good internal control and in compliance with regulatory requirements.

Corporate Structure and Governance

Prudent governance practices support an investment holding company to achieve long-term business success and financial stability. The board members (directors) are elected by the shareholders to oversee the company's interest in the long-term health and the overall success of the business and financial strength. We examine features (including but not limited to) such as the ownership and organisational structure, reporting hierarchy, board composition and independence, board committees, related party transactions, material litigations and prior regulatory sanctions, etc.

A complex and opaque organisational structure, including layers of intermediate holding companies, may raise concerns over effective management, corporate governance and inappropriate intra-group transactions. Publicly listed entities usually have better disclosures and governance practices as they must abide by both listing and regulatory rules. However, private-owned institutions are not necessarily calls for concern.

Management Quality

Professionalism and integrity are two important features in quality management. A solid management team shows good credibility and competence. It manages business in a professional and ethical manner and has a proven record of achieving a company's business and financial goals. The remuneration scheme is established to ensure the alignment of the management's interests and risk preferences with those of the organisation and its stakeholders. Mitigations of key man risk (such as an established succession plan) are also essential especially for a company with a reliance on a specific individual or a few individuals.

Portfolio Quality and Diversity

We focus on investment diversification and valuation to assess an investment holding company's investment portfolio and may also look at the credit quality of invested assets to evaluate the risk of asset impairments. Generally, fair valuation with good transparency and disclosure helps us evaluate the performance of an investment holding company's invested assets. An investment portfolio with low concentration is also considered to be less risky compared with the one with high concentration.

We examine the concentration in terms of asset allocation, geographic distribution and business mix to assess the diversity of the investment portfolio. Normally, a more diversified investment portfolio with diversified sources of income and portfolio value has a better support to an investment holding company's earnings and portfolio value stability, given that it is less likely to be heavily relied on specific investments, industries and/or geographic economies which could cause earnings volatility and risk concentration. Lack of diversification is usually a credit weakness for an investment holding company.

Asset Concentration

High asset concentration occurs if major investments or a limited number of holdings command a high proportion of the total investment portfolio of an investment holding company. The value of an investment holding company's major investments (usually defined as the three largest investments in terms of market value) as a percentage of total portfolio value is measured.

The cash balance is included in the total portfolio value of an investment holding company, but it would not be counted as a major investment when assessing the asset concentration risk of the company. It is due to the fact that cash is highly liquid and not a risky asset in nature.

Geographic Diversity

An investment holding company could avoid significant influence or volatility on its investment portfolio from a specific region by establishing a high level of geographic diversification. The countries or regions where the investments operated in and assets distributed in will be examined.

Normally, an investment portfolio with a high level of geographic diversity brings stability to its earnings and portfolio value. Having said that, countries and regions with high correlations on their economic performance may also be considered when assessing the geographic diversity.

Business Diversity

Similar to asset concentration and geographic diversity, an investment portfolio with a high level of business diversity (i.e. the diversification across a variety of industries, sectors and segments) may help an investment holding company avoid a volatile performance owing to fluctuation from any specific industry. The number of business sectors and the weight of each sector in the investment portfolio of an investment holding company will be examined.

Besides, whether the exposure to the main sectors is balanced by exposure to unrelated sectors will also be considered.

Asset Quality and Valuation

We use available market prices or other valuation methods to derive the fair value of invested assets, and a haircut may be applied to unlisted or illiquid assets. Asset impairments would also be considered for investments with weak credit quality.

Listed investments are generally more transparent in assessing their market values, as market prices of these investments are available, in particular if they are listed in liquid markets. Also, well-regulated markets requiring adequate and timely disclosure of significant information of listed companies help enhance the quality of information. On the contrary, accurate valuation on unlisted investments is challenging given that the information and data of these investments are probably limited, not timely and difficult to be verified.

Financial Structure and Flexibility

We examine an investment holding company's financial soundness by analysing its financial policy, debt servicing capability, liquidity profile, and external funding accessibility and diversity, as well as related key financial metrics, including their historical trends, stability and expectations.

Financial Policy

An investment holding company tends to face greater volatility in its financial leverage relative to other corporates given its exposure to equity risks and fluctuations in asset values. A prudent financial policy would prevent a company from taking excessive risk and indebtedness, while maintaining adequate capital buffers to withstand adverse movements in earnings and capital markets to sustain its viability. Adequate capitalisation also helps maintain investors' confidence in a company and secure its funding accessibility.

We assess an investment holding company's financial policy by looking at its committed capitalisation and leverage, historical levels and stability, and any monitoring and prevention mechanisms in place. An effective management should ensure the company's capital adequacy is commensurate with the risk involved, taking into account investment risks, dividend payouts, potential capital market volatility, etc.

Debt Servicing Capability

Equity investments usually represent the majority of an investment holding company's assets, although other investments, such as real estate and fixed-income instruments, are possible. An investment holding company may fund part of its investments through debt financing. Total debt to the asset value of the investment portfolio ("Loan-to-value ratio" or "LTV ratio") and interest and expense coverage (investment income over interest payments and other recurring expenses) at the investment holding company level are primary financial metrices we commonly look at to measure an investment holding company's debt servicing capability. We may also consider LTV ratios under stressed scenarios and other ratios, such as total debt over investment income, returns on equity, dividend payout ratios, where relevant.

The LTV ratio reflects the potential value of assets available to support an investment holding company's debt obligations. Generally, the higher the LTV ratio, the higher the default risk of the investment holding company, given the lower haircut or buffer of its capital or investment portfolio to cover its debt. On the contrary, a company with lower LTV ratio usually has a lower default risk and higher ability to raise debt. Cash balances are excluded from both asset value and total debt, and other adjustments on debt can also be made, for instance, incorporating other debt obligations and guarantees. Apart from the ratio itself, other characteristics of the investment portfolio, such as the portfolio quality and diversity aforementioned, will also be taken into consideration, as these factors may have an impact on the monetization ability of the investment portfolio.

Interest and expense coverage ratio measures the company's ability to honour its interest payment and recurring expense given its current and expected earning power. Generally, the higher the ratio, the stronger the coverage from its earnings to cover its interest payment and other recurring expense. Investment income generally includes interest income, dividends, capital gains upon disposals of investments, and any other income from invested assets, while the proportion and stability of recurrent income are essential. Other recurring expense mainly includes operating cost and tax expense. Dividend payment is generally not regarded as recurring expense, as it is considered as a distribution of earnings to shareholders of an investment holding company.

Total debt over investment income ratio measures the ability of an investment holding company to honour its debt obligation by its earnings, as measured by the number of years it will take an investment holding company to repay its debt given its current and expected earning power. Generally, the lower the ratio, the stronger the coverage of the debt from its earnings.

Liquidity and Funding

We assess an investment holding company's readily available liquid assets, committed credit facilities and contingency funding plans to meet its debt obligations and potential funding needs. The assessment of an investment holding company's liquidity profile focuses on the liquidity of investment portfolio, liquid assets to short-term debts, and recurrent cash flows. The liquid assets to short-term debt ratio considers and compares the available liquid assets which generally include cash balance and available assets for sale, and short-term debt obligations which mainly include debt repayment within the next 12 months.

A liquid asset portfolio shall enable the investment holding company to sell its investment reasonably quickly without incurring a significant decline in the asset value. We also look at the readily available and potential liquidity from other sources (such as committed credit facilities), the ability to access capital markets to raise funds, the funding structure (e.g. short-term vs. long-term), and the arrangement of rolling over the short-term debt to assess the funding diversity and stability.

External Support Assessment

External support typically comes from the governmental authorities of the country/region where an investment holding company is domiciled or from the company's shareholders. Governmental authorities include the government of the nation, any political subdivision thereof, whether state or local, and any agencies and regulatory bodies pertaining to the government. We assess both the capability and willingness of the potential supporter to provide assistance to sustain the company's viability.

Government Support

We consider that the government's long-term rating/internal credit assessment best captures its capability to provide support to a company. A company's government ownership and control, strategic importance, potential impact of default, and track record of support are key considerations in assessing the public authority's willingness to provide support.

Institutional Support

The institutional parent's credit strength as reflected in its issuer rating/internal credit assessment, its relative size to the subsidiary, and relevant regulations governing the group's operations (particularly the capital and liquidity flows within the group) affect the parent's ability to provide support. In cases where the parent's rating has factored in potential government support, we assess whether this support would flow through to the subsidiary.

The strategic importance of a company to its parent is usually the key factor in assessing the parent's willingness to provide support. The likelihood tends to be high should the subsidiary represent an essential part of the group's operation, carry the same brand name, and its failure may bring reputational risk to the group.

General Approach and Considerations for Rating Conglomerates

A conglomerate typically invests in a number of subsidiaries either wholly owned or majority-owned across various industries. When a particular business segment drives a conglomerate's credit profile, we apply the relevant rating criteria related to this business segment for the credit assessment of the conglomerate, while considering risks/benefits arising from other businesses.

On the other hand, we separately assess the credit profile of a conglomerate's each major business line using respective applicable rating criteria to form a balanced view on the group's overall credit profile. We consider that a weighted sum-of-the parts analysis is an appropriate approach in most cases where a conglomerate acts as one single entity in managing the group's overall business strategy and financial policy. No significant barriers in capital/funding allocation exist within the group and intra-group financial support is expected if needed, particularly to the group's major subsidiaries. The weighting shall represent the contribution of each major business segment to the group's credit quality. Cash flow metrics, such as each major business segment's share of the group's EBITDA, are common approximations for the weighting, although other metrics may be used in some cases.

We may also consider other factors, e.g. potential industry and/or geographic diversification benefits in asset allocations and cash flow streams, the relationship between the parent and subsidiaries, and the ownership structure and debt leverage at the parent level, and incorporate government or institutional support where applicable. We usually view a conglomerate with businesses across various unrelated industries and locations can enjoy diversification benefits, but additional risks could arise due to business complexity. The existence of minority shareholders, debt covenants, and potential regulatory restrictions at subsidiaries may constrain a conglomerate's ability to shift funding across the whole group and limit the available debt capacity and financial support to the holding company or affiliates.

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