

Investment Holding Companies Rating Criteria

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Summary

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These rating criteria explain CSPI Ratings' analytical approach to assigning ratings for investment holding companies (IHCs) whose main business is to generate investment capital gain and dividend cashflows on a long-term basis. We distinguish IHCs from industrial conglomerates and investment management companies based on their management strategy, operational integration, source of funding, control of investments, value creation and so on. In this report, we focus on credit risks and rating factors of IHCs.

The general framework of our rating criteria for IHCs is similar to that of our general corporate rating criteria. Our analysis of an IHC's credit risks leads to our assessment of its business profile and financial profile, which are combined to derive its indicative credit score (ICS). We will then consider other factors like corporate structure and governance, holding company liquidity and a supplementary analysis for an IHC's stand-alone credit profile (SACP). Lastly, potential government or parental support will be assessed to derive an IHC's issuer credit rating (ICR).

An IHC's business profile consists of three rating factors, namely macro-environment, the IHC's industry risk profile and operations profile, whilst the financial profile focuses on the IHC's financial policy, investment portfolio leverage (IPL) and portfolio asset liquidity. Each of these rating factors is decomposed to multiple sub-factors in our analysis and then combined to form our analytical opinion of an IHC's credit risks and associated ratings.

We developed these criteria to address the difference in credit risk characteristics between an IHC and a typical industrial corporate entity. However, we also recognize the high commonalities in the credit risk factors of these two types of issuers. As a result, readers should read this criteria report in conjunction with our general corporate rating criteria.

These criteria will be effective immediately on the date of final publication and we intend to complete the review of all affected ratings, if any, within the next six months. We expect no impact to our current rating portfolio from the completion of these criteria.

Definition of Investment Holding Company

CSPI Ratings defines investment holding companies (IHCs) as companies whose main business objective is to hold stakes in other companies for long-term investment and derive value through investment income such as dividends and capital gains.

CSPI Ratings recognizes there are several differences between an IHC and an industrial conglomerate. In our view, the single most significant difference is the IHC's operational strategy to act as a financial investor and its fundamental objective of seeking financial returns through equity investments. Business synergies among investee companies are not the main consideration for the IHC. The investee companies and the IHC often separate their financial resources and debt obligations. Cross-default clauses are very rare among investee companies and their holding company. On the other hand, a conglomerate often acts as a single entity and there is no significant barrier for the group to reallocate financial resources among the subsidiaries and parent company. Conglomerates often aim for a long-term business strategy that may maximize the value of the entire group, while coordination and cooperation among subsidiaries and the parent company are common.

Another difference is an IHC often takes minority stakes in their investee companies and doesn't influence the daily operations and management of the investee companies. Even though an IHC may acquire majority stakes in investee companies, its involvement in the majority-owned subsidiaries' operations is limited. In contrast, a conglomerate often controls its key subsidiaries through their board and management teams, and actively shapes their strategies and business directions to serve the overall strategy of the conglomerate. A conglomerate parent often owns majority shareholdings of its key subsidiaries, and the management integration between the parent and subsidiaries is usually very high.

The last difference is the investment horizon and rotation of investments. An IHC often rotates its investment holdings in investee companies and will add new investments and exit previous investments within a shorter period than a conglomerate. An IHC may divest investments in investee companies as long as it meets its investment return targets. However, a conglomerate's investment in its subsidiaries are often long-term and not driven by short-term gains.

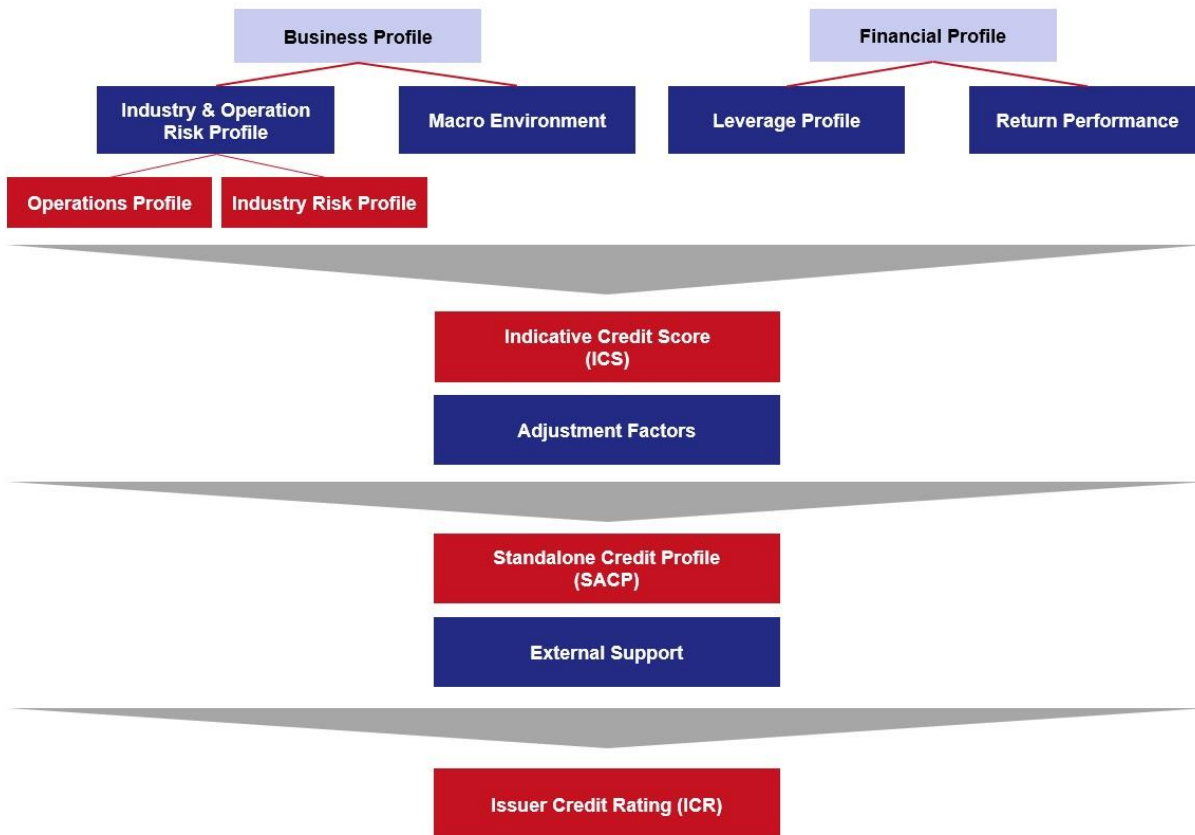
In addition, these criteria do not include investment funds which hold investments such as properties and shares as a form of tradable asset to derive gains from the purchase and sale of these investments. Unlike an IHC, an investment fund's principal activity is investment trading.

Rating Criteria Structure

The fundamental building blocks of our IHC rating criteria include the business profile, financial profile, adjustment factors and external support. Each of these building blocks consists of several factors which may be qualitative and quantitative. We will illustrate some of the factors in detail in this article, whilst we may keep the explanation simple for other factors in this report.

Our criteria combine an IHC issuer's business profile with its financial profile to derive an indicative credit score (ICS) first, then we consider three company-specific adjustment factors for our assessment of an issuer's stand-alone credit profile (SACP). The three adjustment factors are corporate structure and governance, liquidity and supplementary analysis. These adjustment factors may be applied to certain issuers to reflect their unique credit risks that could not be adequately captured by the above building blocks. After we form a view of an IHC's SACP, we will factor possible external support into our analysis, then reach a conclusion on the issuer's credit rating (ICR). Exhibit 1 demonstrates an overall framework of the IHC criteria.

Exhibit 1: Overall Framework of Investment Holding Company Criteria



Indicative Credit Score (ICS)

Similar to our corporate criteria, the ICS criteria use a matrix to combine the business profile and financial profile, and then derive an ICS for an IHC. The ICS is meant to capture the common risk factors that may impact an IHC issuer's credit rating regardless of its region, industry and business type, and allows readers and market participants to compare all IHC issuers on these risks.

The business profile assessment is derived mostly through our analysis of a variety of qualitative factors while the financial profile is mainly driven by quantitative analysis. It would be less meaningful to combine the two assessment outcomes through mathematical means as they are very different in nature, in our view. The influence of these factors on credit ratings is often nonlinear and non-quantitative, therefore we combine the business profile and financial profile through a matrix approach set out in Exhibit 2.

CSPI Ratings uses the financial profile assessment as the foundation to derive the ICS, because we believe an issuer's default risks are first reflected and captured in its financial performance. For companies with similar operational strengths and market positions (or business profiles), the higher-leveraged companies usually are less creditworthy than less-leveraged companies. On the other hand, for companies of similar financial leverage and profitability (or financial profile), a stronger business profile often means the companies have a better chance to withstand financial stress and maintain access to funding and cashflow in the markets. However, the interaction between the business profile and financial profile and their impact on the ICS are not always linear and straightforward.

The mechanics to derive the ICS are as follows: we use an IHC issuer's financial profile as the starting point, then adjust the financial profile score up or down, according to the relative strength of its business profile, to derive the ICS for this company. The impact of the business profile on the ICS is not even along the score spectrum of the financial profile, particularly when the financial profile and business profile are at the far end of their spectrum.

When a company's financial profile is at the high end of the score spectrum such as bbb- or above, the business profile mostly exerts an increasing downward impact on the ICS as it weakens. On the other hand, when a company's financial profile is at the lower end of the score spectrum such as bb and below, the business profile usually exerts an increasingly upward effect on the ICS as the business profile strengthens. For example, if a company has a financial profile of 'aaa', its business profile can drag down the ICS to 'bb-' if the business profile is assessed as 'vulnerable', which is 12 notches lower than its financial profile. As the company's financial profile weakens to 'b', the company's business profile can uplift its ICS to 'bbb-' if the business profile is assessed as 'excellent', which is 5 notches higher than its financial profile.

When combining the business profile and financial profile, we tend to consider a range of results instead of one specific value, and the criteria allow rating analysts to choose the final ICS value from such a range of values. For example, if a company is assessed as having a 'moderate' business profile and 'bbb+' financial profile, the initial ICS is then 'bbb-' according to the matrix table. We will also consider the combination of the 'moderate' business profile and 'bbb-/a-' financial profile, which will yield ICS values of 'bb+' and 'bbb-', respectively. Therefore the final ICS can be chosen between 'bb+' and 'bbb-'. When deciding whether to choose a higher or lower ICS value, we use the relative strength of the business profile as the indication. If we believe the company's business profile is at the higher and stronger end of 'moderate', we will choose 'bbb-' for the ICS; and if the company's business profile is at the lower and weaker end of 'moderate', then we will choose the ICS to be 'bb+'.

Exhibit 2: Determining Indicative Credit Score

FINANCIAL PROFILE	BUSINESS PROFILE						
	7 Excellent	6 Very Strong	5 Strong	4 Moderate	3 Weak	2 Fairly Weak	1 Vulnerable
aaa	aaa	aa	a+	a-	bbb	bb+	bb-
aa+	aa+	aa	a	bbb+	bbb	bb+	bb-
aa	aa+	aa-	a-	bbb+	bbb-	bb+	bb-
aa-	aa	a+	bbb+	bbb	bbb-	bb+	bb-
a+	aa	a	bbb+	bbb	bbb-	bb+	bb-
a	aa-	a	bbb	bbb-	bb+	bb	bb-
a-	a+	a-	bbb	bbb-	bb+	bb	bb-
bbb+	a	bbb+	bbb-	bbb-	bb+	bb	b+
bbb	a-	bbb+	bbb-	bb+	bb	bb-	b+
bbb-	a-	bbb	bbb-	bb+	bb	bb-	b+
bb+	bbb+	bbb	bbb-	bb+	bb	bb-	b+
bb	bbb+	bbb-	bb+	bb	bb-	b+	b
bb-	bbb	bbb-	bb+	bb	bb-	b+	b
b+	bbb-	bb+	bb	bb-	b+	b+	b
b	bbb-	bb+	bb	bb-	b+	b	b-
b-	bb+	bb	bb-	b+	b	b	b-
ccc+	bb+	bb	bb-	b+	b	b-	ccc+
ccc/ccc-	bb	bb-	b+	b	b-	ccc+	ccc/ccc-

Business Profile Analysis

CSPI Ratings' business profile analysis focuses on a variety of descriptive and qualitative factors, supported by quantitative assessment. The business profile is designed to rank an IHC's business risk exposure and market standing by analysing the macro operating environment, its competitive strength relative to peers, and the different industry risk exposure each company faces. Together with the financial profile, the business profile is one of the two anchor factors to derive the ICS.

Within the business profile, there are three components we use to assess a company, which are macro-environment, industry risk profile and the company's operations profile. Among them, CSPI Ratings believes an IHC's operational strength (determined by its operations profile) and industry characteristics (reflected by its industry risk profile) are the two anchor factors when judging an IHC issuer's business-related credit risks. The macro-environment's impact on an IHC issuer's creditworthiness is not always obvious in relatively stable, developed or somewhat developed countries, and may only become noticeable when a company's operating environment deteriorates to an extreme scenario such as an extremely unfriendly political and legal environment, war zone, or constant and massive social unrest.

Macro-environment

The analysis of an IHC's macro-environment addresses the risk factors that originate from the external operating environment and may potentially have great impact on an IHC's creditworthiness. Macro-environmental risks may include a country's political and legal risk, economic risks, institutional risk and financial system risk.

The macro-environment is scored on a five-point scale with '5' representing the strongest macro-environment and '1' the weakest. When determining an IHC's macro-environment score, we will consider its domicile location and where its senior management team is located, its treasury operations' location, and where its shares are traded if the IHC is listed. We assess the weakest link of these factors and determine the highest risk exposure. If an IHC's domicile country has a macro-environment score of '3' but its treasury operations are located in a country with a macro-environment score of '2', we will assign a score of '2' to this IHC's macro-environment risk.

Industry Risk Profile

The IHC's business model is to use debt and generated returns to invest in equities. We regard such a business model as having an industry risk profile of '3', out of our five-point scale for industry risk assessment.

CSPI Ratings considers an IHC as typically having the following credit risks: 1) asset-liability mismatch risk that may weaken an IHC's ability to refinance its debts on maturity. The IHC's debt obligation and liabilities are relatively stable compared to its assets such as the equity value of its investee companies which may fluctuate materially over time. If an IHC can not generate sufficient cashflow through investment dividends to meet its obligations, the IHC may be forced to sell its assets to repay debt principal and interest. In a distressed scenario, a fire-sale may lead to great loss for IHC's investors; 2) cashflow uncertainty risk that may cause an IHC to face liquidity pressure. In addition to selling equity assets, an IHC generates its cashflow mainly through dividends paid by its investee companies. Since investee companies usually will use the cashflow to service their own obligations and finance their operations first before paying dividends, the dividend payments to an IHC are often discretionary and subordinated. An IHC needs to manage its liquidity carefully when servicing its own debt obligations.

Operation Profile

CSPI Ratings assesses an IHC's operations profile on four factors: portfolio size, asset quality, portfolio diversity, as well as investment record and strategy. Portfolio size measures the scale of an IHC's investment operations. We focus on asset quality in evaluating the credit quality of investee companies. Portfolio diversity is examined to understand an IHC's portfolio concentration risk and investment distribution in terms of industry, geography and investee companies. Investment record and strategy is a factor that we assess to understand an IHC's past performance and investment behaviour such as acquisition and divestment of assets, and its discipline of sticking to a predefined investment strategy. Operations profile is a weighted average assessment of portfolio size, asset quality, portfolio diversity, and performance record and investment strategy, with the weight of 15%, 25%, 20%, 20% and 20% respectively, as shown in Exhibit 3.

Exhibit 3: Operations Profile Assessment

Weight	Sub-Factors
15%	Portfolio Size
25%	Asset Quality
20%	Portfolio Diversity
20%	Performance Record
20%	Investment Strategy

We assess most sub-factors on a seven-point scale, with ‘excellent (7)’ as the highest score and lowest risk, and ‘vulnerable (1)’ as the lowest score and highest risk. The operations profile is expressed on a seven-category scale: ‘excellent (7)’, ‘very strong (6)’, ‘strong (5)’, ‘moderate (4)’, ‘weak (3)’, ‘fairly weak (2)’, and ‘vulnerable (1)’ according to Exhibit 4.

Exhibit 4: Translation Table for Weighted Average Assessment Scores to Operations Profile

Weighted average assessment score	Operations Profile
>6.5 - 7	(7) Excellent
>5.5 - 6.5	(6) Very Strong
>4.5 - 5.5	(5) Strong
>3.5 - 4.5	(4) Moderate
>2.5 - 3.5	(3) Weak
>1.5 - 2.5	(2) Fairly Weak
1.0-1.5	(1) Vulnerable

Portfolio Size

We believe a critical mass in portfolio size is essential for an IHC to achieve risk diversification and reduce portfolio valuation volatility. Moreover, the larger the portfolio is, the more flexibility an IHC has in servicing its debt obligations. We score an IHC’s portfolio size at seven levels, as shown in Exhibit 5, where a larger size means a higher score. For IHCs with portfolio size within 15% of the threshold level, a score corresponding to either above or below the threshold level may be assigned. We typically assign a higher score only if we believe the IHC can sustain its portfolio size going forward.

Exhibit 5: Portfolio Size Assessment

	Portfolio Size (US\$ million)
7	Above 5,000
6	4,000 – 5,000
5	3,000 – 4,000
4	2,000 – 3,000
3	1,000 – 2,000
2	500 – 1,000
1	Below 500

Asset Quality

Our assessment of an IHC’s asset quality focuses on the credit quality of each investee asset in the IHC’s investment portfolio. Even though the credit quality of investees may not be directly linked to the likelihood of default by an IHC, the substantial deterioration of credit quality of investee companies owned by the IHC often increases the default and bankruptcy risks of the investee companies, which in turn causes the IHC to lose on its equity investments. Therefore, understanding the credit quality robustness of the investee companies is a crucial element in our credit analysis of an IHC.

CSPI Ratings scores the IHC’s asset quality based on the weighted average creditworthiness of its investee portfolio. We estimate the creditworthiness of each investee company on a stand-alone basis, and average the portfolio’s creditworthiness according to each investee company’s weight in the portfolio. Once the average creditworthiness is calculated, the asset quality score will be assigned according to Exhibit 6.

Exhibit 6: Asset Quality Assessment

Weighted-average Creditworthiness of Investee Companies	
7	bbb or above
5	bbb ~ bb (inclusive)
3	bb--b-(inclusive)
1	ccc+ or below

Portfolio Diversity

We assess an IHC's portfolio diversity on three aspects: asset diversity, industry diversity and geographic diversity. Asset diversity measures how much an IHC's investment portfolio concentrates on one or a few large investee companies. We believe an IHC's portfolio is more vulnerable to value volatility if investments are mostly held in a small number of assets. Industry diversity measures how wide an IHC's portfolio is diversified across different industries, as we think investment in uncorrelated industries may create resilience to one specific sector downturn risk and help an IHC maintain portfolio value in a highly challenging environment. Similarly, geographic diversity is a factor we use to assess the resilience of an IHC's portfolio in a country or region's economic cycles. An IHC's portfolio is considered less vulnerable if its investments are more widely spread over different geographical markets.

Exhibit 7 summarizes the score guidelines that CSPI Ratings use to guide our analysts and rating committees when assigning a portfolio diversity score to an IHC. We take a holistic approach in judging an IHC's portfolio diversity, which means we will assess the three diversity sub-factors separately and draw a collective conclusion.

Exhibit 7: Portfolio Diversity Assessment

Asset Diversity	Industrial Diversity	Geographic Diversity
7 No single asset constitutes more than 5% of total portfolio value, and the three largest assets account for less than 10% of total portfolio value.	Eleven or more industries that have low correlation	Investments are fully diversified across many major economies or countries in different regions, and economic correlations among these countries are low.
6 No single asset constitutes more than 10% of total portfolio value, and the three largest assets account for less than 20% of total portfolio value.	Nine to ten industries that have low correlation	Investments are diversified across five major economies or countries and economic correlations among these countries are low.
5 No single asset constitutes more than 15% of total portfolio value, and the three largest assets account for less than 30% of total portfolio value.	Seven to eight industries that have low correlation	Investments are diversified across four major economies or countries and economic correlations among these countries are low.
4 No single asset constitutes more than 20% of total portfolio value, and the three largest assets account for less than 40% of total portfolio value.	Five to six industries that have low correlation	Investments are spread across three larger economies or countries that have low economic correlations, and diversified within each country.
3 No single asset constitutes more than 30% of total portfolio value, and the three largest assets account for less than 60% of total portfolio value.	Three to four industries that have low correlation	Investments are spread across two larger economies or countries that have low economic correlations, and well-diversified within each country.
2 No single asset constitutes more than 40% of total portfolio value, and the three largest assets account for less than 80% of total portfolio value.	Two industries that have low correlation	Investments are concentrated in one large country or two to three mid-size countries, but reasonably diversified within that country.
1 One single asset constitutes more than 40% of total portfolio value, and the three largest assets account for more than 80% of total portfolio value.	One industry	Investments are concentrated in one mid-size country or a few small countries that have some economic correlations.

Performance Record

An IHC's performance track record is another crucial part of our credit risk analysis, which will reveal the investment management capability and expertise of an IHC's management team. We examine an IHC's performance on two aspects: value creation over the past three years and the investment / loss record. We regard an IHC's performance as excellent if the company can create excess value for investors consistently and avoid investment losses over a long period even when the overall market condition may be challenging at times. Exhibit 8 summarizes the assessment guidelines for this sub-factor.

Our key considerations for the investment / loss record include the scale of losses, number of loss-making investments together with the time horizon when the losses occurred. For example, we may consider the loss record to be weak, if the portfolio has not recorded individual investment losses in the most recent three years, but suffered substantial losses before that and such losses do not exceed 10-20% of total portfolio value. The loss record supplements our analysis of an IHC's value creation capability. If an IHC's value creation is assessed to be '5' but the loss record is found weak and losses may occur again in future, we would adjust down the value creation score by one or two points to reflect the potential event risk for this IHC's portfolio.

Exhibit 8: Value Creation

Value Creation	
7	Net asset value development over the last three years exceeds the relevant stock market benchmark returns by 1.5 standard deviations.
6	Net asset value development over the last three years exceeds the relevant stock market benchmark returns by one standard deviation.
5	Net asset value development over the last three years exceeds the relevant stock market benchmark returns by 0.5 standard deviation.
4	Net asset value development over the last three years is in line with the relevant stock market benchmark returns
3	Net asset value development over the last three years lags behind the relevant stock market benchmark returns by 0.5 standard deviation.
2	Net asset value development over the last three years lags behind the relevant stock market benchmark returns by one standard deviation.
1	Net asset value development over the last three years lags behind the relevant stock market benchmark returns by 1.5 standard deviations.

Investment Strategy

The last assessment factor in an IHC's operations profile is the company's investment strategy, which we regard as an indication of the IHC's management discipline and execution capability. We qualitatively assess an IHC's investment strategy in order to understand the long-term sustainability of its business profile. If an IHC's investment decisions are prudent and its risk tolerance is low, we consider this IHC as having a higher chance of succeeding over the long term and creating value for its investors. In addition, if an IHC has not made any operational mistakes during its investment process, we will regard its execution capability as clean and strong.

We assess the investment strategy qualitatively on a seven-point scale, with 'excellent (7)' as the highest score and lowest risk, and 'vulnerable (1)' as the lowest score and highest risk. Exhibit 9 summarizes the assessment rules for the investment strategy sub-factor.

Exhibit 9: Investment Strategy Assessment

Management Discipline	Execution Capability
7 There are clearly defined investment management processes, criteria and strategy, and management's discipline in following such processes, criteria and strategy are supported by a strong track record and evidence. The board and senior management are very conservative on risk tolerance, and an active risk management mechanism is in place and strongly enforced.	Excellent track record of execution capability and professionalism, and no evidence of any operational errors and failures.
6 There are some defined investment management processes, criteria and strategy, and management's discipline in following such processes, criteria and strategy are supported by a moderately strong track record and evidence. The board and senior management are fairly conservative on risk tolerance, and an active risk management mechanism is in place and strongly enforced.	Strong track record of execution capability and professionalism, and no evidence of any operational errors and failures.
5 There are defined investment management processes, criteria and strategy, and management's discipline in following such processes, criteria and strategy are supported by a track record and evidence. The board and senior management are somewhat conservative on risk tolerance, and a risk management mechanism is in place and enforced.	Good track record of execution capability and professionalism, and limited evidence of major operational errors and failures.
4. The investment management processes, criteria and strategy, as well as management's discipline in following them, are in place but incomplete. The board and senior management have some appetite for risky investments, and an active risk management mechanism is not clear.	Average track record of execution capability and professionalism, and no evidence of major operational errors and failures.
3 The investment management processes, criteria and strategy are not all clear, and management is not entirely consistent in following such processes, criteria and strategy. The board and senior management have some appetite for risky investments, and an active risk management mechanism is not clear.	Mediocre track record of execution capability and professionalism, and some noticeable operational errors and failures in recent years.
2 The company has few descriptions on investment management processes, criteria and strategy, and management is not entirely consistent in following such processes, criteria and strategy. The board and senior management have very high risk appetite when making investment decisions, and there is limited active risk management.	Poor track record of execution capability and lack of operational professionalism, and some noticeable operational errors and failures occurred in recent years.
1 There is absolutely no defined investment management process, criteria and strategy, and management has no intention to follow any investment process, criteria and strategy. The board and senior management are speculative when making investment decisions, and there is no risk management mechanism.	Very poor track record of execution capability and lack of operational professionalism, and some major operational errors and failures occurred in recent years.

Financial Profile Analysis

CSPI Ratings assesses an IHC's financial profile on two aspects: leverage profile and return performance. To form a view of an IHC's preliminary leverage profile (PLP), we analyse a set of leverage ratios such as Debt-to-Market Value of Portfolio (DMVP) and Cash Flow Interest Coverage (CFIC). Unlike our corporate criteria that mainly uses cashflow-based leverage ratios to assess a corporate entity's leverage profile, our IHC criteria assesses an IHC's leverage mostly based on balance-sheet leverage ratios. Once a preliminary leverage profile is determined, we will assess a set of toning factors to adjust preliminary leverage profile to derive the final leverage profile. Toning factors are similar to those we defined in our general corporate criteria, which are debt structure, financial policy and financial volatility. Lastly, the return analysis focuses on return on investment (ROI) and volatility of returns.

The leverage profile is scored on an 18-point scale ranging from 'aaa' as the highest to 'ccc/ccc-' as the weakest, and return performance is assessed on a five-category scale, which are 'very strong', 'strong', 'moderate', 'weak' and 'very weak'. The leverage profile and profitability assessment then will be combined to derive the financial profile according to Exhibit 10:

Exhibit 10: Determining the Financial Profile

Leverage Profile	Return Performance				
	VS	S	M	W	VW
aaa	aaa	aaa	aaa	aa+	aa
aa+	aaa	aa+	aa+	aa	aa-
aa	aa+	aa+	aa	aa-	a+
aa-	aa+	aa	aa-	a+	a
a+	aa	aa-	a+	a	a-
a	aa-	a+	a	a-	bbb+
a-	a+	a	a-	bbb+	bbb
bbb+	a	a-	bbb+	bbb	bbb-
bbb	a-	bbb+	bbb	bbb-	bb+
bbb-	bbb+	bbb	bbb-	bb+	bb
bb+	bbb	bbb-	bb+	bb	bb-
bb	bbb-	bb+	bb	bb-	b+
bb-	bb+	bb	bb-	b+	b
b+	bb	bb-	b+	b	b-
b	bb-	b+	b	b-	ccc+
b-	b+	b	b-	ccc+	ccc+
ccc+	b	b-	ccc+	ccc+	ccc/ccc-
ccc/ccc-	b-	ccc+	ccc/ccc-	ccc/ccc-	ccc/ccc-

How to score the leverage profile

The two preliminary leverage ratios are Debt-to-Market Value of Portfolio (DMVP), defined as the net debt borrowings divided by the market value of the IHC's investment portfolio, and Cash Flow Interest Coverage (CFIC), that is calculated as the sum of cash inflows such as cash dividends and interest income plus cash-based management fees divided by the cash interest expense. The net debt is calculated on an unconsolidated basis, unless the guarantee is provided by the investee companies.

These two ratios are both assessed on an 18-point scale and combined to calculate a weighted average preliminary leverage score based on the weights of 75% for DMVP and 25% for CFIC. The preliminary leverage score then will be converted to a preliminary leverage profile ranked according to an alphabetic scale as shown in Exhibit 11.

Exhibit 11: Converting Numeric Scores to Letter Scale

Numeric Score	Letter Scale
>17.5	aaa
>16.5 - 17.5	aa+
>15.5 - 16.5	aa
>14.5 - 15.5	aa-
>13.5 - 14.5	a+
>12.5 - 13.5	a
>11.5 - 12.5	a-
>10.5 - 11.5	bbb+
>9.5 - 10.5	bbb
>8.5 - 9.5	bbb-
>7.5 - 8.5	bb+
>6.5 - 7.5	bb
>5.5 - 6.5	bb-
>4.5 - 5.5	b+
>3.5 - 4.5	b
>2.5 - 3.5	b-
>1.5 - 2.5	ccc+
<=1.5	ccc/ccc-

The DMVP and CFIC assessments will be combined to derive the preliminary leverage profile as shown in Exhibit 12. We use the most recent financial data to calculate an IHC's current DMVP, and no forward projections will be made. Since we aim to estimate the market value of the IHC's investment portfolio, we would use the latest available information including shares

held in unlisted and listed assets, debt amount, cash and liquid assets. When estimating the listed assets, we use the latest available spot market prices. For unlisted assets, we may accept the appraisal value if the appraiser is an independent and respectable third party, otherwise we use the latest available book value.

The CFIC is assessed on a five-year weighted average with the time weights of 10%, 15%, 25%, 25% 25% for year t-2, t-1, t, t+1, t+2 respectively, where t represents the current year. More weight is given to future years to emphasize that CSPI Ratings' ratings are forward-looking opinions of a company's creditworthiness. However, when an IHC's portfolio assets go through a drastic transformational event that could lead to material changes of CFIC, the historical financial data may not properly represent what a company will be in future. In such cases, CSPI Ratings applies the weights of 40%, 30%, 30% for the current year and subsequent two years.

Exhibit 12: Leverage Profile Analysis Ratios

Letter	Numeric	DMVP (%)		CFIC	
		Low	High	Low	High
aaa	18	---	9	10	---
aa+	17	9	12	9	10
aa	16	12	15	8	9
aa-	15	15	18	7	8
a+	14	18	21	6.5	7
a	13	21	24	6	6.5
a-	12	24	27	5.5	6
bbb+	11	27	30	5	5.5
bbb	10	30	34	4.5	5
bbb-	9	34	38	4	4.5
bb+	8	38	42	3.5	4
bb	7	42	46	3	3.5
bb-	6	46	50	2.5	3
b+	5	50	55	2	2.5
b	4	55	60	1.5	2
b-	3	60	65	1	1.5
ccc+	2	65	70	0.5	1
ccc/ccc-	1	70	---	---	0.5

Toning Factors for Leverage Profile

The preliminary leverage profile that is assessed based on the two core financial leverage ratios reveals most of an IHC issuer's financial risks, but not all. Even though the leverage ratios are calculated on a time-weighted basis, they don't capture information on how a company's debt structure, such as short-term debt concentration, and financial policies, such as management's financial aggressiveness, will impact the company's longer term financial performance. To arrive at the final leverage profile assessment, CSPI Ratings fine tones the preliminary leverage profile based on four toning factors: debt structure, financial policy, dividend control and financial volatility.

Debt Structure

CSPI Ratings assesses an IHC issuer's debt structure according to a 3-category scale: neutral, negative and very negative, and the three sub-factors that we analyse are short-term debt concentration, foreign currency debt exposure and interest rate risk. Of these three sub-factors, the short-term debt concentration ratio is the key determinant for our assessment of an IHC issuer's debt structure. If an IHC's short-term debt accounts for less than 50% of total debt, the debt structure assessment will be 'neutral'; if the ratio is 50-80%, CSPI Ratings considers this issuer's debt structure as 'negative'; if the concentration exceeds 80%, the debt structure assessment will be 'very negative'. Even if the short-term debt concentration is less than

50%, the debt structure assessment could still be negative if the company has substantial foreign exchange risk and interest rate risk exposure.

When examining foreign exchange risks, we focus on how much an IHC's debts are denominated in foreign currencies and how much foreign currency investments and cashflows this IHC holds and can generate to service its foreign currency debts. In case of mismatch of foreign currency obligations and investments or cashflows, CSPI Ratings further assesses the company's access to new foreign currency borrowings or capital market funding to determine the true currency risk over the short-term and long-term horizon. Large mismatch between foreign currency obligations and investments or cashflows will lead to a negative assessment of the currency risk exposure.

Interest rate risk exposure is also an important consideration. For IHCs with large amounts of debt with variable interest rates, CSPI Ratings stress-tests the company's ability to service its interest payments under a hypothetical interest hike scenario. The stress scenario is usually set at increments of 100bps on the interest rates. The key indicator to be assessed are cash flow-to-interest coverage ratio. If the rating committee believes there is substantial vulnerability in the coverage ratios to interest rate changes, CSPI Ratings may adjust down the debt structure assessment.

Financial Policy

The financial policy analysis is another important factor in our assessment of an IHC's financial risk profile and is designed to assess the IHC's financial discipline and its management's tolerance of leverage. The financial risk analysis based on the standard assumptions of cashflow assessments and financial ratios doesn't always capture all the credit risks that may arise from an IHC's operations, particularly if an IHC's financial policies may indicate greater event risks. An IHC's sudden corporate actions and investment decisions often change its balance sheet and cashflow in future, and will have a great impact on the ratings if such decisions and actions are beyond our standard assumptions. CSPI Ratings assesses a company's financial policy mainly from three aspects: management's intention and tolerance of the company's financial leverage level, the comprehensiveness and transparency of the company's financial policies, and management's track record of following established financial policies. Some other factors may also be considered, such as management's effective communications to external parties on the company's financial policies, and shareholder's influence on the company's short-to-long term financial targets.

CSPI Ratings assesses a company's financial policy according to a 3-category scale: positive, neutral and negative.

Combining the debt structure and financial policy assessments, the impact on a company's leverage profile score is set in Exhibit 13. The leverage profile can be raised one notch if the debt structure is neutral and the financial policy assessment is positive, and lowered by up to three notches if the debt structure is very negative and the financial policy assessment is very negative.

Exhibit 13: Adjustments for effect of debt structure and financial policy assessments

Debt Structure	Financial Policy Assessment		
	Positive	Neutral	Negative
Neutral	+1 notch	0	-1 notch
Negative	0	-1 notch	-2 notches
Very Negative	-1 notch	-2 notches	-3 notches

Dividend Control

The control of the dividend distribution influences an IHC's control of cash. The amount of dividend that an IHC receives and the stability of such dividend payment streams are often affected by the IHC's influence on the investee's dividend policy, industry regulations and investment terms. There can be significant restrictions on dividend distribution by investee companies, such as regulatory restrictions in some industries like insurance or financial institutions, or ring-fenced project finance structures with strict control of dividends. If the rating committees believe an IHC lacks control of dividend payments by most of its investees, CSPI Ratings may lower the leverage profile assessment by one notch.

Financial Volatility

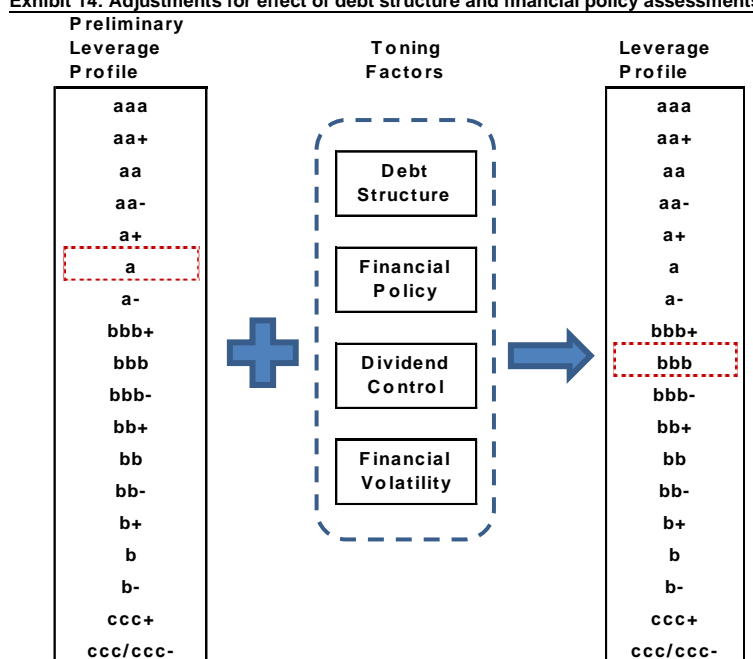
In a standard scenario, our cashflow and leverage analysis have a horizon of five years: 2 years of historical performance plus three years of financial projections. However, the longer-term financial performance may also carry some credit indications on how a company performed in the distant past, particularly in the last economic or industry down-cycle. The extreme leverage case often tells how stretched a company's financial leverage can be, despite its current leverage profile.

For example, our cashflow analysis may produce a leverage profile score of ‘a+’, but the company’s leverage profile dipped to ‘b’ five years ago, when the industry was experiencing a severe downturn. If the analysts think such volatility has a high likelihood of repeating in future, the rating committee may lower this company’s leverage profile score. This downward adjustment is considered a cushion between the current financial performance established in our base-case projections and potential medium-term variance that may arise in extreme cases.

The financial volatility toning factor is like a downward pressure adjustment to ratings, and the maximum downward adjustment is 3 notches.

The combined effect of these four toning factors may be positive or negative for a company’s leverage profile, and their impact on the final leverage profile assessment is illustrated in Exhibit 14.

Exhibit 14: Adjustments for effect of debt structure and financial policy assessments



How to score the Return Performance

The return performance is one of the key measures in determining how an IHC performed compared to its peers. In general, consistently higher returns over a long period means better ability to generate value for the company’s stakeholders. We always regard an IHC with higher and sustainable returns as superior. We use the annualized return on investment (ROI) as the main measure to assess an IHC’s overall ability to generate returns. CSPI Ratings not only assesses the company’s absolute returns, but also considers the long-term trend and volatility of an IHC’s return performance.

For absolute returns, we compare the IHC’s ROI with its peers along a three-point scale, which are ‘above’, ‘average’ and ‘below’. We also use a three-point scale to assess the trend and volatility of the return performance, which are ‘outperform’, ‘average’, ‘underperform’. The absolute returns, and the trend and volatility of the returns then will be combined to arrive at our return analysis, which is expressed with a five-point scale: ‘very strong (VS)’, ‘strong (S)’, ‘medium (M)’, ‘weak (W)’, ‘very weak (VW)’, as shown in Exhibit 15.

Exhibit 15: Determining the Return Analysis

Trend & Volatility	Level of ROI		
	Above	Average	Below
Outperform	VS	S	M
Average	S	M	W
Underperform	M	W	VW

When assessing the level of returns, the ratio of ROI is employed and defined as gain on investments minus the cost of investments, divided by the cost of investments. We will use the annualized ROI to compare IHCs. CSPI Ratings rating committees will take a holistic view of an IHC's return performance, instead of simply relying on the arithmetic average or sum of the numeric ratios. We calculate a three-year simple average annualized ROI with equal weights on t-3, t-2, and t-1.

Adjustment Factors

In these criteria, ICS captures the common rating factors for all IHC issuers regardless of region, industry and business type, but there are some company-specific rating factors that are not commonly applied to all issuers. To properly reflect such company-specific rating factors and their impact on the credit rating, CSPI Ratings makes adjustment factors to modify the ICS before deriving an SACP for an IHC issuer. CSPI Ratings defines the three adjustment factors as corporate structure and governance, liquidity and supplementary analysis.

Corporate Structure and Governance

In an increasingly globalized world, companies are often conducting businesses across regions and jurisdictions, and more countries are participating in global trade and cross-border commercial activities than ever. Even within one country, companies are becoming more sophisticated and complicated when conducting business. However, some of the companies are also using unnecessarily complicated corporate structures for various reasons, like maximizing the benefits of certain shareholders and avoiding investigations and scrutiny from certain jurisdictions. CSPI Ratings believes that as the complexity of corporate structure increases, the legal complexity and recovery prospects of corporate bonds become increasingly uncertain. CSPI Ratings does not automatically penalize any IHC issuers for having complicated corporate structures, but we will lower the ICS if the rating committees decide that substantial corporate structure risks exist.

If an IHC's corporate complexity reaches an extreme level, CSPI Ratings may classify such a company as a conglomerate and adopt a different analytical approach to assess it.

Corporate governance is another key factor in the assessment of corporate structure and governance. There are several elements in our corporate governance analysis: the effectiveness and independence of the board and management, the board's oversight of management, the integrity of the executives, management's strategy creation and implementation, management's ability to align company strategy with its business position etc.

CSPI Ratings may lower the ICS by up to two notches if both the corporate structure and governance are assessed negatively. Rating committees conclude the analysis based on historical evidence and expected corporate practices.

Liquidity

Whether an IHC faces imminent default risks is often determined by its liquidity situation. For a highly leveraged issuer, its default risk may not be imminent if its liquidity is abundant. On the other hand, the default risk would be much higher for an IHC with very tight liquidity, even if its financial leverage is relatively low. Therefore, liquidity is a crucial factor for IHC's credit rating.

For an IHC issuer, we use the cashflow liquidity ratio as the starting point for our assessment and make adjustments based on the IHC's other potential liquidity sources, and might consider raising the liquidity score based on the IHC's portfolio liquidity to arrive at the final assessment. The liquidity factor will modify up or down the ICS by one or multiple notches, depending on the level of the ICS and the liquidity assessment. We assess an IHC's liquidity on a 7-point scale with '7' as the highest score and strongest liquidity condition and '1' as the lowest score and weakest liquidity condition.

The cashflow liquidity ratio is designed to measure the IHC's refinancing risk of its short-term debts and how the short-term cash inflows cover its mandatory short-term cash outflows, and is defined as the sum of available cash and cash inflows, divided by the sum of IHC's short-term cash outflows.

The available cash and cash inflows include IHC's liquid assets on hand, projected dividends and management fees to be received from investee companies, net proceeds from asset divestiture, any undrawn banking facilities, likely equity infusion from shareholders etc. On the other hand, the short-term cash outflows include operating expenses, short-term debt payments, cash interest and tax, contracted acquisitions, committed investments in existing investees, preferred dividend etc.

Exhibit 16 demonstrates the scoring range of the cashflow liquidity ratio, which is assessed on a 6 to 24-month forward looking basis. We focus on a 24-month forward liquidity assessment for investment grade issuers, and a 12-month liquidity

assessment for speculative grade issuers. The liquidity assessment period may be shortened to 6 months for some highly speculative or near-default issuers, which usually carry an ICS of 'b-' or below.

Exhibit 16: Liquidity Profile Analysis ratios

	Cash Flow Liquidity	
	Low	High
7	2.0	---
6	1.8	2.0
5	1.5	1.8
4	1.2	1.5
3	1.0	1.2
2	0.6	1.0
1	---	0.6

The cashflow liquidity ratio only provides a starting point for the liquidity assessment. CSPI Ratings also considers other factors like the company's relationship with lending institutions and access to capital markets, the company's undrawn and committed banking facilities, the company's reputation among lenders and regulators, and the company's unconsolidated long-term financial investments that can be liquidated quickly. These extra considerations may revise up or down the initial assessment.

The portfolio liquidity is affected by the percentage of liquid assets that are publicly listed and held in the portfolio as well as how liquid those assets are. When we assess the liquidity of these assets, we consider factors such as the listing exchange, the floating amount of the securities traded, IHC's percentage of ownership in the assets, and related legal restrictions on disposal. We consider the portfolio liquidity to be strong if the IHC holds minority shareholdings in most of its investee companies, most of which are listed in established exchanges with good trading liquidity and no legal restriction on asset disposal. CSPI Ratings might consider raising the liquidity score by up to three notches when the IHC's liquidity score is below "2" and its portfolio liquidity is strong, in which case the IHC can cash out on its investees quickly in case of liquidity stress.

The liquidity assessment may modify up and down the ICS by multiple notches. Its actual impact on the ratings is summarized in Exhibit 17. The influence of the liquidity assessment on the ICS is nonlinear and may have a ceiling effect on the IHC's SACP. For example, for an IHC to be rated investment grade which is 'bbb-' or above, its liquidity must be assessed at '4' or above. If the liquidity assessment is '2', the SACP will be capped at 'b' if the company's ICS is 'bbb-' or above, and capped at 'b-' if the company's ICS is 'b-' to 'bb+'. Similarly, if an IHC's liquidity assessment is the worst at '1', the company's SACP will be capped at 'b' or 'b-' depending on the ICS.

The liquidity assessment may also have an uplifting effect on a company's ICS when the liquidity is assessed at the strong end of the score range. As shown in Exhibit 18, we allow the company's SACP to have a minimum of 'b-', even if the ICS is 'ccc+' and 'ccc/ccc-', when its liquidity condition is extremely strong at '7' or '6'.

Exhibit 17: Impact of Liquidity Assessment on Indicative Credit Score

ICS	Liquidity Assessment						
	7	6	5	4	3	2	1
aaa	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
aa+	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
aa	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
aa-	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
a+	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
a	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
a-	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
bbb+	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
bbb	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
bbb-	0	0	0	0	Cap SACP on 'bb+'	Cap SACP on 'b'	Cap SACP on 'b'
bb+	0	0	0	0	-1	Cap SACP on 'b'	Cap SACP on 'b'
bb	0	0	0	0	-1	Cap SACP on 'b'	Cap SACP on 'b'
bb-	0	0	0	0	-1	Cap SACP on 'b'	Cap SACP on 'b'
b+	+1	+1	0	0	0	Cap SACP on 'b'	Cap SACP on 'b'
b	+1	+1	0	0	0	Cap SACP on 'b'	Cap SACP on 'b'
b-	+1	+1	0	0	0	Cap SACP on 'b'	Cap SACP on 'b'
ccc+	+2	+1	+1	0	0	0	0
ccc/ccc-	+2	+2	+1	+1	0	0	0

Supplementary Analysis

The supplementary analysis is the last component in determining the SACP of a company, and is designed to fine-tune our ratings. The supplementary analysis involves a holistic review of the company's credit risk profile and can cause us to raise the ICS by one notch if the assessment is positive and lower the ICS by one notch if the assessment is negative. A neutral assessment of the supplementary analysis results in no change to the ICS.

We assess each of our underlying sub-factors to be values or points within a possible range, which are not absolutely precise. Consequently, each of these assessments may be at the upper, lower or mid-point of such a range. The SACP may reflect the upper, lower or mid-point of the range. To fine-tune the ratings to reflect peer comparisons, we adjust the ICS one notch higher if the SACP is believed to be at the upper end of the ranking range, one notch lower if the SACP is believed to be at the lower end of the ranking range, and no change if the SACP is believed to be at the middle of the ranking range. Such adjustment is reflected in our supplementary analysis.

CSPI Ratings also considers additional factors that are not already covered in the assessment of the ICS. Such factors are generally less frequently observed credit risk characteristics, may impact one specific group of companies in a positive or negative way, and may reflect unpredictability or uncertainty risk attributes positively or negatively.

We do not expect the supplementary analysis adjustment to be a rare or exceptional event. Instead we believe it may be rather common to refine our view of a company or capture the unique risks for certain conglomerates in the increasingly complicated capital markets.

Stand-Alone Credit Profile (SACP)

Both the ICS and SACP are not ratings. They are just components of an issuer credit rating (ICR) or issuance rating. We do not assign outlooks to SACPs or ICSs, nor place them on credit watch. The SACP is CSPI Ratings' opinion of an issuer's creditworthiness in the absence of extraordinary support or burden from external parties. The SACP differs from an ICR in that it does not include the potential extraordinary support from a parent or government in the event of credit stress. However, the SACP does include the systemic and recurring support from external parties like the parent or government.

For IHC issuers, the SACP is generally assigned at the issuer level, and not assigned to specific obligations, except in some cases when an issuer does not have an ICR. Both the ICS and SACP are expressed on a scale of 'aaa' to 'd', which parallels the issuer credit rating scale 'AAA' to 'D'. We use the lowercase letters for ICS and SCAP to indicate their status as the components of a rating rather than a rating.

External Support Assessment (ESA)

CSPI Ratings considers any extraordinary support for an IHC issuer in the event of a credit distress, which could come from a parent, the relevant government or an associated entity. The assessment of the likelihood of such external support focuses on two parts: 1) the strategic importance of a company and its ties with its supporters, either parent or government, which will determine the willingness of the supporting entity to support the company; and 2) the supporting entity's credit strength often determines how much support it can extend to recipients of that support. The external support assessment, if assessed to be likely, will uplift a company's SACP by one or more notches to finally determine its ICR.

CSPI Ratings assesses a parent's willingness to support on a five-point scale which are: 'extremely strong', 'very strong', 'strong', 'moderate', and 'low'. We assess the willingness to support by a government on a seven-point scale which are 'almost certain', 'extremely strong', 'very strong', 'strong', 'moderately strong', 'moderate', and 'low'. Combined with the ability of the supporting entity to provide support, the actual support level is determined for the recipient of the support.

We adopt both top-down and bottom-up approaches to determine the actual notch uplifts for support from both parent and government. In the categories of higher willingness to support, a top-down approach is usually applied, and in the categories of less willingness to support, a bottom-up approach is usually adopted.

In CSPI Ratings' rating criteria, whether a supporting entity holds an economic interest, such as equity shares, in the support receiving entity is not the basis to determine whether such support is likely. As long as the analysts and rating committees believe an entity's default may cause economic loss, business disruptions, reputational damage or other forms of losses for the potential supporter at a magnitude that cannot be accepted by the supporter, CSPI Ratings may believe there is a willingness to support.

The parent or government's ability to support is determined by their credit strength and financial resources. We may use their SACP or ICRs as the measure of their ability to provide support.

Related Criteria and Research

- Rating Symbols and Definitions, 7 May 2017
- General Principles of Credit Ratings, 21 November 2017
- General Corporate Rating Criteria, 15 March 2018

DISCLAIMER

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