

## **PARENT SUPPORT METHODOLOGY**

PEFINDO views that the final credit rating of a company should reflect the company's standalone credit strength as well as potential support given by the party controlling the company (Parent Company or "Parent"), particularly during financial distress situation. Level of support will be determined by the Parent's credit strength as well as the likelihood of the Parent to support the subsidiary. Therefore, after assessing the Subsidiary's standalone rating, PEFINDO then will analyze the Parent's financial capability whenever the information suffice. In the case that PEFINDO decides the Parent of having stronger credit profile than the Subsidiary, then PEFINDO will assess the Subsidiary's degree of importance to the Parent, which will determine the likelihood of the Parent's support. If PEFINDO believes that the Parent does not have better financial capability or credit strength than the Subsidiary, then the assessment on the likelihood of support will be irrelevant. On the other side, there may be no notching up even from a higher rated Parent if PEFINDO views that there is remote probability that the Subsidiary will be given support during financial distress by the Parent.

The parent support methodology will be applied for private companies while for companies owned by the central or regional government, PEFINDO will apply the Government Related Entities (GRE) rating methodology in assessing the support from the Parent.

### **Parent's rating assessment to determine financial capability**

In order to determine the Parent's financial capability, PEFINDO will conduct rating assessment on the Parent level. If Parent is an operating company, then PEFINDO will analyze the Parent's based on its business and financial performance. If the Parent is a business conglomerate having several subsidiaries, PEFINDO may decide the Parent's credit profile based on the credit strength of its subsidiaries with substantial contribution to the Parent.

The rating assigned to the Parent should be comparable to other long-term ratings issued by PEFINDO. If the Parent has not given mandate to PEFINDO to assign rating, then PEFINDO will conduct credit assessment based on any publicly available information. In the case that the Parent is already rated by global credit rating agency especially Standard & Poor's, then PEFINDO may use the global rating from international rating agencies as the indicator of the Parent's financial capability to support the Subsidiary, although ultimately PEFINDO will need to conduct its own rating assessment. If PEFINDO could not find sufficient information to analyze the Parent's financial strength, then PEFINDO may assume that likelihood of support is not possible as the capability of the Parent is unknown.

### **Assessment on likelihood of support from the Parent: Core, Strategically Important, or Nonstrategic Subsidiary?**

After PEFINDO views that the Parent has substantially higher financial capability than the Subsidiary being rated, the next step is to assess the probability of support of the Parent to that particular Subsidiary. When reviewing degree of willingness from the Parent to support the subsidiary, PEFINDO will classify the Subsidiaries' status in the perspective of the Parent into three categories: Core Subsidiary, Strategically Important Subsidiary, or Nonstrategic Subsidiary.

#### **Core subsidiary**

Core Subsidiaries are subsidiaries that PEFINDO considers having close integration to the Parent's business and future strategy, and accordingly will have the highest likelihood to be supported including when the Subsidiary is in financial distress. Financial failure of a Core Subsidiary will substantially affect the Parent's overall creditworthiness. For the Core Subsidiaries, PEFINDO will assign the final rating using the Parent's rating as the base rating. PEFINDO may assign rating of Core Subsidiary close to or even same as the

Parent's rating, based on PEFINDO's analysis of the Subsidiary's level of importance to the Parent. Core Subsidiary should meet most of the following criteria:

1. Constitute a significant proportion to the Parent's overall position. The higher the Subsidiary's contribution to the Parent's assets or revenue, PEFINDO will be more certain on the likelihood to support. On the other side, the proportion can also be derived from how much the Parent has invested in the subsidiary compared to other subsidiaries.
2. Core Subsidiary should be strongly controlled by the Parent, which can be assessed through the Parent's ownership in the Subsidiary and also the engagement of the Parent's key personnel in the Subsidiary's strategic positions. More than 50% ownership from the Parent may ensure control of the Subsidiary's policy to be in line with Parent's strategy.
3. Operate in lines of business which is integral to the Parent's strategy. The activities or the products of the Subsidiary are very closely aligned to the mainstream business of the Parent. Moreover, the nature of the Subsidiary's business should not be substantially more risky than the Parent's overall business. The Subsidiary may act as the Parent's main raw material provider or the marketing arm of the Parent's products with significant portion.
4. Failure in the Subsidiary will significantly affect the Parent's reputation as well as its future business performance. PEFINDO views that sharing brand name is an indication of the Parent's to share its reputation risk with the Subsidiary and accordingly show strong willingness to support the Subsidiary to maintain the Parent's image.
5. PEFINDO views the Subsidiary operate more as a division of the Parent despite being a different legal entity. Core subsidiaries will often share distribution network and administration with the Parent or other subsidiaries within the Parent.
6. Core Subsidiaries should be performing reasonably successful compared to the Parent's overall performance. PEFINDO views that subsidiaries that underperform will have lower degree of importance than other subsidiaries within similar category but with better performance.
7. PEFINDO views that there is a small likelihood that the Core Subsidiary could be disintegrated/divested from the Parent due to its administrative, operational, or infrastructure dependence.
8. The Subsidiary has been within the Parent for a considerably long time, and was established by the Parent to support the Parent's business. There should be a track record of support given by the Parent to the Subsidiary or other subsidiaries particularly during financial distress situation.

### **Strategically important subsidiary**

Strategically Important Subsidiaries are subsidiaries that based on PEFINDO's assessment are important to the Parent's overall business strategy, but with lesser degree than core subsidiaries. These subsidiaries may be supported during financial distress, but there is also probability that the Parent will choose to divest for capital gain or other motives. When assigning the final rating of a Strategically Important Subsidiary, PEFINDO will use the Subsidiary's standalone rating as the base rating, and give notching up based on the judgment of the importance level to the Parent. In most cases PEFINDO the final rating after notching should be closer to the standalone rating rather than to the Parent's rating, except for the cases where the rating gap between the Subsidiary and the Parent is very close. Maximum notching up given to a Strategically Important Subsidiary should be up to 3 notches. However, PEFINDO may give higher notching up to a Strategically Important Subsidiary if there is a strong and written support from the Parent. PEFINDO believes that a recently acquired subsidiary will be no more than strategically important rather than a core subsidiary, regardless how big is the investment value, at least during their initial years. On the other hand, significant and continuous operating deterioration or earnings underperformance at a Core Subsidiary could trigger PEFINDO to reclassify it as strategically important or even nonstrategic.

PEFINDO may regard subsidiaries as strategically important to the Parent even though they clearly operate outside the mainstream business of the Parent. These subsidiaries' products might typically be sold to different customer groups and through different distribution channels than those of the parent's principal companies. The management of these subsidiaries might not be closely integrated into the parent.

Nevertheless, PEFINDO may judge these companies as strategically important if the parent has demonstrated a strong commitment to the subsidiary, and PEFINDO believe it's unlikely the Parent will sell the subsidiary. In general, Strategically Important Subsidiaries should meet most of the following criteria:

1. The subsidiary has less significant contribution to the Parent's overall performance. Therefore fluctuation in the Subsidiary's cash flow generation will not have significant impact to the Parent's credit profile.
2. Subsidiaries are important to the parent's long-term strategy but operate more on a stand-alone, autonomous basis. There may be a business synergy with the Parent's overall strategy, however PEFINDO views that without the subsidiary the Parent will still be able to run the business profitably through other non-affiliated companies having similar business model as the subsidiary.
3. PEFINDO views that failure in the Subsidiary level may affect the Parent's reputation especially if they share similar brand name, but it will not necessarily damage the Parent's performance. Different name between the Subsidiary and the Parent can be viewed as a way to distance the Subsidiary from the Parent's reputation.
4. There is lower degree of control from the Parent indicated by non-controlling ownership (less than 51%) and limited presence in the subsidiary's board of management.
5. The nature of the subsidiary's business has a significantly higher risk profile than the Parent overall business and could constitute a potentially significant threat to the earnings and/or financial strength of the Parent.
6. Strategically Important Subsidiaries should be performing reasonably successful relative to the Parent's overall performance.
7. Subsidiary is less integrated to the Parent's overall business strategy than other core subsidiaries, and therefore may be divested for capital gain motive.

### **Nonstrategic Subsidiary**

PEFINDO categorizes nonstrategic subsidiaries as similar to passive investments. They could be sold opportunistically in the near or intermediate term. In most cases, PEFINDO rates these nonstrategic subsidiaries on a purely stand-alone basis, and such ratings would almost always be lower than the Parent's rating. In rare cases PEFINDO may add one additional notch of support if the subsidiary possesses several strategically important characteristics, if it is not obviously a candidate for sale over the short term, and if PEFINDO believes the subsidiary would receive parental support were it to experience financial difficulties.

PEFINDO defines nonstrategic subsidiaries as those that:

1. Failure at the subsidiary level may have limited impact to the Parent level.
2. PEFINDO believes might be sold in the relatively near or intermediate term.
3. Are highly unprofitable or marginally profitable and for which PEFINDO thinks there is little likelihood of a turnaround or of additional support from the Parent.
4. The subsidiaries engage in auxiliary business not strongly related to the Parent's business.

### **Impact of lower rated Parent to the Company's final rating**

There are some cases that the Parent's capability is considered lower than the Subsidiary, reflected by the Parent's lower rating compared to the Subsidiary's standalone rating. In these cases PEFINDO will assess the probability of the Subsidiary is being forced to support the Parent during financial distress. If PEFINDO finds there are strong evidences of the Subsidiary's cash flow is taken out by the Parent up to the level that may affect the Subsidiary's credit profile through such methods as excessive dividend payment, transfer pricing, abnormal management fees, or other inter-related party transactions, then it is possible to lower the Subsidiary's rating close to the Parent's rating. PEFINDO may also give notching down to the Subsidiary's standalone rating if there is a strong indication supported by past track record that the Parent can override the Subsidiary's business decision including in fulfilling its financial liabilities. If PEFINDO believes that there is a remote possibility of such actions, then there may be no notching down given to

the Subsidiary, as we views that the Parent's financial failure may not substantially affect the Subsidiary's credit profile.

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