

Rating Methodology for Investment Holding Companies

Summary

This rating methodology adopted by China Chengxin (Asia Pacific) Credit Ratings Company Limited (“CCXAP”) applies to investment holding companies (“IHCs”) and conglomerates. Investment funds are excluded from the scope of this rating methodology.

IHC is a corporate entity constituted as financial investor, which holds non-controlling equity stakes in private or publicly traded companies or holding significant or full ownership stakes in a smaller number of companies with the aim of making long-term capital gains. A conglomerate is a holding company which mainly owns controlling stakes in a number of subsidiaries of different businesses. Each subsidiary of the conglomerate operates independently as the conglomerate acts as one group. An investment fund is a supply of capital collectively purchased by numerous investors while each investor retains ownership and control of their own shares.

The major differences of an IHC from a conglomerate are lack of control and operational integration, the funding being strictly segregated between operating company and holding company, and the value being created by capital gains and dividends.

This rating methodology introduces the key determinants for rating IHCs and conglomerates. CCXAP assigns credit ratings to them using its rating scale.

Introduction of Rating Methodology

The key rating determinants are divided into qualitative determinants and quantitative determinants. The rating methodology provides a summarized guidance for the important factors used in assigning ratings, but it does not include every aspects of rating consideration. As a result, the mapped rating may not match the final rating of each company.

In this rating methodology, there are five rating factors comprising 11 sub-factors as follows:

Rating Factors	Sub-factors
Asset Quality	Asset Liquidity
	Asset Concentration
	Geographic Diversification

	Business Diversification
Investment and Financial Policy	Investment Policy Financial Policy
Profitability	Return on Equity (%)
Solvency	Loan to Value (%) Investment Income/Interest Expense (x) Total Debt/Investment Income (x)
Liquidity	Cash/Short-term Debt (x)

Key Rating Determinants

Rating factors and sub-factors are discussed in details in this section, including rationale, measurement and how they will affect the ratings.

1. Asset Quality

In the evaluation of asset quality, CCXAP considers the factors based on asset liquidity, asset concentration, as well as the geographic and business diversification of investment assets. Assets of above-average quality could generate relatively stable returns and cash flow in different stages of an economic cycle.

(1) Asset Liquidity

Asset liquidity is defined as the value of the IHC's investment in listed companies as a percentage of total portfolio value. This sub-factor plays an important role in determining the company's ability to dispose easily of the investment. The focus of our assessment is the duration the IHC uses to liquidate its assets at a reasonable price. An investment portfolio with high asset liquidity is characterized by relatively liquid unlisted assets and listed assets with loose restriction on disposal.

(2) Asset Concentration

CCXAP considers asset concentration as the value of the IHC's three largest investments as a percentage of total portfolio value. A wide diversified investment portfolio could reduce concentration risk and overall volatility. When the three largest assets of an IHC account for a relatively low percentage of total portfolio value, asset concentration risk to the IHC is lower.

(3) Geographic Diversification

CCXAP evaluates geographic diversification as the number of the investment assets distributed in different regions. We take this sub-factor into account since it contributes greater stability of the investment incomes and more stable market values with higher level of geographic diversification. A higher level of diversification can help insulate the company from influences of a specific region.

(4) Business Diversification

CCXAP assesses business diversification as the number of business sectors covered by the IHC. In addition, we consider the extent to which exposure in the main sector that is balanced by exposure to other unrelated sectors. As with the factor of geographic diversification, we believe that the company

with higher level of business diversification has greater stability of investment incomes and market values.

2. Investment and Financial Policy

The investment and financial policy of IHCs play a significant role in assessing the credit profile and overall investment position.

(1) Investment Policy

In assessing the investment policy, CCXAP evaluates the company's investment strategy, professionalism and execution. These factors are jointly taken into consideration to assess the company's risk tolerance and the company's risk management capability.

A higher rating should be given to a company which has highly stable investment strategy, excellent track record in executing its strategy, and highly experienced investment experts specialized in various sectors. Low risk of significant transition of the quality of portfolio and clearly-defined investment guidelines providing long-term visibility of business profile are also considered to be positive indicators for a higher rating.

(2) Financial Policy

The assessment of financial policy includes financial prudence and financing capacity. The financial policy is a key rating determinant as the financial risk management will affect the debt level and the capital structure of a company.

Access to capital, cost of funds and debt maturity are taken into consideration of financing capacity. Moreover, CCXAP evaluates the company's capability of using different types of financial instruments to raise fund in the capital markets. Clear public commitment of the management by adapting a prudent financial policy and strong track record of financing capacity are considered to be credit positive for an IHC.

3. Profitability

In assessing profitability of IHCs, CCXAP uses the ratio of return on equity, which is calculated by dividing net income by average shareholders' equity expressed as a percentage.

(1) Return on Equity

The financial ratio of return on equity indicates a company's earning capacity by revealing how much profit the company generates with the money shareholders have invested. An IHC with a good earning capacity can increase its capital and enhance its capacity to meet its financial obligations in a timely manner.

4. Solvency

The factor of solvency means the ability of IHCs to meet its financial obligations. In the evaluation of solvency, CCXAP reviews three quantitative determinants including loan to value ratio, investment income divided by interest expense and total debt divided by investment income. Investment income is defined as the income coming from interests, dividends, capital gains upon the sale of assets, and any

other profits made through any kind of investment.

(1) Loan to Value

CCXAP measures the financial risk profile using the ratio of loan to value which is calculated by dividing total debt by estimated investment value expressed as a percentage. Loan to value reflects the potential asset coverage available to repay debt commitments. A significant fall in investment value will cause a surge in loan to value ratio, which is credit negative for the company.

(2) Investment Income/Interest Expense

CCXAP assesses the ability to repay of an IHC by its interest coverage, which indicates whether the interest payments rely on investment earnings or sale of assets. With higher ratio of the interest coverage, the company's strength for interest payment is stronger.

(3) Total Debt/Investment Income

The ratio of total debt divided by investment income is a measurement of financial leverage, and it reflects the ability of the IHC to cover debts by its investment earnings. A lower ratio is a positive indicator that the IHC has sufficient investment returns to meet its financial obligations.

5. Liquidity

Since refinancing is a key risk for IHCs, liquidity and funding are especially important for the financial flexibility. In the evaluation of this factor, CCXAP reviews the company's liquidity ratio, which is calculated by dividing cash balances by short-term debt.

(1) Cash/Short-term debt

Sources of liquidity include cash flows, cash balances, asset sales and credit lines. Uses of liquidity include debt repayments (interests and principals), dividend payments, and capital expenditures. The company with a high liquidity ratio can help maintain its competitiveness in a tight market situation. Shortage of liquid funds would be the direct cause of failure of the investment.

Other Rating Considerations

Other than the factors and sub-factors discussed above, the availability of external support to a company when needed can help strengthen its credit capacity. CCXAP gives consideration to dividend distribution policy, corporate governance and support from shareholders when assessing a company's overall credit strength.

Dividend Policy

Dividend policy is a set of guidelines invested companies use to decide how much it will pay out to shareholders in the form of dividends. It is a significant rating consideration which can be probably influenced by minority stakeholders. CCXAP considers the factors which affect the flexibility in making additional liquidity, including track record of stable dividend distributions and level of control over dividend distributions.

Corporate Governance and Management

Corporate governance and management represents the system of rules, practices and processes by which the company is controlled and directed, and it is an important rating consideration. The company with strong corporate governance has fair and transparent sets of rules and controls in which all stakeholders have aligned incentives.

External Support

Support from companies' shareholders affects the company's future development and credit profile. CCXAP believes that the extent of support from shareholders is closely related to the subsidiary's importance to the holding company. We measure the willingness of support by development strategy, market position, ownership structure, and the subsidiary's importance within the group. CCXAP also views that a company with strong shareholders may receive parental support of capital injection.

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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 805-808, 8/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656