



Criteria for Consolidation of Companies

Introduction

ACER Credit Rating Private Limited (ACER), a SEBI-registered credit rating agency, is committed to providing independent and transparent opinions on issuer and credit ratings. ACER's credit insights aim to empower investors, lenders, and businesses with opinions on ratings. It enables external stakeholders with informed decisions and fosters confidence in India's financial markets. With a clear vision to support India's economic growth story, ACER upholds the highest ethical and analytical standards, combining deep domain expertise, advanced analytics, and rigorous processes to ensure every rating is objective and insightful.

The Company reserves the right to amend this policy from time to time in accordance with the applicable regulations, circulars, and directives issued by the Securities and Exchange Board of India. This rating criteria will be reviewed annually.

Background

Companies frequently conduct their business operations through diverse corporate structures that extend beyond a single legal entity. These structures typically include subsidiaries, joint ventures, associates, special purpose vehicles, and other group entities, established for operational, legal, taxation, or regulatory considerations. While some group entities operate in similar business lines with substantial financial linkages, others engage in diversified activities with minimal operational overlap. This structural diversity reflects both strategic business decisions and practical requirements imposed by regulatory frameworks and market conditions.

A fundamental limitation of standalone financial analysis becomes apparent when examining companies with complex group structures. Standalone analysis of the parent company alone provides insights into individual entity risks but fails to capture critical interlinkages, contingent liabilities, cash flow interdependencies, and implicit support obligations that emerge particularly during financial stress. Analysis of consolidated financial aims to address this limitation by treating the parent company and its related entities as a single economic unit, thereby providing a consolidated view of the group's aggregate resources, total obligations, market position, earnings stability, and consolidated cash generation capacity.

ACER's consolidation criterion outlines the rating agency's comprehensive approach to assessing and consolidating group credit risk when assigning ratings to parent entities and evaluating linkages with subsidiaries, joint ventures, associates, and special purpose vehicles. The criteria also address situations where entities without direct shareholding relationships but controlled by common promoters may be analyzed on a combined basis, reflecting business similarity and demonstrated financial fungibility.



A. Objectives of Consolidation Approach

ACER may employ consolidation analysis to achieve several critical objectives that enhance the comprehensiveness, fairness, and comparability of credit assessments. These objectives are on the basis of all consolidation decisions and ensure that analytical approaches align with their objectives.

The primary objective is to provide a comprehensive credit assessment that aggregates the financials of the rated company and its related entities. This aggregation produces a fair representation of the group's overall financial health, consolidated net worth, aggregate leverage ratios, liquidity position, and combined credit risk assessment. Standalone financial statements frequently overlook explicit liabilities and implicit support obligations that may crystallize during stress. For example, if a manufacturing parent derives 65% of its revenue from a subsidiary or subsidiaries that distributes its products, and that subsidiary carries significant debt, standalone analysis of the parent company would significantly understate the integrated group's credit risk and leverage. Consolidated analysis insights into the full capital requirements across the supply chain and the integrated nature of operational cash flows.

A second key objective is evaluation of the group's business risk assessment. ACER Ratings encompasses all business sectors and industries in which the group operates or plans to enter, enabling assessment of sustainability of the group's market position, earnings generation capacity, and consolidated cash flow generation across economic cycles. This comprehensive business evaluation helps in reflecting credit ratings on the basis of the group's diversification, market concentration, and earnings stability at the consolidated level.

ACER evaluates support and its degree of integration across group entities. The consolidation criteria incorporate a continuum of support ranging from explicit contractual commitments to implicit reputational obligations, assessing operational, managerial, and financial integration across entities. This evaluation ensures that ratings are comparable with peer companies operating in similar industries and with similar integration levels.

Additionally, consolidation analysis identifies and adjusts for intra-group transactions, cross-investments, and both documented and implicit moral obligations that could materially impact consolidated debt servicing capacity. By systematically eliminating intra-group transactions, ACER produces financial statements that reflect only the group's external obligations to third parties.

Finally, ACER ensures regulatory transparency in all consolidation assumptions and disclosures, aligning with Securities and Exchange Board of India requirements. This transparency provides investors, lenders, and other stakeholders with clear visibility into consolidation methodologies and underlying rationale.

B. When Consolidation Becomes Relevant

Consolidation becomes relevant when the parent company exercises direct or indirect controlling interests in other entities, or when group entities exhibit interlinkages sufficiently strong to



materially affect the parent's financial position. Consolidation analysis may get triggered in several key scenarios that warrant analysis beyond the parent company's standalone perspective.

Consolidation becomes relevant when a parent company establishes subsidiaries or special purpose vehicles for legal, tax, or regulatory purposes. These structures may include leveraged buyouts, project finance vehicles designed to isolate cash flows, securitization structures, or entities created for geographic expansion or new market entry. Although such structures are often designed to isolate specific cash flows and facilitate non-recourse debt financing, they typically signal implicit parental support expectations, particularly during periods of project underperformance or adverse market conditions.

When intra-group transactions, cross-holdings, inter-company loans, or poorly defined obligation structures materially affect the parent's debt servicing capacity, consolidation analysis becomes essential. These transactions may include inter-company service agreements, management fees, royalty arrangements, or other economic arrangements that transfer value between entities and affect cash flow availability.

Consolidation is particularly relevant when standalone analysis of the parent company materially understates credit risks because subsidiaries contribute significantly to group revenue or profitability while simultaneously carrying high debt levels. In such situations, standalone analysis presents an incomplete and potentially misleading credit assessment.

Entities forming part of homogenous groups lacking formal shareholding relationships but sharing common promoters, centralized decision-making, and demonstrable cash flow fungibility warrant consolidated analysis as a single economic unit. Traditional family businesses and promoter-controlled holding structures frequently exhibit these characteristics despite separate legal incorporation.

Conversely, consolidation is generally not relevant for completely ring-fenced entities operating in fundamentally different sectors with no demonstrated support relationships, such as a standalone financial services subsidiary of a manufacturing parent without cross-guarantees. However, even in such cases, the cash flow impacts from parental investments remain relevant to analysis of the parent company.

The criterion on consolidation of companies combines the financial and business risk profile of the group and the entity as one single business unit. Here the parent is rated on a consolidated profile, and the rating of the subsidiaries is derived from the linkages with the parent. Thus, the rating of the parent may differ from the subsidiary. On the other hand, a 'consolidated view' of group entities takes all entities of the group as a single enterprise, in substance. This considers common credit risk profile of subsidiaries and parent, given strong business, financial and management linkages, resulting in a similar rating for the parent and the subsidiary.

C. Types of Consolidation with Illustrative Examples



ACER evaluates consolidation approaches by analyzing ownership structures, parental control, inter-entity linkages, and relationship dynamics. The chosen method depends on group-specific characteristics.

Full Consolidation is the most comprehensive approach, combining all assets, liabilities, revenues, expenses, and cash flows of subsidiaries line by line, presenting the group as a single economic entity. It is typically applied when the parent company holds majority ownership and demonstrates strong operational, financial, and managerial integration. Under this method, intra-group transactions are eliminated, receivables and payables are netted, and consolidated statements reflect only external obligations.

For example, a flagship manufacturing parent with complete ownership of subsidiaries engaged in raw material sourcing, distribution, and ancillary production may adopt full consolidation. These subsidiaries share management, operate under unified treasury and working capital systems, leverage the parent's brand, and benefit from centralized quality and R&D. Full consolidation captures this unified reality, offering a holistic view of the supply chain.

Partial Consolidation includes entities in consolidated analysis based on the parent's ownership stake rather than on a full line-by-line basis. This approach may typically be employed for joint ventures and partially owned subsidiaries where the parent exercises significant influence but not majority control. Under partial consolidation, only the parent's proportionate share of each entity's assets, liabilities, revenues, and expenses is included in consolidated analysis.

For example, a parent company with a 40 percent stake in a strategic joint venture for regional expansion holds board representation and participates in decision-making but does not exercise unilateral control. Under proportionate consolidation, only 40 percent of the joint venture's financials would be incorporated into consolidated analysis, reflecting the parent's actual economic exposure without overstating control.

The Combined Approach may be considered for closely held promoters or family-controlled groups where formal shareholding relationships may not exist, but entities are operationally and financially integrated through common ownership, centralized control, shared cash flows, and business similarity. Under this approach, separately incorporated entities may be generally combined subject to exceptions as if they were a single economic unit despite the absence of traditional parent-subsidiary ownership.

For instance, a textile industry group consisting of multiple separately incorporated manufacturing and trading entities, all controlled by the same promoter family with interconnected operations and regular intra-group capital flows, exemplifies this approach. Despite the absence of formal shareholding relationships, these entities may be analyzed on a combined basis as a single economic unit, recognizing rating differentiation, as applicable, among entities based on strategic importance.

The consolidation of companies can be done using the Equity method, which includes associate companies and non-controlling entities where the parent exercises significant influence, typically



indicated by ownership stakes between 20 and 50 percent, without achieving majority control. Under this method, only the parent's share of the associate's profits and losses, and the investment value itself, may be incorporated into consolidated analysis rather than aggregating the associate's balance sheet line-by-line.

For instance, if a parent company holds a 30 percent stake in an associate company and has provided a corporate guarantee for 60 percent of the associate's debt, the consolidated analysis would include the parent's 30 percent share of the associate's annual results and recognize the guarantee obligation as a contingent liability, allowing appropriate adjustment for potential support without overstating parental involvement.

Another widely used method and ACER's preferred approach is the 'Pooling of Interests' method. This treats all group entities as a single business unit while analyzing combined financial risk assessment. Intra-group transactions may be adjusted appropriately during consolidation; investments in group companies are adjusted against consolidated net worth, and intra-group borrowings are adjusted against inter-company advances. By adjusting intra-group transactions and focusing on external obligations, this method provides clear visibility into the group's credit risk assessment and debt servicing capacity.

D. Key Criteria for Consolidation

The determination of appropriate consolidation degree is likely to depend on comprehensive evaluation of integration levels across multiple dimensions. Strategic Importance and Business Linkages represent the first evaluation area. ACER may consider whether the subsidiary is strategically critical and integral to parent operations or functions as a peripheral activity. Quantitative metrics may also include the percentage of parent revenues sourced from the subsidiary, production capacity dependencies, and profit contribution. A parent company deriving 60-80 per cent of revenue from sales to a subsidiary that performs final assembly, with no alternative customer base for specialized production, demonstrates high strategic importance warranting full consolidation. Major aspects that may be assessed for establishing degree of consolidation are given below.

- I. **Management and Operational Control** It examines aspects related to centralization of management decision-making, board composition, strategic planning integration, treasury and working capital management, and use of common branding and market positioning, its organisational structure where subsidiary managing directors report to the group CEO, centralized financial planning, common banking relationships, and human resources support. Conversely, subsidiaries with independent boards, autonomous management, separate banking relationships, and distinct operational systems justify more limited consolidation approaches.
- II. **Financial Linkages and Support History** It evaluates documented patterns of financial support including inter-corporate deposits, subordinated loans, equity infusions, and capital contributions. Historical support patterns may be few indicators of probable future support than intent. If a parent company has consistently capitalized loss-making subsidiaries over a five-year period, cumulatively



infusing support while deferring dividend payments to fund such infusions, this documented history demonstrates that the parent views the subsidiary as operationally critical and willingly subordinates its own financial objectives to support the subsidiary.

- III. **Legal Obligations and Contingent Liabilities** It evaluates contractual and legal arrangements creating explicit support obligations, including corporate guarantees of subsidiary debt, cross-default clauses linking multiple entities' creditworthiness, cross-guarantees among group entities, and subordinated loan agreements. Cross-default clauses are particularly significant because they create cascading credit deterioration risk. If loan agreements contain cross-default provisions affecting multiple group entities, default by one entity triggers default across the entire group, requiring stress analysis of the entire consolidated structure.
- IV. **Restrictions on Fund Flows and Structural Barriers** It evaluates constraints limiting practical fund movement across group entities, including foreign exchange regulations restricting dividend repatriation, loan covenants prohibiting inter-company loans above specified levels, minority shareholder rights restricting dividend distributions, ring-fencing arrangements legally isolating subsidiary cash flows, regulatory restrictions limiting fund transfers among jurisdictions, and escrow structures holding subsidiary cash in trust. Funds legally or practically prevented from moving to the parent company are treated as economically trapped and excluded from consolidated liquidity assessments. For example, a parent company owning 80 percent of a foreign subsidiary generating substantial profits faces foreign exchange controls limiting annual dividend repatriation to 25 percent of subsidiary profits and loan covenants restricting dividends to 50 percent of annual net income. The consolidated analysis would recognize only the portion of subsidiary profits actually available to the parent company after these constraints.
- V. **Reputational and Economic Incentives** It evaluates reputational considerations creating implicit support obligations, including shared branding between parent and subsidiary, market positioning tying parent reputation to subsidiary performance, family business considerations where family reputation is tied to group performance, and economic benefits accruing to the parent from subsidiary support. A holding company with prestigious brand reputation owning multiple branded subsidiaries faces reputational damage from allowing branded subsidiary failure. While no contractual obligation may exist, the economic incentive to support the subsidiary through financial distress is substantial.

E. Adjustments for Inclusions and Exclusions

The consolidation process requires systematic identification of which entities should be included in group analysis and what adjustments to intra-group transactions are necessary to reflect obligations accurately. Entities demonstrating strong linkages with the parent—such as strategic subsidiaries contributing materially to operations, non-controlling entities backed by explicit guarantees, or homogenous group companies with cash flow fungibility—are typically consolidated.



During consolidation, intra-group transactions are adjusted to avoid double-counting. Inter-company loans are netted by reducing receivables and liabilities equally. Parent investments in subsidiary equity are eliminated against corresponding subsidiary equity, ensuring consolidated equity reflects only incremental contributions. Inter-company sales, purchases, management fees, royalties, and service agreements are also removed, leaving only external revenues and costs. For example, if a parent invests Rs 150 million in a wholly owned subsidiary with Rs 200 million equity, consolidation eliminates duplication, showing full subsidiary assets and liabilities but only Rs 50 million incremental equity.

Entities that are demonstrably independent and insulated may be excluded. Typical exclusions include ring-fenced special purpose vehicles with non-recourse debt, subsidiaries in unrelated industries with no operational linkages, and entities where parental support is explicitly disclaimed. Exclusion, however, does not imply irrelevance. Any parental investment in excluded entities remains part of standalone analysis, as it represents capital unavailable for operations or debt service.

For instance, a manufacturing parent holding a 60% stake in a financial services company may appropriately exclude the subsidiary from consolidated analysis due to its distinct business model, regulatory environment, and risk profile. Nevertheless, the parent's Rs 300 million equity investment would still be factored into standalone assessment.

This framework ensures consolidated credit analysis captures both interdependencies and independence, providing a balanced view of group risk and financial resilience.

F. Treatment of Interrelated and Contingent Exposures

Group entities often carry complex interrelated exposures and contingent obligations that materially affect consolidated credit risk, even if not visible on balance sheets. Intra-group loans, receivables, payables, and guarantees are eliminated during consolidation to avoid double-counting, yet they remain analytically relevant. Such exposures reveal cash flow dependencies and support expectations; for instance, recurring parental advances to a subsidiary highlight reliance on parental support.

Contingent obligations can crystallize quickly under stress, converting implicit liabilities into explicit debt. Guarantees—whether formal corporate guarantees or implicit moral obligations tied to shared branding—must be assessed for likelihood of crystallization. If a subsidiary defaults, guaranteed debt may shift to the parent, worsening consolidated leverage and debt service capacity.

Cross-default clauses further intensify group linkages. A default by one entity can trigger automatic defaults across linked entities, creating cascading deterioration. In such cases, entities are treated as a unified credit unit, with stress analysis applied across the group. Ratings of subsidiaries linked through cross-default are typically capped at the parent's level, since their credit quality cannot exceed that of the guarantor or co-defaulting parent.



This framework ensures consolidated analysis captures hidden dependencies, contingent risks, and systemic linkages critical to group credit assessment.

G. Infrastructure Groups and Special Purpose Vehicles

Infrastructure groups frequently employ special purpose vehicles to isolate project-specific cash flows, limit lender recourse, and facilitate project-level debt financing. The consolidation approach for infrastructure groups and SPVs requires specialized analysis because project cash flows are typically ring-fenced through non-recourse debt structures while simultaneously being subject to sponsor support expectations and surplus cash distribution arrangements.

ACER may evaluate infrastructure group consolidation based on assessment of whether SPV cash flows are truly ring-fenced and independent or whether SPVs are operationally and financially integrated with the sponsor group. Ring-fenced project cash flows that are structurally insulated through non-recourse debt arrangements where lender recourse is limited to project assets and project revenue streams may be excluded from consolidated analysis if the parent company has not guaranteed SPV debt and the SPV demonstrates independent debt servicing ability. Such SPVs may sustain operations during parent company financial distress, justifying standalone treatment.

However, if project cash flows are constrained by commodity price fluctuations, demand volatility, or regulatory price controls, and the sponsor parent has provided implicit or explicit support commitments, the SPV may be consolidated with the parent company. The purpose of analysis is whether the parent company would allow SPV default or would provide support to protect parental reputation, strategic position, or asset base.

If the parent company has provided corporate guarantees of SPV debt, shortfall undertakings committing the parent to cover SPV operational deficits, or completion guarantees committing the parent to complete projects on time and within budget, the SPV may be consolidated with the parent, as these explicit commitments create parent company liabilities. Similarly, if cash flows from the SPV are regularly transferred to the parent through dividend distributions or if the parent regularly provides capital infusions to the SPV, consolidation is appropriate.

Consider a power generation company establishing an SPV to develop and operate a 500 MW facility under a long-term power purchase agreement providing stable, predictable cash flows. The project debt is non-recourse with lender recourse limited to project assets and cash flows. The debt documents include no cross-default clauses linking project debt to other company obligations. The power company has no obligation to support the SPV if project cash flows prove insufficient. The SPV is appropriately excluded from the parent company's consolidated analysis and rated independently based on project cash flows and power purchase agreement strength. The parent company's equity investment is recognized as a parent asset but SPV debt and operational results are not consolidated.

In contrast, a road infrastructure company establishing an SPV to develop and operate a toll road with significant construction risk provides a completion guarantee and commits to provide shortfall support if toll revenues fall below specified thresholds. The SPV may be consolidated with the parent company because these guarantees create explicit support obligations representing



contingent parent liabilities that could crystallize if construction costs overrun or toll revenues underperform.

Debt service reserve accounts and liquidity buffers established under project debt agreements are project-specific and may be treated as restricted to project use rather than as available group liquidity. A DSRA funded to cover 12 months of anticipated debt service represents cash held in trust for project creditors and is not available to support other group entities.

H. Conclusion

ACER's consolidation criteria provide a structured framework for assessing group credit risk with fairness, transparency, and analytical rigor. The approach balances full integration of operationally linked entities with clarity for ring fenced or distinct operations, ensuring comparability and credibility of ratings.

The degree of consolidation is determined through systematic evaluation of strategic importance, operational integration, financial linkages, legal obligations, cash flow fungibility, and restrictions on fund movement. Based on these factors, ACER applies the most suitable methodology—ranging from full consolidation, proportionate consolidation, equity method treatment, combined analysis, or limited consolidation.

Rating differentiation within groups is applied when entities exhibit distinct risk profiles, autonomy, or support relationships. A holding company with minority stakes in independent subsidiaries may be rated lower than its subsidiaries, while a weaker but strategically critical subsidiary may benefit from uplift, though capped below the parent's rating. All differentiation is disclosed with clear rationale.

ACER discloses all consolidation assumptions, included or excluded entities, and analytical reasoning in line with SEBI requirements. Recognizing evolving group structures, ACER commits to continuous monitoring and dynamic reassessment of consolidation assumptions.