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S&P Global

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Analytical Adjustments to Companies' Reported Financial Data

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The purpose of this commentary is to provide more transparency to the market of our analytical approach when we review a company's reported financial information. In our view, an entity's financial statements and data are typically important inputs to our cash flow/leverage and competitive position analysis. Adjustments to reported financial statements to calculate adjusted credit ratios may occur in order to:

- Better align an entity's reported financial data with the view of the underlying economics of specific transactions, as well as continuing operations. This may include adjustments for transformational events.
- Improve the comparability of financial data between companies and across industries.
- Adjust the consolidation approach embedded in reported financials to best reflect the opinion of an entity's business, economic, and financial ties to other members of the group including subsidiaries, holding companies, and affiliates.

Below are illustrations of some of the adjustments we may contemplate. We may have more or less adjustments than the examples below, based on the abovementioned guiding principle. We may or may not make these adjustments, depending on the individual company's situation.

Adjusted Debt Principle

In general, items that we may add to reported debt to calculate adjusted debt include:

- On- and off-balance-sheet commitments to purchase or use of long-life assets (such as lease obligations) or businesses (such as deferred purchase considerations) where the benefits of ownership are accruing to the company.

Accessible Cash and Liquid Investments

We may calculate adjusted debt net of surplus cash and liquid investments (accessible cash), because a company that has cash available to repay debt on short notice has more financial flexibility than a company with no such cash available. In analyzing a company's cash and investments, we focus on their accessibility and liquidity. Our adjustment for accessible cash is company specific.

Leases

Under lease arrangements, the lessee contracts for the use of an asset, entering into a debt-like financing obligation to make periodic rental payments. To account for this, we typically adjust debt, earnings, cash flows, and interest for better comparability among companies.

Capitalized Development Costs

In financial reporting, research costs are almost universally treated as an expense. However, the treatment of development costs varies because of the subjectivity in determining when development costs are capitalized. To enhance comparability, we generally treat all capitalized development costs as if they were expensed in the period incurred.

Hybrid Capital Instruments

The treatment of hybrid capital instruments in our leverage and debt service ratio calculations depends on the equity content classification of the instrument as determined by us.

Capitalized Interest

As financial statements capitalize interest costs during the construction of fixed assets, this can obscure the total interest that has been incurred during the construction period, hindering comparisons of the interest burden between companies that capitalize and do not capitalize interest. We generally include interest costs that have been capitalized in adjusted interest in the period when they were incurred.

Financial Guarantees

A financial guarantee is a promise by one party to assume a liability of another party if that party fails to meet its obligations under the liability. If a company has guaranteed liabilities of a third party or an unconsolidated affiliate, we typically consider the guaranteed amount in the context of the company's reported debt.

Earn Outs and Deferred Consideration for Business Acquisitions

Companies acquiring other companies sometimes finance a portion of the purchase price by entering into contingent consideration arrangements (that is, "earn outs") and/or by paying a fixed sum on a delayed basis (deferred consideration). We typically view these transactions as a form of financing and therefore we may add the liability to debt to reflect this view.

The above reflects some of the adjustments that we often consider when reviewing a company's reported financial information. The adjustments we may apply vary by company and their relative importance in determining our underlying view of the financial position of a company and its relevance for our credit analysis and any credit opinion determination we may make.

This report does not constitute a rating action.

This document is prepared in both English and Chinese. The English translation is for reference only, and the Chinese version will prevail in the event of any inconsistency between the English version and the Chinese version.