

Spread Research: Rating Process & Rating Methodology

EXECUTIVE SUMMARY

This document is aimed at providing an overview of Spread Research's rating process (including rating initiation and rating monitoring) and rating methodology.

RATING DEFINITION & RATING SCALE

RATING DEFINITION

A corporate rating is Spread Research's measure of the future credit quality of an issuer within a 6- to 12-month horizon, that is closely linked to a Probability of Default (and not an Expected Loss). The Loss Given Default is captured separately by the recovery rate.

RATING SCALE

Spread Research uses the following rating scale:

Rating	Issuer Key characteristics
AAA	Highest credit quality and extremely low business and financial risk
AA+	Very large scale and very high level of diversification, very low-risk business (proven resilience through economic crisis), very high FCF and very low leverage
AA	
AA-	
A+	Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), high FCF and very low leverage
A	
A-	
BBB+	Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), positive FCF and/or low leverage
BBB	
BBB-	
BB+	Medium/low-risk business (stable and predictable cash flows), positive FCF and/or low leverage
BB	
BB-	
B+	High-risk business, negative FCF and/or high leverage
B	
B-	
CCC+	Very high leverage, negative FCF, weak liquidity and/or restructuring/default likely
CCC	
CCC-	
CC	Out-of-court consensual restructuring
C	In-court restructuring without failure to fulfill financial obligations.
D	Missed payment on interest or principal (post-grace period)



RATING PROCESS

RESPONSIBILITIES

The lead rating analyst is responsible for conducting the fundamental credit analysis, formulating a rating recommendation based on Spread Research's relevant criteria and methodology, as described later, and presenting sufficient and relevant information to the Rating Committee.

INFORMATION REQUIRED

The minimum public information required is:

- The two latest annual reports and their audit certification;
- The latest interim report of any (either quarterly or semi-annual report); The management's discussions on operating results, including the review of competition and market developments;
- The documentation on public bond instruments;
- One access to management during the last twelve months, either through an earnings call or a one-to-one call between Spread Research's rating analyst and the company's management or investor relations department.

In case Spread Research has access to non-public information, we will require obtaining in addition the main terms and conditions of credit facilities agreement, including financial covenants.

RATING PRODUCTION

The rating production process is organized through the following steps:

- Step 1: Review of annual reports (at least the two latest) and their audit certification;
- Step 2: Review of the quarterly results and all information available in the investor relation section;
- Step 3: Review of competition and market developments. This can be done thanks to the company's information on its market position, or information available from its competitors, industry associations or the regulator's database;
- Step 4: Review of the bond preliminary prospectus when available;
- Step 1-4: for each of the previous steps, the rating analyst fills in Spread Research's excel model with historical data available, including financial statements, the breakdown of the group's (1) revenues, (2) operating margin, and (3) debt structure, the summary of the financial covenants that have been disclosed to Spread Research;
- Step 5: Call with the management, when available; in particular, the lead rating analyst pays attention to the company's strategy, its acquisition and dividend policies, as well as its financial leverage target (if any);
- Step 6: The quality of the information received and used through the rating process is summarized in the "Transparency Index" issued by Spread Research's analysts. This index gives a fair assessment of the quality of the information used in the rating methodology.

Spread Research produces documents that are mapping key financial ratios for each level of rating (i.e. adjusted EBITDA margins, leverage ratios, coverage ratios), and these document can serve as a benchmark for the rating assignment exercise.



RATING METHODOLOGY

INTRODUCTION

- Spread Research defines a default as either (i) a missed payment (post-grace period) on a coupon or the debt principal; (ii) an in-court restructuring with a failure to fulfill financial obligations; or (iii) a liquidation.
- Spread Research assigns corporate ratings. A corporate rating does not take into account structural or contractual considerations; it is the rating that would be assigned assuming a single corporate entity and a single class of debt. Spread Research also assigns instrument ratings derived from the corporate rating taking into account structural and contractual considerations, the total debt structure, the recovery rate of the rated instrument and specific elements if needed on a case by case basis.
- Spread Research's rating applies to the consolidated group for which audited consolidated accounts are available. Debt located at holding company level (e.g. PIK) above the consolidated group may be factored in on a case-by-case basis depending upon the degree of protection offered by group covenants against cash leakage to service such debt.
- Ratings are forward-looking and thus (i) look in part through the cycle (depending upon its length); and (ii) incorporate event risk whose likelihood is material and flagged by the analyst.
- Spread Research only assigns local currency ratings; i.e. ratings that measure an issuer's ability and willingness to meet its debt obligations regardless of the currency in which such obligations are denominated. Local currency ratings thus assume no risk of (i) conversion of local currency into foreign currency; and (ii) transfer of foreign currency to non-residents. Nevertheless, they factor in all the other risks associated with the environment in which issuers operate, including country/political risk, fiscal risk, FX exposure, etc.

METHODOLOGICAL APPROACH

Ratings assigned by Spread Research are based on the analysis of a mix of qualitative factors (business risk profile, management strategy) and quantitative factors (historical and projected credit metrics, liquidity). More specifically, a rating is the combination of an issuer's business risk profile and of its financial risk profile.

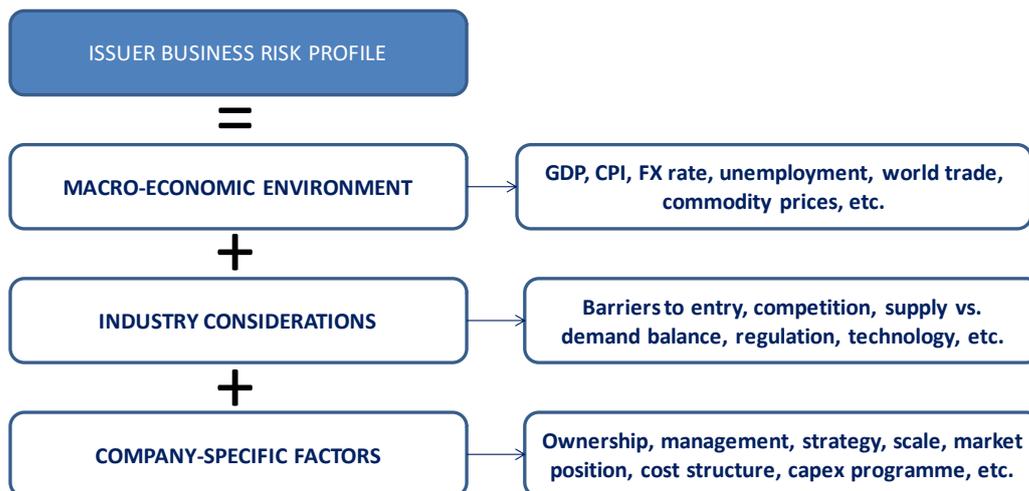
Certain specific credit considerations may subsequently cap such rating to a lower level than originally envisaged. These include: country risk, liquidity profile and transparency, among other.



For example, a weighting of 70% may be assigned to the business risk profile whilst a weighting of 30% may be assigned to the financial risk profile. These proportions may vary in accordance with the cyclical nature of the industry the issuer operates in. Generally, the greater the cyclical nature, the higher the weighting on the business risk profile, and vice versa. For example, airlines will see a high weighting assigned to their business risk profile as their ratios, which are by essence highly volatile, are less relevant within the context of the rating assessment. Conversely, cable issuers which demonstrate very stable earnings will see a higher weighting assigned to their financial risk profile as their credit rating will likely be driven by the level of their credit metrics.

RATING FACTORS: BUSINESS RISK PROFILE

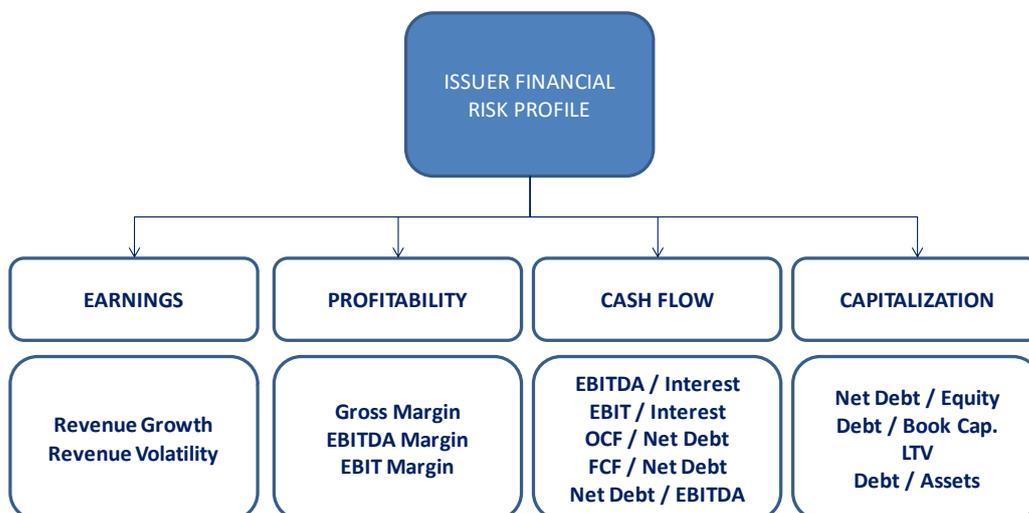
We assess the business risk profile of an issuer based on a number of qualitative factors as per chart below. Typically, our assessment is comprised of three layers of analysis, including (1) the macro-economic environment, (2) industry-specific considerations and (3) company-specific considerations. Please note that although the factors shown below and discussed thereafter are the most commonly used, we may use other factors depending on the industry and the business model considered. Also, the factors presented below may not be relevant for a specific issuer depending again on the industry in which it operates (e.g. competition may not be relevant in a regulated industry).



RATING FACTORS: FINANCIAL RISK PROFILE

We assess the financial risk profile of an issuer based on a number of key credit metrics as per chart below. We look at both historical and projected metrics, although ultimately projected metrics carry more weight as long as there is sufficient comfort in those.

Please note that although the ratios shown below and discussed thereafter are the most common metrics used, we may use other ratios depending on the industry considered. Also, the ratios presented below may not be relevant for a specific issuer depending again on the industry in which it operates.



INSTRUMENT RATING APPROACH

This methodology is mostly used for issuers of subordinated debts with several layers of debt, typically having a corporate rating below BBB. The instrument rating is derived from the corporate rating on which a notching is applied (up, down or neutral). The notching depends mainly on the capital structure of the issuer and the recovery rate for the relevant instrument or class of debt (e.g. senior secured term loan and senior secured bond that are pari passu are in the same class of instruments). The capital structure of the issuer is analysed from a quantitative and qualitative perspective. The qualitative perspective is based on the review of the documentation of the different layers of debt to determine structural and contractual seniority or subordination as well as the structure and quality of the security package. The quantitative perspective relates to the size of the rated instrument relative to the total amount of debt (e.g. its percentage of total debt). Recovery rates are assessed in a way that neutralizes short term evolution that could be linked to seasonality of the business of the issuer or other variables bringing volatility.

Instrument notching may go between +2 and -3 notches based on the debt structure, instrument specific features and recovery rate. The final decision about the assignment of the instrument rating remains subject to the Rating Committee's decision based on a case by case specific assessment if needed.

RATING MONITORING

FREQUENCY

Spread Research's ratings are monitored on an ongoing basis.

In addition, the Rating Committee must assess the rating of a rated entity at least every 12 months, even if the lead rating analyst recommends maintaining the existing rating.

RESPONSIBILITIES

After a rating initiation, the leading rating analyst is in charge of monitoring developments on a continuous manner:

- The lead rating analyst is in charge of collecting and analyzing relevant information on the rated entity on an ongoing basis.
- The lead rating analyst reviews the consolidated financial statements of rated entities within its coverage on a regular basis. The timing of such reviews will depend on the frequency of financial reporting by rated entities (in most cases on a quarterly or semi-annual basis, and at least on an annual basis). Following the release of financial reports by the rated entity, the lead rating analyst reviews and comments the results, he or she updates Spread Research's excel spreadsheet with historical data, and he or she revises his/her financial projections for the next three fiscal years.
- The lead rating analyst shall have access to the rated entity's management or investor relations department at least every 12 months, through its participation in investor call/meetings, or the organization of one-to-one meetings.
- The lead rating analyst may request a Rating Committee meeting, and formulate a new rating recommendation whenever he or she believes that a change in the rating is appropriate. The primary rating analyst initiates a rating review (even if he recommends maintaining the rating) at least annually.
- The lead rating analyst applies Spread Research's relevant criteria and methodology.



MONITORING PROCESS

COLLECTION OF INFORMATION

The monitoring is primarily based on the following pieces of information:

- Rated entity's financial information. Public information is released by the rated entity on its website, or sent to investors by e-mail. Public financial information includes financial press releases, financial reports, and results presentations. The lead rating analyst must ensure that Spread Research has signed up for e-mail alerts sent by the rated entity, when the service is available. The lead rating analyst or the backup rating analyst listens to the company's investor call where management discusses the latest results (either by attending the meeting or listening to the phone call / webcast / replay). If there are no regular investor calls, the lead rating analyst organizes a physical or a phone meeting with the rated entity's management (or the rated entity's investor relations department) at least every 6 months. In case the rated entity's financial information is private, the lead rating analyst ensures that financial information / reports are timely disclosed by the rated entity.
- Press articles that are posted on Bloomberg's financial data base. The lead rating analyst ensures that Spread Research has established filters that can redirect material news on the rated entity to one of Spread Research's mailbox.
- Market indicators, where available. In that respect, Spread Research collects prices on debt instruments issued or related to the rating entities, in particular bond prices and 5-year CDS prices that are available on Bloomberg's financial database.
- Press releases issued by credit rating agencies that provides solicited ratings (mainly Fitch Ratings, Standard & Poor's and Moody's). These releases can be found on Bloomberg's financial database.
- Available documentation on bond and bank debt; either final or preliminary. This information can be of private nature.
- Information on the web from sector research firms providing market and competition analysis, or regulators.

ANALYSIS & ASSESSMENT OF INFORMATION

Whenever a financial report of the rated entity is available (mostly on a quarterly basis, but it can be on a semi-annual or on an annual basis), all models are updated and all new quarterly results lead to a new fundamental review of the issuer.

The analysis of information could be either qualitative or quantitative:

- Qualitative analysis – the lead rating analyst conducts SWOT-analysis (strengths, weaknesses, opportunities and threats), assesses management and potential shareholder support, pays special attention to the company's competitive position and its strategy.
- Quantitative analysis – the lead rating analyst assesses ratios that determine the financial position of the rated entity, and assesses the evolution of the operating performance on a sequential or year-over-year basis.

Spread Research's ratings are forward-looking, and historical data as well as market forecasts are used in a way to determine the rated entity's credit trend and default risk in the near future.



TRIGGER FOR A RATING CHANGE

The lead rating analyst may recommend a change in rating when he or she becomes aware of any financial, business, economical or operational information that he or she thinks might result in a rating action, consistent Spread Research's relevant criteria and methodology, such as:

- A news that is deemed as significant such as a material acquisition;
- The publication of financial results that differ materially from expectations;
- The announcement of a change in the capital structure of the rated entity, following an event in the history of the rated entity (merger, divestment, debt repayment, equity issuance, debt restructuring, failure to pay a coupon, etc...);
- A macroeconomic event affecting the operations of a rated entity, whether directly or indirectly impacting the rated entity;
- A change in some financial measure (for example, interest rates), having a direct or indirect effect on the credit worthiness of the rated entity;
- A change in the rating methodology;
- A change in regulation;
- Any other significant changes.



APPENDIX 1—OUTLOOK

DEFINITION

The outlook is Spread Research's indication relative to where the credit metrics of an issuer are heading within a 12-month horizon.

Please note: Spread Research's outlook is not a measure of the likelihood of a rating change.

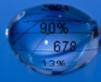
SCALE

Positive, Stable or Negative.

ANALYTICAL APPROACH

- The outlook is based on Spread Research's own financial projections and forecasts relative to future credit metrics.





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