# Long-term Corporate Rating Methodology

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This document provides an overview of the approach taken by EthiFinance Ratings (EFR) when assigning long-term ratings to corporates.

With this updated methodology, we present further refinements and clarifications in order to provide additional transparency and clarity regarding our methodology. Among other areas, this update gives further details in the following areas:

- Each section of the rating scorecard is disclosed and explained throughout the rating process for further transparency.
- We made some minor editorial changes in order to give further details on our methodology and we have provided examples for how some specific cases are treated under this methodology.
- We revised our geographic diversification grid.
- We separated the rating process from the rating methodology.

We have also introduced the notion of 'ratings under review'.

These adjustments are not expected to result in any material change to any of EFR's existing corporate ratings.

EthiFinance Ratings

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# 1 Framework and rating scale

## 1.1 Corporate issuer rating

EthiFinance Ratings' corporate ratings indicate an issuer's credit quality, for which we assess the company's business profile (such as its positioning, the underlying market trends of its operations, its diversification, and other business-related criteria) and financial profile (financial policy, cash flow generation, leverage etc).

When determining an issuer's rating we perform both an historical analysis of the financial data and a forward-looking analysis with forecasts using qualitative and quantitative information. Our forward-looking analysis factors in the potential impact of risk factors which we have identified during our analysis and which may have an impact on the credit profile of the company.

EthiFinance Ratings' corporate ratings are assigned assuming a single corporate entity and a single class of debt, regardless of structural or contractual considerations. Consequently, our ratings apply to consolidated groups for which audited consolidated accounts are available for the ultimate consolidating holding company. Debt located at the holding 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.

## 1.2 Instrument rating

EthiFinance Ratings may also assign instrument ratings. Instrument debt ratings reflect our assessment of the credit quality of the corporate debt instrument. These ratings can be assigned for both short-term and long-term debt instruments.

Our long-term ratings are assigned to long-term debt instruments and derive from the issuer's corporate rating and its recovery rate in a hypothetical default scenario, as well as case-by-case factors which are covered by the following methodology:

https://files.qivalio.net/documents/compliance/QIVALIO-Recovery-and-instrument-rating-methodology-External_28Oct20.pdf

Our short-term ratings are assigned to short-term debt instruments such as commercial paper and other instruments with a maturity of up to 15 months. Our short-term ratings derive from the issuer's corporate rating, its liquidity profile, and our assessment of its credit metrics' expected evolution. Short-term ratings are covered under this methodology:

https://files.qivalio.net/documents/compliance/short-term-methodology-04March2022.pdf

### 1.3 Rating scale

Our ratings are split using the following grid:

| | | |
|---|---|---|
| INVESTMENT GRADE CATEGORY | AAA | Highest credit quality and extremely low business and financial risks. |
| | AA+<br>AA<br>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 ratio. |
| | A+<br>A<br>A- | Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), high FCF and very low leverage ratio. |
| | BBB+<br>BBB<br>BBB- | Large scale and high level of diversification, low-risk business (proven resilience through economic cycles), positive FCF and / or low leverage ratio. |
| SUB-INVESTMENT GRADE CATEGORY | BB+<br>BB<br>BB- | Medium / low risk business (stable and predictable cash flows), positive FCF and / or low leverage ratio. |
| | B+<br>B<br>B- | High-risk business, negative FCF and / or high leverage ratio. |
| | CCC+<br>CCC<br>CCC- | Very high leverage ratio, negative FCF, weak liquidity and / or restructuring / probable default. |
| | CC | Out-of-court consensual restructuring. |
| | C | In-court restructuring without failure to fulfill financial obligations. |
| | D | Missed payments on interest or principal (post-grace period), or in-court restructuring with a failure to fulfill financial obligations, or liquidation. |

# 2 Corporate rating methodology

## 2.1 Methodological approach and scorecard

Ratings assigned by EthiFinance Ratings are based on analysis of both qualitative factors (business risk profile, management strategy etc) and quantitative factors (historical and projected credit metrics, liquidity etc). More specifically, a rating is the weighted average of an issuer's business risk profile and its financial risk profile as reflected by the following scorecard.

EthiFinance Ratings

| | | AAA | AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|---|---|
| BUSINESS RISK PROFILE | | | | | | | | |
| Scale & business position | | | | | | | | |
| Revenues (€bn) | 11.00% | R > 30.0bn | | 30.0bn > R > 15.0bn | 15.0bn > R > 5.0bn | 5.0bn > R > 1.0bn | 1.0bn > R > 0.2bn | 0.2bn > R |
| Diversification by geography | 9.00% | See diversification table | | | | | | |
| Business position | 7.00% | Very strong position with #1 ranking on substantially (>80%) all segments and geographies.<br>Complete ability to set prices.<br>Need to be present in 3 geographical areas or more. | | Strong position with #1 or #2 ranking on at least 60% of revenue or geographies, ability to influence prices.<br>Need to be present in 2 geographical areas or more. | Moderate position of strength (#1, #2, #3) on at least 30% of revenue or geographies.<br>Leader in a niche market.<br>Need to be present in several countries of 1 geographical area. | Some position of strength (#1, #2, #3) in certain segment representing around 30-50% of revenue. | Not very significant player with larger peers. | Marginal player with significantly larger peers.<br>Fully commoditized price. |
| Business diversification | 6.00% | Large product offering in several industries that are not correlated. | | Large product offering in several industries. | Large product offering in several segments. | Large product offering in one segment or narrow product offering in several segments. | Narrow product offering in one segment. | Only one product, similar to competitors. |
| **Industry** | | | | | | | | |
| Industry demand | 6.00% | Demand backed by long-term contracts (> 5 years), high volume from OECD customers with strong credit profile. | | Secular increase in demand supported by strong long-term drivers.<br>Absence of volatility of the demand. | Demand growth less correlated to GDP growth.<br>Very limited risk of product substitution. | Demand growth correlated to GDP growth.<br>Limited risk of product substitution. | Weak growth of demand.<br>Moderate risk of product substitution. | Demand on a secular decline.<br>High risk of product substitution. |
| Industry barriers to entry | 7.00% | Very strong barriers to entry.<br>High level of regulation with approval to operate needed and necessity for very large investment. | | Strong barriers to entry with strong ability to dictate prices.<br>High amount of capital, know-how or brand image needed. | Medium barriers to entry.<br>Significant amount of capital and know-how, and/or brand image needed. | Moderate barriers to entry.<br>Significant amount of assets needed. | Limited barriers to entry.<br>Required capital or know-how is rather limited. | Virtually no barriers to entry. |
| Industry volatility | 7.00% | Absence of volatility due to long-term contracts with garanteed IRR over a long period of time.<br>Track record of stability with very disciplined players. | | Very low volatility of volume/prices/profitability.<br>Absence of quarter-on-quarter (qoq) volatility.<br>Frequent use of long-term contracts. | Low volatility of volume/prices/profitability.<br>Low qoq volatility. Subject to low commodities price swings. | Moderate volatility of volume/prices/profitability.<br>Moderate qoq volatility.<br>Subject to moderate commodities price swings. | High volatility of volume/prices/profitability.<br>High qoq volatility. Subject to high commodities price swings. | Very high volatility of volume/prices/profitability.<br>Very high qoq volatility.<br>Subject to high commodities price swings. |
| **Total** | **53.00%** | | | | | | | |
| | | | | | | | | |
| FINANCIAL RISK PROFILE | | | | | | | | |
| Financial policy | | | | | | | | |
| Financial policy | 15.00% | Very prudent clearly stated policy within a structured organisation.<br>Very strong track record/adherence to it. | | Prudent policy with strong track record/adherence to it. | Adequate policy and track record/adherence. | Mildly agressive policy. | Limited disclosure on financial policy or weak adherence to it.<br>Agressive policy with reliance on debt. Frequent debt-funded M&A. | No financial policy disclosed at all.<br>Very agressive with high reliance on debt. |
| Leverage & coverage | | | | | | | | |
| Net adjusted debt / adjusted EBITDA[R] | 12.00% | R < 0.5x | | 0.5x < R < 1.5x | 1.5x < R < 2.5x | 2.5x < R < 4.0x | 4.0x < R < 6.0x | R > 6.0x |
| Adjusted FFO / Net adjusted debt | 10.00% | R > 100.0% | | 100.0% > R > 65.0% | 65.0% > R > 35.0% | 35.0% > R > 14.0% | 14.0% > R > 3.0% | R < 3.0% |
| Adjusted EBITDA[R] / adjusted interest | 5.00% | R > 25.0x | | 25.0x > R > 15.0x | 15.0x > R > 8.5x | 8.5x > R > 2.75x | 2.75x > R > 1.75x | R < 1.75x |
| Adjusted EBIT / interest | 5.00% | R > 16.0x | | 16.0x > R > 9.0x | 9.0x > R > 4.5x | 4.5 > R > 1.4x | 1.4x > R > 0.9x | R < 0.9x |
| **Total** | **47.00%** | | | | | | | |

## 2.2 Rating factors: Business risk profile

We assess the business risk profile of an issuer based on a number of qualitative factors as per the previous chart. Typically, our assessment is comprised of two layers of analysis, including (1) the scale and business position, and (2) industry-specific considerations (which encompass the macro-economic environment).

### 2.2.1 Scale and business position

Revenues: The larger the company, the more competitive it can be thanks to synergies, and the more resilient it is expected to be. Our credit analysis factors in scale based on revenues as reported by companies. We may apply a discount to revenue or assess operating earnings rather than revenues for a certain industry (e.g. due to high volumes of sales in the food retail market, we usually apply a discount to the revenues of retailers for the purpose of comparison with other sectors). Conversely, concerning companies operating in infrastructure, EBITDA margin is usually high with respect to other industries, whereas revenues are lower than for most industries. As a consequence, EthiFinance Ratings may apply a premium to the level of revenues to correct that bias.

| | AAA | AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|---|
| Revenues (€bn) 11.00% | R > 30.0bn | | 30.0bn > R > 15.0bn | 15.0bn > R > 5.0bn | 5.0bn > R > 1.0bn | 1.0bn > R > 0.2bn | 0.2bn > R |

Geographic diversification: The more diverse a company, the stronger it is from a risk perspective. Geographic split can be analyzed through revenues, the location of production sites etc. The highest grades are assigned to the companies whose revenues and/or location sites are split evenly between the 4 geographical areas which we consider.

Table 1: Diversification by geography

| Geographical diversification. Presence in geographical areas / concentration per geographical area | 4 geographical areas | 3 geographical areas | 2 geographical areas | 1 geographical area |
|---|---|---|---|---|
| 25% ≤ Largest geographical area < 30% | AAA | AA+ | n.a. | n.a. |
| 30% ≤ Largest geographical area < 40% | AA | AA- | n.a. | n.a. |
| 40% ≤ Largest geographical area < 60% | A | BBB+ | BB+ | B+ |
| 60% ≤ Largest geographical area < 80% | n.a. | BB+ | BB- | B |
| 80% ≤ Largest geographical area ≤ 100% | n.a. | n.a. | B | B- |

Note 1: To be present in a geographical area is to have at least 15% of revenues from that area. The four areas we consider are Americas, Africa & Middle-East, Asia-Pacific, and Europe & Russia.

Note 2: If Africa/Middle-East is > 30%, automatic two-notches below the grid because of increased political and economic risks.

Note 3: Diversification in countries within one geographical area, or cities within one

country, can entail up to two notches up or down with respect to the grid.

Note 4: If EthiFinance Ratings assesses that there is significant distortion between diversification in revenues and diversification in EBITDA, it may adjust the grid and use the more accurate of the two metrics.

Business position: Our business position factors in competition in the market and the position of the company with respect to competitors. Highest grades are assigned to companies which are leaders in their markets and drive trends in their sectors. Conversely, companies which are followers and have only limited market share are assigned lower grades. Niche markets are considered to be in between. Companies can be leaders in niche markets and thus be more resilient but they will also be limited by the size of the niche.

| | AAA AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|
| Business position 7.00% | Very strong position with #1 ranking on substantially (>80%) all segments and geographies. Complete ability to set prices. Need to be present in 3 geographical areas or more. | Strong position with #1 or #2 ranking on at least 60% of revenue or geographies, ability to influence prices. Need to be present in 2 geographical areas or more. | Moderate position of strength (#1, #2, #3) on at least 30% of revenue or geographies. Leader in a niche market. Need to be present in several countries of 1 geographical area. | Some position of strength (#1, #2, #3) in certain segment representing around 30-50% of revenue. | Not very significant player with larger peers. | Marginal player with significantly larger peers. Fully commoditized price. |

Business diversification: We assign our highest grades to companies which have a diversified range of products in several industries. Conversely, single-product or niche market companies are more exposed in the event of a downturn of their market.

| | AAA AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|
| Business diversification 6.00% | Large product offering in several industries that are not correlated. | Large product offering in several industries. | Large product offering in several segments. | Large product offering in one segment or narrow product offering in several segments. | Narrow product offering in one segment. | Only one product, similar to competitors. |

### 2.2.2 Industry considerations

Industry demand: Demand influences financial performance as it drives volumes and product/service prices. Our demand criterion factors in the existence of long-term contracts, growth in demand, correlation to GDP, the risk of product substitution.

The way EthiFinance Ratings factors in ESG considerations and their potential impact on ratings is described in the following methodology:

https://files.qivalio.net/documents/compliance/QIVALIO-ESG-Considerations.pdf

Companies with long-term visibility, and top-ranked products, are more likely to have high ratings whereas companies which operate in sectors with declining demand or a high risk of product substitution are often assigned low ratings.

| | AAA AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|
| Industry demand 6.00% | Demand backed by long-term contracts (> 5 years), high volume from OECD customers with strong credit profile. | Secular increase in demand supported by strong long-term drivers. Absence of volatility of the demand. | Demand growth less correlated to GDP growth. Very limited risk of product substitution. | Demand growth correlated to GDP growth. Limited risk of product substitution. | Weak growth of demand. Moderate risk of product substitution. | Demand on a secular decline. High risk of product substitution. |

Industry barriers to entry: The higher the barriers, the more resilient the players within the industry. High barriers to entry can relate to strong know-how, high investments needed, and/or highly regulated markets with authorities' approval needed (e.g. pharmaceutical companies) and/or significant networking required. Conversely, markets with little know-how, low necessary investment, and/or low networking required are likely to be more competitive and drive ratings down.

| | | AAA AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|---|
| Industry barriers to entry | 7.00% | Very strong barriers to entry.<br>High level of regulation with approval to operate needed and necessity for very large investment. | Strong barriers to entry with strong ability to dictate prices.<br>High amount of capital, know-how or brand image needed. | Medium barriers to entry.<br>Significant amount of capital and know-how, and/or brand image needed. | Moderate barriers to entry.<br>Significant amount of assets needed. | Limited barriers to entry.<br>Required capital or know-how is rather limited. | Virtually no barriers to entry. |

Industry volatility: Stable markets where prices, volumes and track records are predictable and resilient over a long period of time, notably through the use of long-term contracts, generate high ratings. Conversely, markets with commodity price swings and where volumes vary widely in a short period of time, due to the discretionary spending of the end-user for instance, entail low ratings.

| | | AAA AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|---|
| Industry volatility | 7.00% | Absence of volatility due to long-term contracts with garanteed IRR over a long period of time.<br>Track record of stability with very disciplined players. | Very low volatility of volume/prices/profit ability.<br>Absence of quarter-on-quarter (qoq) volatility.<br>Frequent use of long-term contracts. | Low volatility of volume/prices/profit ability.<br>Low qoq volatility.<br>Subject to low commodities price swings. | Moderate volatility of volume/prices/profit ability.<br>Moderate qoq volatility.<br>Subject to moderate commodities price swings. | High volatility of volume/prices/profit ability.<br>High qoq volatility.<br>Subject to high commodities price swings. | Very high volatility of volume/prices/profit ability.<br>Very high qoq volatility.<br>Subject to high commodities price swings. |

## 2.3 Rating factors: Financial risk profile

We assess the financial risk profile of an issuer based on a number of key credit metrics. We look at both historical data (we usually focus on the last three years but may go back further in the event the past three years do not represent the normative situation, for example if the perimeter of the group has changed or if an economic crisis has happened and impacted the credit metrics) and projected metrics, although ultimately projected metrics carry most of the weight as long as there is sufficient confidence in them.

### 2.3.1 Financial policy

EthiFinance Ratings captures in this element a variety of characteristics such as management's (or in some cases shareholders') risk appetite for discretionary spending such as acquisitions, dividends, share buybacks, in relation with stated strategy, and the extent to which these are funded via debt. EthiFinance Ratings also takes into account management's quality and guidance, its ability to maintain a track record in line with the stated financial policy. For instance, EthiFinance Ratings will classify companies as having a prudent financial policy where there is a strong financial profile even if they have a material shareholder dividend policy or notably a significant share buyback policy, whereas a weak financial profile company with the same policy of share buyback/dividend distribution will be assessed more severely. Financial policy is assessed with respect to the cash generation capacity and the financial situation of the company at the time of the assessment.

| | AAA AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|
| Financial policy 15.00% | Very prudent clearly stated policy within a structured organisation. Very strong track record/adherence to it. | Prudent policy with strong track record/adherence to it. | Adequate policy and track record/adherence. | Mildly agressive policy. | Limited disclosure on financial policy or weak adherence to it. Agressive policy with reliance on debt. Frequent debt-funded M&A. | No financial policy disclosed at all. Very agressive with high reliance on debt. |

As illustrated in Appendix 1, we look at four main ratios. We have a cash-oriented approach and we therefore focus on metrics which give an overview of the cash flow generation of the company, its debt protection, and its credit risk.

### 2.3.2 Leverage ratios

Net adjusted debt/adjusted EBITDA(R): This is the standard and most commonly used measure of an issuer's ability to repay or refinance its outstanding adjusted debt. The net adjusted debt and adjusted EBITDA(R) are defined in section 2.3.3 and 2.3.4 of this methodology.

| | AAA AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|
| Net adjusted debt / adjusted EBITDA(R) 12.00% | R < 0.5x | 0.5x < R < 1.5x | 1.5x < R < 2.5x | 2.5x < R < 4.0x | 4.0x < R < 6.0x | R > 6.0x |

Adjusted FFO/net adjusted debt: Concerning the ratio below, FFO includes cash interest expenses, taxes, as well as some other cash items (dividends paid to minority interests, dividends received from associates) but excludes the payment of lease liabilities regardless of the accounting reporting standards. EthiFinance Ratings indeed abides with the accounting treatment of most companies reporting under IFRS 16, which consists in reporting lease payments in the financial section of the cashflow statement and not in FFO (as it used to be before the introduction of IFRS 16).

| | | AAA | AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|---|---|
| Adjusted FFO / Net adjusted debt | 10.00% | R > 100.0% | | 100.0% > R > 65.0% | 65.0% > R > 35.0% | 35.0% > R > 14.0% | 14.0% > R > 3.0% | R < 3.0% |

### 2.3.3 Interest coverage ratios

Adjusted EBITDA(R)/adjusted interest: This is the standard and most commonly used measure of the issuer's ability to service its debt.

| | | AAA | AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|---|---|
| Adjusted EBITDA[R] / adjusted interest | 5.00% | R > 25.0x | | 25.0x > R > 15.0x | 15.0x > R > 8.5x | 8.5x > R > 2.75x | 2.75x > R > 1.75x | R < 1.75x |

Adjusted EBIT/interest: Compared to the above ratio this ratio factors in D&A. As a consequence, this ratio takes into account the capital intensity of the issuer's business as D&A is usually used as a proxy for sustaining the actual amount of a company's PP&E.

| | | AAA | AA | A | BBB | BB | B | CCC |
|---|---|---|---|---|---|---|---|---|
| Adjusted EBIT / interest | 5.00% | R > 16.0x | | 16.0x > R > 9.0x | 9.0x > R > 4.5x | 4.5 > R > 1.4x | 1.4x > R > 0.9x | R < 0.9x |

In order to capture the best picture of a company's credit risk we tend to apply a number of adjustments, especially at the debt and EBITDA levels.

### 2.3.4 Adjustments

#### 2.3.4.1 Adjusted net debt

We capture in our definition of adjusted debt all capital markets debt and bank debt, in order to have a more accurate picture of a company's liabilities. Based on the issuer's disclosures we also include in our adjusted debt items such as unfunded pensions deficit, operating leases for companies which do not report under IFRS, hybrid capital, and other debt-like items (such as deferred payment, deconsolidated factoring). We explain below the rationale for treating these items as debt.

Employee benefits (pensions…)

Companies which have underfunded defined benefit pension plans have to record pension liabilities on their balance sheet. EthiFinance Ratings adds to the debt 100% of the pension deficit (computed as projected benefit obligation or PBO less fair market value of plan assets - i.e. the amount required, if any, for pension plans to be fully funded).

Operating leases

Operating leases do not transfer ownership of the underlying asset; payments are made for usage of the asset and as such both the assets and liabilities are not reported on the balance sheet - unless companies report under IFRS 16 - despite the fact that entities are using the assets and contractually obligated to pay the lease. EthiFinance Ratings adjusts the balance sheet for the debt associated with operating leases by using i) for sectors where leases are an intrinsic part of the business/financing model (e.g. transportation, services), a capitalization multiple of the annual lease payment (generally between 3x and 8x); and ii) for other sectors, the higher of net present value (NPV) of commitments relative to future operating lease payments as of the latest balance sheet date, based on a notional discount rate of 7% and industry capitalization multiple. Accordingly, we compute EBITDAR by adding back to EBITDA the annual lease payment; and adjusted interest by adding to interest the portion of the annual lease payment that relates to interest (33%).

With the introduction of IFRS 16 as of January 1, 2019, companies reporting under IFRS now have to disclose on their balance sheet their lease liabilities while EBITDA is also retreated for the amount of lease depreciation. This is having a significant impact on the

reported financial profile of the companies as these liabilities were off-balance sheet before the change of rule. Overall, the introduction of IFRS 16 did not materially impact our ratings as our adjusted credit metrics already factored in operating leases before the reporting change.

Hybrid capital/convertible bonds

Hybrid capital relates to instruments that have both equity and debt characteristics. This type of instrument is generally complex and ranked junior to debt in the capital structure but senior to classic equity instruments. We will generally retreat these capital instruments as debt if interest payments are in cash, if there is no conversion option, if the maturity of the hybrid capital falls before a senior debt, or if there is a steep step-up clause for the interest rate.

Off-balance sheet and other debt-like items

EthiFinance Ratings may adjust the debt of the company with other off-balance sheet items which are considered debt-like such as debt guarantees, securitization, and deconsolidated factoring. Furthermore, EthiFinance Ratings may adjust net debt for hedging assets/liabilities.

2.3.4.2 Adjusted EBITDA/ Adjusted EBITDAR

EthiFinance Ratings adds back rental payments to EBITDA to calculate EBITDAR. We may also include in our adjustments, and based on the issuer's disclosures, other adjustments such as exceptional costs that we deem recurring in nature, restructuring costs needed for the business. We may also retreat capitalized R&D as an expense the year it is incurred, which also entails an adjustment of capitalized R&D depreciation in EBIT. Conversely, we may also exclude non-cash items such as gains from financial instruments or asset sales.

## 2.4 Rating factors: specific considerations

After having assessed the business risk profile and the financial risk profile of an issuer, EthiFinance Ratings looks at certain key rating factors the presence of which could cap the final rating at a lower level than that resulting from the risk profile assessments.

This is because such rating factors are either seen as necessary for the company to survive on a going-concern basis, are key to monitor the performance of the issuer (transparency), or expose the issuer to material event risks which are tougher to quantify through a grid and thus cannot be factored in otherwise (country risk, some ESG risks). This denotching applied to the rating originally envisaged can be as much as three notches, although it is more usually one or two notches.

### 2.4.1 Transparency

EthiFinance Ratings measures the degree of transparency of an issuer based on the quality of the information and the level of details provided to investors, including quarterly financial statements, market data, KPIs, operational and financial guidance etc. Listed companies tend to score higher on this metric relative to privately-owned companies. Transparency is measured by EthiFinance Ratings on a scale of '0' to '5'.

Transparency is key for investors to monitor the operating and financial performance of an issuer. Whilst a high level of transparency may not raise a rating, a material lack of sufficient transparency may cause us to cap a rating at a level lower than normally envisaged to capture the risks associated with poor disclosure, including that of unforeseen events arising. Ultimately, an extremely low level of transparency may not be commensurate with the ability to maintain a public rating, and could cause us to withdraw such a rating (if it is the Rating Committee's decision).

### 2.4.2 Liquidity

Liquidity is key for an issuer to operate both in good times and even more importantly in times of stress. EthiFinance Ratings applies a liquidity assessment as an overlay to the initial rating. As a consequence, the absence of sufficient liquidity as defined below may cause an issuer's rating to be lower than that resulting from the combination of its business and financial risk profiles.

EthiFinance Ratings' liquidity analysis results in a score of 0, 1, 2 or 3, based on the result of a combination of both quantitative and qualitative analysis as illustrated by the table below.

| | | Liquidity analysis stressed scenario | | | |
|---|---|---|---|---|---|
| | | 3 years | 2 years | 1 year | 0 year |
| Refinancing profile | Solid financial profile / Virtually no issues expected to refinance | 3 | 3 | 3 | 1 |
| | Medium financial profile / Refinancing not expected to be an issue but may depend on the conditions in financial markets at the time of refinancing | 3 | 2 | 2 | 1 |
| | Low financial profile / refinancing may be challenging or at a very expensive conditions | 3 | 2 | 1 | 0 |

#### 2.4.2.1 The quantitative driver: liquidity analysis – stressed scenario

The quantitative analysis is a measure of how long an issuer can finance its operations assuming that access to both equity and debt capital markets is closed. It is measured on a scale of '0' to '3' years, and one on the refinancing profile:

- 0 year: the issuer has insufficient liquidity to face its debt obligations in the coming years, and/or may run out of liquidity due to cash burn or covenant breach deriving from an issuer-related situation and not a macro-economic situation;
- 1 year: the issuer can meet its debt obligations for the coming year;
- 2 years: the issuer can meet its debt obligations for the coming two years;
- 3 years: the issuer can meet its debt obligations for at least the coming three years.

The liquidity analysis is based on EthiFinance Ratings' own forward-looking covenant computations and financial forecasts which enable us to assess the balance between an issuer's projected sources and uses of funds.

Sources of funds considered by EthiFinance Ratings include unrestricted cash, undrawn committed credit facilities with expiry > 1 year and FFO (post-working capital). EthiFinance Ratings typically excludes from its assessment restricted cash, the minimum level of cash required to run the business (when available, alternatively we may use the historically lowest quarterly cash level exhibited or a percentage of turnover), uncommitted credit facilities, and asset disposals (if already agreed upon). EthiFinance Ratings also factors in new debt issued at the time of the analysis.

Uses of funds considered by EthiFinance Ratings include capex, acquisitions already agreed upon, dividends, and debt maturities.

The liquidity score is adjusted for the potential impact of a covenant breach.

Until Q3 in a fiscal year; the liquidity score captures the remaining quarters left during that year as well as the two following fiscal years. In Q3, the starting point of the assessment shifts to the beginning of the following fiscal year and captures the three fiscal years thereafter.

The qualitative analysis reflects the issuer's refinancing profile, which is its ability to refinance its debt based on its financial profile, among other things. The refinancing profile assessment is divided into three possible outcomes: i) Very high financial profile / Virtually no issues expected to refinance, ii) Medium financial profile / Refinancing not expected to be an issue but may depend on the conditions in financial markets at the time of refinancing, and iii) Low financial profile / refinancing may be challenging or at very expensive conditions.

#### 2.4.2.2 The qualitative driver: the refinancing profile

By introducing the notion of refinancing profile, EthiFinance Ratings values companies which have a very strong financial profile and virtually no issues to refinance their debt by assigning them a score of 3/3, independently from the liquidity analysis under a stressed scenario, with the exclusion of a score of '0 year' which EthiFinance Ratings believes is not commensurate with a very strong financial profile. Conversely, companies which have a very weak financial profile and therefore no refinancing guaranteed are basically assessed through the stressed scenario only.

### 2.4.3 Country risk

Whilst the absence of country risk does not contribute to a better rating than indicated by the scorecard, the presence of an issuer in an unstable operating environment is likely to weigh negatively on its rating, and could cause the rating to be lower than if the issuer had similar operations in a more stable environment – such as an OECD country.

Risks concerned include among others political risk (risk of civil war, riots, etc.), risk of expropriation/nationalization, regulatory risk, fiscal risk, environmental risk, currency control, as well as safety issues. EthiFinance Ratings uses a number of measures to track country risk; including the ratings of French credit insurer Coface.

Generally, the corporate rating will be capped to the rating of the country in which the rated corporate operates, which reflects the fact that a company's credit risk is a function of its country of operation risk. Additionally, as we describe in more detail in our recovery analysis, a recovery rate is capped by the country of operation of a company in order to take into account the creditor-friendliness, or otherwise, of jurisdictions and enforceability of security in the event of a default.

### 2.4.4 Other considerations

Other specific considerations may relate to potential M&A operations which may not have been analyzed through the financial risk profile. Likewise, financially stressed companies may not always be easily identified through standard credit metrics, which may justify additional denotching. Another significant consideration may relate to ESG criteria. The way EthiFinance Ratings factors in ESG considerations is described in the following document:

https://files.qivalio.net/documents/compliance/QIVALIO-ESG-Considerations.pdf

While ESG factors are usually captured through the scorecard, EthiFinance Ratings may sometimes factor in one criterion outside of the scorecard. For instance, the social risk associated with the status of couriers for food delivery companies cannot be fully captured through the scorecard. However, it is of such a nature as to increase the credit risk, thereby leading to a manual adjustment of the scorecard.

# 3 Ratings under review

When an event of such nature that it could change the rating of a company occurs, but EthiFinance Ratings lacks information or needs further analysis to review its rating, thereby preventing an immediate reaction, EthiFinance Ratings may decide to put the rating under review. The label 'under review' is a temporary classification by which EthiFinance Ratings may inform stakeholders of a potential upcoming rating action. When a rating is put under review, the current rating remains valid until the next rating action. Ratings can be under review for upgrade, downgrade, or in some rare cases, uncertain. Unlike outlooks, ratings under review will usually result in a rating action from one to 2 months after the review has been announced, but may sometimes last longer when EthiFinance Ratings is expecting further guidance and information in order to assign its ratings. Events which usually trigger such reviews are mergers, acquisitions, disposals of a significant part of a company, significant unforeseen change in the financial situation of a company or its operating environment. Ratings under review may result in an upgrade, a downgrade or no change at all for the rating, based on work performed by EthiFinance Ratings' analysts.