EthiFinance Ratings

Corporate Rating Short-Term Methodology

1. Framework & Rating

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

This methodology presents some changes to the liquidity assessment, keeping the overall liquidity assessment with a double entry table with the quantitative liquidity profile and the qualitative refinancing profile.

None of the above modifications are expected to change any of EthiFinance Ratings' existing short-term ratings.

1.1. Short-term rating

EthiFinance Ratings' short-term ratings are a measure of an issuer's ability to fulfill its debt-related payments over the next 15 months.

More specifically, EthiFinance Ratings' short-term ratings are usually used to assess the risk of short-term instruments that are mostly unsecured and have a maturity less than 15 months. Such instruments include, but are not limited to commercial paper and short-term notes.

EthiFinance Ratings has identified three important parameters impacting short-term ratings:

- The long-term rating which is covered by a long-term methodology.
- The liquidity risk (see definition below).
- The credit metrics expected evolution (CMEE).

EthiFinance Ratings' short-term ratings are assigned assuming a single entity and a single class of debt. For the purpose of this methodology, a group is an entity operating through various fully-or partly-owned subsidiaries and/or affiliates, not necessarily engaged in the same business activities, and generally represented by a Parent company. The Parent company may or may not be a holding company. A group span of control is reflected in its consolidated financial statements. EthiFinance Ratings' short-term ratings are assigned assuming a single entity and a single class of debt, regardless of structural or contractual considerations. Debt located at a level above the consolidated group (e.g., PIK in a holding), 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 located above the consolidated group.

1.2. Instrument rating

Unless subject to specific conditions, all short-term instruments of the same issuer have the same short-term rating, which in turn coincides with the entity short-term rating. As such, when EthiFinance Ratings assigns a short-term rating to an instrument, such as a NEU CP program, it usually does not specify the short-term entity rating.

2. Long-Term Rating

Long-term ratings provide an assessment of the overall credit quality of the issuer and are the starting point for assigning a short-term credit rating although the latter is not determined by the former since, in the assignment of a short-term rating, the other two parameters - liquidity risk and CMEE - must also be considered. Once the long-term rating is established it will be used in the transition matrix (see in section 5) along with the other two parameters to determine the short-term rating.

3. Liquidity Analysis

EthiFinance combines the assessments of a firm's level of liquidity with that of its refinancing profile to arrive at a liquidity risk assessment of 'very weak', 'weak', 'adequate' and 'superior' (see Table 1).

Table 1 – Liquidity risk assessment

		Level of liquidity		
		Poor	**Reasonable**	**High**
Refinancing profile	**Weak**	Very weak	Weak	Adequate
	Satisfactory	Weak	Adequate	Superior
	Strong	Weak	Adequate	Superior

3.1. The quantitative driver: Assessing the level of liquidity

To assess a company's level of liquidity, we determine how many years of liquidity a company has. A 'Poor' assessment would be assigned to a company if there is a risk of insufficient liquidity in the coming year; a 'Reasonable' assessment would be given if EthiFinance believes a company has sufficient liquidity between the coming year and the next, and a 'High' assessment would be assigned to a company if it is expected to have sufficient liquidity beyond 2 years (see Table 2).

Table 2 – Level of liquidity (years)

Poor	**Reasonable**	**High**
<1 year	<1 – 2>	> 2

Level of liquidity is determined by reviewing sources and uses of funds. Sources of funds include unrestricted cash, operating cash flow and undrawn committed lines of credit over one year of maturity; and uses of funds include upcoming debt maturities, capital spending, dividends, and any commitments that EthiFinance Ratings believes have reasonable likelihood of materializing in the period under review.

3.2. The qualitative driver: Assessing the refinancing profile

The assessment of a firm's refinancing profile (Table 3) is closely tied to the assessment of its financial profile and reflects its capacity to access funds from financial markets in a timely manner and at market conditions under moderate stress conditions. We assess the strength of a company's refinancing profile using the following three categories:

Table 3 – Refinancing profile

Weak	Satisfactory	Strong
Firms with a weak financial profile (typically firms with a financial profile score of 6 or 7) further undermined by capital structure risks such as concentrated debt maturities, currency or interest rate mismatches, restrictive covenants or adverse terms and conditions. We expect that access to refinancing for these firms may be challenging, or at very expensive conditions under even moderate stress conditions	Firms with a satisfactory refinancing profile would have a medium financial profile (typically with a financial profile score of 5), and no overarching capital structure weaknesses, but their capacity to refinance may depend on market conditions at the time of refinancing.	Firms with a strong financial profile (typically score of 4 or lower) complemented by well spread-out debt maturities, little currency or interest rate risks, and few restrictive debt covenants. We expect these firms to have uninterrupted access to financial markets at market conditions under most circumstances.

We choose to assess refinancing profiles against moderate stress conditions. This is because we observe that all firms, irrespective of their credit quality, may find access to financial markets to be challenging under extreme financial market conditions, such as these seen during the Great Financial crisis.

4. The Credit Metrics Expected Evolution (CMEE)

The credit metrics expected evolution (CMEE) is EthiFinance Ratings' indication of where the credit metrics of an issuer are heading within a 12-month timeframe. The CMEE can be Positive, Stable or Negative. The CMEE directly derives from EthiFinance Ratings' forecasts used during the financial analysis when assigning ratings. The assessment of the CMEE is made with the idea to remove the short-term impact of particular but exceptional events resulting in credit ratios decreasing, then increasing back to the starting point.

5. Short-term/long-term rating correspondence

The following chart provides an indication of the mapping between different ratings and criteria, although the credit committee remains free not to follow these guidelines under specific circumstances, linked to a lack of information, for instance.
When the liquidity is very weak, the best short-term rating that can be assigned is EF5, based on a long-term rating capped at CCC+.

		Liquidity risk assessment			
EFR LT rating	CMEE	Very weak	Weak	Adequate	Superior
AAA	Positive				
AAA	Stable				
AAA	Negative				
AA+	Positive				
AA+	Stable				
AA+	Negative				
AA	Positive				
AA	Stable			EF1+	
AA	Negative				
AA-	Positive				
AA-	Stable				
AA-	Negative				
A+	Positive				
A+	Stable				
A+	Negative				
A	Positive				
A	Stable				
A	Negative				
A-	Positive				
A-	Stable				
A-	Negative			EF1	
BBB+	Positive				
BBB+	Stable				
BBB+	Negative				
BBB	Positive				
BBB	Stable				
BBB	Negative				
BBB-	Positive			EF2	
BBB-	Stable				
BBB-	Negative				
BB+	Positive				
BB+	Stable				
BB+	Negative				
BB	Positive			EF3	
BB	Stable				
BB	Negative				
BB-	Positive				
BB-	Stable				
BB-	Negative				
B+	Positive				
B+	Stable				
B+	Negative				
B	Positive				
B	Stable				
B	Negative			EF4	
B-	Positive				
B-	Stable				
B-	Negative				
CCC+	N/S/P				
CCC	N/S/P				
CCC-	N/S/P		EF5		
CC	N/S/P				
C	N/S/P				
D	N/S/P			EFD	

6. Specific Considerations

In some specific cases, EthiFinance Ratings may override the transition matrix if it seems more accurate to do so. For instance, if an issuer has a level of cash representing more than several times its short-term debt or overall debt, the scorecard of its long-term rating combined with the transition matrix may still place it in the EF1 category. However, the rating committee may decide that the excess cash position is commensurate with an EF1+ rating as there is very low short-term risk.

This document updates the previous version while preserving its original methodological criteria; therefore, all existing ratings remain unchanged. In this version, the format has been updated and includes a higher level of detail.