Short-term corporate rating methodology and rating process

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1. Introduction

This document is aimed at providing an overview of Qivalio's analytical approach and methodologies relative to short-term ratings. This methodology is linked to Qivalio long-term corporate rating methodology published in January, 2020.

2. Framework and definition

2.1 Definition

Qivalio's short-term ratings are a measure of an issuer's ability to fulfil its debt-related payments within a 12-15 month timeframe.

2.2 Scale

Qivalio uses a specific scale, as per the table below.

Ratings	Description	Category
SR 0	Very low short term risk and very strong ability to reimburse short term debt.	Low risk
SR 1	Low short term risk linked to the issuer's ability to anticipate short term funding risks.	
SR 2	Moderate short term risk linked to potential external risks.	⇕
SR 3	Medium short term risk. The issuer's ability to reimburse its short term debt may be hampered by external or specific risks.	
SR 4	High short term risk	High risk
SR 5	Very high risk / In- or out-of-court restructuring.	
SR D	Default on the short term debt	

2.3 Analytical approach

Qivalio's short-term ratings are used to assess the risk of short-term instruments that are mostly unsecured and have a maturity less than 15 months. Such instruments include commercial paper, short-term notes or long-term notes close to maturity.

Long-term ratings give an overall credit quality of the issuer, whereas they are not suitably accurate to capture specific short-term risks. There is not a direct link between long-term and short-term ratings analysis; however, the rating and approval methodologies do engage the same processes for each.

In some cases, long-term highly rated issuers may have a higher short-term risk vis-a-vis long-term lower rated issuers for various reasons. The main reason is that large and well known issuers may be used to fund themselves in the short-term market when market confidence allows them to achieve lower interest rates through the issuance of rolling short-term instruments. On the flipside, long-term, lower rated companies may attempt to fund themselves on a longer term basis when they know that the capital markets or banks will not always be open to lend them money. Moreover, short-term ratings are linked to the level of cash set aside as an operating cash flow buffer in an amount that may differ widely amongst sectors.

Qivalio has identified three important parameters impacting short-term ratings. The first one is the outlook (see definition below) and the second one is the liquidity risk (see definition below). The third parameter is the long-term rating, whose methodology was published in January, 2020.

3. Outlook

3.1 Definition

Qivalio's indication for where the credit metrics of an issuer are heading within a 12-month timeframe.

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

3.2 Scale

Positive, Stable or Negative

3.2 Analytical Approach

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

Changes to the outlook, if warranted, are made by the lead analyst upon publication of quarterly results or significant news.

4. Liquidity

3.1 Definition

Qivalio's measure of how long an issuer can finance its operations assuming that access to both equity, bank and debt capital markets is closed.

3.2 Scale

0, 1, 2 or 3 years

3.2 Analytical Approach

The liquidity analysis is based on Qivalio's own forward-looking covenant computation and financial forecasts that allow us to assess the balance between an issuer's projected sources and uses of funds.

Sources of funds considered by Qivalio include unrestricted cash, undrawn committed credit facilities with expiry > 1 year, FFO (post-WC) and short-term back up lines. In the calculation, Qivalio typically removes from its assessment the following items: restricted cash, the minimum level of cash required to run the business (when available; alter-natively, the historically lowest quarterly cash level on hand, or a percent-age of turnover), uncommitted credit facilities and, finally, asset disposals (unless already agreed upon).

Uses of funds considered by Qivalio include capex, acquisitions already agreed upon, dividends and debt pay-downs.

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 two fiscal years thereafter.

Changes to the liquidity score are proposed by the lead analyst upon revision of financial forecasts or significant news.

5. Short-term rating process

Qivalio can provide a short-term rating in the absence of a long-term rating, and vice versa.

The granting of a short-term rating is organized via the following steps:

- Step 1: Review of annual reports (at least the latest three) and their audit certification;
- Step 2: Review of the quarterly results and all information available in the investor relations section;
- Step 3: Review of competition and market developments. This can be done based on the company's information regarding its market position, or information available from its competitors, industry associations or the regulator's database;
- Step 4: Review of the debt documentation.

Step 1-4: for each of the previous steps, the rating analyst completes Qivalio's excel model with available historical data, including financial statements, the breakdown of the group's (1) revenues, (2) operating margin, and (3) debt structure, e.g., the summary of financial covenants that have been disclosed to Qivalio;

- Step 5: Call with management; in particular, the lead rating analyst focuses on the company's strategy, its acquisition and dividend policies, as well as its financial leverage target (if any);
- Step 6: Review of the issuer's liquidity risk.
- Step 7: Review of the issuer's outlook.
- Step 8: The quality of the information received and used during the rating process is summarized in the "Transparency Index" issued by Qivalio's analysts. This index gives a fair assessment of the quality of the information used in the rating process.

Short-term ratings are decided by the credit committee and communicated to the issuer before publishing. Short-term ratings are reviewed by the credit committee following the lead analyst proposal, following significant news and at least once a year.

6. Link between short-term and long-term ratings

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.

<table>
<tr><th colspan="6">SR Short-Term Rating</th></tr>
<tr><th>SR LT Rating</th><th>SR0</th><th>SR1</th><th>SR2</th><th>SR3</th><th>SR4 - SR5 -SRD</th></tr>
<tr><td>AAA</td><td rowspan="6">SR0</td><td></td><td></td><td></td><td></td></tr>
<tr><td>AA+</td><td></td><td></td><td></td><td></td></tr>
<tr><td>AA</td><td></td><td></td><td></td><td></td></tr>
<tr><td>AA-</td><td></td><td></td><td></td><td></td></tr>
<tr><td>A+</td><td></td><td></td><td></td><td></td></tr>
<tr><td>A</td><td rowspan="4">SR1</td><td></td><td></td><td></td></tr>
<tr><td>A-</td><td></td><td></td><td></td><td></td></tr>
<tr><td>BBB+</td><td></td><td></td><td></td><td></td></tr>
<tr><td>BBB</td><td></td><td rowspan="3">SR2</td><td></td><td></td></tr>
<tr><td>BBB-</td><td></td><td></td><td rowspan="5">SR3</td><td></td></tr>
<tr><td>BB+</td><td></td><td></td><td></td></tr>
<tr><td>BB</td><td></td><td></td><td></td><td rowspan="8">SR4</td></tr>
<tr><td>BB-</td><td></td><td></td><td></td></tr>
<tr><td>B+</td><td></td><td></td><td></td></tr>
<tr><td>B</td><td></td><td></td><td></td><td></td></tr>
<tr><td>B-</td><td></td><td></td><td></td><td></td></tr>
<tr><td>CCC+</td><td></td><td></td><td></td><td></td></tr>
<tr><td>CCC</td><td></td><td></td><td></td><td></td></tr>
<tr><td>CCC-</td><td></td><td></td><td></td><td></td></tr>
<tr><td>CC</td><td></td><td></td><td></td><td></td><td rowspan="2">SR5</td></tr>
<tr><td>C</td><td></td><td></td><td></td><td></td></tr>
<tr><td>D</td><td></td><td></td><td></td><td></td><td>SRD</td></tr>
</table>

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