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CREDIT RATING AGENCY

# METHODOLOGY
## FOR ASSIGNING
## CORPORATE CREDIT RATING

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The credit rating is an impartial assessment of the credit worthiness of the company. It expresses an outside, objective and independent opinion with regards to the ability of the company to service its debt promptly and in a timely manner.

### ANALYTICAL FRAME

The corporate credit rating is an easy to grasp assessment of the risk from default on or inability to pay the liabilities of a given company. This risk has various sources and is examined on several levels: risk, related to the sector (industry), business-risk and financial risk. The corporate credit rating examines these elements in detail.

### ANALYSIS OF THE SECTOR

The historical development of the sector is examined and its current status is analyzed. The basic trends in the sector are analyzed, and their impact on the analyzed company. Based on the performed analysis a forecast of the future development of the sector is prepared.

BCRA performs analysis of the structure of the sector and examines its relationships with other sectors and industries. It analyzes the dynamics of these relationships, and the existing and potential risks to the rating company are derived.

Last but not least, BCRA examines the legal frame regulating the activity of the companies in the sector and the risks arising from its current status and its eventual changes.

## BUSINESS RISK ANALYSIS

The business risk originates from several factors.

BCRA performs a detailed analysis of the competitive position and financial strength of the majority (direct or indirect) shareholder in the company being rated. A strong majority holder may be a source of know-how and other kinds of support. BCRA evaluates the ability of the majority shareholder to adequately capitalize the analyzed company.

BCRA analyzes in detail the operations of the rated company. The product mix, market shares in the individual segments, the production volume/services offered, the existing capacity of the company are being analyzed. The relationship of the company with its business partners is examined, as well as the risks arising from the concluded agreements and established practices.

Main item of the business risk assessment is the evaluation of the company management. The management is analyzed from the point of view of its competence, the created management structure, the established practices and existing systems of management in the company. An adequate support from IT systems is necessary in many branches. When the management is assessed the strategy of the company is being examined, the vision of management about the business activity at the moment and their projections for the future.

BCRA evaluates the competitiveness of the company and its ability to cope with the competitive pressure and other challenges from the environment.

## FINANCIAL ANALYSIS

The financial status of the company is an indicator of the overall strength of the business, and a direct source of risk.

The status of the company in the different periods is analyzed in detail using four main fields: Profitability, Operating Return, Debt ratio and Liquidity ratio. The conclusive point of the analysis is a projection model showing the future net cash flows of the company and the coverage of the present and eventual future liabilities.

### Return on sales

The various sectors have different average values of the profitability ratios. In order to create a comprehensive picture BCRA analyses several ratios comparatively. The structure of expenses is examined in order to identify potential problems and risks.

### Operating return

BCRA examines several ratios showing the operating return of the analyzed company. Analysis is performed by comparison where ratios for their specific sector are used for the different companies.

### Debt ratio

Having debt is a main source of risk since it gives rise to expenses, and when the rated company is unable to meet them – this may lead to insolvency. Liabilities are assessed through several indicators for the different periods. BCRA also examines each individual liability of the company and its impact on its current and future financial status.

### Liquidity ratios

Liquidity is evaluated by using several ratios comparing the liquid assets of the company with its liabilities for the next 12 or 18 months. The low level of liquidity is source of risk since it is a factor, which may prevent the rating company from repaying its liabilities "promptly and in time".

### Projection model

The projection model is created based on the conservative projections of analysis from BCRA, outside experts and the management of the analyzed company. It shows the future net cash flows of the company and the coverage of the current and eventual future liabilities.

## BASE RATING, CEILING, FINAL RATING

The result from applying the listed above analysis comprises the so-called base rating. The final stage of the calculation of the rating is the potential adjustment of the base rating due to the general sovereign-risk factors, as evaluated by BCRA using the Sovereign Rating Methodology (see http://www.bcra-bg.com/). The analyzed rating factors in this Methodology are: 1) Political Risk, 2) Macroeconomic Stability, 3) Fiscal Flexibility, and 4) Effectiveness of the Monetary Policy. The rating "ceiling" is the term used for this limitation on the rating caused by sovereign-risk factors. Slightly less limited are the ratings of those subsidiaries whose direct or indirect majority shareholder is a foreign legal entity able in one way or another to make up for the deleterious effects of the local environment. The ceiling of local subsidiaries would surpass the sovereign rating by one or more notches, which in turn cause their final rating to surpass the sovereign rating.

$$Final\ rating = \begin{cases} ceiling, & ceiling < base\ rating \\ base\ rating, & ceiling \geq base\ rating \end{cases}$$

## NATIONAL-SCALE RATING

BCRA could also issue a national-scale rating to entities or issues (see **http://www.bcra-bg.com/files/file_341.pdf** ). This type of rating is relative, in comparison to other rated entities in the country, taking into consideration only the specific risk factors of the entities and not the effect of the local environment on them. That is, the national-scale rating does not represent an absolute evaluation of creditworthiness, but only a relative evaluation within the bounds of given country. For this reason, it is impossible to draw any comparison between national-scale ratings of entities or issues from different countries. BCRA issues national-scale ratings when a sufficiently large sample size of rated entities is available for the given country, which would allow one to draw comparisons between those entities.

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## RATING SCALE

### LONG-TERM RATING

| | | |
|---|---|---|
| Investment | **AAA** | Extremely high capability for servicing debt-related financial obligations in a timely manner. Substantial financial stability. Excellent prospects for development. Exclusively low credit risk. |
| | **AA** | Very high capability for servicing debt-related financial obligations in a timely manner. Substantial financial stability. Very low credit risk. |
| | **A** | High capability for servicing the debt-related financial obligations in a timely manner. Low vulnerability to unfavourable changes in the political or economic environment. Financial stability. Low credit risk. |
| | **BBB** | Fair capability for servicing the debt-related financial obligations in a timely manner. Fair financial condition. Moderate vulnerability to unfavourable changes in the political or economic environment. Moderate credit risk. |
| Speculative | **BB** | The ability to service debt-related financial obligations is to a large extent influenced by the unfavourable changes in the political or economic environment. The financial condition is relatively fair. Substantial credit risk. |
| | **B** | High level of insecurity with regards to the financial stability and capability for paying off the debt-related financial obligations. High vulnerability to unfavourable changes in the political or economic environment. Relatively high credit risk. |
| | **CCC** | Unfavourable changes in the political or economic environment may bring to a considerable deterioration of creditworthiness and a failure to fulfill the debt-related financial obligations. Weaknesses in the financial condition. High credit risk. |
| | **CC** | A high risk of going into default exists. Low capability for paying off the debt-related financial obligations. Substantial problems in the financial condition. |
| | **C** | Very high risk for going into default exists. Substantial danger of failure to fulfill the debt-related financial obligations and significant dependence on favourable changes in the political environment. Very weak financial condition. |
| | **D** | Incapability to pay a debt-related financial obligation in a timely manner according to BCRA’s definition for default. |

**Note:** The symbols „+” and „-” modifying rating categories AA through CCC are used to represent the relative creditworthiness within a single rating category

## SHORT-TERM RATING

| | |
|---|---|
| **A-1+** | Considerable financial stability and excellent capability for timely and full payment of debt-related financial obligations to a great extent regardless of the changes in the political or economic environment. |
| **A-1** | Financial stability. Weak or inconsiderable vulnerability to the changes in the political or economic environment. |
| **A-2** | Good financial condition. Certain vulnerability exists to unfavourable changes in the political or economic environment. |
| **A-3** | Good financial condition. Moderate vulnerability to unfavourable changes in the political or economic environment. |
| **B** | Relatively fair financial condition and presence of certain risk of untimely and incomplete payment of the debt-related financial obligation. High vulnerability to unfavourable changes in the political or economic environment. |
| **C** | Substantial problems in the financial condition. Presence of dependence on favourable changes in the political or economic environment in order to avoid untimely or incomplete payment of debt-related financial obligations. |
| **D** | Incapability to pay off a debt-related financial obligation in a timely manner according to BCRA's definition for default. |

## DEFINITIONS

**Debt-related financial obligations:** obligations towards financial institutions, obligations related to bonds and other fixed-income securities and any other financial instruments that do not qualify as securities.

- In the case of Financial Strength Rating of Banks, the obligations include deposits and obligations related to bank guarantees;
- In the case of rating of the ability of insurance companies to pay claims, the obligations are insurance claims, and the definition for default consists of the competent authority taking the decision to revoke the license;
- In the case of credit rating of a corporation, group of companies and/or individual companies in the group, and leasing company, the definition for default is that the company is in insolvency or liquidation; it does not meet its financial liabilities;
- In the case of issue credit rating the definition of default is that there is an impossibility for meeting the payments under the issuance.

The **short-term rating** reflects the possibility of servicing the short-term/current liabilities (within one year).

**Outlook:**
***Positive*** – reflecting expectations for passing into an upper category rating within 1 year;
***Negative*** – reflecting expectations for passing into a lower category rating within 1 year;
***Stable*** – reflecting expectations for keeping the rating category within 1 year;
***In development*** – reflecting expectations of the occurrence of an event, which may have negative/positive influence on the rating category.

**Watch Status:**
A credit rating may be placed "under review" and, accordingly, be marked with the symbol (under review), if there are expectations that further analysis of a recent or an imminent event is likely to lead to a change in the rating category in the near future. When a credit rating is placed under review, its previously assigned outlook becomes invalid.