METHODOLOGY
FOR ASSIGNING
CREDIT RATING OF A GROUP OF COMPANIES AND/OR INDIVIDUAL COMPANIES IN THE GROUP

The Credit rating is an impartial appraisal of the Company. It expresses an external, objective and independent opinion for the capability of the Company to serve its liabilities in full, and on time.

BCRA awards short-term and long-term credit ratings of liabilities. Short-term credit ratings of liabilities are defined for short-term debt instruments and liabilities (with initial maturity less than a year). All other liabilities are awarded with a long-term credit rating.

The Credit ratings, assigned by BCRA, express the probability of default, without taking into consideration the level of the expected loss in a case of default.

ANALYTICAL FRAMEWORK

The Credit rating of liabilities is an easy-to appreciate appraisal of the risk from the arrears, or from inability for payment of the liabilities of a given Company. This risk has different sources, and it is investigated at several levels: risk, connected with the sector (the industry), business risk and financial risk. The credit rating of liabilities of a group of companies reviews these elements in details.

SECTOR ANALYSIS

The historical development of the sector is reviewed and its present state is analyzed. The main trends of the sector are analyzed, as well as the manner, in which these influence on the analyzed Company. Based on this analysis, a forecast is made for the future development of the sector.

BCRA prepares an analysis of the structure of the sector, and reviews its relations with other sectors and industries. The dynamics of the above-stated relations is analyzed, and the existing and potential risks for the rated Company are concluded.

Last but not least, BCRA reviews the legal framework regulating the activity of the companies in the respective sector, as well as the risks, which are derived from the present state of the Company and from the possible changes therein.

BUSINESS RISK ANALYSIS

Business risk comes from a number of factors.
BCRA makes a detailed analysis of the competitive position and financial strength of the main (direct or indirect) shareholders in the rated Company. A strong major shareholder can be a source of know-how and other support. BCRA assesses the ability of the main shareholder to adequately capitalize the Company in scrutiny.

BCRA analyzes the operating activity of the rated Company in details. Reviewed are the product mix, the market shares in the separate segments, the volume of products sold/services rendered, and the existing capacity of the Company. Reviewed are also the relations of the Company with its counterparts, as well as the risks, which can arise from the agreements made and from the practices applied.

The main point in the appraisal of business risk is the appraisal of the Company management. The management is being analyzed from the viewpoint of its competency, of the management structure created, of the practices applied, and of the existing systems for Company management. In many branches, the adequate support of the IT systems is obligatory. When appraising the management, the Company strategy, the vision of the managers for their business at present, and their projections for the future are also reviewed.

BCRA provides an appraisal of the competitiveness of the Company and of its ability to cope with the competitive pressures and other challenges of the environment.

FINANCIAL ANALYSIS OF THE WHOLE GROUP

The financial state of the main Company in the group (parent company) is an indicator for the overall strength of their business, as well as a direct source of risk.
In order to assess the financial state of the parent company, analysis of its financial state is done first, and then a forecasted model of the separate companies falling under the group structure is implemented.
The state of the parent company is analyzed in details in four basic areas: Profitability, Operating effectiveness, Indebtedness, and Liquidity.

Profitability of sales

The different sectors have different average values of their profitability indicators. In order to create a broad picture, BCRA analyzes a number of ratios, comparatively. Reviewed is the structure of spending, so that the potential problems and risks can be identified.

Operating effectiveness

BCRA reviews a number of ratios illustrating the operating effectiveness of the analyzed Company.

Indebtedness

The policy of financing of the current and future activity of the Company (new projects inclusive) is, to a large extent, decisive for the level of financial risk. Indebtedness is assessed, in time, through a number of indicators. BCRA also reviews the separate liabilities of the Company and their importance for its current and future financial state.

Liquidity

Liquidity is assessed through several ratios, which compare the liquid assets of the Company with its liabilities for the forthcoming 12 months or 18 months. Low liquidity is a source of risk, because it is a factor, which could obstruct the rated Company to meet its liabilities “in full and on time”.

DEFINITION OF THE STRATEGIC MEANING OF THE COMPANIES IN THE STRUCTURE OF THE GROUP

The companies of the group are assessed with a view of their strategic meaning for the group based on a set of criteria. The “key” and “strategically significant” companies in the team of the group are defined. The strategic meaning of the separate company also defines the level of support which it receives or shall receive within the group and, respectively, the possible amendation of its individual rating.

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.

Effective as of July 4th 2016

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.