

## **METHODOLOGY FOR ASSIGNING CREDIT RATING OF A LEASING COMPANY**

---

The Credit Rating (rating of an Issuer) is an impartial appraisal of the creditability of a 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 ratings. The short-term ratings present an opinion for the possibility that the rated Company fails to meet its liabilities, within the short term (up to 12 months).

### **ANALYTICAL FRAMEWORK**

The Credit Rating is an easy-to-appreciate appraisal of the risk from entry in 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 reviews all above elements in detail.

### **SECTOR ANALYSIS**

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

BCRA also reviews the legal framework, regulating the activity of the companies in the Sector and the risks, resulting from its current state, and possible changes in it.

## **ANALYSIS OF BUSINESS RISK**

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 analyzed Company.

BCRA analyzes the operating activity of the rated company in details. The portfolio of the leasing company, as well as the market share and competitive position of the company are reviewed. 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. When appraising the management, the Company strategy, the vision of the managers for their business at present, and their forecasts for the future are also reviewed.

## **FINANCIAL ANALYSIS**

The financial state of the Company is an indicator for the overall strength of their business but also a direct source of risk.

The state of the Company is being analyzed in four main areas: Profitability, Operating effectiveness, Indebtedness, and Liquidity.

With a view of the specific activity of the leasing companies, the main point in the analysis is set on the management of the interest, currency, liquidity and credit risk, as well as on the risk of the residual activity.

## 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.bcrabg.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.bcrabg.com/files/file\\_341.pdf](http://www.bcrabg.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 4<sup>th</sup> 2016**



CREDIT RATING AGENCY

**RATING SCALE**

**LONG-TERM RATING**

<b>Investment</b>	<b>AAA</b>	Extremely high capability for servicing debt-related financial obligations in a timely manner. Substantial financial stability. Excellent prospects for development. Exclusively low credit risk.
	<b>AA</b>	Very high capability for servicing debt-related financial obligations in a timely manner. Substantial financial stability. Very low credit risk.
	<b>A</b>	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.
	<b>BBB</b>	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.
<b>Speculative</b>	<b>BB</b>	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>B</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.
	<b>CCC</b>	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.
	<b>CC</b>	A high risk of going into default exists. Low capability for paying off the debt-related financial obligations. Substantial problems in the financial condition.
	<b>C</b>	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.
	<b>D</b>	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

<b>A-1+</b>	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.
<b>A-1</b>	Financial stability. Weak or inconsiderable vulnerability to the changes in the political or economic environment.
<b>A-2</b>	Good financial condition. Certain vulnerability exists to unfavourable changes in the political or economic environment.
<b>A-3</b>	Good financial condition. Moderate vulnerability to unfavourable changes in the political or economic environment.
<b>B</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.
<b>C</b>	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.
<b>D</b>	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.