Article Title: ARCHIVE | General Criteria: How Standard & Poor's Uses Its 'CCC' Rating Data: (EDITOR'S NOTE: — This article has been superseded by "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," published Oct. 1, 2012.) Criteria For 'CCC' Ratings 'CCC' Fundamentally, the 'CCC' category is merely an extension of the rating scale to the most risky situations regarding potential default; it is not a special category, reserved for designated situations (as opposed to 'C', 'D', 'SD', and 'R'). Standard & Poor's Ratings Services defines 'CCC' as applying to entities that are vulnerable to nonpayment and depend on favorable business, financial, and economic conditions to be able to meet all their financial commitments. As a general rule, companies that face a 50-50 chance of eventual default should be rated in the 'CCC' category. 'CCC' is also appropriate--even at a lower probability threshold--if the risk of default is near term, i.e., within the next 12 months. Most often, we assign the 'CCC' rating to companies previously rated higher, but have since experienced declining fortunes. However, the rating can also be appropriate from the outset, if the risk level is sufficiently high. (During the recent period of seeming investor indifference to credit risk--2005-2007--we initially rated several companies 'CCC'.) The 50-50 standard implies a relatively high level of upgrades for the 'CCC'–rated companies that do not actually default. While we try to avoid changing ratings excessively, high-risk companies deservedly have more volatile rating patterns. Note also the consistency with our speculative-grade repositioning earlier this year, which called for greater responsiveness to change and accepting higher volatility for speculative-grade credits. (Please see Leveraged Finance: Standard & Poor’s Revises Its Approach To Rating Speculative-Grade Credits, published May 13, 2008, on RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis.) 'CC' The 'CC' category is more appropriate where a company is at substantial risk of default generally within six months, especially when a default date can be determined. While we generally expect issuers in the 'CC' category to incur a payment default fairly imminently, in some instances companies find resources to continue operations for a longer period. This could occur through asset sales, extreme reductions in working capital (e.g., by stretching out supplier payments), or a last-minute contribution by a financial sponsor. We would not upgrade an issuer from this category merely because the time to default is being extended, as long as we still deem default to be inevitable or very likely. 'C' 'C' is not assigned as an issuer credit rating (ICR), but is reserved for issue ratings in various special situations: Structured or project finance obligations that are currently highly vulnerable to nonpayment that do not have an ICR; Issues with poor recovery prospects for issuers when the ICR is 'CCC-' or 'CC'; Issues that have continued to pay while the company is in bankruptcy*; Preferred stock and deferrable-payment debt that is paying, but in arrears; Preferred stock and deferrable-payment debt that passed on a payment, deferred payment, or paid-in-kind, in accordance with their terms (with some exceptions, notably, so-called toggle notes)**; and Corporate or government issues that miss a scheduled maturity (as opposed to legal maturity), in accordance with the terms of the instrument**. *Note that ratings can actually be higher--even much higher--when the continuity of payment is assured by the structure of the issue and the related legal considerations. For example, equipment trust certificates of bankrupt entities rated in 'BBB' category; debtor-in-possession loans can typically be rated 'A'. **Prior to July 2008, we assigned a 'D' issue rating in these situations. Frequently Asked Questions How does Standard & Poor's distinguish between 'CCC+', 'CCC', and 'CCC-' ratings? Similar to the plus/minus refinements in other rating categories, these are fine distinctions, not subject to precise demarcation. Regarding the use of 'CCC' for junior issues of entities with higher ICRs, however, the notching conventions lead to more straightforward application. For example, in the case of an issuer with a 'B' ICR, an issue that has poor recovery prospects is rated two notches below that ICR, or 'CCC+'. Will CreditWatch be used differently for 'CCC' ratings? Considering their high chance of default, there is an inherent negative CreditWatch associated with 'CCC' ratings. Nonetheless, an explicit CreditWatch placement may be appropriate in some cases. A positive listing is appropriate in cases where we expect an improving credit picture within the next three months. In addition, rating committees have the discretion to use CreditWatch placements to highlight or comment on situations that are unusual, complex, or hold great interest for investors. Are outlooks assigned to 'CCC'/'CC' ratings? In most instances, issuers in this category have either a negative or developing outlook. A negative outlook is more common, reflecting the reason the issuer resides in this category in the first place: the high probability of default. However, sometimes a developing or positive outlook is justified--e.g., where a potential equity infusion is an upside scenario. What are the most common factors that lead to CCC ratings? Assignment of 'CCC' ratings can be attributed to any factor that gives rise to high risk of default. These include business risk, financial risk, and/or liquidity concerns. A survey of recent 'CCC' assignments turned up the following factors: Deteriorating operating performance; Escalating raw material costs; Intense competition; Industry-specific pricing deterioration; Violation of financial covenants; Narrowing covenant cushion; Impact of legislation (e.g., Nevada banning smoking in casinos); Delay in filing financial statements; Significant near-term maturities; Unforeseen crisis (e.g., Hurricane Katrina, product recalls); C corporate governance issues; Low cash position; and Engaging strategic advisors to explore strategic alternatives. Perhaps the single most common event that leads to a downgrade to 'CCC' involves the breach of financial covenants--or the high likelihood of that happening. (A covenant breach resulting in technical default, however, is not itself considered a default for rating purposes. Rather, the breach typically holds implications for impending default via loss of liquidity—especially through curtailed access to revolving credit facilities. Indeed, if the issuer has adequate cash balances to sustain operations until the covenant violation is cured, it may not merit a 'CCC' rating.) Generally, 'CCC'-rated companies often default without a material positive development, such as a change to their capital structure or business model--as the definition of this category suggests. But we have observed that many struggling companies can and do endeavor to make such positive developments materialize. If this occurs, some may subsequently be upgraded to reflect the improved situation--but a good percentage of these slip back into distress and ultimately default. Recent upgrades out of 'CCC' were for the following reasons: Purchase by a stronger entity; Refinancing; Debt repayment ; Restructuring, including exchange offers; Timely filing of financials; Waiver and amendment of covenants; Market factors, e.g., higher copper prices ; and Asset sales. Please see "'CCC' Rating Population Multiplying As Downturn Extends," published today on RatingsDirect.