Article Title: ARCHIVE | Criteria | Corporates | General: Criteria Policy Update: Short-Term Speculative-Grade Rating Criteria Data: Short-term speculative-grade ratings represent Standard & Poor's Ratings Services' opinion of the relative creditworthiness of an obligor with specific reference to a short-term time horizon, which shall generally be the following 12 months (on a rolling basis). For issuers with long-term ratings of 'BB+' or lower, their short-term ratings will fall in a range, including 'A-3', 'B-1', 'B-2', 'B-3', 'C', and 'D'. For corporate issuers (industrial and utility sectors), the emphasis for short-term speculative-grade ratings will be on cash flow analytics, liquidity (including loan covenant analysis), and relevant near-term business factors. Standard & Poor's ratings are an opinion of the general creditworthiness of an obligor or the creditworthiness of an obligor with respect to a particular debt security or other financial obligation, based on relevant risk factors. Corporate credit ratings have traditionally considered a medium- to long-term horizon, which is typically defined as three to five years. Standard & Poor's believes that this time horizon remains of vital interest to investors; long-term ratings will continue to offer a relatively stable opinion of credit quality that attempts to "look through" the economic cycle. Near-term credit factors are often similar to longer-term credit factors, and Standard & Poor's always considers credit issues over a variety of time horizons in assigning long-term ratings. However, for speculative-grade issuers, the short-term horizon can be particularly critical, in terms of liquidity, event risk, and susceptibility to changes in business conditions. Standard & Poor's expanded short-term speculative-grade ratings are intended to give market participants an additional indicator of creditworthiness with respect to issuers with speculative-grade long-term ratings. Short-term ratings for speculative-grade issuers will focus first and foremost on liquidity, which is the leading driver of creditworthiness over the short term for the majority of corporate issuers in the speculative-grade category. In addition to liquidity, Standard & Poor's considers various other factors in determining the short-term rating. The business factors will vary by industry and, for example, might address the following: cyclical factors such as commodity pricing environment, potential regulatory changes or rate reviews, potential legal issues, potential new products, or potential sources of delay in introducing products, such as regulatory approvals, potential entry into new business line or exit from existing lines, significant potential competitive developments, near-term country risk factors faced by material emerging market subsidiaries, or other potential event risk. An explanation of the critical factors considered in arriving at a company's short-term speculative-grade rating can be found in the summary analysis or research update for a given issuer under the subheading "short-term credit factors." The short-term credit factors comments are expected to be updated at least quarterly. Short-term speculative-grade ratings will be assigned as an "issuer" rating, i.e., one that addresses relevant short-term credit factors for a particular issuer. Standard & Poor's would also assign ratings to specific short-term notes or loans (i.e., issue ratings) upon request. All else being equal, companies with exceptional liquidity characteristics are those most likely to have short-term ratings at the upper end of the scale, since they can rely on their liquidity cushion to shelter them from near-term risks. Companies with corporate credit ratings of 'BB+' may even achieve an 'A-3' short-term rating, which is equivalent to the 'A-3' rating assigned to investment-grade issuers. Despite strong liquidity and what may be favorable near-term industry conditions, these companies' speculative-grade long-term ratings indicate exposure to significant risks over time, for example: vulnerability to a downturn in the domestic economic cycle, product obsolescence risk, expected medium-term competitive developments, regulatory risk, legal risk, or other types of event risk. Liquidity analysis is naturally a key focus for both short- and long-term speculative grade ratings. The sections below will review the cash flow and liquidity analytics focus for the short-term rating. Internal Sources Of Liquidity Cash, marketable securities. A company's cash position is of course the most reliable source of liquidity. However, not all of the cash position can be viewed as surplus: virtually every company has some base amount of cash that must be retained for day-to-day operating purposes. In addition, balance-sheet figures cannot be taken at face value: information on published balance sheets may be stale; cash may be held at operating subsidiaries and not available to the holding company, due to covenant restrictions, cross-border tax inefficiencies, or foreign-exchange restrictions for emerging market subsidiaries; or cash may be pledged to a certain facility. What companies classify as "marketable securities" may in fact be more or less liquid, may be subject to significant swings in value, and depending on the accounting jurisdiction, may or may not be marked to market on a regular basis. Marketable securities also need to be scrutinized for risk concentrations (credit risk; country risk; and currency risk). For weaker credits, signs of a deliberate strategy to build a cash-cushion prior to a filing for reorganization (such as Chapter 11 in the U.S.) need to be considered. Therefore, in analyzing a company's cash position as a source of liquidity, Standard & Poor's evaluates the quality and availability of the cash position, taking into account the factors previously mentioned. Careful review of the notes to financial statements, other regulatory disclosures, understanding management's liquidity investment policy, and questioning management directly are sources utilized. Cash flow A company's ability to generate free cash flow (cash flow after working capital needs and capital expenditures) is a key source of liquidity. Building blocks for the cash flow analysis include: Funds from operations. This basic cash flow indicator (cash flow before working capital adjustments and capital expenditures) is scrutinized for historical and projected annual level and relative volatility, including seasonal or commodity price-related fluctuations. Working capital/operating cash flow. Working capital can be a critical use or potential source of cash flow, depending on the nature of the company and its operating cycle. Standard & Poor's reviews companies with a high degree of seasonality and working capital variation, such as retailers, for peak and trough levels of working capital usage and related liquidity needs and sources. A company may also be able to extract cash from working capital at least temporarily, for example, by monetizing receivables through factoring or securitization, liquidating unneeded inventories, or stretching out payments to suppliers. Each of these techniques has potential drawbacks, however, in terms of time needed to execute, or—in the case of stretching out payments—sending potentially alarming signals to suppliers. Capital expenditures/free cash flow. Standard & Poor's expectations about a company's required maintenance capital expenditures, as well as likely growth-related capital expenditures, are factored into the cash flow analysis to arrive at projected free cash flow. The relative flexibility the company may have to cut back on capital expenditures, if needed, is also analyzed. External/Other Sources Of Liquidity Bank lines of credit Key factors reviewed are total amount of facilities; whether they are contractually committed; facility expiration date(s); current and expected usage and estimated availability; bank group quality; evidence of support/lack of support of bank group; and covenant and trigger analysis. Financial covenant analysis is critical for speculative-grade credits. Standard & Poor's requests copies of all bank loan agreements and bond terms and conditions for rated entities, and reviews supplemental information provided by issuers for listings of financial covenants and stipulated compliance levels. Standard & Poor's reviews historical covenant compliance as indicated in compliance certificates, as well as expected future compliance and covenant headroom levels. Entities that have already tripped or are expected to trip financial covenants will be reviewed for their ability to obtain waivers or modifications to covenants. Penalties for violating financial covenants are also reviewed as to whether they trigger an event of default (most severe) or a debt incurrence limitation. Material adverse change clauses are also reviewed for potential ability to affect bank group behavior during a liquidity or other crisis. Ratings triggers are less common for speculative-grade issuers than for investment-grade issuers. Nevertheless, rating triggers are sometimes found at the 'BB' or 'B' level (i.e., a downgrade from 'BB-' to 'B+' may trigger a put option or immediate unavailability of a bank facility for future borrowings). Market access Although market access cannot be taken for granted, companies are reviewed for their track record in ability to access debt and equity markets. Particularly outside the U.S., a company's role in the national economy can enhance its access to bank and capital markets. Near-term, well-defined, highly executable bank or capital market financings are included in Standard & Poor's near-term cash flow projections, while potential execution risks are also considered. Ability to access securitization markets on an ongoing basis should also be considered. This assessment should take into account the current and anticipated liquidity in securitization markets, as well as the nature of assets available to be securitized (amount, quality, and salability). Committed multi-seller and single-seller bank conduit facilities should be considered where applicable. Ability to sell nonstrategic assets Identified, marketable nonstrategic assets may be considered as a form of backup liquidity support. However, execution risks may be considerable; timing of the closing of such transactions (i.e., receipt of funds) can be notoriously unpredictable. Parent support Parent support may be considered as a potential source of liquidity, albeit with a healthy dose of skepticism. The track record of the parent in supporting the subsidiary or other similar subsidiaries, the strategic nature of the subsidiary, or the presence of cross defaults related to the subsidiary in parent debt agreements all may lead Standard &

Poor's to conclude that temporary liquidity support from a more highly rated parent is likely. However, parents often change their views with regard to the relative importance of keeping a subsidiary out of default or bankruptcy, as the parent company's own business and financial strategies evolve. Uses Of Cash In addition to working capital and capital expenditures, expected near-term uses of cash may include the following: Debt maturities A company's debt maturity schedule is carefully reviewed, with particular scrutiny of short-term debt (debt with original maturity within one year) and the current portion of long-term debt (the portion of bond or long-term bank debt maturing within one year). For most speculative-grade companies, market access is not guaranteed. Periods of market illiquidity or temporary spikes in credit spreads may make market access difficult, expensive, or both. Short-term bank debt rollovers also cannot always be taken for granted. Companies with the highest short-term ratings will have sufficient cash to cover near-term maturities or a refinancing plan that Standard & Poor's views as having little execution risk (such as planned market access with committed credit facilities as a backup). While the focus is 12 months forward on a rolling basis, this does not mean that debt maturities just beyond this horizon will be ignored in the short-term rating analysis. Standard & Poor's would want to see that the company has a credible strategy for repaying or refinancing debt maturing up to 18 months for companies to achieve the highest short-term ratings. As maturities move into the forward 12-month time horizon, Standard & Poor's will start placing more weight within the short-term rating analysis on the materiality of upcoming maturities and the company's refinancing strategy and execution ability. Debt maturing within six months, depending on materiality relative to liquidity sources, would be weighted quite significantly in the short-term rating, with proportionally less credit given to refinancing strategies not yet executed. Particularly for companies in the weaker short-term rating categories, the specific timing of debt maturities can be critical. Maturities are scrutinized by month, and for companies with severe liquidity problems, constructing a day-by-day schedule of material maturities may be needed. Besides bank and bond debt, other financial obligations are considered, including leases and contingent obligations. Dividends Expected common and preferred dividends are factored into projected use of cash. Standard & Poor's will also consider a company's flexibility to reduce dividends if needed. Companies may find it difficult to reduce dividends if they have maintained a long track record of maintaining or increasing dividends per share, which in turn is considered critical to maintaining access to equity markets. Acquisitions Expected near-term acquisitions (and funding strategy) are factored into cash flow projections. For particularly acquisitive companies, Standard & Poor's may make a base-case assumption about acquisitions in our forecast, although no specific acquisition target may have been identified. Other projected uses of cash may include: Pension funding Obligations arising from derivatives (margin calls) Take or pay obligations Debt buybacks Litigation Environmental obligations The liquidity table presented below is an example of the table constructed by Standard & Poor's analysts to summarize key projected liquidity factors. The liquidity table is used in conjunction with the various analytical caveats and considerations indicated in the criteria (see table). Sample Short-Term Speculative-Grade Liquidity Table CASH AND SHORT-TERM INVESTMENTS, AS OF BEGINNING OF PERIOD CREDIT LINE AVAILABILITY* PROJECTED FUNDS FROM OPERATIONS PROJECTED CHANGES IN WORKING CAPITAL MARKET ACTIVITY (DEBT, EQUITY ISSUANCE) PENDING ASSET SALES FFO VOLATILITY ASSESSMENT (HIGH; MEDIUM; LOW) TOTAL CASH SOURCES MATURITIES: SHORT-TERM DEBT MATURITIES: CURRENT PORTION, LONG-TERM DEBT CAPITAL BUDGET: MAINTENANCE CAPITAL EXPENDITURES CAPITAL BUDGET: GROWTH CAPITAL EXPENDITURES DIVIDENDS SHARE REPURCHASE OTHER USES TOTAL CASH USES *CREDIT LINE MATURITY DATES Covenant review: lists covenants, compliance, comments Guidelines For Speculative-Grade Short-Term Issuer Ratings Standard & Poor's considers the various factors listed below for each rating category. The final rating incorporates a qualitative weighting of these and other industry risk factors; therefore, the guidelines are not meant to be definitive. 'A-3' A small portion of speculative-grade credits, those with outstanding short-term creditworthiness, may obtain an 'A-3' short-term rating (i.e., cross-over to investment grade for their short-term rating). These issuers should have relatively low default risk over the near term, despite speculative-grade characteristics over the medium to long term. They must have a combination of outstanding liquidity and lack of near-term event risk. In particular, the issuer should exhibit a combination of most of the following characteristics: Free cash flow positive for prior (rolling) 12 months and per Standard & Poor's projections for next (rolling) 12 months; Cash and easily liquidated short-term investments more than cover short-term debt maturities (i.e., no refinancing risk in the near term); Has ample backup liquidity from unutilized lines of credit and no chance of covenant breech or rating trigger activation; Enjoys very good access to external financing, including debt (bank, securitization, and other debt markets), and equity. Event risk over the short term (acquisitions, industry downturn, adverse regulatory/legal rulings, adverse competitive developments) should be minimal. 'B-1' Issuers with a 'B-1' short-term rating have above-average creditworthiness over the short term compared to other speculative-grade issuers, despite credit concerns over the medium to long term. They should have a combination of very strong liquidity and limited near-term event risk. In particular, such issuers should exhibit the following: Should be free cash flow positive for prior (rolling) 12 months and per Standard & Poor's projections for next (rolling) 12 months; Cash and easily liquidated short-term investments should nearly cover short-term debt maturities (i.e., limited refinancing risk). Alternatively, backup liquidity from unutilized lines of credit may help cover short-term debt maturities, if there is virtually no chance of covenant breach or rating trigger activation; Have ample backup liquidity from unutilized lines of credit and little chance of covenant breech or rating trigger activation; Total liquidity (cash, marketable securities, unutilized bank lines, projected 12-month funds from operations) should well exceed total near-term uses (working capital requirements, capital expenditures, dividends, pension funding requirements, debt maturities); Typically enjoy good access to external financing (debt-including securitization facilities), equity, or both); and There may be some event risk over the short term (acquisitions, industry downturn, adverse regulatory/legal rulings, adverse competitive developments), but assessed potential impact should be minimal. There may be more significant event risk identified over the medium term. 'B-2' Issuers with a 'B-2' short-term rating have average speculative-grade creditworthiness over the short term. They should have adequate to good liquidity and may have limited near-term event risk. In particular, these issuers should have the following traits: May be neutral to slightly free-cash-flow-negative (for prior [rolling] 12 months and per Standard & Poor's projections for next [rolling] 12 months); Cash and easily liquidated short-term investments, plus backup liquidity from unutilized lines of credit, should nearly cover short-term debt maturities (i.e., may have some refinancing risk); Have some backup liquidity from unutilized lines of credit. There may be some chance of covenant breach, although limited impact is expected (i.e., either lines of credit are not critical liquidity sources, or banks are expected to waive); Total liquidity (cash, marketable securities, unutilized bank lines, projected 12-month funds from operations) should cover total near-term uses (working capital requirements, capital expenditures, dividends, pension funding requirements, debt maturities). Some reliance on rollovers (particularly for bank lines where covenant coverage is ample) may be factored in; Typically enjoy access to external financing (debt, equity, or both), but disruptions can be anticipated; and There may be some event risk over the short term (acquisitions, industry downturn, adverse regulatory/legal rulings, adverse competitive developments), but assessed potential impact should be moderate. There may be more significant event risk identified over the medium term. 'B-3' Issuers with a 'B-3' short-term rating have weak speculative-grade creditworthiness over the short term (next 12 months). They may have poor to merely adequate liquidity and have significant near-term event risk. In particular, the issuers should exhibit the following: May be neutral to significantly free cash flow negative (for prior [rolling] 12 months and per Standard & Poor's projections for next [rolling] 12 months); Cash and easily liquidated short-term investments, plus backup liquidity from unutilized lines of credit cover only a fraction of short-term debt maturities (i.e., may have significant refinancing risk); Have some backup liquidity from unutilized lines of credit. There may be a significant chance of covenant breach, although such a breach should not lead to an immediate liquidity crisis; Total liquidity (cash, marketable securities, unutilized bank lines, projected 12-month funds from operations) should nearly cover total near-term uses (working capital requirements, capital expenditures, dividends, pension funding requirements, debt maturities). Some reliance on rollovers (particularly for bank lines where financial covenant compliance is comfortable) may be factored in; Typically have only sporadic access to external financing (debt, equity, or both); and Typically there is some identified event risk over the short term (acquisitions, industry downturn, adverse regulatory/legal rulings, adverse competitive developments); assessed impact would be significantly negative. There may be more significant event risk identified over the medium term. 'C'

Issuers with a 'C' short-term rating have very weak creditworthiness over the short term. They have a combination of poor liquidity and/or significant event risk, suggesting a high near-term default risk. In particular, these issuers should have the following: Be typically free-cash-flow-negative; Have no capital market access and limited bank line availability. They also have large near-term maturities. Covenant breach may be expected in the near term, with a high level of uncertainty by Standard & Poor's over the issuer's ability to obtain bank waivers; Have high near-term event risk (such as materially adverse litigation result expected); and Default is highly probable in the near term, unless a significantly positive development materializes that is not in our base case (i.e., external sources of liquidity found through asset sales, cash injection from parent, acquisition by a stronger company, event risk is reversed). Appendix 1 Note: Speculative-grade short-term ratings will have a certain natural correlation with long-term ratings. However, with certain exceptions, several short-term rating outcomes are possible for an issuer with a given long-term rating. Issuers with long-term ratings of 'BB' and lower are not expected to achieve a short-term rating of 'A-3' or higher; issuers with long-term ratings of 'CCC+' and lower are not expected to achieve a short-term rating higher than 'B-3'.