

General Rating Methodology

**Euler Hermes Rating  
Deutschland GmbH**

March 2012

# Contents

<b>1 Organisational Background</b>	<b>2</b>
1.1 Introduction	2
1.2 Individual Steps of the Rating Process	4
1.3 Monitoring	6
1.4 Abortion of Solicited Rating Process	7
1.5 Withdrawal of Published Ratings	8
1.6 Ratings on the Watchlist	8
1.7 Media Releases	9
<b>2 Areas of Analysis</b>	<b>10</b>
2.1 Financial Analysis	10
2.2 Market Environment	11
2.3 Strategy and Planning	12
2.4 Management and Organisation	13
<b>Notes</b>	<b>14</b>
Definitions	14
Financial Ratios	16

# 1 Organisational Background

## 1.1 Introduction

Euler Hermes Rating Deutschland GmbH (or “EHRG” or “Agency” for short) is publishing this rating methodology so that companies, investors and other interested members of the business community are able to assess the rating methods and processes used by EHRG.

As a general rule, an EHRG rating constitutes an opinion on a company’s creditworthiness and is expressed by using an established and defined ranking system. Ratings are not recommendations to buy, sell or hold securities of any kind. They refer solely to the credit risk to the exclusion of all other kinds of risk. The rating notation symbols used by EHRG correspond to those applied by the international rating agency Standard & Poor’s.

EHRG conducts rating processes in which the representatives of the rated entity (see definitions) place a written request with the Agency for such a rating (solicited ratings) as well processes in which no written request is received from the rated entity (unsolicited ratings).

In the case of solicited ratings, EHRG provides full and financial strength ratings on the basis of internal information with which the rated entity’s representatives furnish EHRG and which they explain to EHRG analysts. This is not the case with unsolicited rating processes, which are based solely on public information collected by the analysts. Similarly, there is no visit to the company.

A financial strength rating comprises a financial analysis entailing only part of the analytical process for a full rating and is based solely on external accounting data (including the annual and consolidated financial statements) of a rated entity. In contrast to a full rating, it does not include an assessment of the market conditions, a review of the plausibility of the corporate strategy and forecast data or an assessment of the management or organisation of the entity. In view of the narrower information base for financial strength ratings, EHRG does not publish any twelve-month forecasts as it does in the case of full ratings (see definitions).

EHRG offers unsolicited financial strength ratings in order to provide the capital market with an impartial impression of the creditworthiness of non-rated companies. These are prepared on the basis of information available to the general public and are designated with the term PI (“public information”) upon publication to distinguish them from solicited financial strength ratings. Information quality is safeguarded as unsolicited financial strength ratings are only prepared for companies which are listed on the stock market and must therefore comply with the disclosure rules for capital-market-oriented companies.

	Full Rating	Financial Strength Rating
<b>Content</b>	Comprehensive assessment of the company's creditworthiness and future viability (financial analysis, market environment, strategy, risk management)	Assessment of the company's current financial strength
<b>Information basis</b>	All information (see documents requested on placement of rating request)	Annual financial statements for the past three financial years and recent quarterly reports
<b>Company visit</b>	Approx. 1 - 2 days	None
<b>Analysts</b>	2-3 analysts (+ 2 rating committee members)	1 analyst (plus +2 rating committee members)
<b>Documentation</b>	Detailed rating report (approx. 25 - 30 pages)	Brief rating report (approx. 5 pages)
<b>Publication</b>	Possible	Possible
<b>Request status</b>	Solicited	Solicited or unsolicited
<b>Notation</b>	AAA-D	Solicited: AAA-D (plus FSR designation) Unsolicited: AAA-D (plus FSR-PI designation)
<b>Twelve-month forecast</b>	Yes	No

The rating methodology presented here does not describe the processes for full and financial strength ratings separately as the financial strength ratings form the basis for the analytical process for full ratings and the two rating processes are identical from the "rating committee" stage onwards (see diagram setting the steps of a rating process).

A financial strength rating is determined in the first stage of the analysis for a full rating. The financial strength rating and the related assumption concerning the rated company's future viability must be confirmed in other parts of the analysis. If this is not the case, e.g. because the rated company's future profitability is assumed to be weak on account of an expected slump in the market, the rating is adjusted in the light of the company's risk structure. The individual areas analysed in a full rating are:

Aspects Analyses For Full Ratings	
<b>A Finance</b>	<ul style="list-style-type: none"> <li>• Earning power and profitability</li> <li>• Capital structure and debt</li> <li>• Internal funding potential and financial flexibility</li> </ul>
<b>B Market environment</b>	<ul style="list-style-type: none"> <li>• Sector trends</li> <li>• Analysis of the competition</li> </ul>
<b>C Strategy and planning</b>	<ul style="list-style-type: none"> <li>• Strategic orientation</li> <li>• Financial planning</li> </ul>
<b>D Management and organisation</b>	<ul style="list-style-type: none"> <li>• Corporate governance</li> <li>• Planning and steering instruments</li> <li>• Risk management</li> </ul>

All the analysts' views on the individual areas analysed are documented in a rating report and condensed by the project team to form a rating, which is confirmed or adjusted by a rating committee.

The rating committee is the sole instance for assigning a rating. At the same time, it performs quality-assurance and verification functions by reviewing the statements made in the rating report and confirming the rating report or returning it for improvements. Thus, the rating committee forms a key element in efforts to ensure the reliability and impartiality of the ratings assigned by EHRG. A rating committee is made up of experienced analysts who were not involved in the rating process for the company in question.

As a general rule, EHRG only grants full ratings and financial strength ratings if the project team and the rating committee are satisfied with the quality of the information available on the rated company. Failing this, the rating procedure is aborted or a published rating withdrawn.

Ultimately, EHRG seeks to reduce information asymmetries between the various stakeholders of the rated company, particularly between the creditors and the management of the rated company, by offering high-quality ratings, thus enhancing the transparency of the German capital market.

## 1.2. Individual Steps of the Rating Process

The following table sets out the individual steps of the processing leading to an EHRG full rating.

Process For Full Ratings	
<b>A</b>	<b>Request for rating</b>
<b>B</b>	<b>Analysis of documents</b>
<b>C</b>	<b>Visit to company</b>
<b>D</b>	<b>Rating report and proposed notation</b>
<b>E</b>	<b>Rating committee</b>
<b>F</b>	<b>Submission of rating report to company</b>
<b>G</b>	<b>Decision on publication</b>

### A Request for rating

After a request for a full rating has been received, the rated entity is sent a list of the documents which it must submit. These documents are used to prepare the visit to the company. This customarily entails the following documents:

#### Financial analysis

- Original copies of the audited consolidated financial statements for the past three financial years
- Information on business performance during the year, e.g. the latest quarterly report, current business performance evaluation
- Current version of the articles of incorporation or bylaws
- Current version of the organisational chart setting out the corporate structure including all equity investments and shareholders
- Statement of bank liabilities (loans and credit facilities, extent of utilisation, collateral provided, maturities, conditions and, where available, contracts)
- Current liquidity planning

#### Market environment

- Description of past and future sector trends (sector reports, market studies)
- Description of main competitors (competition studies)

#### Strategy and planning

- Written qualitative and quantitative description of the corporate strategy including details of the underlying market assumptions
- Medium-term business plan derived from the strategy including liquidity, finance, revenue, cost, capex and personnel plans
- Deviation analysis for the strategic business segments for the last three years with respect to sales and earnings

#### Management and organisation

- Organisational chart setting out the corporate structures within the company and allocation of personnel
- CVs of the management board and Tier 1 management

- Description of the risk management system or other documents describing the risk management system (processes, authorisations, reports etc.)
- Quality management manual
- List of certifications
- Examples of the main business planning and reporting instruments including receivables management and liquidity/finance planning

After receipt of a request for a rating, a project manager, who is normally a senior rating analyst or director, and a further analyst are assigned to the case depending on the requirements arising from the execution of the rating process. In the case of financial strength ratings, the project team comprises an analyst, who in hierarchical terms is a rating analyst or higher.

## B Analysis of Documents

After receipt of the requested documents, they are examined by the responsible analysts, who prepare a list of questions for each part of the analysis for submission to the rated company as preparation for the visit by EHGR.

## C Company Visit

The main element of the company visit comprises talks with management, which are then verified at the operational level. The number and duration of the talks depend on the size and complexity of the company. The duration of the individual conversations during the company visit is determined by the relevance of the department concerned for the company as a whole. Usually, talks with management and the financial officers take more time than the other talks.

## D Rating Report with the Proposed Notation

The information and documents obtained during the visit to the company are analysed in conjunction with the documents already received and the results documented in a rating report.

The provisional rating report is discussed by the team members in preparation for the determination of the provisional rating assessment. The purpose of the discussion is for the project team to approve the proposed notation. This is done in the realisation that each team member holds responsibility for the rating assessment and the quality of the rating report. The project manager submits the proposed notation and the rating report to the rating committee.

In the case of financial strength ratings the project manager prepares the provisional rating report alone and then submits it together with the proposed notation to the rating committee.

## E Rating Committee

The same rating committee processes are used for both company and financial strength ratings. The rating committee is the sole instance for allocating the rating in the case of both rating and monitoring processes. In addition, the rating committee decides on entries in the watchlist, the withdrawal of any ratings already published and the abortion of ongoing rating processes. The purpose of the rating committee is to ensure impartiality in the rating assessments, thus heightening the quality of the rating in terms of its content as well as its formal structure. In this connection, the rating committee is primarily responsible for determining the rating notation by verifying the plausibility of the notation proposed by the project team.

The identity of the people who are eligible to be members of the rating committee is known at all times. All members have experience in managing rating processes of their own. A rating committee is constituted at the initiative of the rating process project manager for each rated entity and comprises two experienced analysts who are not involved in the rating process in question. The rating committee remains the contract partner for the project manager for the duration of the monitoring and rating review process. If a rating review process is repeated, the members of the rating committee are replaced in accordance with the EHRG rotation policy

(published at [www.ehrg.de](http://www.ehrg.de)) to ensure the independence of the rating committee over time.

The rating committee decides on the rating assessment for the rated entity on the basis of the rating report and the explanatory information provided by the project manager. During the decision-making process, the rating committee can

- confirm or alter the notation proposed by the project team,
- propose or request changes to the rating report,
- request further information,
- request further details from the representatives of the rated entity.

All decisions are made unanimously by the members of the rating committee; for this purpose, a consensus is sought with the project manager, who does not have any voting rights however. If no unanimous decision can be achieved, a further member is added to the rating committee. This enlarged rating committee then makes a majority decision.

## **F Submission of the Rating Report to the Company**

The project manager arranges for the draft rating report to be sent to the rated entity. The rated entity is invited to notify the project manager in writing of any errors or omissions in the rating report; this also applies to unsolicited ratings. The rated entity is normally informed of the rating assessment by EHRG within a few work days, during which the rated entity is able to submit a statement on the report as well as additional documents. In exceptional cases in which swift capital market reporting is crucial, this period can be reduced to 12 hours before the planned date of publication.

EHRG reserves the right to reject any objections concerning errors and omissions if such objection merely serves the purpose of notifying the capital market of the rating.

Further discussion of the rating report may be necessary in response to the rated company's written comments. The project manager records any comments submitted by the rated company's representatives for assessment by the project team. If this results in any changes to the rating assessment, the revised draft report and proposed notation are submitted to the rating committee for approval.

After the company's comments on the final rating report have been considered and approved by the rating committee, the rating report is sent to the rated company.

## **G Decision on Publication**

In the case of solicited full ratings and financial strength ratings, the rated company is asked when the final version of the rating report is sent to it to state in writing whether it wishes the rating to be published. Unsolicited financial strength ratings are published at EHRG's discretion. Media releases (see below) are used to publish new or revised ratings.

If a rating is to be regularly updated rather than being tied to a specific date, a monitoring process is required (see below). In the case of publication tied to a specific date, the rating awarded applies only to the date stated by the rating committee in its decision and is designated with the words "date-related". Regularly updated ratings have the designation "current". If the rated entity decides that it does not want the rating published, the rating is always tied to a specific date.

Unsolicited financial strength ratings are always published after the receipt of any written comments from the rated entity and then undergo monitoring as the agency prepares unsolicited ratings in the interests of the capital market.

# **1.3 Monitoring**

Monitoring refers to the period during which the current rating is published in the case of a non-date-related rating. If a published rating is tied to a specific date, it is not updated, meaning that no monitoring takes place. Monitoring ensures that the rating notation published is always valid and that any changes of relevance for the rating are detected and factored into the rating. For this to be achieved, it is crucial for EHRG to receive or collect all information of relevance for ratings as early as possible. Accordingly, in the case of solicited ratings, the rated company undertakes for the duration of the monitoring period to furnish any information liable to influence the rating. However, the responsible project managers are also responsible for ensuring that any potential

changes in factors which are relevant for the rating are duly noted so that the rating committee can revise the rating assessment if necessary. In the case of unsolicited financial strength ratings, the project managers are solely responsible for obtaining the necessary information.

The monitoring period covers the period between two regular rating dates and normally lasts 12 months. During the monitoring period, a rating may be retained, changed, placed on the watchlist, withdrawn or aborted (see below).

If there is unambiguous information available resulting in a change in a published rating during the monitoring period, the changed rating is published in a media release (see below) immediately after the rated entity has been notified within the applicable period.

During the monitoring period, the rated entity is normally informed of the revised rating assessment by EHRG within a few work days, during which the rated entity is able to submit a statement on the report as well as additional documents. In exceptional cases in which swift capital market reporting is crucial, this period can be reduced to 12 hours before the planned date of publication.

### Collection of Information during the Monitoring Period

The information to be collected for a published full rating chiefly covers the strengths, weaknesses, opportunities and threats identified in the rating report and the company's financial performance on this basis. As a rule, the rated entity should submit the following information to EHRG as soon as possible after the end of the quarter:

- Overview of the company's present and planned projects,
- Quarterly financial statements / business performance evaluations
- Other documents on the company's financial condition (e.g. income statistics and cost analyses/provisional balance sheets, if possible with deviation analyses)
- Updated forecasts
- Liquidity budgets
- Order intake data

Depending on the specific characteristics of the rated company, the project manager may also request further information. In addition, the rated company is required to disclose any ad-hoc information on material individual occurrences, e.g.

- changes in the terms and conditions underlying material contracts, e.g. purchase of assets, insurance and finance (including non-project-related credit facilities etc.)
- changes in accounting and controlling
- changes in key positions
- changes in the company's structure or management
- loss of major customers or clients
- expected delays in payments or liquidity shortfalls
- impairment losses or sale of non-current assets
- planned changes to the funding structure

This list of ad-hoc information is not conclusive and does not relieve the rated entity of its duty to disclose to EHRG any other information which may also be relevant for its rating.

## 1.4 Abortion of Solicited Rating Process

EHRG and the rated entity may at their own discretion abort the full or financial strength rating process at any time. This may, for example, be necessary if EHRG does not receive sufficient information due to inadequate



cooperation on the part of the representatives of the rated entity or the information provided renders it impossible to validly assess the rated entity or the representatives of the rated entity about the rating process.

In the case of published solicited ratings, the abortion of the rating process results in the status “suspended” with the reasons stated; if the ratings are not published, the abortion of the rating process is not publicly disclosed.

An aborted solicited rating mandate may be converted into a unsolicited rating mandate if EHRG takes the view that a rating is of interest for the business community.

## 1.5 Withdrawal of Published Ratings

EHRG may at its own discretion retract published ratings in the following cases:

- 1) errors or omissions in the information provided meaning that it is not possible to validly rate or monitor the company concerned;
- 2) the rated entity enters insolvency;
- 3) the rated entity is reorganised (including mergers and acquisitions).

If a rating is retracted during the monitoring or rating review process, the status is set to “suspended” on the agency’s website, with the date on which it was last updated stated. This status is maintained until the date of the next standard rating date (12 months after the last rating date), after which it is deleted.

A solicited rating may be retracted in response to the termination of the rating mandate by EHRG or the representatives of the rated entity. However, the termination of the rating mandate is not a necessary prerequisite for retracting a rating.

EHRG may modify a rating before it is suspended if it considers the published rating to be misleading in the light of recent information. In this case, the altered rating is updated before being set to “suspended” and the date of the last change stated. In this case, the rating concerned retains its “suspended” status until the next regular rating date.

## 1.6 Ratings on the Watchlist

If any facts liable to justify a change in a published full rating become known and additional information is necessary to calculate a valid rating for the company concerned, a rating committee may decide to place the rating concerned on a watchlist until the necessary information has been received. Financial strength ratings are not placed on the watchlist. The watchlist shows the assumed bias of the rating change: + (plus = upgrade), - (minus = downgrade) and “NE” (not clear). The bias is based on current events and future developments observed at the current point in time. Such events may include future trends in the market or on the part of competitors, statutory changes to underlying conditions, changes in funding structures etc.

When a rating is placed on the watchlist, information to this effect is sent to the rated company and placed on the EHRG website. It is not published in any other way. The inclusion of a rating on the watchlist does not automatically mean that there will be any change in the rating notation. Similarly, ratings which have not been placed on the watchlist may also be changed. Moreover, the watchlist does not include all the ratings which are being reviewed, e.g. current follow-up rating processes.

## 1.7 Media Releases

Solicited full ratings are published on the Agency's website at [www.eulerhermes-rating.com](http://www.eulerhermes-rating.com), in the form of a press release and as a bulletin for subscribers of EHRG's rating report service. In the case of solicited and unsolicited financial strength ratings, EHRG publishes media releases on its website and sends bulletins to the subscribers of its rating report service and the names on its press list.

The publication includes the following information in the case of both full ratings and financial strength ratings:

- Name of the rated entity
- Rating (notation and, where applicable, twelve-month forecast) and the decisive factors underlying the rating
- Mandate status: financial strength ratings are designated with the code "FSR", unsolicited ratings additionally with (PI) for "public information"; no status is shown in the case of full ratings;
- Current rating status: current, tied to a specific date, suspended on on the watchlist.
- Link to details of the rating or the rating report;
- EHRG contact data.

## 2 Areas of Analysis

### 2.1 Financial Analysis

The financial analysis of a rated company forms the basis of the rating analysis. The financial analysis is based on the applicable audit reports (single and consolidated financial statements) for the past three to five years. Business performance during the year is assessed by reference to quarterly reports and the latest business performance evaluations. Disclosures in the annual financial statements are reconciled with the structural accounts by means of corresponding adjustments. With respect to the financial statements, the main focus is on the recoverable value of the reported assets and, where applicable, account grooming (e.g. leasing, factoring). Non-sustainable income and expenses in particular are eliminated from the income statement.

The adjusted data from the annual financial statements not only forms the basis for calculating the financial ratios but is also the starting point for checks to verify the plausibility of forecasts of the company's future performance. The financial ratios are evaluated on the basis of a macroeconomic comparison, with allowance made for the sector in question and the company's specific business risk profile. Benchmarking is used to assess the individual types of financial ratings.

The financial analysis fundamentally covers three areas: *Earning power and profitability, capital structure and debt* and *internal funding potential and financial flexibility*. The analysis has a strong focus on cashflow-based financial ratios. In addition to the areas of analysis and the financial ratios described below, there are numerous other financial ratios providing further information on the company's business performance and its operating structures.

In the analysis of earning power and profitability, special attention is paid to the return on capital over and above sales margins. This approach has the advantage of taking account of differences in value creation and capital structures and is therefore suitable for comparing companies from different sectors.

The main financial ratios in this connection are:

- EBITDA margin
- Total return on capital
- Return on capital employed (ROCE)
- Cash flow return on investment (Cash flow ROI)

Historical performance is assessed on the basis of sales by segment and - using segment earnings as a basis - an analysis of the various expense types to gain a preliminary indication of the company's future financial performance.

The analysis of the capital structure and debt position addresses the (static) capital structure and debt position relative to the cash flows generated (relative debt). With respect to the capital structure, the ratio of economic capital to total capital and to financial liabilities is of particular relevance. This also entails an analysis of the structure and recoverable value of the assets reported and capital turnover. The analysis of relative debt provides an indication of the company's debt repayment potential. In this connection, the cover ratios in the light of capital service are also examined.

The main capital structure and debt ratios are:

- Equity ratio

- Gearing
- Total liabilities/EBITDA
- Net financial liabilities/EBITDA
- EBIT interest coverage
- EBITDA interest coverage

The equity ratio is calculated on the basis of economic capital. In addition to the adjustments made here, allowance may also be made for hybrid financial instruments. Gearing expresses the ratio of economic capital to net financial liabilities. The calculation of (gross) interest coverage is supplemented with an analysis of net interest coverage and debt service coverage.

On the basis of various liquidity levels and asset coverage ratios, an analysis is performed to identify the extent to which the company has engaged in matching-maturities funding for its assets.

The analysis of internal funding potential and financial flexibility initially determines the source and use of funds in past periods on the basis of a step-by-step cash flow calculation.

- Cash flow (DVFA/SG)
- Cash flow from operating activities
- Free cash flow

Cash flow from operating activities, which additionally includes changes in working capital, is derived from DVFA/SG cash flow. Free cash flow additionally includes the impact on liquidity of investing activities and provides a crucial indication of the company's ability to repay its debt. Further key criteria for assessing the company's financial flexibility include changes in liquidity during the year and the evaluation of its unutilised credit facilities. The collateral for credit facilities and possible financial covenants are also important in this respect.

## 2.2 Market Environment

The analysis of the market environment examines changes in the market and competitive environment liable to exert a material influence on the credit rating of a debtor/company. The analysis covers past, current and future trends in the sector of relevance for the company.

In a preliminary step, the main characteristics of the sector, e.g. products, technologies, sector segments, regional structures, competitive factors, are explored. The focus here is on quantitative factors, including production, trends in demand, the cost and earnings situation, trends in insolvency figures. The production and demand-related factors considered include revenues and sales, production, trends in demand, foreign trade, sell-side markets, cyclical exposure.

The causal relationships identified may, for example, include disparate trends in sales and production, which may point to stockpiling or destocking tendencies. An analysis of revenues and sales may, for example, help to understand whether an increase in revenues is due to higher volumes or higher prices.

The trends are analysed across the sector as a whole. The strategy and planning area of the analysis examines the trends identified in the market environment to determine the extent to which they are relevant for the company and to identify the measures which the company has implemented or planned in this connection.

The market environment is analysed in the light of the competitive forces specific to the sector in question.

If the company is engaged in different areas of business, the number of sectors to be analysed is correspondingly higher. Similarly, if it is active in different regions, these may also have to be analysed separately. Business segments which are not relevant for the company's future business performance are excluded from the analysis of the market environment.

The indicators of the sector appeal and the company's position are the size and amplitude of past and future margins and cash flows. The analysis of the factors listed below ultimately serves the purpose of identifying the corresponding causes and determinants.

The information on which the analysis of the market environment is based is provided by the rated company or derived from Euler Hermes Rating's own research. For this purpose, Euler Hermes Rating makes use of internal and external market analyses, the expertise of sector experts and information obtained from renowned economic institutions and associations.

In addition to trends within the sector, the rated company's position within the sector relative to its main peers is examined as far as this information is available. If this is the case, qualitative and quantitative comparative characteristics are examined. The main focus is on determining the company's position relative to the sector average.

For this purpose, the company is analysed in the light of its size and competitive position in its sector. Indicators for this include, for example, market share, innovativeness and market clout. In addition, an attempt is made to determine how the company sees its own position within the sector and the extent to which this is confirmed by external analysis.

The direct comparison with the sector average is based on quantitative factors. The purpose is to determine whether and, if so, in what areas the rated company is above or below the sector average. Depending on the availability of information, the comparison is based on an analysis of revenues, earnings and margin trends, the equity ratio and, where applicable, specific sector ratios (e.g. sales per square metre in the case of retailers).

As far as possible, the comparison with competitors includes not only quantitative factors but also qualitative ones (comparison of strengths and weaknesses, strategy comparison and, where applicable, a portfolio analysis). Strategic comparisons with competitors are particularly used if there is any evidence of changes in the sector(s) (change in positioning, development of new areas of business, acquisitions or merger etc.). This also involves identifying critical determinants which may have a particular relevance for the rated company's strategy on account of the (changed) future orientation of its peers and therefore have a decisive competitive effect.

## 2.3 Strategy and Planning

The analysis of strategy and planning examines the rated company's strategic orientation and the measures which have been taken to implement it.

The strategy analysis explores the scope which the company has for generating sustained earnings in the future. This also entails a consideration of future trends in the company's earnings, net assets and liquidity. The decisive factors here are the amount and security of the expected earnings and cash flows. This analysis also takes account of qualitative factors to enable the plausibility of the strategy and planning to be assessed. The strategy analysis comprises the following sections, which are described individually in the rating report:

- Company's strategic orientation
- Financial forecasts

The strategy analysis proceeds from the main objectives defined by the corporate strategy and assesses their plausibility. In a further step, the correctness, quality, consistency and reliability of the financial planning are verified. The ratios derived from financial planning permit a more granulated evaluation of the company's expected future performance. The reliability of the financial planning is evaluated not least of all in the light of possible implementation risks. These risks to the implementation of the corporate strategy may arise from a non-coherent strategy in the light of the market environment or the company's internal situation.

## 2.4 Management and Organisation

The analysis of management and the company's organisation describes and evaluates the potential which the company has for implementing its corporate strategy on the basis of its management and organisational structures. This primarily entails the following aspects:

- Corporate governance
- Planning and steering instruments
- Risk management

The management analysis particularly considers the extent to which the company's management and organisation are able to cope with changes arising from the strategy and can enhanced as a result. Material shortcomings identified in the company's management and organisation may call into question its overall ability to implement its strategy, thus adversely affecting the assessment of the company's expected future performance. By the same token, particular strengths in the company's management and organisation may have a positive effect.

The analysis of the planning and steering instruments assesses the extent to which the company has suitable planning, information and steering systems to implement and monitor its strategic goals effectively and securely. This is based on the assumption that the company is able to derive from its medium and long-term goals specific objectives for the operating levels, to document them in annual, quarterly and monthly plans and to allocate responsibilities to organisational subunits such as business segments, function holders etc. In addition, the company should be able to measure the successful achievement of its goals at the operating level on the basis of its steering systems, detect any deviations from its plans at an early stage and take suitable measures to rectify this.

The risk management analysis examines the company's ability to systematically detect and address risks to its going-concern status. This is done as part of the examination of the risk management system. The main purpose of the analysis is to assess the extent to which the company is systematically able to recognise threats to and opportunities for its going-concern status on a preventive and timely basis using standardised methods, to derive appropriate conclusions for its corporate activities and to implement measures.

# Notes

## Definitions

### Rated entity

An entity rated by EHRG is a single or parent company, which is a separate legal entity and whose creditworthiness is expressly evaluated in a rating regardless of whether the company in question has requested the rating process or provided the information required for it.

### Rating

A rating is an assessment of the rated entity's creditworthiness conducted on the basis of a defined rating process for rating categories. A full rating comprises the rating notation and the twelve-month forecast or outlook. A financial strength rating comprises only the rating notation without the twelve-month forecast.

### Twelve-month forecast (outlook)

EHRG's twelve-month forecast assesses changes in the full rating over a period of 12 months. Depending on the rating committee's assessment, the twelve-month forecast is published together with the relevant full rating and may take three different forms: positive (pos), negative (neg) or stable (sta).

### Rating analyst

A rating analyst is a person who performs the analyses necessary for awarding a rating.

### Default

A rated entity defaults if it is no longer able to or has failed to meet its obligations under financial liabilities and EHRG takes the view that the rated entity will not be honouring its remaining financial obligations within the requisite period. Moreover, a default is deemed to occur if the rated entity becomes the subject of insolvency proceedings or a settlement in court or out of court or a petition for the commencement of insolvency or title execution proceedings is lodged.

If an issuer defaults with respect to a certain financial liability or class of liabilities but is still able to honour its payment obligations under other financial liabilities or classes of liabilities, the issuer is assigned SD (selective default) status.

In order to identify a default, EHRG relies on information from the capital market or information provided by the rated entity itself. In the case of solicited ratings, the representatives of the rated entity are under a duty to disclose any default events. With unsolicited rating, EHRG is solely responsible for obtaining the necessary information.

Failure to settle a trade payable does not result in the default of the rated entity. It is assumed that a default occurred on the earliest of the date

- on which EHRG downgraded the rating to D or SD, or
- on which the rated entity failed to observe its payment obligation, or
- on which it became insolvent, or

- on which the rated entity becomes the subject of insolvency proceedings or settlement in court or out of court or a petition for the commencement of insolvency or title execution proceedings is lodged.



## Financial Ratios

### Earning power and profitability

<b>EBITDA-Margin</b>
<b>Numerator</b>
EBITDA
<b>Denominator</b>
Total revenues

<b>ROCE</b>
<b>Numerator</b>
Adjusted operating result (= EBIT)
<b>Denominator</b>
Net financial liabilities + Economic capital (= Capital employed)

<b>Total return on capital</b>
<b>Numerator</b>
Adjusted operating and finance result + Interest expense
<b>Denominator</b>
Adjusted total capital

<b>Cashflow-Return on Investment (Cashflow-ROI)</b>
<b>Numerator</b>
EBITDA
<b>Denominator</b>
Adjusted total capital

### Capital structure and gearing

<b>Equity ratio</b>
<b>Numerator</b>
Adjusted equity (= Economic capital)
<b>Denominator</b>
Adjusted total capital

<b>Gearing</b>
<b>Numerator</b>
Net financial liabilities
<b>Denominator</b>
Net financial liabilities + Economic capital (= capital employed)

<b>Net financial liabilities</b>
Bonds
+ Liabilities to banks
+ Bill liabilities
+ Other interest-bearing liabilities
+ Operating lease liabilities
+ Adjustments for ABS/factoring transactions
- Cash and cash equivalents

<b>Total liabilities / EBITDA</b>
<b>Numerator</b>
Total capital - Economic capital (= Total liabilities)
<b>Denominator</b>
EBITDA

<b>Net financial liabilities / EBITDA</b>
<b>Numerator</b>
Net financial liabilities
<b>Denominator</b>
EBITDA

<b>EBIT interest coverage</b>
<b>Numerator</b>
Adjusted operating result (= EBIT)
<b>Denominator</b>
Interest expense

<b>EBITDA interest coverage</b>
<b>Numerator</b>
EBITDA
<b>Denominator</b>
Interest expense

## Cash flow ratios

<b>DVFA/SG cash flow</b>
Net income after tax
+/- Depreciation/writeups
+/- Increase/decrease in non-current provisions

<b>Cash flow from operating activities</b>
DVFA/SG cash flow
<b>Changes in assets</b>
-/+ Changes in inventories
-/+ Changes in trade receivables
-/+ Changes in other receivables and assets
-/+ Changes in prepaid expenses
<b>Changes in shareholders' equity and liabilities</b>
+/- Changes in trade payables
-/+ Changes in bill liabilities
-/+ Changes in prepayments received
+/- Changes in other current liabilities
+ /- Changes in deferred income

<b>Free Cashflow</b>
Cash flow from operating activities
+/- Payments received from/made for investing activities

## Rating Notations

Category	Explanation
<b>AAA</b>	AAA rated companies demonstrate an excellent credit quality. Such companies are characterized by an extremely positive future outlook and are viewed as being “first class” business partners. Although the various security elements can certainly change, such changes – to the extent this can be assessed - are highly unlikely to adversely affect the fundamentally strong position of such companies.
<b>AA</b>	AA rated companies demonstrate very high quality with respect to future security. Along with the AAA rated companies, this group forms the so-called “quality class.” Security margins may, however, be comparatively thinner, the solidity of the security elements may fluctuate more or individual assessment components may indicate a greater long-term risk than is the case for AAA rated companies.
<b>A</b>	A rated companies demonstrate high quality with respect to future security. They show many favourable features which secure their future. Nevertheless, there may be isolated factors which reveal a slightly increased susceptibility to the worsening of circumstances and general economic conditions in the future.
<b>BBB</b>	BBB rated companies demonstrate reasonable quality with respect to future security. Compared to A rated companies, however, it is more likely that worsening of general economic conditions could weaken the capability of fulfilling financial obligations.
<b>BB</b>	BB rated companies still have structures adequate to secure their future. Yet they are subject to greater insecurities. Negative business developments or changes in the general financial and economic conditions can make it impossible for them to fulfil their financial obligations in a suitable manner.
<b>B</b>	B rated companies lack the usual structures to secure their future. Negative business developments or changes in the general financial and economic conditions will most likely make it impossible for them to fulfil their financial obligations in a suitable manner.
<b>CCC</b>	CCC rated companies have structures which greatly endanger the security of their future. Capital service is in jeopardy. Such a company is dependent on a favourable development of general economic conditions if it is to be able to meet its financial obligations in the long term.
<b>CC</b>	Companies receiving a CC rating have very little security for their future. Capital service is in great jeopardy.
<b>C</b>	C rated companies have the least future security of all. The basic conditions enabling such debtors to fulfil their financial obligations are extremely poor. Default is imminent.
<b>D</b>	Companies with a D rating are already in default of payment or have filed for bankruptcy. The D rating is irrelevant for the future; it documents solely the bankruptcy of the company.
<b>SD</b>	If an issuer defaults with respect to a certain financial liability or class of liabilities but is still able to honour its payment obligations under other financial liabilities or classes of liabilities within the requisite period, it is assigned SD (selective default) status.
<b>NR</b>	A debtor or an issuer not rated by Euler Hermes Rating is classified as NR (Not Rated).
<b>PLUS (+) MINUS (-)</b>	Rating notations from AA to CCC may be complemented by a PLUS (+) or MINUS (-) if required, in order to show their relative position within the respective rating category.