

## S&P Debt Rating Definitions

A Standard & Poor's corporate or municipal debt rating is a current assessment of the creditworthiness of an obligor with respect to a specific obligation. This assessment may take into consideration obligors such as guarantors, insurers, or lessees.

The debt rating is not a recommendation to purchase, sell, or hold a security, inasmuch as it does not comment as to market price or suitability for a particular investor.

The ratings are based on current information furnished by the issuer or obtained by S&P from other sources it considers reliable. S&P does not perform an audit in connection with any rating and may, on occasion, rely on unaudited financial information. The ratings may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances.

The ratings are based, in varying degrees, on the following considerations:

1. Likelihood of default-capacity and willingness of the obligor as to the timely payment of interest and repayment of principal in accordance with the terms of the obligation.
2. Nature of and provisions of the obligation.
3. Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights

### **Investment Grade**

**AAA** Debt rated 'AAA' has the highest rating assigned by S&P. Capacity to pay interest and repay principal is extremely strong.

**AA** Debt rated 'AA' has a very strong capacity to pay interest and repay principal and differs from the highest rated issues only in small degree.

**A** Debt rated 'A' has a strong capacity to pay interest and repay principal although it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories.

**BBB** Debt rated 'BBB' is regarded as having an adequate capacity to pay interest and repay principal. Whereas it normally exhibits adequate protection parameters, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal for debt in this category than in higher rated categories.

### **Speculative Grade<sup>1</sup>**

Debt rated 'BB', 'B', 'CCC', 'CC', and 'C' is regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal. 'BB' indicates the least degree of speculation and 'CCC' the highest. While such debt will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major exposures to adverse conditions.

**BB** Debt rated 'BB' has less near-term vulnerability to default than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to inadequate capacity to meet timely interest and principal payments. The 'BB' rating category is also used for debt subordinated to senior debt that is assigned an actual or implied 'BBB-' rating.

**B** Debt rated 'B' has a greater vulnerability to default but currently has the capacity to meet interest payments and principal repayments. Adverse business, financial, or economic conditions will likely impair capacity or willingness to pay interest and repay principal. The 'B' rating category is also used for debt subordinated to senior debt that is assigned an actual or implied 'BB' or 'BB-' rating.

**CCC** Debt rated 'CCC' has a currently identifiable vulnerability to default, and is dependent upon favorable business, financial, or economic conditions to meet timely payment of interest and repayment of capital. In the event of adverse business, financial, or economic conditions, it is not likely to have the capacity to pay interest and repay principal. The 'CCC' rating category is also used for debt subordinated to senior debt that is assigned an actual or implied 'B' or 'B-' rating.

**CC** The rating 'CC' typically is applied to debt

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### <sup>1</sup> **Bond Investment Quality Standards:**

Under present commercial bank regulations issued by the Comptroller of the Currency, bonds rated in the top four categories ('AAA', 'AA', 'A', 'BBB', commonly known as "investment grade" ratings) generally are regarded as eligible for bank investment. Also, the laws of various states governing legal investments impose certain rating or other standards for obligations eligible for investment by savings banks, trust companies, insurance companies and fiduciaries generally.

subordinated to senior debt that is assigned an actual or implied 'CCC' rating.

**C** The rating 'C' typically is applied to debt subordinated to senior debt that is assigned an actual or implied 'CCC-' debt rating. The 'C' rating may be used to cover a situation where a bankruptcy petition has been filed, but debt service payments are continued.

**CI** The rating 'CI' is reserved for income bonds on which no interest is being paid.

**D** Debt rated 'D' is in payment default. The 'D' rating category is used when interest payments or principal payments are not made on the due date even if the applicable grace period has not expired, unless S&P believes that such payments will be made during such grace period. The 'D' rating also will be used upon the filing of a bankruptcy petition if debt service payments are jeopardized.

**Plus (+) or minus (-):** The ratings from 'AA' to 'CCC' may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

**c** The letter 'c' indicates that the holder's option to tender the security for purchase may be canceled under certain pre-stated conditions enumerated in the tender option documents.

**L** The letter 'L' indicates the rating pertains to the principal amount of those bonds to the extent that the underlying deposit of collateral is federally insured and interest is adequately collateralized. In the case of certificates of deposit, the letter 'L' indicates that the deposit, combined with other deposits being held in the same right and capacity, will be honored for principal and accrued pre-default interest up to the federal insurance limits within 30 days after closing of the insured institution or, in the event that the deposit is assumed by a successor insured institution, upon maturity.

**p** The letter 'p' indicates that the rating is provisional. A provisional rating assumes the successful completion of the project being financed by the debt being rated and indicates that payment of debt service requirements is largely or entirely dependent upon the successful and timely completion of the project. This rating, however, while addressing credit quality subsequent to completion of the project, makes no comment on the likelihood of, or the risk of default upon failure or, such completion. The investor should exercise his own judgement with respect to such likelihood and risk.

**N.R.** Not rated.

territories are rated on the same basis as domestic corporate and municipal issues. The ratings measure the creditworthiness of the obligor but do not take into account currency exchange and related uncertainties.

Debt Obligations of Issuers outside the U.S. and its

## GLOSSARY

**Pretax income from continuing operations.** Net income before (1) special items, (2) minority interest, (3) gains on reacquisition of debt, plus income taxes.

**Eight times rents.** Gross rents paid multiplied by capitalization factor of eight.

**Equity.** Shareholders' equity (including preferred stock) plus minority interest.

**Free operating cash flow.** Funds from operations minus capital expenditures minus (plus) the increase (decrease) in working capital (excluding changes in cash marketable securities, and short term debt).

**Funds from operations (or funds flow).** Net income from continuing operations plus depreciation, amortization, deferred income taxes and other noncash items.

**Gross interest.** Gross interest incurred before subtracting 1) capitalized interest, 2) interest income.

**Gross rents** Gross operating rents paid before sublease income.

**Interest expense.** Interest incurred minus capitalized interest.

**Long-term debt.** As reported, including capitalized lease obligations on the balance sheet.

**Operating income** Sales minus cost of goods manufactured (before depreciation and amortization), selling, general, and administrative, and research and development costs.

**Total debt** Long-term debt plus current maturities, commercial paper, and other short-term borrowings.

**Permanent capital** Sum of (1) the average of the beginning of year and end of year current maturities, long-term debt, noncurrent deferred taxes, minority interest, and shareholder's equity and (2) average short-term borrowings during year per footnotes to financial statements.

## Formulas for Key Ratios

$$\text{Pretax interest coverage} = \frac{\text{Pretax income} + \text{interest expense}}{\text{Gross interest}}$$

$$\text{Pretax interest coverage including rents} = \frac{\text{Pretax income} + \text{interest expense} + \text{gross rents}}{\text{Gross interest} + \text{gross rents}}$$

$$\text{EBITDA interest cov. (x)} = \frac{\text{Pretax income} + \text{interest expense} + \text{depr.} + \text{amor.}}{\text{Gross interest}}$$

$$\text{Funds operations (funds flow)/total debt (\%)} = \frac{\text{Funds operations}}{\text{Total debt}} * 100$$

$$\text{Free operating cash flow/total debt (\%)} = \frac{\text{Free operating cash flow}}{\text{Total debt}} * 100$$

$$\text{Pretax return on permanent capital (\%)} = \frac{\text{Pretax income} + \text{interest expense}}{\text{Permanant capital}} * 100$$

$$\text{Operating income/sales (\%)} = \frac{\text{Operating income}}{\text{Sales}} * 100$$

$$\text{Long-term debt as \% of capitalization} = \frac{\text{Long-term debt}}{\text{Long-term debt} + \text{equity}} * 100$$

$$\text{Total debt as \% of capitalization} = \frac{\text{Total debt}}{\text{Total debt} + \text{equity}} * 100$$

$$\text{Total debt} + 8x \text{ rent as \% of capitalization} = \frac{\text{Total debt} + 8x \text{ gross rents}}{\text{Total debt} + \text{equity} + 8x \text{ gross rents}} * 100$$



## KEY INDUSTRIAL FINANCIAL RATIOS

Industrial Long-Term Debt  
Three-year (1990-1992) medians

	AAA	AA	A	BBB	BB	B	CCC
Pretax interest coverage. (x)	16.7	9.3	4.4	2.3	1.3	0.8	(0.1)
Pretax interest coverage. incl. rents (x)	6.8	4.8	2.9	1.8	1.2	0.9	0.5
EBITDA interest coverage. (x)	20.1	12.7	6.4	4.0	2.4	1.5	0.6
Funds from operations/total debt (%)	128.5	72.7	43.1	27.7	16.1	9.2	4.8
Free operating cash flow/total debt (%)	34.8	30.6	13.3	4.1	1.3	(1.9)	2.7
Pretax return on perm. capital (%)	28.2	19.2	14.9	9.8	10.0	6.1	(0.4)
Operating income/sales (%)	21.6	16.0	13.9	12.3	10.3	9.7	9.8
Long-term debt/capital (%)	11.1	17.0	29.7	40.4	53.0	56.8	74.8
Total debt/capitalization incl. short term debt (%)	21.9	26.4	37.2	46.5	59.7	65.9	84.6
Total debt/capitalization incl. short term debt (incl. 8 times rents) (%)	33.0	37.8	48.1	58.5	72.7	75.1	87.1

Industrial Long-Term Debt  
Three-year (1989-1991) medians

	AAA	AA	A	BBB	BB	B	CCC
Pretax interest coverage. (x)	12.1	8.7	4.4	2.7	1.4	0.7	0.5
Pretax interest coverage. incl. rents (x)	5.9	4.8	3.1	2.0	1.3	0.8	0.7
EBITDA interest coverage. (x)	14.8	11.5	6.4	4.5	2.5	1.6	1.2
Funds from operations/total debt (%)	113.1	73.1	42.5	29.7	16.7	8.4	4.3
Free operating cash flow/total debt (%)	35.2	23.3	11.1	3.2	(0.1)	(2.2)	(2.2)
Pretax return on perm. capital (%)	28.4	20.4	15.4	11.3	9.9	6.8	4.8
Operating income/sales (%)	21.0	16.5	14.5	11.9	10.4	9.3	9.8
Long-term debt/capital (%)	10.8	16.8	30.0	39.7	48.7	57.1	73.8
Total debt/capitalization incl. short term debt (%)	26.2	28.8	36.9	46.7	56.8	65.4	77.8
Total debt/capitalization incl. short term debt (incl. 8 times rents) (%)	37.6	39.7	49.6	59.6	68.5	78.5	81.3

Industrial Long-Term Debt  
 Three-year (1988-1990) medians

	AAA	AA	A	BBB	BB	B	CCC
Pretax interest coverage. (x)	11.1	9.4	4.7	3.2	1.9	0.9	0.6
Pretax interest coverage. incl. rents (x)	5.5	5.1	3.0	2.2	1.5	0.9	0.7
EBITDA interest coverage. (x)	13.7	11.7	6.7	5.0	3.0	1.6	1.2
Funds from operations/total debt (%)	82.9	74.2	45.6	31.7	18.7	8.4	7.0
Free operating cash flow/total debt (%)	24.8	23.4	8.7	3.4	(0.5)	(3.4)	(4.2)
Pretax return on perm. capital (%)	26.2	21.1	16.7	13.0	11.1	7.4	8.1
Operating income/sales (%)	21.6	15.9	14.9	12.0	12.5	9.3	12.3
Long-term debt/capital (%)	12.9	16.6	29.5	39.4	45.7	63.5	79.3
Total debt/capitalization incl. short term debt (%)	25.1	27.6	37.3	48.0	54.8	73.7	85.5
Total debt/capitalization incl. short term debt (incl. 8 times rents) (%)	38.2	38.7	50.9	58.6	65.5	78.5	87.2