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Corporates

Global
Master Criteria

Corporate Rating Methodology

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Related Research

- *Recovery Ratings and Notching Criteria for Non-financial Corporate Issuers* (November 2009)
- *Operating Leases: Updated Implications for Lessees' Credit* (August 2009)
- *Definitions of Ratings and Other Scales (March 2009)*
- *Coercive Debt Exchange Criteria* (March 2009)
- *Country Ceilings* (September 2008)
- *Equity Credit for Hybrids & Other Capital Securities* (June 2008)
- *Rating Industrial Investment Holding Companies* (May 2008)
- *Evaluating Corporate Governance* (December 2007)
- *Analysis of US Corporate Pensions* (September 2007)
- *Parent and Subsidiary Rating Linkage – Fitch's Approach to Rating Entities Within a Corporate Structure* (June 2007)
- *Short-Term Ratings Criteria for Corporate Finance* (June 2007)
- *Fitch's Approach to Rating Sukuk* (March 2007)
- *National Ratings – Methodology Update* (December 2006)
- *The European Pensions Debate* (October 2006)
- *Country-Specific Treatment of Recovery Ratings - Revised (August 2006)*
- *Cash Flow Measures in Corporate Analysis – Amended* (October 2005)

This "*Corporate Rating Methodology*" updates and replaces the Corporate Rating Methodology dated 13 June 2006

Summary

Fitch Ratings' corporate ratings reflect both qualitative and quantitative factors encompassing the business and financial risks of fixed-income issuers and their individual debt issues.

Key Rating Factors

- Industry Risk
- Operating Environment
- Company Profile
- Management Strategy/Governance
- Group Structure
- Financial Profile
  - Cash Flow and Earnings
  - Capital Structure
  - Financial Flexibility

Corporate Ratings

An Issuer Default Rating (IDR) is an assessment of an issuer's relative vulnerability to default on financial obligations, and is intended to be comparable across industry groups and countries. Issuers may often carry both long-term and short-term IDRs. Because both types of IDRs are based on an issuer's fundamental credit characteristics, a relationship exists between them (see *Table 1* and the criteria report "*Short-Term Ratings Criteria for Corporate Finance",* dated 12 June 2007).

Fitch's analysis typically covers at least three years of operating history and financial data, as well as the agency's forecasts of future performance. These are used in a comparative analysis, through which the agency reviews the strength of an issuer's business and financial risk profile relative to that of others in its industry and/or rating category peer group. This comparative analysis includes consideration, where appropriate, of the potential for changes in the issuer's operating environment or financial strategy relative to its ratings. The weighting between individual and aggregate qualitative and quantitative factors varies over time. As a general guideline, where one category is significantly weaker than others, this weakest element tends to attract a greater weight in the analysis.

The ratings of individual debt issues (typically senior unsecured debt ratings) incorporate additional information on priority of payment and likely recovery in the event of default. The rating of an individual debt security can be above, below or equal to the IDR, depending on the security's priority among claims, the amount of collateral, and other aspects of the capital structure. Fitch's criteria report "*Recovery Ratings and Notching Criteria for Non-financial Corporate Issuers"*, dated 24 November 2009, and "*Country-Specific Treatment of Recovery Ratings – Revised",* dated 21 August 2006, address Fitch's methodology in this regard.

Industry Profile and Operating Environment

Industry Risk

Fitch determines an issuer's rating within the context of each issuer's industry fundamentals. Industries that are in decline, highly competitive, capital intensive, cyclical or volatile are inherently riskier than stable industries with few competitors, high barriers to entry, national dominance, and predictable demand levels. Major industry developments are considered in relation to their likely effect on future performance. The inherent riskiness and/or cyclicality of an industry may result in an absolute ceiling for ratings within that industry. Therefore, an issuer in such an

Table 1: Relationship Between Long-Term and Short-Term IDRs

Long-Term IDR	Short-Term IDR
AAA	F1+
AA+	F1+
AA	F1+
AA-	F1+
A+	F1 or F1+
A	F1
A-	F2 or F1
BBB+	F2
BBB	F3 or F2
BBB-	F3 or F2
BB+ to B-	B
CCC to C	C
RD/D	D

Source: Fitch's *Short-Term Ratings Criteria for Corporate Finance*, 12 June 2007

industry is unlikely to receive the highest rating possible ('AAA') despite having a very conservative financial profile.

Equally, reflecting differences in financial, management and country risk profile, not all issuers in low-risk industries can expect high ratings. Instead, many credit issues are weighed in conjunction with the risk characteristics of the industry, to arrive at a balanced evaluation of credit quality.

Operating Environment

Fitch explores the possible risks and opportunities in an issuer's operating environment resulting from social, demographic, regulatory and technological changes. The agency considers the effects of geographical diversification and trends in industry expansion or consolidation required to maintain a competitive position. Industry overcapacity is a key issue, because it creates pricing pressure and, thus, can erode profitability. Also important are the stage of an industry's life cycle and the growth or maturity of product segments, which determine the need for expansion and additional capital spending.

In rating cyclical companies, Fitch's forecasts take a view on credit-protection measures and profitability "through the cycle" — to identify an issuer's equilibrium or mid-cycle rating. The primary challenge in rating a cyclical issuer is deciding when a fundamental shift in financial policy or a structural change in the operating environment has occurred that would necessitate a rating change. Even for less cyclical companies that are likely to suffer profit downturns in a recession, Fitch's analysis focuses on the degree to which the resultant forecast of the financial profile and/or a decline in prospects for the business model may leave an issuer fundamentally weakened by the passage through a recession.

In addition to considering the political risk of operating in a particular country, Fitch considers the country's economic situation, its legal regime, and the development and transparency of relevant markets, in the principal countries in which a company operates. Even if a company operating predominantly in one or a small number of emerging markets has an excellent financial profile comparable with that of a high-rated peer which operates in developed countries' markets, its ratings will still reflect the environment(s) within which it operates.

Country Risk

Fitch's sovereign ratings relate to the likelihood that a sovereign issuer will default on its debt, and are not a proxy of the general financial health of an industrial sector within a given country. However, Country Ceilings, which reflect Fitch's judgement regarding transfer and convertibility risk — and are closely correlated to the sovereign ratings of a country — can have an influence over the ratings of issuers in jurisdictions where the Country Ceiling is lower than 'AAA'. As they capture the risk of the imposition of exchange controls that would prevent or materially impede the private sector's ability to convert local into foreign currency, they represent a general constraint on an entity's foreign currency ratings (see "*Country Ceilings*", dated 12 September 2008, and "*Rating Corporates Above the Country Ceiling*", dated 8 August 2006).

Recovery Ratings, which are based upon the expected relative recovery characteristics of an obligation upon the curing of a default, emergence from insolvency, or following the liquidation or termination of an obligor or its associated collateral, are also constrained by Fitch's judgements of country risks. Recovery Ratings are subject to a soft cap reflecting the creditor-friendliness of different jurisdictions, and enforceability of security in the event of default, as explained in "*Country-Specific Treatment of Recovery Ratings*", dated 21 August 2006.

Company Profile

Several factors indicate an issuer's ability to withstand competitive pressures, which can include, for example, its position in key markets, its level of product dominance, and its ability to influence price. Maintaining a high level of operating performance often depends on product diversity, geographical spread of sales, diversification of major customers and suppliers, and the comparative cost position.

Size may be a factor if it confers major advantages in terms of operating efficiency, economies of scale, financial flexibility, and competitive position. Size may not, however, always support higher ratings. For example, in commodity industries, size is not as important as cost position, since the ability of one participant to influence price in a global commodity is usually not significant.

Management Strategy and Corporate Governance

Fitch's consideration of management strategy focuses on operating strategy, risk tolerance, financial policies and corporate governance. Corporate goals are evaluated, centering upon two main factors — strategy and track record.

Fitch reviews management strategy to form a view on how priorities are balanced between the company's debt and equity investors. This may involve the company's attitude towards capital structure, and the resources allocated to dividend payments and share buybacks.

Equally, strategies for growth may exhibit different levels of risk tolerance. Strategy may be oriented to rapid growth that maximises near-term earnings, with higher uncertainty regarding the stability of future performance, or alternatively exhibit a conservative style geared toward optimizing cash flow over the long term. A policy of growth through acquisition is not necessarily a negative credit factor, especially in a consolidating industry in which new projects would dampen prices for all participants.

Key factors considered are the mix of debt and equity in funding growth, the issuer's ability to support higher levels of debt, and the strategic fit of new assets. The historical mode of financing acquisitions and internal expansion provides insight into management's risk tolerance.

Financial performance over time provides a useful measure of management's ability to execute its operational and financial strategies. Fitch considers management's track record in terms of its ability to create a healthy business mix, maintain operating efficiency, and strengthen its market position. Fitch also gives management credit for delivering on past forecasts or fulfilling previously articulated (successful) strategies when evaluating future growth plans, related financial forecasts, and proposed capital structure.

Corporate governance — effective controls for ensuring sound policies and procedures in boardroom effectiveness, board independence, management compensation, related-party transactions, and integrity of accounting and audit — operates as an asymmetric consideration. Where it is deemed adequate or strong, it typically has little or no impact on the issuer's credit ratings. Where a deficiency which may diminish bondholder protection is observed, the consideration may have a negative impact on the rating assigned. Fitch's approach to evaluating corporate governance is described in the criteria report "*Evaluating Corporate Governance*", dated 12 December 2007.

Ownership, Support and Group Factors

Group Structure

Fitch also considers the relationship between parents and their subsidiaries in assigning IDRs and debt issue ratings. In most cases, separate issuers of debt within a corporate group are typically assigned separate (though potentially identical) IDRs. The criteria report "*Parent and Subsidiary Rating Linkage (Fitch's Approach to*

Rating Entities Within a Corporate Group Structure)", dated 19 June 2007, explains Fitch's linkage framework reflecting the multi-faceted relationships between group entities. These include legal jurisdiction, corporate structures, company bylaws, loan documentation, the degree of integration between the entities, and the strategic importance of each subsidiary.

Financial Profile

The quantitative aspect of Fitch's corporate ratings focuses on an issuer's financial profile and its ability to service its obligations from a combination of internal and external resources. The sustainability of these credit-protection measures is evaluated over a period of time — using both actual historical numbers and Fitch's near-term forecasts — to determine the strength of an issuer's debt-servicing capacity and funding ability.

Fitch intends to publish and periodically update medians and ranges for key credit metrics by rating category for regions, countries, and industries that are sufficiently homogenous for comparisons to be meaningful. Credit metrics are not used in a determinate fashion to assign ratings. Credit metrics for the same rating category should be expected to vary among these groups. For example, an industry with low earnings volatility can tolerate higher leverage for a given credit rating than an industry with high earnings volatility.

Cash Flow Focus

Fitch's financial analysis emphasises cash flow measures of earnings, coverage and leverage. Sustainability of cash flow from operations provides an issuer with both internal debt-servicing resources and a stronger likelihood of achieving and retaining access to external sources of funding.

Fitch regards the analysis of trends in a number of ratios as more relevant than any individual ratio, which represents only one performance measure at a single point in time. Fitch's approach attributes more weight to cash flow measures than equity-based ratios such as debt-to-equity and debt-to-capital. The latter rely on book valuations, which do not always reflect current market values or the ability of the asset base to generate cash flows. In addition, these measures do not reflect an issuer's debt-servicing ability as transparently as those based on cash flow generation.

Cash Flow and Earnings

Key elements in determining an issuer's overall financial health are profits and cash flow, which affect the maintenance of operating facilities, internal growth and expansion, access to capital, and the ability to withstand downturns in the business environment. While earnings form the basis for cash flow, adjustments must be made for such items as non-cash provisions and contingency reserves, asset write-downs with no effect on cash, and one-time charges. Fitch's analysis focuses on the stability of earnings and continuing cash flows from the issuer's major business lines. Sustainable operating cash flow provides assurance of the issuer's ability to service debt and finance its operations and capital expansion without the need to rely on external funding.

Capital Structure

Fitch analyses capital structure to determine an issuer's level of dependence on external financing. Several factors are considered to assess the credit implications of an issuer's financial leverage, including the nature of its business environment and the principal funds flows from operations (see *Table 4*: *Definitions of Cash Flow Measures and Financial Ratios*). Because industries differ significantly in their need for capital and their capacity to support high debt levels, the financial leverage in an issuer's capital structure is considered in the context of industry norms.

As part of this process, an issuer's level of debt is typically adjusted from fair value to nominal debt outstanding, where applicable, and for a range of off-balance-sheet liabilities by adding these to the total on-balance-sheet debt level. Such items include the following:

- Borrowings of partly-owned companies or unconsolidated subsidiaries that may involve claims on the parent issuer.
- Disclosed debt associated with receivables securitisations, if there is recourse to the issuer.
- In cases where debt is described as non-recourse to the rated entity, Fitch reviews each situation to ascertain the relevance of including the debt as part of the total debt calculation.
- Operating lease obligations.

Adjustments may also be made to incorporate pension, health care and other post-retirement obligations where information is available.

In situations where specific liabilities are excluded from the debt calculation, Fitch may also exclude any related cash flow, income or assets. Where appropriate, the issuer's history in supporting off-balance-sheet investments with additional funds will also be a factor in determining the appropriateness of including or excluding these amounts from total debt in the absence of a formal guarantee or commitment.

Preferred stock issues with fixed dividend payments or redemption dates may be considered as quasi-debt instruments, and may be granted a degree of "equity credit" between 0% and 100%, depending on their terms. As Fitch's corporate analysis is heavily cash flow-oriented, the level of equity credit which is granted mainly affects the quantum of debt in adjusted leverage ratios, and 100% of the coupons on hybrid instruments continue to be incorporated in coverage ratios used to measure the issuer's debt-servicing ability. For details of Fitch's approach to equity credit for these hybrid instruments, see the criteria report "*Equity Credit for Hybrids and Other Capital Securities*", dated 25 June 2008.

Financial Flexibility

Financial flexibility allows an issuer to meet its debt-service obligations and manage periods of volatility without eroding credit quality. The more conservatively capitalised an issuer, the greater its financial flexibility. In general, a commitment to maintaining debt within a certain range allows an issuer to cope better with the effect of unexpected events on the balance sheet.

Other factors that contribute to financial flexibility are the ability to redeploy assets and revise plans for capital spending, strong banking relationships, and the degree of access to a range of debt and equity markets. Committed, long-dated bank lines provide additional support. A large proportion of short-term debt in the capital structure can indicate reduced financial flexibility, except in cases where overall gross leverage is very modest — as is the case for a small number of very highly-rated issuers whose very moderate debt burdens are predominantly based on Commercial Paper funding with liquidity back-up. See "*Liquidity Considerations for Corporate Issuers*", dated 12 June 2007, for further discussion of these issues.

Contingent Liabilities and Pensions

Financial flexibility can also be diminished by significant unfunded pension obligations, unfunded post-employment benefits other than pensions (OPEB), and contingent obligations such as guarantees, collateral requirements for derivative exposures, and legal liabilities. Each of these can cause substantial drains on cash flow, which can severely reduce or even eliminate financial flexibility (eg the numerous asbestos bankruptcies). While pension funding requirements vary from country to country, Fitch has developed methodologies for estimating future funding requirements for under-funded pension plans. These are explained in "*The*

European Pensions Debate", dated 16 October 2006, and "*Analysis of U.S. Corporate Pensions",* dated 24 September 2007.

Accounting

Fitch's rating process does not include an audit of an issuer's financial statements. Accounting policies may inform Fitch's opinion on the extent to which an issuer's financial statements reflect its financial performance. Relevant areas include consolidation principles, valuation policies, inventory-costing methods, depreciation methods, income recognition and reserving practices, pension provisions, and treatment of off-balance-sheet items. As part of its rating analyses, Fitch will restate figures, where necessary, to enhance the comparability of financial information across issuers. Fitch also considers the differences among national accounting standards, and the effect these differences may have on the financial results of issuers within the same industry and domiciled in different locations.

Because different accounting systems can affect an issuer's assets, liabilities and reported income, Fitch may make adjustments as appropriate to increase comparability with other companies in the peer group. Such adjustments include those made for revenue recognition, asset values, leased property, contingency reserves, and treatment of tax and off-balance-sheet liabilities. The general principal Fitch applies in its adjustments is to get back to measurements of cash: cash balances, cash flow, and cash needs.

Fitch analysts typically use audited accounts that are prepared according to International Financial Reporting Standards (IFRS) or US Generally Accepted Accounting Principles (US GAAP). If such statements are not available, Fitch will use accounts in local GAAP, other statements provided, and published management comments to make appropriate adjustments for comparative analysis, if appropriate and provided the quality of the auditors or other reviewing parties employed — and disclosure — is adequate.

Limitations of Corporate Methodology

As detailed in Fitch's "*Guidelines for Developing and Revising Criteria"*, dated 30 September 2009, this "*Corporate Rating Methodology"* is a *Global Master Criteria* used in rating non-financial corporates. Since non-financial corporates consist of a broad universe of entities, additional reports — including those specific to a sector, to a class of liability, to a particular form of cross-sector risk, or to a particular form of corporate structure — provide additional background to the application of this *Master Criteria* piece, and are available on fitchratings.com. This *Master Criteria* identifies factors that are considered by Fitch in assigning ratings to a particular entity or debt instrument within the scope of the *Master Criteria*. Not all rating factors in this criteria may apply to each individual rating or rating action. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action.

"Event Risk"

"Event Risk" is a term used to describe the risk of a typically unforeseen event which, until the event is explicit and defined, is excluded from existing ratings. Event risks can be externally triggered — a change in law, a natural disaster, a hostile takeover bid from another entity — or internally triggered, such as a change in policy on capital structure, a major acquisition, or a strategic restructuring.

Merger & acquisition risk is statistically the single most common event risk (see "*International Rating Actions - Rating Changes and Their Causes"*, published 14 November 2006). It can serve as an example of how it may be included or excluded from ratings.

Table 2: Event Risk

Event	Rating incorporation
Company announces opportunistic acquisition, against previously declared strategy of organic growth.	Event excluded from prior rating. Event typically generates a rating review based on materiality and impact, depending on funding mix and cost.
Company announces opportunistic acquisition, in line with previously declared intent to undertake USD20bn of debt-funded acquisitions over three years in the company's current sector.	Event largely included in prior rating. Event nonetheless generates a rating review to ensure parameters of current acquisition consistent with expectations already incorporated in the rating.
Company announces intention to expand through acquisitions. No clear indication of cost or anticipated funding mix.	Event excluded from prior rating. Event typically generates a rating review which will adjust the issuer's outlook or make a change in the rating, depending on Fitch's assessment of likely targets, bid sizes, valuations, and the company's track record in funding mixes.

Source: Fitch

In common with other IDRs, general limitations relevant to the issuer credit rating scale include:

- The ratings do not predict a specific percentage of default likelihood over any given time period
- The ratings do not opine on the market value of any issuer's securities or stock, or the likelihood that this value may change
- The ratings do not opine on the liquidity of the issuer's securities or stock
- The ratings do not opine on the possible loss severity on an obligation should an issuer default
- The ratings do not opine on the suitability of an issuer as a counterparty to trade credit
- The ratings do not opine on any quality related to an issuer's business, operational or financial profile other than the agency's opinion on its relative vulnerability to default.

Appendix I: Guide to Credit Metrics

Fitch uses a variety of quantitative measures of cash flow, earnings, leverage and coverage to assess credit risk. The following sections summarise the key credit metrics used to analyse credit default risk and compare them to measures based on operating earnings before interest, taxes, depreciation and amortisation (EBITDA). EBITDA is still an important measure of unlevered earnings capacity, and the most commonly used measure for going-concern valuations. As such, EBITDA plays a key role in Fitch's recovery analysis for defaulted securities (see the criteria report "*Recovery Ratings and Notching Criteria for Non-financial Corporate Issuers",* dated 24 November 2009).

However, given the limitations of EBITDA as a pure measure of cash flow, Fitch utilises a number of other measures for the purpose of assessing debt-servicing ability. These include funds flow from operations (FFO), cash flow from operations (CFO) and free cash flow (FCF), together with leverage and coverage ratios based on those measures — which are more relevant to debt-servicing ability and, therefore, to default risk than EBITDA-based ratios.

The following definitions are only an introduction to the cash flow measures and credit metrics used by Fitch in its analysis. Detailed definitions and sample calculations are provided in the criteria report "*Cash Flow Measures in Corporate Analysis*", dated 12 October 2005. Specific industries, such as media and telecommunications, may have industry-accepted definitions and practices that differ from the terms described below. These are highlighted in other sector-specific reports.

Table 3: Definitions of Cash Flow Measures

	Revenues
–	Operating expenditure
+	Depreciation and amortization
+	Long-term rentals
=	**Operating EBITDAR**
–	Cash interest paid, net of interest received
–	Cash tax paid
+	Associate dividends (cash dividends received)
–	Long-term rentals
+/–	Other changes before FFO
=	**Funds Flow from Operations (FFO)**
+/–	Working capital
=	**Cash Flow from Operations (CFO)**
+/–	Non-operational cash flow
–	Capital expenditure
–	Dividends paid
=	**Free Cash Flow (FCF)**
+	Receipts from asset disposals
–	Business acquisitions
+	Business divestments
+/–	Exceptional and other cash flow items
=	**Net cash in/outflow**
+/–	Equity issuance/(buyback)
+/–	Foreign exchange movement
+/–	Other items affecting cash flow
=	**Change in net debt**
	Opening net debt
+/–	Change in net debt
	Closing net debt

Source: Fitch

Table 4: Definitions of Cash Flow Measures and Financial Ratios

Cash Flow Measures	
Funds Flow from Operations Post-interest and tax, pre-working capital	FFO is the fundamental measure of the firm's cash flow after meeting operating expenses, including taxes and interest. FFO is measured after cash payments for taxes, interest and preferred dividends but before inflows or outflows related to working capital. Fitch's computation subtracts or adds back an amount to exclude non-core or non-operational cash inflow or outflow. FFO offers one measure of an issuer's operational cash-generating ability before reinvestment and before the volatility of working capital. When used in interest coverage and leverage ratios, interest paid is added back to the numerator.
Cash Flow from Operations Post-interest, tax and working capital	CFO represents the cash flow available from core operations after all payments for ongoing operational requirements, interest, preference dividends and tax. CFO is also measured before reinvestment in the business through capital expenditure, before receipts from asset disposals, before any acquisitions or business divestment, and before the servicing of equity with dividends or the buyback or issuance of equity.
Free Cash Flow Post-interest, tax, working capital, capital expenditures and dividends	FCF is the third key cash flow measure in the chain. It measures an issuer's cash from operations after capital expenditure, non-recurring or non-operational expenditure, and dividends. It also measures the cash flow generated before account is taken of business acquisitions, business divestments, and any decision by the issuer to issue or buy back equity, or make a special dividend.
Operating EBITDA and EBITDAR	Operating EBITDA is a widely used measure of an issuer's unleveraged, untaxed cash-generating capacity from operating activities. Fitch usually excludes extraordinary items, such as asset write-downs and restructurings, in calculating operating EBITDA — unless an issuer has recurring one-time charges which indicate the items are not unusual in nature. The use of operating EBITDA plus gross rental expense (EBITDAR, including operating lease payments) improves comparability across industries (eg retail and manufacturing) that exhibit different average levels of lease financing and within industries (eg airlines) where some companies use lease financing more than others.
Short-Term Liquidity Measures	
Committed bank facilities	In corporate analysis — and particular financial ratios — sources of liquidity include headroom, or undrawn funds, under committed bank facilities relevant for the period. Bank facilities which (i) are a contractual commitment to lend; (ii) have more than one year until maturity; and (iii) Fitch believes that the relevant bank will lend such amounts taking into account breach of covenant or other considerations, can be included as a source of liquidity. Not all countries have such long-term committed bank funding facilities.
CFO or FFO to debt service	This measures cash generation (CFO or FFO) relative to short-term debt service of gross interest expense and debt due within one year.
FCF + available cash + committed facilities/debt service	This measures FCF, plus period-end available cash and period-end undrawn headroom under committed bank facilities (see above) relative to short-term debt service of gross interest expense and debt due within one year.
Coverage Ratios	
Debt and net debt **Gross interest and net interest expense**	Debt represents total debt or gross debt, while net debt is total debt minus (freely available/unrestricted) cash and equivalents on the balance sheet. Recognising the cultural differences in the approach of analysts and investors worldwide, Fitch evaluates various debt measures on both a gross and net debt basis. Distinctions are also made between total interest and net interest expense. The following definitions include only gross interest and gross debt to illustrate the concepts. For a detailed explanation of net debt and net interest calculations, see the criteria report "*Cash Flow Measures in Corporate Analysis*", dated 12 October 2005.
FFO interest coverage FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.	This is a central measure of the financial flexibility of an entity. It compares the operational cash-generating ability of an issuer (after tax) to its financing costs. Many factors influence coverage, including the relative levels of interest rates in different jurisdictions, the mix of fixed-rate versus floating-rate funding, and the use of zero-coupon or payment-in-kind (PIK) debt. For this reason, the coverage ratios should be considered alongside the appropriate leverage ratios.
FFO fixed-charge coverage FFO plus gross interest plus preferred dividends plus rental payments divided by gross interest plus preferred dividends plus rental payments.	This measure of financial flexibility is of particular relevance for entities that have material levels of lease financing. It is important to note that this ratio inherently produces a more conservative result than an interest cover calculation (i.e. coverage ratios on debt-funded and lease-funded capital structure are not directly comparable), as the entirety of the rental expenditure (i.e. the equivalent of interest and principal amortisation) is included in both the numerator and denominator.
FCF debt-service coverage FCF plus gross interest plus preferred dividends divided by gross interest PLUS preferred dividends plus prior-year's debt maturities due in one year or less.	This is a measure of the ability of an issuer to meet debt service obligations, both interest and principal, from organic cash generation, after capital expenditure — and assuming the servicing of equity capital. This indicates the entity's reliance upon either refinancing in the debt or equity markets or upon conservation of cash achieved through reducing common dividends or capital expenditure or by other means.

Table 4: Definitions of Cash Flow Measures and Financial Ratios (Continued)

Leverage Measures	
FFO adjusted leverage Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock DIVIDED by FFO plus gross interest paid plus preferred dividends plus rental expense.	This ratio is a measure of the debt burden of an entity relative to its cash-generating ability. This measure uses a lease-adjusted debt equivalent, and takes account of equity credit deducted from hybrid debt securities that may display equity-like features. Fitch capitalises operating leases as the net present value of future obligations where appropriate and when sufficient information is available. Otherwise, leases are capitalised as a multiple of rents, with the multiple depending on the industry and interest rate environment (see "*Operating Leases: Updated Implications for Lessees' Credit*", dated 13 August 2009).
Total adjusted debt/operating EBITDAR Total balance sheet debt adjusted for equity credit and off-balance-sheet debt divided by operating EBITDAR	
Pension-adjusted leverage	Fitch believes the general increase in unfunded pension liabilities should be addressed in financial analysis. In European ratings, this is done by first adding pension fund deficits to financial ratios to compute supplementary leverage metrics. If, over a number of years, these supplementary ratios are significantly higher than their unadjusted counterparts, further investigation is performed to understand the broader risks posed to the company by its pension scheme, including a company's funding obligations in the jurisdictions in which it operates, the risks inherent in its funding strategy, and — importantly — the implications these have for the cash drain on the company's resources. The criteria reports "*European Pensions—Implications for Contingent Funding of Pension Schemes on Corporate Credit Ratings*", dated 22 February 2006, and "*The European Pensions Debate*", dated 16 October 2006, discuss the topic in depth. In the US, the shortcomings of current accounting treatment for pension obligations, the role of the Pension Benefit Guarantee Corporation in bankruptcies, and the volatility of pension fund values, make an adjusted-debt figure less useful. As a result, Fitch focuses on cash claims in the near term, represented by required contributions, and assesses these obligations in the context of the issuer's operating cash flow rather than replying upon on a leverage metric adjusted for pension obligations. Fitch recognizes the long-term, and volatile, nature of the obligations represented by an underfunded position. The ability of the issuer to meet these obligations is analysed, but the reported GAAP deficit is not included in the US ratio analysis since it is an inadequate measure of the potential cash funding need. See "*Analysis of US Corporate Pensions*", dated 24 September 2007, for a description of Fitch's methods of screening for under-funding and estimating future payments.

Source: Fitch