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Key Credit Factors For The Operating Leasing Industry

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Key Credit Factors For The Operating Leasing Industry

1. S&P Global Ratings is requesting comments on its proposed criteria for rating companies that provide operating leases (in contrast to full-payout finance leases). The proposed criteria articulate the steps in developing the standalone credit profile (SACP) for a leasing company. This article is related to our global corporate criteria (see "Corporate Methodology," published Nov. 19, 2013) and "Principles Of Credit Ratings," published on Feb. 16, 2011.

SCOPE OF THE PROPOSAL

2. This proposed methodology applies to companies where leasing is the chief driver of earnings or to leasing units that operate as part of a more diversified company. The proposed methodology would not apply to entities that we classify as "captive" finance companies, which function primarily as a means to market a company's products (as defined in "Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers," published Dec. 14, 2015). This proposed methodology applies only to companies that retain some economic risk in the underlying asset; if a company instead mainly engages in full-payout leases that essentially transfer the economic risk mostly to the lessee, with only the credit risk retained by the lessor, we would apply our nonbank financial institutions criteria.
3. The proposed methodology also does not apply to companies that rent equipment with a combination of the following characteristics: a) short rental periods; b) highly cyclical cash flows; and c) equipment that is relatively illiquid in industry downturns. Characteristics of relatively illiquid leasing sub-segments include those where the asset has relatively narrow applications, exacerbating demand volatility in cyclical downturns, and where we expect more severe and protracted declines in secondary markets valuation for the equipment. These companies' capacity to support debt leverage comes primarily from cash flow generation, with relatively less capacity to raise funds in a downturn from balance sheet assets. Therefore, we analyze them under our Corporate Methodology, which focuses on earnings and cash flow risk. Examples of companies with these characteristics are companies that rent construction and industrial equipment under mostly short-term contracts.

SUMMARY OF THE PROPOSAL

4. The proposed criteria describe the methodology we use to determine the standalone credit profile (SACP) for leasing companies. Consistent with our Corporate Methodology, our assessment of operating leasing companies takes into account country risk, industry risk, competitive position, cash flow leverage, and modifiers in determining the SACP. While our Corporate Methodology is largely applied, there are some significant differences in deriving the SACP for operating leasing companies. We derive our preliminary cash flow leverage assessment through adjusted EBIT coverage, as opposed to the core ratios defined in the Corporate Methodology. We apply modified versions of the capital structure, financial policy and liquidity analysis in the Corporate Methodology to reflect differences between operating leasing companies and corporate issuers. We derive an issuer credit rating (ICR) from the SACP using the

same approach as in our Corporate Methodology, including the treatment of group or government influence.

SPECIFIC QUESTIONS FOR WHICH WE ARE SEEKING A RESPONSE

5. S&P Global Ratings is seeking market feedback on its proposed methodology and responses to the following questions:
- In your opinion, are there any redundancies or omissions in the criteria proposed below?
 - What is your view of the proposed methodology for assessing a leasing company's business risk position?
 - Do you think we have correctly differentiated asset types in terms of their contract terms and operational stability? If not, please suggest alternatives.
 - Do you think we have identified the best metrics for measuring the profitability and financial leverage of a leasing company, and that we have defined appropriate calibrations for these metrics? If not, please suggest alternatives.

IMPACT ON OUTSTANDING RATINGS

6. We expect these proposed criteria, if implemented as proposed, to result in some rating changes. Based on our preliminary testing, we expect that less than 20% of ratings on operating leasing companies could change. We expect that these changes would be evenly distributed between one-notch upgrades and downgrades. We currently do not expect rating changes of two or more notches.

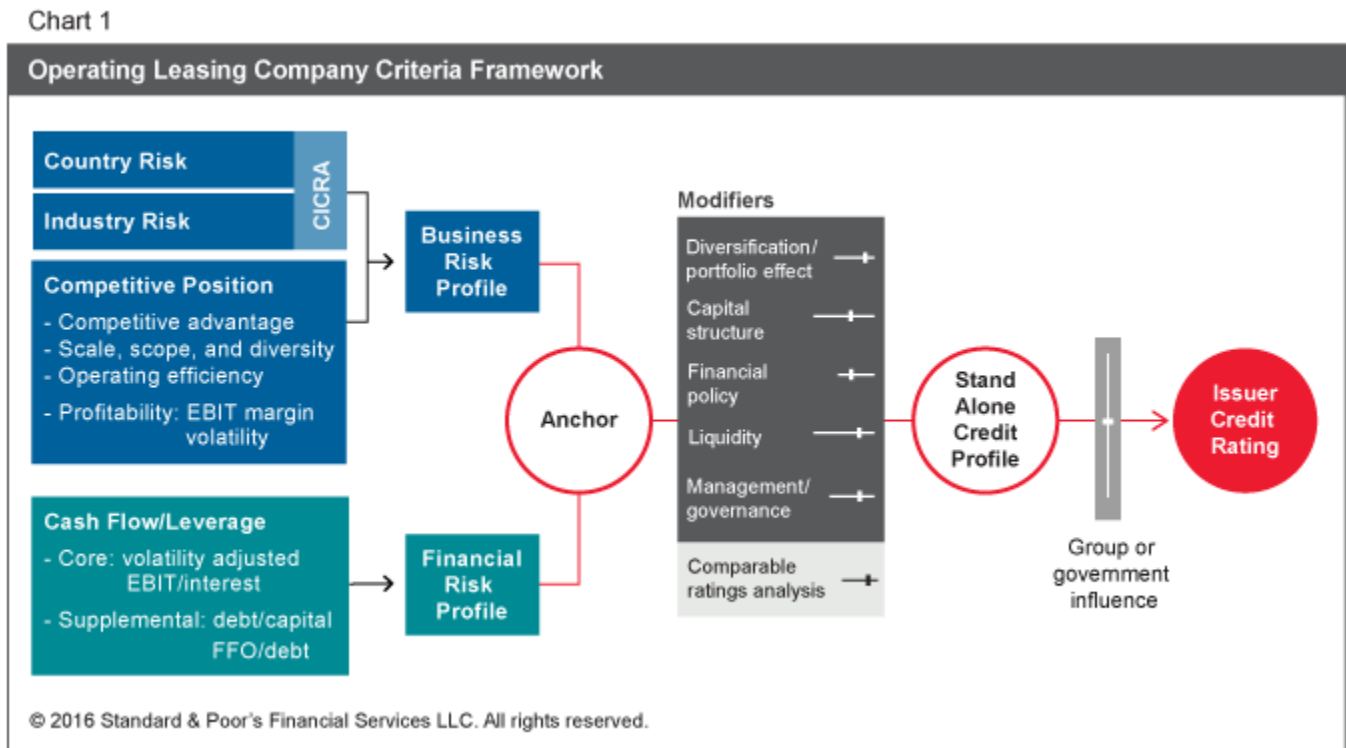
RESPONSE DEADLINE

7. We encourage interested market participants to submit their written comments on the proposed criteria by August 22, 2016 to https://www.standardandpoors.com/en_US/web/guest/ratings/rfc. We will review and consider such comments before publishing our definitive criteria once the comment period is over. Generally, S&P Global Ratings (Ratings Services) may, in cases when the commenter has not requested confidentiality, publish comments in their entirety, except when the full text, in Ratings Services' view, would be unsuitable for reasons of tone or substance.

PROPOSED METHODOLOGY

8. Some of the general characteristics of operating leasing companies, such as the relative stability of operating cash flows, revenue visibility provided by contractual lease agreements with their customers, and the liquidity of their equipment assets (which facilitates sales and secured borrowing), enable these companies to operate at higher leverage than similarly rated corporate entities. Railcar and aircraft leasing companies, with their large, expensive assets and long-term leases, are examples of operating lease companies whose characteristics are more like those of financial institution than of rental car companies, which have very short rental periods but whose equipment is very liquid in the resale market and can be used to raise secured financing even in industry downturns.
9. We use the components of the corporate ratings framework defined in our Corporate Methodology. To determine the assessment of business risk profile, the criteria combine our assessments of industry risk, country risk, and competitive position. Cash flow leverage analysis determines a company's financial risk profile assessment. As in Corporate

Methodology, the analysis then combines the corporate issuer's business risk profile assessment and its financial risk profile assessment to determine its anchor. After we determine the anchor, we use additional factors to modify the anchor and arrive at the SACP. Please see chart 1 below for a schematic representation of the methodology. We apply group and/or government influence when appropriate to arrive at an ICR.



10. Significant differences from the Corporate Methodology include:

- Our analysis of competitive position includes an analysis of the leasing sub-segment in which the company operates (for example, aircraft leasing or truck leasing).
- We derive our preliminary cash flow leverage assessment using adjusted EBIT coverage, as opposed to the core ratios defined in the Corporate Methodology. We apply ratio ranges unique to the industry for operating leasing companies.
- We modify some components of the capital structure analysis in the Corporate Methodology to provide relevant credit ratio tests.
- We modify some components of the liquidity analysis in the Corporate Methodology to reflect the higher leverage and access to asset-based financing for operating leasing companies.
- We modify some aspects of the financial policy analysis regarding ownership by financial sponsors.

11. If we view an issuer's capital structure as unsustainable, or the company is dependent upon favorable business, financial, and economic conditions to meet its commitments on its obligations, or if its obligations are currently vulnerable to nonpayment, then we determine the company's SACP using "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," published Oct. 1, 2012.

A. Industry Risk

12. We view leasing as an "intermediate risk" industry (the equivalent of category 3, as defined in our general corporate criteria; see "Methodology: Industry Risk," Nov. 19, 2013). Our assessment reflects our view of the segment's low (2) cyclical and intermediate risk (3) competitive risk and growth score, based on observed cyclical in revenue and profit. The industry has averaged peak-to-trough (PTT) declines in revenue and profitability of 7.7% and 3.7%, respectively, since 1950 (based on global Compustat data).
13. Fluctuations in supply and demand for leased equipment are the main cause of cyclical. However, demand is a derived demand, caused by changes in the fortunes of the industries served. These industries, mostly transportation, are in turn affected by economic growth, as measured by gross domestic and global product, industrial production, and changes in fuel prices. Changes in supply are a function of investment decisions by participants in each leasing sub-segment, and overly optimistic capital spending can cause excess supply and pressure on pricing.
14. Leasing companies compete on price (i.e., lease rate), but also to varying degrees on the availability of the particular type of equipment sought by a customer. Some types of leased equipment, such as marine cargo containers, are very generic, but others, such as aircraft, are more differentiated. Car rental companies compete on service and geographic coverage, as well as price.

Cyclical

15. We assess the operating leasing industry as having low (2) cyclical. The industry has demonstrated modest cyclical relative to other industries in both revenue and profitability, which are two key measures we use to derive an industry's cyclical score (see "Methodology: Industry Risk," published Nov. 19, 2013). Based on our analysis of global Compustat data, leasing companies experienced an average PTT decline in revenues of about 7.7% during recessions since 1950. The decline was 12.6% during the most recent (2008-2009) economic downturn.
16. Since 1950, operating leasing companies have experienced an average PTT decline in EBITDA margin of about 3.7% during recessions. The decline was 5.2% during the 2008-2009 downturn. The relatively low decline in margins reflects the fact that lease contracts often have multiyear terms, so that only a fraction of them are renewed (and thus exposed to weaker demand and pricing in a downturn) each year. Also, leasing companies respond to weak demand by cutting back, often sharply, on capital spending for new equipment.
17. There can also be some countervailing benefits of cyclical downturns for leasing companies. Some end customers for the equipment/assets may choose to lease instead of buy during periods of economic uncertainty, giving a boost to leasing activity. In addition, such periods can present a buying opportunity for savvy leasing companies, since they can place orders for equipment at reduced prices during a period that may be more stressful to their original equipment manufacturer (OEM) suppliers.

Competitive risk and growth

18. We view operating lease companies as having intermediate (3) competitive risk and growth based on our scoring of these four sub-factors:
 - Effectiveness of industry barriers to entry;
 - Level and trend of industry profit margins;
 - Risk of secular change and substitution by products, services, and technologies; and

- Risk in growth trends.

19. Within this industry, sub-segments vary in terms of their competitive risk and growth characteristics. The overall industry evaluation represents an average, and some of the differences among sub-segments are captured in the asset class economics (ACE) component of competitive position.

Effectiveness of barriers to entry: medium risk

20. Equipment leasing companies provide equipment that a new entrant could acquire and that rarely has proprietary features. However, scale, geographic coverage of leasing offices, and the substantial capital required to become a meaningful competitor provide barriers to entry.
21. Leasing companies have economies of scale in purchasing, in having the desired type and amount of equipment to meet a customer's needs, and in spreading overhead sales and administrative expenses. These factors support a high level of industry concentration in certain leasing sub-segments, in some cases furthered by mergers (e.g., U.S. car rental) leaving only a handful of large competitors.
22. Geographic coverage can be significant for competitors in sub-segments such as car rental (at airport and other locations), marine cargo containers (at ports), and leasing companies that provide maintenance and repair services (some railcar and truck leasing). Operating leasing companies in many cases provide more than just financing, and providing those added services may require a network. Even when that is not the case, the location and availability of equipment can be a differentiating factor, particularly if lease terms are short (and thus equipment is rented and returned frequently).
23. The capital intensity of the leasing industry means that new entrants, or existing participants that seek to grow, need access to large amounts of debt and equity on terms that allow them to earn a reasonable return on investment.
24. The asset intensity of the industry has both positive and negative credit implications. Typically, a lessor's assets comprise equipment with relatively sound intrinsic values (that is, independent of the fortunes of the owner/lessor). Accordingly, leasing companies can attract substantial debt financing—asset-backed, secured, and unsecured—even at higher levels of leverage than similar industrial companies.
25. Many, if not most, leasing companies take advantage of the leveragability of their assets in order to grow or enhance after-tax returns. This debt-capital intensity tends to limit credit quality. Leasing companies can mitigate the high leverage somewhat by matching debt maturities to asset holding periods and lease terms and by using a mix of fixed and floating-rate debt that corresponds to expected fluctuations in rental rates relative to interest rates.
26. Moreover, a leasing company typically has a high ongoing requirement for capital to maintain its fleet. Maintenance and repair and refreshing of the fleet are critical to the success of the operations over the long term. Since the age of the lease fleet is critical to operations, we view leasing capital expenditures as akin to cost of goods sold for other industries. EBITDA is thus a less meaningful metric for both profitability and cash flow adequacy. Although capital expenditures to maintain and refresh the fleet are important for long-term competitive success, they are mostly discretionary in the short term. Leasing companies often scale back their spending sharply during an industry downturn and may thus actually generate more free cash flow than they do during an industry upturn.

Level and trend of industry profit margins: low risk

27. Leasing companies face varying degrees of competitive pricing pressures, but industry profit margins are overall fairly stable, both through cyclical downturns and over long-term trends.
28. Relative to many companies in other industries, leasing companies enjoy superior visibility and lower operational volatility, since most of their revenues are contractually fixed. Indeed, for most industry sub-segments, the leases are multiyear contracts that cover a substantial fraction of the asset's economic life. In many segments, the lessee customer often renews its leases, so that the asset may stay with the same user for most, or even all, of the equipment's economic life. The expiry of the leases is spread over several years, which reduces the companies' year-to-year fluctuations in performance as well as exposure to short-term obstacles or industry problems.
29. Customer credit risk is a less important factor for operating leasing companies than for finance leasing companies or banks. The operating lease companies rely principally on their ability to repossess equipment and re-lease it to other customers. Re-leasing equipment that comes off lease at the end of a contract term is a normal part of their business, so they tend to be well prepared to do so if a customer defaults.
30. The principal cause of revenue and margin fluctuations is re-leasing equipment at lower rates (or having it sit idle) when leases expire in a downturn. For this reason, our assessment of ACE includes consideration of average lease terms, renewal rates, and how much of the total customer industry fleet of equipment is leased. For example, about three-quarters of railroad tank cars in North America, just under half of marine cargo containers globally, and around 40% of passenger aircraft globally are owned by operating leasing companies. In such cases, leased equipment is not just marginal capacity but a core part of the customers' fixed assets.
31. Aside from cyclical fluctuations in demand, industry pricing can be affected by the collective capital spending decisions of competitors in a particular sector. Overly optimistic growth plans can lead to excess industrywide supply of equipment, pressuring pricing for all. This tends to self-correct as leasing companies pull back on capital spending, but the speed of the adjustment is affected also by how long they hold their assets. Long-lived assets such as railcars and aircraft take longer to correct supply/demand imbalances, but are also less likely to experience a rapid increase in supply, because they are relatively expensive to acquire.

Risk of secular change and substitution by service offerings: medium risk

32. Although some types of leased equipment incorporate advanced technology (e.g., aircraft), changes in the overall industry fleet of equipment tend to be evolutionary, in part because of the high capital cost of replacing existing models on a large scale. Other types of equipment (e.g., marine cargo containers) are fairly generic and improve marginally over time. Environmental and safety regulations can impose added costs or force early retirement, as demonstrated by regulations implemented in 2015 on railroad tank cars in the U.S. and Canada. However, even those regulations are usually influenced by the practical necessity of the time and money needed to effect industrywide replacements.
33. Substitution risk relates mainly to customers using alternative forms of acquiring and financing their equipment, and is an ongoing competitive factor. However, by taking on residual risk and offering lease terms shorter than the economic life of the assets, albeit at higher lease rates than finance leases, operating leasing companies provide a useful service to customers that may not wish to own (or be able to finance) all of their equipment. To the extent that the mix of

ownership and leasing has shifted in some sub-segments, it has tended to be in the direction of more leasing. Aircraft operating leasing has grown from a small industry in the 1970s to a global business that owns 40% of the world fleet of passenger planes, a share that is likely to grow further.

Risk in growth trends: low risk

34. Growth prospects mostly mirror those of the industries served, although there are cases, as noted, where operating leasing is gaining market share over ownership. In those instances, the operating leasing companies are benefiting from a gradual trend toward customers seeking more flexible, variable-cost means of obtaining fixed assets, relative to ownership or long-term finance leases, in some industries.
35. Most operating leasing companies we rate serve transportation industries. Some of these sectors are growing faster than GDP. Global air traffic is growing in excess of global GDP, as it benefits from long-term trends toward globalization. Other freight transportation sectors that leasing serves, such as railroads and trucking, are mature industries that grow at a rate around that of nominal GDP. Nontransportation equipment, such as land-based storage containers, and modular space (e.g., trailers used as temporary offices at construction sites or as temporary classrooms at schools) are growing at or slightly faster than GDP.
36. Operating leasing companies, like financial entities, have benefited from the trend toward lower interest rates over the past several decades. The higher rates that operating leases carry, relative to finance leases or secured debt, are less onerous for customers when interest rates are low overall. A reversal in this trend could slow capital spending of all types, including expenditures for equipment on operating leases. Still, we believe that the main potential credit effect of higher interest rates would be on specific companies that have not done a good job matching the term and fixed/floating mix of their lease portfolio to debt used to fund it, an analytical topic that we address on a company-by-company basis in our assessment of capital structure.

B. Country Risk

37. We assess country risk using "Country Risk Assessment Methodology and Assumptions," published on Nov. 19, 2013. For operating leasing companies with exposure to more than one country, we typically measure the proportion of exposure to each country or region based on revenues or assets by country.

BUSINESS RISK PROFILE

38. Under the proposed methodology, we would assess a leasing company's business risk in terms of its country risk, industry risk, competitive position, and profitability, as with companies assessed using our Corporate Methodology. Competitive position, in turn, is a function of: competitive advantage; scale, scope, and diversity; and operating efficiency.

COMPETITIVE POSITION

39. Under the proposed methodology, we would assess a leasing company's preliminary competitive position based on the same sub-factors as described in the Corporate Methodology: competitive advantage; scale, scope, and diversity; and operating efficiency.

40. We use a competitive position group profile (CPGP) that assigns weights of 60% to competitive advantage, 20% to scale, scope, and diversity, and 20% to operating efficiency. We believe this weighting of sub-factors in the CPGP is appropriate for analyzing the competitive position of leasing companies.
41. We use the same assessments for each sub-factor of our preliminary competitive position as in the Corporate Methodology: strong; strong/adequate; adequate; adequate/weak; and weak.

Competitive advantage

42. Our analysis of competitive advantage incorporates two aspects: those that are typical of the particular sub-sector in which the company participates (which we call ACE) and other factors that tend to vary more from company to company. We view ACE as the more important of the two aspects in determining an assessment of a company's competitive advantage, with the relative importance of that and the other factors varying somewhat from sub-sector to sub-sector. For most leasing sub-sectors, we would view ACE as contributing a substantial majority of the overall competitive advantage assessment. However, where brand recognition and service reputation are significant (e.g., car rental companies) or where assets are sufficiently differentiated based on the particular models of equipment leased (e.g., aircraft leasing), we would weight our assessment of ACE somewhat less, although it would still contribute a majority of the overall competitive advantage assessment.
43. We use ACE because there are significant differences in the competitive dynamics between the various sub-sectors of operating leasing. This analytical sub-topic addresses factors such as the typical length of lease contracts, the proportion of an asset's economic life covered by each lease, the proportion of total equipment in the customer industry that is provided by leasing companies, cyclicity of the industry served, and volatility of lease rates. Specific asset or equipment types tend to follow a distinct pattern with regard to important risk factors and profit potential. In assessing ACE we generally consider some of the following:
 - Length of lease contracts and the remaining average lease life is the key focus of our assessment. This is because longer lease terms mean that, absent customer defaults, a lesser proportion of an operating lease company's total lease portfolio will come up for renewal in any given year during an industry downturn. Conversely, a short lease term implies that a large portion of leases might come due and be replaced at lower rates (or not replaced at all if the some equipment sits idle) during a downturn.
 - --Contract lengths of six or more years, with an associated three or more years of remaining life (assuming steady state) are generally consistent with strong.
 - --Contract lengths of two to five years, with an associated remaining life of 1 to 2.5 years (assuming steady state) are generally consistent with adequate.
 - --Contract lengths of less than one year, with an associated remaining life of less than one year (assuming steady state) are generally consistent with weak.
 - Percent of economic life of asset covered by contract period, and likelihood of contract renewal. To the extent that average lease terms are long relative to the asset's economic life, that means that there will be fewer renewals required and the operating lease company will recover a higher proportion of the asset's acquisition cost through rentals under the first lease, limiting risk somewhat. However, if a high proportion of leases are renewed by the same customer, the operating lease company faces re-pricing risk but at least forgoes the expense and uncertainty of seeking a new lease customer for equipment as it comes off lease. For example, the initial lease of a newly

delivered aircraft may average seven to 10 years, representing around a third of the asset's economic life. This is more than a five- to seven-year term of the initial lease for a new railcar, covering only a fifth of its economic life. However, most airlines leasing aircraft do not plan to renew operating leases for the plane's full economic life, while many railcar leases are renewed repeatedly for most or all of the life of the asset. Furthermore, most aircraft operating lease companies that acquire new planes seek to sell them well short of their full economic life (e.g., after 15 years), thus incurring more residual risk than do the specialized railcar operating lease companies.

- Percent of total customer industry assets provided by leasing companies, which in turn helps determine the extent to which leased assets are core or marginal for lessee customers. A higher percentage of total customer industry assets would positively influence our assessment of ACE; for example:
 - --Leasing companies provide a majority of certain types of railcars (tank cars, auto carriers, and intermodal container railcars) in North America, making the leased equipment vital to ongoing rail operations.
 - --About half of the world's marine cargo containers and 40% of the world's aircraft are provided by leasing companies.
 - --By contrast, leasing companies provide a relatively small proportion of trucks operated by trucking companies.
 - Risk of technological obsolescence includes, for example:
 - --Aircraft are technologically sophisticated, and newer models are more fuel efficient than older ones, but these changes evolve over fairly long periods with good visibility for airlines and leasing companies.
 - --Railcars (especially those that carry hazardous or environmentally damaging commodities, such as tank cars) are subject to regulations, but these are typically phased in over time or, where retrofitting is mandated, the cost of such changes is often passed on to the customer.
 - --Transportation, which forms a large portion of leased assets, is overall fairly generic and not subject to pronounced or rapid technological risk.
 - Barriers to entry and extent to which the leasing sector is consolidated or fragmented will affect both competitive dynamics generally and the fortunes of specific companies.
 - Extent of physical disrepair to be expected from lessee usage and contractual provisions that may cover repair costs (e.g., maintenance reserves paid as part of lease rentals).
 - Cyclical demand and utilization in the customer industry served, which varies by sub-segment (e.g., marine cargo container leasing companies serve the volatile international shipping industry).
 - Historical volatility of utilization and rental rates for leased assets.
 - Robustness of used equipment markets. A broad market makes it easier to sell equipment in a downturn (e.g., U.S. car rental companies were able to sell autos, albeit at reduced prices, to rapidly shrink their fleet during the last two economic downturns).
 - Degree of specialization or standardization. Specialized equipment can often command higher lease rates but also costs more to acquire and may have fewer potential users, while commodity-like assets tend to have more competitive operating lease markets. For example, refrigerated marine cargo containers are much costlier than standard dry cargo containers, but serve trade flows that are fairly stable and command much higher rates.
44. Leasing sub-sectors, such as, for example, railroad tank cars in North America, that we would assess as having strong or strong/adequate ACE may include some or all of the following characteristics:
- Average lease terms of six or more years, with an average remaining life of three or more years;
 - Initial lease terms for new equipment that last at least a third of the expected economic life of the asset;
 - Leasing companies provide a significant (more than a quarter) percentage of the total equipment used in the customer industry;
 - There are some barriers to entry and/or the industry is fairly concentrated; and
 - The industry or industries served are fairly stable, at least in regard to its demand for the leased equipment, and

lease rental rates and utilization have tended to have limited or moderate cyclicity.

45. Leasing sectors, such as car rental and modular space rental, which we would assess as having weak or adequate/weak ACE may include some or all of the following characteristics:
- Average lease terms of less than a year;
 - Initial lease terms for new equipment cover very little (less than 10%) of the total economic life of the asset;
 - The industry is very price competitive; and
 - The industry or industries served are cyclical, resulting in volatile demand for leased equipment and in leasing company utilization and lease rental rates.
46. Since leasing companies ordinarily focus on a particular type of equipment, our assessment of ACE plays an especially important role in the determination of the overall competitive advantage. To the extent that a particular leasing company pursues a strategy that is materially different than that of most competitors regarding the factors noted above (e.g., uses short-term rentals in a sector normally characterized by long-term leases, which we view as increasing risk), we would adjust our assessment of ACE to take that into account. Similarly, if the ACE characteristics listed above are notably different for a certain market than for the rest of the sub-sector, we could adjust the ACE assessment upward or downward. For example, the U.K. passenger rail operating companies rely heavily on equipment leased to them by rolling stock operating companies (ROSCOs). The ROSCOs benefit from a supportive regulatory framework that protects their contractual cash flows in the event of lessee insolvency and encourages long-term leasing of rolling stock from them. Based on these and other positive factors, we would assess the ACE of the ROSCOs as better than that for railcar leasing generally.
47. The second aspect of competitive advantage, which relates to other, company-specific aspects, tends to be less important than our assessment of ACE in our determination of a company's overall competitive advantage. However, this aspect can be meaningful in select cases where there is a significant deviation, positive or negative, from the norm. These include:
- For aircraft leasing companies, having a fleet comprised of particular models that are likely to be in higher demand is a significant advantage. Some aircraft models are more widely used or more technologically advanced than others. The lease rates of these models tend to hold up better through industry downturns than those for less popular or older models.
 - Car rental companies spend heavily on advertising and seek to maintain certain standards of service. This can manifest itself in brand awareness and favorable (or unfavorable) customer perceptions (several large global car rental companies have multiple brands, targeted at different customer segments).
 - Available "one-stop-shopping" that translates into higher, and higher-margin, revenues.
 - --Multiple products
 - --Choice of OEMs
 - --Specialized add-ons/tools/consumables
 - --Ancillary services—maintenance, insurance, other services
 - Customer relationships. Multiyear relationships—and especially exclusivity arrangements—evidence satisfaction with the product offering, and such customer loyalty enhances the prospects for stability of a leasing company. Such relationships are more prevalent where the equipment is highly specialized or the lessor provides logistical support or other services.
 - Age of fleet/other popularity features. Although most equipment (aside from aircraft) is fairly generic, a particularly

young equipment fleet relative to the competition—can attract customers, and vice versa. Powered transportation equipment (trucks, automobiles, ships, and aircraft) can be distinguished by fuel efficiency and maintenance requirements, and some lessors may have equipment fleets with more favorable characteristics.

- Some leasing companies control valuable locations that allow them to attract business more easily (e.g., car rental companies with operations at busy airports or container lessors at busy ports). In most cases, the leading competitors all have access to major markets, but control of real estate can represent a barrier to entry for smaller companies.

48. A leasing company that we view as having strong or strong/adequate company-specific aspects of competitive advantage may have some or all of the following characteristics:

- For leasing companies competing in sub-sectors that have equipment that can be significantly differentiated, such as aircraft, ownership of lease equipment that is considered particularly desirable in the market because of its technical features, age, or performance characteristics;
- For leasing companies competing in sub-sectors in which a network of lease or rental locations is a material competitive advantage, such as car rental, possession or control of a broad network. Car rental companies can also distinguish themselves based on superior customer service (timeliness, product offering, responsiveness of employees, etc.).
- For leasing companies in most leasing sub-sectors, scale and a geographically broad network of lease locations is a competitive advantage, although not as important as for high-service companies such as car renters.
- Longstanding relationships with customers in contracts with high renewal rates, which may be based on availability of information technology that allows for easy tracking of individual lease assets, ability to provide maintenance on leased equipment, offerings of ancillary products (e.g., insurance, modified versions of equipment) that a customer values.

49. A leasing company that we view as having weak or adequate/weak company-specific aspects of competitive advantage may have some or all of the following characteristics:

- An absence of lease equipment that is considered particularly desirable in the market based on its technical features, age, or performance characteristics when the leasing company is competing in a sub-sector where such differentiation is a competitive advantage;
- A relatively modest network of lease locations, particularly in sub-sectors such as car rental, where such networks are a competitive advantage; and
- Relatively high customer turnover, which may compel a leasing company to compete on price alone to attract customers.

50. We incorporate our assessments of ACE and company-specific competitive advantage to arrive at an overall competitive advantage assessment, using the relative importance determined by the leasing sub-sector in which the company participates.

Scale, scope, and diversity

51. Although leasing companies tend to concentrate their participation in only one industry segment, they still vary substantially in terms of the scale, scope, and diversity of their operations. The relevant factors may include:

- Market share within segment and within the relevant geographic markets. Some segments are global (aircraft

leasing, marine cargo containers), others national or regional (railcar leasing, car rental), although in the latter case a company may have a global footprint competing in multiple national/regional markets.

- Offering broad equipment range within a particular segment rather than an overly-narrow product range. For some equipment categories, providing choices from more than a single OEM enhances the scope and diversity of the leasing company. However, diversity of equipment is less important than having the equipment that is likely to be in high demand.
- Possessing adequate service capabilities, where relevant (for example, auto rental, container leasing, and truck leasing); service capability is important both in terms of attracting and retaining business and diversifying the revenue stream.
- Ability to provide other ancillary services, such as fleet management.
- Geographic footprint. While some leasing segments are global or national in nature, others are local. In the latter instance, we assess the extent of a leasing company's diversity in terms of its multiple local operations and its ability to shift resources between them.
- Customer diversity. Typical customer concentration varies significantly. While customer concentration is generally viewed negatively, high customer credit quality or diversity of geography or industries among the top customers may mitigate this. Aircraft leasing companies often serve weak airline customers, but if they are geographically diverse and the largest customers (sometimes 5%-10% of total lease revenues) are not particularly weak, this is less of a concern.

52. A leasing company that we view as having strong scale, scope, and diversity may have some or all of the following characteristics:

- Substantial share in the markets in which it competes;
- Customers that are broadly diversified by industry or geography; and
- An overall scale of operations, as measured by revenues and assets, that is large relative to other operating leasing companies in the same or other leasing sub-sectors.

53. A leasing company that we view as having weak scale, scope, and diversity may have some or all of the following characteristics:

- Relatively small share in the markets in which it competes;
- Limited diversity in its customer base, unless the customers are of high credit quality or the contractual relationship with those customers is such that we believe there are high barriers to substitution by a competitor; and
- An overall scale of operations, as measured by revenues and assets, that is small relative to other operating leasing companies in the same or other leasing sub-sectors.

Operating efficiency

54. Leasing companies can differentiate themselves operationally in several ways:

- Fleet utilization. Leasing companies typically operate with utilization of 85%-95%. Chasing higher levels of utilization at times of low rates or when rates seem to be rising is, of course, counterproductive. So a leasing company needs to anticipate rate changes and balance its approach. We assess the level of capacity utilization relative to peers while being mindful of the rates being quoted on new contracts.
- Lease rental rates. Leasing companies charge rates based on the balance of supply and demand in the markets where they compete. They also seek to maximize revenues by trading off utilization against rental rates. A more

comprehensive measure that includes the effects of both utilization and rental rates is asset yield, which we define as lease revenues divided by the book value of assets available for lease.

- Turnaround time. Related to utilization, a successful leasing company needs to be nimble in dealing with equipment coming off lease, to repair, refurbish, and reposition it for another contract as quickly as possible. A leasing company should also be competent at repossessing (and re-leasing) equipment when necessary.
- Supplier relationships. A strong leasing company typically enjoys beneficial relationships with OEM suppliers. (Leasing companies are often the largest or one of the largest customers of the OEM, and/or may grant the OEM preferred vendor status. On the other hand, a leasing company should avoid being dependent on a single supplier as a sole source.) These may include preferential pricing, and preferential access to equipment when order lead-times are long.
- Purchasing acumen. It can be critical that a leasing company buys the right equipment for its fleet at favorable prices. It must be able to correctly anticipate which units will be in demand—sometimes well in advance. For example, an aircraft lessor must consider the features that will make one model more desirable than others in the future—fuel efficiency, size, range, noise levels, etc.—when ordering for its fleet. A railcar lessor must anticipate future demand for various commodities in deciding the car types that should make up its fleet.
- --Additionally, getting a good price for fleet purchases is often a function of timing—or pursuing contrarian strategies. To get advantageous pricing, the purchaser must correctly anticipate which units will be in demand before everyone else comes to the same conclusion. A leasing company may also take advantage of an OEM's cyclical lack of demand to place large multiyear orders.
- --We assess a leasing company's purchasing abilities based largely on its track record. However, market timing is inherently more risky. We would be wary of company strategies that, in effect, place large bets on its ability to outsmart the market.
- Credit underwriting and customer credit quality. We assess the credit quality of individual customers if they account for a significant amount of revenues of the leasing company. We also assess the aggregate credit dynamics of the customer base.
- --Empirically, credit losses have not been much of an industry problem—especially when taking account of recovery upon repossession. Still, we seek to ascertain that a leasing company is prudent in controlling credit losses through appropriate underwriting and diligent workout/repossession efforts. While a leasing company may not experience material losses on receivables, the bankruptcy of a customer means that assets on lease will often be returned at a low point in the industry cycle and thus command much lower rates on the next lease. This, more so than receivables write-offs, is the principal economic risk relating to customer credit quality for leasing companies.

55. A leasing company that we view as having strong operating efficiency may have some or all of the following characteristics:

- High rates of equipment utilization, relative to competitors in the same sub-sector;
- High rental rates, relative to competitors in the same sub-sector; and
- Low credit losses and demonstrated skill in repossessing equipment from defaulting or troubled lessee customers, and re-leasing it to new customers.

56. A leasing company that we view as having weak operating efficiency may have some or all of the following characteristics:

- Low rates of equipment utilization, relative to competitors in the same sub-sector;
- Low rental rates, relative to competitors in the same sub-sector; and

- High credit losses or difficulties in repossessing and re-leasing equipment, which may manifest itself in high costs or greater-than-typical delays.

PROFITABILITY

57. The income statements of operating lease companies are fairly simple. Lease revenues (and sometimes, to a much lesser degree, related services) are generated from owned assets. The principal expenses are depreciation; sales, general and administration (SG&A, which includes the cost of maintenance, re-leasing and repossessions), and interest expense. Companies that provide long-term leases with few added services (e.g., aircraft leases) will have large amounts of depreciation and interest costs, but relatively low SG&A expense. Conversely, companies that offer short-term rentals and offer significant related services, such as car rental companies, will have much greater overhead costs.
58. The profitability measures for operating lease companies typically cannot be compared in terms of levels with those of industrial companies. Operating margins, both before and after depreciation, tend to be quite a bit higher than for comparably rated industrial companies. This reflects the substantial depreciation and interest costs, and, in some segments, modest SG&A expense. EBITDA margins for aircraft leasing companies can exceed 80% or even 90%. Margins are narrower for more service-intensive operating lease companies. However, because of the capital intensity of leasing, return on capital is low compared with comparably rated industrial companies. This, and the relative stability of earnings and cash flow, is what causes operating lease companies to use higher financial leverage than most industrial companies in order to achieve an acceptable return on equity.

a) Level of profitability

59. We determine the profitability level on a three-point scale: above average, average; and below average. We use EBIT margin as the primary indicator of an operating leasing company's profitability level and compare companies to peers in the context of the overall industry in which they operate, not just in their narrower subsector.
60. Our analysis to determine thresholds for levels of profitability (see table 1 below) incorporates the performance of global operating leasing companies during the past two years and our expectation of performance over three years of forecast. For this assessment, we typically determine the five-year average EBIT margin using the last two years of historical results and three years of forecasted results. We may put more emphasis on forecast years if historical data is not deemed representative, or to take into account deteriorating or improving profiles where prospective ratios meaningfully differ from average ratios.

Table 1

EBIT Margin Profitability Threshold Levels			
Below average	< 18%		
Average	18-45%		
Above Average	> 45%		
Operating Leasing Companies' EBIT Margin Thresholds			
	Below average	Average	Above Average
EBIT Margin	< 18%	18-45%	> 45%

b) Volatility of profitability

61. We determine the volatility of profitability on a six-point scale with 1 capturing the least volatile companies and 6 capturing those with very high volatility. Volatility of profitability is determined using the standard error of regression (SER) assessment, in accordance with our global corporate criteria. EBIT margin is the metric we use to determine the SER for operating leasing companies. We determine SER only when companies have at least seven years of historical annual data to ensure the results are meaningful. In accordance with the general corporate criteria and subject to certain conditions being met, we may adjust the SER assessment by up to two categories better (less volatile) or worse (more volatile).
62. For operating leasing companies, one potential source of volatility in reported results is write-down of assets. Although such asset value adjustments provide useful information in judging absolute profitability over a multi-year period, they can distort measures of volatility of profitability. The timing of such losses is somewhat artificial—there is no immediate cash effect when the write-down occurs, and the real economic effect of a loss in value is future reduced lease rentals or an eventual loss on sale. Accordingly, we may adjust the results of the SER assessment in a favorable direction if material write-downs are distorting the volatility of profitability. If we do not have sufficient historical information to determine the SER, we follow the global corporate criteria guidelines to determine the volatility of profitability assessment.

COMPETITIVE POSITION

63. We combine our assessment of the preliminary competitive position and profitability as described in the Corporate Methodology to arrive at a competitive position.

BUSINESS RISK PROFILE

64. We combine our corporate industry and country risk assessment (CICRA) and competitive position assessments as described in the Corporate Methodology to arrive at the business risk profile.

FINANCIAL RISK PROFILE

65. Under the proposed methodology, we would assess an operating leasing company's financial risk profile based on our assessment of its cash flow leverage, as is the case under the Corporate Methodology. However, the way we assess cash flow leverage would differ from that in the Corporate Methodology.

FINANCIAL RISK PROFILE: ACCOUNTING AND ANALYTICAL ADJUSTMENTS

66. Our analysis of a company's financial statements begins with a review of the accounting to determine whether the statements accurately measure a company's performance and position relative to its peers and the larger universe of corporate entities. To allow for globally consistent and comparable financial analyses, our rating analysis may include

quantitative adjustments to a company's reported results. We use "Corporate Methodology: Ratios And Adjustments," Nov. 19, 2013, and apply several additional industry-specific adjustments.

67. Operating lease companies may provide finance leases as well as operating leases to their customers. Payments made by customers under the finance leases are accounted for as interest income (part of revenues) plus repayment of principal (not recorded as revenue, but rather as a non-operating source of cash flow). Inasmuch as all of the payments, both interest and repayment of principal, are sources of cash flow to service debt, we add the repayment of principal to funds from operations, reclassifying those payments as an operating source of cash flow.
68. Operating lease companies often sell equipment as part of a normal pattern of acquiring, leasing out, and disposing of their assets. To the extent that gains and losses realized on such equipment sales are part of the normal turnover of leased assets, we include such gains and losses as an adjustment to depreciation and an operating expense.

FINANCIAL RISK PROFILE: CASH FLOW LEVERAGE

69. We assess cash flow leverage as minimal (1), modest (2), intermediate (3), significant (4), aggressive (5), or highly leveraged (6). We use a combined score based on EBIT interest coverage, an adjustment for volatility, and debt to capital (debt to debt plus equity) as our core ratio. We use funds from operations to debt, and total debt to total capital as supplemental ratios. We calculate weighted average ratios using the same range of years and the same weightings for each year as in the Corporate Methodology, with one exception. We use the standard weighting of years (10% two years earlier, 15% previous year, and 25% each for the current year, next year, and two years in the future) even when there is negative cash flow available for debt repayment. Because operating leasing companies are more highly leveraged than most other corporate issuers, and because they typically use debt to finance a substantial portion of their capital spending, cash flow available for debt repayment is negative most of the time. Often this does not cause deterioration in credit ratios, and even when it does, in many cases this reflects investment to meet rising demand. Therefore we do not view negative cash flow available for debt repayment, in itself, as reason to use a weighting of years that is different than the standard weighting. However, if there is negative cash flow available for debt repayment and credit ratios are weakening because of deteriorating operating performance, aggressive growth in excess of what we would expect to for the company to meet a normal cyclical upturn, or an increase in returns to shareholders (dividends and share buybacks), then we would use the alternative weighting of 30% for the current year, 40% for the next year, and 30% for the year thereafter.
70. Core ratio: We use EBIT interest coverage to assess the financial leverage of operating leasing companies. We believe that this ratio is reflective of financial risk for operating leasing companies across various different sub-sectors. We believe that the core ratios we use for analyzing most corporate issuers, debt to EBITDA and funds flow to debt, are less useful for comparisons across various types of equipment leasing companies because they measure cash flow available for debt service before accounting for depreciation expense. Operating leasing companies that own equipment with relatively short economic lives or that hold that equipment for a relatively short period (e.g., car rental companies that hold their automobiles for only a year before selling them and buying new ones) may generate strong EBITDA and funds from operations, but they also have large capital spending needs to renew their equipment fleet. Conversely, operating leasing companies that own long-lived equipment (e.g., railcars, aircraft) may not generate as

much EBITDA or funds from operations each year, but they also have more modest capital spending needs, as their assets last a long time. Accordingly, we would not consider a funds-flow-to-debt ratio or a debt-to-EBITDA ratio of a given level as indicating comparable financial risk for two operating leasing companies whose lease asset lives and holding periods are very different.

71. To determine a cash flow leverage assessment, we calculate our core and supplemental credit ratios for a time series, using the weightings indicated in the Corporate Methodology (except for entities with negative cash flow available for debt repayment and deteriorating credit ratios as explained in paragraph 69). We then compare the weighted average EBIT interest coverage ratio to the ranges in table 2, below (Operating Leasing Company Core Cash Flow Leverage Ratio) to determine an initial cash flow leverage assessment.
72. We may modify our assessment based on historical volatility of EBIT interest coverage, typically measured over the past seven years. We use the ranges indicated in table 3, below (Adjustment For Volatility Of EBIT Interest Coverage) to confirm or modify upward or downward by one category the initial EBIT interest coverage assessment. In limited circumstances, we may also modify the adjustment derived in table 3 for expected changes in EBIT interest coverage volatility if we believe that the conclusion indicated by the SER of EBIT interest coverage is not representative of a company's ongoing future volatility, or a level of volatility observed in a peer. Examples include, but are not limited to:
- Large asset write-downs that, when accounted for, make EBIT appear volatile but whose revenue and cash flow implications are spread out over many years.
 - The acquisition or disposal of other companies or of large portfolios of equipment;
 - EBIT volatility caused by business units or subsidiaries that have since been sold or closed down; and
 - Stable EBIT, which we believe is unrepresentative because it occurred during a period of benign economic conditions and the company operates in a leasing sub-sector that we believe is likely to be more volatile in the future.
73. If we modify the adjustment for volatility of EBIT interest coverage, the change would be limited to one category. For example, if the SER of EBIT coverage suggests raising the assessment by one category we could choose not to change the assessment, however, we could not choose to lower the assessment by one category.

Table 2

Operating Leasing Company Core Cash Flow Leverage Ratio	
EBIT interest coverage (x)	Score and descriptor
> 3.5	1 - Minimal
2.4-3.5	2 - Modest
1.7-2.4	3 - Intermediate
1.3-1.7	4 - Significant
1.1-1.3	5 - Aggressive
< 1.1	6 - Highly leveraged

Table 3

Adjustment For Volatility Of EBIT Interest Coverage	
Standard error of regression of EBIT coverage	Adjustment
0-0.15	1 category better
0.16-0.92	No change

Table 3**Adjustment For Volatility Of EBIT Interest Coverage (cont.)**

Standard error of regression of EBIT coverage	Adjustment
> 0.92	1 category worse

74. As part of our assessment of cash flow leverage, we consider a supplemental ratio of debt to total capital (debt to debt plus equity), using table 4:

Table 4**Debt To Capital Assessments**

Debt to debt plus equity (%)	Assessment
< 45	1 - Minimal
45-60	2 - Modest
60-75	3 - Intermediate
75-82	4 - Significant
82-90	5 - Aggressive
> 90	6 - Highly leveraged

75. In addition, we consider a second supplemental ratio of funds from operations (FFO) to debt, using table 5, but do so within the context of the various leasing sub-sectors. We divide the operating leasing companies into three groups, based on the length of the economic lives of the assets and the typical length of the lease contracts. Group 1 comprises leasing companies that have long-lived assets (more than 20 years, such as aircraft and railcars) and typically have fairly long (five years or more) lease terms. Group 2 contains leasing companies that have medium-lived assets (5-20 years) such as marine cargo containers and trucks) and mostly medium-term (2-5 years) leases. Group 3 contains leasing companies that either have shorter-lived assets, hold their assets for a fairly short period (e.g., rental cars), or lease medium-lived assets on a short-term (less than a year) basis. If we cannot easily assign an operating leasing company to groups 1 or 3, due to an atypical mix of characteristics, we would generally assign it to group 2.
76. If we view an operating leasing company as having a less favorable assessment of ACE in our analysis of competitive advantage than is typical of its leasing sub-sector, then we will also use a FFO to debt group table that requires higher ratios for each financial risk assessment than would normally be the case for a company in that sub-sector (e.g., the group 3 column, rather than the group 2 column). Conversely, if we view an operating leasing company as having a more favorable assessment of ACE than is typical of its leasing sub-sector, we would use a FFO to debt group that requires lower ratios for each financial risk assessment than would normally be the case for a company in that sub-sector (e.g., the group 1 column, rather than the group 2 column). The change in the FFO to debt group cannot exceed one category in either direction (e.g., if a railcar leasing company, usually assigned to group 1, is viewed as having an assessment of ACE that is much less favorable than its peers, we would still use a FFO to debt group that is only one group different, i.e. we would use the group 2 column, rather than the usual group 1 column).

Table 5**Operating Leasing Company Supplemental Ratio: FFO To Debt (%)**

Assessment	Group 1	Group 2	Group 3
1- Minimal	> 35	> 50	> 60

Table 5**Operating Leasing Company Supplemental Ratio: FFO To Debt (%) (cont.)**

Assessment	Group 1	Group 2	Group 3
2- Modest	23-35	35-50	45-60
3- Intermediate	13-23	23-35	30-45
4- Significant	9-13	13-23	20-30
5- Aggressive	6-9	9-13	12-20
6- Highly leveraged	< 6	< 9	< 12

FFO--Funds from operations.

77. If either or both of the supplemental ratios indicates a cash flow leverage assessment that is different from that indicated by our assessment based on the core ratio, we may modify the assessment from the core ratio by up to one category in the direction (better or worse) indicated by the supplemental ratios. We first consider the debt to total capital supplemental ratio. We would typically modify the assessment from the core ratio using the debt to total capital supplemental ratio only if that supplemental ratio is two categories different from the core ratio assessment. In that situation, we typically would choose to modify the core ratio assessment, rather than leave it unchanged. However, if the debt to total capital supplemental ratio is two categories different from the core ratio assessment, but the FFO to debt supplemental ratio is one or more categories different from the core ratio assessment in the opposite direction, then we may choose either to modify the core assessment or leave it unchanged. If we do modify the core assessment based on the debt to total capital supplemental ratio, then we would not further modify the assessment based on the FFO to debt supplemental ratio, as we apply only, at most, one supplemental ratio change. Alternatively, if we do not modify the core assessment based on the debt to total capital supplemental ratio, then we may modify the core assessment based on the FFO to debt supplemental ratio, using the same approach as described in the Corporate Methodology for supplemental ratios in general.
78. Lastly, we determine the final cash flow leverage assessment based on a volatility adjustment, consistent with the approach outlined in the Corporate Methodology (in the section "Aggregating the Credit Ratio Assessments"). The application to operating leasing companies is identical, except that the generalizations regarding typical percentage declines in EBITDA for volatile and highly volatile companies are not applicable to operating leasing companies, for which we focus on EBIT as a measure of operating earnings. Typically a company that we assess as volatile would experience a decline of more than 30% of EBIT in periods of stress. Typically, a company that we assess as highly volatile would experience a decline of more than 50% of EBIT in periods of stress.

DIVERSIFICATION/PORTFOLIO EFFECT

79. We apply the same criteria as in the Corporate Methodology.

CAPITAL STRUCTURE

80. We apply the same criteria as in the Corporate Methodology, but with one modification to reflect the different credit

ratios that we use to assess cash flow leverage for operating leasing companies. Thus, in determining when to evaluate foreign currency risk through further analysis (in the section "Capital Structure Analysis: Assessing the Subfactors, Subfactor 1: Currency Risk of Debt"), we do not use a test of debt to EBITDA of greater than 3.0x. Rather, we would undertake the further analysis when we assess the core ratio (as determined in paragraph 70 of these criteria) as significant (4), aggressive (5), or highly leveraged (6), and the situation meets the other conditions specified in the Corporate Methodology.

FINANCIAL POLICY

81. We apply the same criteria regarding financial policy as in the Corporate Methodology, except that the treatment for financial sponsor-owned operating leasing companies differs in some aspects. Because interest and principal payments are a large claim on cash flow for leasing companies, and because access to capital markets is crucial for success, financial sponsor owners have been wary of placing very high leverage on operating leasing companies. In many cases, such companies have credit ratios that are consistent with significant (4) or aggressive (5) financial risk profiles.
82. We assess the influence of financial sponsor ownership as FS-4, FS-5, FS-6, and FS-6 (minus) depending on how aggressive we assume the sponsor will be and assign a financial risk profile accordingly. In some cases, financial sponsor-owned issuers will receive an assessment of FS-6 or FS-6 (minus), leading to a financial risk profile assessment of highly leveraged (6). An FS-6 assessment indicates that, in our opinion, forecasted credit ratios in the medium term are likely to be consistent with a highly leveraged financial risk profile, based on our assessment of the financial sponsor's financial policy and track record. An FS-6 (minus) would likely be applied to companies that we forecast to have near-term credit ratios consistent with a highly leveraged financial risk profile, but we believe the financial sponsor is very aggressive and that leverage could increase materially from our forecasted levels.
83. A financial sponsor-owned entity could receive an assessment of FS-5 when we project that the company's leverage will be consistent with an aggressive (5) financial risk profile, we perceive that the risk of re-leveraging is low based on the company's financial policy and our view of the owner's financial risk appetite, and liquidity is at least adequate.
84. In some cases, we could assess the financial policy of a financial sponsor-owned entity as FS-4. This assessment will apply when the following conditions are met: We project that leverage is currently consistent with a significant (4) financial risk profile, the company has said it will maintain leverage at or below this level, and liquidity is at least adequate.

Table 6

Financial Risk Profile Implications For Sponsor-Owned Leasing Companies		
Assessment	What it means	Guidance
FS-4	Financial risk profile set at Significant (4)	Issuer must meet all of the following conditions: • EBIT interest coverage is greater than 1.3x and debt to capital is less than 82% and we forecast the ratios to remain at those levels; • There is evidence that we believe is credible that the company is committed to a level of leverage that is consistent with a significant or better financial risk profile (that is, debt to capital less than 82%); and • We assess liquidity to be at least adequate, with adequate covenant headroom.

Table 6**Financial Risk Profile Implications For Sponsor-Owned Leasing Companies (cont.)**

Assessment	What it means	Guidance
FS-5	Financial risk profile set at Aggressive (5)	Issuer must meet all of the following conditions: '• EBIT interest coverage is greater than 1.1x and debt to capital is less than 90% and we forecast the ratios to remain at those levels; '• We believe the risk of releveraging beyond 90% is low; and '• We assess liquidity to be at least adequate, with adequate covenant headroom.
FS-6	Financial risk profile set at Highly leveraged (6)	Debt to capital is greater than 90%, but we believe leverage is unlikely to increase meaningfully beyond these levels.
FS-6 (minus)	Financial risk profile set at Highly leveraged (6), and anchor reduced by one notch (unless this results in a final rating below 'B-')	In determining the anchor, the financial risk profile is Highly leveraged (6), but we believe the track record of the financial sponsor indicates that leverage could increase materially from already high levels.

LIQUIDITY

85. We apply the liquidity criteria applicable to corporate issuers (see "Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers", published Dec. 16, 2014), with some modifications.
86. In determining sources of liquidity for purposes of calculating the following determinations: A/B: Liquidity sources (A) divided by uses (B), and A-B: Liquidity sources (A) minus uses (B), we normally do not include uncommitted sources of debt financing. However, when assessing liquidity for operating leasing companies we do include secured debt used to finance acquisition of new equipment, because these companies generally can borrow on a secured basis for such purposes even in an industry downturn. In our liquidity assessment, we would assume an advance rate (loan-to-value) that is more conservative than what the company could arrange under normal circumstances, and reflects borrowing arrangements that we believe would pertain in a stress scenario.
87. In assessing uses of liquidity, we apply the corporate liquidity criteria, with one modification to the amount of capital expenditures. In determining the amount of capital expenditures for operating leasing companies that we assess as strong or exceptional, we use an average of the forecast capital expenditures and the minimum capital spending that we believe they would make in a stress scenario. This is intended to approximate a moderately reduced level of capital spending. For leasing companies, the minimum spending is usually only contractually committed acquisitions of equipment plus an amount to cover minimum operating requirements (e.g., information technology). Using the average of minimum and forecast capital spending (rather than the full amount of forecast spending, as specified in the corporate liquidity criteria for strong and exceptional assessments) reflects the fact that operating leasing company capital spending is almost all discretionary in nature, and even strong companies usually choose to reduce spending in an industry downturn as a matter of choice rather than necessity. For leasing companies that buy and sell rental equipment on a fairly short-term basis (holding equipment for only 1-2 years, as do car rental companies), we net the estimated equipment disposals against capital spending for new equipment and use the net capital spending as a use of cash (or a source of cash, if disposals exceed capital spending).
88. The tests to achieve each liquidity assessment are the same as those specified in the Liquidity Criteria as regards the A/B ratio.

MANAGEMENT AND GOVERNANCE

89. We apply the management and governance criteria applicable to corporate issuers (see "Management And Governance Credit Factors For Corporate Entities And Insurers," published Nov. 13, 2012).

COMPARABLE RATINGS ANALYSIS

90. We apply comparable ratings analysis as applicable to corporate issuers (see Corporate Methodology). Alternatively, for operating leasing companies that have material nonleasing operations, we may apply a comparable ratings analysis adjustment if we believe that the business risk and financial risk of the nonleasing operations has better or worse overall risk characteristics than the leasing operations, or the nonleasing operations are sufficiently material (usually more than 20% of EBITDA) in size to affect the overall credit profile relative to peers. In any case, the maximum adjustment to the anchor as a result of using the comparable ratings analysis will be one notch, similar to the approach in the Corporate Methodology.

RELATED CRITERIA AND RESEARCH

Related Criteria

- S&P Global Ratings Definitions, June 29, 2016
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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