Principles of Assessing Industry Factors in the Rating Analysis of Non-financial Corporations

Wholesale and Commodities Trade

This document is part of the Methodology for Assigning Credit Ratings to Non-financial Corporations under the International Scale (hereinafter, the Methodology) and describes the specifics in conducting rating analyses of the operational and financial profiles of wholesale and commodities trade corporations.

The document provides lists of indicators used, factor weights, assessment score boundaries for quantitative factors, and the principles of assessing qualitative factors for companies in the industry.

1 Industry Companies

The assessment approaches described in this document are applicable to wholesale companies[1] whose core business is focused on the following two areas:

- Wholesale trade in general goods (hereinafter, Goods Traders, or GTs). In contrast with Commodity Traders, Goods Traders are generally characterized by a higher degree of diversification into global manufacturing and processing assets.
- Wholesale trade in commodities (hereinafter, Commodity Traders, or CTs). Commodity Traders are companies that have more than 70% of their income (in EBITDA terms) from trading operations and the risks of their activities are associated with trading in commodities. These companies sell physical volumes of commodities using derivatives primarily to hedge risks. Commodity Traders typically have large physical stocks of commodities, logistics assets, and may have vertical diversification into production and processing assets associated with their core business. In some cases, a wider range of goods may be traded.

2 Rating Factor Structure

Creditworthiness analyses of rated entities in the wholesale trade industry are based on assessing six factors, which are combined in two profiles and have their own weights totaling 100%. The weights presented in Table 1 are base weights, i.e., they may change depending on the assessment scores derived for factors (see Subsection 4.1.3 of the Methodology for a description of the floating weights concept).

Table 1. Scorecard for the wholesale and commodity trade sector

Profile	Factor	Factor weight	Sub-factor
Operational profile	Business profile	30%	Market position and its stability
			Product, operations and geographic diversification, product offer and its riskiness, customer relationship with manufacturers and buyers, availability of logistics assets
	Financial policy and corporate governance	20%	Financial policy
			Corporate governance
Financial profile	Size	15%	Revenue (USD bln)

[1] Hereinafter, unless indicated otherwise, the term "wholesale companies" includes companies engaged in both the wholesale of general goods and the wholesale of commodities.

			GT. Total Assets (USD bln) **CT.** Fixed assets (USD bln)
	Leverage	20%	Gross debt to Book Capitalization
			Net debt to EBITDA
			FFO before interest to gross debt
			Qualitative leverage assessment
	Coverage	10%	FFO before interest to interest
	Liquidity	5%	Liquidity ratio
			Qualitative liquidity assessment

Source: ACRA

3 Operational Profile

The following describes the basic factors in the rating analysis of the operational profile, the degree of their influence when determining the credit rating of a non-financial corporation, and assessment specifics.

To assess operational profile qualitative indicators for rated entities in the industry, ACRA uses a set of characteristics specific to the industry that translate into a qualitative assessment category.

Operational profile indicator weights are shown in Table 4.

3.1. Business Profile

GTs operate in various sectors in global markets, moving goods and resources to end consumers. These companies differ from CTs by a stronger vertical integration. Their global network may include their own production facilities as well as significant manufacturing and logistics facilities used to bring goods to markets.

CTs' business is to acquire, move and sell commodities. These companies usually have significant logistics assets (elevators or silos, warehouses, storage facilities for liquid goods, tanks, port assets, etc.). This allows them, in contrast to brokers and sales agents, to increase the ultimate business margins by providing value-added services. Derivatives are widely used by CTs to increase the marginality of business. The dominating commodities are agricultural products, energy resources, and metals.

Assessing the business profile of companies in the industry involves taking into account the stability of market position, product, operational and geographic diversification, product offer and its riskiness, customer relationship with manufacturers and buyers, and the availability of logistics assets.

The sector companies depend on the level of market competition in the regions where they operate, as well as on the presence of market entry barriers and threats of technological change.

The business profile is assessed taking into account the following sub-factors subject to qualitative assessment.

3.1.1. Market position and its stability

Market position is determined taking into account the diversification of the markets where a company operates and their stability in terms of demand volatility, market size and the level of its economic development.

Table 2. Market position

Assessment category	Main features
I	**GT**. A highly diversified global player in markets with low volume and price volatility, which leads to highly sustainable returns throughout the economic cycle (ROA at least 6% during the economic cycle) **CT.** A pronounced global market leader in several countries across all product segments (top 3), as evidenced by the sustainability of the operational margin (at least 10%); other competitors are significantly smaller in size
II	**GT.** A highly diversified global player, sustainable returns throughout the economic cycle, low-volatile operational indicators in terms of volumes and prices **CT.** A long-term market leader in several countries in all key product segments, a limited number of competitors of comparable size, and a large number of smaller players; the largest region accounts for less than 40% of total sales
III	**GT.** A moderately well-diversified global player, moderate returns throughout the economic cycle, low-volatile operational indicators; certain volatility of financial performance may be offset by the sale of a range of non-key assets **CT.** A long-term market leader in a range of product segments, a limited number of larger competitors, and a large number of smaller players; the largest region accounts for less than 50% of total sales
IV	**GT.** A player in the market of one continent or region in several product segments, demonstrating volatility in financial performance, which can be partially offset by the sale of assets **CT.** Strong position in global markets, a large number of larger companies and companies of comparable size; the largest region accounts for less than 65% of total sales
V	**GT.** A regional player in the market of one country in a limited number of product segments, demonstrating high volatility of cash flow and financial indicators, and having limited opportunities to offset losses through the sale of assets **CT.** Strong position in one or more markets, a large number of larger companies and a limited number of smaller players: the largest region accounts for less than 90% of total sales

Source: ACRA

3.1.2. Product and geographic diversification, uniqueness, and competitive advantages

Geographic diversification is assessed in terms of business concentration on sales markets and the presence of operational or production assets in a region, country, or continent. In addition, we assess whether the trading company is a global, regional or local player.

Product diversification is assessed in terms of the company's concentration on one or more product segments, which increases the degree of its dependence on the cyclicality and other characteristics of market demand for and supply of a particular product. A diversified product line allows the company to reduce the risks of price and consumer shocks inherent in a particular type of product. In addition, the risk profile of traded goods is assessed: whether the product portfolio consists mainly of exchange-traded commodities (WTI or Brent crude oil, oil products, gas supplied from the USA and Europe, thermal coal, metals traded on the LME (aluminum, copper, lead, zinc, nickel), agricultural commodities (soybeans, wheat, corn, sugar) or riskier ones (biofuels, electricity, iron ore, alumina, coking coal, rice, cotton, cocoa, coffee, perishable agricultural commodities).

The analysis also includes the uniqueness of the product offer, including the depth of vertical integration, the presence of logistics assets, their ownership or lease, the quality of their maintenance, and the company's ability to maintain high quality storage of products. In addition, the company's connections with the world's leading manufacturers and buyers is assessed, the longevity and sustainability of these connections, including the presence or absence of long-term offtake contracts, the concentration on one manufacturer / supplier or buyer, as well as whether the company is trading its own goods or derivatives.

The qualitative assessment category for product and geographic diversification is determined according to Table 3.

Table 3. Qualitative assessment of product and geographic diversification

Assessment category	Main features
I	**GT.** Wide geography of presence (global player), no concentration of the product line, consumers, location of operational or logistics assets High degree of vertical diversification, long-term offtake contracts. No proprietary trading in commodities and derivatives Very well developed risk management procedures that are publicly available **CT.** The largest independent global commodity trader with a well-established reputation Well-diversified sales geography, long-term high-diversified product portfolio includes mainly exchange-traded commodities Long-term connections with the largest producers of commodities and industrial consumers, highly efficient inventory turnover Wide access to logistics assets, no logistics-related operational problems Availability of other lines of business supporting the core business The minimum volume of trade operations (merchandising trading), the business is more tied to vertically integrated assets The use of derivatives is tied to the ownership of physical assets, no proprietary trading in commodities

II	**GT.** Good geographic diversification of the portfolio of operational assets (global player), wide range of services in all segments of the product portfolio, insignificant concentration in terms of geography of presence, sales markets and consumers Good vertical diversification; offtake contracts. No proprietary trading in commodities and derivatives Well-developed risk management procedures that are publicly available **CT.** One of the largest independent global commodity traders with a well-established reputation Wide sales geography and operational diversification, long-term well-diversified product portfolio includes mainly exchange-traded commodities Long-term connections with the largest producers of commodities and industrial consumers, efficient inventory turnover Access to logistics assets, no logistics-related operational problems Availability of other lines of business supporting the core business Minimal volume of proprietary trading in commodities, most derivatives are tied to the ownership of physical assets Incentive policy prevents taking risks with respect to trading in own goods and trading in derivatives
III	**GT.** Globally diversified player present in multiple business segments and offering a wide range of services, certain concentration in terms of geography of presence, sales markets and consumers Very good vertical structure of supplies; long-term offtake contracts Minimal proprietary trading in commodities or no proprietary trading in derivatives **CT.** Long-term and well-established regional market position, moderately diversified product portfolio includes mainly OTC-traded commodities No leadership in any product segment Limited number of agreements with key producers of commodities and industrial consumers (no long history or shorter-term nature), certain concentration on a single producer / consumer; moderately efficient inventory turnover Business is mostly related to trading, good logistics infrastructure, almost no logistics-related operational problems Strict management's control over the proprietary trading in commodities and derivatives in line with the established procedures and policies setting forth risk limits for all traders Derivatives are used to support real (not speculative) trading positions; risk appetite is approved by the board of directors; incentive policy prevents high-risk transactions

IV	**GT.** Wide product range in some segments, moderate concentration on certain sales markets and consumers Good vertical structure of supplies; limited number of long-term offtake contracts Historically good risk control function carried out by management Minimal proprietary trading in commodities, no proprietary trading in derivatives **CT.** Limited business size No long-term ties with leading producers or industrial consumers, concentration on clients; it is more relevant to those players that are not leaders in their segments Business is mostly related to trading, logistics assets meet the requirements but may have certain limitations or cause problems Significant management's control over the proprietary trading in commodities and derivatives in line with the established procedures and policies setting forth risk limits; limited ability to increase risk limits without an approval from the board of directors; incentive policy deters the interest to high-risk transactions Trading in derivatives is aimed at supporting physical (real) positions
V	**GT.** Presence in a limited number of segments, wide product range in at least one of them, high concentration on certain markets and customers Minimum degree of vertical integration, or minimum number of offtake contracts Certain amount of proprietary trading in commodities and derivatives **CT.** Limited business, mainly OTC trading Limited product portfolio (two or three main products), low positions in their product segments No long-term agreements with producers or industrial consumers, concentration on a limited number of producers and consumers, mainly industry outsiders The business is represented exclusively by trading transactions, availability of some regional logistics assets that do not allow for the efficient movement of goods Large volume of derivatives traded, including those not related to physical ownership of assets Proprietary trading in commodities and derivatives is carried out with or without risk-taking procedures and restrictions, management may change these restrictions, or they are very loose, incentive policy encourages risk-taking

Source: ACRA

3.2. Financial Policy and Corporate Governance

To assess the financial policy and corporate governance of rated entities in the wholesale and commodity trading industry, ACRA uses a common set of characteristics that translate into a qualitative assessment category for all industries (for a general description of the concept of the corporate governance qualitative assessment, see Section 5 of the Methodology). The assessment of financial policy and corporate governance is carried out according to Table 4.

4 Financial Profile

The following describes the basic factors in the rating analysis of the financial profile, the degree of their influence when determining the credit rating of a non-financial corporation, and assessment specifics.

To assess the qualitative indicators in the financial profile of rated entities, ACRA uses a common set of characteristics that translate into a qualitative assessment category for all industries (for a general description of the qualitative assessment of financial profile indicators, see Section 6 of the Methodology).

Quantitative indicators in the financial profile are assessed in scores based on being part of a particular range, with qualitative indicators based on qualitative assessment categories according to Table 5.

4.1. Size

Revenue

To assess the business scale of companies in the industry, ACRA uses the size of their revenues, which is important for assessing the creditworthiness of rated entities. The volume of revenues of a company reflects the economies of scale when purchasing and distributing products. In addition, business size is an evidence of a more diversified portfolio of commodities and a vertically diversified business.

Assets

To determine the size of assets, two indicators are used: total assets for GTs and fixed assets for CTs; this allows for differences in business models of these types of companies to be taken into account.

The total assets indicator is used to determine the size of GT's assets, as companies in this subsector tend to engage in trading that generate highly liquid receivables and inventories, which can represent a significant portion of a company's total assets. Moreover, GTs, in addition to the main business, can make long-term low-liquid investments. Higher asset size indicates a well-diversified portfolio, significant operating assets, and potential cash flow from asset sales.

The fixed assets indicator is used to determine the size of CT assets, since it is a more stable indicator for such companies than the amount of revenue. A large amount of fixed assets, as a rule, indicates a more stable performance of a company in terms of income and cash flows. Using a fixed asset size indicator instead of an asset size indicator reduces the volatility of this indicator (fixed assets size), since the size of assets also takes into account the size of working capital, which is influenced by both seasonality and changes in commodity prices.

4.2. Leverage

To assess leverage, ACRA uses the following three ratios:

1) Debt/Book Capitalization is used as a one-time relative indicator showing how much assets were financed with borrowed funds or capital;
2) Net Debt/EBITDA: for GTs, it shows the debt covered with EBITDA; for CTs, it may be highly volatile, depending on commodity prices; nevertheless, this ratio may stabilize for those CTs that use a significant amount of cash to smooth price volatility and seasonal fluctuations in working capital;
3) FFO before interest to gross debt (FFO/Debt).

To assess leverage, in addition to the above ratios, qualitative indicators are used too.

4.3. Coverage

To assess coverage, ACRA uses the ratio of FFO before interest to interest.

4.4. Liquidity

To assess liquidity, ACRA uses the short-term liquidity ratio and qualitative characteristics.

Table 4. Operational profile factors

Factor	Sub-factor	Sub-factor weight	Sub-factor score				
			5	4	3	2	1
Business profile	Market position and its stability	50%	V	IV	III	II	I
	Product, operational and geographic diversification; product offer and its riskiness; connections with producers and buyers; availability of logistics assets	50%	V	IV	III	II	I
Financial policy and corporate governance	Financial policy	50%	V	IV	III	II	I
	Corporate governance	50%	V	IV	III	II	I

Source: ACRA

Table 5. Financial profile factors

Factor	Sub-factor	Sub-factor weight	Sub-factor score				
			5	4	3	2	1
Size	Revenue (USD bln)	50%	[0; 5)	[5; 20)	[20; 50)	[50;100)	[100; ∞)
	GT. Assets (USD bln)	50%	[0; 25)	[25; 50)	[50; 100)	[100; 150)	[150; ∞)
	CT. Fixed assets (USD bln)		[0; 1)	[1; 5)	[5; 10)	[10; 30)	[30; ∞)
Leverage	Debt/Book Capitalization	40%	[65%; ∞)	[55%; 65%)	[45%; 55%)	[35%; 45%)	(-∞; 35%)
	GT. Debt/EBITDA	20%	(8; ∞)	(6; 8]	(4; 6]	(2; 4]	[0; 2]
	CT. Debt/EBITDA		(6; ∞)	(4; 6]	(3; 4]	(2; 3]	[0; 2]
	FFO before interest / Debt	20%	(-∞; 10%)	[10%; 15%)	[15%; 25%)	[25%; 50%)	[50%; ∞)
	Qualitative leverage assessment	20%	V	IV	III	II	I
Coverage	FFO before interest / Interest	100%	(-∞; 1)	[1; 3)	[3; 6)	[6; 10)	[10; ∞)
Liquidity	Liquidity ratio	50%	(-∞; 0.8)	[0.8; 1)	[1; 1.25)	[1.25; 1.5)	[1.5; ∞)
	Qualitative liquidity assessment	50%	V	IV	III	II	I

Source: ACRA

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