RATING METHODOLOGIES

Corporates

2024 – Public Version

1. TASSNIEF'S Corporate Rating Methodology

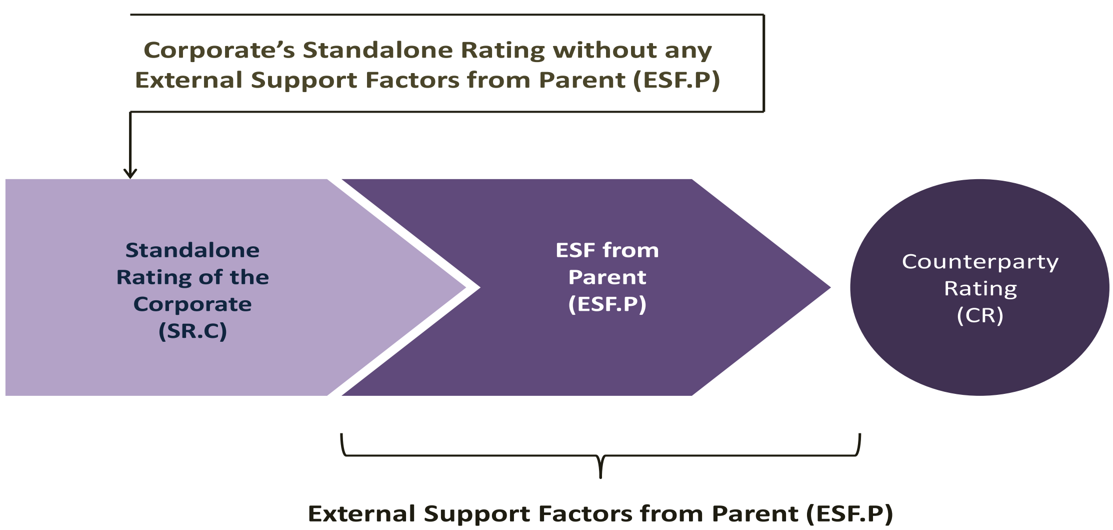
1.1. Summary: A Simplified Sequential Approach

This rating methodology represent TASSNIEF's approach to assess credit quality of entities in the corporate sector. The rating methodology applicable to **Industrial and Commercial Corporations** (Corporates) is built on a **simplified sequential approach**. This sequential analysis leading to the *long-term* **Counterparty Rating** (CR) of a corporate stand on two pillars: (i) the **Standalone Rating of the Corporate** (SR.C); and (ii) the **Parental External Support Factors** (ESF.P). TASSNIEF's approach incorporates a combination of both quantitative and qualitative factors. TASSNIEF does not capture any Systemic External Support Factors for Corporates, neither at the national level, nor at the international one. Tassnief ratings are also based on future performance expectations of the corporate. While past metrics are important, any final rating outcome will take into account TASSNIEF's opinion on future metrics. Public-sector companies constitute an exception, described in section 4.4. SMEs are also treated in a specific manner as described in section 4.5. In summary, TASSNIEF opts for the following approach:

CR = SR.C + ESF = SR.C + ESF.P

Graphically, *figure 12* below summarizes the simplified sequential approach of Tassnief when it comes to rating corporate issuers.

Figure 12. Summary of TASSNIEF'S sequential approach for corporate ratings



1.2. Standalone Rating of Corporates (SR.C)

1.2.1. Definition and general principles

The Standalone Rating of a Corporate (SR.C) reflects its intrinsic financial strength, which does not depend on any parental External Support Factor. The SR.C stands as TASSNIEF'S opinion on a Corporate's capacity to face, alone, the drawbacks of the economic cycle as well as internal and external shocks susceptible to affect it. The SR.C is the starting point of any credit analysis applicable to Corporates. TASSNIEF will publish the SR.C of all the corporate issuers that TASSNIEF will be asked to rate. In general, a Corporate will be assigned a CR relatively close to its SR.C, as by experience Corporates tend to benefit from a limited amount of external support.

TASSNIEF determines the SR.C based on 9 **Standalone Rating Factors for Corporates** (SRF.C), within 3 broader categories: (i) the **Structural** SRF.C; (ii) the **Qualitative** SRF.C; and (iii) the **Financial** SRF.C.
Each SRF.C (from SRF.C1 to SRF.C9) is subject to a **Score** (S_n, n=1 to 9) and a **Weight** (W_n, n=1 to 9). The SR.C is the weighted sum of the 9 scores, as per the following formula:

$$\mathrm{SR.C} = \sum_{n=1}^{9} \mathrm{W_n} \, \mathrm{x} \, \mathrm{S_n} + \text{Adjustment}$$

1.2.2. Weighting the Standalone Rating Factors for Corporates (SRF.C)

The list and weighting of the 9 SRF.C in their three categories are reported on the table below:

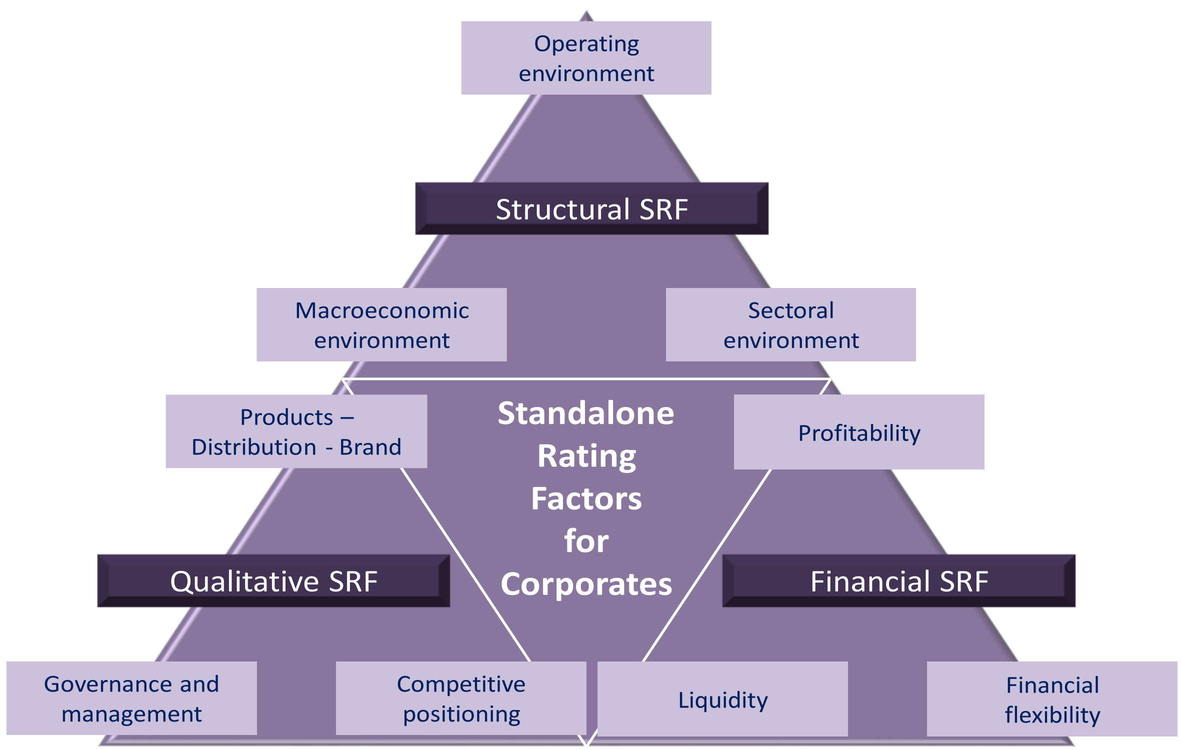
SRF.C	Categories	Nature of risk factors	Acronyms	Weights (categories)	Weights Wn (per SRF.C)	Scores	Weighted Scores
SRF.C1	STRUCTURAL SRF	Macroeconomic environment	ME	20%	8%	S1	W1xS1
SRF.C2		Operating environment	OE		7%	S2	W2xS2
SRF.C3		Sectoral environment	SE		5%	S3	W3xS3
SRF.C4	Qualitative SRF	Products - Distribution - Brand	PB	40%	15%	S4	W4xS4
SRF.C5		Governance and management	GM		15%	S5	W5xS5
SRF.C6		Competitive positioning	CP		10%	S6	W6xS6
SRF.C7	Financial SRF	Profitability	PR	40%	13%	S7	W7xS7
SRF.C8		Liquidity	LQ		12%	S8	W8xS8
SRF.C9		Financial flexibility	FF		15%	S9	W9xS9
					Total Weighted Score		∑WnxSn

Mechanically, the sum of weighted scores leads to the Total Weighted Score (TWS). This TWS does not necessarily reflect the opinion of TASSNIEF'S Rating Committee as to the financial strength of the Corporate. TASSNIEF's Rating Committee will exercise judgment which may allow deliberated deviation.

1.2.3. Definition of Standalone Rating Factors for Corporates

The 9 Standalone Rating Factors for Corporates (SRF.C) that TASSNIEF uses are summarized on the following *figure 13*. This TASSNIEF'S **Corporate Pyramid**.

Figure 13. Summary of the 9 SRF.C and the 3 categories of SRF: TASSNIEF'S Corporate Pyramid



(i) Structural SRF.C: 20% weight

<u>SRF.C1: Macroeconomic environment (ME; Weight of 8%)</u>
Weighted at 8% of the SR, the ME factor, like the other Structural factor, is common to all entities rated by TASSNIEF in a given country, including Corporate entities. This factor captures business opportunities and macroeconomic constraints for industrial and commercial firms. It includes output volatility in a given country, its diversification and its long-term sustainability. The Macroeconomic environment factor also measures the quality of economic policies, cyclical and structural, and there influence on the corporate sector. Finally, this factor tends to identify the robustness of the industrial and commercial networks in a given country, as well as the

interactions that the industrial and commercial sector builds with other economic sectors in order to strengthen the macroeconomic performance of the domestic economy.

ME measures the economic risks weighing on the industrial and commercial sector of a given country as a whole.

SRF.C2: Operating environment (OE; Weight of 7%)

The second Structural factor, OE, relates to the structural operating features that corporate entities need to take into account while conducting their industrial, commercial and financial operations. This factor, weighted 7%, includes a measure of the governance of the economic system in general, and that of the commercial and industrial sector in particular, the availability of qualified and trained financial professionals, the level of Corporates' equipment in technology, the quality of infrastructure (especially telecommunication), the degree of granularity of technical and commercial information available to industrial and commercial corporations in their respective target markets, and the relevance of management tools used by corporate institutions in a given country.

OE measures the operating risks weighing on a country's industrial and commercial sector as a whole.

SRF.C3: Sectoral environment (SE; Weight of 5%)

The third Structural factor, SE, measures the competitive dynamics and the degree of maturity of the industrial or commercial sector in which the rated Corporate operates. TASSNIEF'S starting point is that the relative success of a corporate entity depends equally on its macroeconomic environment and on the meso-economic dynamics of its business sector. Indeed, the industrial and commercial sectors are not all necessarily pro-cyclical in nature: some of them are counter-cyclical, and some other are not cyclical at all. TASSNIEF will use particular care not to overweight macroeconomic rating factors, as sector idiosyncrasies can considerably alter the way a corporate entity behaves on its market. In particular, TASSNIEF will measure the effects of competitive pressures on margins, the industry's cost structure, its key factors of success and its future development opportunities, which will facilitate the positioning of any rated Corporate in comparison to its contenders. Such analysis will be performed by TASSNIEF'S Analysts within the perspective of the life cycle of the given industry, not as an abstract exercise, but rather in the context of the domestic economy.

SE measures the sector risks weighing on the Corporates that are competing on their respective market(s) in a given country.

(ii) Qualitative SRF.C: 40% weight

SRF.C4: Products – Distribution – Brand name (PB; Weight of 15%)

Weighted at 15%, the PB factor is one of the 6 factors (from SRF.C4 to SRF.C9) that are specific to the rated corporate issuer, not to its environment, like SRF.C1 to SRF.C3. TASSNIEF defines « Products – Distribution – Brand name » as the strategic positioning of the company, its degree of specialization or, on the contrary, of diversification by businesses or products (range), and of course its size (the best proxy of which being its market share). An industrial or commercial corporate entity must maximize its returns based on its competitive advantages, themselves the source of its differentiation strategy (in price, quality, or time, which is further captured by SRF.C6). Strictly speaking, SRF.C4 includes the diversity of the range of products, the diversity of company's sales geographically, the diversity of the company's client and supplier base (domestic/international), its distribution strategies (direct/indirect), as well as the degree of entrenchment and visibility of its brand(s). Each of these sub-factors is scored by TASSNIEF'S Rating Committee.

PB measures the risks of strategic obsolescence weighing on an industrial or commercial corporate entity, in an idiosyncratic way.

SRF.C5: Governance and management (GM; Weight of 15%)

With PB, this individual factor is weighted, at 15%. TASSNIEF'S starting point is the theoretical concept and empirical evidence that governance and management are critical to the success or, on the contrary, to the failure of a corporate strategy. Human capital, policies and procedures, value chain management, incentive mechanisms, the fine-tuning of investment policies and risk appetite are all vital dimensions the GM factor tends to encapsulate. Consequently, TASSNIEF adopts a descending (« *top down* ») approach to capture the mechanisms by which the company is run. The analysis starts at the level of the *Board of Directors*, using the « governance » concept. The nature, quality and relevance of governance instruments are measured by TASSNIEF'S Analysts. Then, the « processes » (which include all the execution mechanisms pertaining to the company's *Management* and *Strategy*) are carefully studied and scored. In other words, such scores reflect both the *conceptual design* of the company's strategy and its *actual implementation*.

GM measures the quality and relevance of the policies and procedures that lead to the design and execution of the company's strategy, given the general orientations of the shareholders, management know-how and the constraints of the competitive landscape.

SRF.C6: Competitive positioning (CP; Weight of 10%)

TASSNIEF considers that corporate entities build a limited number of competitive advantages to strengthen their competitiveness in time. Competitiveness derives in the short term from a price advantage (itself dependent on the company's ability to curb costs) or from a quality advantage (itself dependent on a particular knowledge or know-how). In the longer run, however, building future competitive advantages depends on the company's investment efforts in technology and human resources, as well as its innovation capabilities, in view of its onward development.

CP measures the risks faced by a corporate entity with regard its competitiveness, as well as the short- and long-term means it uses to protect and develop it in time.

(iii) Financial SRF.C: 40% weight

SRF.C7: Profitability (PR; Weight of 13%)

The focus of the analysis is on the historical and forecasted operating efficiency of the Company. This entails an assessment of the profit margin, observed over a period of time, which indicates whether a company can sustain its present cash accruals. Over here the analysis focusses on the percentage margins and the absolute quantum of profit generated. A high absolute quantum of profits gives the Company financial flexibility and exhibits the ability to withstand business adversity. The Company's net margins, absolute quantum of profits and return on equity are benchmarked relative to other players in the industry. A key focus of the assessment is on recurring profitability which is adjusted for any one-offs. TASSNIEF evaluates Return on Capital Employed (RoCE) which indicates the returns generated by a company on the total capital (equity + debt) employed in the business. A consistently low RoCE reflects the company's poor viability over the long term.

PR measures the risks of insufficient returns, either because of margin compression, or because of cost inflation, or because of volumes levelling off.

SRF.C8: Liquidity (LQ; Weight of 12%)

On top of insufficient returns, liquidity is another major reason why Corporates tend to default. The concept of liquidity has several meanings: TASSNIEF identifies asset liquidity, outflows of liabilities and asset-liability management (ALM). Consequently, the calibration of the « liquidity » section of the scorecard encompasses these three dimensions of corporate liquidity: the main focus is on *asset liquidity*; in addition, TASSNIEF combines in one single score the issue of *the funding mix and balance sheet management*, as solutions the company uses to face its immediate liquidity needs, given the pace at which assets are transformed into flows of cash. Working capital management is important for companies, especially which operate in working-capital-intensive industries. Efficient working capital management reduces pressure on a company's liquidity, and hence enable timely servicing of debt.

LQ captures the quality and relevance of the measures, mechanisms and instruments for balance sheet management.

SRF.C9: Financial flexibility (FF; Weight of 15%)

Finally, financial flexibility forms an opinion about how the corporate entities' liability mix is constituted. TASSNIEF defines the concept of liability structure in its broader sense, including equity and funding tools like bank debt and bond securities, be they secured, unsecured or subordinated. TASSNIEF places emphasis on the equity position of a rated corporate entity, but more crucially on the structure of its debt. That said, the larger the equity base, the less indebtedness will weigh on the rated Corporate's financial policy. An entity is obliged to pay both interest and principal in a timely manner from its operating cash-flows which increases the burden on the costs, thus increasing the default risk in some cases. Such financial pressure will be captured by a series of ratios: i) interest coverage ii) debt service coverage iii) debt payback period and iv) capitalization (gearing position).

FF measures insolvency risks weighing on corporate issuers, either because of excessive financial leverage (i.e. insufficient equity capital), or because of uncontrolled deterioration of the cost of debt, or because of sources of cash flow drying up.

1.3. Parental External Support Factors (ESF.P)

A number of corporate entities that will require TASSNIEF'S rating services will be subsidiaries of industrial or financial groups, which in turn will be rated either publicly or confidentially. Subsidiary Corporates will be entitled, in many cases, to receive parental support, which can be made available to them in several forms: operating support, liquidity support and/or capital support in particular. Therefore, these forms of support must be reflected in the Counterparty Rating of the subsidiary.

TASSNIEF's thus includes **Parental External Support Factors** (ESF.P) in corporate ratings, when deemed necessary. For TASSNIEF, the Counterparty Rating (CR) of the subsidiary Corporate will be derived from the sum of SR.C and ESF.P:

CR = SR.C + ESF.P

ESF.P mainly depends on the degree **Strategic Importance (I-Strat)** of the subsidiary to the parent. TASSNIEF distinguishes between 3 degrees of Strategic Importance: High, Medium, or Low.

1.4. The case of Public-Sector Entities

Public-Sector Entities (PSE), also named **Government-Related Entities** (GREs), are defined as industrial, commercial or administrative corporations with public-sector shareholders. From the perspective of TASSNIEF, there are two sorts of GREs: i) GREs that have no public service mandate; and ii) GREs that have been given a public service mandate, and/or even a policy role. GREs that behave like private-sector entities will be rated under the standard Corporate Rating Methodology. On the contrary, GREs with a public service mandate and/or a policy role will be rated according to a specific approach that includes some methodological adjustments.

These adjustments have no impact on the SR.C of the GRE, but only on the inclusion in the CR of External Support Factors. Because the GRE is owned at least partially by the State, directly or indirectly, TASSNIEF believes that standard support rules described in section 1.3 are not directly applicable to eligible GREs. Consequently, TASSNIEF applies other, less conservative criteria for these GREs.

RATINGS METHODOLOGY

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No statement in this paper is to be construed as a recommendation
To buy, sell or hold securities, or as investment advice, as it does not
Comment on the security's market price or suitability for any particular investor.

While every effort has been made to incorporate the salient points of
TASSNIEF's experience in relation to the methodology, we note that
The information contained could be updated and altered depending
on changes in our internal views, market conditions, accounting
Practices and regulations.

The methodology is also based on factors
Relevant to the Kingdom of Saudi Arabia and may require adaptation to local conditions.