SEBI's May 21, 2020 circular for Review of Credit Ratings – a boon for companies with sound fundamentals

There have been instances wherein companies experienced a shorter-term liquidity issues leading to cash flow mismatch and delay in servicing debt in a timely manner. Though some of these companies are in a position to clear the dues within reasonable period, the mis-payment has triggered a rating action leading to proclaiming such ratings as "Default Grade" and necessitating the Rating Agency to wait for a minimum period of 90 days to move the borrower out of the "Default Grade" to "Non-Investment / Sub-Investment Grade" rating. Besides, there is a need to wait for 365 days before the company could be moved to "Investment Grade: BBB- (Triple B Minus) and above.

This has led to many companies getting into rating trap as it curbed their ability to roll over / renew banking facilities due to "Default Grade" thereby putting further squeeze on the liquidity and affecting the working capital cycle for a longer tenure. This liquidity squeeze leads to major issues requiring companies to raise long term sources (generally at higher cost – Private Equity / NBFC funding) or go for re-structuring with banks. Either way, the company suffers on the cost competitiveness in the market and takes time to get back to profitable mode.

However, Securities and Exchange Board of India's circular dated May 21, 2020 is a big boon for those companies which are safe and secured but suffered a short-term cash flow mismatch. The easing of the norm wherein the Rating Agency can shorten the timeline, as stated earlier of 90 and 365 days to move the rating into "Non-Investment / Sub-Investment Grade" and "Investment Grade", respectively, from the Default

Grade is going to help such companies to recover from the liquidity crunch and help them raise much needed working capital finance in these difficult times.

We at MP Financial Advisory Services LLP, believe that this move of SEBI is timely and much needed for all those companies which are in a position to correct the short-term cash flow mismatch but got entangled into earlier regulatory requirement of minimum days to move out of Default Grade rating.

Besides, in the wake of Covid-19 scenario, there is a like hood of many companies getting into stressed liquidity scenario. The easing of norms would help the Rating Agencies to formulate their own policy, on case-to-case basis, to correct the ratings of the companies which are backed by strong fundamentals by moving them to Non-Investment / Sub-Investment Grade" and "Investment Grade", as the case may be.

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