PEFINDO's Default Recognition

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This article summarizes our approach on the definition of default in our ratings as well as how we determine a company's rating to non-defaulted status once the repayment is made. PEFINDO consider rating is in default when a company fails to pay one or more financial obligations in a full and timely manner. When determining whether a payment has been made in full and timely, there can be nuances, for instance relating to how remedial periods can impact the date on which an obligation is due and what happens when a company restructures an obligation. In this article, we set out how we address these nuances in assessing default.

In most cases, PEFINDO will recognize a default (identified by a rating of $_{id}$D or $_{id}$SD) as stated under the original contractual promise if:

- Payments failure (principal or interest) within five business days in the absence of a stated remedial period; or no payments made during the stated remedial period.
- The issuer or obligor has a high probability of payment failure within the stated remedial period;
- The issuer undertakes capital market transactions (exchange, a repurchase, or a term amendment) which constitutes a distressed exchange. The issuer conducts the action close to or after the maturity date;
- A bankruptcy filing or legal receivership by the debt issuer or obligor which increases the likelihood to miss or delay in future contractually obligated debt service payments.

PEFINDO may not recognize debt instrument(s) as default, should the company obtain approval to extend the remedial period from the securities holder and/or trustee, although the period is longer than 30 days. However, PEFINDO may lower the ratings to 'near to Default' which is the $_{id}$CCC rating or revise the rating outlook to CreditWatch upon missed payment.

We will likely recognize a distress exchange offer under these two criteria:

1. The investor will receive significantly less value than the promise of the original contractual terms implicitly, such as:
   - Reduction in principal;
   - Lower interest rate compared to the initial yield;
   - Extended maturity beyond the original promised;
   - Change from a cash pay basis to payment-in-kind (PIK), discount basis, or another form of non-cash payment;
   - Altered in ranks to a more junior or debt swap equity;
   - Cash tender for significantly less than par;
   - Repurchase of debt below par by a related party.

2. The exchange offers are conducted to avoid bankruptcy, similar insolvency, intervention proceedings, or a traditional payment default

We will consider a company as 'opportunistic' if a strong credit profile company, leverages its credit profile to amend the original contractual promise to take advantage of market pricing, excess liquidity, or other factors benefitting the Company instead of fulfilling its original contractual promise.

A third party debt-guaranteed instruments, a missed payment will be recognized as a default upon failure to deliver timely payment on the guaranteed obligation by the guarantor within the time stipulated in the guaranteed mechanism when the trustee/banker invokes the guarantee.

PEFINDO does not consider breach in covenants as a default unless the obligor fails to cure the covenant breach and honor the resulting debt acceleration which may be required. PEFINDO will further reassess the rating of the company's business and financials in light of the covenant breach which in turn might lead to a rating downgrade.

If a missed payment occurs due to non-credit reasons such as clerical and/or human errors, then we will assess on the following factors:

- Willingness and ability (including its fund availability on that particular time) of the issuer prior to the missed payment to make the respective payment on the due date;
- Expectation to service the missed payment within a maximum of two business days and whether the issuer has taken corrective measures to avoid such occurrences in the future.

If both criteria are met, a missed payment will not be likely recognized as a default, since the instances does not constitute a weakening in credit quality. However, we may reassess its key success factors under the business risk assessment such as operating management (management & governance) and/or financial policy under the company's financial risk assessment.

PEFINDO's Curing Period

Generally, after we lower a rating to default, the rationale and the timing of any upgrade to a non-default rating ($_{id}$CCC or higher) involve consideration of: the nature of the event that caused the downgrade to default, and whether the event was resolved. The weight on each factor varies depending on the nature of the situation. For instance, if we lower a company's rating to $_{id}$D or $_{id}$SD because of bankruptcy filing, we will only raise the rating once the company emerges from such bankruptcy proceedings, typically following the bankruptcy court's approval of the proposed composition plan.

We will consider an upgrade in the company's rating based on these guidelines:

- A maximum final rating to $_{id}$BB- if we view that a default has minimum impact on its business and financial profiles and a strong expectation of the company's ability to service all obligations under the new contractual promise in a timely manner;
- A maximum final rating on $_{id}$B category if we view a degradation or major changes in its business and financial profiles after the default, which lowers our expectation of its ability to service all obligations under a new contractual promise in a timely manner;
- A maximum final rating on $_{id}$CCC if we strongly believe post default, a Company have a minimum capability to fulfill its upcoming obligation under the new restructure agreement and a miss payment is imminent

A rating upgrade to an investment grade rating category ($_{id}$BBB- and above) within 365 days post default is unlikely as we view a post-default event increases the risk profile of a company including its financial flexibility in obtaining external funding, and accordingly the issuer must demonstrate and show track record in fulfilling its financial obligations.

However, we may deviate from specific timelines on a case-by-case basis if we have a strong expectation a default event will not occur in the near future. Rating action should be in conjunction with a reassessment of its business risk (improvement in operating environment) as well as financial risk (showing comfortable cashflow protection and leverage indicators to support business requirement, including adequate liquidity to manage working capital requirement).

Conditions that may lead to a rating action upgrade of fewer than 365 days post-default event is cured:

- Change in management;
- Acquisition by a stronger company with a strong credit profile;
- Benefits arising out of a regulatory action;
- Force majeure event leading to Default;
- Restructuring of loans, as long as business risk profile of the Company continues to remain strong.

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