Pandemic to weigh on India Inc's credit quality

Ratings Round-Up, Second-half of fiscal 2020

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Key messages

Credit quality outlook: Negative

- Credit ratio weakened to 0.77 time in H2-20 from 1.21 times in H1-20 with a slowing domestic economy
- In fiscal 2021, downgrades will continue to outnumber upgrades driven by economic impact of the Covid-19 pandemic.

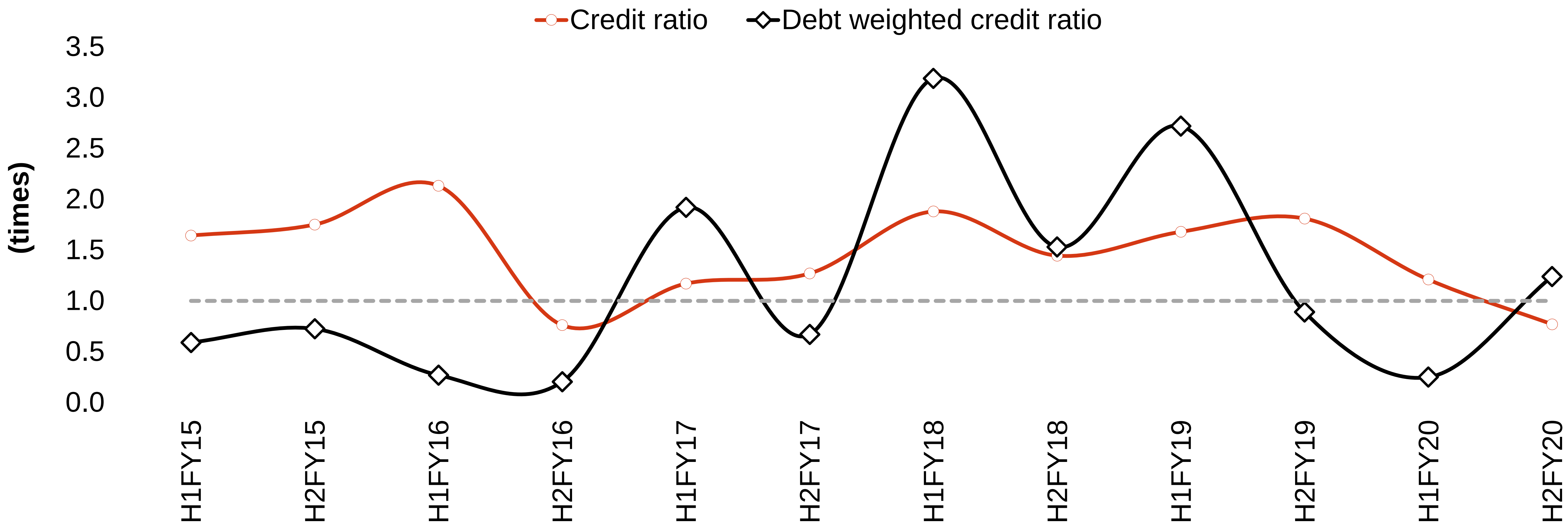
Covid-19 impact on corporates – Extent of recovery a function of demand resilience and working capital normalisation

- Loan moratorium will provide immediate relief.
- Study across 35 sectors reveals that these sectors are evenly split in terms of intermediate term resilience in the post Covid-19 era
- While strong balance sheets or continuing demand during, and an anticipated sharp pick-up in demand post, the lockdown will support resilience of some sectors, collapsing discretionary demand or high leverage will likely constrain the others

Covid-19 impact on financial services – Function of asset class and pace of recovery

- Most CRISIL-rated non-banks have adequate liquidity to manage non-bank debt repayments till May end, even with no collections
- 94% of securitization transactions to remain highly resilient during the moratorium period.
- Post lockdown, asset classes such as microfinance, unsecured loans, and SME borrowers (including the LAP segment) will see continuing pressures on asset quality due to weaker profiles of borrowers and expectation of only a gradual economic recovery.

Credit ratio weakened to 0.77 time in H2FY20 from 1.21 times in H1



- In September 2019, CRISIL expected a further moderation in its credit ratio due to intensified demand pressures amidst a slowing economy
- In addition, the second half of fiscal 2020 also faced pressures from the spread of Covid-19, which led to trade disruptions.

Source: CRISIL

Credit ratio is defined as the ratio of number of upgrades to number of downgrades. A ratio of more than 1 indicates that there are more upgrades than downgrades, and vice versa. Credit ratio excludes rating actions on non-cooperative issuers.

Debt-weighted credit ratio is defined as the total value of debt upgraded to debt downgraded. This debt pertains to the book debt in the firms upgraded or downgraded. This excludes non-cooperative issuers as well as financial sector entities.

Covid-19 impact on corporates

Extent of recovery a function of demand resilience and working capital normalisation

Study of Covid-19 impact on corporates

Criteria for selecting sectors

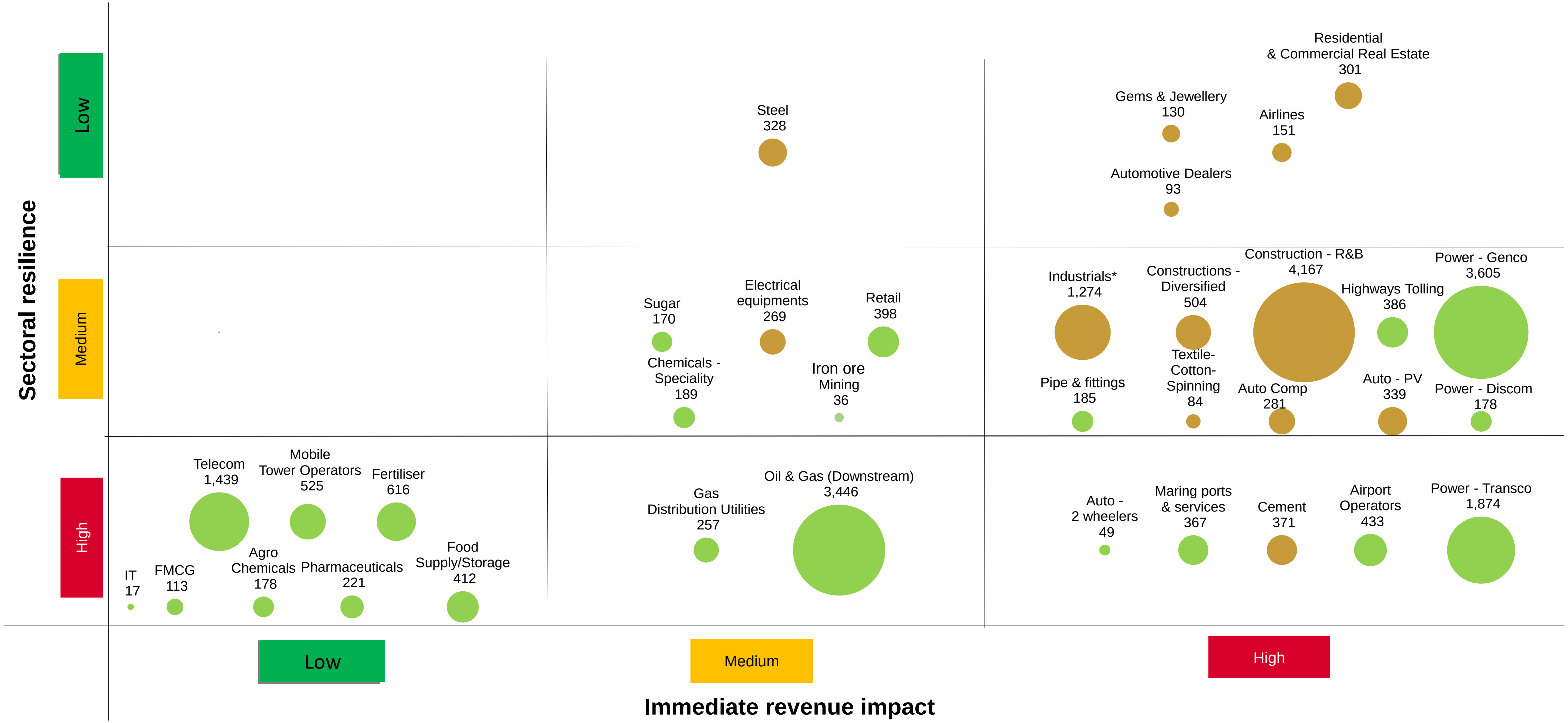
- Top 35 sectors constituting 70% of rated debt and those with significant revenue contribution

Parameters for impact assessment and key determinants:

Immediate impact on revenues (Erosion of cash flows due to lockdown)	Sectoral resilience (Ability of the sector to sustain the lockdown & bounce back to production in post Covid-19 scenario)	Time to reversal (Recovery of demand in the sector to normal capacity after lifting of Covid-19 restrictions)
• Essential vs discretionary goods • Continuous production vs batch processing • Labour intensity of the sector & labour migration related issues • Counterparty payment related issues (if any)	• End product linked with - discretionary/non-discretionary spending • Demand elasticity • Strength of the balance sheet in terms of leverage and liquidity available for entities in the sector • Level of Government/ regulatory support available to the sector	• Regulatory hurdles in restoring demand • Is the sector's demand a derived demand of another downstream sector • Will government incentives mean quicker/sluggish offtake of products of sector

Impact on sectors because of the Covid-19 lockdown

Size of the bubble indicates rated debt quantum (figures in Rs ' 00 crore)



*Industrials comprise engineering and capital goods, industrial machinery and consumables, heavy electrical equipment, and EPC contracts

- X axis denotes immediate revenue impact on the sector amid lockdown:
  - Ex. Airlines has high revenue disruption – categorised as high
- Y axis denotes resilience of the sector to weather the Covid-19 lockdown
  - Airlines has low resilience due to weak balance sheets – categorised as low
- Colour of the bubble denotes time to recovery for the sector
  - (Green - Recovery to normal operations expected over near term;
  - Amber – Recovery to be expected over medium term)

Key conclusions

Base assumption* on Covid-19 impact

Lockdown period 1-2 months, followed by 1 month for return to normal state

Most sectors to face sizeable and immediate revenue impact

Despite short term disruptions due to lockdown, nearly half of the sectors will show high resilience supporting their credit quality while remaining may see downward bias

Adverse impact is seen in sectors where consumption spend is discretionary in nature

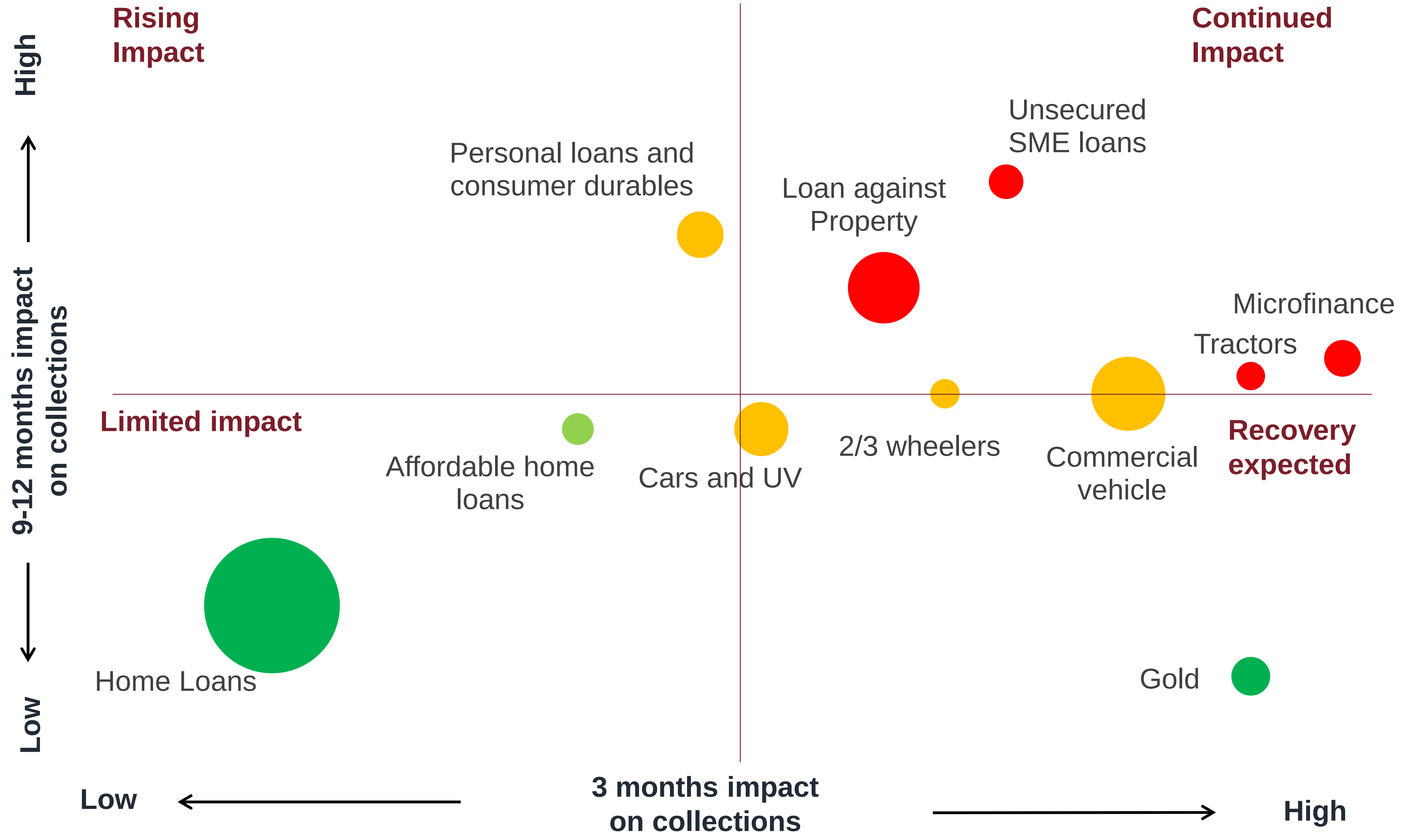
In all, 35 sectors analysed	Total rated debt (excluding finance sector) is Rs 23 lakh crore
15 sectors to see high resilience supporting their credit quality	Corresponds to Rs 10 lakh crore rated debt (~44%)
15 sectors to see moderate resilience and might see a downward bias	Corresponds to Rs 12 lakh crore rated debt (~52%)
5 sectors have low resilience could see adverse impact on credit quality	Corresponds to Rs 0.92 lakh crore rated debt (~4%)

*Assumption factors in present relief measures and payment default exemptions announced by the RBI (March 27, 2020) and SEBI (March 30, 2020). This assumption may undergo a change based on the extent of Covid-19 spread and effectiveness of the government's containment measures

Covid-19 impact on financial sector

Economic recovery holds the key

Asset class-wise collections outlook



Note : *Non-banks = NBFCs (excluding government owned) + HFCs*

Key influencers and variables for recovery

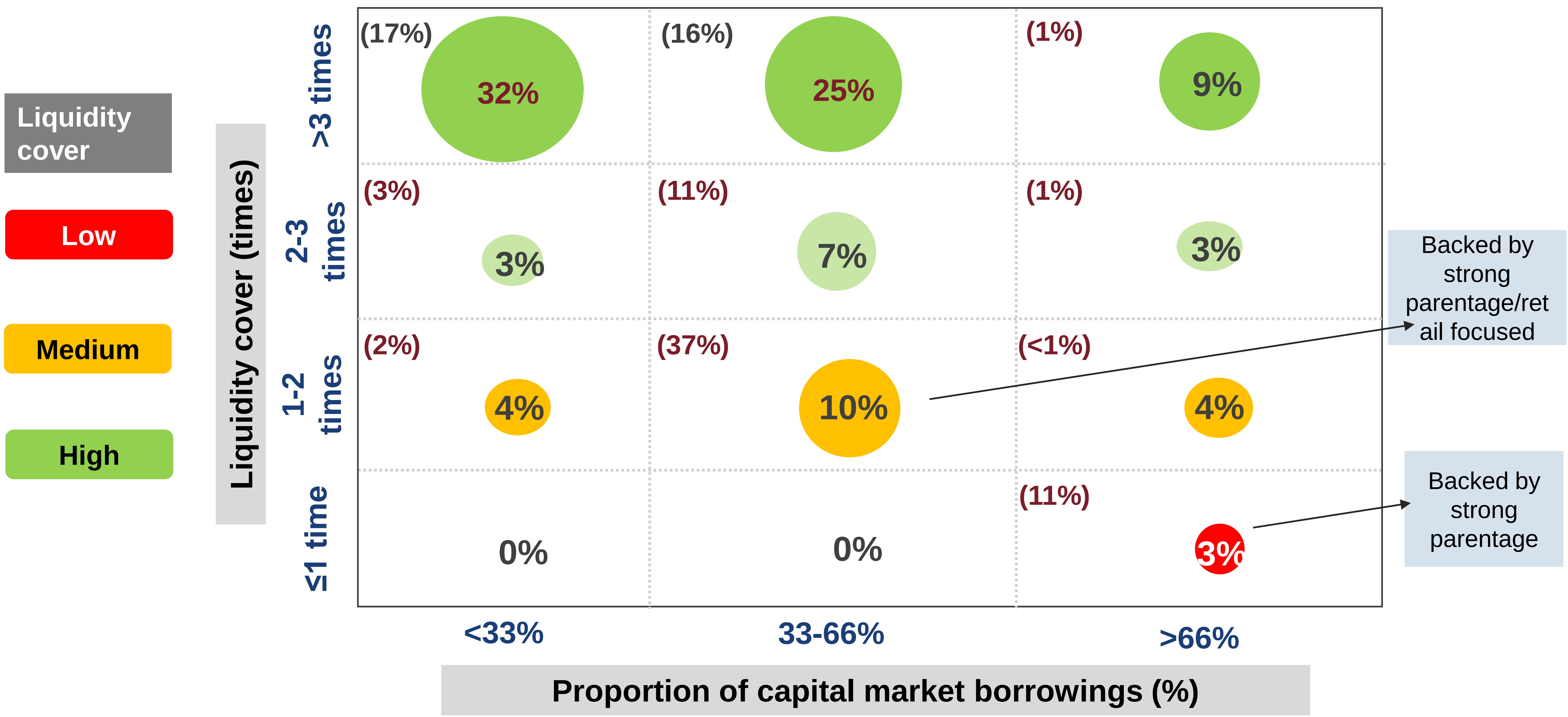
2-3 months' outlook

- Customer income source
- Field-intensive nature of operations
- Collection mode (including cash collections)

9-12 months' outlook

- Extent, duration and intensity of Covid-19 spread
- Economic growth trends
- Government spending
- Customer income source
- Impact of global economic slowdown on jobs

Non-banks have adequate liquidity to manage capital market debt repayments for next 2 months



- On the assets side, collections are likely to be limited in the near term.
- On the liabilities side, while banks may provide moratorium to non-banks, no moratorium on capital market instruments so far.
- Liquidity management over the next 2 months holds the key. .

Note: *Numbers in bubble indicate % of companies and numbers in parentheses indicate % of assets under management (AUM) in each category*
Liquidity cover *= Liquidity cushion including unutilised available bank lines/debt repayment (excluding bank debt) till May 31, 2020*
Source: Company data; CRISIL estimates companies covering >80% of industry AUM

Impact of the moratorium on securitised instruments

- Investor approval required for providing moratorium on assigned loans and PTCs

Increasing vulnerability, if no redrawing of PTC payments

Asset class	Structure of the transaction	Credit cover available
Gold, consumer durables & other shorter tenure loans	Timely interest and timely principal (TITP) structures	TCR > 10 %
Unsecured SME loans		TCR : 0 - 10 %
Vehicle loans	Timely interest and ultimate principal (TIUP) structures	
Mortgages		TCR = 0%

Longer tenure assets with low monthly amortization are more resilient to short-term collection challenges

(Ultimate payment structures, where the principal promise is only by end of maturity of the transaction, can withstand collection shocks; timely payment structures are more vulnerable)

The higher the threshold collection (break-even collection or TCR) required in the next two months, the higher the vulnerability

Most CRISIL-rated PTCs can withstand a sharp drop in collections till May 20

Vulnerability[&]	Mortgages	Gold[#]	Other secured assets[^]	Unsecured assets[$]	Total
High	1%[*]	0%	2%	3%	6%
Moderate	0%	0%	2%	1%	3%
Low	19%	4%	39%	29%	91%

Key asset classes in securitisation space

*Trustees of transactions with Dewan Housing Finance Limited-originated pools may not have access to the cash collateral; hence marked as vulnerable
^Other secured asset classes include vehicle loans and secured SME loans.
$Unsecured asset classes include personal loans, microfinance loans, consumer durables, education loans.
#All gold loan receivables backed transactions under CRISIL's surveillance have ultimate payment structure either with maturity beyond Jun-2020 or with nil TCR.
&Based on number of securitisation transactions under which CRISIL has ratings outstanding as on 27 March, 2020.

While systemic measures announced to support in near-term, economic recovery will be key

Increased access to funding from banks against bank's borrowings through LTRO

Number of banks have announced COVID-19 emergency credit facilities/lines for their borrowers for meeting liquidity requirements

Moratorium of 3 months on term loans and deferment of interest on working capital lines

Impact on asset quality to differ across asset classes depending on resilience of underlying borrower segment to lockdown and eventual lifting of the same

However, pick-up in economic activity will be critical for number of borrower segments

Implication of measures announced by RBI and SEBI

- **RBI, on March 27th, announced its relief package to tide over the economic fallout from Covid-19**
  - Banks and NBFCs permitted to provide a three-month moratorium for term loans and working capital facilities
  - Lenders also permitted to recalculate ‘drawing power’ by reducing margins and/or by reassessing operating cycles
  - No asset classification downgrades or reporting to credit information companies owing to these measures
- **SEBI, on March 30th, announced temporary relaxation of default recognition norms for CRAs during the moratorium period; no default to be recognized in case of:**
  - Procedural delays in approval of moratorium by lenders
  - Reschedulement of debt prior to due date with approval of investors / lenders

CRISIL’s default recognition norms during the moratorium:.

Approval of lender for moratorium	Bank / Non-bank loans	Capital market Instruments
Accepted	Due date shifts under moratorium, hence no risk of default	Due date shifts in case of prior approval of investor, hence no risk of default.
Applied for / Under consideration	Relevant lenders’ policy and inclination to be considered	Inclination of investor to restructure the payment through bilateral agreement to be considered.
Denied	Default to be recognised upon lenders dis-approving moratorium	

After the moratorium CRISIL’s default recognition policy (one day, one rupee) will apply on the revised payment schedule approved by lenders/investors

Conclusion

- **Credit outlook for fiscal 2021 is negative with downgrades likely to significantly outnumber upgrades**
- **However, the extent of impact and recovery will depend on the containment of spread of Covid-19 and subsequent gradual economic recovery in later half of fiscal 2021**
  - Corporates credit quality will be impacted in sectors with low and moderate resilience; Balance sheet strength to absorb prolonged slowdown will determine credit quality
  - NBFCs and securitisation transactions with exposure to weak borrower segments, and a prolonged recovery, will see credit quality pressures
- **Risks to these expectations**
  - High Intensity, spread and duration of the Covid-19 pandemic
  - Prolonged consumption slump
  - Slower than expected pace of economic recovery
  - Fiscal and monetary policy measures

Thank you

How to interpret the Covid-19 impact analysis table

Sectors	Sector placement*	Immediate revenue impact	Resilience
Highway tolling	H-M	• High, as tolling is suspended during the Covid-19 lockdown period, and hence revenues of SPVs will be zero	• Medium, as availability of DSRA could cushion the impact of tolling suspension, and stabilisation of traffic volume could take time to reach pre-Covid-19 levels
Telecom	L-H	• Low, as it is considered an essential service during the Covid-19 lockdown period, and increased use of telecom services due to ‘work from home’ will boost data revenues for telecom providers	• High, with no likely impact, as telecom services will continue unabated during the lockdown period and operators will be paid for their services
Gems and jewellery	H-L	• High, as it is considered a non- essential product during the lockdown period, and hence revenues of jewellers will be zero • Even diamond polishing companies may face export order cancellations	• Low, as risk of defaults is heightened due to delayed payments/ interruption in cash-flow cycle
Airlines	H-L	• High, as complete halt in passenger transportation during the lockdown period means airline revenues will be zero	• Low, as risk of defaults is heightened due to high debt service obligations; possible lingering impact on Covid-19 scare on passenger occupancy levels for 6-9 months
Airport operators	H-H	• High, as travel has been restricted by the government	• High, as top operational airports have strong liquidity to tide over the crisis

**H=High/M=Medium/L=Low*

Spokespeople available for Q&A on the teleconference

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- Somasekhar Vemuri, Senior Director, CRISIL Ratings
- Krishnan Sitaraman, Senior Director, CRISIL Ratings