

A microscopic image showing several spherical virus particles with prominent surface spikes, set against a dark background with a bokeh effect of light spots.

# Pandemic to weigh on India Inc credit quality

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## Foreword

We are in unprecedented times. The Covid-19 pandemic is spreading across the world and India is no exception. The lockdown of nearly 130 crore people and a large number of businesses is leading to disruptions and dislocations on a scale never imagined. It has slammed the brakes on economic activity and caused enormous human suffering. And we may be in early stages of the pandemic yet.

As may be expected, both markets and the economy have reacted sharply to the pandemic and its implications for businesses. Sample the shivers:

- India's gross domestic product (GDP) growth for fiscal 2021 was pegged at 6% by the Reserve Bank of India (RBI) on February 6, and by CRISIL at 5.2%. CRISIL has since revised its reading 170 basis points lower to 3.5%, while the RBI in its monetary policy meeting in March, decided not to provide an outlook on GDP growth!
- Since February 1, 2020
  - S&P BSE Sensex is down over 30%, and most global indices have crashed and seen sharp volatility
  - Crude oil is down 64%, while the rupee is trading 6% lower compared with the dollar
  - AAA corporate bond yields have fluctuated in a wide band of over 200 basis points

In times like these, every assumption and model needs repeated recalibration because the environment can change rapidly. Modelling revenue growth, sector profitability, non-performing assets or any other metric for fiscal 2021 can be perilous because of inadequate information. But as the leading and most trusted credit rating agency in India, form a view we must with whatever is available – and also share with you.

It is in this backdrop that we are presenting this edition of Ratings Round-Up. Our views will be updated as the intensity, reach and duration of the pandemic and its implications become clear. We will continue to communicate those over the coming week and months.

As you are aware, this six monthly publication typically focuses on rating actions of the past six months and then underscores the credit outlook for India Inc.

In this edition, too, we present a brief summary of rating actions for the past six months. However, the primary focus is on trying gauging what's ahead in the near to medium term, given investor interest in the implications of the pandemic and lockdown for India Inc's credit profiles.

Take care and stay safe!

– Somasekhar Vemuri, Subodh Rai and Krishnan Sitaraman

## Executive summary

Intensifying Covid-19 pandemic and a looming global recession have cast an unprecedented cloud over the credit quality outlook of India Inc, which has already been impacted by a slowing economy. This has forced CRISIL to slash its base-case GDP growth forecast for fiscal 2021 to 3.5%<sup>1</sup>.

The slowing economy is reflecting in rating actions with downgrades (469) outnumbering upgrades (360) in the second half of fiscal 2020, and CRISIL's credit ratio falling to 0.77 time from 1.21 times in the first half.

Amid intensifying credit pressures, timely measures by the RBI to permit banks to offer moratorium on servicing of bank loans until May 2020 comes as a big breather in the immediate term. Over the near to medium term, however, credit quality trends would be driven by the resilience of companies in terms of bouncing back from the near-standstill demand situation.

We foresee India Inc's credit quality deteriorating in the near term. Our study of 35 sectors, both from manufacturing and services, however, shows sharp variation in resilience in a post-Covid-19 landscape. While strong balance sheets or continuing demand will support some sectors during the current lockdown, a sharp pick-up in demand thereafter will help. However, some other sectors could be cramped by collapsing discretionary demand or high leverage.

These 35 sectors account for over 3,000 firms and over 71% of the debt (excluding financial sector) in CRISIL's rated portfolio. The key conclusions of this study include:

- **Nearly 44%** of the debt is in sectors expected to be in the high-resilience category. These include pharmaceuticals, fertilisers, oil refineries, and power & gas distribution & transmission due to the essential nature of products and even government support in some. Telecom and fast-moving consumer goods (FMCG) will see the least demand impact and for some of their sub-segments may indeed benefit from demand uptick during the pandemic-driven disruption
- **Nearly 52%** of the debt is in sectors expected to be in medium-resilience category. These include automobile manufacturers, power generators, roads and construction. While these sectors have moderate-to-high disruption due to the lockdown, key mitigating factors that cushion the cash flows include the presence of strong balance sheets or liquidity or expected stronger recovery in demand
- **Around 4%** of the debt in sectors in the least-resilience category. These include airlines, gems & jewellery, auto dealers and real estate due to the discretionary nature of goods and services, and weak balance sheets

In the financial services segment, the lockdown restrictions will have a near-term impact on both collections and fresh loan disbursements.

While the RBI moratorium provides some relief on the assets side, it is on the liabilities side that challenges could emerge for non-banking financial companies (NBFCs) with high share of capital market borrowings. That's because no moratorium has been announced so far for capital market borrowings (such as bonds and

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<sup>1</sup> See CRISIL press release dated March 26, 2020, titled 'Slashing India's growth by 170 bps'

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commercial paper) and unless investors expressly consent to restructure the instrument terms, repayments on these will have to be made on time, during a period when collections would be impacted significantly.

NBFCs rated investment-grade by CRISIL have high levels of liquidity and/or enjoy strong parentage. CRISIL's analysis of the top 100 rated NBFCs indicates that a significant majority have liquidity buffer<sup>2</sup> of over 2 times towards the repayment of capital market borrowings due in the next two months.

In terms of the resilience of the underlying asset classes, CRISIL's analysis reveals that:

- Gold loans will see faster asset-backed recovery despite weaker income profile of borrowers, while home loans will be the least affected as majority of borrowers are salaried
- Vehicle loan and affordable home loan segments are expected to see moderate recovery as economic activity resumes.
- Microfinance, unsecured loans, and small and medium enterprise borrowers (including the loan against property segment) will continue to be impacted severely over the next 9-12 months owing to weak credit profile of borrowers amid a gradual economic recovery

An analysis of CRISIL-rated securitisation transactions shows that over 94% of them would be able to service initially promised cash flows to investors on time even if there is a near cessation in collections in the next two months. Long tenures, flexible payment structures and adequate cash collateral are factors that contribute to high safety in rated transactions. Securitisation transactions involving shorter tenure asset classes, structures with timely interest and timely principal (TITP) promise to investors and pools with relatively low amortisation, are some pockets of vulnerability.

Clearly, even as the pandemic rages, supportive measures from the Government of India and the RBI have eased pressure on cash flow across various sectors for the near term. As the lockdown is lifted, credit profiles will be back to being driven by fundamentals – namely, pace of economic recovery, demand resilience in respective sectors, and normalisation of working capital cycles.

However, the duration, spread and intensity of Covid-19 pandemic will continue to cloud the credit outlook for fiscal 2021 heavily, with rating downgrades likely to far outnumber upgrades. Any further fiscal and/or monetary support measures, as may be necessary, will be key monitorables for any upside to this expectation.

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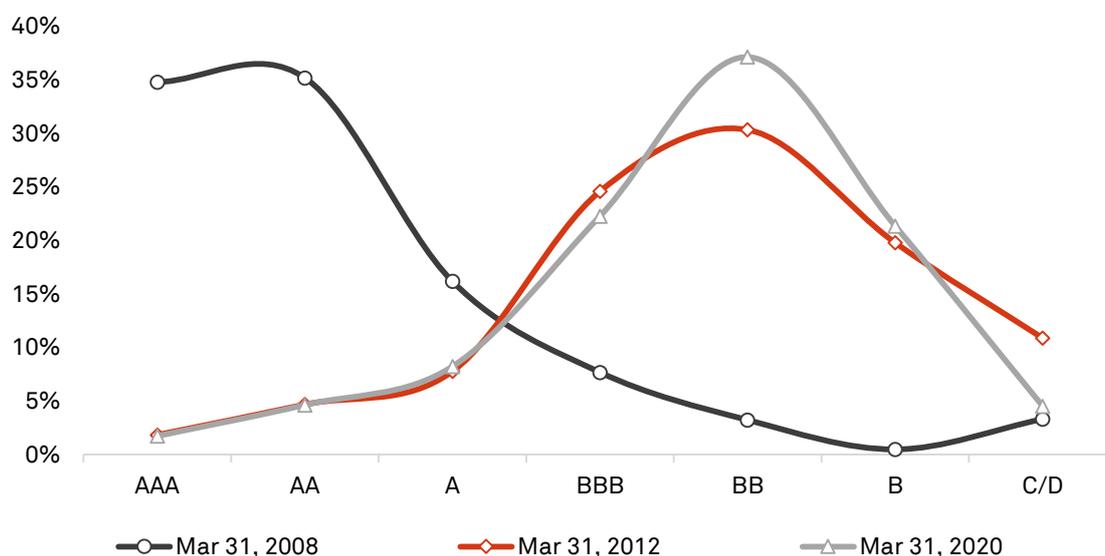
<sup>2</sup> Measured as (Cash available with NBFC + Unutilised bank lines)/(Capital market debt falling due till May 31, 2020)

## About Ratings Round-up

The Ratings Round-up is a semi-annual publication that analyses CRISIL’s rating actions and traces the linkages between such actions and the underlying economic and business trends. This edition analyses CRISIL’s rating actions in the six months through March 2020. However, we focus a lot more on trying to see what lies ahead over the near to medium term, in consideration of investors’ keen interest to know the implications of Covid-19 and the ensuing lockdown for India Inc’s credit profiles.

## CRISIL’s portfolio and median rating unchanged

**Chart 1: Trends in rating distribution**

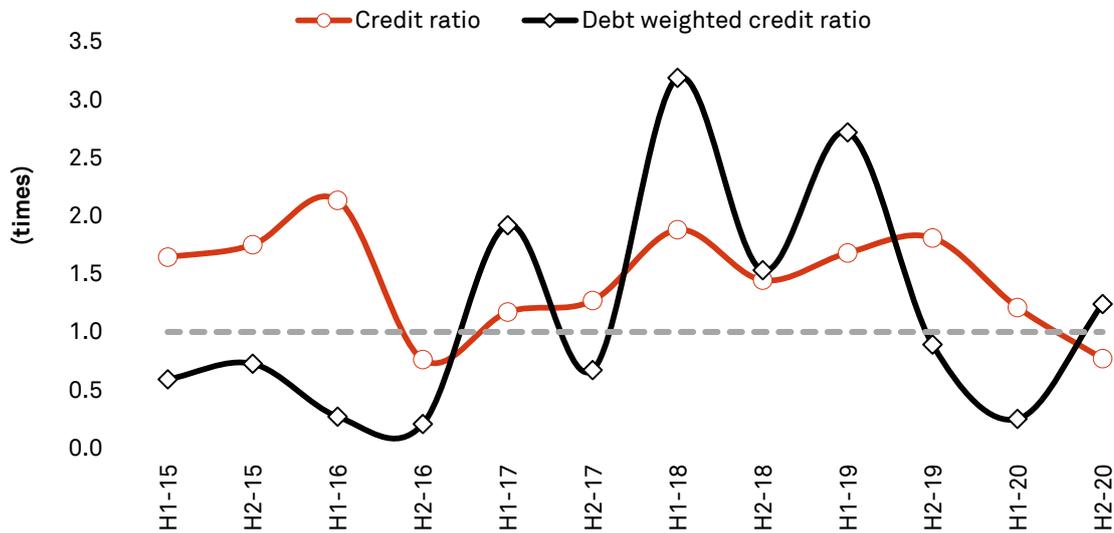


Source: CRISIL Ratings

The ratings outstanding as on March 31, 2020, in CRISIL’s portfolio cover about 10,000 companies. Of these, 65% are in ‘BB’ or lower categories. Consequently, the median rating has stayed put in the ‘BB’ category. With the introduction of bank loan ratings in 2007 and rapid expansion of CRISIL’s portfolio, especially into lower rating categories, the median rating has moved to ‘BB’ as on March 31, 2020, from ‘AA’ as on March 31, 2008.

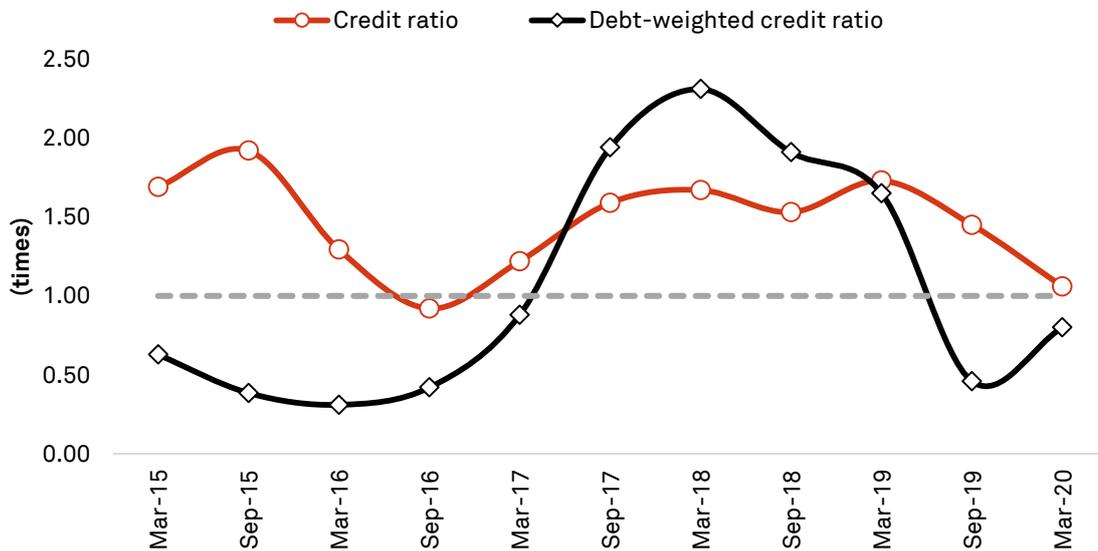
## Downgrades outpace upgrades in the second half of fiscal 2020

Chart 2: Trends in credit ratio and debt-weighted credit ratio



Source: CRISIL Ratings

Chart 3: Trends in credit ratio and debt-weighted credit ratio (on a rolling basis)



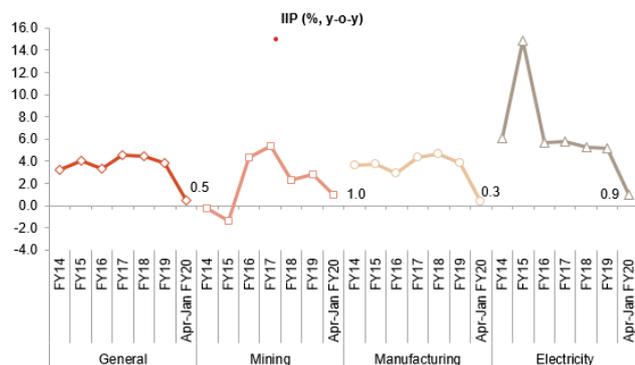
Source: CRISIL Ratings

CRISIL's credit ratio and debt-weighted credit ratio were at 0.77 time and 1.24 times, respectively, for second half of fiscal 2020, against 1.21 times and 0.25 time in the first half. Similarly, the credit ratio and debt-weighted credit ratio for fiscal 2020 were at 1.06 times and 0.80 time, respectively, as against 1.73 times and 1.65 times, respectively, for fiscal 2019.

In the Ratings Round-Up of September 2019, CRISIL had expected the credit ratio to moderate in fiscal 2020 because of slowing government spending and weakening of the global economy.

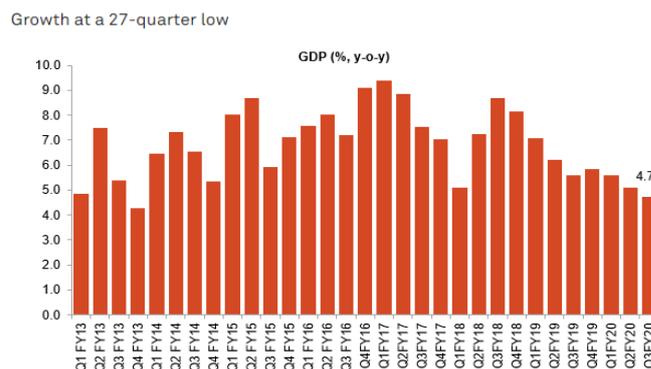
However, as the following charts show, there was a sharper decline in key macroeconomic indicators in fiscal 2020. During the second half of fiscal 2020, GDP reached a decadal low as growth slipped further vis-à-vis the first half. A decline in private consumption, fixed investment, and gross value added are a result of weak consumption demand, reduced government spending, and low capacity utilisation due to contraction in manufacturing, respectively.

**Chart 4: Trends in Index of Industrial Production**



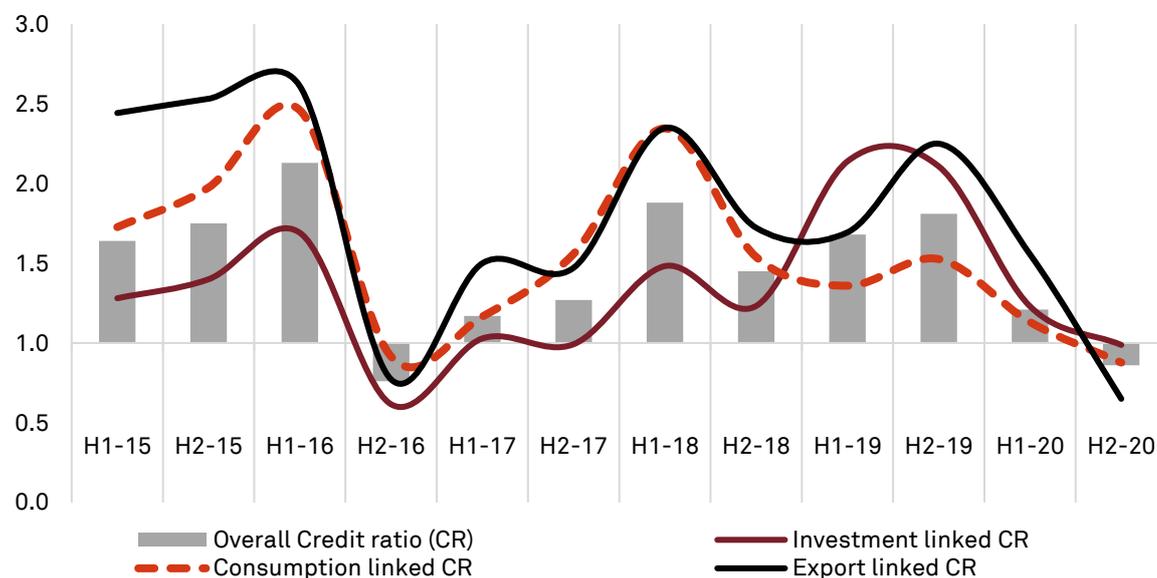
Source: National Statistical Office

**Chart 5: Trends in GDP**



Source: National Statistical Office

**Chart 6: Trends in sector-wise credit ratio**



Source: CRISIL Ratings

The credit ratio declined across sectors, reflecting macroeconomic trends and the grim outlook for fiscal 2021.

In the wake of the disruption caused by the pandemic and its ramifications on domestic and global economic activity, CRISIL Research has slashed India's GDP growth estimate for fiscal 2021 to 3.5% from 5.2%. And even this assumes two things: a normal monsoon and recovery from the pandemic in the first quarter of fiscal 2021.

CRISIL Research has also noted that 'the non-linearity and complexity of what's unfolding creates uncertainties not only for businesses but for all mankind, and weighs heavily on sentiment and outlook, with

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risks tilted to the downside. Inability to control the pandemic and extension of the lockdown will aggravate supply and demand shocks.’

Hence, quantifying downside risks become difficult. These factors are expected to have a significant bearing on the credit quality outlook for fiscal 2021, as detailed in subsequent sections.

## Investment-linked sectors Government spending slackening

**41%**  
of ratings outstanding as on date

H2-20



FY21



**Table 1: Sectoral trends in first and second halves of fiscal 2020**

	Demand	Realisations	Working capital	Credit quality H2-20	Remarks
Construction & engineering	↓	↔	↓	↓	Weak orders; working capital stretch
Industrial machinery	↓	↔	↓	↓	Weak order book
Real estate	↓	↓	↔	↔	Few upgrades from commercial real estate
Steel	↓	↑	↔	↑	Moderating but better realisations
Renewable power	↔	↔	↔	↑	Acquisitions by entities with better credit profile

Source: CRISIL Ratings

The credit ratio of investment-linked sectors has skidded to less than 1 time in the second half of fiscal 2020 due to the slackening pace of government investments and the overall domestic slowdown. Hence, downgrades increased significantly in sectors such as construction and engineering, and industrial machinery, which were hit by slower execution of orders apart from continued challenges in real estate.

**Consumption-linked sectors**  
**Slump in private consumption**

**43%**  
of ratings outstanding as on date

H2-20  
→  
FY21  
→



**Table 2: Sectoral trends in first and second halves of fiscal 2020**

	Demand	Realisations	Working capital	Credit quality H2-20	Remarks
Gems & jewellery	↓	↔	↓	↓	<i>Covid-19 exacerbated demand challenges from Hong Kong for exporters</i>
Automotive components	↓	↔	↔	↓	<i>Weak automobile demand</i>
Auto retailers	↓	↓	↓	↓	<i>Weak automobile demand</i>
Hotels	↓	↓	↔	↓	<i>Challenges post Covid-19 social distancing measures in India</i>
Multiplexes	↓	↓	↔	↓	<i>Challenges post Covid-19 social distancing measures in India</i>
Agricultural products	↑	↔	↔	↑	<i>Supported by good monsoons; hangover of Covid-19 remains</i>

Source: CRISIL Ratings

The credit ratio for consumption-linked sectors continued to decline sharply in the second half of fiscal 2020. The slowdown in the automobile sector because of changes in emission norms, lower discretionary consumption in apparel and lifestyle goods on lower wage growth, and tightening of credit conditions following the NBFC crisis dampened retail sentiment. Agricultural commodities, however, have performed well on the back of a good monsoon. Consequently, sub-sectors such as rice constituted a major portion of upgrades, driven by volume growth and better financial risk profiles of smaller entities.

## Export-linked sectors Rising global uncertainties to impact demand

**12%**  
of ratings outstanding as on date

H2-20  
→  
FY21  
→



**Table 3: Sectoral trends H1-20 vs H2-20**

	Demand	Realisations	Working capital	Credit quality H2-20	Remarks
Textiles (readymade garments)	↓	↓	↓	↓	<i>Continued high competitive intensity; Covid-19 overhang on demand</i>
Textiles (ginning & spinning)	↓	↓	↔	↓	<i>Increase in cotton prices and weak demand</i>
Electronic components	↓	↓	↓	↓	<i>Post Covid-19 impact in key consuming countries</i>
Pharmaceuticals	↑	↔	↔	↔	<i>Players with product diversification benefitted while select few with weak balance sheets witnessed downgrades</i>

Source: CRISIL Ratings

The credit ratio of export-linked sectors weakened in fiscal 2020, much sharper (to less than one time) in the second half. These sectors were already affected, albeit not severely, by the US-China trade war combined with economic slowdown in the Europe. However, they also benefitted from new opportunities, especially in the pharmaceuticals and information technology sectors. Growth in the readymade garments industry remained crimped by intense competition in the export markets, despite the depreciation of the rupee.

# Impact on the corporate and finance sectors

## Extraordinary times, extraordinary measures

The shock to the global economy from Covid-19 is unprecedented, given the pandemic's non-linear spread and lack of textbook solutions to deal with it. The global economy is in free fall, making it difficult to predict time horizons of any sort, with the impact being swifter and more severe than any crisis seen before.

Across, demand has fallen off the cliff, with supply disruptions exacerbating matters. In India, the lockdown has intensified pre-existing demand pressures and slowdown. We see two orders of disruption.

The first-order effect has come from the global slowdown and trade disruptions, with sectors such as textiles, automobile parts and components, and steel taking a direct hit in their revenue growth as volumes and realisations are under pressure. The second-order blow has come from the countrywide lockdown and social distancing, driving factory closures, reduced labour wage growth, travel bans, and decimated retail consumption. This has influenced sectors such as retailers, airport operators, hospitality & tourism, and roads. Second-order effects may also include liquidity crunch besides reduced domestic consumption. Prolonged social distancing could disrupt capital formation and ultimately labour participation and productivity.

In this uncharted territory, while many have declared a global recession, quantifying the impact on demand across sectors beyond the obvious prediction of de-growth is still a huge challenge. Fluidity of the current scenario raises questions about the trajectory of the ongoing shock and recovery timelines across various sectors. Nevertheless, it is necessary to estimate the pace of revival and whether there will be any long-lasting structural impact on the economy.

### Interventions by government, regulators provide offset

The government and various regulators have announced a series of measures to support corporates and individuals during the lockdown. Some of the initiatives include:

**Table 4: Recent policy measures**

Ministry/Regulator	Measures taken
Ministry of Finance	<ul style="list-style-type: none"><li>Pradhan Mantri Garib Kalyan package to address liquidity needs of the poor, provide insurance to health workers, and ensure adequacy of necessary utilities such as pulses and gas cylinders</li></ul>
RBI	<ul style="list-style-type: none"><li>Loan moratorium of three months ending May 2020</li><li>Banks may revise their working capital limits</li><li>Long-term repo operations extended to corporate debt securities</li></ul>
Securities and Exchange Board of India (SEBI)	<ul style="list-style-type: none"><li>Relaxation of default recognition norms for credit rating agencies(CRAs) during the moratorium period</li></ul>

*Source: Websites of MoF, RBI and SEBI*

The lockdown and subsequent policy measures including the moratorium will have varied impact across different sectors. While corporates benefit by conserving cash, financial institutions are facing a double whammy in terms of limited collections and no moratorium on capital market instruments.

Recovery after the lockdown will also be varied across sectors, depending on the structural resiliency in the sectors and the progress in the underlying consumer class. In the following sections, we attempt to gauge the likely impact on credit quality for various sectors.

## For corporates, recovery a function of demand resilience and working capital normalisation

Falling demand and supply disruptions in the wake of the pandemic will impact the performance of companies. Timely policy measures partly address near term issues and may partially support cash conservation for corporates. While these relief measures may partly address the near term issues, extent of contagion and time to lifting up of lockdown remains contingent upon the effectiveness of containment measures.

In the following section, CRISIL has put forth an assessment of extent of revenue loss and level of resilience of a sector to withstand the impact of the pandemic-led slowdown. Our analysis suggests that different sectors will display varying degree of resilience to withstand the impact and bounce back in the post-Covid-19 scenario.

It may be pertinent to note that we are amidst early stages of an unprecedented pandemic and the lockdown associated with it. The views expressed herein are based on present set of assumptions. In a rapidly evolving environment, implications could differ depending on the intensity and duration of the pandemic and economic deceleration. We will continue to communicate our views regularly as the environment evolves.

### Methodology and assumptions

The study of the sectors is solely based on the Covid-19 impact and does not attempt to factor in any other macroeconomic variables' impact on the sector selected. CRISIL has analysed 35 key sectors on the three parameters: a) immediate revenue impact, b) time taken to recovery to normal operations, and c) sectoral resilience. These 35 sectors contribute 71% of its total rated portfolio (excluding financial services).

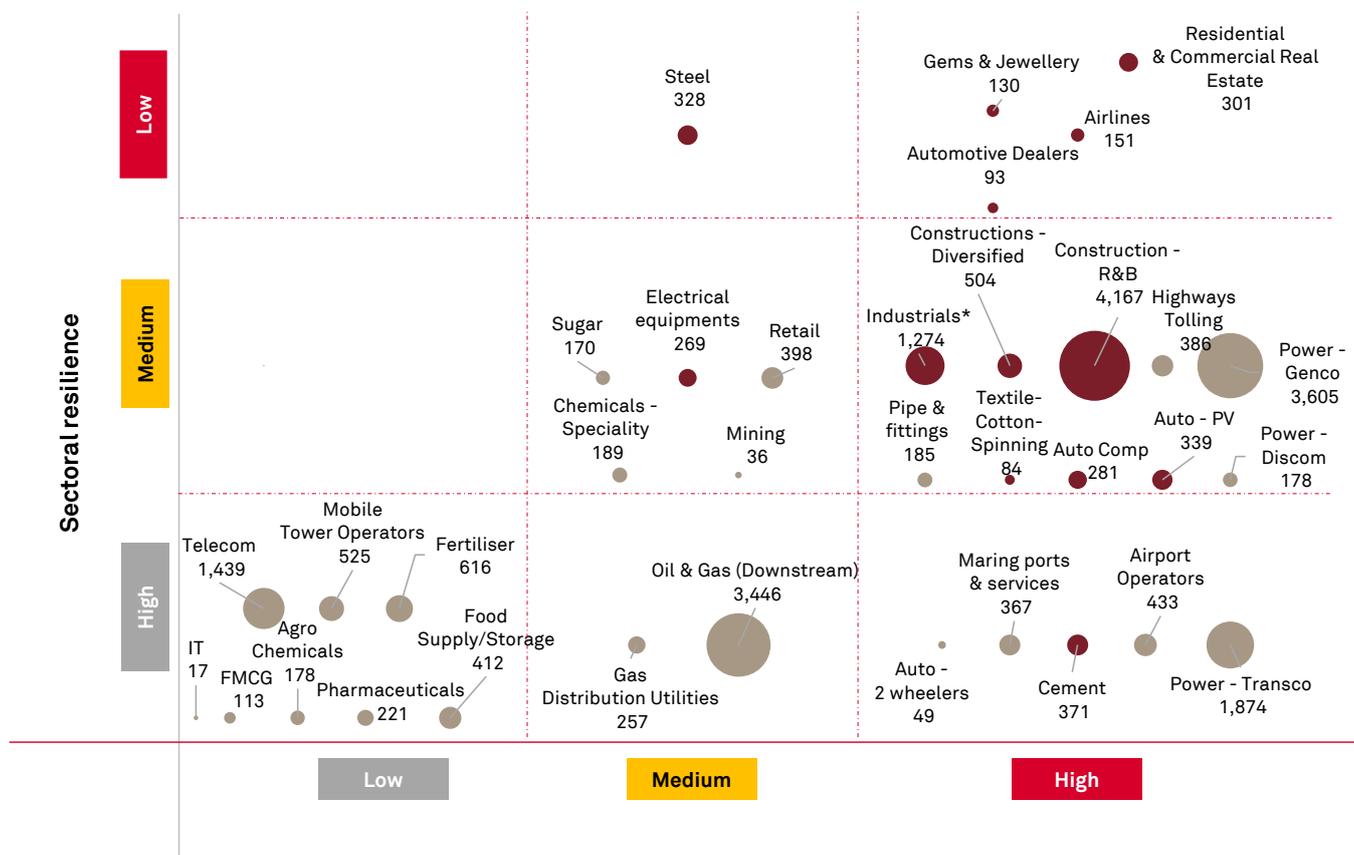
### Some terminologies used in this report, and what they mean

**Revenue impact:** This term indicates the extent of revenue loss in the three months (April–June 2020) due to the Covid-19 related disruption to the sector.

**Time taken to recovery:** This is the time taken for the sector to recoup and operate at normal capacity. Normal capacity is defined as the capacity which is sustainable after all critical factors of production are available on a steady state basis (like labour is available for shifts, production is carried out without disruptions, deliveries/stocking of Finished Goods/Raw material are done without any contingency measures applied).

**Sectoral resilience:** Ability of the sector to sustain the revenue impact of Covid-19 and bounce back to full production in post-Covid-19 scenario. The factors at play that can lead to this bounce back can be multiple - category of goods (essential/ non-essential); nature of demand (discretionary or non-discretionary), strength of the balance sheet in terms of leverage and liquidity available for entities in the sector and the level of government/ regulatory support available to the sector.

Chart 7: Sectoral resilience, diced in three ways



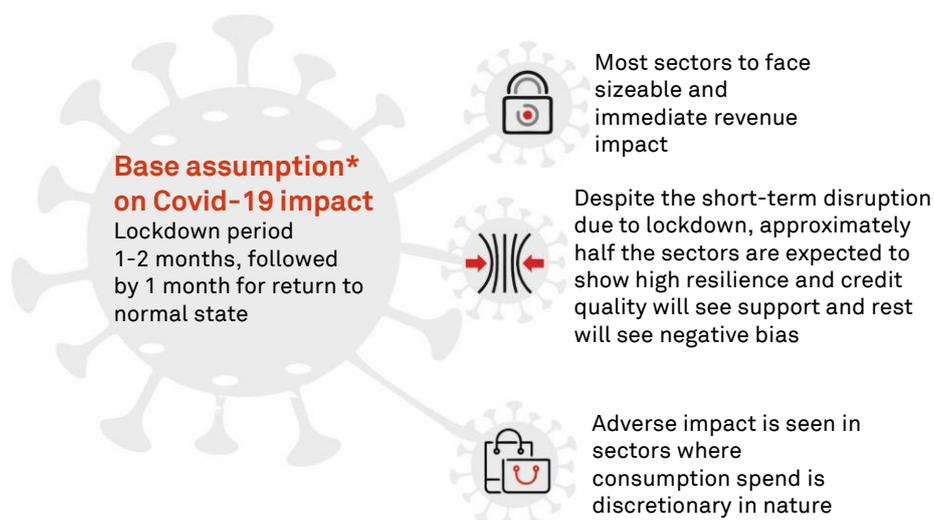
Size of the bubble indicates rated debt quantum (figures in Rs ' 00 crore)

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

Source: CRISIL Ratings

- X axis denotes immediate revenue impact on the sector amid lockdown:
  - For example, airline has high revenue disruption – categorised as high
- Y axis denotes resilience of the sector to weather the Covid-19 lockdown
  - Airline has low resilience due to weak balance sheets – categorised as low
- Colour of the bubble denotes time to recovery for the sector (Grey- reversal to normal operations expected over near term; Red - reversal to normal operations expected over medium term) Ex. Airlines is coloured red to highlight the longer time taken to recover

## Key messages



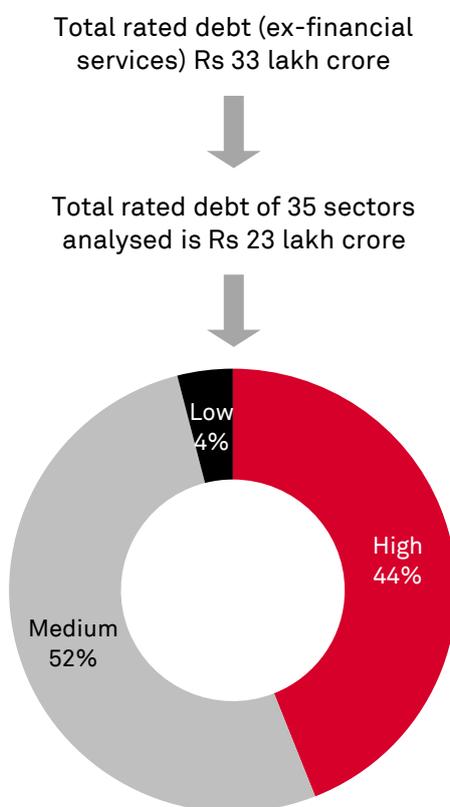
\*Assumption factors in present relief measures and payment default exemptions announced by the RBI (March 27, 2020) and SEBI (March 30, 2020). This assumption may undergo a change based on the extent of Covid-19 spread and effectiveness of the government's containment measures

## The big picture is, India Inc is more resilient than it appears

Our analysis reveals that while most of the sectors will undergo stress, there are sizable number of sectors where impact could be low.

- **Nearly 44%** of debt is in high-resilience sectors. These include pharmaceuticals, fertiliser, oil refineries, and power and gas distribution & transmission because of the essential nature of products and government support in some. Telecom and FMCG will see the least demand impact and some of their sub-segments may benefit from demand uptick during the pandemic disruption
- **Nearly 52%** of debt is in medium-resilience sectors. These include automobile manufacturers, power generators, roads and construction. While these are seeing moderate to high disruption because of the lockdown, the key mitigating factors cushioning cash flows include the presence of strong balance sheets or liquidity, or expected stronger recovery in demand
- **Around 4%** of debt is in least-resilient sectors such as airlines, gems and jewellery, auto dealers and real estate because of the discretionary nature of their goods and services, and weak balance sheets

**Chart 8: Breakup of debt under study**



Source: CRISIL Ratings

## High sectoral resilience in 44% of rated debt analysed

Nearly half of the sectors (15) may display high resilience due to multiple reasons such as presence of sufficient cash reserves to reach production readiness, continued/uninterrupted production being part of chain of essential goods and services, high prospects of immediate demand restoration as soon as the pandemic restrictions are lifted and government or regulatory support.

**Table 5: Trends in sectors with high sectoral resilience and rationale**

Sectoral Resilience	Reason	Sectors
High	Despite revenue impact, high cash reserves and lower leverage increases resilience. Regulated business model in airports.	Two-wheelers
		Cement
		Airport operators
	Low leverage provides ability to brace the impact of sluggish Import and export volumes	Ports
	Low operational costs and strong counterparties help weather the impact of risk of payments delay	Power transmission
	Despite revenue impact, strong government support will provide resilience	Oil marketing companies
	Immediate demand restoration after Covid-19 restrictions are lifted; Low leverage provides ability to sustain operations.	City gas distribution
		Fertilisers
	Part of the chain of essential products and services	Agrochemicals
		Food supply
		Pharmaceuticals
		Mobile tower
	Low demand elasticity and increased consumer dependency during Covid-19 lockdown	Telecom
		FMCG
	Mostly sustain operations remotely hence minimal revenue impact, favourable currency trends and low sector leverage	IT consulting

Source: CRISIL Ratings

## Medium sectoral resilience in 52% of rated debt analysed

15 sectors show 'Medium' resilience to revenue disruptions. Here uncertainties in demand pick-up post-Covid-19 may impact the business over the 9-12 months though mitigants may partly offset the impact.

**Table 6: Trends in sectors with moderate sectoral resilience and rationale**

Sectoral resilience	Reason	Key sectors
Medium	Uncertainty around ready availability of labour and likely slow build-up of order book	Construction – Roads and bridges Construction – Diversified
	Traffic build up to be gradual but cash reserves to support Covid-19 disruptions	Highway tolling
	Moderate revenue pick-up due to slowdown in industrial activities	Speciality chemicals Industrials Pipes and fittings Electrical equipment
	Part of essential services but build-up of receivables from distribution companies may impact cash flows	Power generation companies
	Likely weak collections partly offset by being an essential services and moratorium on payments to power generation companies	Power distribution companies
	Sluggish demand will impact revenues however low leverage in some companies may offset the impact	Auto OEMs
	Cos. with high after-market sales and low leverage will weather the storm. However, ones exposed to original equipment manufacturer (OEM) demand and have higher leverage may be impacted	Auto ancillary
	Low demand risk but high leverage	Sugar
	Part of essential services but manpower constraints	Iron ore mining
	Slower pickup in discretionary demand in non-food retail categories. Partly offset by growth in essentials like food & grocery	Retail
	Low labour intensity may result in faster reversal but high leverage	Textiles – Cotton spinning

Source: CRISIL Ratings

## Low sectoral resilience in 4% of total debt

Under the analysis, we found that sectors which may see high revenue disruption and a low resilience of the sector to state of readiness in the post-Covid-19 scenario. That is because of the combination of discretionary nature of products or services and expectation of an elongated demand recovery. These sectors include:

**Table 7: Trends in sectors with moderate sectoral resilience and rationale**

Sectoral Resilience	Reason	Key sectors
Low	Pandemic to elongate demand recovery in passenger airline sector	Airlines
	Consumers may defer purchase of Non-essential nature of products in these sectors	Gems and jewellery
		Auto dealers
	Real estate	
	Slowdown in demand in key consuming sectors like auto OEM, auto ancillaries, and construction sector	Steel

Source: CRISIL Ratings

## Conclusion

The raging pandemic will disrupt normal business operations for most businesses. CRISIL believes 15 sectors are likely to exhibit high resilience, while 20 (accounting for over 55% of the rated debt analysed) fall into medium-to-low resilience category, which would amplify credit quality pressures on India Inc in fiscal 2021.

Supportive measures from the government and the RBI have eased pressure on cash flow across various sectors for the near term. However, duration, spread and intensity of the pandemic will determine the extent of disruption in business performance. Any fiscal and/or monetary support, as may be necessary, will be key upside in this expectation.

## For the financial sector, economic recovery is key

### Outlook on banking

Given the rapidly evolving situation, as well as the uncertainty all around on account of Covid-19 pandemic, it is difficult to ascertain exact credit growth and asset quality forecasts for fiscal 2021 at this juncture.

However, both these parameters are now expected to be significantly weaker than CRISIL's earlier estimates of 8-9% growth and ~9% gross non-performing assets (NPAs). These were predicated on CRISIL's GDP growth forecast of 5.2% in fiscal 2021, which has now lowered to 3.5%.

CRISIL is now evaluating the following key factors, the interplay of which will determine banking sector performance this fiscal:

- Credit offtake by the corporate sector is expected to remain muted. The retail segment, which has driven banking sector credit growth in recent years, should also be subdued till economic recovery gets traction. With debt capital market investors turning cautious, banks could benefit from refinancing opportunities presented by their corporate customers
- In the near term, there could be some uptick in the non-statutory liquidity ratio investment book of banks as they look to tap RBI's targeted long-term repo operations, or TLTRO window, and deploy the proceeds in investment-grade corporate bonds and commercial papers
- Revival of various sectors post lockdown and government initiatives, if any, should spur credit demand. Speed of revival and pace of economic recovery will play a role in how fundamental asset quality pans out. This is not only applicable for large enterprises, but will also have an impact down the chain for micro, small and medium enterprises (MSMEs) and retail customers
- Further, actions by RBI including any continued forbearance offered on recognition and reporting of NPAs from June 2020 onwards will need to be seen. Currently, RBI has permitted lenders to offer a three-month moratorium on term loans and deferment of interest payment for working capital facilities. There would be no change in asset classification where such moratorium is applied, thereby limiting the impact on reported NPAs
- Impact of lower credit growth on reported NPA, given the denominator effect

Banking sector profitability in fiscal 2021 will be centrally dependent on how asset quality, and therefore provisioning costs, pan out. With slower credit growth, pre-provisioning operating profits would be impacted reducing the cushion to absorb credit costs. In this context, ability to control operating expenses will gain importance in managing profitability.

We expect to see leading private sector banks gain market share, benefiting from their higher capitalisation levels. Public sector banks (PSBs), on the other hand, apart from coping up with the challenges of the Covid-19 disruptions, will also need to spend management bandwidth and efforts to successfully operationalise the merger of 10 banks into 4 effective April 2020. This will impact their ability grow in the near term.

Overall, for CRISIL rated banks, we expect reasonable stability in credit quality. For private sector banks, this will be driven by strong capitalisation and profitability while PSBs will continue to benefit from government support.

## Outlook on NBFCs

Since September 2018, NBFCs have faced multiple headwinds, with constrained funding access, coupled with rising borrowing costs and re-calibration of loan book, which has constrained their growth sharply. CRISIL had earlier expected NBFC sector growth to touch a decadal low of ~7% in fiscal 2020. However, in the light of the lockdown, the typical sharp increase in disbursements seen in March-end of a fiscal would be absent, and hence, overall growth would have a downward bias and is estimated to be less than 5% in fiscal 2020.

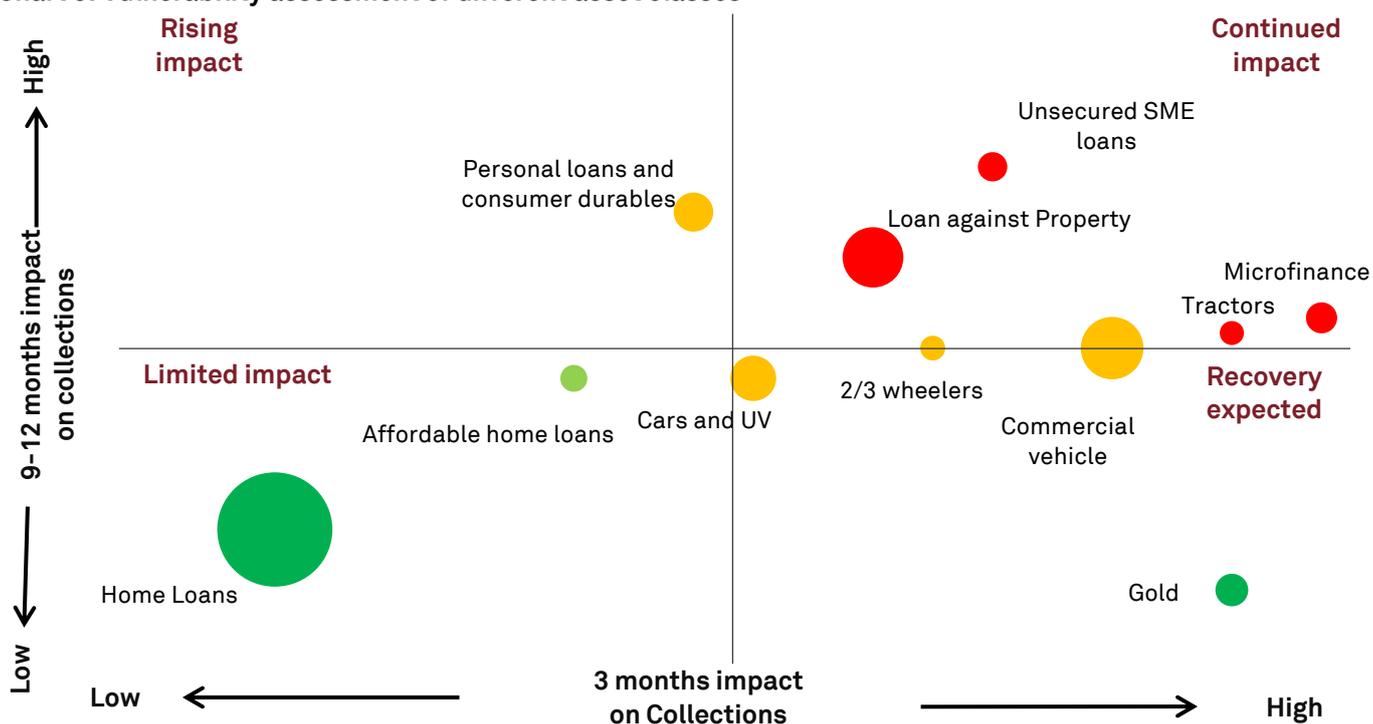
For fiscal 2021, CRISIL had previously estimated overall growth to see a marginal uptick in fiscal 2021 to ~7-8% as the funding access for NBFCs was expected to gradually stabilise. However, growth for fiscal 2021 is now expected to be significantly lower than our earlier estimates as we expect NBFCs to significantly curtail disbursements during initial three months of fiscal 2021 in order to conserve liquidity.

In terms of asset quality outlook, the NBFC sector is more retail and MSME oriented and hence, the lockdown is expected to hit the sector harder than banking. The extent of this impact on asset quality and collections for NBFCs will vary and depend on four factors in the near term - asset class, income source of the customer, level of field work in operations and proportion of cash collections. As the lockdown restrictions are lifted and business comes back to rails, what will also be important is government spending and pickup in economic activity.

- The largest segment of home loans will be less affected on asset quality because more than two-thirds of the borrowers are salaried and collections are through auto-debit instructions. In contrast, affordable housing loans could witness increase in delinquencies over the medium term because of higher proportion of self-employed borrowers, whose income streams have been affected more by the lockdown. However, the strong moral obligation linked to residential property will help keep overall asset quality in control
- The second largest asset class of vehicle finance would face immediate challenges in collections due to the lack of movement in goods other than essentials. Both inter-city and intra-city goods movement has virtually come to a standstill, other than that for essential goods. However, the government has, on March 30, eased the movement of goods to cover even non-essentials. Hence, we expect the pace of freight movement to restart steadily. Overall, the vehicle finance segment has strong correlation with pickup in economic activity. While we expect the economic growth to be lower at 3.5% for fiscal 2021 (as against our earlier estimate of 5.2%), the steps taken by the government in terms of rural spending and incentives to boost manufacturing will be a key determinant for the recovery in vehicle finance segment
- In terms of the MSME sector, the lockdown is expected to result in high impact on collections as most establishments have faced significant disruption in business. The impact on their cash flows could remain high even after lockdown restrictions are lifted as many of them may grapple not just with how economic activity picks up, but also with business specific supply chain issues and counterparty debtor risk across the value chain. Consequently, CRISIL expects the MSME financiers to continue to face asset quality challenges over the next one year

- In the unsecured segment (personal loans and consumer durables), while there will be pressure on asset quality, the near term impact on collections is not expected to be very high as good proportion of borrowers are in the salaried segment. However, over the medium term, uncertainty over economic revival could have domino effect on jobs in both the blue collar segment as well as informal / cash salaried segment. Additionally, self-employed segment remains vulnerable. Hence, delinquencies could continue to rise over the medium in this segment
- The microfinance segment will be the most impacted during the lockdown because the business model involves extensive field visits to households. More importantly, microfinance institutions (MFIs) deal with under-banked and un-banked citizens who typically have weak credit profiles and their income-generation activities would have been disrupted. In terms of asset quality, overdues in the 0-60 days bucket will rise. In the past, however, we have seen MFIs recovering well after stress such as after demonetisation, floods and other local socio-political disturbances. It remains to be seen whether the same tenacity will be on show this time, too. CRISIL expects borrowers to resume servicing their loans once the lockdown is lifted and as disbursements stabilise, while they may still be in the overdue bucket in the foreseeable future.

**Chart 9: Vulnerability assessment of different asset classes**



Source: CRISIL Ratings

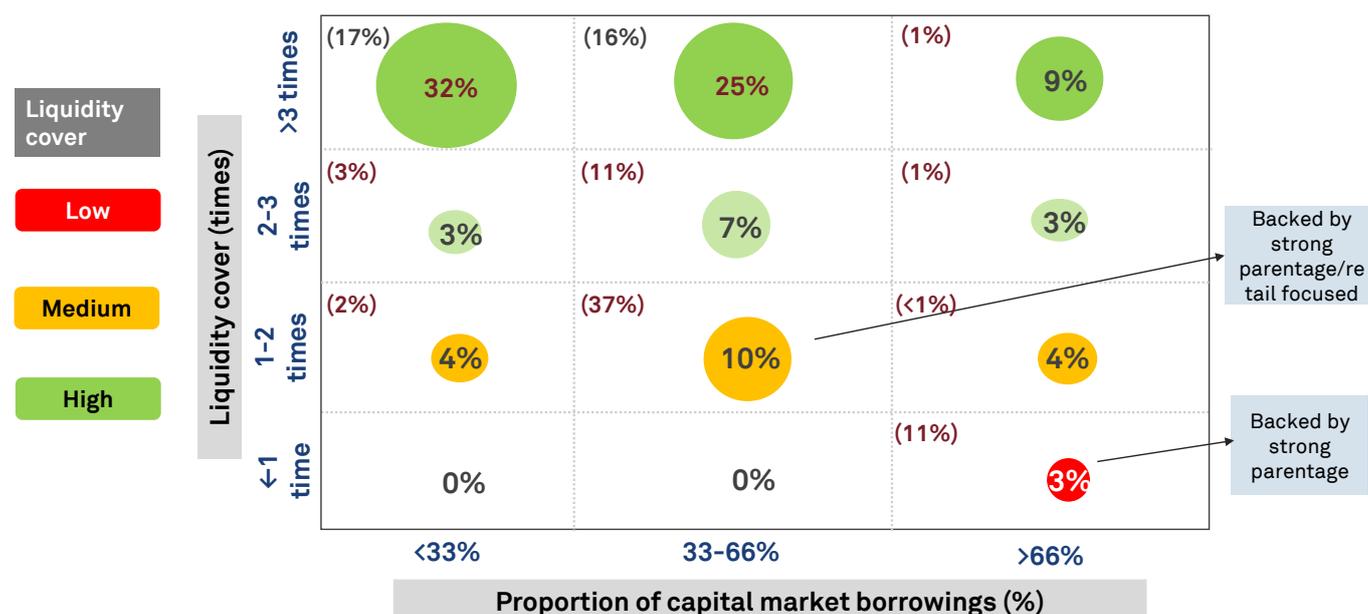
## Liquidity buffer analysis for NBFCs

During the moratorium provided by the RBI, NBFCs may face ALM challenges due to the higher proportion of capital market borrowings. What can exacerbate the situation is that mutual funds – a large investor base for higher rated NBFCs – are facing redemption pressure and hence are unlikely to roll over commercial paper or reinvest in debentures immediately to any substantial extent. However, any restructuring or rescheduling permitted by the investors will help alleviate the pressure on repayments.

To analyse the implications for NBFCs, CRISIL has evaluated the liquidity cushion available with them. An analysis of the top CRISIL-rated NBFCs – covering >80% of industry assets under management (AUM) – indicates that a significant majority have liquidity buffer<sup>3</sup> of over ~2 times towards the repayment of capital market debt due in the next two months.

For NBFCs aggregating to 11% of AUM where liquidity cover is below 1 time, CRISIL does not foresee any immediate repayment risk as these have strong parentage. For other NBFCs, we will continue to monitor the liquidity levels closely as the situation evolves.

Chart 10: Liquidity assessment of NBFCs



**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*

<sup>3</sup> Liquidity cushion including unutilised available bank lines/ Capital market debt repayment till May 31, 2020

## In securitisation, vulnerability levels vary

As with other sectors, lockdown restrictions to manage Covid-19 pandemic will impact collections from underlying loan contracts in pools backing rated securitisation transactions. Nevertheless, bulk of the CRISIL rated securitisation transactions have adequate credit enhancement to manage their servicing for the next two months even in a situation of near zero collections.

The RBI has permitted banks and other lenders to provide a repayment moratorium till May 2020 on bank facilities to mitigate debt servicing burden on borrowers.

However, the ability of originators in securitisation transactions to reschedule the investor payouts, in line with the moratorium on underlying loan contracts will depend on them procuring the consent of all counterparties in the securitisation transactions. Put in another way, the stance taken by the counterparties would determine the impact of the moratorium on the rated securitisation transactions.

As at the time of publishing this report, CRISIL's discussions with various originators indicates that where public sector banks (PSBs) are investors, many of them seem to be agreeable to rescheduling the payout schedules and this will be a support factor for the transactions. The stance of other investors will be a key monitorable for the medium term resilience of transactions that have non-PSB investors.

Investor approvals are critical to effect a change in repayment schedule on securitised instruments. In their absence, the pool collections might not be sufficient to make the initially promised investor payouts if the lockdown restrictions prolong. That's a concern because collection efficiencies in the securitised pools are anyway expected to be low across asset classes over April and May 2020.

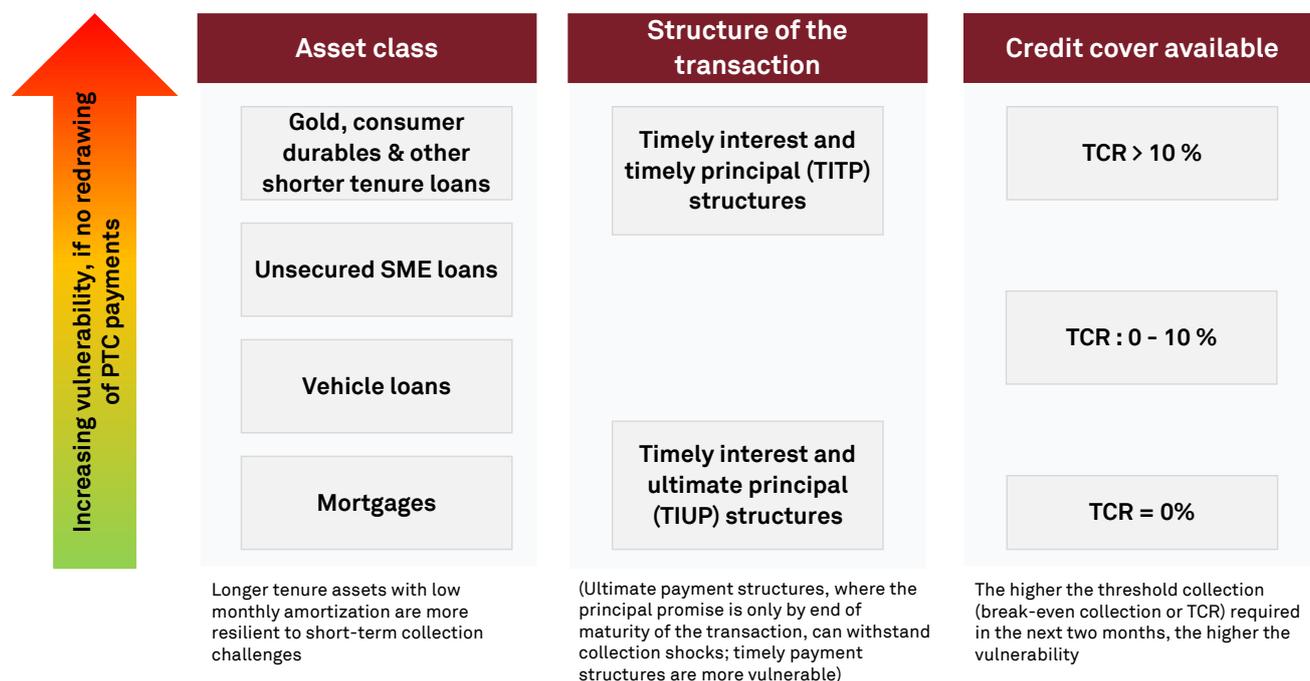
### **Impact to vary depending on transaction structures**

The impact of low collections in pools with no attendant change in investor payout schedule of securitised instruments would be varied across transactions depending on its structure, asset class, and level of amortisation of the pools at present.

Two structures are prevalent in the market and the vulnerabilities of each are different.

**Timely interest and ultimate principal (TIUP)** – In these structures, only interest is promised on a monthly basis. Principal payment is promised by the maturity of the transaction. Non-payment of principal on a monthly basis is not ground for credit enhancement usage and not considered default. Given that only interest is promised each month, in most TIUP structures, even if the collection efficiencies fall to nil for a few months, interest payouts can be fully made through cash collateral. Consequently, these structures have low vulnerability to collection shortfalls due to the recent developments.

**Timely interest and timely principal (TITP)** – In these structures, both interest and principal are promised on a monthly basis. Monthly promised payouts (including scheduled principal billings) are typically sizeable. Hence, sufficiency of cash collateral to make full investor payouts if collection efficiencies remain very low for several consecutive months would depend on the asset class. At similar levels of credit enhancement and low level of amortisation of pools, longer tenure asset classes such as mortgages would be most resilient. In that case, cash collateral would be able to make payments for much longer when collection efficiencies are low. Transactions with shorter tenure asset classes such as consumer durable, gold, two-wheeler, and microfinance loans would be most vulnerable.



## 94% of CRISIL-rated transactions can bear a big drop in collections in the next two months

CRISIL has evaluated all its rated securitised transactions for vulnerability (inability to make scheduled investor payouts) in light of the impending drop in collections, assuming investor approvals for restructuring the payouts are not available. CRISIL's analysis shows that 94% of its rated transactions would be able to withstand a sharp drop in collections over a two-month period. Longer tenure asset classes are least vulnerable to the ongoing disruptions. Gold loan receivables-backed issuances, while short-tenure in nature, are all under TIUP structure, and hence, not categorised as vulnerable. Asset classes with shorter tenors, and with a fair share of TITP structures and pools with relatively low amortisation, are where the pockets of vulnerability reside.

**Table 8: Vulnerability classification of CRISIL-rated securitisation transactions**

Vulnerability classification (% of transactions)	Mortgages	Gold	Other secured asset classes <sup>^</sup>	Unsecured asset classes <sup>§</sup>	Total
High	1%*	0%	2%	3%	6%
Medium	0%	0%	2%	1%	3%
Low	19%	4%	39%	29%	91%
Total	20%	4%	43%	33%	100% <sup>&amp;</sup>

\*Transactions with Dewan Housing Finance Ltd-originated pools where trustees may not have access to the cash collateral due to ongoing insolvency resolution proceedings.

<sup>^</sup>Other secured asset classes include vehicle loans and secured SME loans.

<sup>§</sup>Unsecured asset classes include personal, microfinance, consumer durables, and education loans.

<sup>&</sup>Based on number of securitisation transactions under which CRISIL has ratings outstanding as on March 27, 2020.

Source: CRISIL Ratings

## What lies beyond

The trajectory of ratings on securitised instruments over the medium to longer term, i.e., beyond the next two months, would be determined by the extent of continued dip in collections, if any, in the pools due to:

- Cash flow losses to retail borrowers beyond the moratorium period due to Covid-19 and challenges on the economic front, and
- Any changes in borrowers' repayment behaviour on account of the moratorium

Unsecured asset classes such as microfinance and transaction where underlying borrowers are self-employed would be the most affected segments. CRISIL will be closely monitoring the ratings on all its rated securitisation transactions with special emphasis on those backed by receivables from more vulnerable asset classes/borrowers.

## Conclusion

The Covid-19 pandemic is constantly evolving, rendering it difficult to predict or model its implications. There are several initiatives being announced by various agencies to contain the economic fallout of it.

Nevertheless, the credit outlook for first half of fiscal 2021 decidedly is negative. The rating downgrades are likely to far outnumber upgrades as India Inc learns to cope with the pandemic.

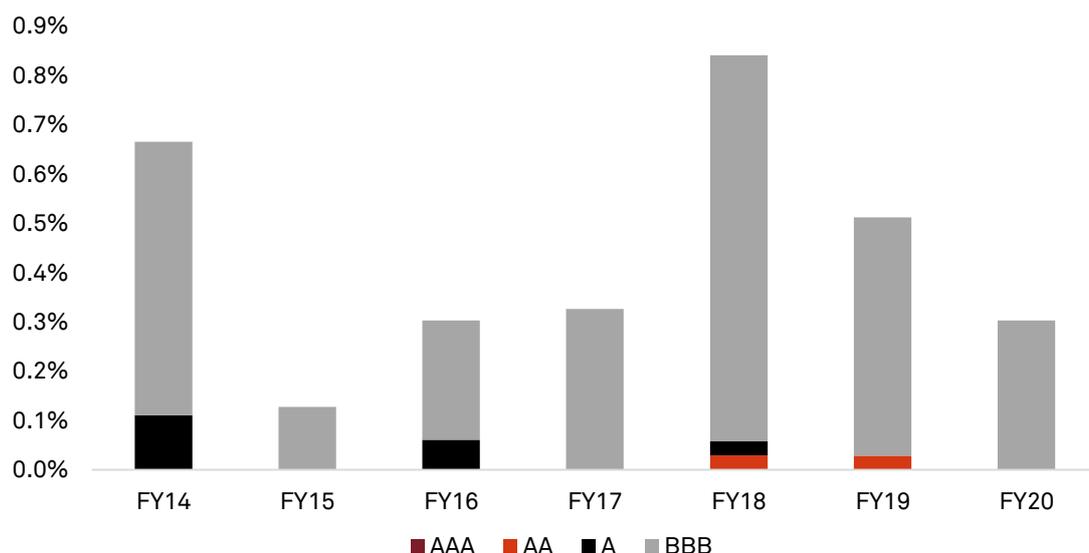
The measures from various government agencies and the central bank have provided some relief. However, the duration, spread and intensity of the pandemic will determine the adequacy of these measures, and any need for further fiscal and/or monetary stimulus.

As the lockdown is lifted, credit profiles will be back to being driven by fundamentals, as opposed to relief measures.

Steady economic recovery, bounce back in demand, and normalisation of working capital cycles are key for recovery in credit quality and different sectors will see varied levels of resilience to the business impact of the pandemic in the months ahead.

## CRISIL's ratings exhibit robust, best-in-class quality metrics in a challenging environment

**Chart 11: Trends in sharp rating changes as % of investment grade ratings**



**Note:** The investment-grade ratings here do not include those on securitisation transactions.

*Source: CRISIL Ratings*

CRISIL's quality metrics stand testimony to its analytical rigour, despite the changing credit landscape and volatile environment. In this section, we assess if CRISIL's ratings have withstood the test of time, using consistent and globally accepted performance metrics.

Backed by the highest analytical rigour, robust criteria and proactive surveillance, CRISIL's ratings have displayed best-in-class quality metrics in the Indian credit rating industry, which is evident from its lowest default rates and highest stability rates, and the lowest intensity of rating actions.

The Securities and Exchange Board of India (SEBI), in its circular dated November 13, 2018, had mandated credit rating agencies to disclose sharp rating actions in the investment grade category for securities. A sharp rating action is defined as a change of more than three notches. Intensity is calculated as sharp rating actions to the total outstanding investment grade portfolio. Intensity of CRISIL's rating actions has been the lowest in the industry for the past five years, especially for investment-grade ratings (see chart 11), with less than 1% of ratings facing rating actions exceeding three notches. It may be noted that high-intensity rating actions have been nil for the AAA category and less than 0.1% for the AA category, over the years.



## About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

## About CRISIL Ratings

CRISIL Ratings is part of CRISIL Limited ("CRISIL"). We pioneered the concept of credit rating in India in 1987. CRISIL is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI"). With a tradition of independence, analytical rigour and innovation, CRISIL sets the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 24,500 large and mid-scale corporates and financial institutions. CRISIL has also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and microfinance institutions. We also pioneered a globally unique rating service for Micro, Small and Medium Enterprises (MSMEs) and significantly extended the accessibility to rating services to a wider market. Over 110,000 MSMEs have been rated by us.

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