Ratings

CRISIL
An S&P Global Company

Stirred and shaken

Ratings Round-Up

First half, fiscal 2021

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Foreword

India has added a whopping six million cases to its Covid-19 tally since the previous edition of Ratings Round-Up on April 2 this year. But given the threat of what economists call hysteresis, or persisting economic scars, the government has been cautiously unlocking economic activities despite the spectre of a second wave of afflictions looming.

Looking back at the past six months, the pandemic has been as much a story of crisis as of resilience of human spirit. Governments and regulatory bodies have stood up to the testing times with stimulus and support measures. Organisations have been adapting to new ways of working. Even as many of us continue to work from home, in an individual capacity, we continue to innovate to cope with the new challenges. This collective effort, resilience and innovation is what affords hope in the long road to recovery.

CRISIL has also continued to adapt to the evolving situation. Our investments in top-notch technology over the years meant we could begin remote work before it became necessary and mandated by the twin challenges of ensuring employee safety and continuing to offer best-in-class services to clients.

We also reached out to our clients proactively to check on their personal and family well-being, the performance of their firms, and the challenges they are facing.

Our vast coverage of around 9,000 active rated issuers and in-depth engagement with clients helped us get a good sense of what was happening on the ground, especially when formal data sources came up short. Our robust processes for tracking and acting on material alerts enabled us to identify vulnerabilities emerging in key sectors and to take timely rating actions.

At the outset of the pandemic, we also laid out a framework for assessing resilience across 35 sectors, categorising into three buckets – high, moderate and low. This helped us anticipate the liquidity and cash-flow impact of the pandemic and the lockdown on sectors with low and moderate resilience, and maintain oversight. Strong surveillance processes and ground-up data analysis enabled us to take timely rating actions and avert sharp rating changes.

The role of regulatory measures in supporting credit quality of firms has been crucial over the past six months and needs to be highlighted.

The moratorium on debt servicing and deferment of asset classification norms by the Reserve Bank of India (RBI), the Targeted Long-Term Repo Operations (TLTRO) opened by it, and government measures such as the Emergency Credit Line Guarantee (ECLG) scheme have been timely interventions that provided cushion to firms facing cash-flow pressures. Further, the relaxation of default recognition norms provided by the Securities and Exchange Board of India (SEBI) also played its part in ensuring continued funding access and even enhanced credit lines to India Inc.

The second half of the current fiscal is half done, and a few high-frequency indicators are giving hope. There are also some green shoots in hinterland because of the above-normal monsoon.

A broad-based and sustained demand revival is the key to both, economic recovery and corporate credit profiles. But the road ahead is likely to be uneven, and the walk slow and unsteady.

On the downside, the risk of a second wave of Covid-19 infections and localised containment measures pose another challenge to demand revival.

In the context, apart from timely implementation of debt restructuring for deserving firms, more fiscal stimulus would be par for the course.

Take care and stay safe!

Krishnan Sitaraman **Somasekhar Vemuri** **Subodh Rai**

Executive summary

CRISIL's credit ratio (upgrades to downgrades) for the first half of the current fiscal printed at 0.54, the lowest in more than a decade, with 296 downgrades and 161 upgrades. While this coincided with India's sharpest gross domestic product (GDP) contraction on record, the credit ratio was cushioned to some extent by regulatory support.

Corporate credit profiles remain vulnerable even as demand claws back amid the raging pandemic.

Interestingly, while the rate of upgrades plunged as expected with the pandemic crushing demand, the rate of downgrades did not surge as feared. That's because credit profiles were cushioned by proactive regulatory measures such as liquidity window made available through the corporate bond market[1], moratorium on debt servicing permitted by the Reserve Bank of India (RBI), and temporary relaxation in default recognition norms of credit rating agencies allowed by SEBI. Without these, CRISIL's credit ratio would have slid even lower.

Over the past six months, credit quality trends have clearly brought to the fore sectoral resilience[2] in terms of demand, balance sheet strength and liquidity. High-resilience sectors such as pharmaceuticals actually had a credit ratio of more than one in the first half of this fiscal, led by steady demand and robust balance sheets. On the other hand, moderate- and least-resilient sectors saw downgrades far outnumbering upgrades, because of the discretionary nature of goods and services, and leveraged balance sheets for several of them.

We expect credit quality pressure on India Inc to persist in the second half of this fiscal. There has been a near-doubling of ratings with a 'negative' outlook, and 'on watch' in the past 12 months. While the moratorium has provided near-term relief, demand recovery for moderate and least-resilient sectors will be protracted. Timely restructuring support from lenders will be crucial to credit quality.

Sectors to watch closely in the least-resilient category include airlines, gems and jewellery, auto dealers, hotels, and real estate. Sectors exhibiting moderate resilience include thermal power generators, textiles, retail, and roads and construction.

The financial sector, too, will bear the brunt with growth in bank credit seen nosediving to multi-decade lows of 0-1% and assets under management of non-banks contracting 1-3% this fiscal.

The one-time restructuring permitted by the RBI could help the asset quality of banks; sans this, non-performing assets would have touched a two-decade high of 11.5% by the end of this fiscal. For non-banks, loan delinquencies could dart up 50-250 basis points (bps), depending on the segment of operation. While collection efficiency has improved from lows of April, the self-employed, MSME and wholesale segments remain under pressure because of vulnerability in borrower cash flows.

Consequently, collection efficiency, liquidity levels and capital-raising ability – especially of non-banks – will determine near-term credit profiles in the financial sector.

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[1] Through the targeted long term repo operations (TLTROs) conducted by the RBI where banks were to facilitate funding availability to other entities.

[2] In April 2020. CRISIL had categorised 35 sectors (excluding financial sector) into three categories, viz., high, moderate and least resilience sectors. Sector resilience is defined as ability of a sector to endure the revenue impact of Covid-19 and bounce back to full production in post-Covid-19 scenario, assessed using a multi-variable framework that comprises category of goods, nature of demand, strength of the balance sheet for entities in the sector, and the level of government/ regulatory support available to the sector.
See CRISIL press release, 'Pandemic grips credit quality, weakens credit ratio' dated April 01, 2020, for further details.

As business activity inches up from the lows of April and May, CRISIL will keep monitoring the timing and extent of demand revival, support provided via debt restructuring, and further fiscal and monetary policy measures. Prudent working capital and liquidity management will also be critical to support the credit profiles of corporates.

While risks to credit quality remain tilted to the downside, a few high-frequency indicators point to early signs of demand revival. For instance, sales of tractors, two-wheelers and packaged consumer goods have been buoyant in the past couple of months, backed by above-average monsoon and good kharif crop, although many of these indicators still remain below pre-pandemic levels.

While recovery could be quicker in select high resilience sectors, we will have to wait for fiscal 2022 for a broader and sustained revival in economic activity.

On the other hand, a continuing spread of the virus, including any second wave and any consequent re-introduction of containment measures, would likely disrupt the pace and trajectory of revival, and thereby, the credit profile of India Inc.

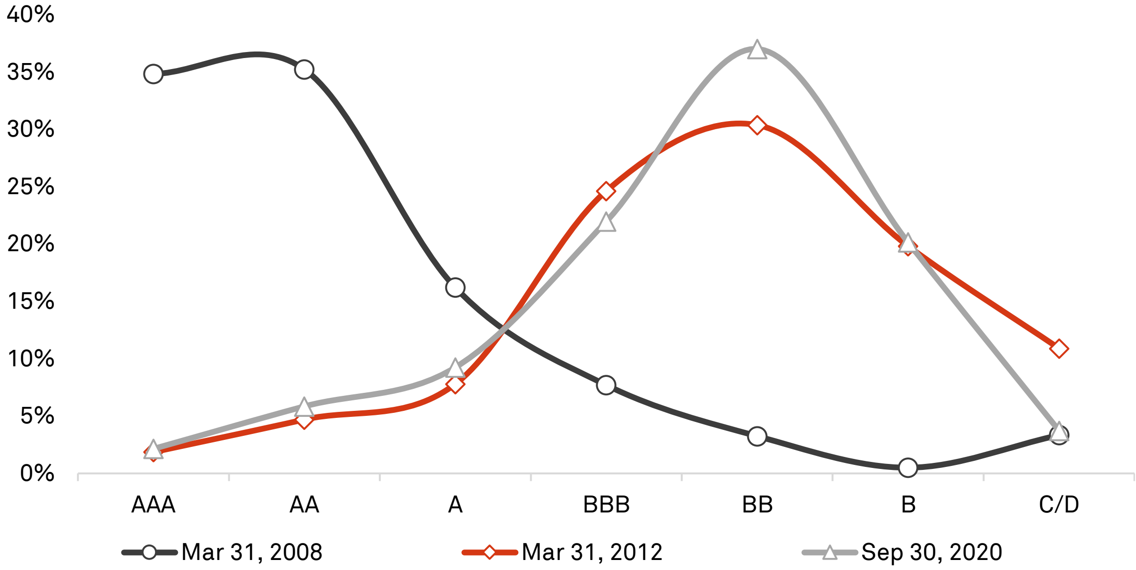
About Ratings Round-Up

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 September this year.

Note: A credit rating is an opinion on the likelihood of timely repayment of debt. Therefore, analysis of rating actions on a large and diverse portfolio of companies is also a reasonable indicator of an economy's directionality.

CRISIL's portfolio and median rating unchanged

Chart 1: Trends in rating distribution



Source: CRISIL Ratings

CRISIL's outstanding ratings as on September 30, 2020, cover around 9,000[3] 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.

[3] This excludes companies in the 'Issuer Not Cooperating' or INC category. CRISIL's portfolio had 9,586 such issuers as on September 30, 2020. If these are included, CRISIL's outstanding rating list will be of 18,175 issuers. But the median rating will remain in the 'BB' category.

Analysis of rating actions in H1-21

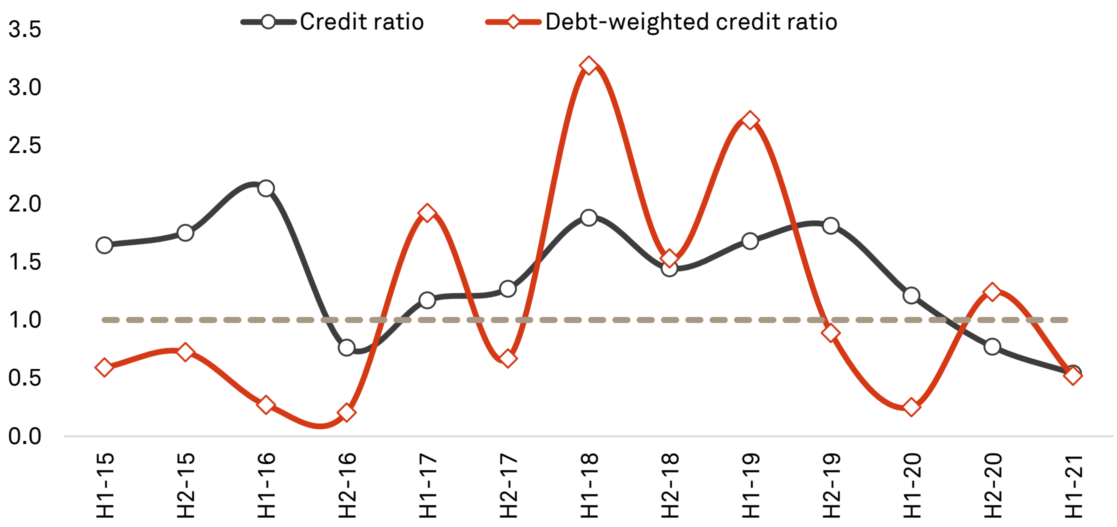
A non-linear event such as Covid-19 raises more questions than there are answers to. While a few questions have been answered over the past six months as we witnessed the impact of the lockdown and the subsequent unlock measures, some on demand revival and the extent and impact of loan restructuring remain unanswered.

We have attempted to answer questions on CRISIL's rating actions in H1-21 and key drivers in this section. In the subsequent sections, we have attempted to provide answers to the latter, on the outlook for the second half of fiscal 2021 and developing uncertainties.

What is the impact of Covid-19 on credit quality?

CRISIL's credit ratio and debt-weighted credit ratio were at 0.54 time and 0.52 time, respectively, for H1-21, against 0.77 time and 1.24 times in the second half of fiscal 2020 (H2-20). On a 12-month rolling basis, the credit ratio and debt-weighted credit ratio[4] for September 2020 were at 0.69 time and 1.16 time, respectively, as against 1.06 times and 0.80 time, respectively, for March 2020.

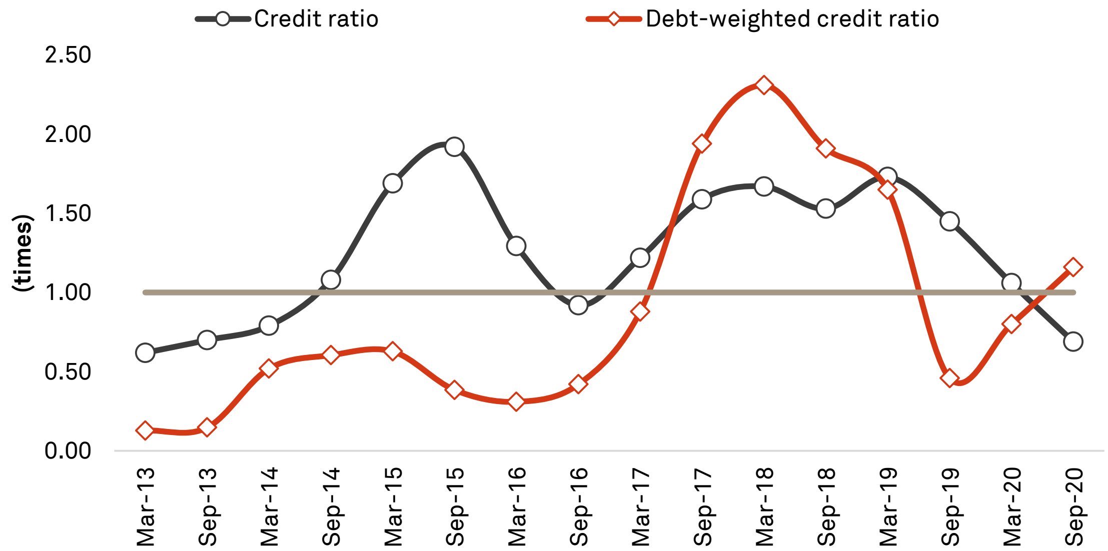
Chart 2: Trends in credit ratio and debt-weighted credit ratio



Source: CRISIL Ratings

[4] The debt-weighted credit ratio includes a telecom firm which constituted major portion of the debt downgraded. Spectrum debt is excluded from their overall debt for the calculation of debt-weighted credit ratio

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



Source: CRISIL Ratings

The Covid-19 pandemic maintains its stranglehold on India Inc despite a nascent recovery in demand, with some states relaxing lockdown measures and others tightening restrictions.

CRISIL recorded its lowest credit ratio in a decade, at 0.54 time — with **296** downgrades and **161** upgrades — as the GDP contracted a record 23.9% during Q1-21.

The decline in the credit ratio was driven by a braking of the upgrade rate rather than a surge in the downgrade rate. The deceleration in the upgrade rate was a result of rapidly declining demand, while the downgrade rate held steady because of prompt regulatory actions such as the moratorium on debt servicing and one-time debt restructuring permitted by the RBI, without which the credit ratio would have seen a steeper fall.

The current uncertain economic climate has also translated into a higher number of negative outlooks, which have more than doubled in the past 12 months.

Since the pandemic started to intensify in India in early March, CRISIL has been closely monitoring its impact across various sectors and has been in constant touch with rated firms to understand the evolving situation. To keep investors informed, CRISIL has issued 10 credit alerts across sectors which were being monitored more closely, in addition to 65 press releases and 20 webinars highlighting sectoral developments.

Driven by comprehensive analysis, robust criteria and proactive surveillance, CRISIL continues to display consistent and best-in-class quality metrics, which is evident from its lowest default rates, highest stability rates, and lowest intensity of rating actions.

How does the current downgrade rate compare with those during the global financial crisis and the taper tantrum?

CRISIL's annual downgrade rate has moved in a relatively narrow band of around 8% in the three business cycles witnessed since 2008. However, it declined marginally to around 6.2% in H1-21.

That said, the Covid-19 pandemic is a rare and unprecedented event with limited, if any, ability to plan or forecast unlike normal economic cycles. Sharper-than-usual changes in share prices, indices, yields and credit ratings, and significant government and regulatory actions are par for such an event because the intensity, spread and duration of a pandemic such as this cannot be foretold.

The pandemic's impact is starkly visible in the credit ratio for H1-21. The credit ratio has declined to 0.54 time due to a higher number of downgrades and, more importantly, very few upgrades, just as one would expect in the current environment.

It must be noted, however, that the overall downgrade rate has not increased despite the extent of disruption and dislocation caused by the pandemic and the consequent lockdowns. This is on account of timely initiatives taken by policy makers that provided some liquidity cushion to corporates, reduced the number of defaults and boosted demand in the rural segment.

Among these key initiatives:

- The RBI announced a moratorium that provided a breather to companies most affected by the pandemic. According to a recent analysis by CRISIL Ratings, around 2,300 companies out of our total rated universe of around 9,000 corporates availed of the moratorium. Of these 2,300 corporates, 75% have sub-investment grade ratings (rated BB+ or lower by CRISIL) and were hit hardest by the lockdown
- Deferment of asset classification norms and the TLTRO are other key reforms by the RBI, which supported short-term cash-flow mismatches of firms. The RBI's cumulative rate cut of 115 bps since March had a cascading effect on ease in lending rates, money market and bond yields
- SEBI relaxed the default recognition norm during the moratorium period, which provided support to any temporary timing mismatches by firms availing of the moratorium
- The Atmanirbhar package announced by the Government of India was an initiative to boost rural growth and support MSMEs. The package helped double the average income per person per month to Rs 1,000 under MGNREGS and provide food to migrant workers. It also helped MSMEs by providing credit guarantee through the Emergency Credit Line Guarantee Scheme (ECLGS) and partial guarantee to bonds rated AA and below issued by non-banking finance companies (NBFCs) to support liquidity

How did key macroeconomic indicators pan out in H1-21 and what is their outlook?

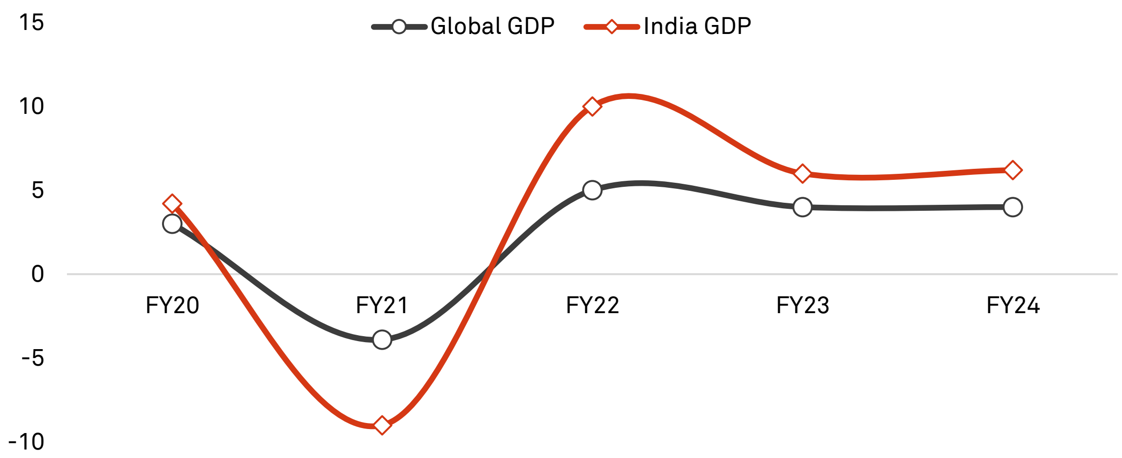
There was a sharp decline in key macroeconomic indicators in fiscal 2020, even before the pandemic hit towards the end of the fiscal. During H2-20, GDP reached a decadal low as growth slipped further vis-à-vis the first half, before turning into negative territory in fiscal 2021.

At the end of H1-21, CRISIL Research revised its real GDP growth forecast for India for fiscal 2021 to negative 9% from negative 5% projected in May. GDP has encountered its worst fall, contracting 23.9% during Q1-21, with a permanent loss of 13%. With the pandemic's peak not yet in sight, rapidly increasing cases and the locus shifting from metropolitan to smaller cities, it seems that we are far from the end of this crisis. Moreover, around 54% of India's total confirmed cases come from states that have a major share in India's GDP — Maharashtra, Tamil Nadu, Karnataka and Andhra Pradesh — together accounting for 36%.

In Q1-21, macroeconomic indicators pointed towards a sharp decline in GDP although there has been some recovery since August as compared with April. However, the constrained government kitty impedes the ability to introduce significant fiscal stimuli. Additionally, the RBI had to curb its rate cuts on account of ascendant retail inflation. The upswing in rural income as a result of above-average rainfall and the likelihood of good kharif output, which has led to an uptick in rural consumption, provides some relief. However, urban consumption, especially the contact-based service segment such as travel and entertainment, is still a long way from recovery.

Industrial and service sectors, accounting for around 85% of GDP, suffered the most because of the nationwide lockdown. The Index of Industrial Production (IIP) and core infrastructure indices correlated with a sharp contraction in gross value added (GVA) by the industry in the first quarter. The increase in retail inflation, combined with job loss and increasing unemployment, has led to low consumer confidence, and hence consumption is likely to remain suppressed. Similarly, on the investment side, low capacity utilisation and deleveraging balance sheets of corporates will drag down private corporate investment. This, coupled with a stressed fiscal position translating into decimated government spending implies that investment recovery is far away.

Chart 4: Trends in GDP growth



Source: S&P, CRISIL Research

The medium-term outlook for India Inc is undoubtedly negative, with capital being constrained and labour dealing with its own challenges. The only hope is economic reforms and efficiency improvement. The government needs to continue to focus on small and medium enterprises (SMEs) and the lower economic strata of population to spur growth in consumption and investment.

What were the sectoral variations in rating actions in H1-21? What was the credit outlook for sectors linked to investment, consumption and exports?

Trends in high-frequency indicators from April to August throw up a pattern of acute de-growth in most sectors in Q1-21, on account of the nationwide lockdown. However, a gradual uptick in demand for some of the key sectors indicates nascent demand recovery.

Table 1: Trends in high-frequency indicators from April to August 2020

		Apr -Jun-20	Jul-Sept 20
GDP	(YoY change)	-23.9%	NA

	2020	(YoY % change of)	Apr	May	Jun	Jul	Aug
Consumption-linked sectors	Tractor sales	Units	-79%	4%	22%	39%	75%
	Passenger cars sales	Units	-100%	-85%	-50%	-4%	14%
	Dom 2W sales	Units	-100%	-84%	-39%	-15%	3%
	2020	**YoY% change of)**	**Apr**	**May**	**Jun**	**Jul**	**Aug**
Export-linked sectors	Total exports	Value in Rs	-57%	-30%	-5%	-2%	-8%
	Exports of textiles garments*	Value in Rs	-79%	-44%	-5%	7%	2%
	Exports of pharmaceuticals^	Value in Rs	14%	33%	19%	32%	24%
	2020	**YoY% change of)**	**Apr**	**May**	**Jun**	**Jul**	**Aug**
Investment-linked sectors	Cement production	in tonnes	-85%	-21%	-7%	-13%	NA
	Steel production	in tonnes	-91%	-65%	-41%	-29%	NA
	Bitumen production	in tonnes	-73%	-19%	28%	-5%	37%

*Textile garments refer to textile articles, sets, worn clothing and worn textile articles, rags
^Pharmaceutical refers to export of pharmaceutical products
Source: MOSPI, DoC and CRISIL Research

Looking at consumption-linked sectors, healthy rainfall has boosted agriculture output and rural income, which increased the demand for agro commodities as well as allied sectors such as tractors. The increase in rural income has led to demand recovery in tractors and some pent-up auto demand in sectors such as for two-wheelers. However, segments such as auto components with linkage to discretionary demand still face issues in overcoming the blow caused by the pandemic.

In investment-linked sectors, there have been signs of recovery in steel, cement and bitumen output, indicating budding demand (primarily from rural segment) in public and private segments.

Export-linked sectors, however, remained a mixed bag with growing demand in sectors with essential consumption spend such as pharmaceuticals alongside sectors such as textiles, which witnessed sluggish demand recovery on account of muted demand in domestic and export markets amid the pandemic-led lockdown.

An analysis of the credit impact on these sectors in H1-21 is detailed below.

Investment-linked sectors

Government spending slackening

41%

of ratings outstanding as on date

H1-21

H2-21

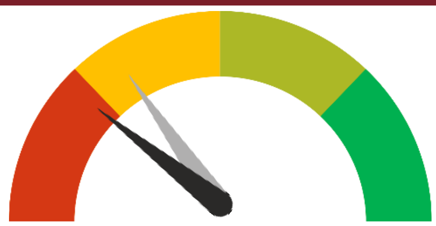


Table 2: Sectoral trends in H1 -21

	Demand	Realizations	Working capital	Credit quality H1-21	Remarks
Construction and engineering	↔	↓	↓	↔	*Orders were weak due to lockdown and labour issues; there was working capital stretch, too. Some firms – especially in the construction, roads and bridges sub-segment – benefited due to healthy order books and buoyant liquidity profiles (mostly BBB category)*
Industrial machinery	↓	↓	↓	↓	*Weak operating performance due to subdued demand in the end-user segment*
Real estate	↓	↓	↓	↓	*Sluggish demand due to the pandemic*
Electrical components and equipment	↓	↓	↓	↓	*Inventory losses due to subdued economic activity amidst the pandemic*
Highway tolling	↔	↑	↔	↔	*Firms achieving project completion or achieving provisional commercial operations benefitted*

Source: CRISIL Ratings

The credit ratio of investment-linked sectors continued to decline at the end of H1-21, as economic activity came to a halt during the lockdown. Demand from end-user segments remained subdued and labour scarce, leading to slower recovery in these sectors. With easing of the lockdown and opening up of the economy, there has been some build-up in demand. However, downgrades increased significantly in sectors such as construction and engineering, and allied industries such as construction materials and real estate development. These, along with sectors such as industrial machinery and electrical components and equipment, were hit by slower execution of orders, inventory pile-up and stretched working capital cycles. Credit ratio is expected to remain below 1 as most of these sectors show a severe lack of public and private investment, which is holding back recovery.

Consumption-linked sectors

Slump in private consumption

42%

of ratings outstanding as on date

H1-21

H2-21

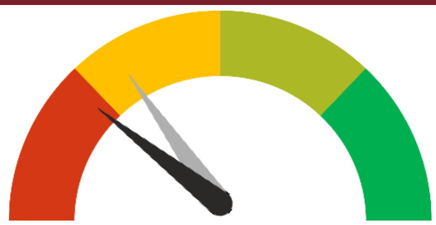


Table 3: Sectoral trends in H1 -21

	Demand	Realisations	Working capital	Credit quality H1-21	Remarks
Gems and jewellery	↓	↓	↓	↓	*Funding challenges; exports dampen due to the pandemic's impact on global demand*
Auto components	↓	↓	↓	↓	*Subdued demand across all auto asset classes amid continued weakness in the economy due to the pandemic. Moderate sectoral resilience driven by balance sheet strength of players in the sector*
Auto retailers	↓	↓	↓	↓	*Subdued demand in the allied industry and impact of the pandemic on domestic as well as global demand.* *Some demand recovery seen in two-wheeler and tractor segments*
Hotels	↓	↓	↔	↓	*Adverse impact on tourism and hospitality industry with travel restrictions due to the lockdown*
Multiplexes	↓	↓	↔	↓	*Challenges post social distancing measures in India*
Educational services	↓	↓	↔	↓	*Dip in occupancy and decline in revenue, driven by low demand*
Hospitals	↓	↓	↔	↓	*Lower occupancy in out-patient department and fewer non-critical surgeries, leading to losses*
Agricultural products	↑	↑	↔	↑	*Supported by good monsoon, but hangover of the pandemic remains*

Source: CRISIL Ratings

The credit ratio continued to decline sharply in H1-21. Overall, auto retail and auto components saw the highest number of downgrades as these sectors were already facing severe demand slump because of the lockdown and subsequent restrictions. Apparel and lifestyle goods, footwear, and education services saw more downgrades than upgrades due to lower wage growth, job losses and increased retail inflation leading to deferment of purchase decisions. Some green shoots, however, were visible on account of good monsoon and stimulus provided by the government, which has led to improvement in rural incomes. As a result, sectors with essential demand such as agricultural products witnessed more upgrades.

The credit ratio is expected to remain muted, below 1, with slight recovery, especially in essential goods and those linked to rural demand, pent up demand and unlocking measures. However, there are downside risks to these expectations in terms of rising afflictions and the consequent containment measures taken by the government.

Export-linked sectors

High global uncertainties to impact demand

12%

of ratings outstanding as on date

H1-21

H2-21

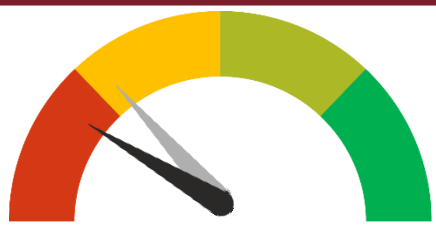


Table 4: Sectoral trends H1-21

	Demand	Realisations	Working capital	Credit quality H1-21	Remarks
Textiles (readymade garments)	↓	↓	↓	↓	*Continued high competitive intensity; pandemic overhang on demand*
Textiles (ginning and spinning)	↓	↓	↔	↓	*Increase in cotton prices and weak demand*
Electronic components	↓	↓	↓	↓	*Pandemic impact on key consuming countries*
Pharmaceuticals	↑	↔	↔	↔	*Players with product diversification benefitted while select few with weak balance sheets witnessed downgrades*

Source: CRISIL Ratings

The credit ratio of export-linked sectors weakened sharply in H1-21.

Most of the downgrades were in the textile sector, which continued to face pressures due to raw material price volatility, delayed receivables and lower demand. It also witnessed muted domestic demand for cotton yarn, which accounts for over 70% of overall textile demand, on account of a slack in end-user segments such as readymade garments and home textiles.

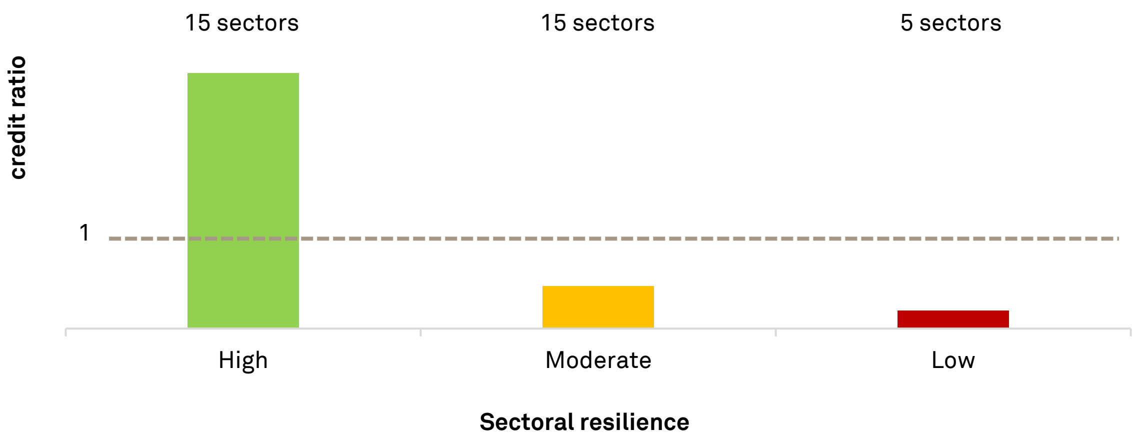
However, other export-linked sectors benefitted from new opportunities – pharmaceuticals and information technology, especially.

The credit ratio is expected to remain below 1, with minor recovery in fiscal 2021, as overall global demand is expected to remain suppressed, albeit with few pockets of growth.

How sectors fared versus CRISIL's April expectations

In the Ratings Round-up published in April, CRISIL classified the credit quality outlook for various sectors based on their ability to recover demand to pre-pandemic levels and survive the lockdown, or, in other words, their sectoral resilience. The underlying assumption for assessing the demand resilience for these sectors was the nature of demand: discretionary or non-discretionary, immediate revenue impact due to the lockdown, and estimated time taken to recovery for these sectors. On this basis, CRISIL classified 35 sectors into three buckets: high, moderate and low resilience. CRISIL analysed trends in rating actions during H1-21 to see how the 35 sectors performed, and found that the trends aligned with the resiliency classification.

Chart 5: Credit ratio as per sectoral resiliency in H1-21



Source: CRISIL Ratings

Looking at rating actions for these three buckets of sectors in H1-21, it was found that:

(i) For *high-resilience* sectors, upgrades outnumbered downgrades significantly for some sectors while for others there were no rating actions, given continued demand due to the essential nature of sectors, such as pharmaceuticals, and healthy balance sheets

(ii) For *moderate-resilience* sectors, downgrades outnumbered upgrades. This category of sectors was a mixed bag, where some reflected better recovery than anticipated, driven by timely initiatives by the government and regulatory bodies, whereas others continued to struggle with slack demand during the lockdown. Sectors such as steel have seen recovery whereas industrials continued to see downgrades

(iii) For *low-resilience* sectors, in spite of government stimulus and unlocking measures, demand recovery remained a challenge. Besides, a few sectors such as gems and jewellery, and airlines continued to be plagued by leveraged balance sheets

How does CRISIL factor the current uncertain economic climate into its rating actions?

The economic landscape is continuously shifting, with the peak of the pandemic still not in sight and the number of cases fluctuating across geographies. These circumstances create cascading, complex interdependencies, resulting in substantial modelling risk regarding the uncertainties that weigh heavily on the outlook, with risks leaning towards a downside.

Given this uncertainty, there has been a fair share of changes in 'outlook'[5] and increase in 'watch'[6] assignments. The share of 'Negative' outlook as of September has more than doubled compared with 12 months ago.

[5] An outlook indicates probable direction in which the ratings will move over the medium term of 1-2 years

[6] A rating watch indicates likelihood of change in rating post a material event, such as merger/de-merger or a regulatory action, in which case additional information may be needed to fully ascertain the impact on the rating (usually resolved within 90 days)

Credit quality outlook of corporates

Business activity crawling back as economy unlocks…

Key corporate sectors are on the slow and patchy road to recovery. Although business activity is still below the pre-pandemic level, the severity of the contraction seen in Q1-21 is easing gradually. Most indicators show gradual inching up of demand and supply (refer to Table 5).

On the demand side, sectors such as tractors and two-wheelers are seeing buoyancy on the back of rural consumption, supported by a good monsoon. Similarly, electricity consumption has increased across states, especially the industrialised ones like Gujarat, Maharashtra and Tamil Nadu, indicating recovery in industrial activity. Also, the movement of material (transport and logistics) and increase in commercial traffic on toll roads indicate that industrial and commercial activity is inching up from lows seen when the lockdown was most stringent.

Caution persists, as part of the improvement can be attributed to pent-up demand post lifting of lockdown restrictions, and its sustainability remains to be seen. Also, sectors in the consumer discretionary space such as hospitality, airlines, retail, and gems and jewellery continue to face headwinds.

…but rising infections may curb pace of recovery

This is further exacerbated by rising active Covid-19 cases bordering on the million mark in September as against less than 25,000 in April. India continues to be one of the largest contributors to the daily global tally.

With the pandemic's peak not yet in sight, the downside risks to India's economic growth have heightened. CRISIL recently revised its fiscal 2021 real GDP growth forecast for India to negative 9% (from negative 5% projected in May).

Failure to get infections under control may set back business activity and consumption, both of which had been slowly picking up after India began easing one of the world's strictest and biggest lockdowns that started in late March.

Table 5: Demand recovery across sectors from April to August

<table>
<tr><th>YoY change (unless otherwise mentioned)</th><th>Apr 2020</th><th>May 2020</th><th>June 2020</th><th>July 2020</th><th>Aug 2020</th></tr>
<tr><td colspan="6">Macro Indicators</td></tr>
<tr><td>Active Covid-19 cases (#)</td><td>24,641</td><td>93,349</td><td>220,546</td><td>564,856</td><td>785,127</td></tr>
<tr><td>IIP</td><td>-57.3%</td><td>-33.9%</td><td>-15.8%</td><td>-10.4%</td><td>NA</td></tr>
<tr><td>Services PMI (points)</td><td>5.4</td><td>12.6</td><td>33.7</td><td>34.2</td><td>41.8</td></tr>
<tr><td colspan="6">Sectoral indicators: Supply side^</td></tr>
<tr><td>Toll road revenues</td><td>-70% to -50%</td><td>-30% to -20%</td><td>-10% to 3%</td><td>-10% to 5%</td><td>-5% to 8%</td></tr>
<tr><td>Port traffic</td><td>-21%</td><td>-23%</td><td>-15%</td><td>-13%</td><td>-10%</td></tr>
<tr><td>Railway freight</td><td>-35%</td><td>-21%</td><td>-8%</td><td>-5%</td><td>3%</td></tr>
<tr><td>E way bill</td><td>-84%</td><td>-53%</td><td>-15%</td><td>-7%</td><td>-3%</td></tr>
<tr><td>-Interstate (lakh per day)</td><td>0.8</td><td>2.7</td><td>5.4</td><td>6.0</td><td>6.1</td></tr>
<tr><td>-Intrastate (lakh per day)</td><td>2.1</td><td>5.5</td><td>9.1</td><td>9.6</td><td>9.8</td></tr>
<tr><td>Power consumption</td><td>-25%</td><td>-15%</td><td>-10%</td><td>-3%</td><td>-2%</td></tr>
<tr><td>Transport & logistics - trucking revenues</td><td>-80% to -70%</td><td>-50% to -40%</td><td>-30% to -20%</td><td>-25% to -15%</td><td>-20% to -15%</td></tr>
<tr><td>Transport & logistics - shipping revenues</td><td>-45% to -35%</td><td>-30% to -20%</td><td>-15% to -10%</td><td>-10% to -5%</td><td>-5% to 0%</td></tr>
<tr><td colspan="6">Sectoral indicators: Demand side^</td></tr>
<tr><td>2W wholesale</td><td>-100%</td><td>-84%</td><td>-39%</td><td>-15%</td><td>3%</td></tr>
<tr><td>PV wholesale</td><td>-100%</td><td>-85%</td><td>-50%</td><td>-4%</td><td>14%</td></tr>
<tr><td>Tractor wholesale</td><td>-79%</td><td>4%</td><td>22%</td><td>39%</td><td>75%</td></tr>
<tr><td>MHCV Whole sale</td><td colspan="3">-95% to -90%</td><td>-80% to -70%</td><td>-60% to -50%</td></tr>
<tr><td>LCV Whole sale</td><td colspan="3">-85% to -75%</td><td>-25% to -15%</td><td>0% to 5%</td></tr>
<tr><td>Consumer durables revenues</td><td colspan="3">-70% to -60%</td><td>0% to 5%</td><td>6% to 8%</td></tr>
<tr><td>FMCG revenues</td><td colspan="3">-17% to -12%</td><td>-5% to 0%</td><td>0% to 5%</td></tr>
<tr><td>Packaging revenues</td><td>-60% to -50%</td><td>-40% to -5%</td><td>-20% to -7%</td><td>-10% to 0%</td><td>-5% to 0%</td></tr>
<tr><td>Steel</td><td>-91%</td><td>-65%</td><td>-41%</td><td>-29%</td><td>NA</td></tr>
<tr><td>Cement</td><td>-85%</td><td>-21%</td><td>-7%</td><td>-13%</td><td>NA</td></tr>
<tr><td>Bitumen</td><td>-73%</td><td>-19%</td><td>28%</td><td>-5%</td><td>37%</td></tr>
</table>

^Data is in volumes unless other-wise mentioned

Source: Health ministry, MOSPI, IHS Markit, Indian Ports Association, Indian railways, GST Network, Power System Operations Corporation Limited, SIAM, Steel ministry, DIPP, PPAC and CRISIL estimates

Methodology and assumptions

CRISIL has analysed 42 key sectors on two parameters: i) revenue impact in the current fiscal, and ii) sectoral resilience. These 42 sectors account for 75% of the total rated portfolio (excluding financial services).

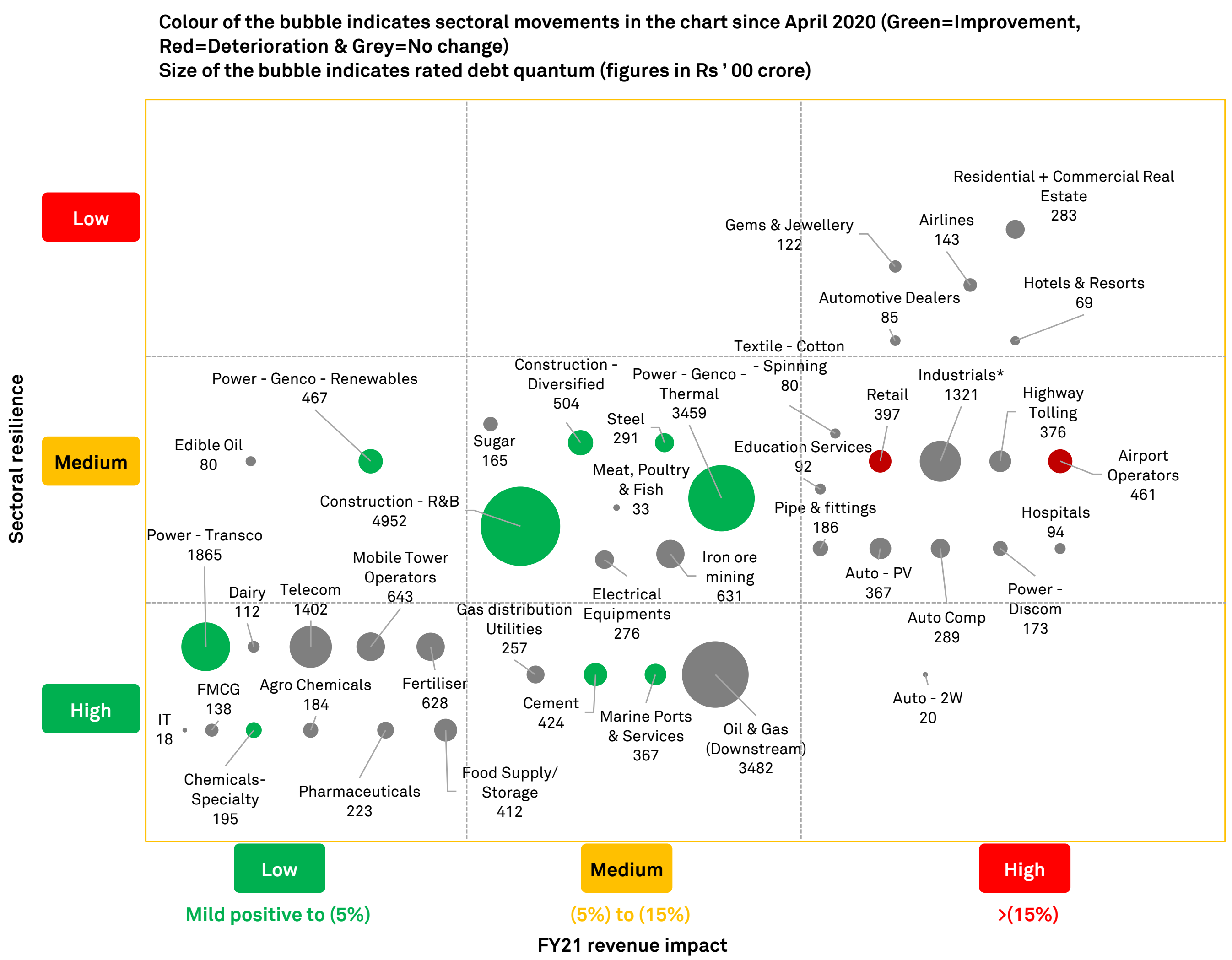
Some of the terminologies used

Revenue impact: Indicates the extent of revenue loss in the current fiscal due to pandemic-related disruptions.

Sectoral resilience: Ability of the sector to withstand the revenue impact of the pandemic and bounce back to full production thereafter. There could be multiple factors at play that can lead to this bounce back: 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 level of government/ regulatory support available to the sector.

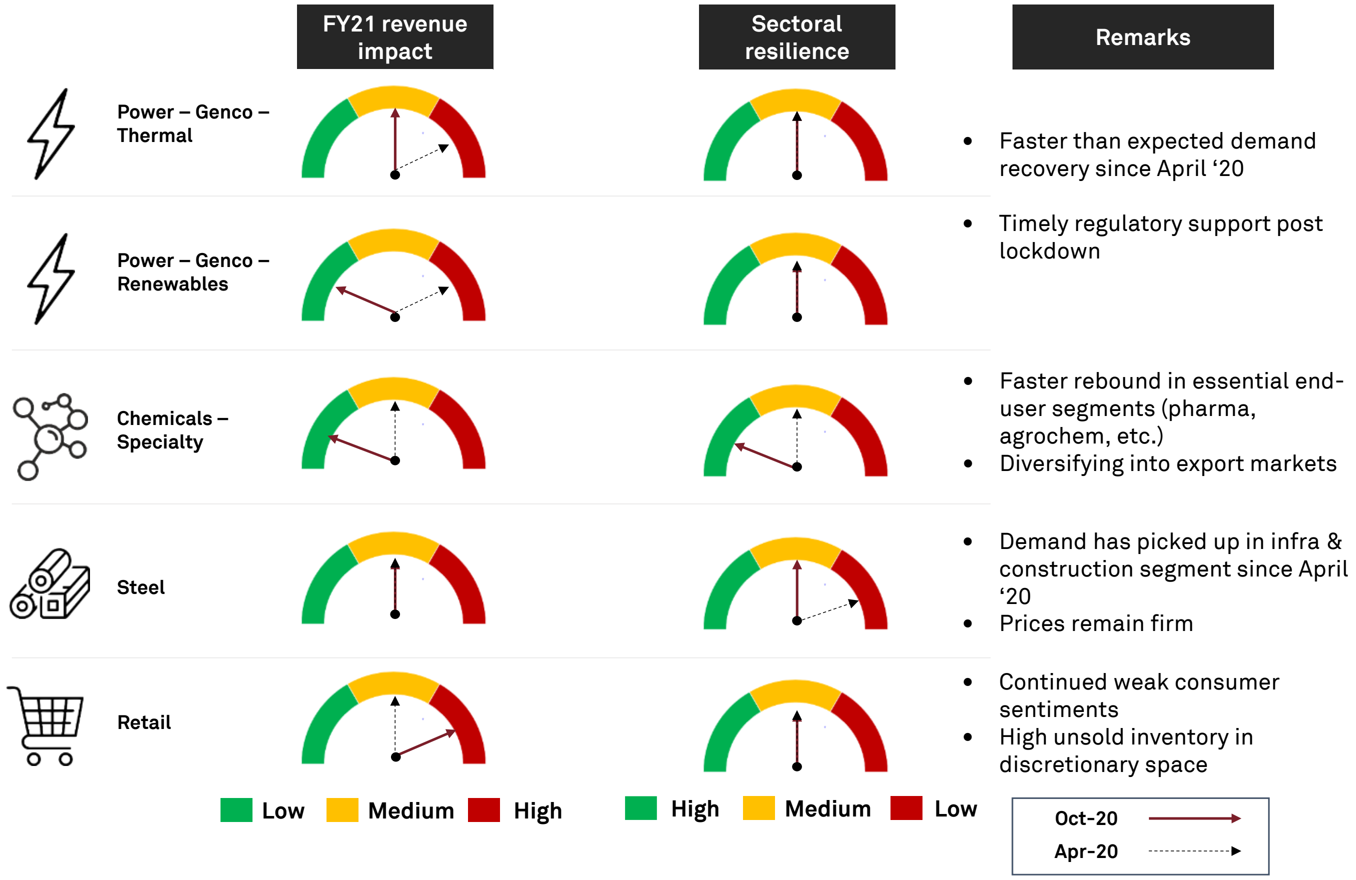
Impact on sectors because of the pandemic

Chart 6: Sectoral resilience diced three ways



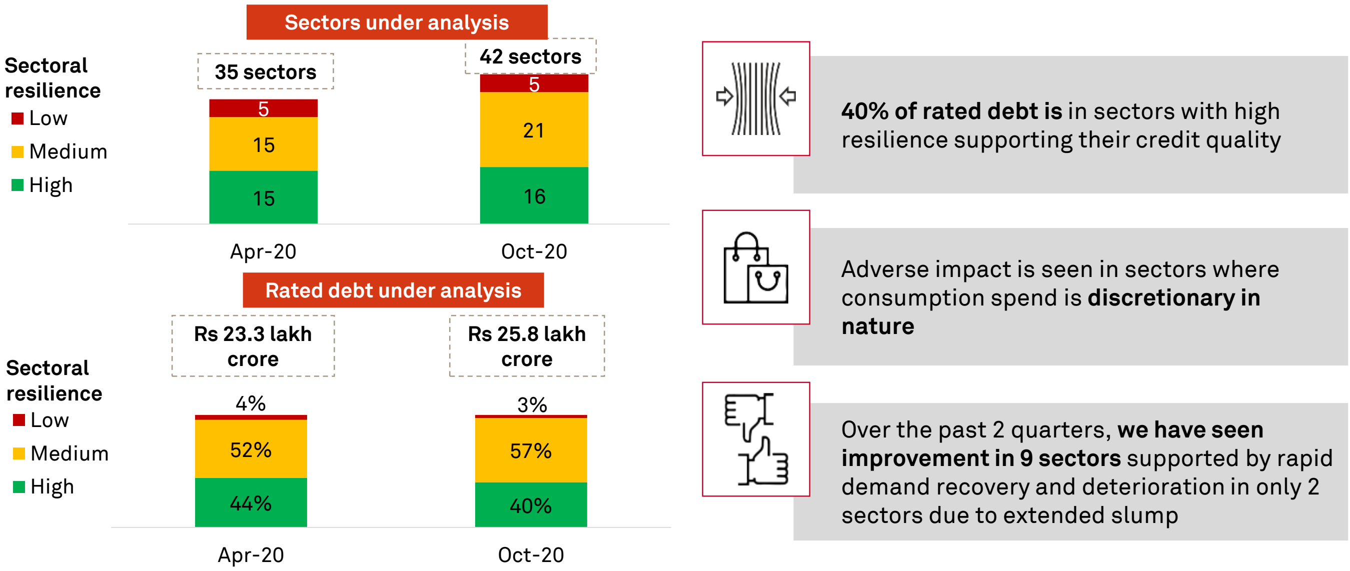
Source: CRISIL Ratings

Some key sectoral movements since RRU H1-21



Source: CRISIL Ratings

Chart 7: Key conclusions on study on sectoral resilience amid Covid-19



Base assumption on Covid-19 impact:

Post unlock full economic recovery to pre-Covid level will likely be gradual and stretch into next fiscal. This assumption may undergo changes based on the pandemic's spread and effectiveness of the government's containment measures.

Note: Sectors included dairy, edible oil, meat poultry & fish, education services, hospitals, hotels & resort. Also, power-genco is spilt into thermal and renewables

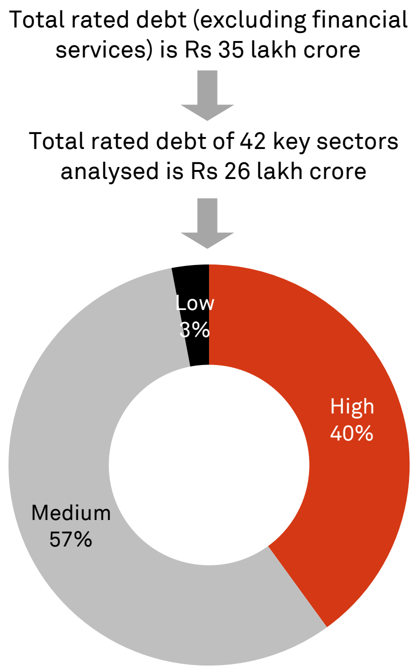
Source: CRISIL Ratings

India Inc resilience tested

Our analysis reveals that while most sectors will undergo stress, a sizeable number of sectors will see low impact.

- **40% of the debt is in sectors in the high resilience category**. These include essentials such as pharmaceuticals, telecom, dairy, and fast-moving consumer goods (FMCG); rural-linked sectors such as fertilisers and agro-chemicals; and segments supported by the government, for example, oil refineries. These sectors may see the least demand impact, and some of their sub-segments may actually see a demand uptick amid the Covid-19 disruption
- **57% of the debt is in sectors in the medium resilience category.** These include auto and auto ancillaries, power generators, roads, and construction. While these sectors have faced moderate to high disruption during the lockdown, key mitigating factors cushioning the stress include strong balance sheets and liquidity or healthy demand recovery
- **3% of the debt is in sectors in the least resilient category.** These include airlines, gems and jewellery, auto dealers, hotels, and real estate as a result of the discretionary nature of goods and services and weak balance sheets

Chart 8: Break-up of debt under study



Source: CRISIL Ratings

High sectoral resilience: 40% of the rated debt analysed

More than a third of the sectors may display high resilience because of reasons such as sufficient cash reserve to reach production readiness, continued/uninterrupted production as part of the chain of essential goods and services, and government or regulatory support.

Table 6: Trends in sectors with high resilience and rationale

	Sectors	Reason
High resilience	**High revenue impact**	
	Two-wheelers	High cash reserve and lower leverage increase resilience
	Medium revenue impact	
	Oil marketing companies	Strong government support provides resilience
	Cement	High cash reserve and lower leverage increase resilience
	Ports	Low leverage provides the ability to brace sluggish import and export volume
	City gas distribution	Improved demand following lifting of lockdown restrictions; low leverage and market exclusivity support resilience
	Low revenue impact	
	Power transco	Low operational costs, strong counterparties and availability-based model help weather the impact of the risk of delay in payments
	Fertilisers	Part of the chain of essential products and services
	Dairy	
	Agrochemicals	
	Food supply	
	Pharmaceuticals	
	FMCG	
	Mobile towers	Low demand elasticity and increased consumer dependency during the lockdown
	Telecom	
	IT consulting	Mostly sustains operations remotely; hence, minimal revenue impact, favourable currency trends and low sector leverage
	Specialty chemicals	Diversified business model, with sizeable export demand to fill up any gap created by domestic demand

Source: CRISIL Ratings

Medium sectoral resilience: 57% of the rated debt analysed

Most sectors show 'medium' resilience to revenue disruptions. Uncertainties in demand pick-up following the pandemic may impact the business over the medium term, though other factors may partly offset the impact.

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

	Sectors	Reason
Medium resilience	**High revenue impact**	
	Cotton spinning	Low labour intensity to result in faster rebound to normalcy, but high leverage a constraint
	Hospitals	Though these are essentials, profitability is impacted by high operating leverage
	Education	
	Airport operators	Reduced traffic flow and slower recovery to deplete cash reserve
	Power discoms	Weak collections partly offset by power being an essential service with market exclusivity
	Auto original equipment manufacturers (OEMs)	Sluggish demand to affect revenue; low leverage in some companies may offset the impact
	Auto ancillary	Companies with high after-market sales and low leverage will weather the storm, but those exposed to OEM demand and with higher leverage may be impacted
	Highway tolling	Gradual traffic build-up but cash reserves lend offset Covid-19-related disruptions
	Industrials	Moderate revenue pick-up; dependence on resumption of industrial activities
	Pipe and fittings	
	Retail	Continued weak consumer sentiments; large unsold inventory in discretionary space
	Medium revenue impact	
	Electrical equipment	Moderate revenue pick-up; dependence on resumption of industrial activities
	Steel and iron ore mining	Improving domestic demand and sustained prices providing resilience
	Construction	Labour availability normalising, but order-book build-up likely to be slow
	Power gencos (thermal)	Part of essential services but build-up of receivables from discoms may impact cash flow; swift government interventions have been helpful
	Sugar	Low demand risk but high leverage
	Meat, poultry and fish	
	Low revenue impact	
	Power gencos (renewables)	Must-run status supported operations in lockdown; build-up of receivables from weaker counterparties with moderate resilience
	Edible oil	Stocking up of essentials by households offsets decline in hospitality demand, but high leverage

Source: CRISIL Ratings

Low sectoral resilience: 3% of the total debt analysed

Some sectors may see high revenue disruption and low resilience and readiness to return to normalcy in a post-pandemic scenario. This is a result of a combination of discretionary products or services and expectation of delay in demand recovery.

Table 8: Trends in sectors with moderate sectoral resilience and rationale

	Sectors	Reason
Low resilience	High revenue impact	
	Airlines	Covid-19 scare to delay demand recovery in passenger airlines
	Gems and jewellery	
	Auto dealers	Consumers may defer purchase of non-essential products in these sectors
	Real estate	
	Hotels and resorts	Muted occupancy until a vaccine is widely available; high leverage lowers resilience

Source: CRISIL Ratings

Conclusion

Corporates are adapting to the new normal and are introducing structural changes both within and outside their workplace in a bid to manage the disruptions caused by the pandemic. Most businesses are slowly recuperating from the major economic upheaval caused by the Covid-19 pandemic, though the pace of recovery remains sluggish.

While 16 sectors exhibit high resilience, 26 sectors (accounting for 57% of the rated debt analysed) fall into the medium to low resilience category, indicating exacerbated credit quality pressure on Indian corporates in fiscal 2021.

Measures by the government and the RBI (extension of moratorium on debt repayment, one-time debt restructuring window, and extension of the Insolvency and Bankruptcy Code suspension, among others) have helped ease the repayment pressure faced by corporates. However, with the pandemic yet to peak, the extent and pace of demand recovery will be a critical determinant of corporate credit outlook over the medium term.

Credit quality outlook of the financial sector

Bank credit growth to fall to a multi-decade low this fiscal

The significant economic impact of the pandemic has affected the banking system, too, with credit growth expected plunge to a multi-decadal low of 0-1% in the current fiscal. Furthermore, economic contraction stemming from the extended lockdown to contain the pandemic, and a likely slow return to normalcy with easing down of lockdown restrictions have impacted the credit quality of borrowers.

Credit offtake by the corporate sector, which constitutes almost half of the total credit growth, is expected to be the worst-hit and may de-grow this fiscal, with heightened risk aversion among banks. Retail lending, which accounts for over a quarter of overall credit and was holding fort so far, is expected to decelerate sharply amid job losses and salary cuts leading to reduced expenditure on discretionary items. MSME loans, on the other hand, are expected to see relatively better growth this fiscal, riding on the government's stimulus package — particularly the Rs 3 lakh crore ECLGS — and driven by public sector lenders. While ECLGS has now been extended to individual borrowers, the intent of banks to lend to retail borrowers in the current environment remains to be seen. Agricultural loans amid well-distributed and normal monsoon and faster recovery, from the pandemic in rural India, should show mid-single-digit growth.

Revival of various sectors following the lockdown, and government initiatives, if any, will be a key determinant of credit demand over the medium term. The speed of demand revival and economic recovery will have a bearing on how asset quality pans out. This is not only applicable to large enterprises, but will also have an impact down the line on MSMEs and retail customers.

Earlier, CRISIL had expected gross NPAs to reach a two-decade high of 11.5% by March 2021 on account of increased stress on the cash flows of borrowers and low credit growth. However, proactive steps by the government and the RBI, a six-month moratorium, and one-time restructuring of loans being allowed under the supervision of the K V Kamath Committee should support the banking system as well as India Inc. That, in turn, will help arrest the deterioration in asset quality compared with what was envisaged earlier. Nevertheless, borrower behaviour with regard to repayment discipline following the six-month moratorium remains to be seen.

The sub-Rs 500 crore corporate and retail exposures, which were earlier expected to see the highest increase in NPAs in percentage terms, are expected to be the major beneficiaries of the restructuring scheme. The debt at risk in these segments — or loans at risk of slipping into NPAs this fiscal unless restructured by banks — is a sizeable Rs 3 lakh crore.

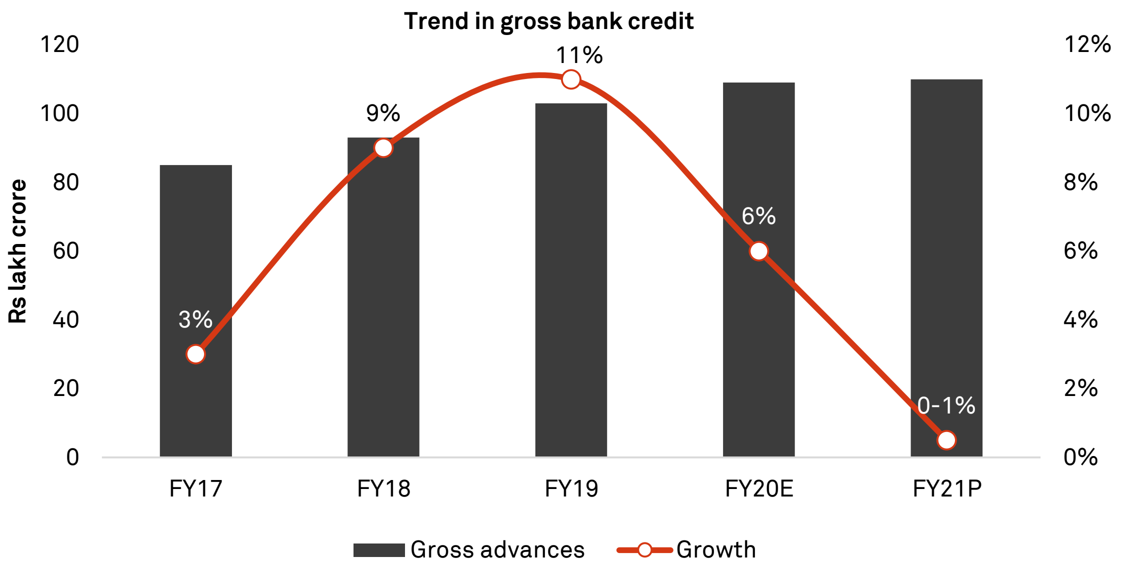
This is where the current situation is different from the asset quality stress cycle that started four years earlier, when the NPAs came primarily from bigger, chunkier accounts. This time, an analysis of the top 100 exposures of our large, rated banks reveals that following a period of consolidation and deleveraging, such large entities are likely to be better positioned to withstand the ongoing challenges. This is based on CRISIL's analysis of the credit profile of banking sector exposures over Rs 25 crore covering around 14,000 companies that constitute over 75% of the overall corporate portfolio of banks, and an analysis of the retail portfolio of banks.

Profitability of the banking sector in fiscal 2021 will be dependent on the extent of implementation of the restructuring scheme and additional provisioning requirements. With slower credit growth, pre-provisioning operating profit would be impacted, reducing the cushion to absorb credit costs. In this context, the ability to control operating expenses will gain importance in managing profitability.

In terms of capital levels for absorbing asset-side risks, leading private sector banks are expected to be well placed, benefiting from recent capital-raising by most of them as well as continued adequate capital buffers. Public sector banks (PSBs), on the other hand, will require capital support from the government for coping with challenges related to pandemic-led disruptions, management bandwidth and efforts to successfully merge 10 banks into four, effective April 2020.

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

Chart 9: Bank credit growth to fall to a multi-decadal low this fiscal



Source: Company data, CRISIL Ratings

NBFC delinquencies could rise 50-250 bps this fiscal

Since the onset of the pandemic and in line with the subdued macroeconomic environment, NBFCs have gone slow on disbursements. Consequently, AUM of NBFCs is expected to de-grow 1-3% in the current fiscal. Lower repayments during the loan moratorium period (March 1 to August 31, 2020) and potential capitalisation of interest accumulated will, however, help limit the de-growth.

Fiscal 2021 will be a story of how multiple factors weigh on NBFCs' growth prospects. One, the challenging macroeconomic environment will curb underlying asset sales, especially in the two biggest segments: housing and vehicle finance. Two, there will be sharper focus on liquidity for NBFCs, as incremental funding continues to be challenging in a confidence-sensitive scenario. Three, there would be increasing competition from banks, as funding costs for many NBFCs remain relatively high. Four, underwriting standards by NBFCs could be tightened amid weak economic activity and expectation of increasing delinquencies.

On the asset quality front, delinquencies are expected to inch up in the current fiscal, but the extent would depend on the business segment. The trend in monthly collection efficiency until August 31, 2020 (unadjusted for moratorium), shows that while there is definite improvement from June onwards with gradual opening up of economic activity, there is still some way to go to attain the pre-pandemic levels. While the recent restructuring scheme afforded by the RBI would curb reported NPAs, underlying challenges continue. Delinquencies of NBFCs could dart up 50-250 bps this fiscal, depending on the business segment, because of vulnerability in the borrower cash flow. This is a base-case estimate without factoring in loan restructuring and the Covid-19 affliction curve.

Home loans, the largest segment, is expected to register marginally positive growth in fiscal 2021, primarily on account of the book under moratorium leading to a lower rundown in the portfolio even as underlying asset sales drop. On the asset quality side, home loans are expected to continue to fare better than the other segments given that more than two-thirds of the portfolio is constituted by the salaried segment, where the impact of Covid-19 on the cash flow is low.

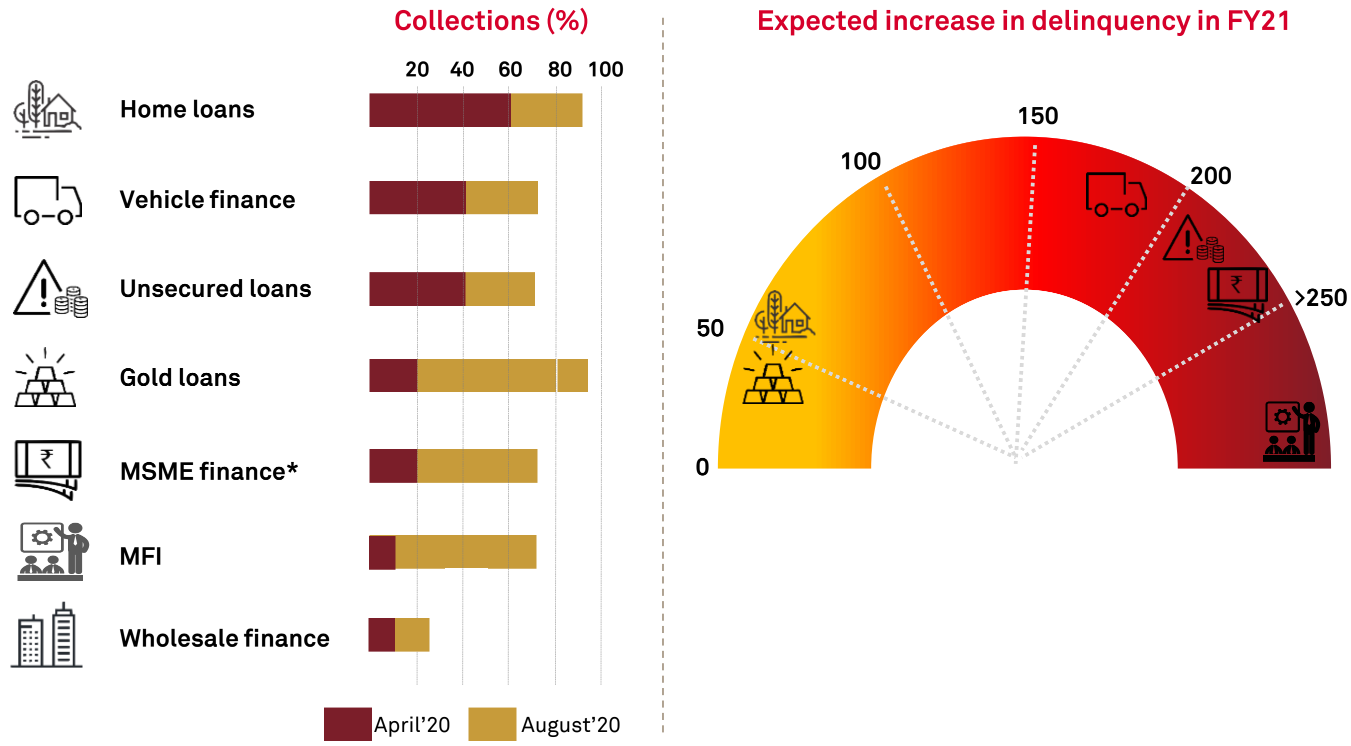
Vehicle finance, the second-largest asset class, is expected to de-grow in fiscal 2021 as disbursements drop substantially amid reduction in underlying asset sales and intensifying competition from banks. Additionally, concerns over increasing delinquencies in this segment are expected to translate into tighter underwriting standards for NBFCs, which too would aggravate de-growth. Asset quality trends will depend on improvement in the macroeconomic environment, as commercial vehicles constitute a bulk of the portfolio. Given the weak economic activity and slow pick-up in freight, collection efficiency has remained well below the pre-pandemic level for vehicle loans. Consequently, the increase in early delinquencies is expected to be relatively higher in this asset class.

The MSME sector is expected to be among the most impacted in terms of growth as well as asset quality. Growth will be marred amid concerns regarding asset quality in this segment, as the cascading impact of the lockdown on the operations of borrowers and lenders and weak economic activity weigh on the delinquency metrics.

For the microfinance segment, asset quality remains a key monitorable. Collections of microfinance institutions (MFIs), which had plunged to near zero in April because of the nationwide lockdown to stem the pandemic, have rebounded to 70-75% in August, with restrictions being lifted gradually. While the recovery has been faster than envisaged, improving it to the pre-pandemic level of 98-99% will be a key monitorable from an asset quality perspective. With the Covid-19 affliction rate still high and steadily percolating in the hinterlands, the ability of MFIs to further improve collections will be a key monitorable in the near term.

Amid all this, easing of funding access for NBFCs remains key to their credit profiles. Over the last two years, non-convertible debenture/commercial paper issuances have dropped substantially. Even securitisation, which had become a substantial source of funding since September 2018, witnessed a drop from March 2020 amid heightened concerns regarding asset quality. There have been some green shoots in the past few months, with NBFC fundraising from banks improving because of the long-term repo operations window opened by the RBI and with the partial credit guarantee scheme and the special liquidity scheme. As capital markets remain confidence-sensitive, continued funding support from banks will remain important for NBFCs. Over the past two years, banks have been providing significant support to NBFCs from a funding perspective, with bank credit growth to NBFCs being considerably higher than the overall system credit growth.

Chart 10: Segment-wise collection efficiency and delinquency trends in NBFCs



*Includes Loans against property and unsecured SME loans

Source: Company data, CRISIL Ratings

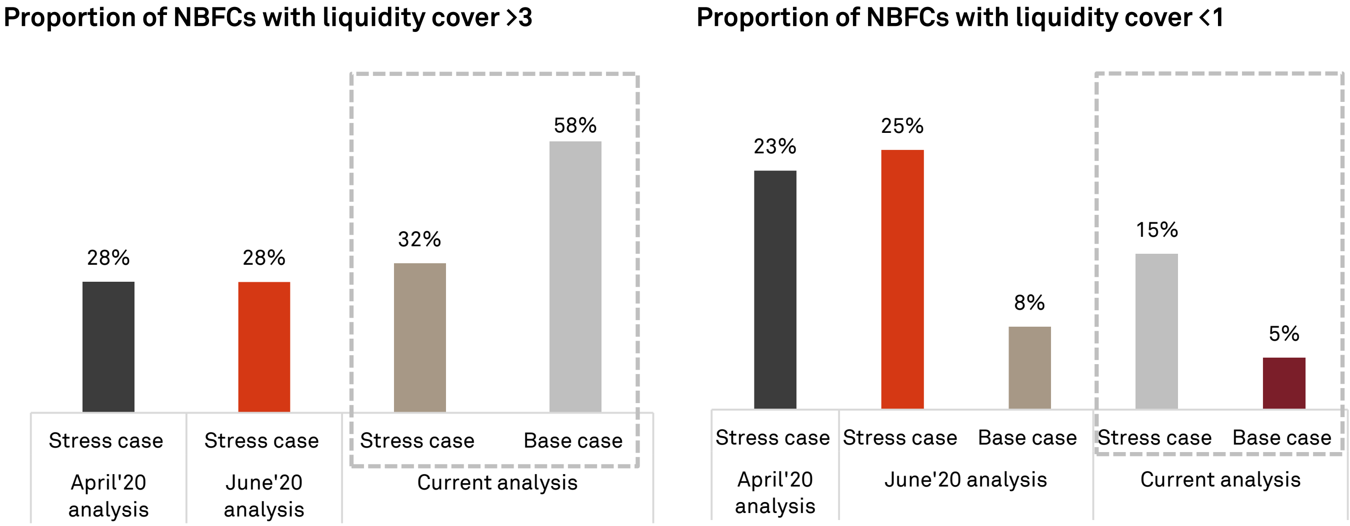
Liquidity buffer analysis for NBFCs

Liquidity covers of NBFCs have remained reasonably steady over the past five months since the start of the lockdown compared with the potential depletion envisaged in April. This is backed by collections, which improved from April to August, plus very low disbursements, which have helped prop up liquidity covers. Additionally, incremental funding continued to add to NBFCs' liquidity.

For the latest analysis, CRISIL envisaged a scenario where collections in the next few months will be similar to July/August levels. Amid this, the proportion of NBFCs with liquidity cover of less than 1 time (low liquidity cover) will be 5% over the three months through November, an improvement from the 23% arrived at in the first analysis carried out as on March 31, 2020. Lifting of the moratorium from September and continuation of the improving trend of collections should further cushion the liquidity covers of NBFCs. In fact, even without collections the share of NBFCs with low liquidity cover has dropped to 15% in the current analysis.

For most of the NBFCs where liquidity cover is below 1 time, CRISIL does not foresee any immediate loan repayment risk, as these NBFCs have strong parentage and had relatively better access to funding in the recent past. For other NBFCs, we will continue to monitor the liquidity levels closely as the situation evolves.

Chart 11: Liquidity analysis of NBFCs



Base case: Liquidity cover = (cash available with NBFCs + unutilised bank lines + collections of July/August continuing till 3 months through November)/Total debt falling due

Stress case: Liquidity cover = (cash available with NBFCs + unutilised bank lines)/Total debt falling due

Note: Numbers indicate % of companies in each category

Source: Company data, CRISIL

Pockets of vulnerability persist despite improving collection efficiency in securitisation transactions

The collection performance of securitised pools of retail loan receivables has improved over the past few months from the lows of April, when India saw the world's strictest lockdown. The median monthly collection ratio (collections excluding prepayments as a percentage of estimated pre-moratorium billing for the month) has risen to above 50% across major asset classes after falling to near zero in many pools in April. However, collection efficiency remains way off the pre-Covid-19 level of over 95%. In the near term, nascent recovery could be threatened by floods in some parts of the country and imposition of localised lockdowns to contain the infection rate.

Following the RBI's Covid-19 Regulatory Package, most investors of securitised instruments (including acquirers of loans) had agreed to extend the moratorium, in part or in full, to underlying borrowers in the pools backing securitisation transactions. This helped retail borrowers manage their debt burden. In many cases, this was accompanied by rescheduling of the liability payouts on pass-through certificates (PTCs), which also included extension of the PTC tenure in a number of instances. Consequently, the available credit enhancement was not utilised during the moratorium period in most CRISIL-rated securitisation transactions.

Repayments of securitised loans were impacted by the country-wide lockdown and announcement of moratorium on loan repayments till August 2020. However, apart from the moratorium extended by investors, for as many as 96% of transactions in CRISIL's rated securitisation portfolio, adequate credit enhancement within the transaction structure helped survive heightened stress in collections during this period without impacting the cushion needed to maintain the assigned ratings. An important factor supporting the credit quality of rated PTCs was the investor-approved payout re-schedulements, which helped mitigate the challenge posed by lower collections on account of the moratorium. In some transactions, vulnerabilities were identified in the course of CRISIL's extensive reviews of its rated portfolio. These were largely a result of factors such as the structure following a Timely Interest Timely Principal (TITP[7]) waterfall where stress build-up is relatively higher, moratorium not being obtained from investors and low amortisation levels. A snapshot of these transactions is as follows:

Table 9: Asset class-wise downward rating actions

Sr no	Asset class[8] backing PTCs	Action	Factors	Portfolio proportion#
1	CV	Downgrade and rating watch	TITP, no moratorium	1%
2	MFI		TITP	1%
3	TW	Watch negative	TITP	2%
Total				**4%**

Outstanding as on date of publication

Source: CRISIL Ratings

[7] TITP: On a given payout date, in case of any shortfall in interest and/or principal repayments, the credit enhancement would be utilised to make good the scheduled payout to the investor.

[8] CV – commercial vehicle loans; MFI – microfinance loans; TW – two-wheeler loans

Securitised pool collection efficiency during the moratorium period

CRISIL-rated transactions have witnessed sequential improvement in collection efficiency from the lows of April 2020. CRISIL has tracked the monthly collection ratio (MCR; collections excluding prepayments as a percentage of estimated pre-moratorium billing for the month) for all CRISIL-rated transactions. The median MCR had fallen to near zero in many pools for the May 2020 payout[9]. Since then, the MCR for pools backed by microfinance and commercial vehicle (CV) loans crossed 65% and 55%, respectively, for the August payout. For SME[10], two-wheeler and mortgage pools, the median MCR crossed 60%, 70% and 74%, respectively (refer to Charts 12-16), for the August 2020 payout.

The recovery in collections is largely attributable to three factors: the gradual restart of economic activity from June 2020, the relative buoyancy of the rural economy and originators leveraging technology for aiding collections through the digital mode, in addition to the physical route.

Trends in asset class-wise collections in CRISIL-rated pools

Chart 12: Collections in CRISIL-rated vehicle pools

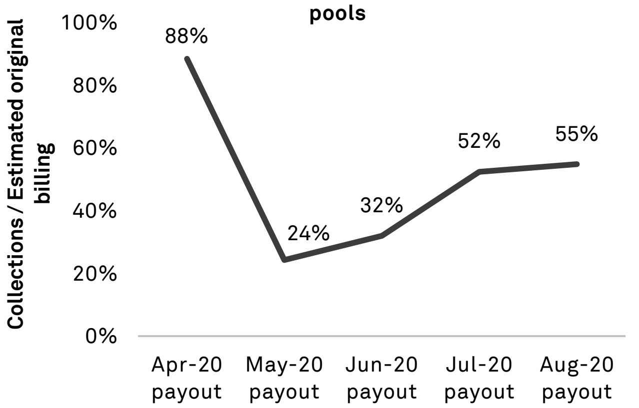


Chart 13: Collections in CRISIL-rated MFI pools

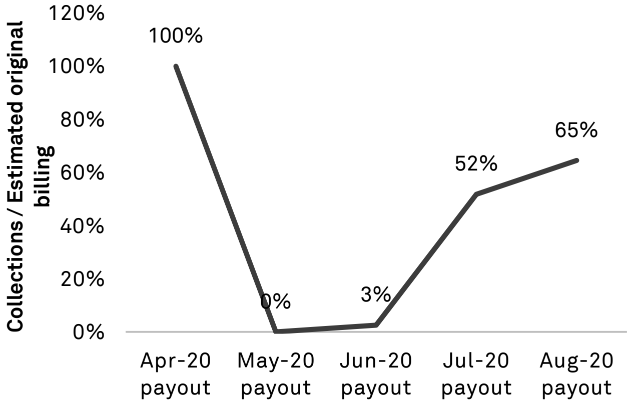


Chart 14: Collections in CRISIL-rated two-wheeler pools

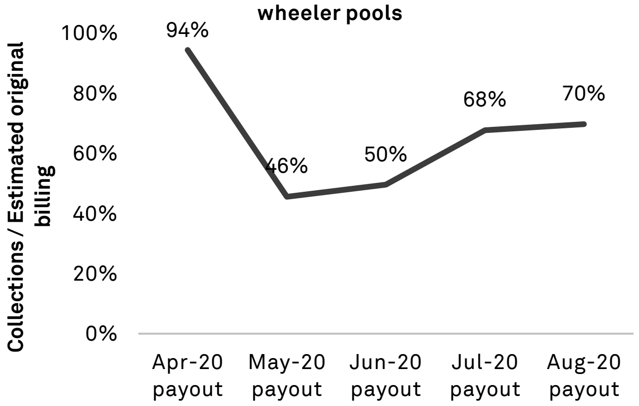
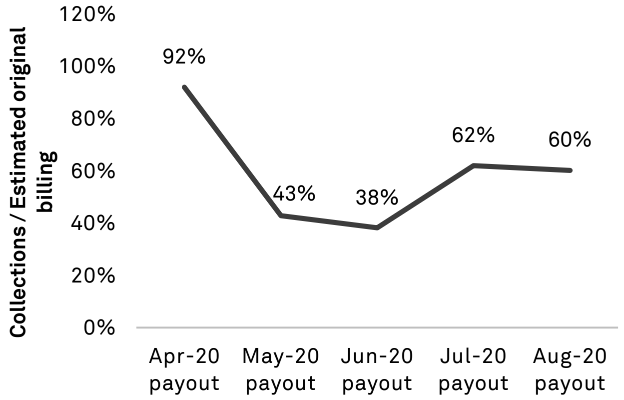


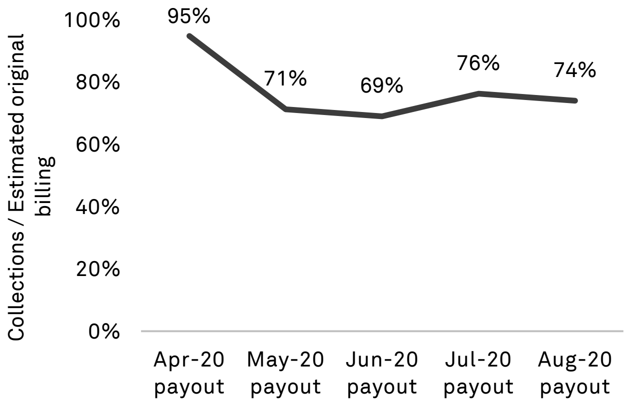
Chart 15: Collections in CRISIL-rated SME pools



[9] Payouts in a month correspond to collections in the previous month. For example, May 2020 payout corresponds to collections in April 2020.

[10] Small and medium enterprises

Chart 16: Collections in CRISIL-rated MBS pools



Source: CRISIL Ratings

Key monitorables for securitised pools

In the short term, the ability of borrowers to commence business activity, restore cash flow and resume repayment of their liabilities would be critical factors impacting the performance of securitisation transactions. Correspondingly, the payout structure and maturity period would influence the post-moratorium credit outlook on the PTCs. Beyond the factors intrinsic to every pool, other factors such as business and collection performance of the originator, broader economic recovery, and change in credit culture and borrower behaviour would also weigh on the performance of the pools.

Notwithstanding the expected improvement in collection efficiency based on the trend seen in the immediate past, re-imposition of localised lockdowns to combat fresh outbreaks of the disease could pose risks related to future collections for asset classes and entities dependent on field staff for cash collections. Any such event or occurrence may necessitate the utilisation of credit enhancement. CRISIL will continue to closely monitor the collection performance of all securitised pools under its surveillance and will take the appropriate rating actions.

Outlook on securitised assets

In the foreseeable future, the pandemic and allied factors will continue to be the most relevant determinants impacting credit assessments. The effects and after-effects will leave their imprint until a durable, sustainable solution is found.

CRISIL is cognisant of divergences in borrower behaviour across asset classes, business profiles and geographies.

Not only would this impact the outstanding securitised pools in the portfolio, but incremental securitisation volume would also be influenced. Additionally, the one-time restructuring would have implications for the contracts underlying securitised pools and in the portfolio of originators by way of extension of tenure for underlying loans. So far, though the collection ratios have been showing an improving trend, they are still well below pre-Covid-19 levels of over 95% across asset classes. Until economic activity returns to normalcy, collection ratios are unlikely to return to business-as-usual levels.

The adequacy of internal and external credit enhancement available as per the transaction structures would be crucial inputs for rating actions on securitisation transactions, which, in turn, would depend on collection recovery.

Conclusion

Overall, the credit quality outlook for fiscal 2021 is undoubtedly negative and downgrades are likely to significantly outnumber upgrades.

Post unlock measures, there will be only a gradual economic recovery in H2-21.

Corporate credit quality is expected to be impacted in sectors with low and moderate resilience, and timely debt restructuring will play a key role in the outlook for these sectors.

Lenders with large exposure to the impacted sectors also need to raise capital to manage potential asset quality hits, although the restructuring scheme could provide some respite.

A persistent second wave of Covid-19, slower-than-expected recovery and a likely prolonged consumption slump can hamper the outlook for fiscal 2021.

Notes

Notes

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.

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