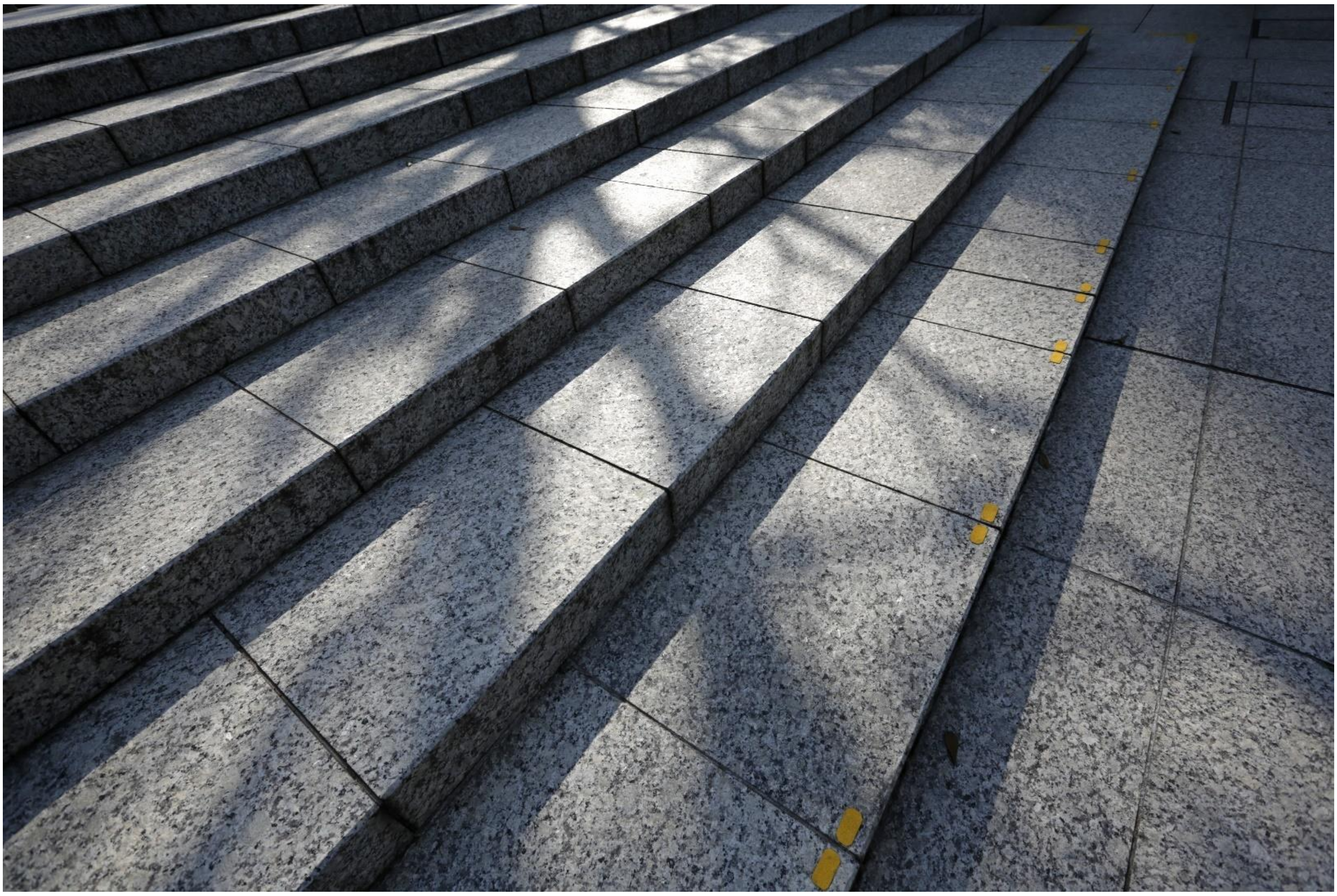
CRISIL
An S&P Global Company

Resilient, brighter morrow beckons

Ratings Round-Up Second half, fiscal 2022



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Executive summary

The CRISIL Ratings credit ratio[1] (upgrades to downgrades) increased to 5.04 times in the second half (H2) of fiscal 2022, compared with 2.96 times in the first half (H1), underscoring continuing improvement in the performance of India Inc.

In all, there were 569 upgrades and 113 downgrades in H2.

The upgrade rate increased to 15.4% in H2 from 12.5% in H1, while the downgrade rate declined to 3.1% from 4.2% in the same period[2]. The downgrade rate is less than half the ~6.5% average seen in the past ten half-year periods.

The performance comes on the back of a sustained improvement in demand (that lifted the revenues of most sectors to their pre-pandemic levels), secular deleveraging by debt issuers (seen over the past few fiscals and through the pandemic), and proactive relief measures by the government (that cushioned the pandemic blow).

CRISIL Ratings' outlook on credit quality remains 'positive', with upgrades expected to outnumber downgrades in fiscal 2023, too. However, going forward, the credit ratio could moderate for two reasons: one, demand and profitability could soften if commodity prices remain high; and two, winding back of Covid-19 relief measures. Further, with offices reopening and business travel restarting, some of the cost savings of 2020-22 would be eliminated.

Demand recovery, nimbleness in managing supply chains, and a tight leash on costs have shored up the median operating profit growth of the upgraded companies by ~41% in the past two fiscals — more than double the rate for the portfolio. The rated companies have continued to deleverage, as underscored by the median gearing, which is estimated to have declined to ~0.55 time as of end-fiscal 2022, compared with nearly 1 time five years back.

CRISIL Ratings conducted a study based on its 'Corporate Credit Health Framework', which analyses the credit quality outlook of the top 40 sectors (by revenue), accounting for over 70% of its rated debt (excluding the financial sector). This framework looks at the strength of balance sheet, improvement in operating cash flows in fiscal 2023 over fiscal 2022, and vulnerability to the Russia-Ukraine conflict.

The key takeaways from the study:

- 15 sectors (~16% of rated debt) are in the 'most buoyant' bucket with favourable operating cash flows and robust balance sheets. These include pharmaceuticals, healthcare, IT, specialty chemicals, auto components, and electric components
- The remaining 25 sectors are expected to see a favourable trend in only one of the two parameters — operating cash flows or balance sheet — and have a positive to neutral credit quality outlook, though the buoyancy may be tempered. Some of these sectors, including FMCG[3], edible oils, and power, benefit from being essential goods and services. Among others, sectors such as textiles benefit from

[1] Excludes rating actions involving ratings with the Issuer Not Cooperating (INC) suffix
[2] Upgrade or downgrade rate refers to the ratio of upgrades or downgrades respectively during the period to total outstanding portfolio at the beginning of the period on an annualised basis
[3] Fast-moving consumer goods

higher demand for exports, while construction, and pipe and pipe fittings benefit from government spending on infrastructure.

- Interestingly, no sector studied seems to be facing an unfavourable trend in terms of operating cash flow and balance sheet strength in fiscal 2023

Meanwhile, the ongoing Russia-Ukraine conflict and the consequent surge in commodity prices can turn sectors such as diamond polishers, agrochemicals and ceramics vulnerable if supply-side challenges continue for long. Oil and gas marketing companies may see their operating profit decline due to delays in retail fuel price increases, but their credit profiles will continue to benefit from government support.

Financial sector companies are expected to have a 'stable' credit quality outlook, with credit growth at both, banks and non-banks trending upwards to 11-12% and 8-10%, respectively, in fiscal 2023.

For banks, credit growth will be largely driven by the corporate segment — the pace of growth could even double — driven by capex in infrastructure and pockets of the manufacturing sector, and incremental working capital demand. Retail credit is also expected to grow at a healthy clip for both, banks and non-banks, supported by continued underlying demand. For non-banks, the home, gold, vehicle and unsecured loan segments are likely to see higher growth.

Overall, asset quality is likely to improve for both banks and non-banks as the uptick in economic activity would support the cash flows of borrowers. Banks will also benefit from a reduction in corporate non-performing assets (NPAs), while non-banks will get a respite owing to the deferral of the stringent NPA recognition norms by the Reserve Bank of India. However, the performance of MSMEs[4], the unsecured loan segments, and the restructured portfolios bears watching at both banks and non-banks.

Our credit quality outlook for India Inc remains 'positive' even as we expect some moderation in the credit ratio. Persistent inflationary trends can affect both, consumption demand and profitability of firms, which can temper corporate credit quality. Any new Covid-19 variant that dilutes the benefit of vaccination also remains a risk to our credit quality outlook. Nevertheless, deleveraged balance sheets structurally position India Inc well to navigate these uncertain times.

[4] Micro, small and medium enterprises

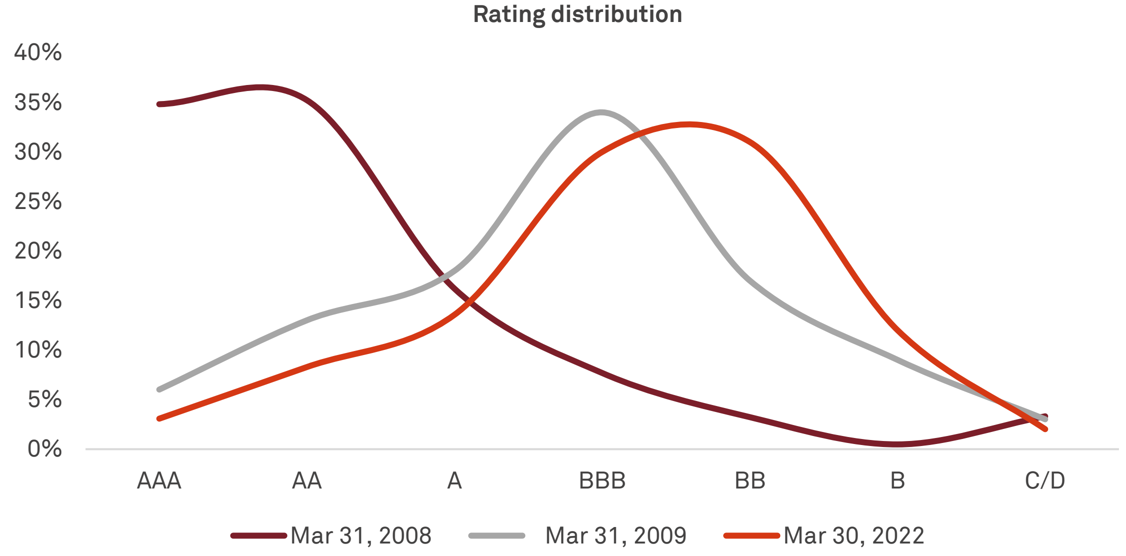
About Ratings Round-Up

The Ratings Round-Up is a semi-annual publication that analyses rating actions by CRISIL Ratings and traces the linkages between such actions and the underlying economic and business trends. This edition analyses the rating actions from September 30, 2021, to March 30, 2022.

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 a reasonable indicator of the economy's outlook.

CRISIL Ratings portfolio: Median rating shifts to 'BBB'

Chart 1: Trends in rating distribution



Source: CRISIL Ratings

Our outstanding ratings as on March 30, 2022, cover around 7,000[5] companies. Of these, ~55% are in the 'BBB' or above rating categories. Since the introduction of bank loan ratings in 2007 and rapid expansion of our rated portfolio, especially into the lower rating categories, the median rating had moved to 'BB' as on March 31, 2010, from 'AA' as on March 31, 2008.

Notably, after staying at 'BB' category till now, the median rating has shifted to the 'BBB' category in fiscal 2022.In fact, the proportion of ratings in the 'BB' or lower category has reduced from ~76% as of March 2013 to 45% as on March 30, 2022.

This is not so much due to the rating actions of CRISIL Ratings as due to the portfolio shrinking at the lower end of the rating spectrum — a phenomenon seen across the rating industry in India. Several banks have increased the threshold of minimum exposure that requires an external credit rating in recent years, leading to withdrawal of ratings, or more commonly, non-cooperation in the rating process by rated entities, especially those in the sub-investment grade categories.

[5] This excludes companies in the 'Issuer not cooperating' or INC category. CRISIL Ratings portfolio had ~11,000 such issuers as on March 30, 2022. Including such ratings, our outstanding rating list would comprise ~18,000 issuers. The median rating, however, would move to 'BB' category.

Analysis of rating actions in the second half of fiscal 2022

May you live in interesting times, goes the apocryphal saying.

Indeed, we are living in one, having endured two years of the pandemic and now bearing witness to a war flaming in Europe, fuelling crude oil prices to a 14-year-high. India Inc has emerged stronger and adapted fast to not just ‘living with the virus’ but thriving in ‘the new normal’, spurred by the sharp return of demand, dexterity in managing supply chains, and tight leash on costs.

Large- and mid-sized corporates have been more resilient, while micro, small and medium enterprises (MSMEs) have borne a disproportionate impact of the pandemic. However, relief measures from the government and regulators have provided timely support and softened the blow.

Containment measures during the second and third waves of the pandemic were more localised, and vaccinations have been conducted at an awe-inspiring pace—1.8 billion doses in just a year—ring-fencing the population from severe impact of a surge in Covid-19 infections. The third wave of the pandemic, though more widespread, did not lead to a proportionate increase in hospitalisations and hence did not have a material impact on demand drivers. Vaccination coverage remains crucial to containing the severity of future surges in infections.

Then there is the Russia-Ukraine conflict. Businesses have had to again navigate new roadblocks to global supply chains, and juggle with price hikes, while ensuring these do not hurt demand amid soaring commodity prices.

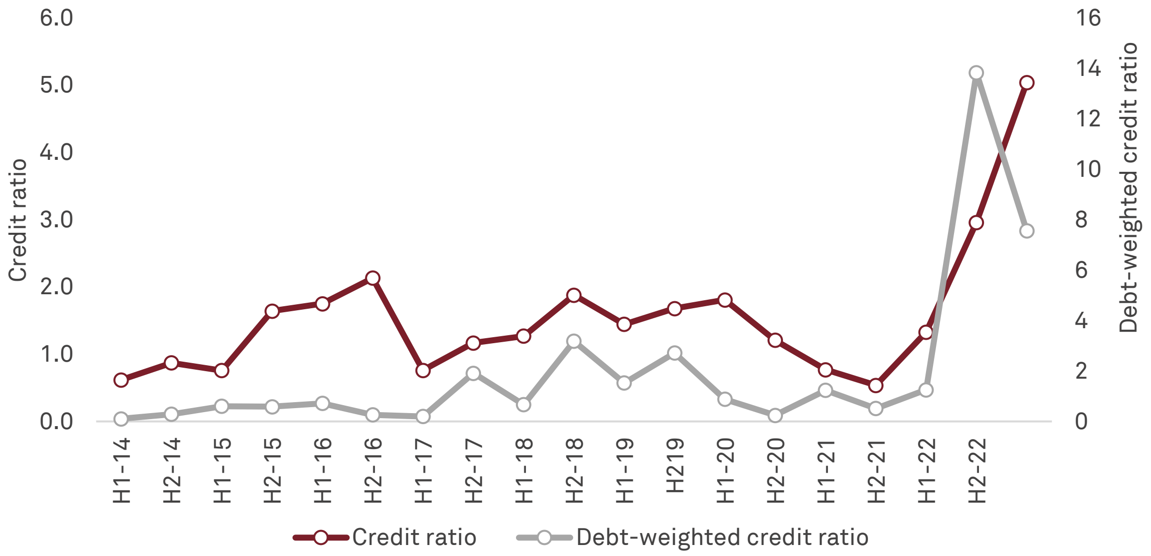
In the forthcoming section, we will address how the inflationary trends, both domestic and global, and the consequent headwinds will weigh on the credit quality outlook.

We will also present the credit ratio and debt-weighted credit ratio trends, enunciate how some sectors have fared in the second half of fiscal 2022, and present our credit quality outlook for fiscal 2023.

Credit ratio at 5.04 in the second half of fiscal 2022, up from 2.96 in the first; downgrade rate dips sharply, upgrade rate remains elevated

In line with our 'positive' credit quality outlook highlighted in the previous Ratings Round-Up, the CRISIL Ratings credit ratio[6] rose to 5.04 times in the second half of fiscal 2022 from 2.96 times in the first, with 569 upgrades and 113 downgrades.

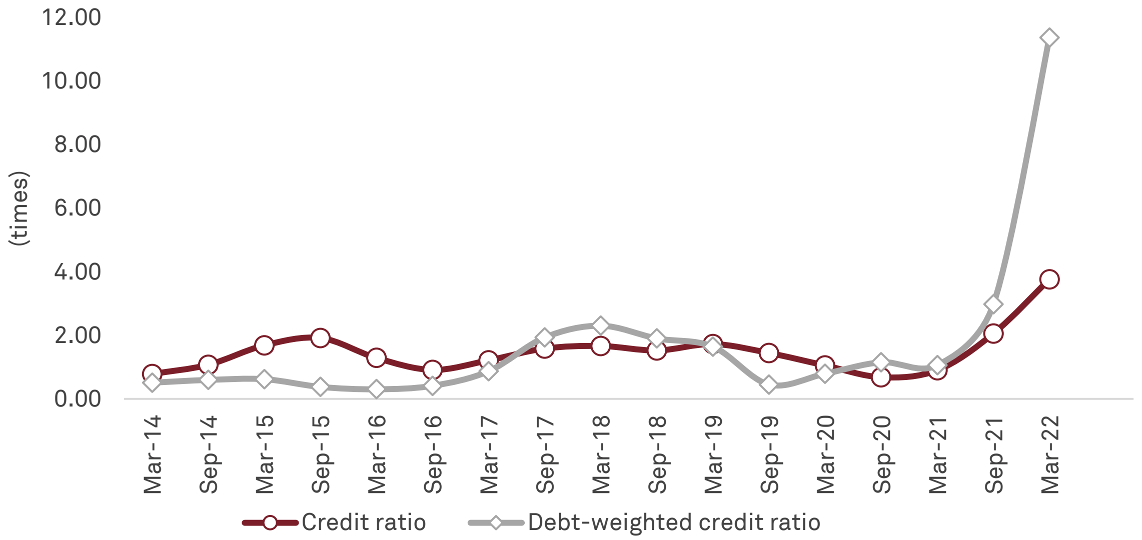
Chart 2: Credit ratio and debt-weighted credit ratio continue to rise



Source: CRISIL Ratings

The debt-weighted credit ratio at ~7.56 times has seen moderation from the H1 and is closer to the credit ratio. In general, large corporates have adapted better amid the pandemic by reorienting their operating models, pruning costs, keeping leverage under control, and conserving liquidity.

Chart 3: Trends in credit ratio and debt-weighted credit ratio (on a 12-month rolling basis)

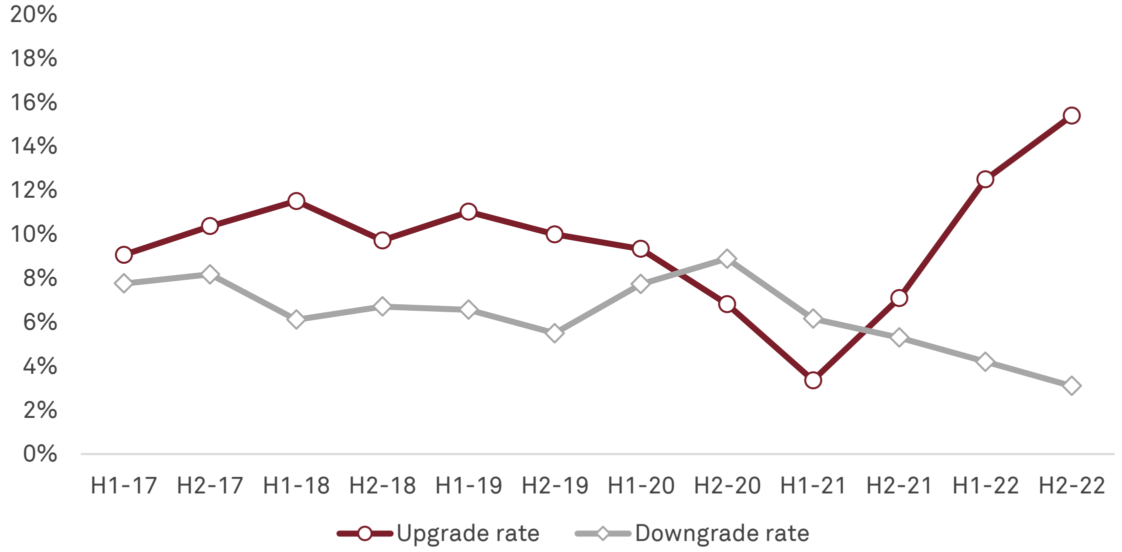


Source: CRISIL Ratings

[6] Excludes rating actions involving ratings with the 'Issuer not cooperating' (INC) suffix

To ascertain the sustainability of the upward trend, the credit ratio is assessed on a 12-month rolling basis. The CRISIL Ratings credit ratio and debt-weighted credit ratio for the second half of fiscal 2022on this basis are 3.77 times and 11.37 times, respectively. This is skewed in fiscal 2022 because of upgrades for a few large corporates, especially in the first half.

Chart 4: Trends in upgrade rate and downgrade rate



The upgrade rate increased to 15.4% in H2 from 12.5% in H1, while the downgrade rate declined to 3.1% from 4.2%. The downgrade rate is less than half the ~6.5% average seen in the past ten half-year periods.

Increase in credit ratio driven by secular deleveraging, sustenance of demand drivers and government support measures during the pandemic

Our previous Ratings Round-Up publication had indicated a 'positive' credit quality outlook for fiscal 2022, with upgrades expected to outnumber downgrades, driven by a secular deleveraging trend visible across the portfolio, sustained improvement in demand with most sectors recovering to the pre-pandemic levels, and proactive government and regulatory relief measures cushioning the pandemic impact. These factors have helped increase the upgrade rate and capped the downgrade rate.

Deleveraging has continued across the CRISIL Ratings portfolio

The deleveraging trend has continued across the CRISIL Ratings portfolio, led by lower capex, equity raise and improved cash accrual — most sectors have reached their pre-pandemic revenue levels — and cost optimisation measures.

This has resulted in stronger balance sheets and improved financial flexibility. An analysis of ~5,400 entities from our rating portfolio indicates a decline in the median gearing to an ~0.55 time as on March 31, 2022, from 1 time five years back. Similarly, the median interest cover has improved to 4.14 times from 3.14 times over the past five years.

Chart 5: Median gearing and interest coverage ratio

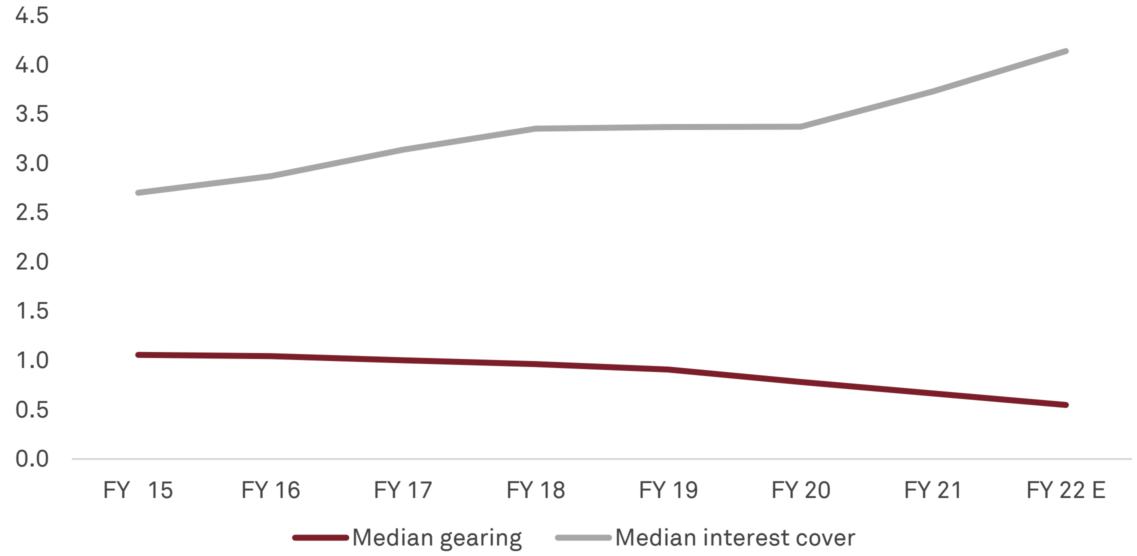
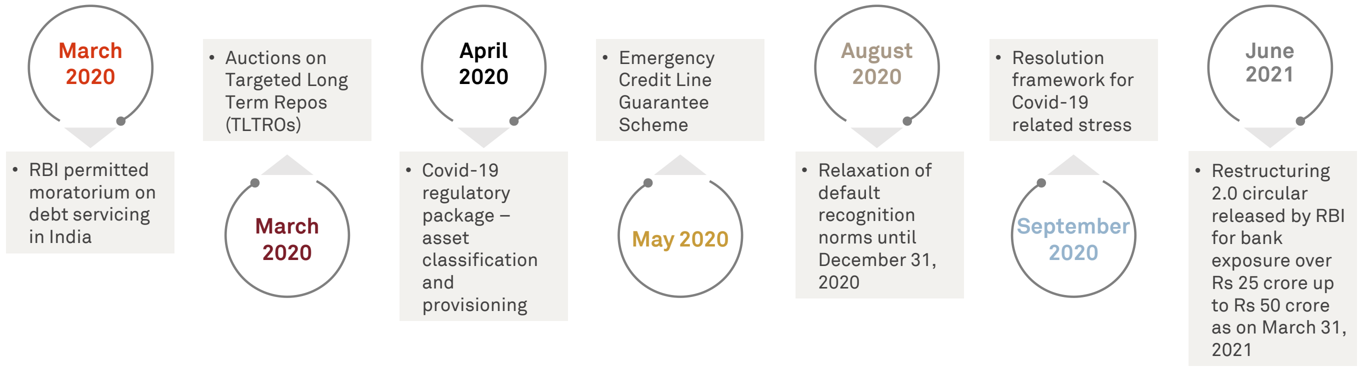


Chart 6: Sectors that saw high upgrades in the second half of fiscal 2022

Proactive government and regulatory support during the pandemic

During the pandemic, the government and regulators announced various relief measures. For instance, the Reserve Bank of India (RBI) announced moratorium on debt servicing, deferment of asset classification norms, Targeted Long-Term Repo Operations (TLTRO), Emergency Credit Line Guarantee Scheme (ECLGS) and one-time resolution (OTR) frameworks for Covid-19 (OTR 1 and 2). These were timely interventions, which cushioned entities facing cash-flow pressures. The relaxation of default recognition norms by the Securities and Exchange Board of India (SEBI) also played its part in providing temporary relief at the peak of the first wave of the pandemic.

Chart 7: Relief measures announced by the government and regulators



Some of the measures were extended during the second wave of the pandemic, which was more severe than the first, and were targeted at contact-intensive sectors. For instance, ECLGS was extended in May 2021 to cover impacted sectors such as civil aviation, hospitality, as well as support building of hospital infrastructure and creation of employment opportunities. ECLGS has further been enhanced to Rs.5 lakh crore and extended till March 31, 2023. As per latest estimates, loans sanctioned under ECLGS have crossed Rs 3.19 lakh crore, and about 95% of the guarantees issued are for loans sanctioned to micro, small and medium enterprises.

Only 1% of eligible companies in the CRISIL Ratings portfolio opted for the debt restructuring facility under OTR 2[7]. Of the entities that did, 95% were rated in the sub-investment grade category.

Migration of ratings to non-cooperative status may have impacted the downgrade rate

While our study focuses on the cooperative portfolio, a large part of rating migrations to non-cooperative status are from the sub-investment grade, where there is a downward bias to the rating. The downgrade rate for sub-investment grade was about 4% for the second half of fiscal 2022, more than twice the investment grade.

Further, of the issuers that were non-cooperative as on March 30, 2022, a vast majority (82%) were small companies with rated debt limits of Rs 25 crore or less. Smaller companies, especially MSMEs, have been impacted disproportionately by the pandemic, as reflected in other indicators, such as increased NPA levels in MSME loans by banks and non-banks, and a higher proportion of MSMEs availing of the OTR schemes.

However, in CRISIL Ratings' portfolio, migration to non-cooperative status does not capture the change in credit profile because of limited information. This may also have contributed to a lower downgrade rate.

[7] A CRISIL Ratings survey of 4,700 companies rated - https://www.crisil.com/en/home/newsroom/press-releases/2021/08/few-takers-for-restructuring-2point0-amid-demand-recovery.html

Increase in group upgrades also lifts the credit ratio

There were 16 upgrades in ‘homogenous groups’ of companies during the second half of fiscal 2022, the highest over the previous 10 halves. These groups are largely homogenous, with significant business, financial and managerial linkages. In such cases, the ratings of individual entities are arrived at by following the homogenous group criteria[8] and the rating actions are usually in tandem.

Considering all the group company upgrades as one, the adjusted credit ratio stands at 4.54. There was no group downgrade.

[8] https://www.crisil.com/mnt/winshare/Ratings/SectorMethodology/MethodologyDocs/criteria/Criteria%20for%20rating%20entities%20belonging%20to%20homogenous%20groups.pdf

Credit quality outlook ‘positive’ despite pressures

'Positive' outlook likely to continue, this time with some caveats

The CRISIL Ratings credit quality outlook for India Inc remains ‘positive’, with rating upgrades likely to outnumber downgrades in fiscal 2023, driven by sustenance of domestic demand, public expenditure for infrastructure projects, and surging exports.

The government-facilitated capex is expected to rise 14.4% in fiscal 2023 over fiscal 2022 as per the latest budget announcement.

However, demand for export-driven sectors may moderate as growth of some of the developed economies is likely to be slow as pandemic-induced accommodative monetary policy stance is being reversed across key countries. Exports crossed $400 billion in fiscal 2022, an annualised growth of 14% over the last two years, led by significant increase in consumption in the US and the European Union.

While upgrades are likely to outnumber downgrades in fiscal 2023, CRISIL Ratings expects some moderation in the credit ratio as continued inflation creates headwinds to demand and profitability across sectors.

Key risk to the credit quality outlook

- Rising commodity prices may reduce demand and impact profitability

Surging demand amid massive stimulus led to inflation, both domestically and globally. This trend was aggravated by the Russia-Ukraine war and likely supply chain disruptions arising from lockdown in China as it copes with the omicron variant.

With Russia’s invasion of Ukraine, commodity prices have risen sharply, and crude oil prices touched a 14-year high of over $130 per barrel from $65 before stabilising at $100. The consequent increase in fuel cost may have a disproportionate impact on some commodity sectors, especially downstream players, and increase logistics cost across sectors.

CRISIL Ratings continues to monitor the impact of rising commodity prices, especially crude oil, on the profitability of its rated entities. Prolonged supply-side snags could have a bearing on sectors such as diamond polishers, agrochemicals, and oil and marketing companies and will remain a key monitorable. Any surge in infections, or any new Covid-19 variant, will bear watching, too.

While the second half of fiscal 2022 was a mixed bag — economic recovery on the one hand, and higher commodity and crude oil prices denting business environment on the other — CRISIL Ratings continued its endeavour to keep investors informed by publishing 50 press releases and hosting 11 webinars on sectoral developments.

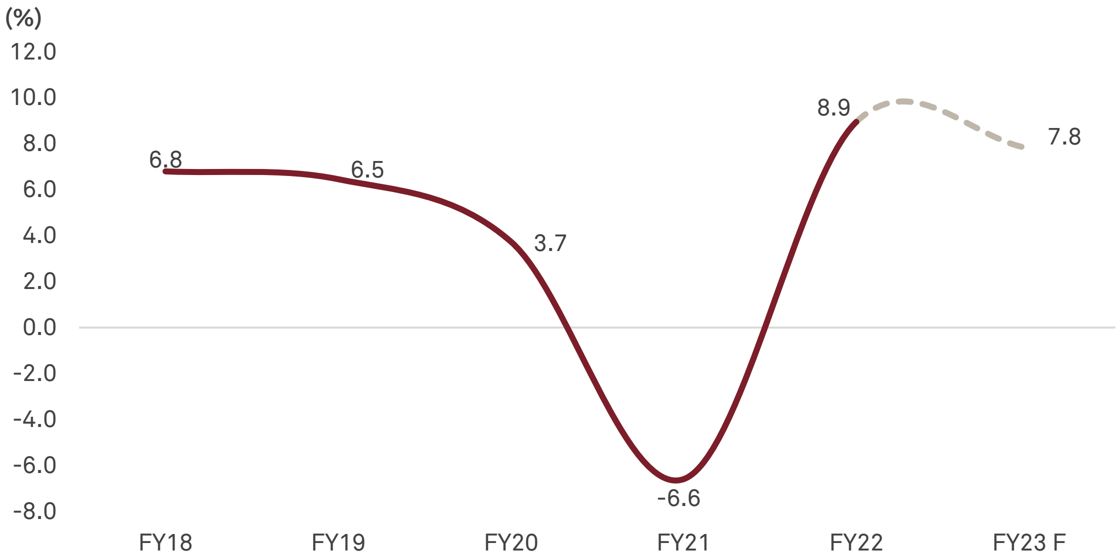
Macroeconomic outlook

The Indian economy is in recovery mode. With most restrictions lifted after the pandemic ebbed, the country is on its way to normalcy. Economic growth will now largely depend on how long the war in Ukraine lasts. The current inflationary pressures, elevated commodity prices, volatile financial markets, and demand-supply imbalances make for a challenging backdrop.

The National Statistical Office estimates India's GDP growth at 8.9% in fiscal 2022. CRISIL expects India's GDP to grow at 7.8% in fiscal 2023, led by sustained demand amid increased vaccinations, gains from supply-side reforms, robust export growth, and fiscal space to ramp up deferred capex. Agriculture growth will be supported by expectation of normal monsoon for the fourth consecutive year.

Investment spending, as measured by gross fixed capital formation (GFCF), is estimated to have grown 15% in fiscal 2022, largely driven by government capex. The government's thrust to quickening a virtuous cycle of growth through capex and infrastructure spending has increased capital formation, lifting investment-to-GDP ratio to 28.3% in fiscal 2022 from 26.6% in fiscal 2021. The Production Linked Incentive (PLI) scheme will also generate private capex in pockets. Exports have been doing exceedingly well, and are 9.9% above the pre-pandemic level in real terms.

Chart 8: Real GDP growth



Inflation can spike due to geopolitical tensions, but fiscal room available to meet new challenges

Global economic growth was expected to decelerate and inflation to accelerate in 2022, even before the start of the Russia-Ukraine conflict. As for risks, the pandemic is down but certainly not out. The milder third, or omicron, wave affords a potential upside, but this will be offset by the ongoing geopolitical strife stemming from the Russia-Ukraine conflict.

India is vulnerable to high oil prices, although agricultural exports could gain in the near term owing to high global prices. If India is able to import substantial amount of crude oil from Russia at discounted prices, as is being offered reportedly, there will be a good offset.

The risks to growth, nevertheless, are tilted downwards at this juncture. The Consumer Price Index-based inflation is expected at 5.4% in fiscal 2023, assuming crude oil price averages $87 per barrel. However, upside risks will emerge if the Russia-Ukraine conflict prolongs, keeping oil and commodity prices higher.

Private consumption, which is the largest component of demand and has been the slowest to recover from the pandemic, will also face headwinds from higher inflation.

CRISIL Ratings believes the fiscal policy will have to be tuned to provide more subsidies.

India's external account and currency soaked the pandemic-induced shock well. This, in part, is attributable to strong build-up of foreign exchange reserves. At $630 billion, India's war chest is the fifth-largest in the world, which affords the RBI substantial elbow room to manage orderly movement of the rupee. The central bank now faces another test because of the Russia-Ukraine conflict and the dial-back of monetary stimulus in the US.

Corporate Credit Health Framework

An indicator of relative positioning of sectors and their credit quality

CRISIL Ratings expects the credit quality outlook to remain 'positive' in fiscal 2023, backed by secular deleveraging across sectors, demand recovery, nimbleness in supply chains and tight leash on costs.

Resurgent demand across domestic and global markets has helped shore up profitability of businesses. In the developed markets, fiscal stimulus fuelled demand for India's exports, which reached an all-time high of over $400 billion in fiscal 2022. A study by CRISIL Ratings reflects that most sectors have reached pre-pandemic levels in revenue terms.

But high commodity prices and return of business travel and advertisement costs could impact the profitability of entities in fiscal 2023. However, volume growth and higher realisations should help sustain operating cash flow growth in most sectors.

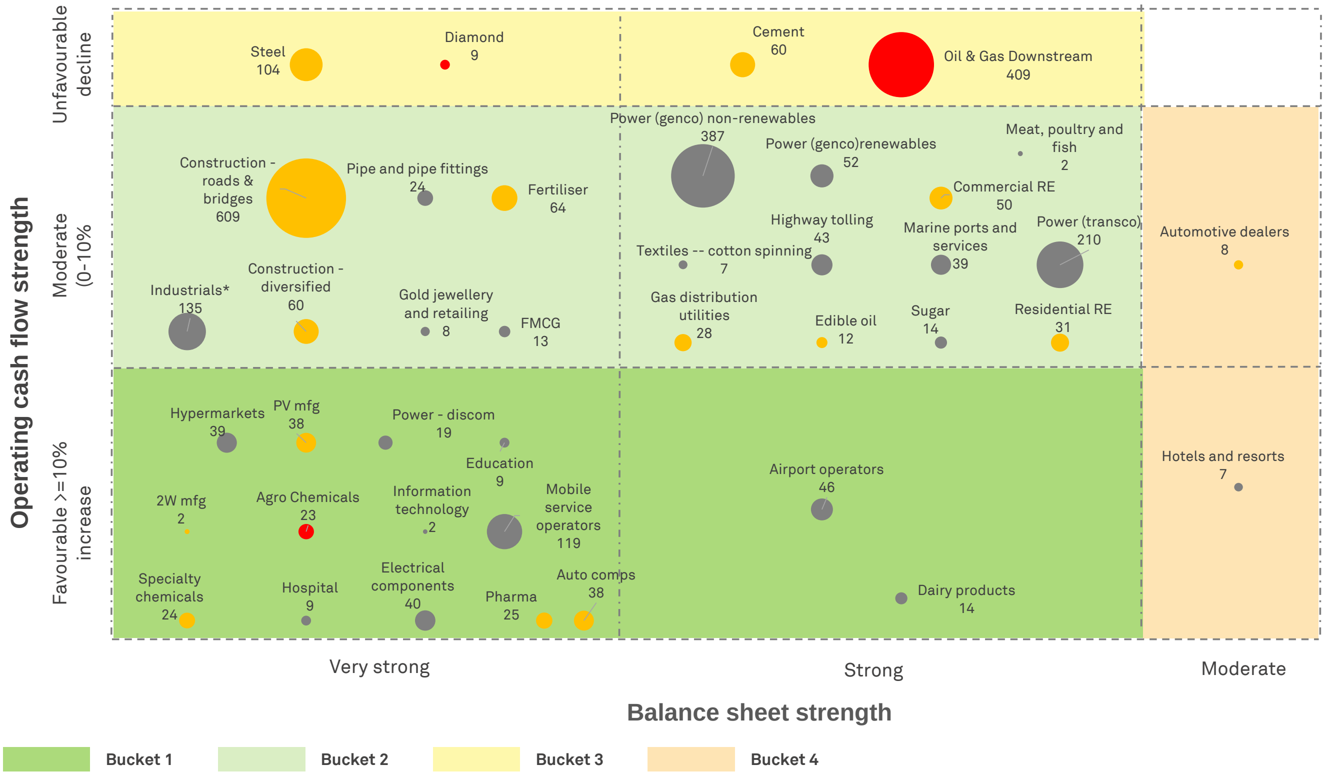
The Russia-Ukraine conflict has added an element of uncertainty, especially with punitive sanctions imposed on Russia by the US and European nations. This could impact profitability of the downstream sectors and growth of sectors dependent on trade with these regions.

In light of these developments, along with the endemic phase of Covid-19, it is necessary to view the credit quality outlook of India Inc from a new lens. The Covid-19 resilience framework that CRISIL Ratings had developed at the onset of the pandemic, and published four times since then, has established that most sectors have reached pre-pandemic levels in revenue terms (*refer to annexure*). Hence, CRISIL Ratings has transitioned to a new framework based on balance sheet and cash flow strength, and vulnerability to the Russia-Ukraine crisis.

Methodology and assumptions

CRISIL Ratings has analysed 40 key sectors, accounting for over 70% of the total debt rated (excluding financial sector entities) on two parameters: one, operating cash flow strength, which considers growth in earnings before interest, tax, depreciation and amortisation (Ebitda) in fiscal 2023 over fiscal 2022; and two, balance sheet strength, which considers expected gearing at the end of fiscal 2023 and change in gearing over the level seen at the end of fiscal 2022.

Chart 9: Corporate Credit Health Framework



Terminologies used in the framework:

- The X-axis denotes balance sheet strength derived using a combination of expected gearing and change in gearing over fiscal 2022. Lower gearing reflects deleveraging, seen across companies over the past two years, and cushions the impact of risks
  - Balance sheet strength could be ‘very strong’, ‘strong’ or ‘moderate’.
  - For example, the pharma sector shows well-managed balance sheets due to low gearing levels and is categorised as ‘very strong’.
- The Y-axis denotes expected on-year growth in Ebitda in fiscal 2023 by taking into consideration volumes, realisations and cost optimisation measures undertaken by entities
  - Cash flow strength will be favourable if Ebitda growth is 10% or above, moderate if Ebitda growth is less than 10%, or unfavourable if there is a decline
  - For example, hospitals continue to display healthy demand growth, benefiting from being part of essential services, with expected absolute Ebitda growth of more than 10% in fiscal 2023
- The placement of a sector has to be read in conjunction with the colour of the bubble representing the sector as recent developments with respect to the war will likely have varying impact across sectors

- The colour of the bubble denotes the impact of the Russia-Ukraine war on sectors in the first half of fiscal 2023:
  - Red – Negative impact on cash flow
  - Amber – Moderately negative impact on cash flow
  - Grey – Neutral impact on cash flow

For example, the diamond polishing industry is denoted by a red bubble as trade and banking sanctions on Russia may impact sourcing of key raw materials such as rough diamonds. Amid mining challenges, production curbs by miners, and rapid increase in demand over the course of the pandemic, the average inventory holding of Indian diamantaires has reduced to around three months from over four months.

For diamond polishers, continued disruption of trade could push up the prices of rough diamonds that, in turn, will squeeze their profitability in fiscal 2023.

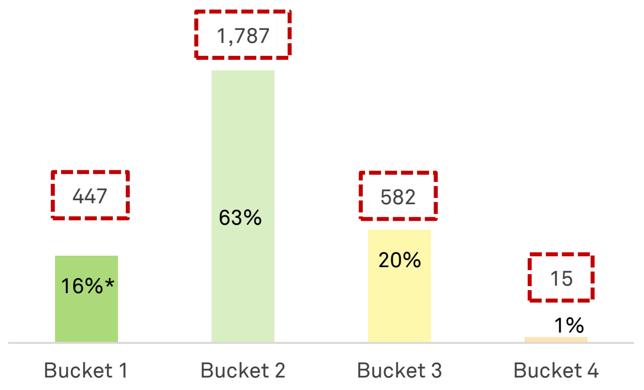
On the other hand, amber for pharma denotes marginal impact of the war, as pharma exports to Russia and Ukraine are exempt from sanctions and the exposure of Indian players to these geographies is low at ~3%. Expected healthy operating performance, supported by a very strong balance sheet, will further dilute the impact of the Russia-Ukraine war.

In our study, we have categorised the sectors into four buckets —Bucket 1, 2, 3 and 4 —as per their placement in the framework.

- Bucket 1 refers to sectors that are expected to see favourable operating cash flow strength, while having robust balance sheets (very strong or strong balance sheets)
- Bucket 2 refers to sectors that are expected to see moderate operating cash flow strength, while having robust balance sheets
- Bucket 3 refers to sectors that are expected to see unfavourable operating cash flow, but would be cushioned by robust balance sheets
- Bucket 4 refers to sectors that are expected to see favourable or moderate operating cash flow, but would have moderate balance sheet

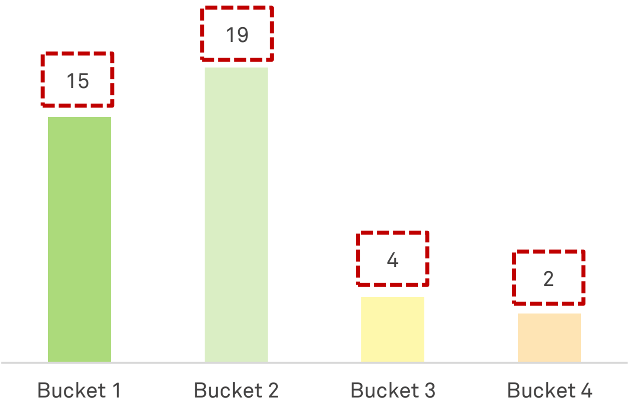
Key conclusions of the study

Chart 10: Rated debt (Rs '000 crore) under analysis



*As a percentage of total rated debt under study

Chart 11: Sectors under analysis



The CRISIL Ratings analysis reveals that a sizeable number of sectors will be able to absorb volatility over the medium term, driven by higher operating profit and stronger balance sheets. However, the credit quality of a few sectors will be moderate and may see a low credit ratio.

- Of the 40 sectors, 15 are in the 'most buoyant' bucket, accounting for 16% of rated debt, and will likely have favourable operating profit and very strong/strong balance sheet strength in fiscal 2023, and show buoyancy in credit quality. Among these, pharma, healthcare, and IT will benefit from healthy demand, while specialty chemicals, auto components, and electric components will benefit from diversified geographical and revenue profile
  - The remaining 25 sectors will see a favourable trend in one of the two parameters — operating profit or leverage — and will have a positive credit quality outlook. Of these, 19 sectors accounting for 63% of rated debt should witness moderate improvement in operating profit, with strong or very strong balance sheets. These largely include investment-linked sectors such as construction, industrials, real estate, or consumption-driven sectors such as FMCG[9], gold jewellery, and meat and poultry, which will benefit from demand recovering to pre-Covid-19 levels but witness moderation in operating profit because of increase in input prices
  - Four sectors — steel, diamond, oil and gas marketing and cement — accounting for 20% of rated debt may see operating profit decline even as balance sheets remain strong or very strong because of their limited ability to completely pass on increase in input prices
  - Two sectors — automotive dealers and hospitality — accounting for 1% of rated debt, are expected to maintain moderate leverage but see operating profit improve
- Interestingly, no sector studied seems to be facing an unfavourable trend in terms of operating cash flow and balance sheet strength in fiscal 2023

Impact of prolonged Russia-Ukraine conflict is a key monitorable

[9] Fast moving consumer goods

In the CRISIL Ratings report titled *'Russia-Ukraine confrontation a strain on multiple sectors'* published on March 07, 2022, CRISIL Ratings had assessed the impact of the Russia-Ukraine war on its portfolio factoring the flurry of punitive sanctions. As per the insight, India Inc may be impacted in two ways. First, the resultant spike in commodity prices, if not passed on, can increase input costs and squeeze the profitability of downstream players. Second, trade and banking sanctions can cull India's export-import activity in the region till workarounds are found. Assuming the conflict is not prolonged, no major structural long-term credit deterioration is expected across the corporate credit market in India. That said, the spread, intensity and duration of the conflict will need to be monitored closely as they can have a bearing on credit profiles in some sectors.

Prolonged disruption in supply chain may impact the profitability of sectors such as diamond, oil and gas, and fertilisers, which may also see moderation of growth.

Indirect impact may be seen on chemicals and paints sectors, which use crude oil derivatives as their primary feedstock. However, natural gas players may witness moderate impact as city gas operators have higher cost pass-through ability. Some sectors, such as primary steel producers and smelters, may see mixed impact with higher margins, while secondary players may face cost pressures.

Having said that, profitability may decline, but absolute profit will be higher, led by higher realisations, as also better volume, driven by sustenance of underlying demand. Deleveraged balance sheets of India Inc have created space to absorb increased working capital requirement amidst higher commodity prices.

The next section will touch upon key factors such as revenue and profitability, working capital requirement, leverage and credit risk profiles across sectors.

Credit quality outlook on key sectors for fiscal 2023

In this section, we present the credit quality outlook for a few key sectors that fall in the four buckets identified in the framework above. The credit quality outlook for fiscal 2023 is presented along with changes in key parameters (revenue visibility, profitability and working capital) versus fiscal 2022. An improvement is represented in green, while amber means marginal improvement or no change, and red represents deterioration in performance.

Very strong buoyancy in credit quality outlook for 16% of rated debt analysed

These sectors are estimated to have a favourable operating profit and very strong-to-strong balance sheet in fiscal 2023. Sectors such as auto and education services are expected to report higher profits, largely led by strong recovery.

	Revenue visibility	Profitability	Working capital	Credit quality
Chemicals – specialty				
	Expectation for fiscal 2023: **Revenue growth: 14-15% Ebitda margin: 17-18%** Resurgence in demand owing to thrust on import substitution and increased export demand to support cash generation. Raw material prices are also expected to remain high in the near term due to the ongoing Russia-Ukraine war. However, ability to pass on cost increases to end users and strong balance sheet strength augur well for a positive credit quality outlook for this sector.			

	Revenue visibility	Profitability	Working capital	Credit quality
Auto components				
	Expectation for fiscal 2023: **Revenue growth: 9-11% Ebitda margin: 13-14%** Domestic auto-component production revenue is expected to increase with expected rise in OEM demand, specifically commercial vehicles and two-wheeler production. Exports and replacement demand are likely to clock double-digit growth, driven by global demand and increased vehicular movement.			

Ratings

	Revenue visibility	Profitability	Working capital	Credit quality
Auto – 2W/PV/CV	Expectation for fiscal 2023: **Revenue growth: 6-8% (2W), 9-11% (PV), 13-18% (CV)** **Ebitda margin: 13-14% (2W), 8-9% (PV), 7-8% (CV)** For two-wheelers (2Ws), revenue growth momentum in fiscal 2023 will be backed by improving rural productivity, new product launches, and focus on premiumisation of models. Improvement in operating margin will be aided by likely rise in sales and ability to pass on raw material price increases to customers. In passenger vehicles (PVs), the semiconductor shortage would persist till the end of fiscal 2023. However, revenue growth will benefit from low base due to consecutive years of double-digit decline and healthy macroeconomic outlook. In commercial vehicles (CVs), the industry is expected to sustain a double-digit volume growth in fiscal 2023 due to continuing economic recovery, infrastructure spending and demand from e-commerce. Operating margin will improve vis-à-vis previous fiscal and support credit profiles.			

	Revenue visibility	Profitability	Working capital	Credit quality
Pharmaceuticals	Expectation for fiscal 2023: **Revenue growth: 9-11% Ebitda margin: 18-20% (large formulation players); 8-12% (active ingredient players)** Government focus on reducing import dependency through setting up of bulk drug parks and the PLI scheme for key active pharmaceutical ingredients and formulations augur well for the revenue streams of pharma players over the medium term. Notwithstanding capital expendture towards PLI scheme, the balance sheet strength and steady cash flow shall continue to support the credit profiles of pharmaceutical players.			

	Revenue visibility	Profitability	Working capital	Credit quality
Healthcare	Expectation for fiscal 2023: **Revenue growth:13-15% Ebitda margin: 12-14%** (large players have higher margins) The operational parameters of hospitals improved with the second wave and return to normalcy of regular demand drivers. Revenue growth in fiscal 2023 is expected to be led by steady demand, especially for elective surgeries. Credit quality outlook remains positive, backed by improvement in operating performance and prudent funding of capex.			

	Revenue visibility	Profitability	Working capital	Credit quality
Information technology				

Expectation for fiscal 2023: **Revenue growth: 10-11% Ebitda margin: 24-26%**

Information technology is likely to see strong rebound on the back of higher demand for outsourcing services and digital acceleration post-Covid-19 across all end-user segments. Digital transformation will drive a multi-year growth cycle. Healthy cash generation and strong balance sheets will support credit quality outlook, which is expected to remain positive for fiscal 2023.

	Revenue	Profitability	Working capital	Credit quality
Education services				

Expectation for fiscal 2023: **Revenue growth: 10% Ebitda margin: 22-24%**

Revenue is expected to improve to ~10% backed by lifting of restrictions on offline learning. Improvement in average fee collection and absence of significant debt-funded capex to support cash flow management and, in turn, credit quality outlook.

Positive to neutral credit quality outlook in 63% of rated debt analysed

These sectors are expected to have favourable trends in one of the two parameters identified in the framework earlier — operating profit and leverage. Absolute operating profit is expected to improve or balance sheet score is strong or very strong.

	Revenue visibility	Profitability	Working capital	Credit quality
Textiles – cotton				

Expectation for fiscal 2023: **Revenue growth: 10-15% (Cotton); Ebitda margin: 15-18%**

Domestic and overseas demand is expected to remain healthy due to ban on cotton exports from the Xinjiang region in China, and competitive domestic cotton prices vis-à-vis international rates. After witnessing a decadal high operating profitability in fiscal 2022, margin is expected to moderate to 15-18% owing to decline in cotton prices. Healthy cash accruals, supported by better operating profits, and deleveraged balance sheets will keep credit outlook positive.

	Order book/Revenue visibility	Profitability	Working capital	Credit quality
Textiles – RMG				

Expectation for fiscal 2023: **Revenue growth: ~15% Ebitda margin: 6-6.5%**

Growth in the readymade garments (RMG) industry will be driven by improved realisations, continued recovery in domestic demand and sustained buoyant export demand owing to the China+1 policy. Higher operating rates to cushion margin against elevated input prices.

Ratings

	Revenue	Profitability	Working capital	Credit quality
Power (genco) renewables	With central government thrust on long-term clean energy goals, healthy growth in the renewables sector is expected to continue. This, coupled with availability of capital to clean energy assets, supports the credit quality outlook of the sector. Key risks in the sector are generation variation that depends on uncontrollable natural factors, and volatility in payment behaviour from state distribution companies.			

	Debt service coverage	Working capital	Credit quality
Highway tolling	Traffic growth and significant toll hike of 8-10% to boost the revenue of toll road operators. Rising coverage of FASTag and hence lower leakages will support stable revenue and overall liquidity. Credit quality outlook remains stable.		

	Revenue visibility	Profitability	Working capital	Credit quality
Residential real estate	After witnessing sharp rise in fiscal 2022, growth is expected to moderate and remain at 5-10% in fiscal 2023. Increasing land, labour and raw material prices are expected keep profitability in check. However, established developers have been able to pass on the increased costs to consumers; and prices are improving across several micro-markets. Strong residential sales, equity raising, and asset and land monetisation have helped established players to strengthen their credit risk profiles. Credit quality outlook remains stable.			

	Revenue visibility	Profitability	Working capital	Credit quality
Commercial real estate	The commercial real estate segment is expected to improve in fiscal 2023 with pick-up in new leasing for office spaces and retail consumption for malls surpassing pre-Covid-19 levels. The credit risk profiles of players in this industry remain resilient due to low leverage, strong counterparties and improving collections.			

	Revenue visibility	Profitability	Working capital	Credit quality
Gold jewellery	Expectation for fiscal 2023: **Revenue growth:** 12-15% **Ebitda margin:** 7.3-7.5% Revenue of gold jewellery retailers is expected to rise at a healthy clip next fiscal, backed by sustained high prices of gold and steady demand. Furthermore, the organised jewellery segment is gaining market share after the introduction of the Goods and Services Tax, and the mandatory hallmarking from June 2021. Credit outlook of portfolio rated by CRISIL Ratings is stable.			

Stable credit quality outlook for 20% of rated debt analysed

These sectors are expected to see a decline in operating profits in fiscal 2023, even as balance sheet strength remains very strong or strong.

	Revenue visibility	Profitability	Working capital	Credit quality
Steel	Demand will likely be tepid in the near term due to elevated steel prices. However, over the medium term, demand will be supported by buoyancy in real estate sector and government spending on the infrastructure. Indian steel exporters are likely to benefit as export potential rises with sanctions on Russia. Given volatile raw material prices, profitability may be impacted in fiscal 2023 on-year. The outlook remains stable due to expectation of passing on of escalated raw material prices to finished steel prices (though with a slight lag).			

	Revenue	Profitability	Working capital	Credit quality
Oil & gas downstream	Expectation for fiscal 2023: **Revenue growth 2023E: 15-20%** Ebitda **margin: 2023E: 5-7%** Prices of crude oil (Brent crude) has zoomed to $105-110 per barrel currently from $70-80 at the start of 2022, mainly driven by the Russia-Ukraine conflict. Since retail fuel prices have not increased in tandem, oil companies are incurring marketing losses. However, inventory gains and healthy gross refining margins (GRMs) in the refining segment would offset these losses to a large extent. Overall, the credit risk profiles of players will be backed by government support. Hence, the outlook on the sector is stable.			

	Order book/ revenue visibility@	Profitability	Working capital	Credit quality
Diamond				
	For diamond polishers, continued disruption of trade due to the ongoing war can make roughs costlier. Furthermore, inability to fully pass on the sharp increase in prices to customers will squeeze their margins in fiscal 2023. However, controlled indebtedness on the back of reduction in inventory, leading to comfortable capital structure, will support credit quality.			

	Order book/ revenue visibility	Profitability	Working capital	Credit quality
Cement				
	Expectation for fiscal 2023: **Revenue growth: 7-8%** **Ebitda** Margin 17-19% For fiscal 2023, the profitability of players in the sector is likely to remain lower compared with the previous three fiscals. This is because power and fuel costs remain high, while freight cost is likely to increase with hike in diesel prices in the second-half of March 2022. Nonetheless, 7-8% expected volume growth would keep cash accruals healthy, gearing low, and liquidity adequate so that the balance sheets of cement makers remain strong and debt protection metrics are stable, thereby limiting the downside risk to their credit risk profiles.			

Steady credit quality outlook for 1% of rated debt analysed

	Revenue	Profitability	Working capital	Credit quality
Hospitality				
	The credit quality outlook is stable given the demand rebound. Occupancy levels should improve for leisure travels, while restoration of business travel spends to pre-pandemic levels remains a key monitorable. Margins will improve in fiscal 2023 with resurgence in demand.			

Credit quality outlook for the financial sector

Banks show resilience owing to better asset quality, higher capital buffers and improving profitability

Credit growth for the banking sector is expected to pick up to 11-12% in fiscal 2023 from an estimated 9-10% in the previous fiscal. While growth in the first half was muted in fiscal 2022, recent months have witnessed an uptick.

The largest segment of bank credit — the corporate segment, constituting about 40% of the total credit — is expected to move to a higher growth trajectory after having been subdued in recent years. In fact, credit growth in the corporate sector is expected to double from fiscal 2022 levels. This will be driven by the project pipeline in the infrastructure sector, uptick in private sector capital expenditure, especially through the PLI scheme, and increased working capital requirement.

The retail segment is expected to continue to grow steadily. Growth is expected to be broad-based across various retail sub-segments. The MSME segment should continue to benefit from government schemes, which would support credit growth.

From an asset quality perspective, gross NPA (GNPA) in the banking system is expected to fall to 5-5.5% by March 2023 from a peak of 11.2% as of March 2018 and 7.3% as of March 2022. The overall restructured portfolio for banks was around 2.5% as on December 31, 2021.

GNPA in the corporate segment is expected to continue to witness the sharpest improvement to an expected 3.2-3.4% as of March 2023 from 16% in March 2018. The decline in corporate sector NPAs also factors in the planned transfer of legacy NPAs to National Asset Reconstruction Company Ltd.

The MSME portfolio, though, has seen relatively higher restructuring levels of about 6%. The performance of this portfolio as it comes out of restructuring is monitorable. In fiscal 2023, this could result in a segment NPA uptick of around 250 basis points.

GNPAs in the retail segment are expected to remain range-bound at 2.3-2.5%.

The banking sector has shown strong resilience on account of banks being better capitalised today.

Leading private sector banks are expected to be well placed, benefiting from recent capital-raising by most of them and continued adequate capital buffers.

Public sector banks (PSBs), with substantial capital infusion by the government in recent years as well as equity raising by some banks, have also seen strengthening of balance sheets and improvement of capital ratios. As of December 2021, all PSBs had a Tier I buffer of more than 100 basis points over regulatory requirements, indicating the ability to absorb asset-side risks and support credit growth. This is in sharp contrast with March 2018, when only about a quarter of the PSBs had a Tier I cushion of over 100 basis points over the regulatory requirement.

Overall, strong resilience of the banking sector also stems from improvement in the earnings profile of banks, backed by increase in pre-provisioning profits and high provisioning cover for GNPAs. In fiscal 2021, PSBs were back in the black for the first time in the past five years, whereas private banks saw their profit after tax double. Furthermore, provisioning coverage ratios (PCRs) have improved over time to above 70%, thus strengthening the balance sheets of banks. Overall profitability of the banking system is estimated to further improve in fiscal 2022, translating to a return on assets (RoA) of 0.9%, compared with RoA of 0.7% in the previous fiscal. With expectation of rebound in credit growth and improvement in the asset quality metrics, overall profitability is expected to increase further in fiscal 2023.

Non-banks to see revival in growth, and improved liquidity, provisioning and capital buffers amid delayed return to funding access normalcy

Non-banks (non-banking financial companies [NBFCs] and housing finance companies [HFCs], excluding government-owned NBFCs), which have seen decadal low growth in fiscals 2020 and 2021, are expected to ride on the tailwinds of improved macro-economic fundamentals and strengthened balance sheets and log a growth of 8-10% in fiscal 2023, up from an estimated 6-8% in fiscal 2022 and 2% in fiscal 2021. This growth is expected to be relatively broad-based across the retail segments. However, the traditional segments of home, gold and vehicle loans are expected to see the highest growth, while loans against property and wholesale loans may witness relatively subdued growth. Unsecured loans should also see an uptick in growth, driven by increase in underlying demand.

Reported GNPAs for NBFCs increased to ~6.8% as on December 31, 2021, a ~150-basis points (bps) increase over September 30, 2021, primarily on account of adherence to the clarifications provided in the RBI circular on NPA recognition issued on November 12, 2021. For HFCs, this impact was only 70 bps on average. However, the impact of the circular varies across segments. For instance, the resilient gold loans segment faced negligible impact because of the inherent bullet nature of the product. However, the vehicle finance was by up to 500 bps. Within this, too, loans such as those for two- and three-wheelers, commercial passenger vehicles and first-time user customer segments saw increased slippages because of higher volatility in the cash flow of borrowers in these segments.

Nevertheless, asset quality metrics are expected to improve hereon for three reasons. First is the follow-up circular issued by the RBI dated February 15, 2022, deferring the implementation of the NPA upgradation norm to September 30, 2022. This provides a reasonable transition time for non-banks to recalibrate processes, revamp their collection infrastructure and teams, and persuade borrowers to align with the new dispensation. The second is the expected improvement in macro-economic activity, which will act as a tailwind. The third is the limited impact of the omicron wave, with businesses remaining functional as a result of low disruptions in the last quarter of fiscal 2022.

ROA is estimated to be subdued in fiscal 2022 because of the impact of higher provisioning requirements. However, in fiscal 2023, incremental credit costs are expected to be lower, as non-banks have already created additional provisioning buffers. Combined with expected improvement in economic activity and consequent credit growth, overall profitability is expected to be higher.

However, funding for some non-banks may take time to normalise, as the debt capital market continues to be confidence sensitive and access to it restricted predominantly to parent-backed entities and very highly rated ones. That said, bank funding has provided strong support to non-banks, with bank credit to the sector going up to nearly Rs 10 lakh crore as of December 2021 from Rs 5.5 lakh crore as of September 2018. Non-banks, which have deposit-taking licenses, have also been enhancing their focus on raising retail deposits, which as a proportion of total borrowings for the sector have gone up to 13% as of December 2021 from 9% as of March 2019. The share will be even higher at ~20% for some of the larger deposit-taking non-banks.

Non-banks have managed the pandemic-induced challenges by adopting a three-pronged formula of strengthening their balance sheets by enhancing the liquidity, provisioning cover and capitalisation, and this has helped support their overall credit risk profiles.

- Liquidity cover for non-banks has improved over time. As per the most recent analysis, only 3% of CRISIL Ratings-rated non-banks have a liquidity cover of less than 1 time over a three-month period, and these are mainly better rated ones with good collections and fundraising ability. This is against nearly a quarter of CRISIL Ratings-rated non-banks with a liquidity cover of less than 1 time as of April 2020
- Non-banks have raised capital at a steady momentum in the last 2.5 years or so, raising more than Rs 60,000 crore in the said period, which is well above the levels seen in the past; this has brought down the leverage levels of non-banks, especially in the context of subdued growth
- Non-banks have built strong provisioning buffers, which should provide a crucial offset in case of fresh slippages in the restructured accounts. This is evident in the increase in gross stage 3 provisioning covers over fiscal 2021 and the nine months through fiscal 2022. More importantly, overall provisioning levels, too, have increased to factor in the restructured book, which would not be part of gross stage 3 assets, but may be categorised as stage 1 or stage 2 assets. For NBFCs, the provisioning cover on the total loan book has increased around 200 bps to ~5.5% as on December 31, 2021, from ~3.5% as on March 31, 2020

Securitisation volume growth subdued in the third quarter of fiscal 2022

Securitisation market volume for the third quarter of fiscal 2022 was Rs 29,000 crore, growing at 8% in comparison with the corresponding period of the previous fiscal. However, the pace of growth was considerably slower than that in the first half of fiscal 2022. Rising uncertainty around the spread of the omicron variant of Covid-19 and mounting concerns about the administrative response to this impacting the pool performance has caused several investors to stay away from the market as a measure of caution. Nevertheless, securitisation volume picked up towards the end of fiscal 2022, as pandemic fears ebbed.

Over the nine months through December 2021, securitisation volume touched Rs 80,000 crore, growing 65% in comparison with April-December 2020 volume. Considering the rise in risk aversion because of investor concerns, several deals under active negotiation remained unexecuted towards the end of December 2021. This was reminiscent of the events of March 2020 and April-May 2021, amid the first and second waves of the Covid-19 pandemic, respectively.

Despite heightened concern, entrenched investors continued to acquire securitised assets. Public and private sector banks cherry-picked mortgage-backed loan assets, comprising housing and loan against property receivables. Mortgage-backed securitisation (MBS) assets comprised 43% of the overall quarterly volume (*refer to annexure*).

In the asset-backed securitisation (ABS) category, commercial vehicle (CV)-backed loans were the dominant asset class, buoyed by past trends, indicating a lower impact from short-term disruptions caused by restrictions on movement of goods and people. Transactions with underlying CV loans comprised 38% of the quarterly volume. Gold (10%), microfinance (8%) and two-wheeler (1%) loans comprised the rest in the third quarter.

Sell-down of loans using the direct assignment route continued to dominate, accounting for as much as 59% of the securitised volume, while the rest was via pass-through certificates (PTCs; *refer to Annexure*).

Nearly 100 players securitised their loans over the first nine months of fiscal 2022, indicating a revival of interest in the securitisation space after a weak fiscal 2021. About 60% of all securitised loans were acquired by private sector banks. Mutual funds, insurance companies and high networth individuals, though, had limited presence in fiscal 2022.

Collections unaffected despite omicron-variant restrictions

Monthly collection ratios (MCRs) of securitised pools rated by CRISIL Ratings have remained stable during the collection months of December 2021 and January 2022 despite the third wave. This was largely because of the localised nature of restrictions imposed to mitigate the effect of the omicron variant. As such, borrower cash flow stayed largely intact and supported timely loan repayment in securitised pools, resulting in minimal impact on pool collections.

CRISIL Ratings consistently tracks the monthly collection ratio (MCR = collections excluding prepayments as a percentage of billing for the month; *refer to Annexure*) for the securitisation transactions it rates. MCRs are seen to be the barometer of underlying economic activity by many market participants, especially since the onset of the pandemic.

All the asset classes have displayed remarkable stability in collection performance. MBS pools witnessed MCR ~100% (*refer to Annexure*) in February 2022 payouts[10], reaffirming the long-held belief that home loans are among the most resilient retail asset classes. Two-wheeler loans and small and medium enterprise (SME) loans saw MCR of ~100% and 96%, respectively, in February 2022 payouts; this was higher than average MCR of 66% and 60%, respectively, for the loans during the first wave and 97% and 93%, respectively, during the second wave.

CV loan pools, meanwhile, saw a marginal fall in MCRs to 99% in February 2022 payouts from 102% in January 2022 payouts — quarter-end collections are usually higher than the preceding two months. However, even at 99%, the MCRs were higher than average MCRs of 51% during the first wave and 95% during the second wave of the pandemic.

Apart from the comparatively lower intensity of restrictions imposed during the third wave in comparison with those in the earlier waves, several financing entities have made extensive efforts to digitalise their collection processes. A large majority of financing entities have re-jigged operations, retrained staff and reoriented expenditures towards technology enablement through management focus to ring-fence collections from business, economic or other disruptions.

[10] The data comes with a month's lag, so February 2022 payout data refers to the collections made for January 2022

Resilience of securitised pools in times of extreme stress

CRISIL Ratings-rated securitisation transactions, including ABS and MBS pools, have shown tremendous resilience in the last two years despite the impact of the various waves of the pandemic. In spite of bouts of tremendous stress on the underlying borrowers in pools, there were very few downward rating actions.

When collection ratios were dented severely, shortfalls to meet promised investor payouts were bridged by credit enhancements (initially provided as part of the transaction structure). These were subsequently replenished, as most of the rated transactions recovered sharply and returned to performance on the expected trajectory.

Outlook on market activity

With exception of the third quarter of fiscal 2022, securitisation volume has seen a remarkable recovery in fiscal 2022 compared with the previous fiscal. The rapid pace of vaccinations, return to macro-economic stability, new regulatory regime and stable portfolio performance are strong anchors for re-emergence of the securitisation space as a reliable tool for liquidity management of the financing entities.

Market participants, particularly investors that have stayed away from the market for want of stability, may find it easier to plan their return to this space. Marquee groups, such as insurance companies, asset management companies and public sector banks, may choose to become more active in the PTC segment. Asset classes, such as education, trade receivables, fintech loans and lease rentals, have the potential to draw more traction. These factors may provide an impetus for volume to touch pre-pandemic levels in fiscal 2023.

In September 2021, the RBI had issued master directions governing securitisation of standard assets and transfer of loan exposures, made effective immediately. Since then, these rules have influenced transaction structures, investor requirements governing operational aspects of deals and mechanisms of providing the originator’s risk sharing in pools. The regulations will continue to shape the quantum of deals, quality of assets and frequency of deals in the market, particularly the simple, transparent and comparable transactions.

Conclusion

As lending resumes pace, funding requirements would necessitate that originators revert to securitisation in order to mobilise resources. The performance of loans in securitised pools vis-à-vis the overall portfolio has been comparatively better because of loans and borrowers being cherry-picked, with good credit quality credentials. This is a pointer to investors that securitisation remains a reliable, time-tested route to gain exposure to quality loan assets.

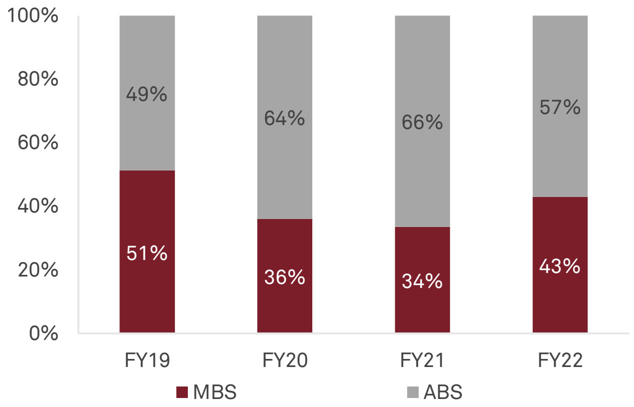
CRISIL Ratings will continue to monitor the performance of the securitised pools under its surveillance and will take appropriate rating actions. In comparison with the first two waves, the third wave was less debilitating.

The emergence of any new variant, likelihood of rise in infection rates, its spread, the response of the authorities to combat any outbreak, and macro-economic factors, such as spike in crude prices impacting the borrower cash flow, will be monitorable.

Any rise in delinquencies or elevation in stress levels of the portfolios of originators seeping into the securitised pools would be continually assessed. The pace of return to normalcy and complete reopening of economic activity will be aspects under consideration as well. Other factors, such as supportive government policies, would also be influencers for the development of the securitisation market.

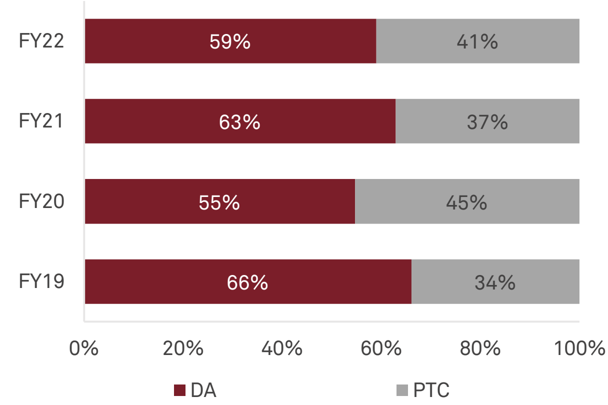
Securitisation market performance over the years

Chart 12: ABS-MBS split of retail securitisation (for the first nine months of each fiscal)



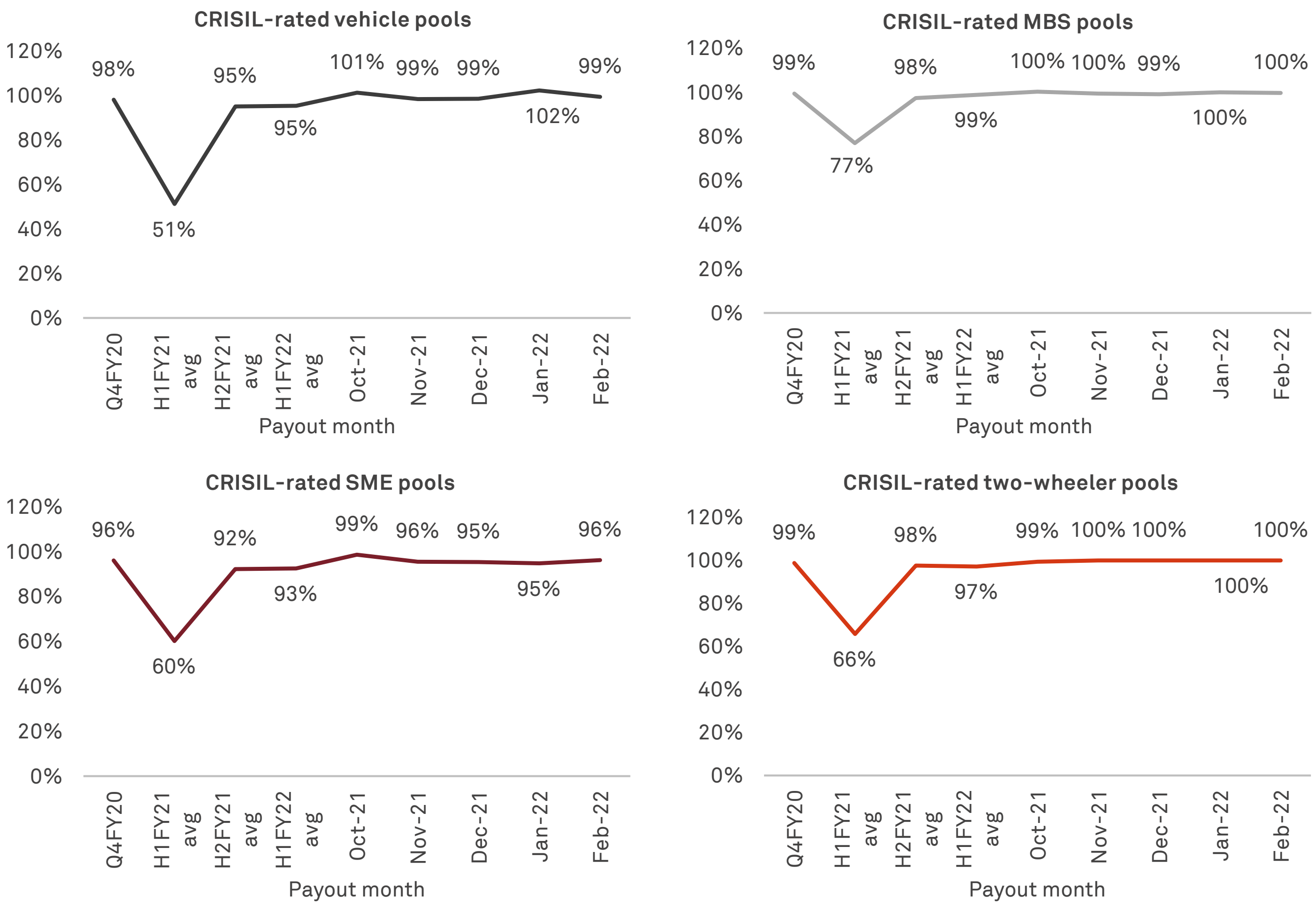
Source: CRISIL Ratings estimates

Chart 13: DA-PTC split of retail securitisation (for the first nine months of each fiscal)



Source: CRISIL Ratings estimates

Chart 14: Collection ratios in securitisation transactions rated by CRISIL Ratings



Source: CRISIL Ratings

Epilogue

Policymakers and India Inc responded with restraint when the third wave of Covid-19 infections emerged, fuelled by the omicron variant. The steep learning curve over the two years of the pandemic has seen us move from the 'world's most stringent' restrictions to a more pragmatic 'living with the virus' approach.

This testing period also saw many companies turning resilient. The CRISIL Ratings outlook on the credit quality of corporates improved from 'Negative' at the beginning of the pandemic to 'positive' in the previous edition of our Ratings Round-Up.

However, some moderation in the credit ratio is likely, given the increase in commodity prices and ensuing profitability pressure, impact of the ongoing Russia-Ukraine conflict, and phasing out of government relief measures.

Furthermore, with employees returning to offices, some part of the cost savings seen during fiscal 2022 will also be eliminated. The structurally salutary part is that India Inc seems to have used the recent crises to become more resilient.

Annexures

CRISIL Ratings Sectoral Resilience Framework – Fifth Edition

At the onset of the pandemic, CRISIL Ratings developed its sectoral resilience framework to analyse and identify the pandemic's impact on different sectors, their resilience, the extent of recovery after the first wave subsided, and their susceptibility to subsequent waves. This is the fifth update on the framework to assess the sectoral resilience and susceptibility to another potential wave is also presented in this section.

Sectoral Resilience Framework to assess: methodology and assumptions

CRISIL Ratings has analysed 43 key sectors on the following three parameters a) Extent of recovery b) Sectoral resilience and c) Sensitivity to Covid-19 resurgence. These sectors contribute 76% of its total rated portfolio (excluding financial services). This framework helped CRISIL Ratings in prioritising its rating surveillance efforts, and communicate its views on credit quality across sectors during the past two years, which saw disruptions caused by the pandemic.

We have reviewed our sectoral resilience framework recently and have shared our conclusions here. With the pandemic now likely entering the ebbing phase, we may not publish this framework going forward, unless there is a new wave that is more virulent and causes severe disruptions.

Some of the key terminologies used are as below:

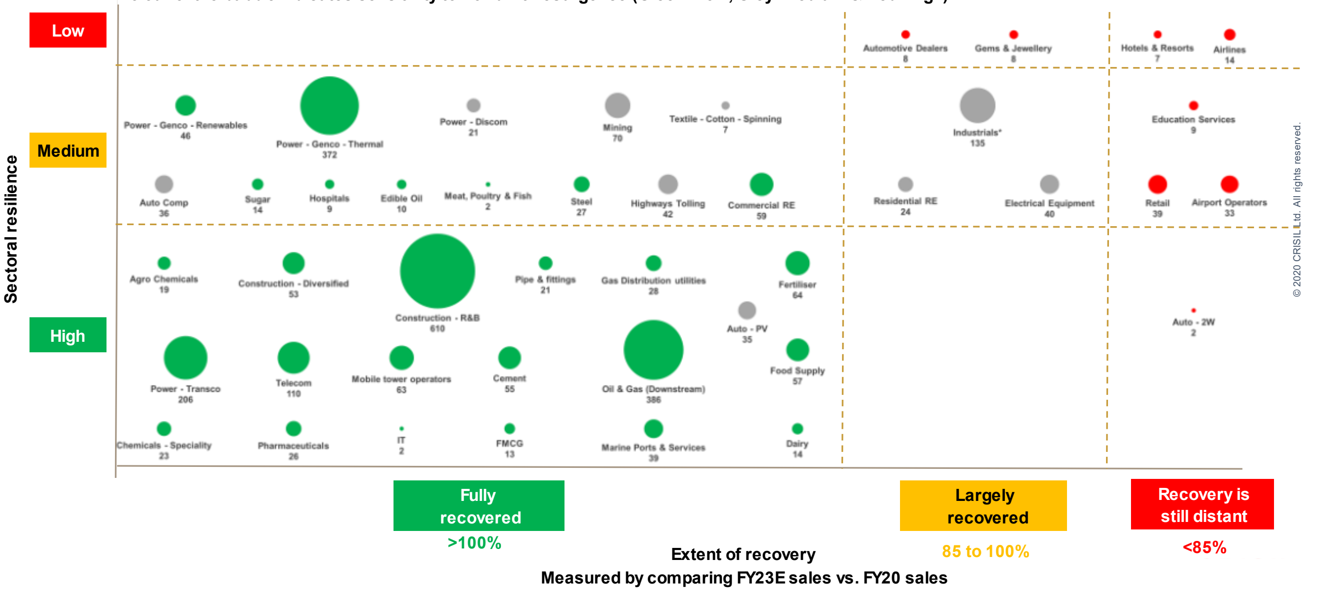
Extent of recovery – Indicates the level of recovery in reference to pre-pandemic level. It is calculated by comparing estimated revenues for fiscal 2023 vs. revenues for fiscal 2020.

Sectoral resilience – Measures the ability of the sector to withstand any future disruptions or shocks. The factors to determine resilience can be multiple - category of goods (essential or non-essential); nature of demand (discretionary or non-discretionary); strength of the balance sheet in terms of leverage; liquidity available for entities in the sector; and the level of Government or regulatory support available to the sector.

Sensitivity to Covid-19 resurgence – Gauges the sector's sensitivity to the risk of another wave of the pandemic. Businesses which have high direct consumer interaction are expected to be more sensitive than those which operate with contactless or remote business model. This parameter indicates the susceptibility of the sector to regulatory containment measures, such as night curfews, limited public mobility and limited operational timings imposed on retail businesses to curb the spread of the virus.

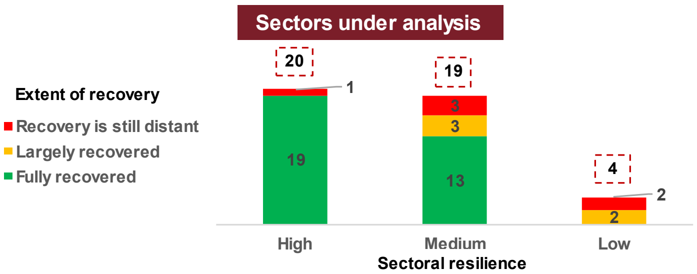
Sectoral resilience amid the pandemic (1/2)

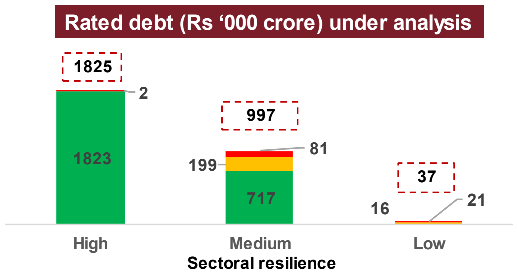
Size of the bubble indicates rated debt quantum (figures in ₹ ’000 Cr.)
Colour of the bubble indicates sensitivity to Covid-19 resurgence (Green=Low, Grey=Medium & Red=High)



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

Sectoral resilience amid the pandemic (2/2)





Majority of sectors are expected to reach their **pre-pandemic levels**

89% of the rated debt under analysis is in sectors that have are expected to be fully recovered in FY23

8 sectors (accounting for around 4% of the rated debt under analysis) seen to be impacted the most by the pandemic resurgence

- Majority of the sectors are expected to recover to pre -pandemic levels; sustenance of the recovery will be crucial, though
- Faster recovery seen post second wave of Covid -19 due to adaptability and localised or less stringent curbs
  - We expect only eight sectors, accounting for 4% of rated debt under analysis, to be susceptible to the third wave

The Big picture:
India Inc's outlook turns 'positive' as most sectors see demand recovering to the pre-pandemic levels

Our analysis reveals that 37 of the 43 sectors assessed have either achieved recovery or are largely recovered. Only six sectors are still a long way from being fully recovered from pandemic-induced disruptions

- **89%** of debt is in sectors which are estimated to be in the 'Fully recovered' category. These include essentials such as FMCG, pharmaceuticals, and telecom, along with infra-linked sectors such as power, roads and construction, cement and steel. These sectors have seen significant demand recovery and are currently operating at above pre-pandemic levels
- **8%** of debt is in sectors which are estimated to be in the 'Largely recovered' category. These include automotive dealers, industrials[11], residential real estate, among others. These sectors have seen gradual demand recovery and are currently operating at close to pre-pandemic levels
- **3%** of debt is in sectors which are in the 'Recovery is still distant' category such as retail, airlines, auto (two-wheelers) and hotels. These sectors have seen subdued demand recovery and are currently operating at well below pre-pandemic levels

'Fully recovered' category – 89% of rated debt

- Sectors in this category have displayed healthy demand growth with month-on-month improvement since the economy opened up
- Broad-based recovery ranging from infra-linked sectors such as steel, cement and construction to essentials such as dairy, FMCG, pharmaceuticals and telecom

Sectors	Major driver of recovery
Telecom	Part of essential product/services
Fertiliser	
Mobile tower operators	
Food supply	
Pharmaceuticals	
Agro chemicals	
Dairy	
FMCG	
IT	
Power - genco - thermal	
Power - genco - renewables	
Power - transco	

[11] *Industrials comprise engineering and capital goods, industrial machinery and consumables and heavy electrical equipment

Sectors	Major driver of recovery
Power - discom	
Sugar	
Hospitals	
Edible oil	
Meat, poultry and fish	
Oil and gas (downstream)	
Gas distribution utilities	
Chemicals - speciality	Improved business activity/mobility
Commercial real estate	
Highways tolling	
Cement	
Steel	
Mining	
Construction - R&B	Uptick in infra and construction activities led by government push
Construction - diversified	
Pipe and fittings	
Marine ports and services	
Textile - cotton - spinning	
Auto – passenger vehicles (PV)	Revival of discretionary spending led by mix of pent up and festive demand
Auto components	

‘Largely recovered’ category – 8% of rated debt

- Sectors in this category have displayed steady demand pick up, albeit at more subdued pace

Sectors	Major driver of recovery
Automotive dealers	PV segment is expected to lead the recovery
Gems and jewellery	Return of consumer discretionary spending/pent up demand/festive cheer and wedding season
Electrical equipment	Uptick in infra and construction activities led by government push
Industrials	
Residential real estate	Improved demand due to consumer preference of additional space amid the pandemic

‘Recovery is still distant’ category – 3% of rated debt

- Sectors in this category continue to see challenges for uninterrupted demand pick up
- This is mainly because of contact intensiveness or the highly discretionary nature of products or services
- Sharp recovery is dependent on pace of decline of active Covid-19 cases, improving mobility and rise in consumer spending power

Sectors	Major impediment to recovery
Auto – two-wheelers	Uneven/slow demand recovery
Airlines	
Airport operators	
Educational services	
Hotels and resorts	Restricted mobility along with higher concentration of consumer spending on essentials
Retail	

Conclusion

Over the past six months, Indian corporates have adapted fairly to the turbulence caused by the pandemic and majority of the businesses are expected to have made a full recovery by the end of fiscal 2022. Demand recovery in most sectors is expected to sustain on the back of strong economic growth, both in the domestic and global markets. Containment measures, if any, are expected to be localised and less stringent compared with the first and second waves, which should keep domestic demand buoyant even if another wave materialises.

Besides regulatory relief measures (restructuring 2.0 and extension of the ECLGS), a secular deleveraging trend has provided India Inc the balance sheet strength to cushion impact of any further disruption.

On account of the above factors, we believe India Inc is on a much stronger footing to counter any risk related to the resurgence of the pandemic.

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