CRISIL Ratings

Outlook positive, but downside risks loom

Ratings Round-Up | First half, fiscal 2024

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Executive summary

First-half credit ratio at 1.91 riding on domestic demand, government capex

The CRISIL Ratings credit ratio, or the proportion of rating upgrades to downgrades, moderated in the first half of this fiscal to 1.91 from 2.19 in the second half of last fiscal.

There were 443 upgrades and 232 downgrades. A ratio above 1 means upgrades outnumbering downgrades.

The first-half upgrade rate dipped marginally to 12.70% compared with 13.46% in the preceding half. However, it continues to be above the decadal average of ~10%. The upgrades were driven by an expected expansion in cash flows this fiscal for sectors linked to domestic demand and for those benefiting from high government spending. These sectors, such as infrastructure, services, and consumables, kept the overall upgrade rate elevated.

Infrastructure and linked sectors[1] accounted for around 29% of the upgrades in the first half. To be sure, infrastructure has benefited not just from high budgetary allocation, but also from better risk sharing among stakeholders and acceptance of investment vehicles such as InvITs, or infrastructure investment trusts.

The overall downgrade rate, meanwhile, rose to 6.65% (6.14% in the previous half), inching closer to the average of ~7% for the past decade. The downgrade rate was seen inching up for export-oriented sectors as well, even as strong balance sheets somewhat cushioned the impact of heightened risks overseas.

The proprietary CRISIL Ratings Corporate Credit Health Framework provides our credit quality outlook on 43 sectors (accounting for ~75% of the rated debt[2]) for the fiscal. It analyses operating cash flow strength (change in absolute estimated Ebitda[3] on-fiscal) and balance sheet strength expected by this fiscal-end.

The key takeaways from the fourth edition of the CRISIL Ratings Corporate Credit Health Framework:

- The most buoyant bucket has 21 sectors — compared with 19 in H2FY23 — with favourable cash flows (more than 10% expansion in estimated Ebitda) and robust balance sheets. They account for 44% of the overall rated debt. Sectors aligned to the domestic story, such as automobile manufacturers and ancillaries, dairy, fast-moving consumer goods, renewable power, primary steel, capital goods, cement and hospitality dominate this bucket. The sectors in this bucket have a positive credit quality outlook

- There are 16 sectors with strong to very strong balance sheets and moderate operating cash flow strength (0% to 10% expansion in operating cash flows). Their credit quality outlook varies from positive to stable. These include segments of the infrastructure sector such as road assets, thermal power, construction and engineering, and real estate

- Six sectors will face headwinds in terms of operating cash flows or balance sheet strength. The export-oriented and commodity-linked sectors in this bucket are likely to see an impact on operating cash flows, while their balance sheets remain heathy. Export-oriented sectors such as textiles - cotton spinning and

[1] Refers to key infrastructure and linked sectors, such as renewables, road assets, construction & engineering, capital goods and real estate
[2] Excluding the financial sector
[3] Earnings before interest, tax, depreciation and amortisation

diamond polishing could see operating cash flows shrink. Commodity-linked sectors, where realisations have been impacted due to supply-side glut — such as agrochemicals and specialty chemicals — will be affected, too. These sectors are likely to witness pressure on their credit quality

As for capex, while government spending has been rising, the private sector has not driven a meaningful pick-up.

For domestic and infrastructure-linked sectors, the conditions now seem ripe for the much-awaited private capex cycle to restart, given the increase in capacity utilisation, deleveraged balance sheets and steadfast demand. However, with only brownfield expansions seen in some pockets, a significant uptick in private-sector capex may be a few quarters away as India Inc remains circumspect about higher interest rates and inflation leashing demand.

In the financial sector, bank credit growth is likely to remain healthy, despite moderating to 13.0-13.5% this fiscal from 15.9% last fiscal on the back of relatively lower economic growth. Corporate and MSME[4] credit growth is expected to be slower, while retail credit is expected to continue to grow at a healthy clip. That said, pace of deposit growth will bear watching.

Non-banking financial companies (NBFCs)[5] are expected to continue seeing strong momentum across retail asset classes and log 16-18% growth in credit.

But both banks and NBFCs could see a marginal compression in net interest margin because of higher deposit and borrowing costs, respectively, even as credit costs trend lower.

Gross non-performing assets (NPAs) of banks are expected to fall to ~3% by March 2024. While retail NPAs could see a 20-25 bps uptick, it will remain below 2%.

The asset quality of NBFCs has improved over the past few fiscals and should stay benign. But delinquencies in unsecured loans need to be monitored, keeping in mind high pace of growth and target customer profile.

Our credit quality outlook remains positive with upgrades expected to outnumber downgrades for the rest of this fiscal, too. But downside risks have increased with inflation obstinately high and major central banks hawkish on interest rates. While growth worldwide has been holding out, the impact of a likely global deceleration on export-oriented sectors (especially goods exports) needs watching. Closer home, erratic rainfall, high food, and crude oil prices can stoke inflation and dampen demand, particularly in the rural and semi-urban markets.

[4] Micro, small and medium enterprises
[5] NBFCs include housing finance companies and exclude government owned NBFCs

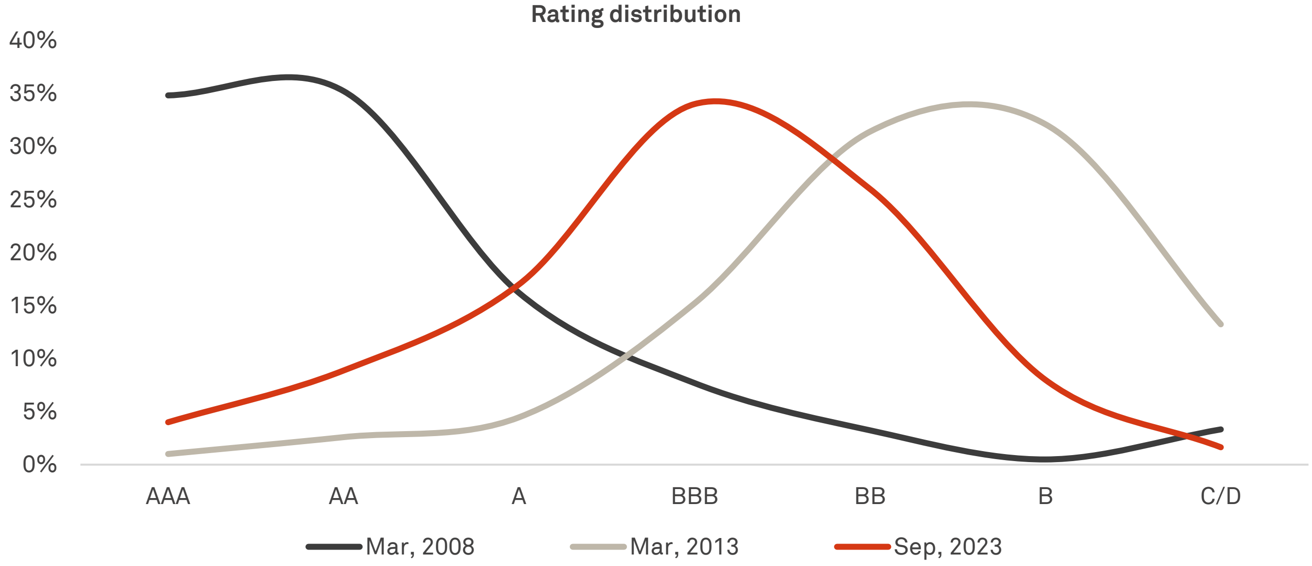
About Ratings Round-Up

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. It takes a deep dive into sectoral trends and outlines expectations for credit quality based on an understanding of the current business environment and performance in the near future. This edition analyses the rating actions from March 31, 2023, to September 29, 2023.

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 outlook for the economy.

Median rating for CRISIL Ratings portfolio remains at 'BBB' category

Figure 1: Trends in rating distribution of the CRISIL Ratings portfolio



Source: CRISIL Ratings

Our outstanding ratings as on September 29, 2023, cover ~7,000[6] companies. Of these, ~64% are in the 'BBB' or above rating categories, up from 61% in the last half. In March 2008 and earlier, the median rating of our portfolio was in the 'AA' category. With the introduction of bank loan ratings in 2007 and rapid expansion of our rated portfolio, especially in the lower rating categories, the median rating had moved to 'BB' as on March 31, 2010, from 'AA' as on March 31, 2008, and remained there till fiscal 2021.

The median rating shifted to the 'BBB' category in fiscal 2022 and stayed put in fiscal 2023. The proportion of ratings in the 'BB' or lower categories declined from ~76% in March 2013 to ~36% as on September 29, 2023.

This is attributable to the portfolio shrinking at the lower end of the rating spectrum — a phenomenon seen across the credit rating industry in India, mainly because many banks have increased the threshold of minimum exposure necessitating an external credit rating over the past several years. This has led to non-cooperation in the rating process by the rated entities, especially in sub-investment-grade categories.

[6] This excludes companies in the 'Issuer not cooperating' (INC) category. The CRISIL Ratings portfolio had ~12,000 INC issuers as on September 29, 2023. Including INC ratings, our outstanding rating list would comprise ~19,000 issuers.

Analysis of rating actions in the first half of fiscal 2024

In its previous Ratings Round-Up, CRISIL Ratings had envisaged a 'Positive' credit quality outlook for the first half of fiscal 2024, with upgrades expected to outnumber downgrades. At the same time, we had expected the ratio of upgrades to downgrades to temper given the challenging global macroeconomic environment and lagged impact of interest rate hikes on demand (both domestic and global).

In line with our expectation, the CRISIL Ratings credit ratio moderated to 1.91 (443 upgrades and 232 downgrades) in the first half of fiscal 2024 from 2.19 in the second half of fiscal 2023.

Halfway through this fiscal, while global uncertainties persist, domestic demand momentum has been reassuring.

India's gross domestic product (GDP) is expected to grow 6% this fiscal, coming off a high base, and expand 6.9% next fiscal. Global GDP growth, however, may slow to 3.1% in calendar year 2023 from 3. 5% in the previous year, impacting exports from India. Merchandise exports are being increasingly affected by global slowdown, as borne by contraction in India's merchandise trade.

On the domestic front, India has maintained momentum, driven by acceleration in private consumption and continued high investment growth, especially propelled by government capex. This has resulted in the upgrade rate, at 12.7%, remaining higher than the 10-year average of ~10%.

The downgrade rate has increased to 6.65% from 6.14%. While downgrades have been broad-based, sectors linked to global markets, either due to exports or commodity prices, have faced the major brunt. These include the textiles, shrimp exporters, and edible oil sectors.

As seen historically, ratings on ~80% of the CRISIL Ratings portfolio were reaffirmed or unchanged during the first half of fiscal 2024. Hence, the modified credit ratio (MCR[7]) held steady at 1.07 (the number was 1.08 last time).

In the next section, we address how global and domestic trends have impacted upgrade and downgrade rates across sectors. We also present the credit ratio and debt-weighted credit ratio trends for the first half of fiscal 2024 and compare them with the first half of previous fiscals.

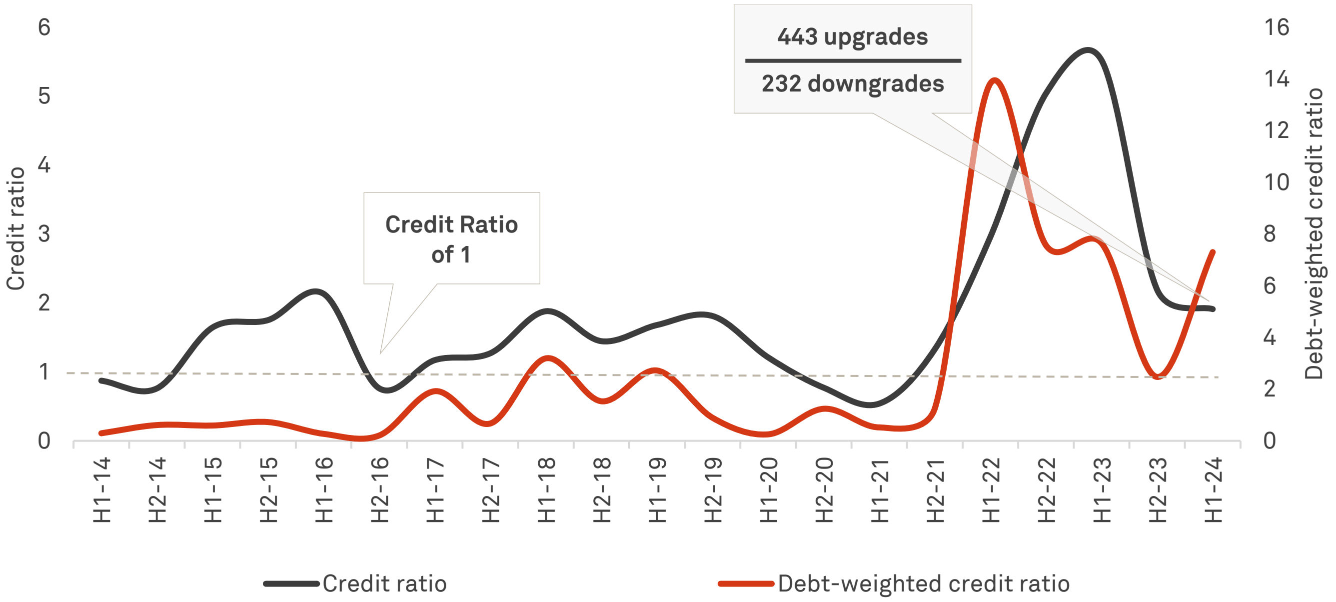
[7] MCR is defined as the ratio of rate of upgrades and reaffirmations to the rate of downgrades and reaffirmations.

Credit ratio at 1.91 for the first half of fiscal 2024, down from 2.19

With 443 upgrades and 232 downgrades, the CRISIL Ratings credit ratio stood at 1.91 for the first half of fiscal 2024.

Upgrades continued to outnumber downgrades because of strong domestic consumption and increase in infrastructure spending.

Figure 2: Credit ratio moderates marginally although debt-weighted credit ratio increases in the first half of this fiscal

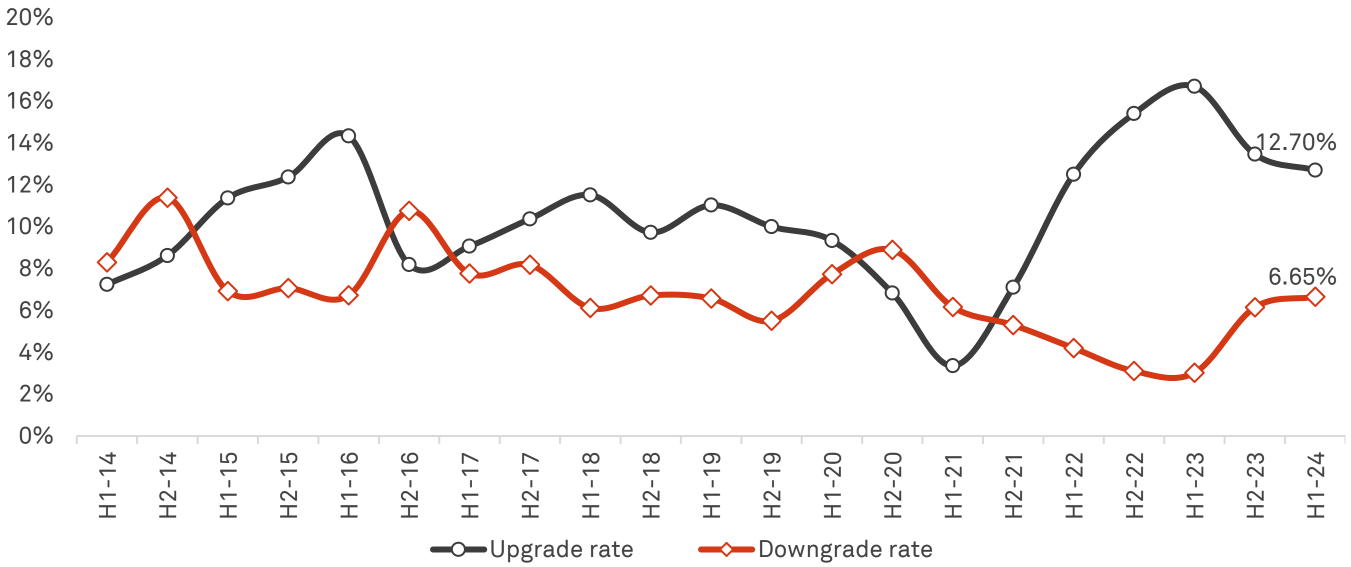


The debt-weighted credit[8] ratio jumped to 7.30 in the first half of fiscal 2024 from 2.47 in the previous half, driven by upgrade of a few large corporates with sizeable debt.

Adjusting for group upgrades and downgrades (where all the group company upgrades and downgrades are considered as one), the credit ratio was 1.76[9] (2.04 in the second half of fiscal 2023).

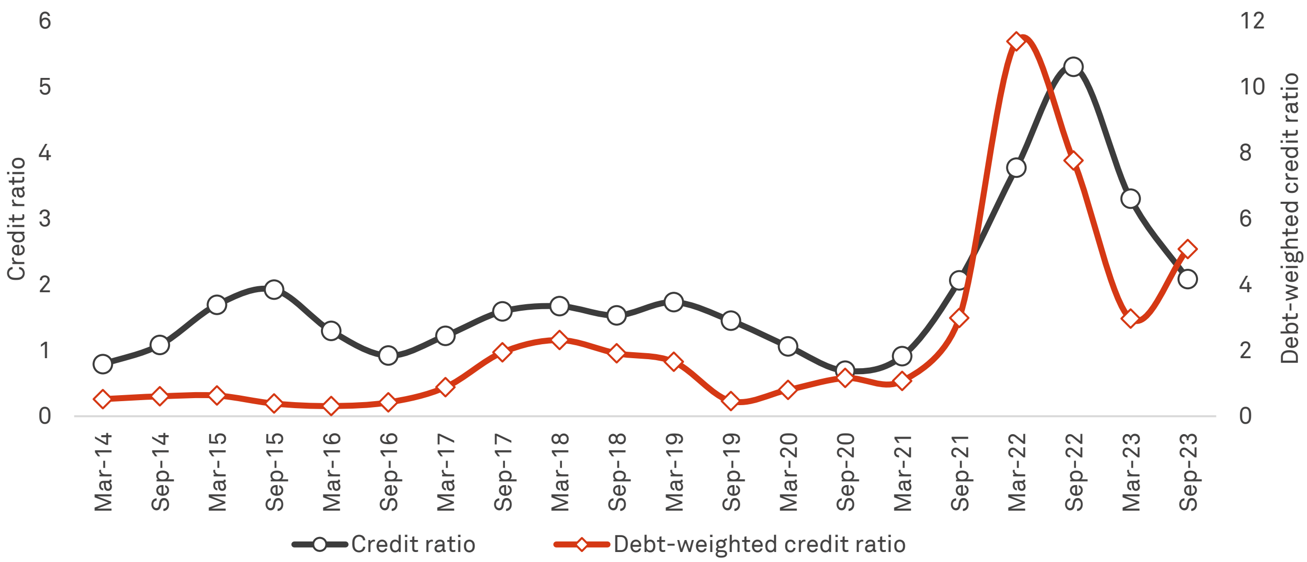
[8] Debt-weighted credit ratio is defined as the ratio of debt in the books of companies upgraded to debt in the books of companies downgraded. This excludes non-cooperative issuers as well as financial sector entities.
[4]https://www.crisil.com/mnt/winshare/Ratings/SectorMethodology/MethodologyDocs/criteria/Criteria%20for%20rating%20entities%20belonging%20to%20homogenous%20groups.pdf
[9] Group upgrades/downgrades are considered for 3 or more companies

Figure 3: Trends in upgrade and downgrade rates



The upgrade rate marginally dipped to 12.70% compared with 13.46% in the previous half. However, it remains above the 10-year average of ~10%. On the flip side, the downgrade rate inched up to 6.65% from 6.14%. That said, a vast majority of our portfolio (~80%) continued to see reaffirmations.

Figure 4: Trends in credit ratio and debt-weighted credit ratio (on a 12-month rolling basis)



On a 12-month rolling basis, the credit ratio dropped to 2.08 this September from 3.30 in March 2023, following a similar trend in the half-yearly credit ratio. The debt-weighted credit ratio increased to 5.07 in September 2023, driven by upgrades of a few companies with large debts.

A deeper dive into the rating actions in first half of fiscal 2024

A. Analysis of upgrades

Domestic demand has grown, propelled by private consumption and government capex. Sectors entwined with domestic demand and government capex saw higher upgrade rates than the overall portfolio.

Infrastructure and linked sectors such as renewable power, road assets and capital goods continued to march ahead with an uptick in their upgrade rate in the first half of this fiscal over the second half of last fiscal.

Similarly, services sectors such as hospitality, logistics and auto dealers saw their upgrade rates rise.

The upgrade rate for consumables moderated but was relatively high. Elevated Consumer Price Index (CPI)-based inflation may have weighed on household consumption. Private consumption did see strong growth with continued pent-up demand, especially from the urban side. In consumables, upgrades were largely seen in automobile ancillaries, ceramics, packaging and agri-related products.

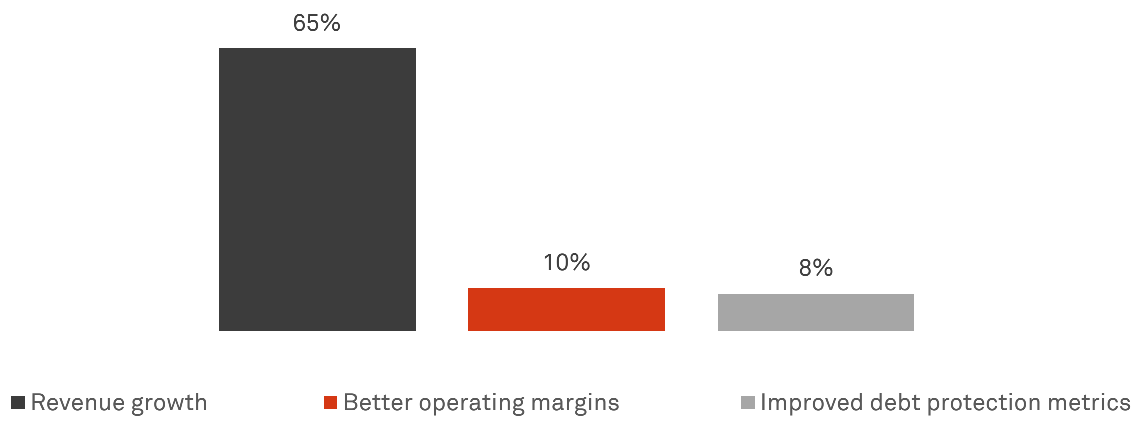
Consumption demand is expected to sustain, with fast-moving consumer goods (FMCG) companies likely to see volume expand 4-6% this fiscal, after subdued growth of 1-3% in the past two fiscals. Also, in the automobiles sector, growth has been driven by sales in the mid- to high-end segments. Revenue of automobile original equipment manufacturers (OEMs) is expected to grow 12-14% this fiscal, backed by continued strong demand from almost all segments, barring tractors, which had hit an all-time high last fiscal.

In the section that follows, we delve further into the driving forces and key factors that contributed to notable upgrades during the first half of this fiscal.

What propelled the upgrades in the first half of fiscal 2024?

An analysis of rating actions by CRISIL Ratings within its portfolio in the first half of this fiscal reveals three primary reasons for rating upgrades.

Figure 5: Top three reasons for rating upgrades during the first half fiscal 2024



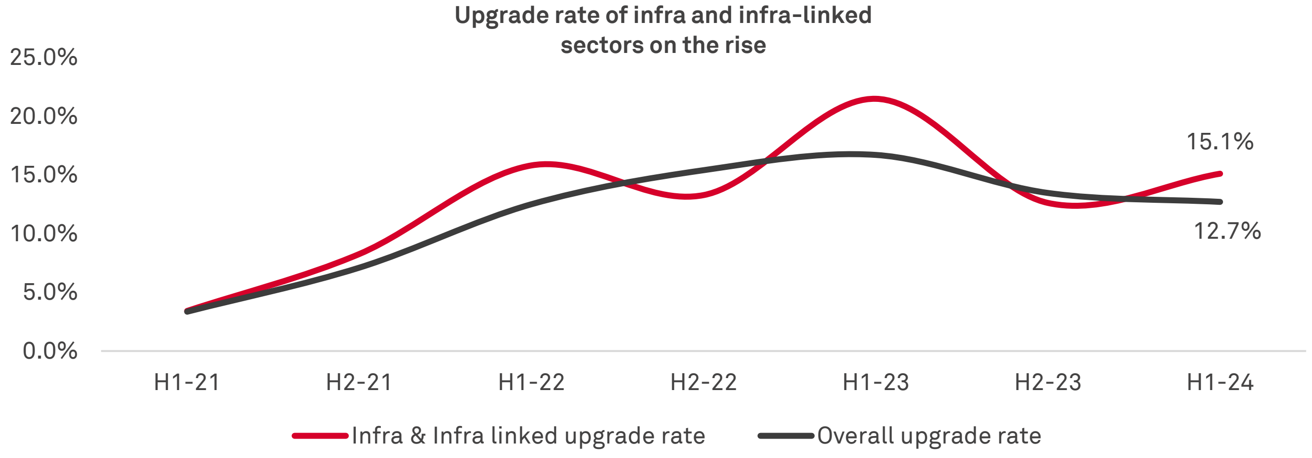
Unsurprisingly, higher-than-expected revenue growth was a significant reason for the high upgrade rate in the first half of this fiscal. This factor alone was responsible for almost two-thirds of all upgrades. Improvement in operating margin and debt protection metrics also contributed to the upgrade rate. The secular deleveraging seen over the past few fiscals has resulted in strong debt protection metrics even in the face of rising interest rates.

Key Infrastructure and linked sectors command nearly 29% share in total upgrades

The infrastructure sector has evolved over the years, mainly because:

- Better risk sharing in contracts awarded and involvement of central agencies as key stakeholders have improved the overall viability and stability of infrastructure projects
- The introduction of the Insolvency and Bankruptcy Code (IBC) and the Reserve Bank of India's push for pre-IBC resolutions have led to early detection of stressed assets and quicker resolutions
- The introduction and acceptability of investment vehicles such as InvITs have resulted in better price discovery

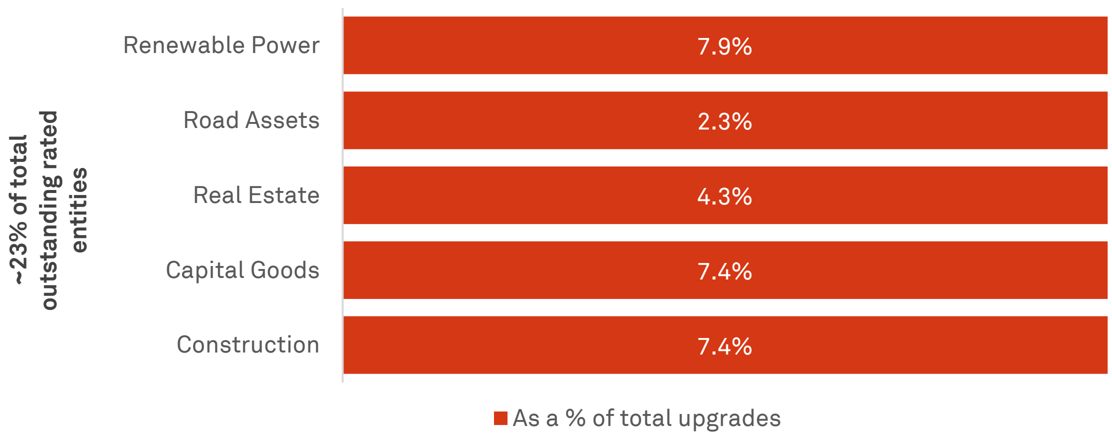
Figure 6: Infrastructure riding on strong government push and increasing funding avenues through investment vehicles



Note: Infra & Infra linked sectors in the chart above includes 25 sectors.

Sectors such as renewable power, road assets, capital goods, EPC and real estate account for 29% of all upgrades, while accounting for less than a fifth of the outstanding portfolio.

Figure 7: Top 5 infrastructure and linked sectors make up ~29% of all upgrades



Strong budgetary allocations have been made, particularly for roads and highways. Renewable energy is among the frontrunners in upgrades in the first half of fiscal 2024. Renewable energy capacities are expected to double with investments of Rs ~6.4 lakh crore expected in the next five years.

The combined budget outlay on roads and renewables for this fiscal and the next is seen at Rs 13 lakh crore, a whopping 35% growth compared with the preceding two fiscals, backed by strong execution and speed.

The pace of construction of roads and capacity addition in renewables is seen increasing 25% and 33%, respectively, this fiscal and the next. This bodes well for the economy, given the high multiplier effect of road development and the critical role renewable energy can play in achieving India's energy transition. Growth is expected to sustain over the medium term, supported by strong investor interest, healthy financial profiles and conducive policies.

Residential real estate has seen sustained demand. Developers, too, are on a strong footing, backed by liquidation of existing inventory and new launches getting absorbed, given incremental demand.

To conclude, domestic demand and government infrastructure spend have considerably offset the global headwinds and supported the overall upgrade rate.

Having said that, the downgrade rate has also inched up and is closer to the 10-year average. In the next section, we will look closely into the reasons for this.

B. Analysis of downgrades

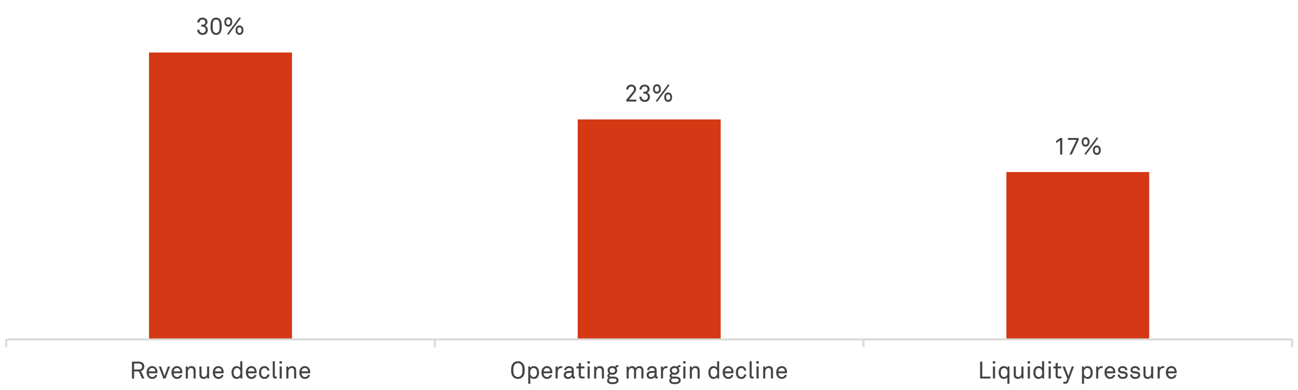
The downgrade rate increased to 6.65% from 6.14%. Consistent with our expectations, there has been a slight upward movement, bringing it closer to the 10-year average of 6.8%, This has particularly affected export-oriented sectors due to the global economic slowdown. Let us delve deeper into the primary reasons for downgrades.

What drove downgrades in the first half of fiscal 2024?

Based on the analysis of rating actions by CRISIL Ratings within its portfolio in the first half of this fiscal, three primary reasons for rating downgrades emerge. These factors accounted for ~70%[10] of the total downgrades.

1. Fall in revenue
2. Decline in operating margin
3. Liquidity pressure

Figure 8: Top three reasons for rating downgrades during first half fiscal 2024



[10] Analysis based on ~91% of all downgrades in the first half of this fiscal

Downgrades were majorly across exports and consumption-linked sectors.

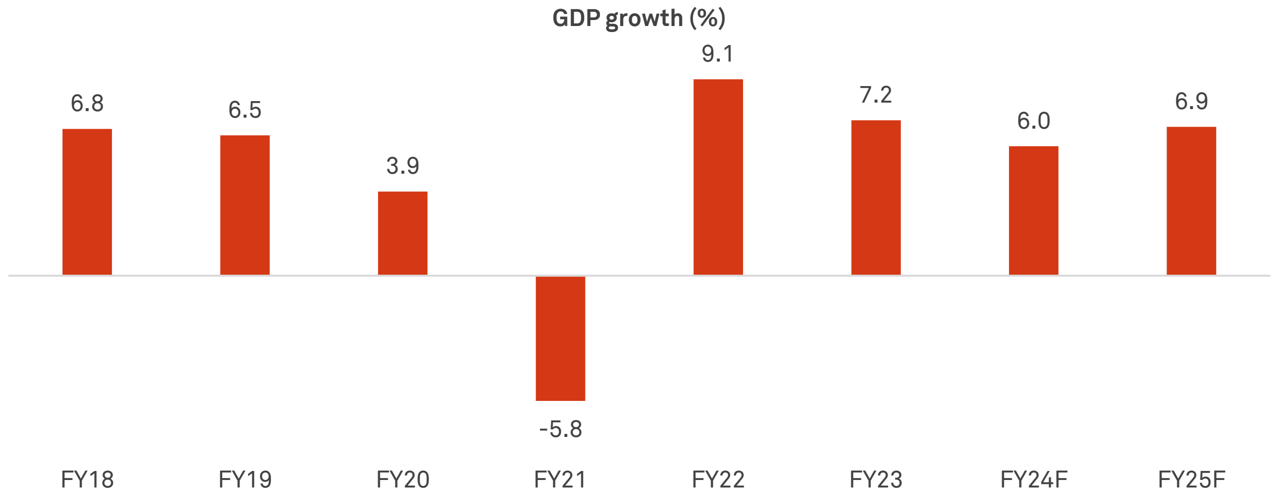
The deceleration in the global economy has impacted Indian exports, particularly mercantile exports. For instance, the Indian cotton yarn market is set to contract 10-12% this fiscal, stemming from lower realisations on subdued global demand. Furthermore, domestic consumption has moderated from previous highs in some sectors, such as edible oil and ceramics, with high inflation impacting the purchasing power of consumers.

Notably, 62% of all downgrades occurred in the sub-investment grade category (‘BB+’ and below), despite this category accounting for only 36% of the entire portfolio. The downgrade rate was 10.9% for sub-investment grade entities compared with 4.08% for investment grade entities.

Macroeconomic outlook

CRISIL expects India's GDP to grow 6% in fiscal 2024 and 6.9% in fiscal 2025. Growth has slowed this fiscal, albeit from a high base. Real GDP growth picked up to 7.8% in the first quarter of this fiscal, compared with 6.1% in the previous quarter. This is the second consecutive quarter of higher growth, with higher domestic private consumption and investments being the key drivers. However, we growth has likely peaked out for now and headwinds are gathering. Monsoon, which has been inadequate and unevenly distributed this year, is the biggest risk for domestic demand. External demand has been declining with advanced economies decelerating. Their interest rates are expected to stay higher for longer to tame inflation. Also, the lagged impact of the 250 basis points of rate hikes since April 2022 will fully manifest this fiscal and weigh on demand. However, robust capex by the government will be supportive of growth.

Figure 9: GDP growth at 6% this fiscal



Source: NSO, CEIC, CRISIL

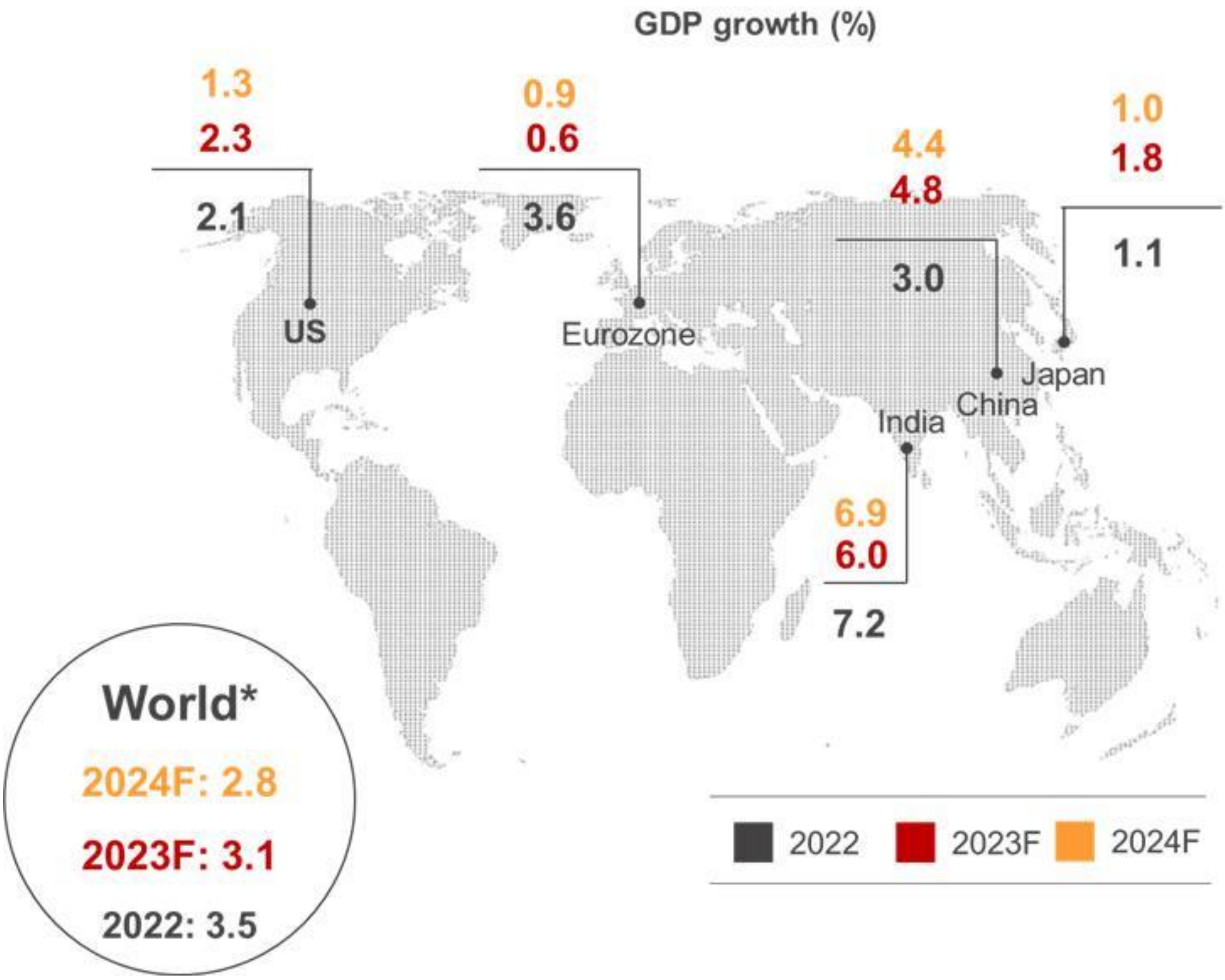
Fixed investment has remained strong, riding on government frontloading of capex in the early part of this fiscal and some private sector investments. The share of investment in GDP remained near the decadal high of 35% in the first quarter of this fiscal. In the private sector, increasing capacity utilisation is stoking hopes of investments. However, it will be a while before this becomes broad-based, taking the baton from the government.

In the first quarter of this fiscal, a sharp decline in retail inflation — CPI print was 4.6% compared with 6.2% in the fourth quarter of last fiscal — is likely to have supported consumption demand. However, some of these gains could have been reversed in the second quarter, with CPI inflation rising past 6%. Domestic inflation pressures remain strong, led by the recent food inflation and further impact of patchy rains. The coming months could, however, see some easing because of softer food prices (especially vegetables). Overall CPI inflation will be lower this fiscal — estimated at 5.5% average, compared with 6.7% in the last fiscal.

Global growth is expected to decelerate in the second half of calendar 2023 as the impact of cumulative rate hikes begins to show. Central banks in the US and Europe have not ended their rate-hiking cycles yet, and rate cuts are not expected before the next calendar year.

S&P Global Ratings expects a longer and shallower slowdown as borrowing costs remain at decadal highs. This will impact demand for India's exports. India's goods exports contracted ~12% till August 2023 this fiscal, because of slowing global demand, while exports of services grew ~5%.

Figure 10: Global GDP growth



Source: S&P Global Ratings September 2023

Credit quality outlook is 'Positive' for this fiscal

CRISIL Ratings maintains a 'Positive' credit quality outlook for this fiscal, with upgrades expected to continue surpassing downgrades, propelled by government-backed infrastructure spending, steady domestic demand and stronger balance sheets.

In the financial sector, while bank credit growth is on course to moderate, NBFCs will maintain strong growth across retail asset classes.

In a world challenged by economic turbulence and uncertainty, India stands out as a shining example of resilience and progress. A remarkable GDP growth of 6% expected this fiscal — and 6.9% over the next two fiscals — is a testament to its ability to withstand global pressures because of robust domestic demand.

Nevertheless, downside risks have gained prominence this fiscal because of challenging global conditions stemming from elevated inflation and interest rates.

These challenges have significantly impacted India's merchandise exports, while service exports have been relatively unscathed.

Additionally, the looming threat of El Niño-induced disruptions to domestic rainfall patterns, coupled with persistent high food inflation and rising crude oil prices, could influence consumer sentiments in the country.

Nonetheless, India Inc’s prudent strategy of maintaining low leverage serves as a safeguard, helping mitigate the effects of these heightened global risks and providing a degree of resilience to the nation's economy.

Corporate Credit Health Framework update:
Sectoral performance versus expectations, and the way ahead

This is the fourth edition of the Corporate Credit Health Framework, which indicates our credit quality outlook for 43 sectors (~75% of rated debt) for this fiscal. It indicates the relative positioning of sectors and their credit quality by assessing two parameters: operating cash flow strength and balance sheet strength.

This helps identify sectors that may require close monitoring in this rapidly changing environment as well as differentiate sectors that will likely remain buoyant.

Methodology and assumptions

CRISIL Ratings has analysed 43 key sectors, accounting for around 75%[11] of the total debt, on two parameters: operating cash flow strength, which considers absolute growth in Ebitda expected this fiscal over last fiscal; and balance sheet strength, which considers expected gearing as on March 31, 2024. The forward-looking framework factors in changes in our expectations on these parameters based on current trends.

X-axis	• Denotes balance sheet strength derived using gearing expected as on March 31, 2024
Y-axis	• Denotes expected year on year growth in absolute Ebitda this fiscal
Colour of the bubble	• Red: Negative movement in operating cash flow or balance sheet strength vis a vis previous expectation • Green: Positive movement in operating cash flow or balance sheet strength or both vis a vis previous expectation • Grey: Neutral with no movement in operating cash flow or balance sheet strength vis a vis previous expectation

Changes in sectors: In this edition, we have made the following modifications to the sectors covered under the framework:

1. The retail sector has been added to the framework. It includes apparel retail, hypermarkets and supermarkets, specialty stores, consumer durables, departmental stores, distributors and general

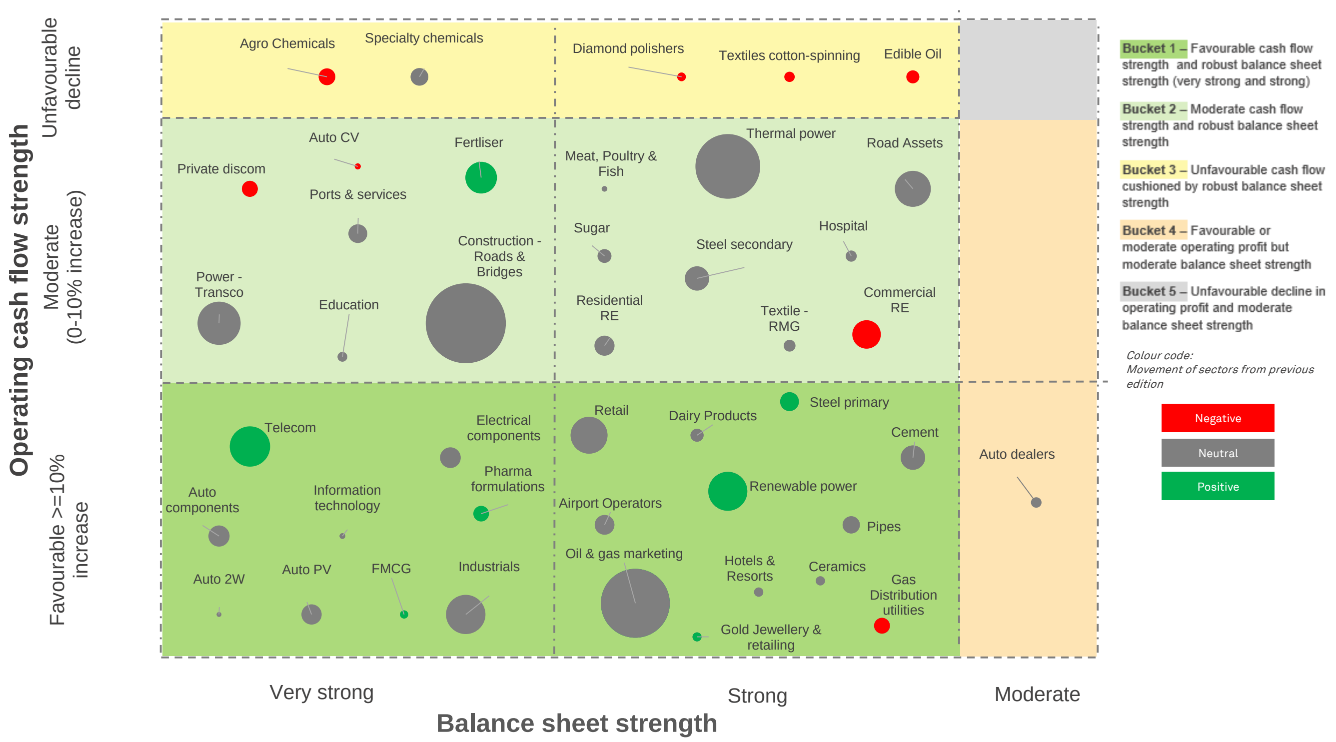
[11] This excludes financial sector companies.

merchandise stores. This covers the spectrum of the retail sector and is critical for analysing domestic trends

2. Ceramics has been added to the framework as it contains a fair number of rated entities in our portfolio
3. Iron ore mining has been removed owing to its insignificant representation in the rated portfolio
4. ‘Construction — diversified has been combined with ‘construction — roads and bridges’

Figure 11: Corporate Credit Health Framework

Expected cash flow and balance sheet strength this fiscal, compared with last fiscal



1) Industrials comprise engineering and capital goods, industrial machinery and consumables, and heavy electrical equipment
2) Abbreviations used — RE: Real estate, CV: Commercial vehicle, PV: Passenger vehicle, RMG: Readymade garments, 2W: two-wheeler and FMCG: Fast-moving consumer goods
3) The size of the bubble indicates rated debt quantum (Rs ’000 crore)
4) The colour of the bubble represents movement of sectors in this edition from expectations set in the Ratings Round-Up for the second half of last fiscal
5) The position of the bubble in the grid does not indicate relative positioning of the sector on any of the parameter

Source: CRISIL Ratings

Terminologies used in the framework:

- The X-axis denotes balance sheet strength, which is derived using gearing expected as on March 31, 2024. Gearing is defined as the ratio of the debt of a company to its networth. The lower the gearing, the stronger is the company’s balance sheet. In the earlier framework, change in gearing in 2024 over 2023 was also used as a component to arrive at the balance sheet score. However, given the deleveraging trend in India Inc, the change in gearing was not significant. Hence, this aspect has not been considered in the current framework.

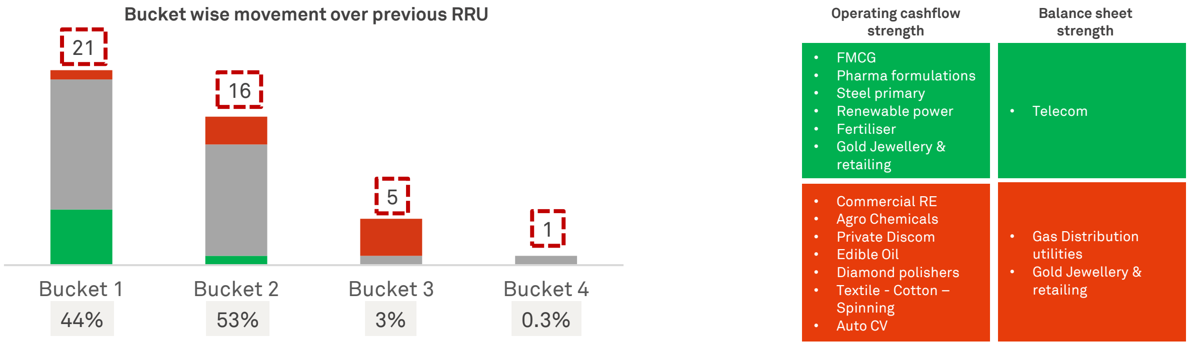
  - The balance sheet strength can be 'very strong', 'strong' or 'moderate'
  - For instance, information technology (IT) shows well-managed balance sheets owing to very low gearing, and are categorised as 'very strong'
- The Y-axis denotes expected growth in absolute Ebitda this fiscal. Absolute growth in Ebitda is an interplay of change in realisation, cost structure and efficiency, and sales volume. It could arise due to substantial volume expansion, albeit at lower margins. For example, in our current analysis, pharmaceutical companies have seen improved profitability owing to steady domestic demand and higher export to regulated markets. Cash flow strength is categorised as favourable if Ebitda growth is 10% or above, moderate if Ebitda growth is less than 10%, or unfavourable if there is a decline.
- In the fourth edition of the Corporate Credit Health Framework, we have again analysed the movement of sectors, compared with the expectations set in the Ratings Round-Up for the second half of last fiscal. Hence, the placement of a sector must be read in conjunction with the colour of the bubble representing the sector, as elaborated below:
  - **Red**: Negative movement in the operating cash flow or balance sheet strength vis a vis previous expectation
    - For instance, Ebitda may decline for the diamond polishers sector this fiscal owing to tepid global demand and an oversupply of lab-grown diamonds impacting realisations. This may lead to a sharp revenue decline. Lower volume sales, along with falling prices, are likely to result in a decline in absolute Ebitda this fiscal, while impacting operating margin
  - **Green**: Positive movement in operating cash flow or balance sheet strength, or both
    - For instance, primary steel companies may see Ebitda margin increase this fiscal as raw material prices ease and utilisation remains healthy for the sector
  - **Grey**: Neutral with no movement expected in operating cash flow or balance sheet strength

In our study, we have categorised the sectors into four buckets as per their placement in the framework:

- **Bucket 1** refers to the most buoyant sectors, which are expected to see favourable operating cash flow — through margin expansion or volume growth or both — as well as robust balance sheets (very strong or strong). We have 21 of the 43 sectors in this bucket, as seen in Figure 11.
- **Bucket 2** refers to sectors that may see moderate operating cash flow strength and robust balance sheets. This covers 16 sectors
- **Bucket 3** refers to sectors that are expected to see unfavourable operating cash flow cushioned by robust balance sheets. We have five sectors here.
- **Bucket 4** refers to sectors that are expected to see favourable or moderate operating cash flow but moderate balance sheets. We have one sector in this bucket.
- **Bucket 5** refers to sectors that are expected to see a decline in operating profit and moderate balance sheet strength. We have no sectors here.

Key conclusions of the study

Figure 12: Bucket-wise split of rated debt (%) and movement of sectors compared with the previous framework



Number in the dotted box represents count of sectors while the % represents rated debt

Favourable movement over previous RRU | Unfavourable movement over previous RRU | No movement over previous RRU

Note:
1. The rectangular box with a percentage in Figure 12 represents the bucket-wise split of the rated debt %; for instance, Bucket 1 sectors represent 44% of the total rated debt
2. On the right side we have captured the sectors that saw favourable or unfavourable movement over previous ratings round up (RRU) (seven green and eight red)

Our analysis shows many sectors will be able to withstand challenges over the medium term, driven by higher operating profit and stronger balance sheets. However, the credit quality of a few will be moderate.

- Of the 43 sectors, 21 are in the 'most buoyant' bucket or bucket 1, accounting for 44% of the rated debt, and will likely have favourable operating profit and very strong/strong balance sheets this fiscal. These sectors will benefit from healthy domestic demand and include auto components, retail, FMCG, hospitality, industrials and telecom. Bucket 1 also includes most of the sectors (six out of seven) that saw favourable movement compared with the previous edition, as reflected in green in figure 11.
- There are 16 sectors in bucket 2 with strong to very strong balance sheets and moderate operating cash flows. These include some infrastructure sectors, such as road assets, thermal power and construction, which have maintained their position in the framework. Infrastructure sectors have benefitted from front-loading of budgetary capex by the government. Bucket 2 includes one sector coloured in green.
- 6 sectors will face headwinds in terms of operating cash flows or balance sheet strength as seen in bucket 3 and 4. The export-oriented and commodity-linked sectors in bucket 3 are likely to see an impact on operating cash flows, while their balance sheets remain heathy. Export-oriented sectors such as textiles - cotton spinning and diamond polishing could see operating cash flows shrink. Commodity-linked sectors, where realisations have been impacted due to supply-side glut — such as agrochemicals and specialty chemicals — will be affected, too. These sectors are likely to witness pressure on their credit quality.
- FMCG, pharma formulations and steel primary saw a favourable movement from the last edition on account of improving operating cash flow strength. Telecom saw a favourable movement on balance sheet strength. These sectors are in the box coloured green.
- Similarly, commercial real estate, agrochemicals and edible oil and other sectors shown in the box-coloured red saw a negative movement on account of reduction in operating cash flow strength.
- 'Gold jewellery and retailing' appears twice because it saw changes in both the parameters compared with the previous edition. The players will see improvement in operating cash flow strength and decline in balance sheet strength. Overall, the sector has improved, moving from Bucket 2 to 1. Hence, it has been highlighted in green

Credit quality outlook for key sectors for this fiscal

In this section, we present the credit quality outlook for this fiscal for some sectors which are part of our Corporate Credit Health Framework, along with performance of key parameters (revenue visibility, profitability and working capital) versus last fiscal. Improvement in performance or continued strong performance is represented in green, marginal improvement or no change in amber, and deterioration in red.

Very strong credit quality outlook for 44% of the rated debt

These sectors will likely have favourable operating profit and very strong or strong balance sheets this fiscal. Sectors such as automotive (auto) and auto components, power, and hospitality will report higher profits.

	Revenue visibility	Profitability	Working capital	Credit quality
Airport				

Airport

This fiscal (P)[12]: revenue growth: 25-30%; Ebitda margin: 50-55%

Next fiscal (P): revenue growth: 15-20%; Ebitda margin: 50-55%

Air traffic volume at Indian airports is expected to grow 16% on-year to 380 million this fiscal and 12% on-year to over 425 million next fiscal.

Buoyed by traffic volume, revenues of airports will also climb. Both aeronautical and non-aeronautical revenues are expected to increase 25-30% this fiscal, driven by increasing volume of higher-spending international passengers and more monetisation opportunities coming onstream from almost-complete capacity expansions at private airports.

After factoring in cost escalations and tariff hikes, cash flows of private airports this fiscal are expected to rise ~50% from last fiscal's levels. This is essential to maintain a long-term debt service coverage ratio (DSCR) of 1.4 times on average.

	Revenue visibility	Profitability	Working capital	Credit quality
Auto components				

Auto components

This fiscal (P): revenue growth: 10-11%; Ebitda margin: 11.5-12.5%

Next fiscal (P): revenue growth: 8-10%; Ebitda margin: 11-12%

Steady demand from OEMs, the largest segment, will continue to drive growth for auto components, followed by the replacement market. That said, export will see limited growth owing to continued inflationary trends impacting consumption in key overseas markets.

Operating margin will improve this fiscal owing to better realisations from improved product mix, moderate reduction in input cost and continued cost-efficiency measures. The working capital cycle will remain stretched this fiscal owing to sizeable inventory as the supply chain is yet to fully normalise.

Capex is expected to increase over 15% this fiscal and will remain at a similar level next fiscal to cater to increased requirement from OEMs, investments for electric vehicle (EV) components and investments related to the Production Linked Incentive (PLI) scheme.

[12] (P): projections

	Revenue visibility	Profitability	Working capital	Credit quality

Auto 2W

Two-wheelers

This fiscal (P): revenue growth: 9-10%; Ebitda margin: 14-15%

Next fiscal (P): revenue growth: 7-9%; Ebitda margin: 14-15%

Revenue growth this fiscal will be driven by higher realisations, backed by increasing proportion of premium motorcycles and full benefit of price hikes taken last fiscal as well as this fiscal. Volume growth will be modest as demand for entry-level motorcycles remains fragile, while exports continue to face headwinds in the form of high inflationary conditions and economic slowdown in key overseas regions. That said, increasing penetration of EVs in the scooter segment will support overall demand for scooters.

Operating margin is expected to inch up 50-100 bps this fiscal as the segment will benefit from an increase in realisations and a moderation in raw material prices.

Capex is expected to remain stable at Rs 2,500-3,000 crore per annum this and next fiscal and will largely be towards EV and maintenance capex. No major capex is expected towards capacity addition, with sufficient headroom available in existing capacities to meet demand.

	Revenue visibility	Profitability	Working capital	Credit quality

Auto PV

Passenger vehicles (PVs)

This fiscal (P): revenue growth: 9-10%; Ebitda margin: 9.5-10%

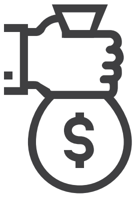
Next fiscal (P): revenue growth: 7-8%; Ebitda margin: 9-9.5%

This fiscal, overall PV revenue is expected to grow 9-10% on-year and vehicle sales are expected to reach a new high of ~50 lakh units even as exports remain sluggish. Domestic demand for utility vehicles (UVs) will remain strong supported by higher incomes and improved semiconductor availability. Revenue growth next fiscal will be marginally lower, albeit from a high base of this fiscal, and will be driven by continued strong demand for UVs.

Operating profitability will benefit from price hikes, higher volumes and modest correction in raw material prices this fiscal. Next fiscal, profitability will be rangebound owing to costs being incurred to comply with new regulations.

The total capex outlay for this fiscal is expected to grow 20-25% to ~Rs 15,500 crore, geared towards new UV models, EV launches, fresh greenfield capacities by major players and debottlenecking. With the trend continuing, capex is projected at similar levels next fiscal.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality



Capital goods

This fiscal (P): revenue growth: 10-12%; Ebitda margin: 10.5-11%

Next fiscal (P): revenue growth: 8-10%; Ebitda margin: 10-10.5%

Healthy balance sheets of corporates and continued private sector investments in sectors such as automobiles, steel and cement, along with government thrust on infrastructure, have resulted in healthy order inflow. Besides, increased activity in a pre-election year, with capacity being built for PLI-driven schemes in automobiles, pharmaceuticals, energy, electronics and textile segments, augurs well. However, the pace of order book growth may slacken because of sluggish economic outlook for overseas markets, though it may remain sizeable.

Improved operating leverage resulting in better coverage of fixed overheads, combined with steady raw material prices, should lead to margin improvement. Given their market position and ability to pass on price increases, OEMs have better margins than EPCs. Capex will remain modest, with sufficient capacity available with capital goods manufacturers. With steady accrual and prudent capex spend, the credit quality of capital goods manufacturers will remain stable.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality

Cement

This fiscal (P): revenue growth: 10-12%; Ebitda margin: 16-18%

Next fiscal (P): revenue growth: 8-10%; Ebitda margin: 17-19%

This fiscal, cement demand is set to grow 10-12% on-year to ~440 million tonne, driven by strong offtake from the infrastructure segment led by government spending. The central government's budget allocation towards core infrastructure sectors was stepped up by 38% this fiscal.

Operating margin will also improve. This is because power and fuel costs, which account for 30-35% of production cost, have fallen 10% during the first quarter of this fiscal and are likely to dip further as existing high-priced inventory is replaced with cheaper inventory, following the softening of coal/petcoke prices. This will improve per-tonne profitability of cement makers to Rs 950-975, as against a multi-year low of Rs 770.

	Revenue visibility	Profitability	Working capital	Credit quality
FMCG				

This fiscal (P): revenue growth: 7-9%; Ebitda margin: 20-21%

Next fiscal (P): revenue growth: 8-10%; Ebitda margin: 20-21%

This fiscal, the sector is expected to grow 7-9%, driven by 4-6% volume expansion with revival in rural demand (which saw six quarters of negative growth). Product realisations are expected to be range-bound, even moderating in a few categories this fiscal because of price cuts in certain products, for which raw material prices have moderated. Increase in minimum support price (MSP) and higher government spending on rural infrastructure projects will drive rural demand.

Lower raw material cost (primarily of edible oil, crude derivatives and chemicals) will help offset higher selling and marketing expenditure, leading to a 50-100 bps improvement in operating margin to pre-pandemic levels.

Strong balance sheets and sizeable liquid surplus will support capex spend for the sector over the medium term.

	Revenue visibility	Profitability	Working capital	Credit quality
Gold jewellery & retailing				

This fiscal (P): revenue growth: 15-17%; Ebitda margin: 7.7-7.9%

Next fiscal (P): revenue growth: 8-10%; Ebitda margin: 7.5-7.8%

The sector is expected to witness healthy revenue growth of 15-17% this fiscal, despite the high base of two strong growth years. Like last fiscal, revenue growth will be driven by higher gold prices, with volume growth contributing modestly. Furthermore, shift in demand from the unorganised to organised sector will aid revenue growth.

With increased marketing and store-related expenses, operating margin is expected to moderate 40-70 bps on-year this fiscal to 7.7-7.9 % but will remain above the pre-Covid level of 6.8-7%.

While debt is expected to increase, to fund higher working capital requirement (inventory), debt metrics will remain adequate.

	Revenue visibility	Profitability	Working capital	Credit quality
Hospitality				

This fiscal (P): revenue growth: 17-19%; Ebitda margin: 33-34%

Next fiscal (P): revenue growth: 4-6%; Ebitda margin: 33-34%

Robust domestic leisure and business travel, supported by strong economic activity and traction in international travel, will drive demand.

Average room rent (ARR) and occupancy are expected to improve, which will drive revenue growth in fiscal 2024.

There may be capacity additions. However, owing to execution timelines, commissioning of hotels will take time and large, organised players will continue to add rooms through management contracts for immediate addition. Such additions will have limited upfront cost outgo and, hence, keep credit profiles healthy.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality
Information technology				

This fiscal (P): revenue growth: 8-10%; Ebitda margin: 22-22.5%

Next fiscal (P): revenue growth: ~10%; Ebitda margin: ~23%

The IT services sector in India will see moderate revenue growth of 8-10% this fiscal, an on-year decline of 800-900 bps, amid global macroeconomic and financial sector headwinds in key markets. On the other hand, stable growth in cost-optimisation deals, along with strong digital solutions, cloud and automation capabilities, provides some comfort.

The slowdown in revenue growth will be because of slower orders from the US and Europe in the banking, financial services and insurance (BFSI) and retail segments. However, manufacturing, communication and other segments will exhibit high single to double-digit growth.

Employee cost is expected to be lower this fiscal, leading to 30-40 bps improvement in operating margin to 22-22.5%, as companies resort to lower net hiring and reduced subcontracting costs.

	Revenue visibility	Profitability	Working capital	Credit quality
Oil and gas downstream				

This fiscal (P): revenue growth: (15)-(20) %; Ebitda margin: 6-7%

Next fiscal (P): revenue growth: (5)-5%; Ebitda margin: 4-5%

Revenue is likely to dip owing to lower crude oil prices this fiscal vis-à-vis last fiscal. In contrast, operating profitability and cash flow are likely to improve. Leverage will moderate with ease in working capital intensity, improving financial metrics. That said, a substantial rise in crude oil prices and/or any decision to slash retail fuel prices may significantly impact the performance of oil marketing companies.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality
Pharma formulations				

This fiscal (P): revenue growth: 8-10%; Ebitda margin: ~21%

Next fiscal (P): revenue growth: 9-11%; Ebitda margin: 21-21.5%

Steady domestic pharmaceutical sales and higher export to regulated markets will drive revenue growth this and next fiscal, even as sales to certain semi-regulated markets face headwinds on account of high inflation (impacting purchasing power) and low foreign exchange reserves.

Domestic growth this fiscal will be supported by a 5-6% increase in realisations and 3-4% growth in volume from sale of existing drugs, especially chronic and new launches.

A 50-100 bps improvement in operating margin to ~21% is expected this fiscal, after consecutive years of moderation, on a fall in input and logistics costs and abating pricing pressure in the US generics market.

Incentives worth Rs 21,500 crore through the PLI scheme will result in capex of Rs 20,000-22,000 crore over fiscals 2022-2026. However, some investments under PLI 2.0 may be part of the regular capex plans.

	Revenue visibility	Profitability	Working capital	Credit quality
Renewable power				

This fiscal (P): revenue growth: 15-20%; Ebitda margin: 80-85%

Next fiscal (P): revenue growth: 15-20%; Ebitda margin: 80-85%

Renewable power capacity will expand with 45-50 GW expected to be added until next fiscal, taking installed capacity to 150 GW by March 2025. Solar capacity additions will be higher than the last few years owing to softening of module costs. This will help improve revenue by ~40% for leading renewable players, while profitability will remain stable.

The sector has been positively impacted by continuous release of stuck receivables by state distribution companies under the late payment surcharge (LPS) scheme.

Operational performance remains a key monitorable. Performance of solar power assets has been largely resilient compared with P90[13] estimates, but performance of wind power assets remains subdued.

	Revenue visibility	Profitability	Working capital	Credit quality
Steel (primary)				

This fiscal (P): revenue growth: 3-4%; Ebitda margin: 17-19%

Next fiscal (P): revenue growth: 3-5%; Ebitda margin: 17-19%

Domestic primary steel producers are expected to see volume growth of 8-10% this fiscal and 4-6% next fiscal, led by the infrastructure and housing segments. This will support robust utilisation of more than 80% for primary steel producers. However, average domestic steel prices are expected to moderate 5-7% this fiscal amid easing raw material prices.

Moderation in realisations will limit revenue growth to 3-4% this fiscal. However, Ebitda margin is seen recovering 300-400 bps to 17-19%, as raw material prices ease, and utilisation rates remain healthy.

The top primary producers are expected to incur capex of Rs 55,000-60,000 crore per annum over the next couple of fiscals, compared with ~Rs 30,000 crore per annum over the past five fiscals, towards capacity expansion and efficiency improvement. Despite ongoing capex, leverage (net debt to Ebitda) is expected to remain modest at ~2 times, compared with ~2.2 times last fiscal, supported by healthy cash accrual. This will sustain balance sheet strength and support the stable credit quality outlook for the sector.

[13] P90 = Annual P90 generation estimate indicates generation that is likely to happen with 90% confidence during the project's tenure. For example, a P90 value of 10,000 kWh for the annual output of a solar power unit implies it will generate over 10,000 kWh 90% of the time.

Positive to stable credit quality outlook for 53% of the rated debt analysed

These sectors are expected to have favourable trends in one of the two parameters — operating profit or leverage. Absolute operating profit is expected to improve for fiscal 2024, or the balance sheet score is expected to be strong or very strong.

	Revenue visibility	Profitability	Working capital	Credit quality

Auto CV

Commercial vehicles (CVs)

Expectation for fiscal 2024 (P): Revenue growth: 7-9%; Ebitda margin: 7-8%

Estimates for fiscal 2025 (P): Revenue growth: 6-8%; Ebitda margin: 7-8%

CV sales volume in fiscal 2024 is expected to inch towards pre-pandemic peak achieved in fiscal 2019. This momentum is expected to moderate next fiscal, albeit on a higher base, supported by continuing government spending, replacement demand, and strong end-user sectors such as construction and mining. Realisations are expected to draw support from price hikes taken by CV manufacturers in view of increased cost associated with implementation of BS-VI phase 2 norms from April 2023. This, along with moderation in raw material prices will result in operating profitability inching up to 7-8% in fiscal 2024 and remaining range bound next fiscal.

Capex in this and next fiscals is expected to be range between Rs 5,000-6,000 crore each and shall be largely towards EV (mainly in light commercial vehicle and buses segment), maintenance capex and for adhering to various regulatory norms.

	Net leasing	Occupancy	Credit quality

Commercial real estate

Net leasing growth 2024E: 2-4%,

Net leasing growth 2025E: 10-15%

Net leasing of commercial office space in India will stagnate this fiscal with the global slowdown impacting hiring and additional space requirement. It is expected to grow 10-15% in fiscal 2025, albeit on a low base, with expectation of higher offshoring to India and continued focus on return to office by employers.

The ratio of debt to Ebitda should be comfortable at 4.7 times in fiscal 2024 and 4.4 times in fiscal 2025. While the cost of debt has been inching up, the debt service coverage indicator should remain adequate at ~1.7 times in fiscals 2024 and 2025.

	Revenue visibility	Profitability	Working capital	Credit quality

Construction (roads)

Estimates for fiscal 2024: Revenue growth: 9-11 %; Ebitda margin: 14.0-14.5%

Expectation for fiscal 2025: Revenue growth: 8-10%; Ebitda margin: 14.0-14.5%

The sector will see steady revenue growth in fiscal 2024, driven by healthy order book positions and enhanced capital outlay by government along with push for increased pace of road construction. The pace of construction of national highways is expected to increase to 32-34 kms per day in fiscal 2024 compared with ~28 kms per day during fiscal 2023.

Operating profitability, after declining over the past two fiscals, is expected to remain steady in fiscal 2024 supported by softening of input costs, despite increased competitive intensity in the sector. Balance sheets have strengthened due to monetisation and equity infusion and are expected to remain healthy going forward with steady internal accruals; incremental asset monetisation will strengthen balance sheets.

	Revenue visibility	Profitability	Working capital	Credit quality

Education

Projection for fiscal 2024: Revenue growth: 8-10%; Ebitda margin: 25-27%

Expectations for fiscal 2025: Revenue growth: 10-12%; Ebitda margin: 26-28%

Revenue of schools and colleges are expected to grow by 8-10% in fiscal 2024 supported by marginal growth in enrolment and regular hike in fees, however this is lower than previous fiscal on a high base effect. Demographic dividends and governmental efforts are likely to push enrolment rates, coupled with regular fees hike, the revenue is expected to grow by 10-12% in fiscal 2025.

Operating profitability remained range bound in the past two fiscal; likely to marginally decline in fiscal 2024 due to increase in operating costs and relatively moderate revenue growth. Annual capex in the industry has increased contributed equally by public and private investments. While the capex is being funded partly through debt, balance sheets of education institutes have the cushion to absorb it.

<table>
<tr><th></th><th>Order book/ revenue visibility</th><th>Profitability</th><th>Working capital</th><th>Credit quality</th></tr>
<tr><td rowspan="2">Hospitals</td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="4">Estimates for fiscal 2024: Revenue growth: 12-13%; Ebitda margin: 15-16%
Expectation for fiscal 2025: Revenue growth: 10-12%; Ebitda margin: 14-15%
Revenue is estimated to grow at 12-13% in fiscal 2024 and continue at similar trajectory in fiscal 2025 also. Steady improvement in already healthy average revenue per operating bed is expected with increasing share of international patients and complex surgeries. In addition, healthy occupancy levels on increased bed capacities will also support revenue growth. Operating margin is expected to be maintained at healthy levels of 14-16% over the medium term, even as fixed costs owing to capacity additions are expected to increase.
In fiscal 2024, pace of bed additions is expected at similar levels as seen in fiscal 2023 i.e., ~3,000 beds which would keep overall capex outlay at ~Rs 6,500 crore. The same is expected to increase by 8-10% in fiscal 2025 with planned greenfield expansions commencing. Prudent funding supported by continuing healthy accruals will keep the sector's credit profile stable.</td></tr>
</table>

<table>
<tr><th></th><th>Revenue visibility</th><th>DSCR (Debt service coverage ratio)</th><th>Credit quality</th></tr>
<tr><td rowspan="2">Road assets</td><td></td><td></td><td></td></tr>
<tr><td colspan="3">Estimates for fiscal 2024: Revenue growth: 9-11%
Expectations for fiscal 2025: Revenue growth: 6-8%
Moderate hike in toll rates this fiscal, along with adequate traffic growth of ~5%, will keep toll revenue growth in double digits, despite the high base of fiscal 2023.
Credit profiles of toll road operators will remain stable, backed by healthy revenue growth and adequate leverage.</td></tr>
</table>

Thermal power	Revenue visibility	Operating Profits	Working capital	Credit quality

Estimates for fiscal 2024P: Revenue growth: 2-5%; Ebitda margin: 25-30%

Expectation for fiscal 2025P: Revenue growth: 2-5%; Ebitda margin: 25-30%

Power demand is expected to grow at CAGR of ~5-6% between fiscals 2024 and 2028, supported by healthy economic growth and change in electricity consumption pattern. Operating profitability of the coal-based power plants with untied capacities[14] is likely to be ~5% higher in fiscal 2024 over fiscal 2023 due to higher demand & margins in short-term markets; however, operating profitability for remaining plants to remain modest as most of the capacities are fully tied-up.

Conventional capacities' addition should remain muted over fiscals 2024 to 2028 due to growing focus on non-fossil fuel capacity. Currently, ~27 GW of coal-based power capacities are under construction which are likely to commission by 2028. Around, 13-14 GW of hydro and 5GW of nuclear power capacities are expected to be added over the same period. Majority of these capacities, mainly coal-based power plants, are likely to be set up by central and state enterprises. Over the last couple of fiscals, working capital release under multiple initiatives of Ministry of Power, like Atmanirbhar Bharat Package and LPS scheme, have worked well for the sector. Sustenance of timely payments by counterparties remains a key monitorable.

Residential real estate	Revenue visibility	Profitability	Working capital	Credit quality

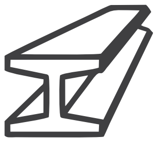
Sales (or revenue) of residential realtors will grow 8-10% on-year in fiscal 2024 after an estimated 15-17% growth last fiscal. This will be driven by 4-6% demand growth and 3-5% increase in capital values across the top six cities (Mumbai Metropolitan Region, National Capital Region, Bengaluru, Pune, Hyderabad and Kolkata). Despite high base of last year, the growth in this fiscal will be driven by buoyant demand across mid, premium and luxury segments.

Large developers are expected to further increase their market share this fiscal, enabled by continued strong sales and collections from their ongoing projects, easier access to financing, and increasing consumer preference towards reputed brands.

Credit risk profiles of residential developers are expected to improve further this fiscal, backed by liquidation of inventory amid healthy sales growth.

[14] ~21 GW of coal-based capacities having untied capacities of ~5 GW

	Revenue visibility	Profitability	Working capital	Credit quality



Steel (Secondary)

Secondary steel

Estimates for fiscal 2024: Revenue growth: 3-5 %; Ebitda margin: 5-7%

Expectations for fiscal 2025: Revenue growth: 0-2%; Ebitda margin: 5-7%

Secondary steel makers are expected to see 8-10% volume growth for fiscal 2024 driven by infrastructure spending and continuing demand from the real estate sector. However, long steel realisations will decline by 7-8%, thus moderating the revenue growth in this fiscal to 3-5%.

Operating margins will witness a moderation by 100 bps to a 5-7% owing drop in realisations. However, lower raw material prices will prevent any further correction. The sector has witnessed healthy capex in the last 2 years owing to healthy demand led high-capacity utilisation; the same is expected to slow down this fiscal with most of the enhanced capacities coming on board. Despite capex, Debt/EBITDA remains in line within 2.5 times. Credit profiles will remain stable owing to healthy balance sheets.

	Order book/Revenue visibility	Profitability	Working capital	Credit quality

Textiles – RMG

Expectations for fiscal 2024: Revenue growth; 8-10%; Ebitda margin: 9-9.5%

Growth of the readymade garment industry will slow to 8-10% in fiscal 2024 from ~14% in fiscal 2023. While volume growth is expected to be higher at 6-8%, realisations are expected to moderate this fiscal on the back of softer cotton prices. Continued buoyant domestic demand and gradual recovery in exports to key destinations (mainly the US and Europe) are expected to aid the operating performance of RMG makers this fiscal.

Steady revenue growth and lower cotton prices will expand operating margins by 50 basis points to 9-9.5% this fiscal.

Credit metrics are expected to remain stable on low capex requirement and healthy cash generation.

Stable credit quality outlook for 3% of the rated debt analysed

The following sectors are expected to see a decline in operating profit in the current fiscal, even as balance sheets remain very strong or strong.

	Revenue visibility	Profitability	Working capital	Credit quality

Agrochemicals

Estimates for fiscal 2024: Revenue growth: 0 – (3%); Ebitda margin: 10-12%

Expectation for fiscal 2025: Revenue growth: 10-12%; Ebitda margin: 13-15%

Revenue growth of the Indian agrochemicals sector is seen subdued this fiscal amid a challenging global environment and uneven domestic monsoon. High channel inventories across international markets and steep fall in realisations across products — caused by continuing Chinese dumping — impacted the sector's exports demand (accounts for ~53% of overall revenue) during the first half of current fiscal. With scenario likely normalising from the latter half of third quarter, exports demand should revive. On the domestic front, revenue growth shall be lower-than-anticipated due to below-average monsoon.

With revenue growth remaining subdued and high inventory losses faced due to steep price correction, especially during the first quarter, the sector's operating margin for fiscal 2024 will see sharp moderation of 400-450 bps. The margins should improve to ~13-15% in fiscal 2025, as demand revives, but could remain below historic average.

Owing to current industry headwinds, companies have deferred capex plans. As a result, overall capex is seen down sharply this fiscal, but should revive next fiscal with demand stabilising.

While revenue de-growth and moderating margins will impact the debt protection metrics, it will still be at adequate levels. Strong balance sheets should provide some cushion to the credit profiles of manufacturers, though.

	Order book/ revenue visibility	Profitability	Working capital	Credit quality

Diamond

Estimates for fiscal 2024: Revenue growth: (30)-(35) %; Ebitda margin: 3.5-4%

India's polished diamonds exports account for ~90% of world consumption. Two-thirds of this is to the US and China. But the US and China are seeing a slowdown in demand, as reflected in Q1 exports. The volume of lab grown diamonds has also picked up amid changing consumer preferences. Slower demand is expected to result in a 10-15% correction in the prices of polished diamonds this fiscal. On their part, miners have announced production cuts to forestall further decline in prices.

Lower volume sales along with falling prices is likely to result in degrowth this fiscal, while impacting operating margin. Working capital requirement will reduce on account of falling inventory prices and cautious approach towards purchases of roughs, as indicated by dip of ~18% in their imports.

Healthy balance sheets should provide some cushion to the credit profiles of diamantaires, though.

Edible oil

	Revenue visibility	Profitability	Working capital	Credit quality

Estimates for fiscal 2024: Revenue growth: 4-6%; Ebitda margin 4.25-4.5%

Expectation for fiscal 2025: Revenue growth: 5-7%; Ebitda margin: 4.5%-4.75%

With steady rise in consumption and moderation of prices, revenue is anticipated to grow 4-6% this fiscal and 5-7% next fiscal. Growth driven by higher volume backed by strong domestic consumption. After improving by 100-130 bps in fiscal 2023 on account of higher realisations, margins are expected to tone down this fiscal because of correction in prices of primary raw material on account of better supplies.

Branded makers have added capacity due to the growing domestic demand and sector's capex is expected to increase by 8%-10% over fiscal 2024 and 2025.

The impact of El Niño conditions and the Ukraine-Russia conflict remain monitorable.

Specialty chemicals

	Order book/ revenue visibility	Profitability	Working capital	Credit quality

Estimates for fiscal 2024: Revenue growth: 3-5%, Ebitda margin 8-10%

Expectation for fiscal 2025: Revenue growth: 10-12%, Ebitda margin: 13-15%

The revenue growth of Indian specialty chemicals will slow down to 3-5% in fiscal 2024 because of steep fall in realisations. While domestic demand (~60% of total revenue) is stable, macroeconomic headwinds in the US and Europe have impacted exports. Operating margin is expected to moderate a sharp 400-450 bps this fiscal owing to lower sale volume, especially in the overseas markets. With demand and pricing situation expected to normalise in the second half of this fiscal, revenue and operating margin are expected to rebound gradually next fiscal.

Manufacturers are expected to conserve cash and go for only essential capex this fiscal. Overall capex outlay is seen moderating ~35-40% this fiscal to ~Rs 7,500-8,000 crore. That said, with long term structural growth drivers such as China+1 supply-chain reshoring strategy and opportunities emanating from lower capacity additions in Europe continuing, capex spends is expected to revert to fiscal 2023 levels of over Rs, 10,000 crore in fiscal 2025.

Textiles

Cotton-spinning

	Revenue visibility	Profitability	Working capital	Credit quality

Expectations for fiscal 2024: Revenue growth: (10)-(12) %; Ebitda margin: 10-11%

Healthy domestic demand driven by recovery in exports and improved price competitiveness due to softer cotton prices will drive volume growth of 4-5% in fiscal 2024. However, revenue is expected to de-grow (10%) to (12%) due to fall in realisation on-year largely because of improved supply of cotton.

Operating margin is expected to remain at similar levels as fiscal 2023 at 10-11% with higher capacity utilisation and stable cotton prices. With stabilisation of cotton prices, margins are expected to improve from the second half of this fiscal, which will help recover the impact of inventory losses incurred during first half of the fiscal, amid falling cotton prices.

Credit quality outlook to remain moderately negative due to lower than previously expected cash accruals, albeit on deleveraged balance sheets.

Credit quality outlook for the financial sector

Bank credit growth to moderate; asset quality, capital buffers and profitability to remain comfortable

After clocking a robust 15.9% growth last fiscal on broad-based economic recovery, stronger balance sheets and the lower base of the preceding two fiscals, bank credit growth is likely to moderate to 13-13.5% this fiscal[15] and improve a tad to 13.5-14% in fiscal 2025 as economic growth picks up. A key monitorable which will determine credit growth going forward is the extent to which deposit growth picks up for banks.

The moderation this fiscal will be because of four key reasons. One, an expected decline in India's GDP growth to 6% this fiscal from 7.2% in the last which will impact overall credit growth. Two, easing of inflation, with some softening in commodity prices leading to reduction in demand for working capital loans. A significant part of growth in wholesale credit (comprising corporates and MSMEs) in fiscal 2023 was driven by higher working capital demand in a high-inflation environment. Going forward, inflation levels are expected to be lower than that seen in last fiscal. Three, bond market issuances have been robust in the first half of this fiscal with the change in interest rate environment. Consequently, bank credit's substitution of debt capital markets, which also supported wholesale credit growth last year, especially in the first half, is not being seen to the same extent this year. And four, the high-base effect, given the strong growth in fiscal 2023, will also be a factor.

Within overall bank credit, wholesale credit (~60% of overall credit) is likely to slow to 11-11.5% in fiscal 2024, from a decadal high of 15% in fiscal 2023. On the other hand, retail credit (~28% of overall credit), is expected to continue to grow at a healthy clip of 19-20%, similar to last fiscal.

Asset quality trends are benign with gross NPAs expected to further trend downwards to ~3% this fiscal. The corporate segment is likely to see continued improvement with gross NPAs expected to fall below 2% this fiscal, from a peak of ~16% as on March 31, 2018, as a result of a significant clean-up by banks and stronger risk management and underwriting norms. Fundamentally, the health of Corporate India has improved with secular deleveraging over the past few fiscals and through the pandemic.

Gross NPA in the retail segment could see a 20-25 bps uptick this fiscal from a multi-year low of 1.4% on March 31, 2023, driven by unsecured lending segments such as personal loans and credit cards. The rise, however, will be modest because of fundamental factors and the denominator effect of continued robust growth. Asset quality in the MSME segment is a monitorable — this sector had seen the highest level of restructuring. While increasing formalisation of the sector enhances the ability of banks to assess and underwrite these loans, the sector remains vulnerable to macroeconomic factors such as rise in interest rates.

In terms of profitability, the improvement in asset quality and high existing provisioning cover ratio (PCR) helped reduce incremental credit costs, thereby enhancing the return on assets (RoA) to 1.1% in fiscal 2023. This fiscal, CRISIL Ratings expects a compression of 10-20 basis points (bps) in net interest margin (NIM) to 3.0-3.1% as deposit rate hikes play out. However, lower credit cost will provide an offsetting tailwind on account of continued benign asset quality and already strong PCR (~75% as on March 31, 2023), resulting in steady RoA levels.

[15] Excluding the impact of the merger of a large housing finance company with a private sector bank in fiscal 2024

From a capitalisation perspective, the banking sector now has adequate buffers and is well placed for growth over the medium term. While most private banks have traditionally maintained comfortable buffers, many are also benefiting from capital raised in the past three fiscals.

Public sector banks (PSBs), too, have raised some equity, apart from the substantial capital infusion by the government in the past few fiscals, and have stronger balance sheets and capital ratios. As of March 2023, all PSBs had a Tier I buffer of more than 100 bps over regulatory requirements, indicating the ability to absorb asset-side risk and support credit growth. This is in sharp contrast with March 2018, when only about a quarter of PSBs had a Tier I cushion of over 100 bps in excess of the regulatory requirement.

From a funding perspective, it is also important that deposit growth does not lag too far behind. The differential between credit growth and deposit growth is likely to narrow to ~200 bps from ~500 bps seen in fiscal 2023 as deposit rates continue to inch up. Competition for deposits among banks will be par for the course. Banks are likely to walk the tightrope between deposit growth and protecting margins, depending on their ability to mobilise cost-effective deposits.

Also, importantly, to avoid a repeat of asset quality challenges seen earlier, banks are likely to maintain their credit underwriting standards while focusing on credit growth. Overall, the banking sector is on a relatively stronger footing today compared with the past few years.

NBFC AUM growth to pick up; profitability to remain healthy, despite marginal compression in NIM

Over the past few fiscals, NBFCs have weathered multiple challenges, which were worsened by the pandemic. But they were back on the growth track in fiscal 2023. With the momentum likely to continue, NBFCs could see assets under management (AUM) grow 16-18%[16] this fiscal, compared with single-digit growth in the three fiscals up to March 2022.

The upturn will ride on several tailwinds — resilient economic activity, stronger balance sheets in the form of higher liquidity, capital and provisioning buffers, and better asset quality. At the same time, certain aspects are monitorables —continued intensity of competition from banks in traditional asset classes, which coupled with rising borrowing cost, is impacting net interest margins (NIMs), and asset quality in the unsecured segment.

Growth in AUM should be relatively broad-based across retail segments but given the competition from banks in traditional asset classes such as home loans and new vehicle finance, unsecured lending is set to outpace other segments.

Home loans (25%[17] of AUM) are set to grow 16-18% in fiscal 2024, with structural factors driving end-user housing demand, despite the rise in real estate prices and interest rates. That said, housing finance companies (HFCs) may further lose market share to banks, given the competitive interest rates, especially in the urban and formal salaried segments. NBFCs are expected to sharpen focus on the affordable and non-urban housing finance segments.

Vehicle finance (27% of AUM) is expected to grow 14-16% in fiscal 2024, compared with an estimated ~13% in the previous fiscal, on the back of solid underlying-asset sales, rising ticket sizes and focus on used vehicle

[16] Growth adjusted for a leading housing finance company which merged with a Bank earlier this fiscal
[17] AUM share is adjusted for a leading housing finance company

segment. Strong demand and new launches will continue to drive car and utility vehicle sales. Resilient economic activity, demand for fleet replacement and focus on last-mile connectivity will support commercial vehicle sales.

In the new-vehicle finance segment, especially cars, borrowers are highly sensitive to interest rates. Hence, competition from banks remains tough, given their ability to offer better pricing. Consequently, NBFCs will likely capitalise on their core strengths of last-mile connectivity, customer relationships, innovation and strong understanding of micro markets. These factors would help them to sharpen focus on segments such as used vehicle and light and small commercial vehicle financing, which offer higher yields and better profitability from a risk-adjusted returns perspective.

However, non-traditional segments are set to grow faster. First, intense competition from banks in traditional retail segments, has translated to increased focus of NBFCs in non-traditional and relatively riskier segments such as affordable housing loans, unsecured loans, MSME loans and used vehicle loans. Unsecured loan (10-12% of NBFC AUM) is expected to be the fastest growing segment at 28-30% this fiscal. Demand for consumer loans is high across durables, travel and other personal consumption activities, while business loans have benefited from macroeconomic tailwinds.

From an asset quality perspective, metrics across retail product segments have improved and fundamentals are expected to hold because of the resilient macroeconomic environment. Nevertheless, any major challenges stemming from rising inflationary pressure, interest rates, and job losses are monitorable. Specifically, given the broad credit spectrum of target customers, asset quality in unsecured loans will need to be monitored. The ability of NBFCs to price these product segments, while adopting a measured approach on risk management, will also be critical.

The other key monitorable is the impact of increased cost of funds. The Reserve Bank of India hiked the repo rate by 250 bps in fiscal 2023, the translation of which for most NBFCs happened in the second half of the fiscal, when they raised fresh funding to meet growth requirements. On the asset side, the speed and extent of pass-through was higher. As a result, NIMs expanded, and given the benign credit cost trends, overall profitability for NBFCs improved with RoA rising to 2.7% in fiscal 2023 from 2.2% in the previous fiscal. However, CRISIL Ratings expects the full impact of increase in cost of funds, to be reflected in fiscal 2024, wherein NIMs could compress by 20-30 bps. Given that credit cost may stabilise in fiscal 2024, after a continued downtrend in fiscals 2022 and 2023, compression in NIMs would translate into RoA normalising to 2.4-2.5%. Even then, RoA would be fairly healthy and at pre-pandemic levels.

Overall, business models of NBFCs continue to evolve. As large NBFCs turn towards non-traditional segments, symbiotic partnerships may increase with emerging NBFCs focused on specific segments such as unsecured lending. This allows large NBFCs to venture into newer segments in a more cost-efficient manner, while reducing the time to market. For emerging NBFCs, it supports capital-efficient AUM growth. Co-lending with banks is another preferred route for growing AUM, especially for mid-sized and emerging NBFCs.

CRISIL Ratings

Securitisation volume growth to continue amid credit growth tailwinds and robust performance of retail pools

Securitisation volume surged ~60% on-year in the first three months of this fiscal to ~Rs 55,000 crore, the highest-ever for a first quarter. The number of transactions exceeded 250, from around 60 reported in the first quarter of fiscal 2023, driven by broad-based market participation from over 80 originators and 50 investors.

Spurt in credit growth for banks and NBFCs, driven by the economic revival, contributed to the momentum and will continue to shape growth. Securitisation allows banks to maintain credit growth without impacting their direct exposure limits to NBFCs' balance sheets, and to diversify exposure to granular retail loans. NBFCs, which are key originators, have been relying on securitisation as a funding avenue, to support their strong credit growth.

The robust collection track record of cherry-picked retail loan pools, despite macroeconomic headwinds such as interest rate hikes and inflationary pressures, has boosted investor confidence. In the last fiscal, pass-through certificates (PTCs) rated by CRISIL Ratings had median monthly collection ratios of 98-100% in secured asset classes and microfinance, and 94-96% in unsecured asset classes.

Traditionally, the share of direct assignments (DAs), largely chosen because of the relatively safer asset classes of mortgage and gold, has been higher than PTCs. However, the share of PTCs rose to nearly 50% in the first quarter of this fiscal, with acceleration in other asset classes such as vehicle, microfinance and unsecured loan segments, which are largely through the PTC route.

The DA-PTC mix will veer further towards PTCs as the share of mortgages and DAs in securitisation volume reduces, following the merger of a large originator in the housing finance space with a bank.

In another departure from a past trend, vehicle loans (including commercial vehicles and two-wheelers) emerged as the dominant asset class, with ~37% share in overall volume, vis-à-vis ~34% for retail mortgage-backed securitisation (MBS), which had hitherto been the frontrunner. Microfinance and gold loan securitisation retained their share of 10% and 8%, respectively.

Among investors, PSBs and private banks have been at the forefront, followed by foreign banks. While foreign banks focused on PTCs, which provide an additional cushion via internal and external credit enhancements, PSBs preferred DA pools. Private sector banks invested in a mix of DAs (mostly mortgage and gold loan pools) and PTCs.

Securitisation in India is an evolving space, paving the way for new and innovative structures to meet the growing needs of investors. For instance, novel structures such as replenishment transactions, which enable longer-tenure PTC issuances to be backed by relatively shorter-tenure loans, have seen increased traction in recent months.

Overall, after a period of muted activity during the pandemic, securitisation volume should bounce back and can even exceed the pre-Covid high of ~Rs.1.9 lakh crore in fiscal 2024, riding on favourable domestic macroeconomic sentiment, healthy performance of securitised pools, and an array of structures tailored to suit market requirements.

Epilogue

In line with our expectations, the CRISIL Ratings credit ratio moderated to 1.91 in the second half of fiscal 2023.

Steadfast demand from the domestic market and government thrust on capex kept the upgrade rate in the first half of this fiscal higher than the 10-year average.

The downgrade rate, however, inched up and is closer to the 10-year average, with export-oriented sectors bearing the brunt on account of the global growth slowdown.

The outlook on credit quality in the rest of the fiscal remains positive, with upgrades expected to outnumber downgrades on the back of healthy domestic demand, capex by government and strong balance sheets.

In the first half, infrastructure and linked sectors kept the upgrade rate elevated, benefiting from front-loading of government capex. To be sure, the sector has evolved, with not only high budgetary allocation, but also better risk sharing among stakeholders, and introduction and acceptability of investment vehicles such as infrastructure investment trusts.

Infrastructure and linked sectors, along with other domestic-focused ones such as services and consumables, are expected to drive upgrades over the rest of the fiscal, too.

At the other end, sectors focused on exports and commodities, whose fortunes are linked with global markets, have seen a moderation in cash-flow expectations this fiscal.

All said, global macroeconomic conditions remain tough, with the spectre of high inflation in developed economies as they grapple with slowing demand. Back home, erratic rainfall and rising inflation in food prices has the potential to impact rural and semi-urban demand.

Notes

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