Professional Risk Opinion

Assessment of Credit quality of CARE's rated portfolio in H1

October 1, 2021

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Professional Risk Opinion

Sustained recovery in H1FY22 : Outlook Positive

- India Inc seems to have overcome the "pandemic" with a sustained recovery as reflected in Credit Ratio* of 2.05 in H1FY22.
- The Credit ratio has seen a sequential improvement from 1.27 in H2FY21 after seeing a downward trajectory in the earlier three half years.
- In H1FY22, CARE Ratings upgraded ratings on 301 entities and downgraded ratings of 147 entities.
- Inspite of the recent second wave of pandemic, the economy seems to have embarked on the recovery path with most sectors recording improved performance. The uptick can also be seen with the core sector output growing by 11.6% in August 2021.
- The sectors which recorded the most improvements are construction, roads and power generation within infrastructure sector and pharmaceuticals, chemicals, steel and textile entities in the industrial sector.
- CARE's Modified Credit Ratio (MCR)^ also improved from 0.92 in H1FY21 to 1.11 in H1 FY22.
- The uptrend in the credit quality can be attributed to the increase in demand (including pent up), incentives by the government like Atmanirbhar Bharat , government spending on infrastructure, benign interest rates, global pick up in demand and impact of China + 1 strategy.
- The credit outlook is expected to be positive..
- Third wave of pandemic (if it assumes large proportions) to be a key monitorable and would be a risk to the credit outlook

*ratio of upgrades to downgrades ^ratio of (upgrades and reaffirmations) to (downgrades and reaffirmations)

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Credit Ratio & MCR

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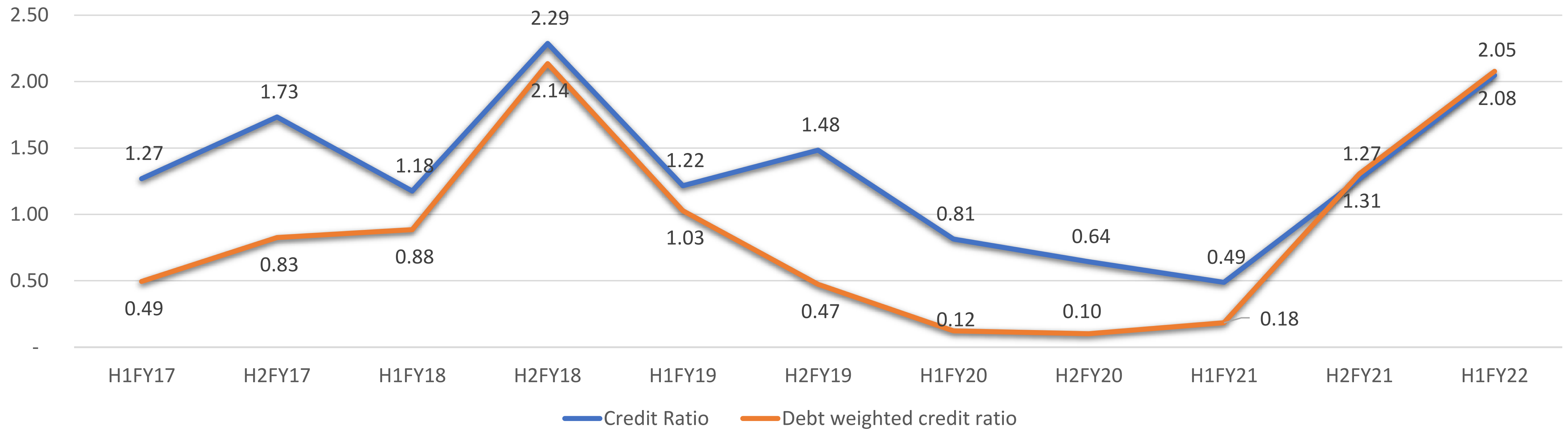
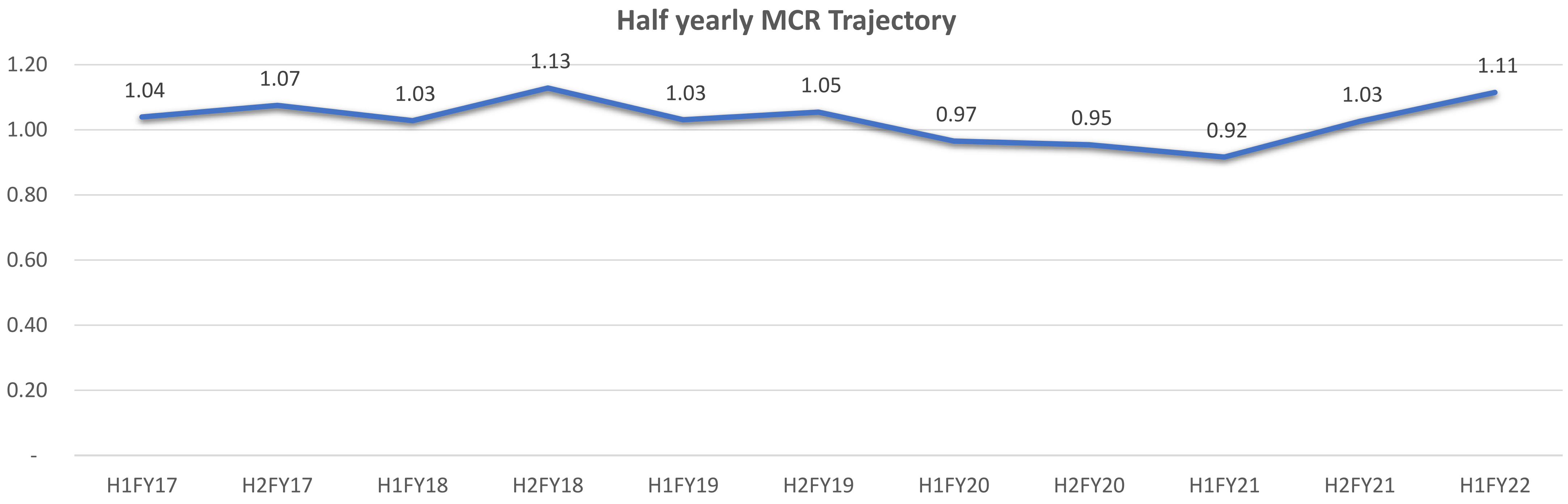
Both the Credit Ratio & Debt weighted Credit Ratio – Depict Sustained Recovery



Credit Ratio (CR) = Upgrades / Downgrades

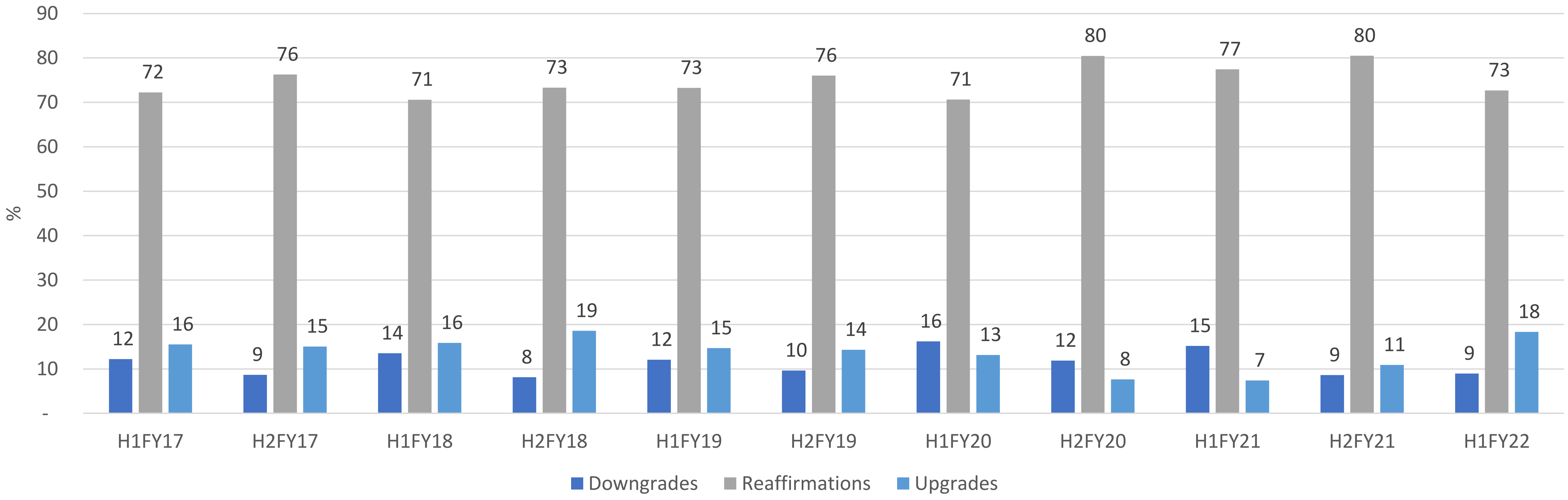
- CR higher than unity denotes higher upgrades than downgrades and an increase from an earlier period denotes higher proportion of upgrades than downgrades. Decline in the same signals a deterioration in credit quality of the rated entities.
- Growth attributed mainly to upgrades in Roads, Construction, Power generation, Chemicals, Steel and Pharmaceutical sectors
- Downgrades seen in NBFCs, Hospitality and Retail

Half yearly MCR : Sustaining above 1 since H2FY21



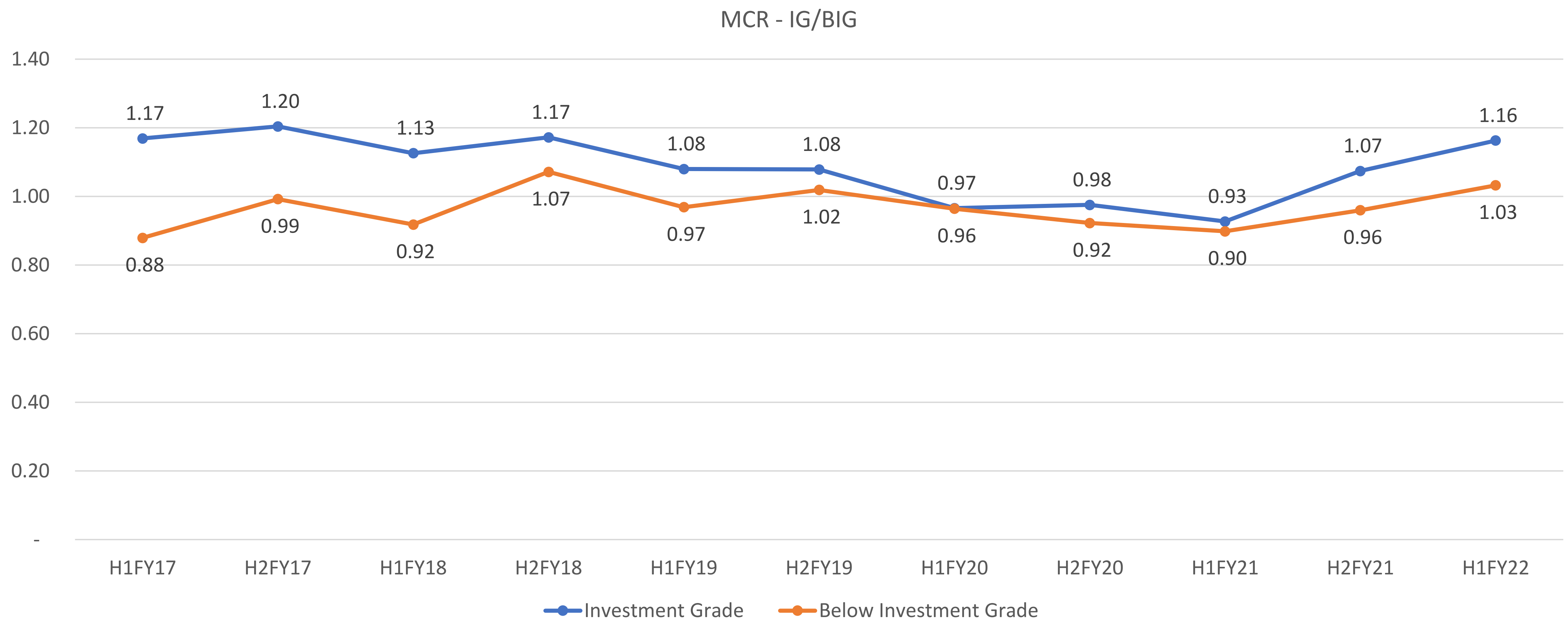
- **Modified Credit Ratio (MCR) = (Upgrades and Reaffirmations) / (Downgrades and Reaffirmations)**
- An MCR closer to one indicates higher stability in the ratings, with a larger proportion of reaffirmations.
- Majority of the entities (73%) saw their credit ratings being reaffirmed in H1 FY22

Proportion of upgrades, downgrades & reaffirmations : High Reaffirmations denoting stability



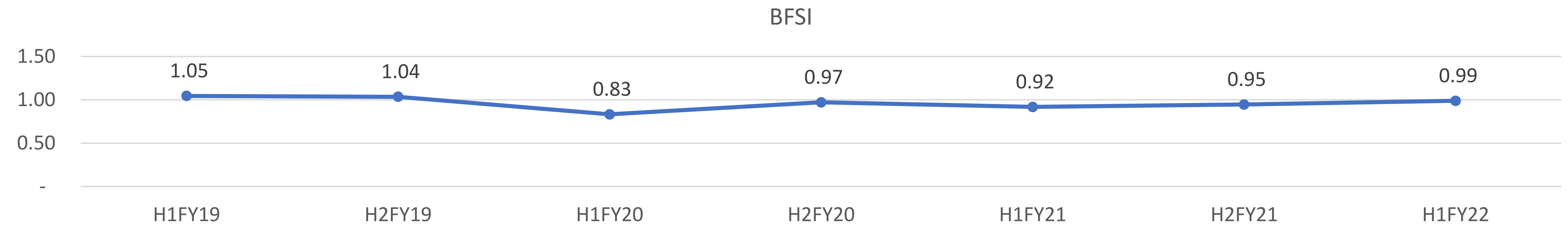
- Proportion of upgrades increased from 7% in H1 FY21 to 18% in H1 FY22

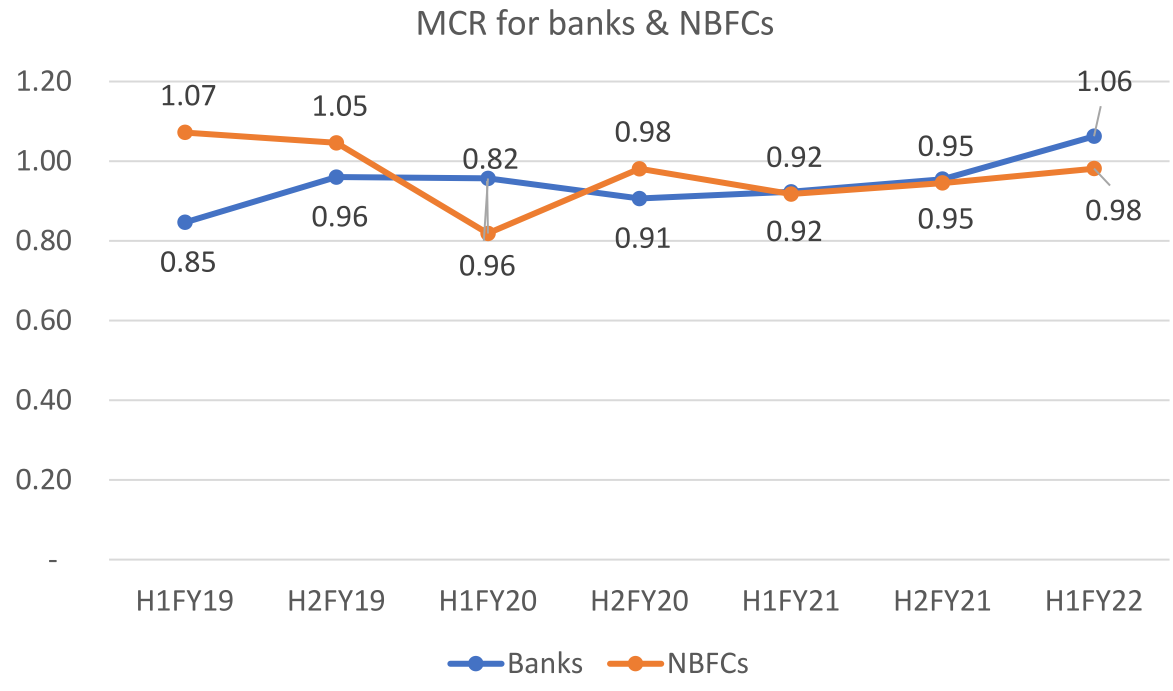
Investment Grade (IG) cases have exhibited a stronger revival in Credit Quality



Sector MCRs

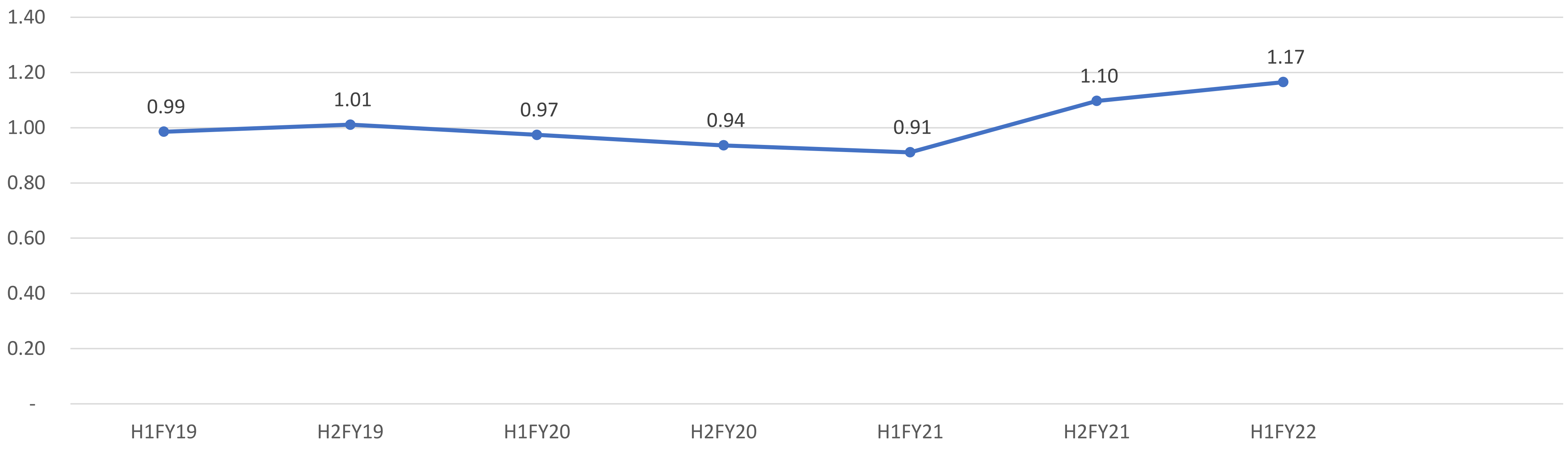
BFSI : Slow and Steady improvement - MCR marginally below unity





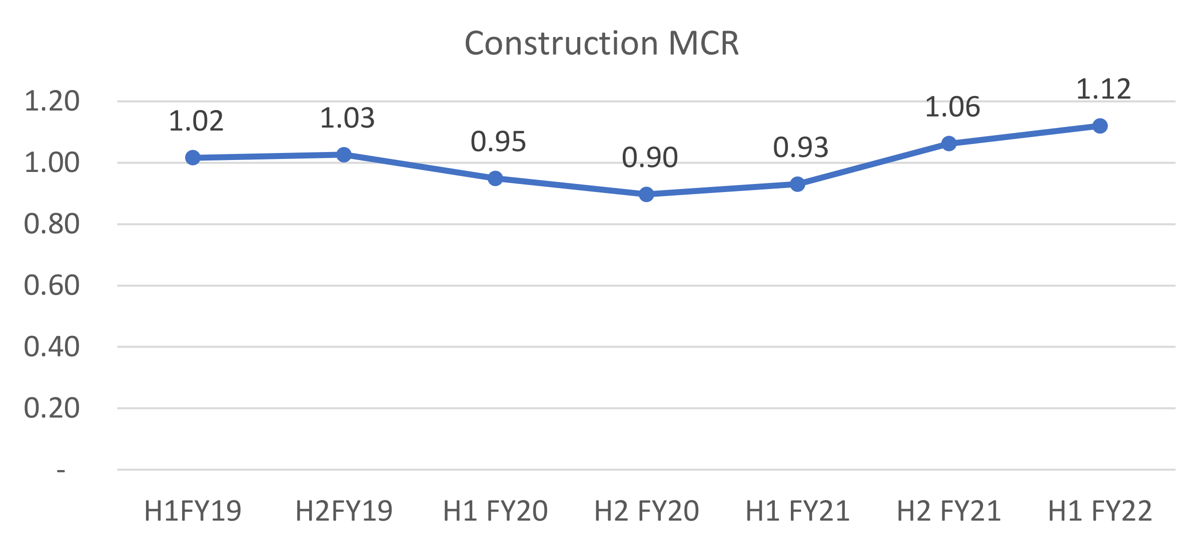
- The Banking Sector has largely witnessed retention of ratings with some upgrades due to improved capitalisation levels and lower than expected asset quality issues.
- MCR for NBFC sector is also improving, however remains below unity. The sector saw downgrades in this half year mainly due to :
  - ✓ Deterioration in profitability due to higher credit costs
  - ✓ Erosion of capital buffers
  - ✓ Restricted physical movement of collection staff in the second wave of pandemic leading to weak collections
  - ✓ Deterioration in financial and liquidity profile of the parent company

Infrastructure : MCR Galloping ahead

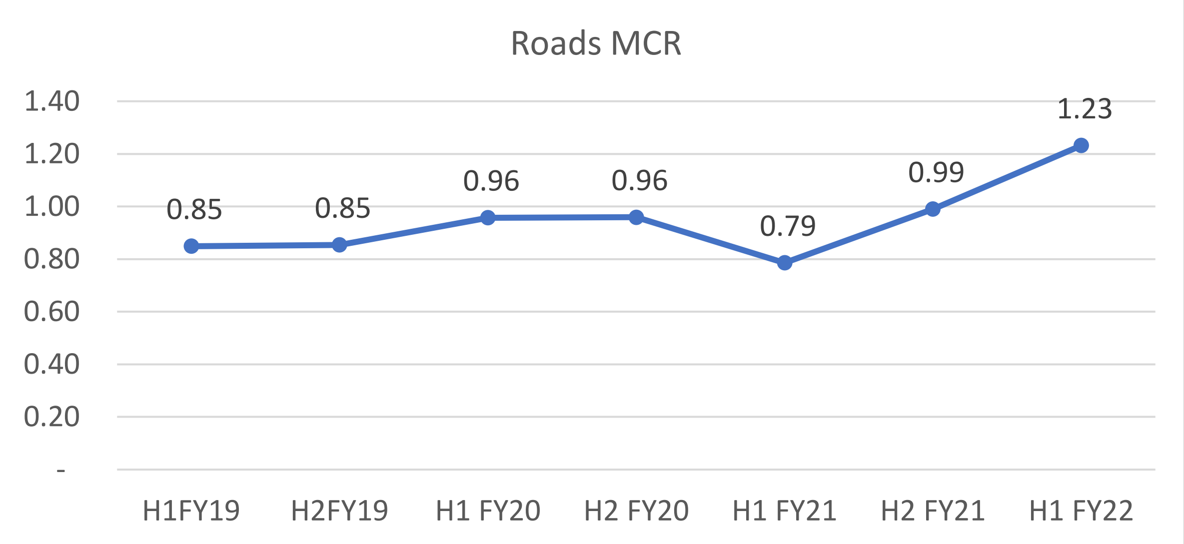


- MCR for Infrastructure entities improved to above unity from second half of the last fiscal hinting at recovery in the economy.
- The upgrades in this segment are driven mainly by construction, roads and power generation sectors.
- Improvement in entities in the power sector was mainly seen in the renewables space with better liquidity, track record of operations and receipt of earlier stuck dues from customers.

MCR for construction & roads swinging up

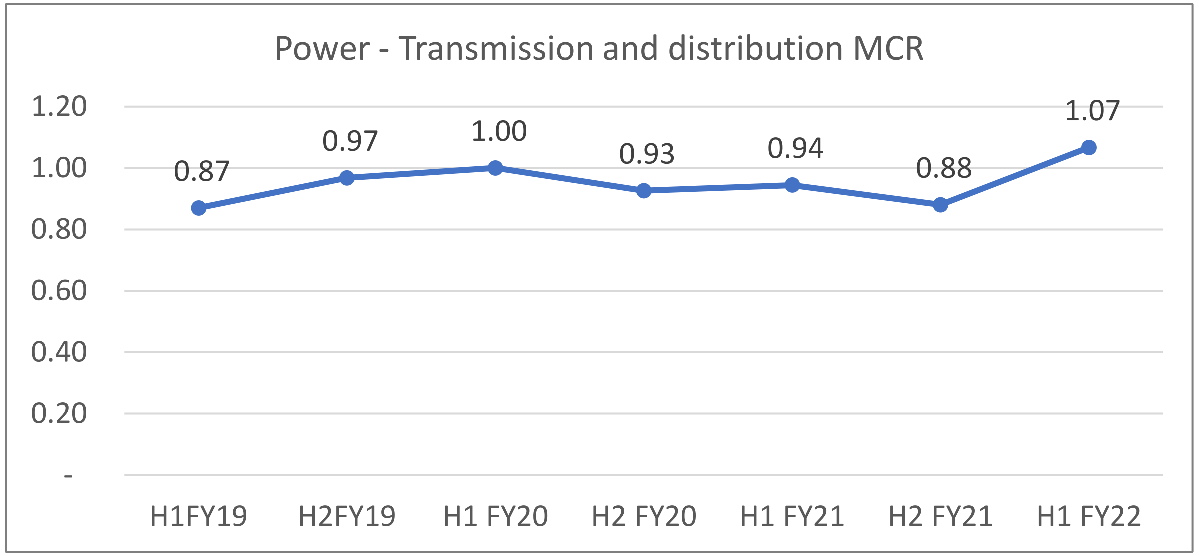


- **Construction sector** : This sector witnessed significant pain in H1FY21 with the pandemic bringing in execution challenges due to migration of labour.
- MCR improved in H1 FY22 due to:
  - ✓ Pace of execution picking up due to the unlock process
  - ✓ Revenue visibility enhanced with infrastructure push by the Government spending
  - ✓ Improvement in profitability

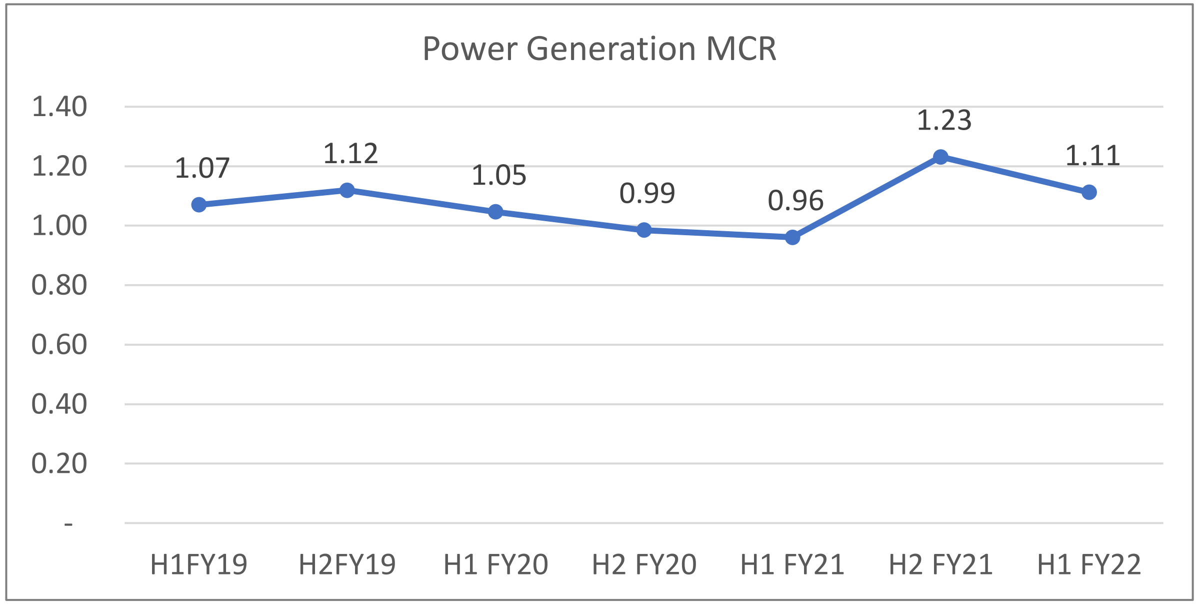


- **Roads** : This sector also witnessed a very low MCR of 0.79 in H1 FY21 which significantly changed to 1.23 in H1 FY22
- Upgrades were triggered by:
  - ✓ Better toll collections post achievement of commercial operations as also due to implementation of FASTag,
  - ✓ Increase in pace of roads construction activity, completion of four laning of NH-3 and shift in mode of transport from buses to cars
  - ✓ Change in ownership with strong sponsors taking control
  - ✓ Debt reduction with transfer of certain assets to InvITs
  - ✓ Establishment of track record of annuity receipts

MCR for power stays strong

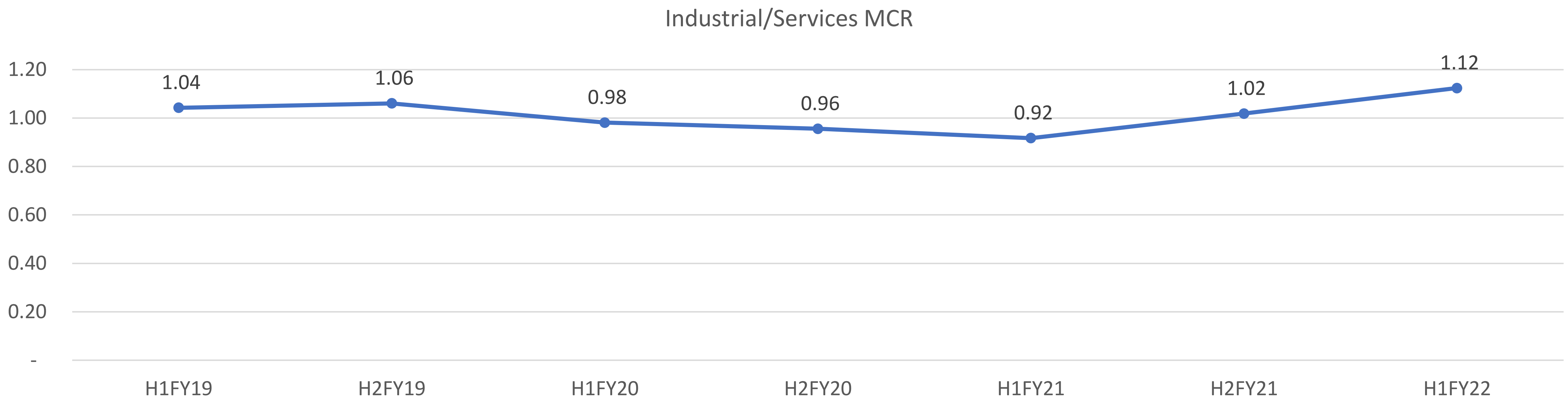


- **Power Transmission and Distribution** : This sector has witnessed a range bound MCR in the past few years.
- MCR marginally improved in H1 FY22 due to stabilisation post achievement of commercial operations.



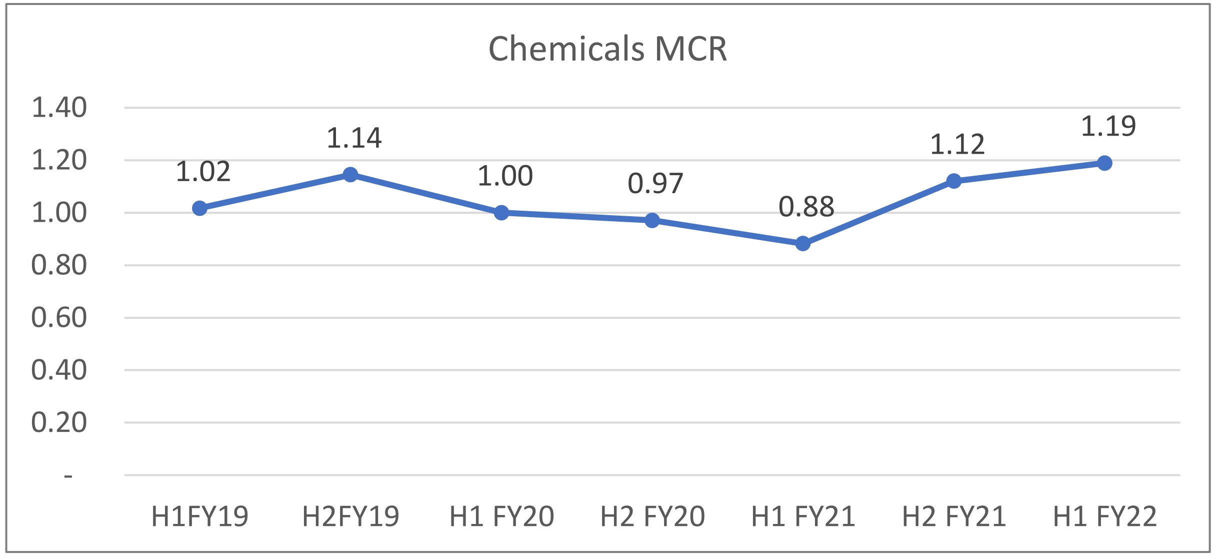
- **Power generation :** MCR dipped slightly in H1 FY22, continued to remain above 1.
- Upgrades triggered by:
  - ✓ Settlement of overdue receivables after disbursement by PFC/REC funds
  - ✓ Improved liquidity on receipt of funds under Atmanirbhar Bharat scheme reducing borrowing
  - ✓ Better availability of cheaper coal
  - ✓ Improved operational performance/track record of operations

Industrial / Services : Uptrend in H1FY22

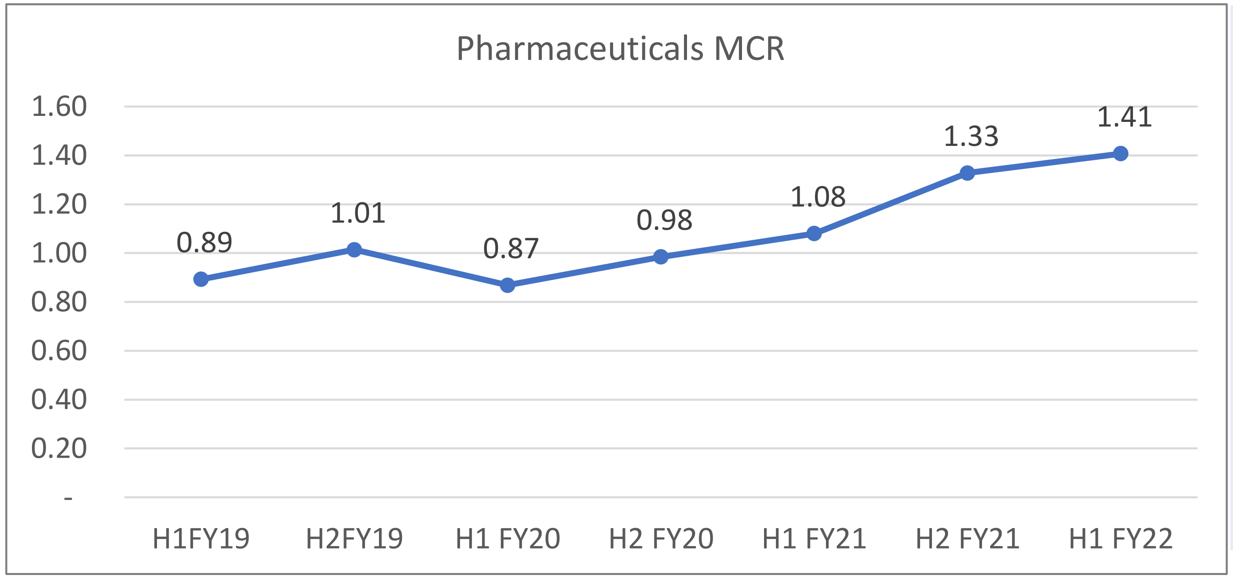


- MCR for Industrial / Services sector has also witnessed an up-tick from H2FY21, with the trend continuing in H1 FY22.
- Industries that witnessed upgrades were pharmaceuticals, chemicals, steel and textiles.
- Industries like hospitality and retail are yet to recover with low MCR

MCR for chemicals and pharmaceuticals : Consistent performers

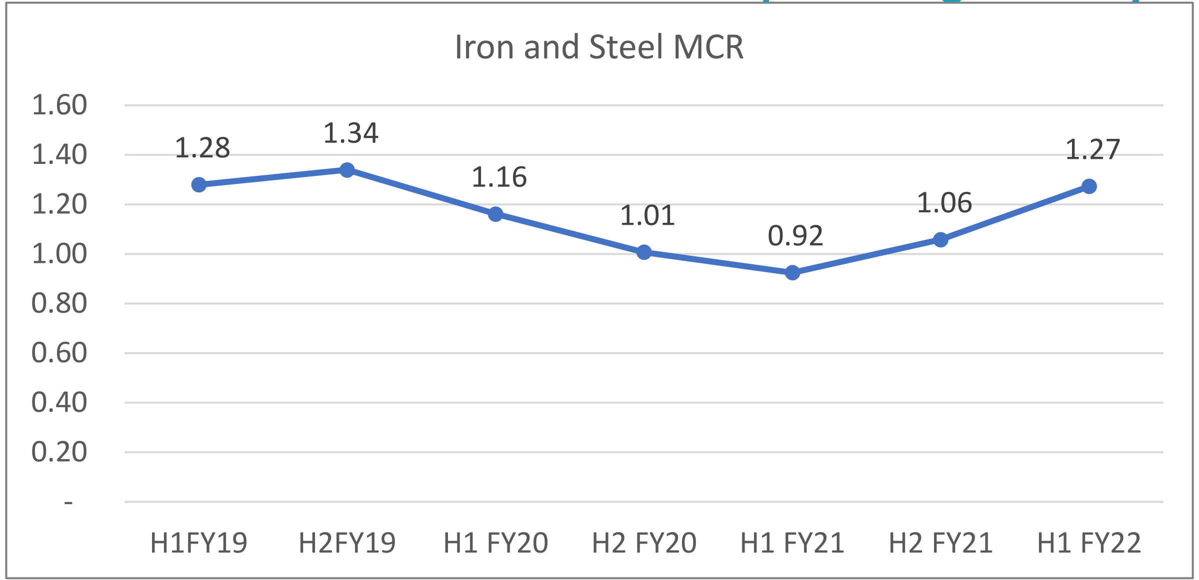


- **Chemicals** : MCR inched above unity in H2 FY21 and the uptrend continued in H1 FY22.
- Upgrades in the sector triggered by:
  - ✓ Increased demand for Indian suppliers substituting Chinese players
  - ✓ Improved realisations supported by increased global demand and pent up domestic demand
  - ✓ Increase in demand from pharmaceutical industry



- **Pharmaceuticals** : This has been the most resilient sector with Covid 19 creating high demand. MCR has been above 1 since FY21.
- Upgrades triggered by:
  - ✓ The pandemic and consequent increase in importance of healthcare
  - ✓ Increased scale of operations, profitability and revenue visibility
  - ✓ Companies playing a role in vaccine development

MCR for Iron & steel and Textiles : improved significantly



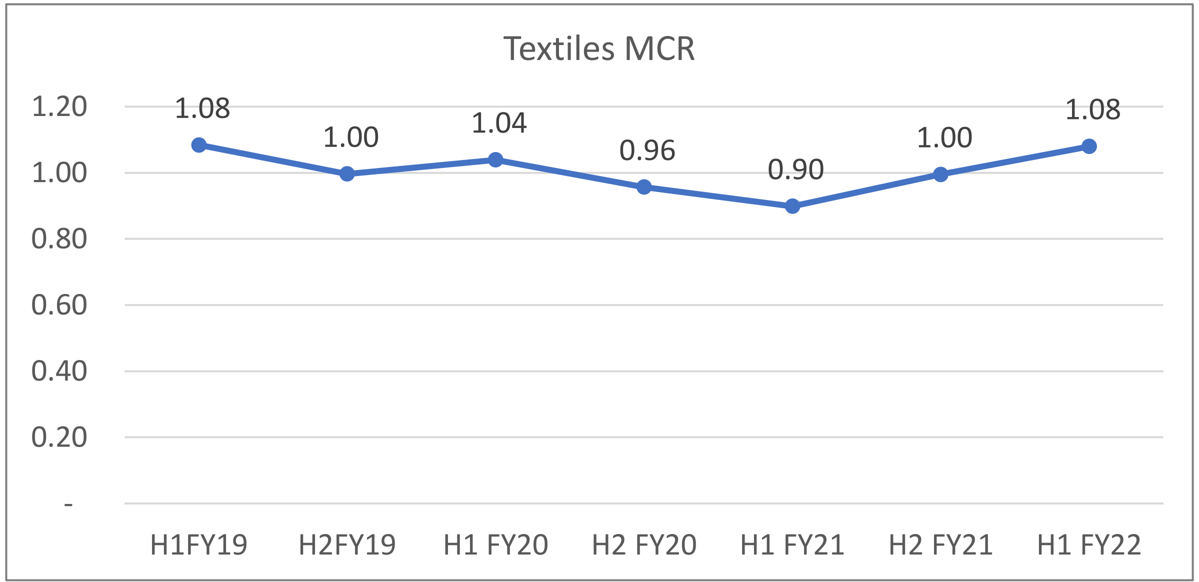
- **Iron and steel**
- Higher upgrades witnessed due to:

  ✓ Sizable deleveraging due to strong operating performance

  ✓ Jump in realizations by nearly 80% in flat steel and 50% in long steel since June 2020 in line with the trend in global steel prices

  ✓ Expectations of elevated domestic prices

  ✓ Sales volumes expected to pick up on the back of strong demand from infrastructure



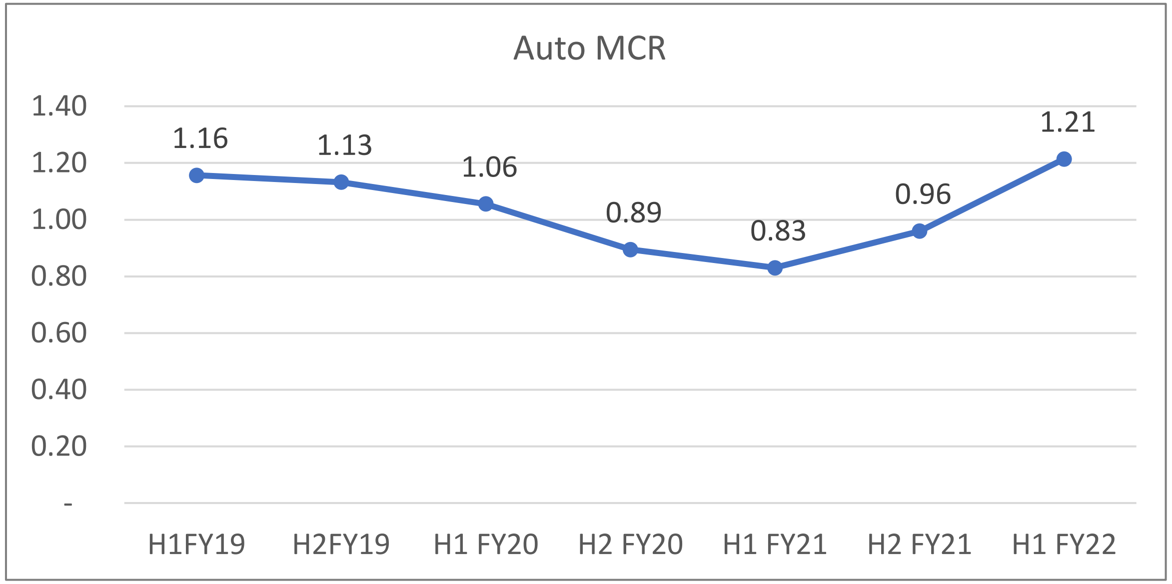
- **Textiles**
- Upgrades in the sector were for the following reasons:

  ✓ The industry witnessed strong demand post the pandemic, from domestic and export market

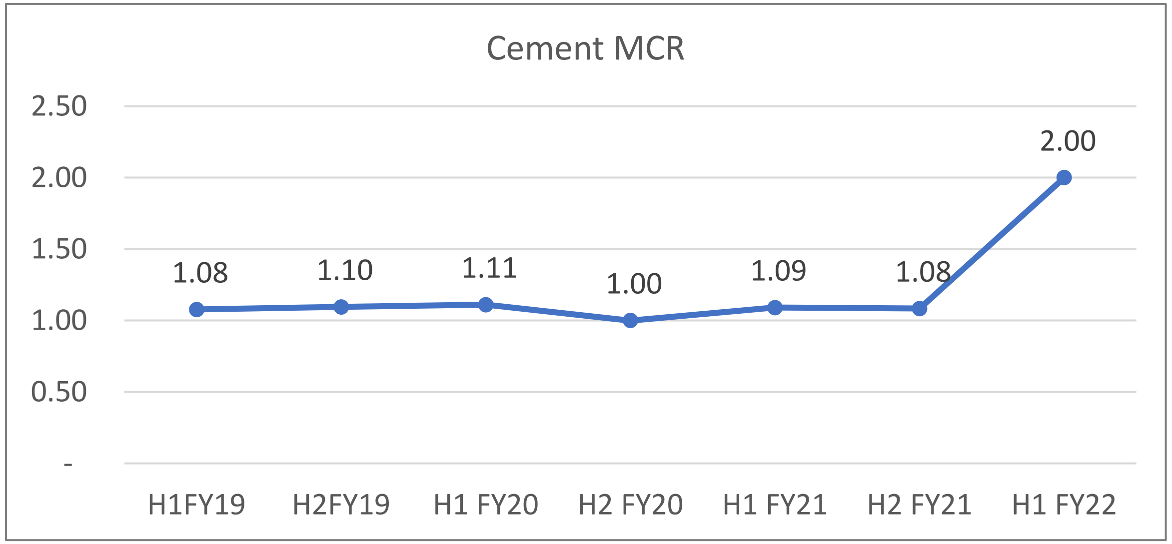
  ✓ Indian exporters derived benefit from China+1 strategy

  ✓ Spinners saw significant improvement in yarn prices relative to cotton.

MCR for auto and cement : Sudden Spurt



- **Auto**
- Higher upgrades witnessed due to:
  - ✓ Upcycle in the CV segment with uptick in the end-user industries
  - ✓ PV segment also showing improvement due to pent up demand
  - ✓ Ancillaries supplying to the OEMs benefitting correspondingly due to growth in order book from the OEMs



- **Cement** was one of the least affected sectors by the pandemic
- Upgrades were triggered by:
  - ✓ Improvement in turnover and profitability with higher demand from infrastructure and other end-user industries
  - ✓ Collections and liquidity improved with better performance of the end-user industries

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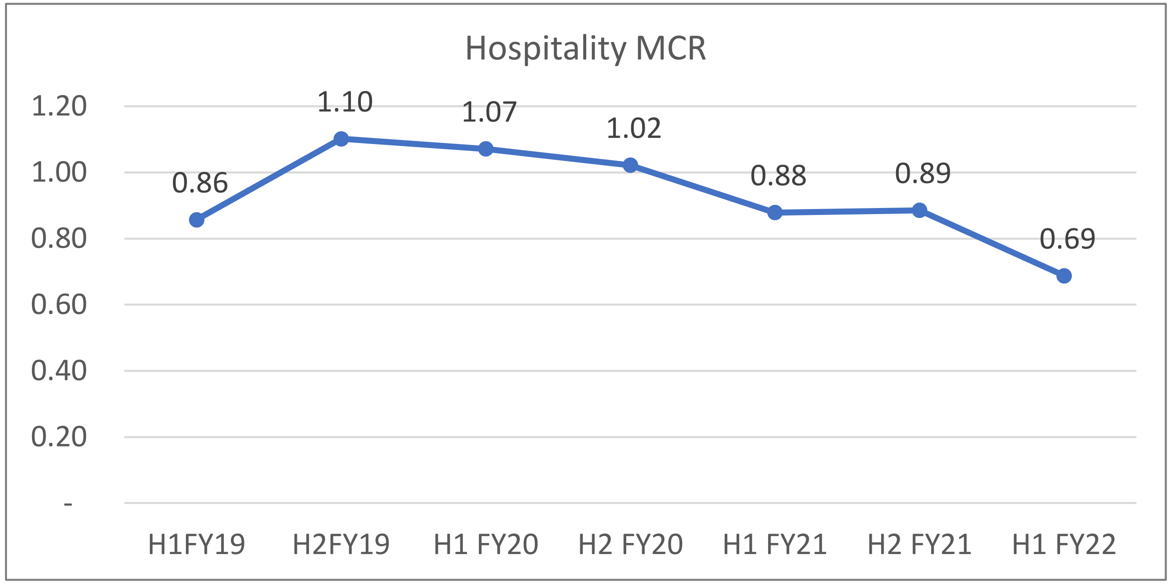
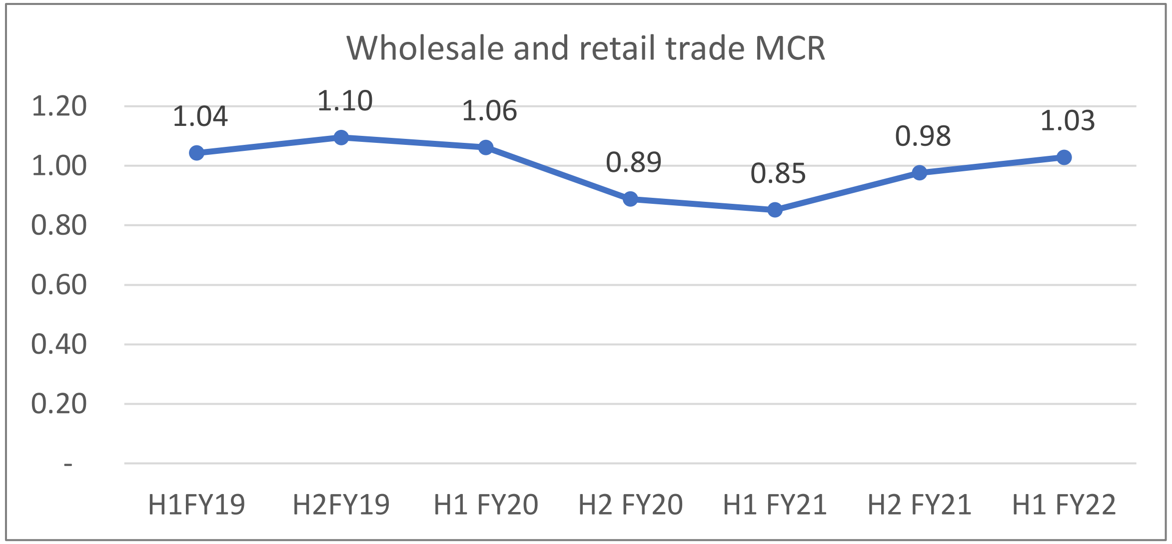
MCR for hospitality and retail : Pandemic Casualties



- **Hospitality** : Worst hit sector due to the pandemic.
- Downgrades in the sector in H1 FY22 mainly triggered by:
  - ✓ Tourism activity yet to pick up, though unlock process has started
  - ✓ Business travel also restricted due to Covid



- **Trading entities**
- Upgrades were mainly in the wholesale trading industry while the retail trading entities witnessed downgrades.
- Downgrades in the retail sector were mainly driven by:
  - ✓ Covid related stress still not over for the sector
  - ✓ Stretched liquidity with funds stuck in working capital

MCR for other industries

Sector	H1FY19	H2FY19	H1 FY20	H2 FY20	H1 FY21	H2 FY21	H1 FY22
Coal Mining	1.00	1.00	1.50	0.80	1.00	1.25	1.50
Telecom	0.91	1.05	0.60	0.77	0.85	0.89	1.11
Beverages	1.25	1.23	1.75	0.96	0.95	1.15	1.13
Ceramics	1.05	1.19	1.10	0.95	0.76	1.04	2.00
Education	0.91	0.98	0.89	1.12	1.11	0.93	1.03
Gems & Jewellery	1.07	1.00	0.57	0.91	1.00	0.99	1.00
Real Estate	0.91	0.95	0.88	0.87	0.88	0.89	1.03
Sugar	1.00	0.94	1.13	0.89	1.50	1.00	1.45

- MCR for most industries shows an upward trend

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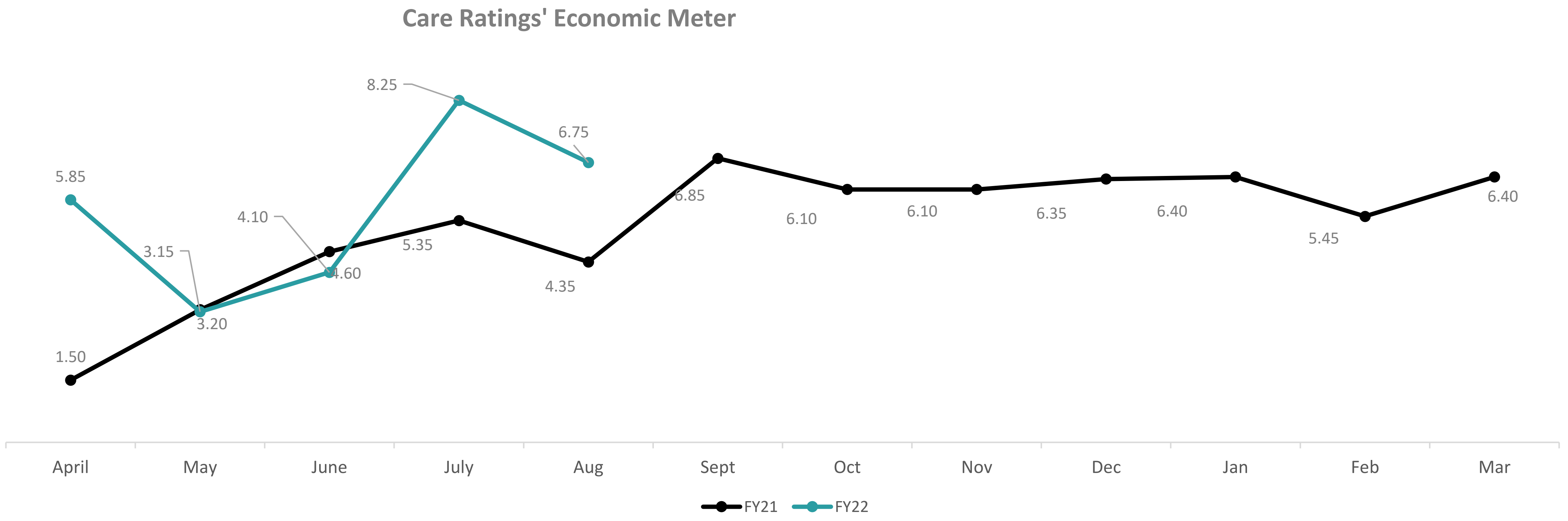
Economy

CARE Ratings Economic Meter



- India's economic recovery continued in August, albeit at a moderate pace compared with the impressive expansion in July
- A score in the range of 6-8 indicates steady state position. The score of 6.25 in August is encouraging, suggesting that economy is showing initial signs of stability.

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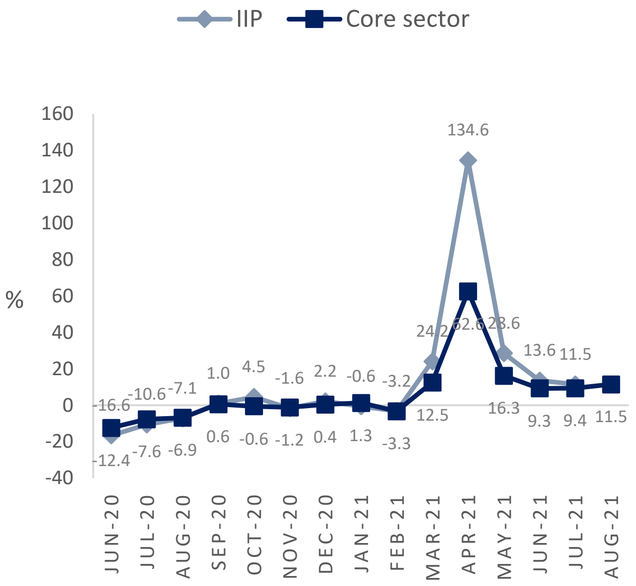
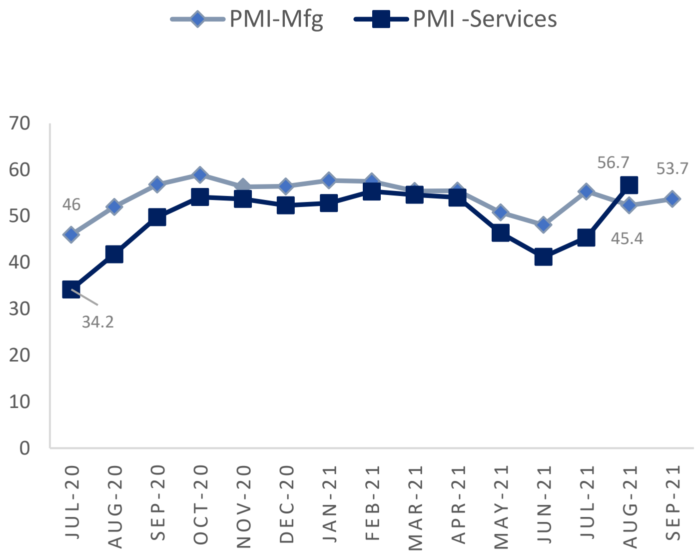
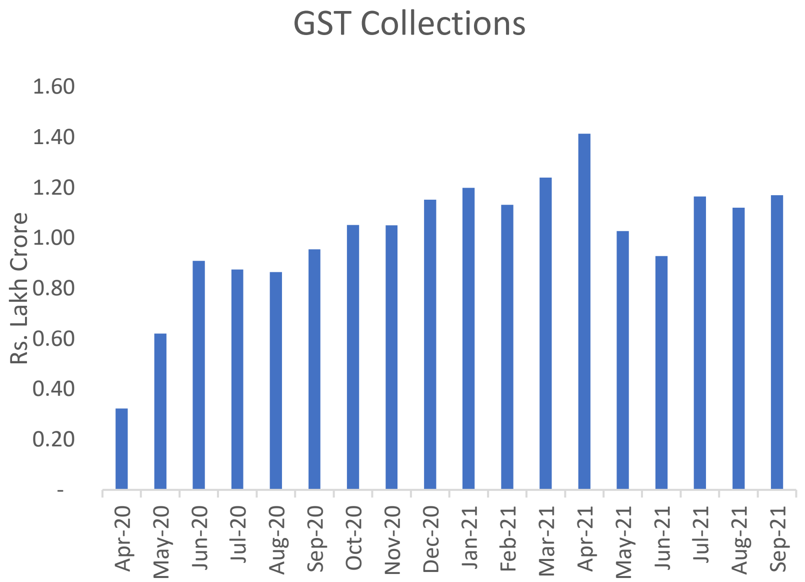
Steady improvement in manufacturing, foreign trade and GST collections







- Manufacturing activity and electricity output witnessing month-on-month growth since June
- GST collections on the rise – over Rs. 1 lakh crore since Jul'21
- Robust exports and imports growth – Exports growth at 68% and Imports growth at 82% during Apr-Aug'21 (y-o-y)
- Bank credit growth has been subdued – incremental credit growth during April-10 Sept'21 is (-)0.3%

Economic Outlook

- GDP growth for FY22 is expected to be 9.1%
- Economic activity is expected to attain and surpass pre-pandemic level from Q3 FY22 onwards
- The downside risk to the projection would primarily be a resurgence in the pandemic and weak demand conditions. A pickup in consumption during the festive season in Q2 and Q3 would be key to the country's economic growth prospects for the financial year
- The main drivers of the economy would be agriculture and industry. Growth in industry estimated at 9.4% in FY22.
- RBI is expected to maintain its focus on growth and continue with its accommodative policy stance. Policy rate to be retained at 4% in 2021 calendar year
- Investment to get limited boost this year, though FY23 can be different. Given the state of the economy and surplus capacity in industry on a marginal increase in private investments is expected
- PLI scheme to activate investment though the acceleration would be from FY23

Thank You

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