CareEdge
RATINGS

# Corporate India: Steady ship in turbulent waters

## Credit quality assessment for H1FY23

# Highlights

- Turbulent times with geopolitical tensions, financial market volatility and possibility of recession in major global economies.
- High frequency economic indicators for India, showed mixed signals with Goods and Service Tax (GST) collections, Purchasing Managers' Index (PMI), auto sales, bank credit growth and Index of Industrial production (IIP) showing recovery, while exports and unemployment statistics are weakening.
- CareEdge Ratings has seen an all-time high credit ratio of 3.74 in H1FY23, significantly up from 2.64 in H2FY22. There were 318 upgrades and 85 downgrades during H1 FY23.
- Upgrades in H1FY23 were mainly driven by a post-pandemic broad-based recovery across sectors, with manufacturing sector's credit ratio at 4.59, leading the overall improvement in the credit ratio.
- The sectors which witnessed high upgrades in H1FY23 were healthcare, steel, chemicals, textiles, automobiles, pharmaceuticals and real estate in the manufacturing/services sector and roads, construction and power within the infrastructure sector. NBFCs saw most upgrades in the BFSI sector.
- Pent-up domestic demand and significant deleveraging across sectors aided recovery to a large extent for manufacturing sector and enhanced pace of execution along with strong order inflows, refinancing of projects at better financing terms and structured financing avenues like InvITs drove upgrades in the infrastructure sector.
- BFSI credit ratio saw a sharp improvement moving up from 1.24 in H2FY22 to 4 times in H1FY23, driven by upgrades in NBFCs. Significant equity infusions and scaling up of operations amid waning of the pandemic related concerns in collections, drove majority of the upgrades.
- Government schemes such as Production Linked Incentives (PLI), Gati Shakti, National Infrastructure Pipeline (NIP) and National Monetisation Pipeline (NMP) should help in the regaining of the capex cycle.
- Despite the ongoing global headwinds, CareEdge Ratings believes that Corporate India has remained steady and will continue to grow at a gradual pace.

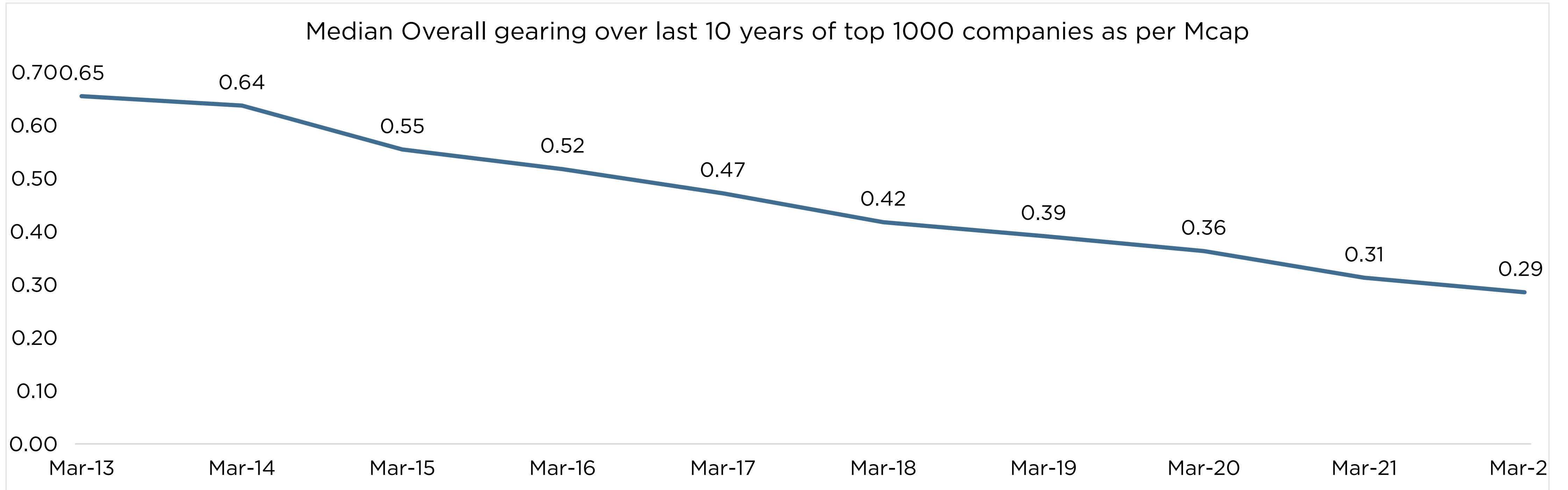
# Global Economy in a turbulence

- Global economies are struggling with slowing growth, high inflation and interest rates. Organisation for Economic Co-operation and Development (OECD) has lowered global GDP growth forecast for 2023 to 2.2% (from earlier forecast of 2.8%), while retaining the 2022 global growth forecast at 3%.
- Global trade volume growth estimated to reduce to 3% in 2022 (against earlier estimate of 4.7%), as per World Trade Organisation.
- US has recorded two subsequent quarters of contraction (Q1 and Q2 2022) in GDP and has high Consumer Price Index (CPI) inflation of around 8%.
- EU has recorded weak GDP growth of 0.8% in Q2 and is feared to slip into recession given the energy crisis.
- US Federal Reserve has hiked policy interest rate by 3 percentage points in last seven months, resulting in sharp strengthening of dollar index and volatility in the global financial markets.
- China's growth has slowed sharply due to zero-COVID strategy and crumbling real estate sector. World Bank has lowered China's GDP growth estimate to 2.8% for 2022.

# India's economy relatively better placed

- India's economy recorded modest GDP growth of 3.8% in Q1FY23 when compared to pre-pandemic period of Q1 FY20.
- High frequency economic indicators like GST collections, E-way bills, PMI, auto sales, bank credit growth look healthy.
- Consumption in the economy to improve as economy gathers momentum, but rural demand remains a concern given uneven distribution of rainfall.
- Investment in the economy to get a boost from healthy capex by the Central Government. Private capex to improve amidst rising capacity utilization level.
- Exports have been adversely impacted by global economic slowdown, resulting in widening of India's trade deficit.
- In midst of the global turmoil, India relatively better placed with CareEdge Ratings' GDP growth estimates for FY23 at 6.8-7%.
- CPI inflation rose to 7% in August 2022 after decelerating in the previous three months. We expect CPI inflation to inch below 6% by the end of the fiscal year. High food inflation and volatile commodity prices pose a challenge for domestic inflation.
- RBI has hiked repo rate by 190 bps in last five months to counter inflation.

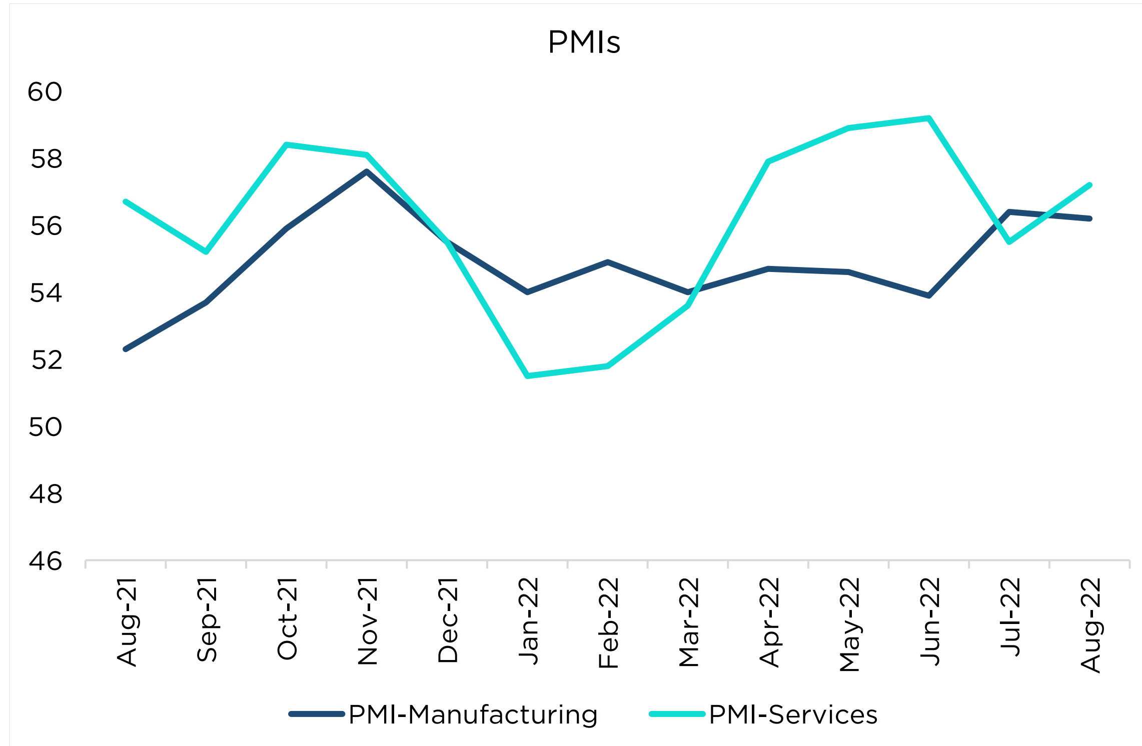
# Deleveraging trend over a long-term horizon



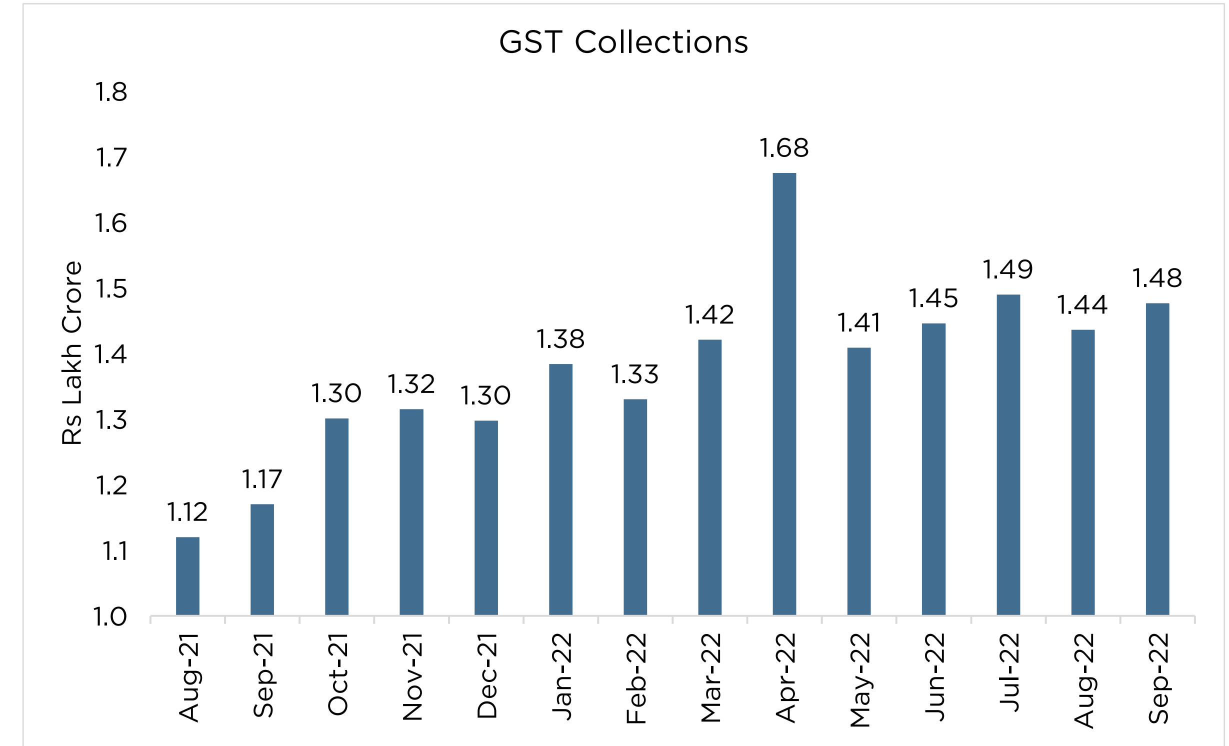

Source: Ace Equity and CareEdge Ratings
*Gearing ratio (i.e. Total Debt / Equity) for top 1000 companies as per market cap

Balance sheets of corporates growing stronger with deleveraging over the last 10 years

# High frequency economic indicators showing improvement



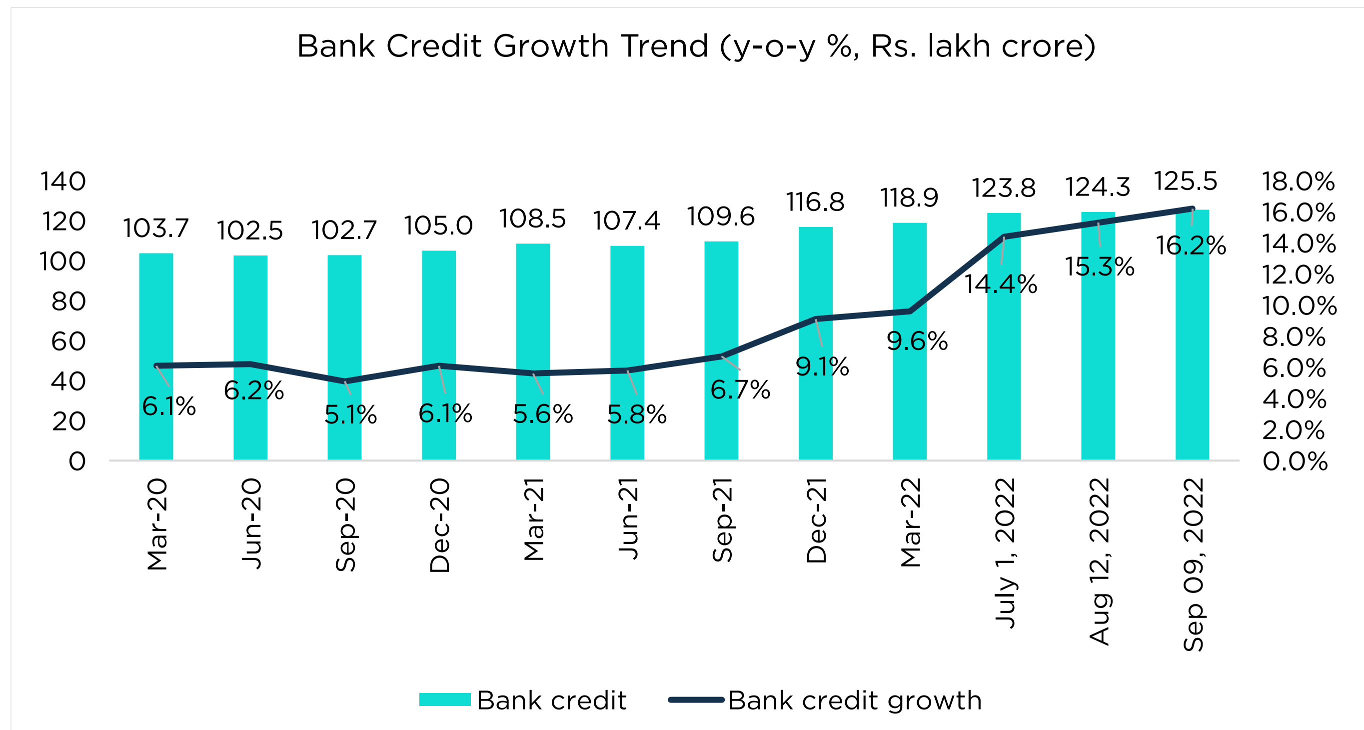

Source: CMIE



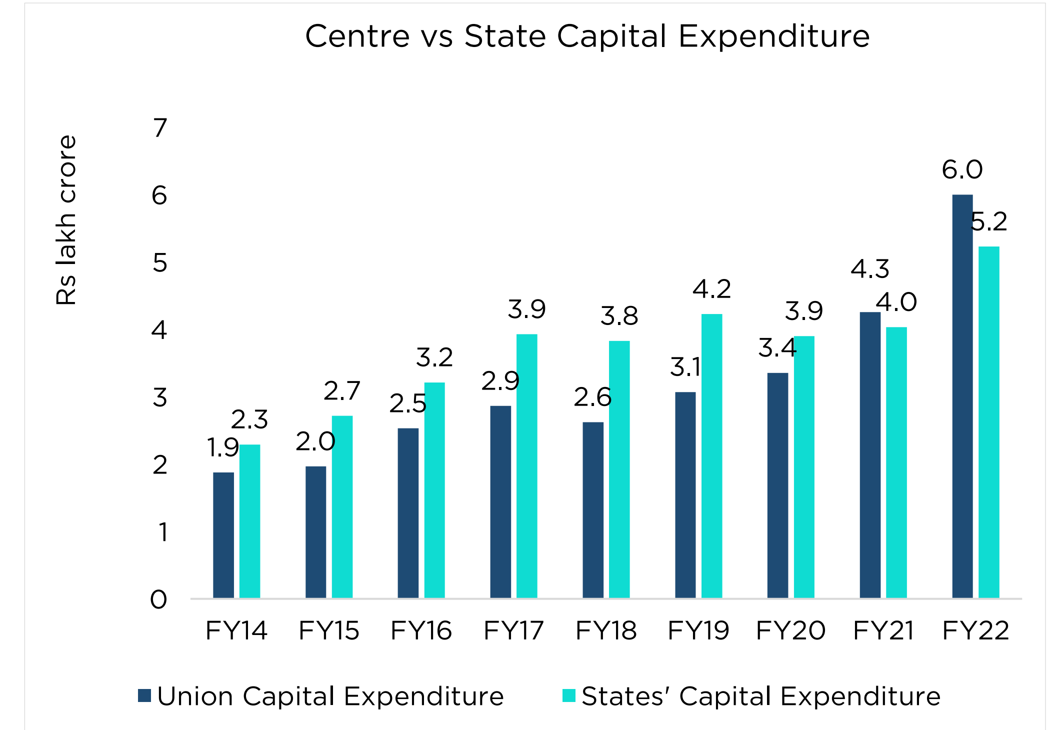

Source: CMIE

- PMI for Manufacturing and Services shows gradual improvement in the expansionary zone (above 50).
- GST collections robust with average monthly collections at over Rs 1.4 lakh crore for the past seven months.
- Other high frequency indicators like auto sales, e-way bill collections, imports (non-oil and non-gold) also showing improvement.

# Credit Demand shows momentum




Source: RBI




Source: Comptroller and Auditor General of India (CAG) and CGA; *Note: States' capital expenditure is for a total of 27 states

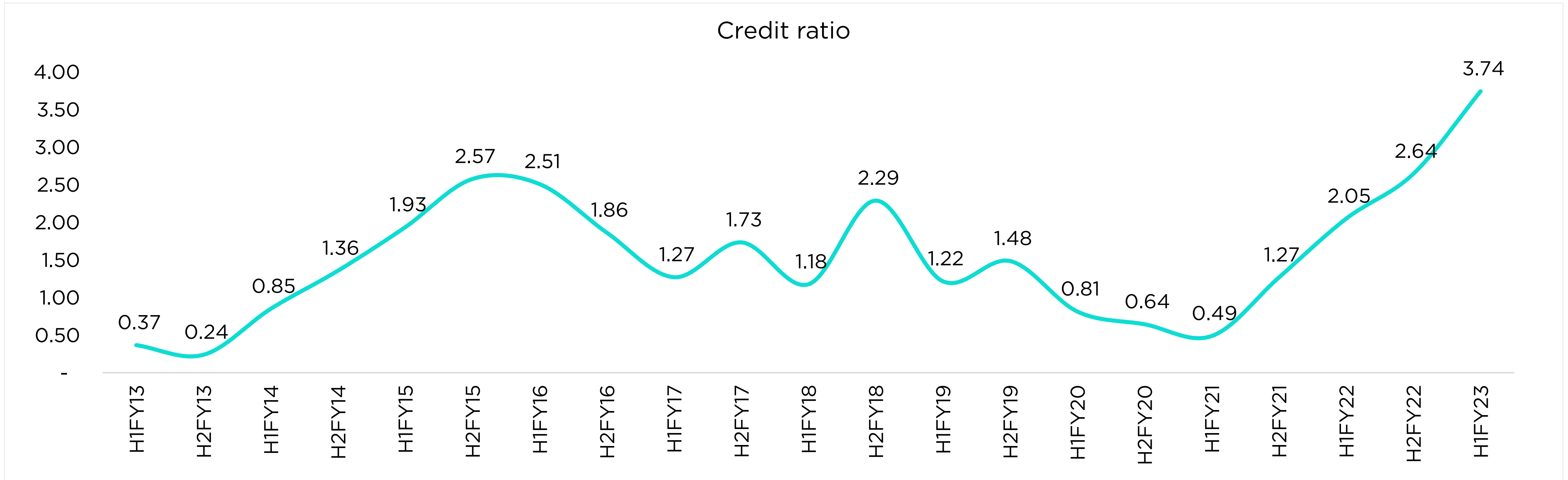
- Gross bank credit witnessed double-digit growth of 16.2% y-o-y in September 2022. Credit growth has maintained its growth momentum driven by sustained retail and rising corporate loan growth. This rise is likely to continue in FY23, however, it could be tempered by inflation and rate hikes.
- Centre and State capital expenditures have shown high improvement over the last 9 years.

CareEdge RATINGS

CareEdge
RATINGS

# Ratings Portfolio

# Credit Ratio at an all time high



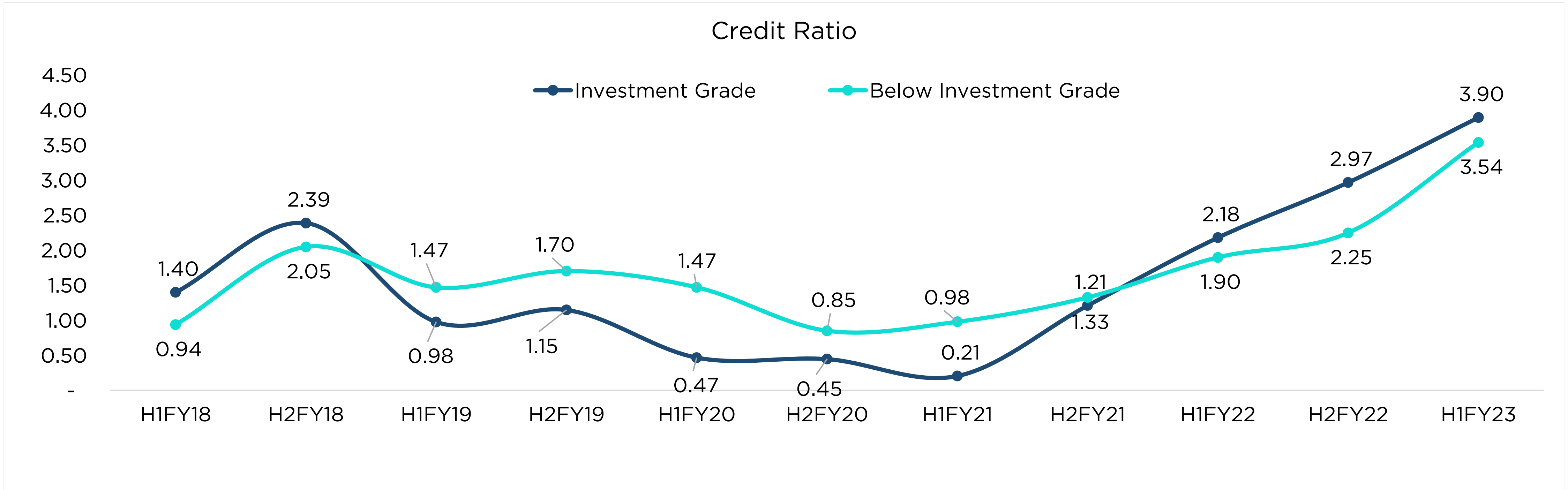

Source: CareEdge Ratings

**Credit Ratio = Upgrades/Downgrades -** A ratio higher than unity denotes more upgrades than downgrades. An increase in ratio as compared to previous periods denotes an improvement in the credit quality of rated entities and vice versa.

The credit ratio improved to 3.74 times in H1FY23 from 2.64 times in H2FY22, led by high number of upgrades in the manufacturing sector.

CareEdge RATINGS

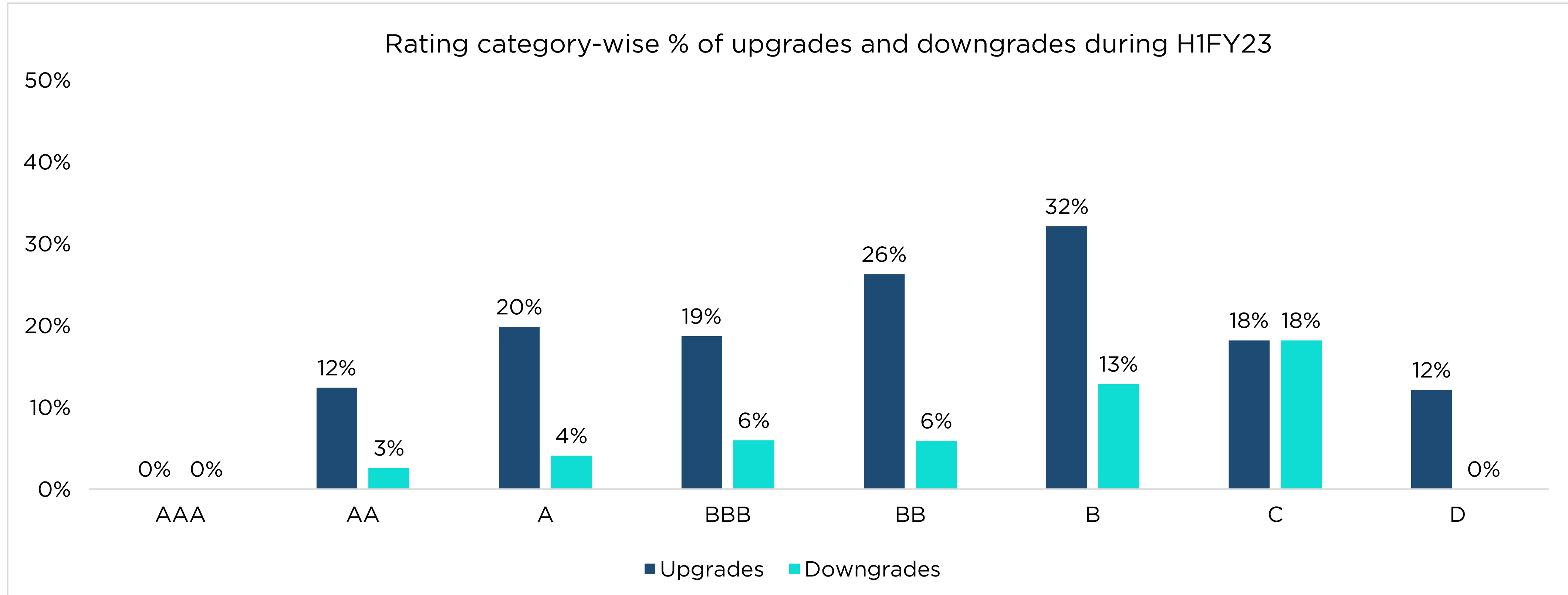
# Credit ratio of both IG and BIG at its peak




Source: CareEdge Ratings
Investment Grade: CARE BBB- and above ratings
Below Investment Grade: CARE BB+ and below ratings

The credit ratio of both, Investment grade (IG) and Below investment grade (BIG) entities for H1FY23 is at an all-time high.

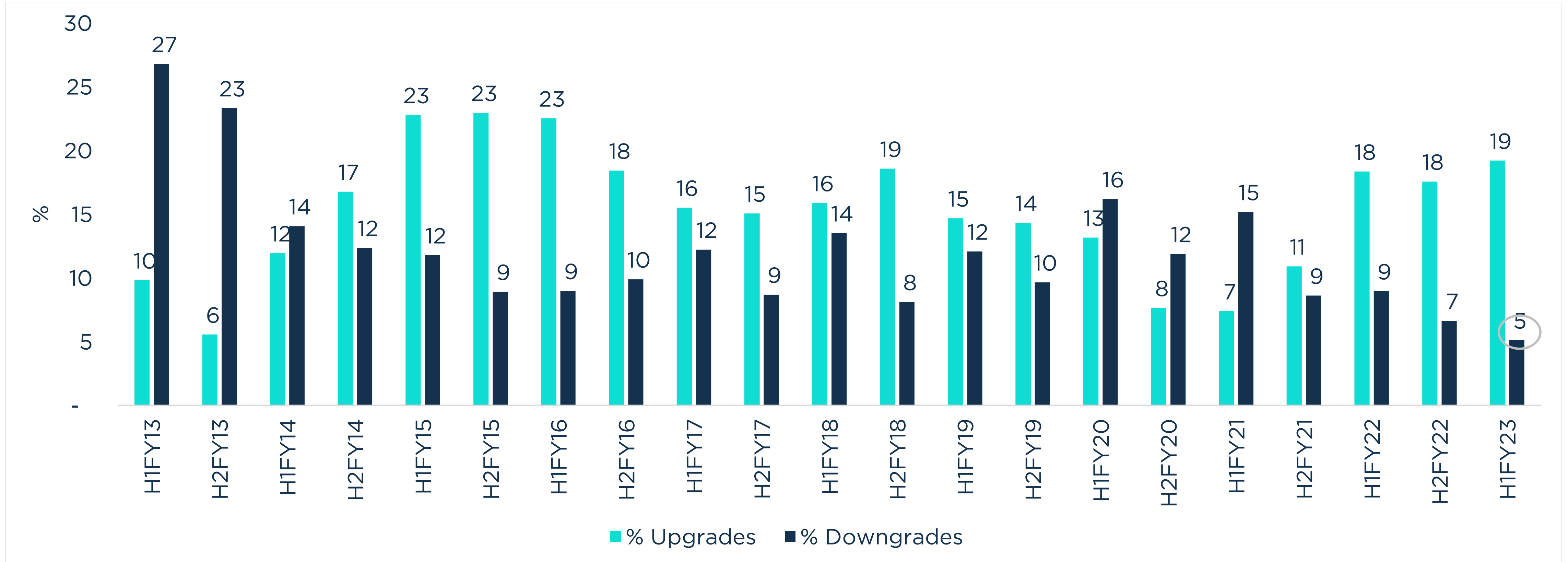
# Upgrades spread across Rating Categories




Source: CareEdge Ratings

CareEdge RATINGS

# Lowest % of downgrades in the last decade



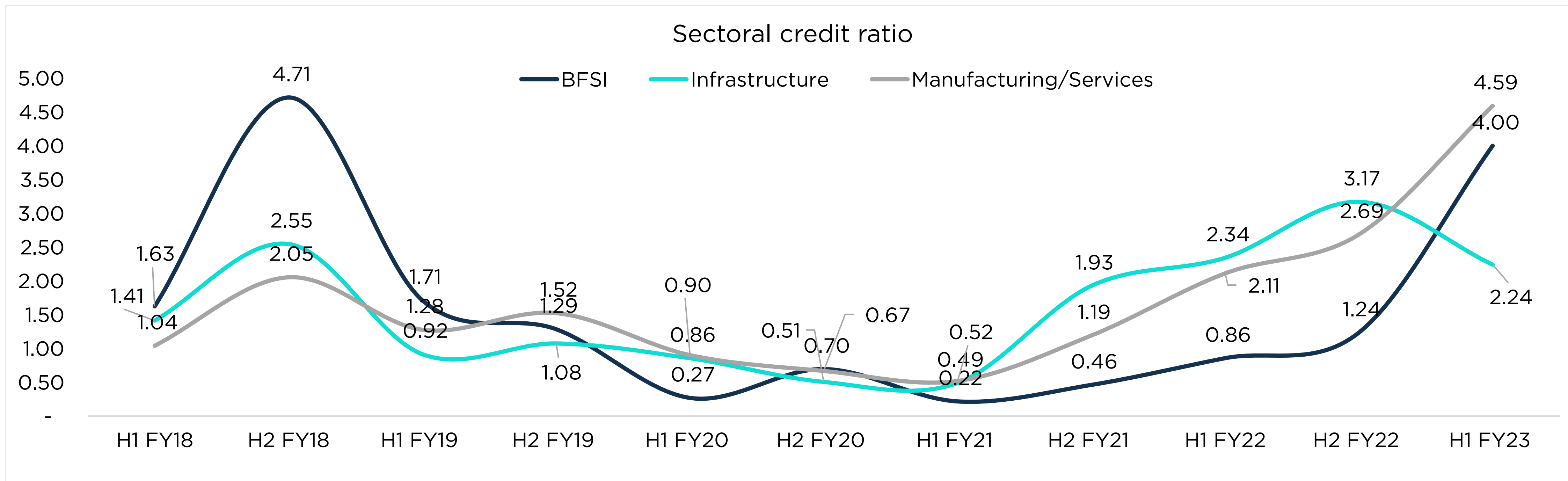

Source: CareEdge Ratings

CareEdge RATINGS

CareEdge RATINGS

# Sectoral Credit Ratio trends

# Broad- based uptick across sectors




Source: CareEdge Ratings

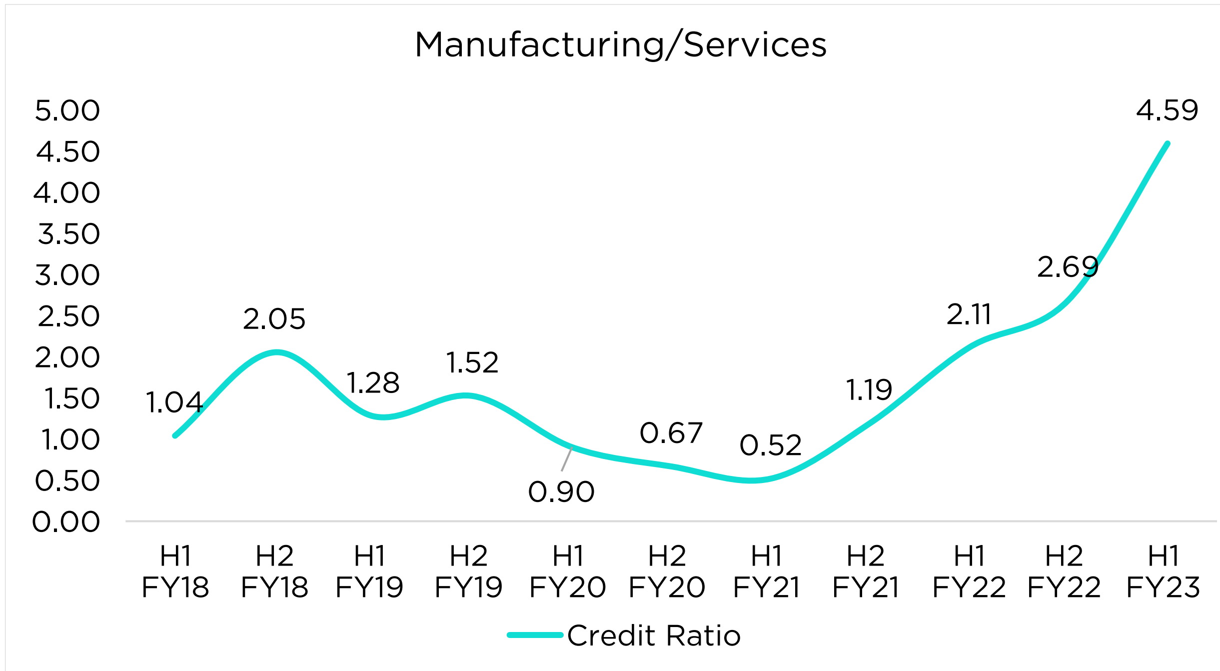
- Broad-based uptick across sectors in H1 FY23 driven by Manufacturing/Services sector due to deleveraging of balance sheets, growth in domestic demand and support from Govt initiatives like PLI and Gati Shakti, and China + 1 strategy
- Similarly, BFSI sector has seen the sharpest improvement, driven by NBFC upgrades, riding on equity infusion and growing scale of operations amid stable asset quality and waning of the pandemic threat.
- Infrastructure has seen moderation in credit ratio in H1FY23 as compared to H2FY22. However, upgrades still significantly outnumbered downgrades.

CareEdge RATINGS

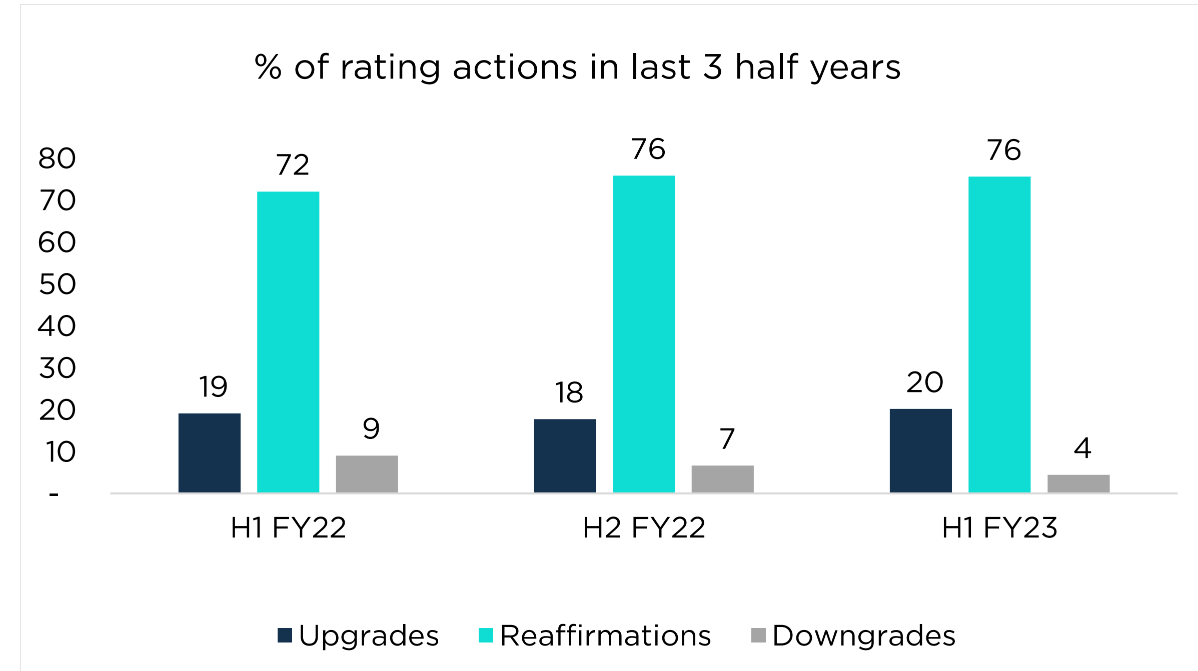
CareEdge
RATINGS
Manufacturing
/ Services

# Manufacturing/Services: Resilient Credit Quality

Outlook: Stable




Source: CareEdge Ratings




Source: CareEdge Ratings

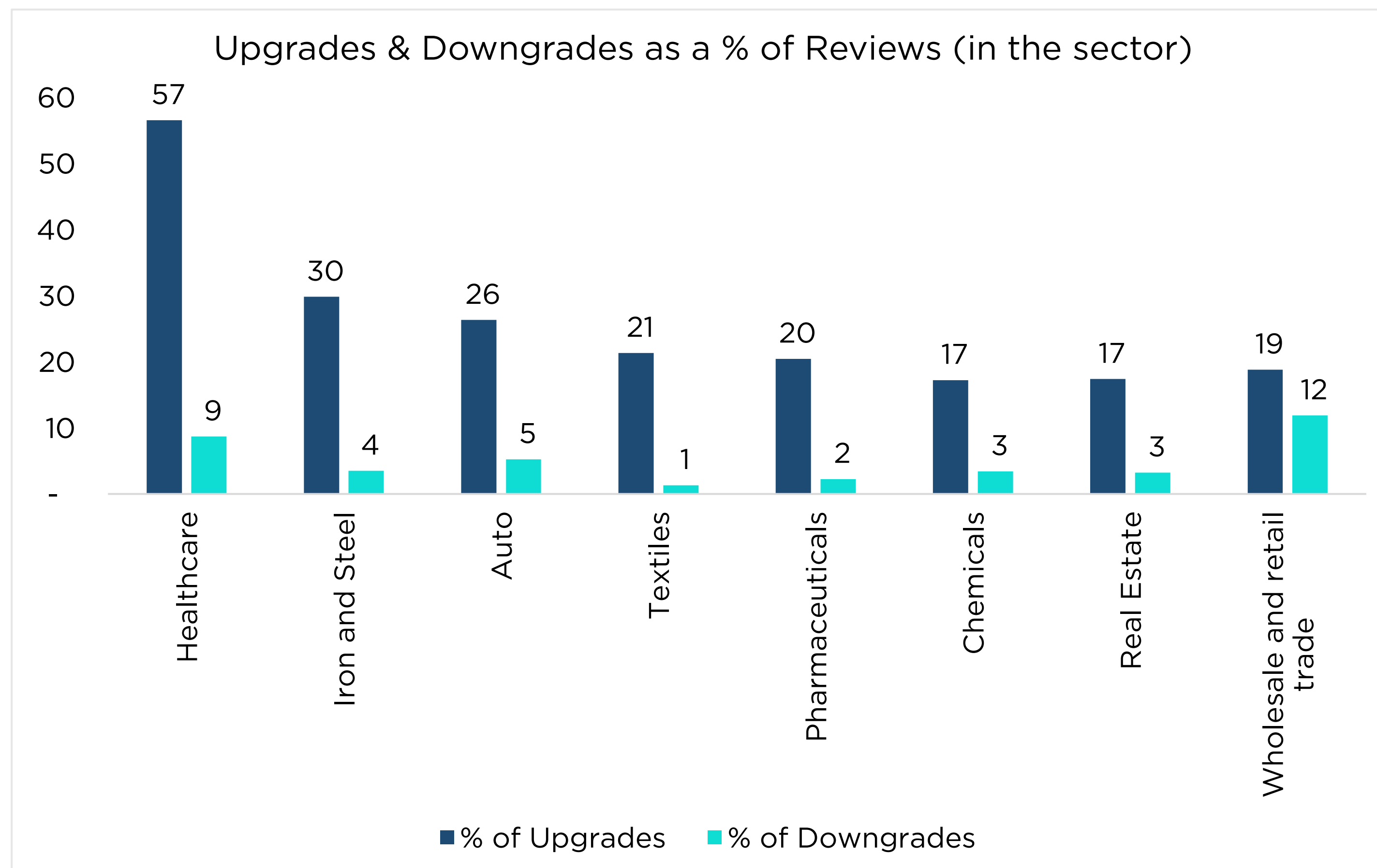
Higher proportion of upgrades in H1FY23 attributed to:

- Demand growth domestically
- Credit quality supported by deleveraging efforts of corporates
- Government initiatives

CareEdge RATINGS

# Manufacturing/Services: Resilient Credit Quality

Outlook: Stable

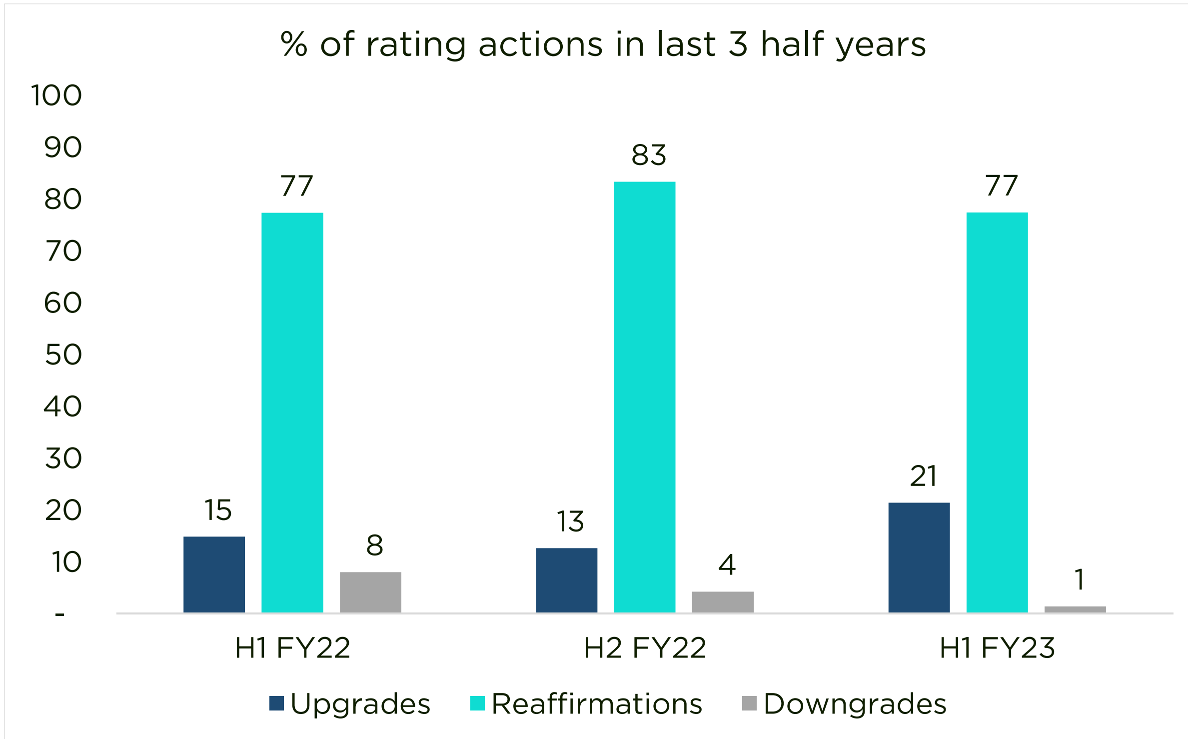



Source: CareEdge Ratings

**Outlook:**

- Majority of the upgrades were contributed by sectors such as Auto and Auto ancillaries, Steel, Healthcare, Textiles, Chemicals, Pharmaceuticals and Real estate.
- The uptrend in the credit quality is expected to continue in some sectors due to higher demand in the economy, improvement in profitability in H2FY23 after a moderation in H1FY23, and significant deleveraging by India Inc.
- Government spending on infrastructure and schemes such as PLI, Gati Shakti and National Infrastructure Pipeline (NIP), and China + 1 strategy would continue to aid India Inc.
- Impact of Russia-Ukraine crisis, recessionary trends in the US and EU, inflationary pressures and rising interest rates are key monitorables on credit risk.

# Textiles: Stitching Demand under Cost Pressure




Source: CareEdge Ratings

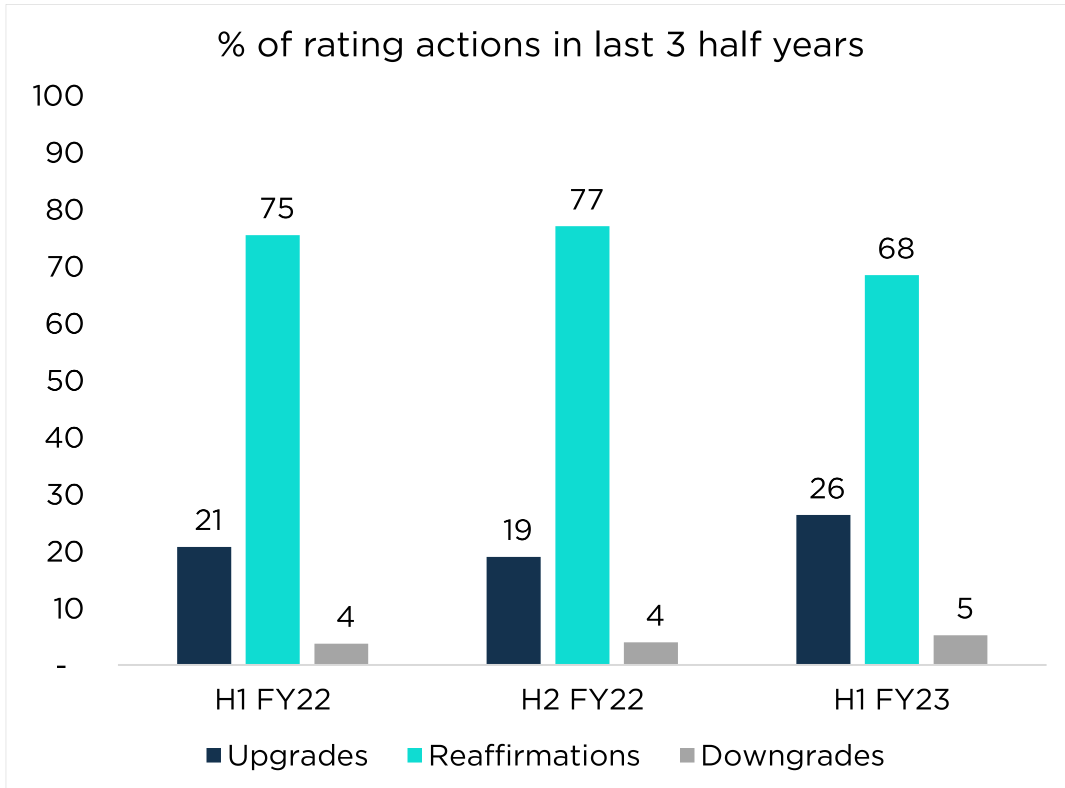
**Upgrades driven by:**

- Strong demand, both in domestic and international markets post removal of Covid restrictions.
- Indian exporters continued to derive benefit from the China+1 strategy, sourcing restrictions of Xinjiang (China) cotton and prolonged Covid impact in China.
- Strong demand across various segments of textile industry resulted in improved cash flows and leverage position.

**Outlook:**

- Cotton prices expected to moderate with arrival of new crop post October 2022, but will remain higher than pre Covid levels on account of US ban on Xinjiang cotton and weather calamities in US and Pakistan.
- High Cotton-Polyester Staple Fibre (PSF) spread has led to increased substitution of Man-Made Fibre (MMF) benefitting MMF companies.
- Cotton spinners are expected to benefit from softening cotton prices.
- Readymade Garments (RMG) expected to witness buoyant demand in domestic market while increased inflation in global economy may impact export demand.

# Auto : Demand Picking up Gear




Source: CareEdge Ratings

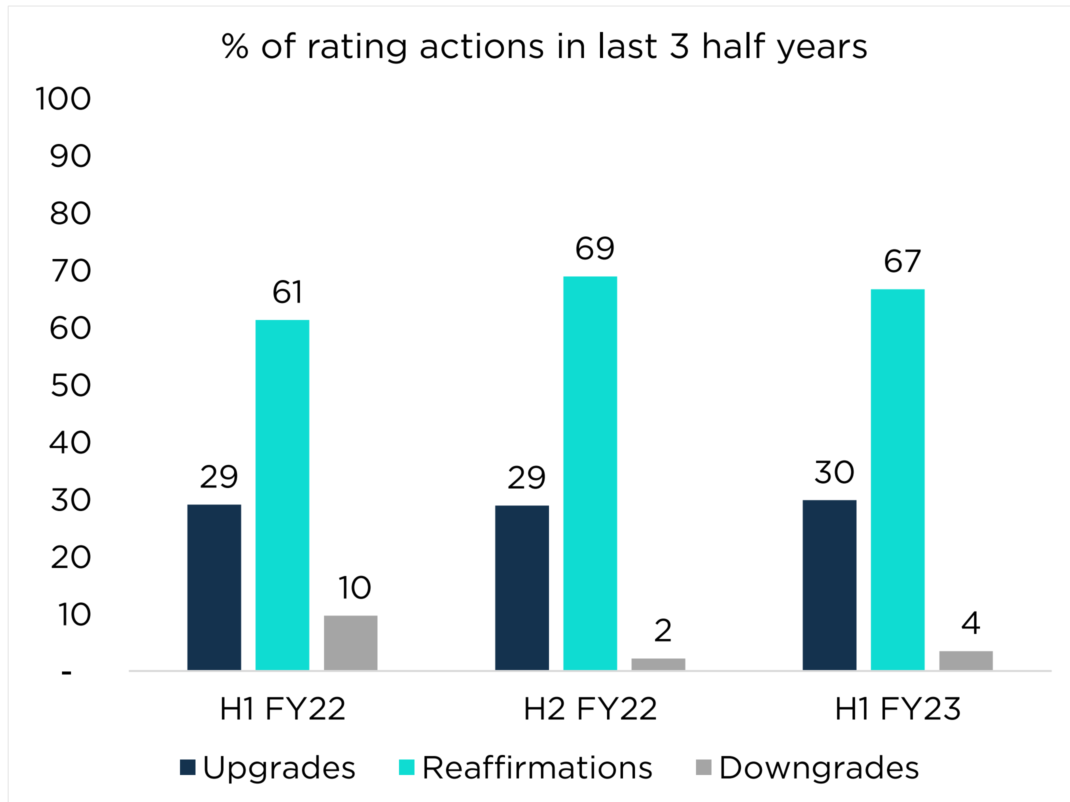
**Growth in sales volumes of auto OEMs being driven by:**

- Ease of supplies of semi-conductor chips.
- Uptick in manufacturing, infrastructure and construction segments leading to increased demand for Medium & Heavy Commercial Vehicles (MHCVs).
- Last mile uptick from e-commerce segment sustaining demand for Light Commercial Vehicles (LCVs).
- Higher urban demand off-setting weak rural demand and sustaining moderate growth in two-wheeler (2W) segment.

**Outlook:**

- Passenger vehicles to grow at around 8%-10% in FY23 and 6%-8% over FY23-FY25.
- MHCVs to grow at 15%-18% in FY23 and 7%-10% over FY23-FY25.
- 2Ws to grow at 8%-10% in FY23 and 10%-12% over FY23-FY25.
- High fuel prices and rising interest rates to dampen demand for automobiles to an extent
- Overall, the credit profile of auto OEMs is expected to remain stable.
- Auto dealers and ancillaries are also expected to display stable credit profile driven by steady volume growth displayed by the OEMs.

# Steel: Operating Margins to normalise




Source: CareEdge Ratings

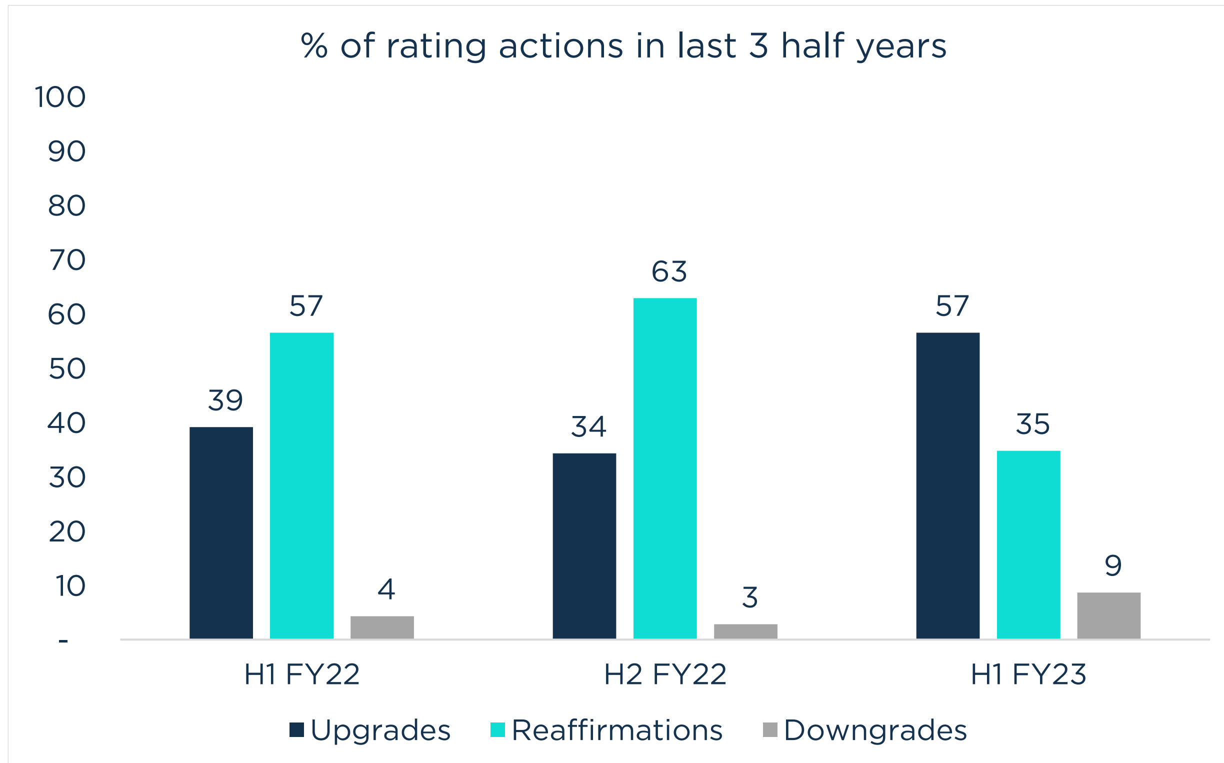
**Upgrades driven by:**

- Improved operating performance in FY22, due to significant improvement in demand and realizations.
- Significant deleveraging activity leading to improvement in debt coverage parameters.
- Improvement in liquidity position of companies

**Outlook:**

- Volatility in raw material prices likely to stabilize during H2FY23.
- For the domestic producers, decline in iron ore prices and increased availability of iron ore owing to export duties has resulted into cost rationalisation.
- Post monsoon, demand recovery is likely to push the prices higher
- With the imposition of export duty on steel products, net exports have recorded a decline. Unless the duty is reduced/withdrawn, export potential would remain impacted.

# Healthcare: Improving Occupancies and Margins




Source: CareEdge Ratings

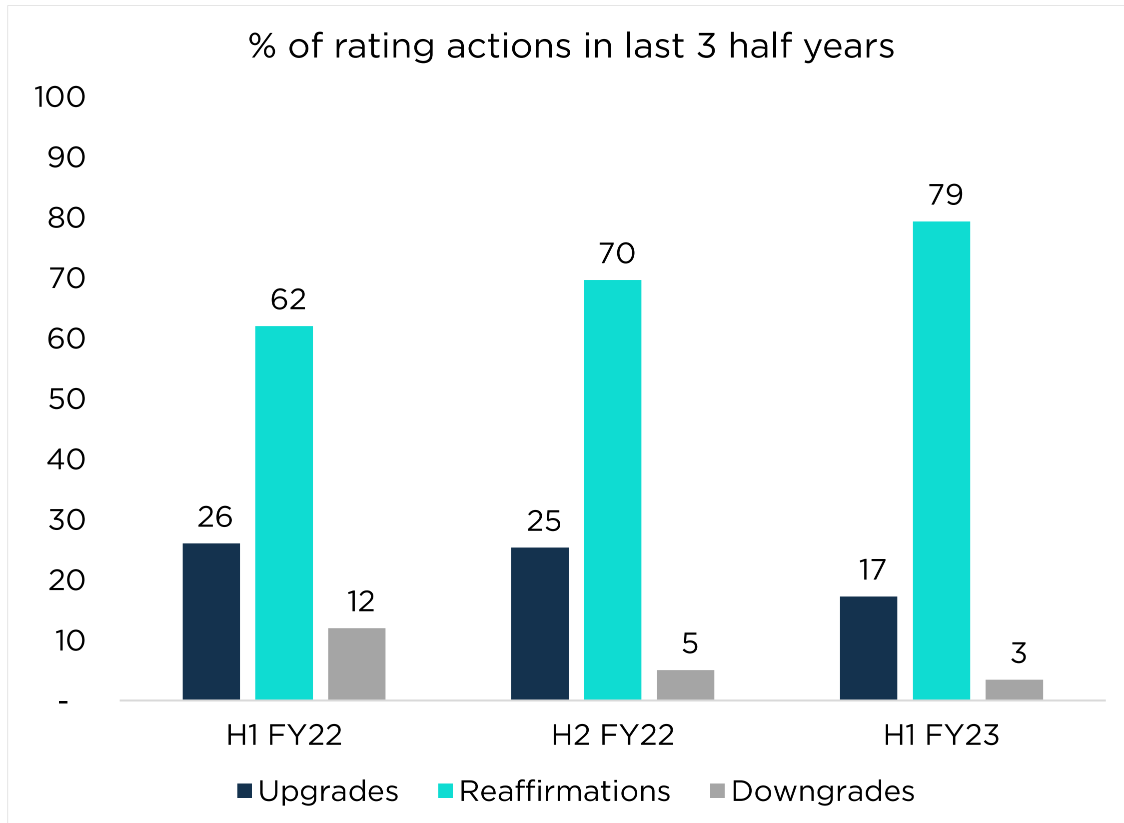
**Upgrades driven by:**

- Higher occupancy and Average Revenue Per Occupied Bed (ARPOB) translating into enhanced profitability and debt coverage indicators.
- Gradual stabilization of hospital operations post pandemic disruption.

**Outlook:**

- Sector expected to witness improvement in profitability driven by better occupancy, higher ARPOBs, price revisions, non-postponement of elective surgeries.
- Benefits from rationalized operational costs and ramp up in international patient business would aid the sector.
- Higher spending expected on greenfield/ brownfield expansion to cater to under-penetrated healthcare reach.

# Chemicals: Demand Uptick with Moderating Margins




Source: CareEdge Ratings

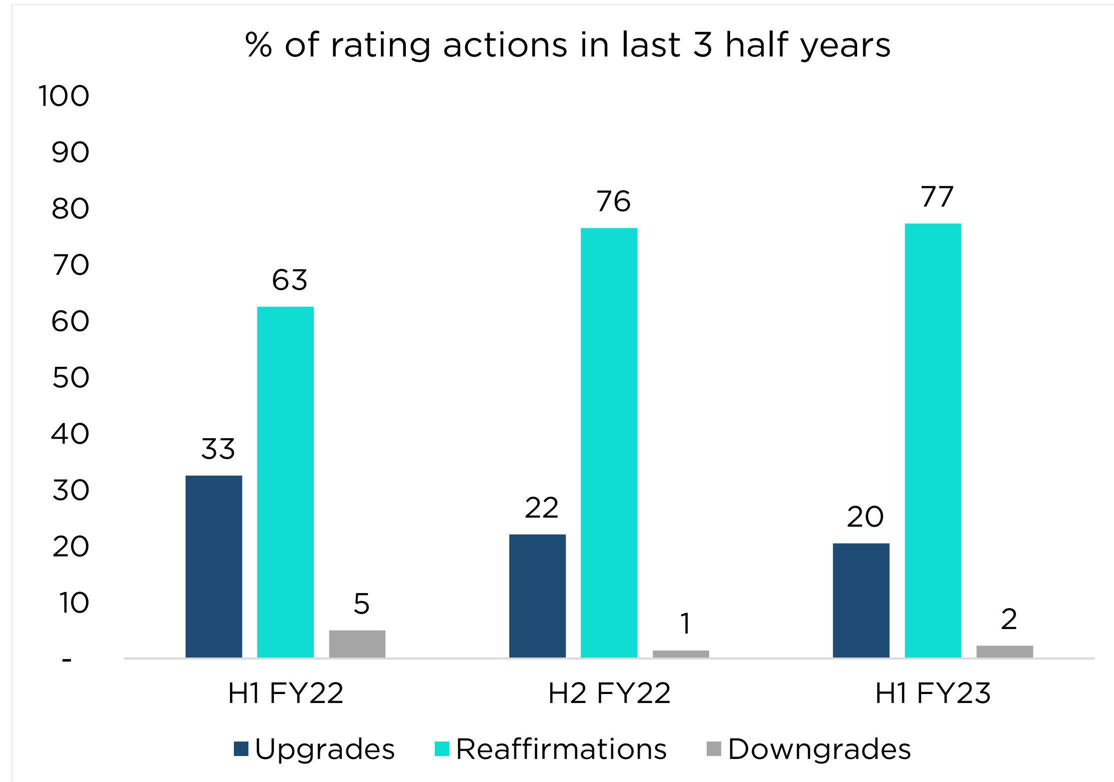
**Upgrades driven by:**

- Improvement in performance and promising sector outlook.
- Domestic players are benefitting from China+1 strategy and import substitution.
- High demand from domestic end user industry.

**Outlook:**

- Sustained growth momentum backed by increase in demand from end user industries, import substitution and benefit from global supply chain diversification of China+1 strategy.
- Raw material prices are expected to remain volatile and elevated in near term.
- Operating margins are expected to moderate by 2-3% during FY23, considering the lag effect of passing-on any volatility in input prices.
- Leverage expected to remain comfortable; capex would largely be funded through internal accruals.

# Pharmaceuticals: Margins set to dip




Source: CareEdge Ratings

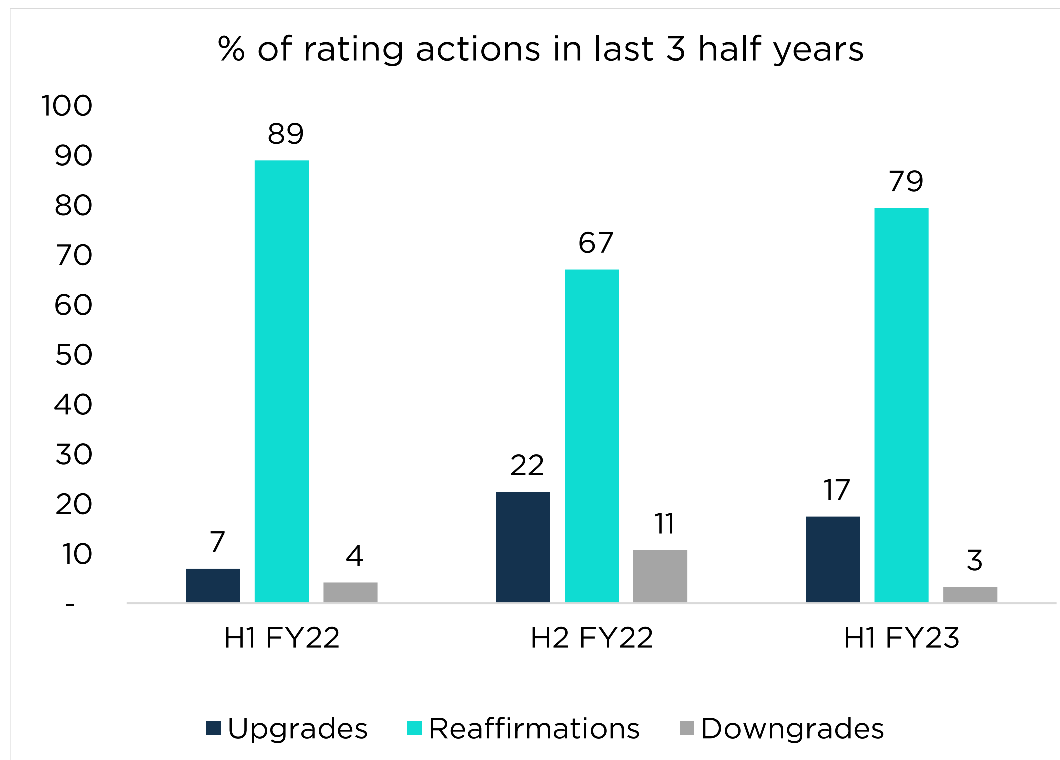
**Upgrades driven by:**

- Continued demand for pharma products.
- Significant equity infusion resulting into strong liquidity.
- Healthy balance sheets with relatively low debt levels.

**Outlook:**

- Operating profitability (PBILDT) margin of the Indian pharma sector would shrink by 200-250 bps during FY23 over FY22 due to an increase in cost of raw materials, primarily, Active Pharmaceutical Ingredients (APIs) and Key Starting Material (KSMs) and increase in the cost of packing material, freight and compliance.
- Exports and domestic markets expected to grow at 6-8% in FY23.
- Credit profile of the pharma companies would remain stable due to their lower reliance on debt and healthy balance sheets.

# Real estate sector: Cementing Demand Momentum




Source: CareEdge Ratings

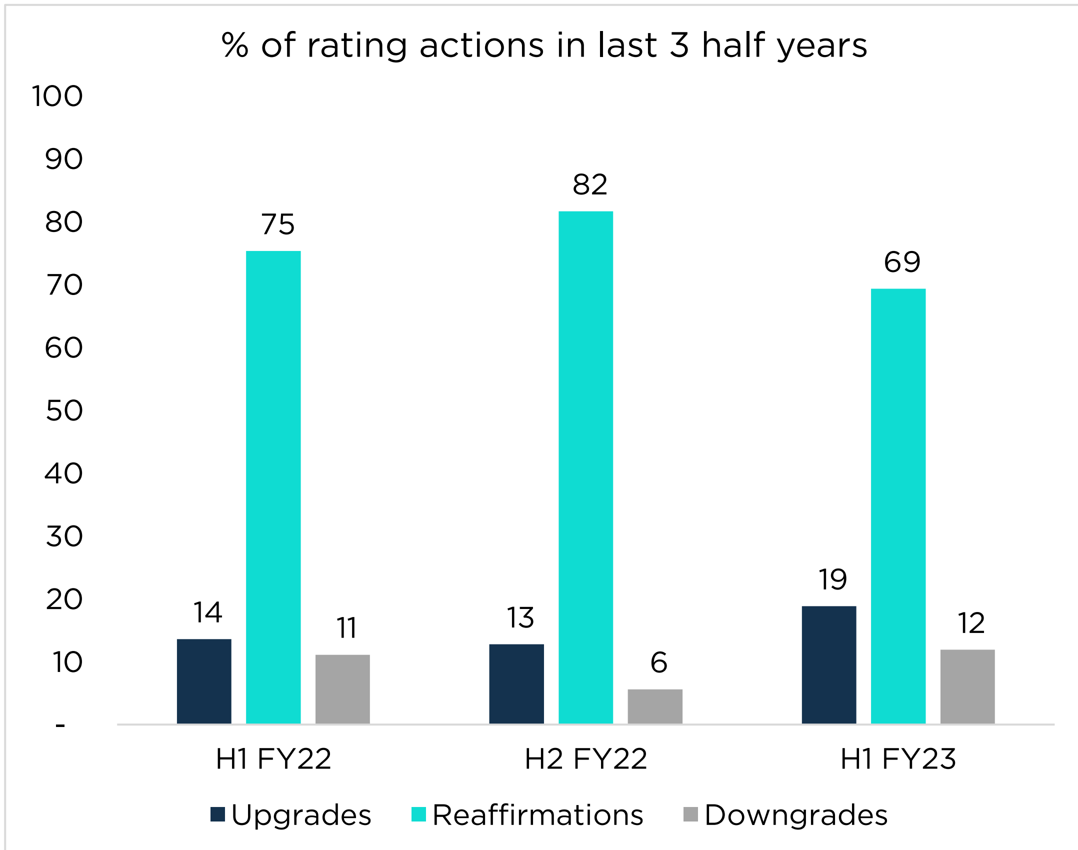
**Upgrades driven by:**

- Healthy sales and collection during FY22 leading to lower than envisaged debt levels.
- Improved occupancy levels in leased assets.
- Significant project construction reducing execution risk.

**Outlook:**

- Residential - housing demand and launches expected to remain healthy. Affordable and mid income segment shall continue to spur the launches ahead.
- Commercial leasing – demand for office space expected to remain stable supported by resumption of back to office plans and robust hiring in IT/ITES sector. Rental rates remain monitorable.
- Warehouse leasing growth prospects are driven by demand for Grade A warehouses with rising demand from e-commerce and third-party logistics (3 PL) players.
- Lease demand from retail segment is also expected to remain stable with increasing footfalls post the pandemic. Food and beverage (F&B), apparel and entertainment continue to drive footfalls.

# Wholesale and Retail trade: Growth supported by resilient domestic economy




Source: CareEdge Ratings

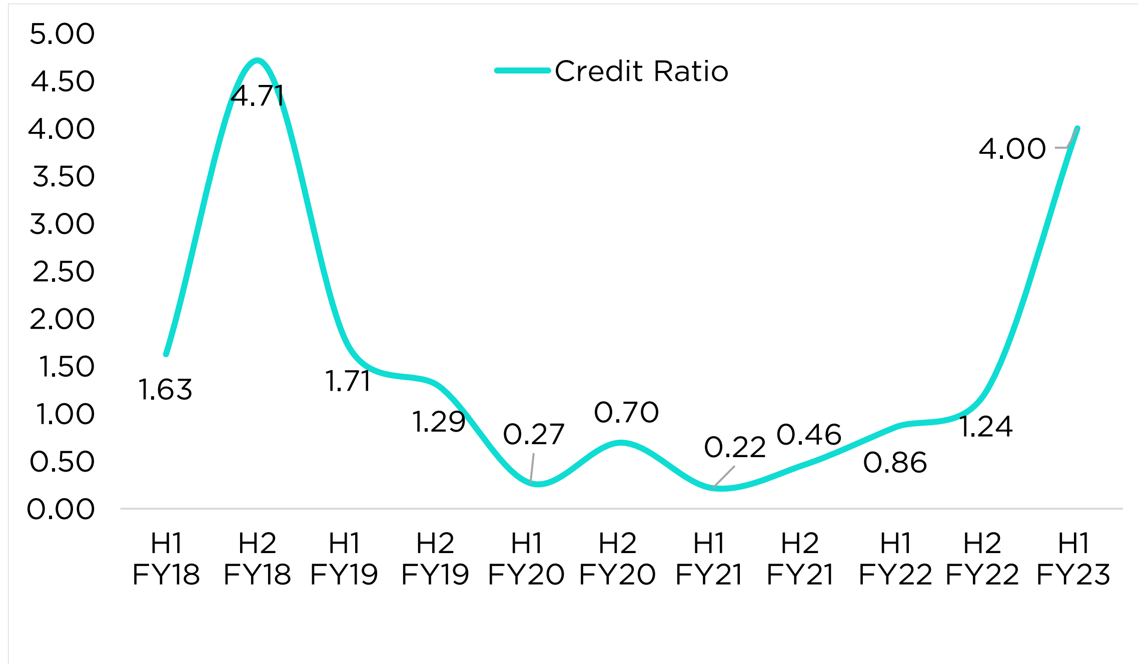
Upgrades were due to increase in scale of operations and better profitability with restoration of supply chain issues and uptick in overall demand scenario.

**Outlook:**

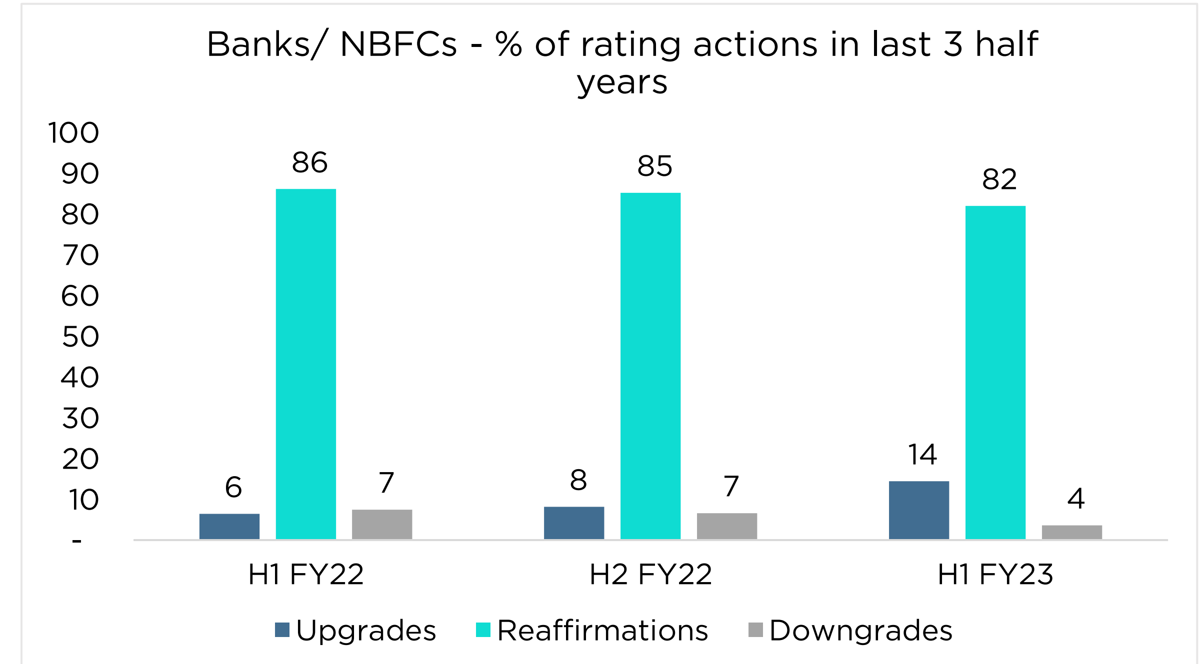
- Global inflationary pressures, monetary tightening by central banks and heightened concerns around recession in major economies are expected to impact the global trade outlook.
- Export-oriented trading entities are likely to feel the pinch of slowdown in global growth.
- The import momentum is expected to continue fueled by a rebound in domestic economic activity.
- Domestic demand outlook remains resilient with uptick in infrastructure projects, some easing of inflation and onset of festive season.
- Robust GDP growth expectation of 6.8-7% of CareEdge augurs well for the prospects of trading entities.

CareEdge
RATINGS
Banking and Financial Services

# BFSI: Sharpest rise in Credit Ratio




Source: CareEdge Ratings




Source: CareEdge Ratings

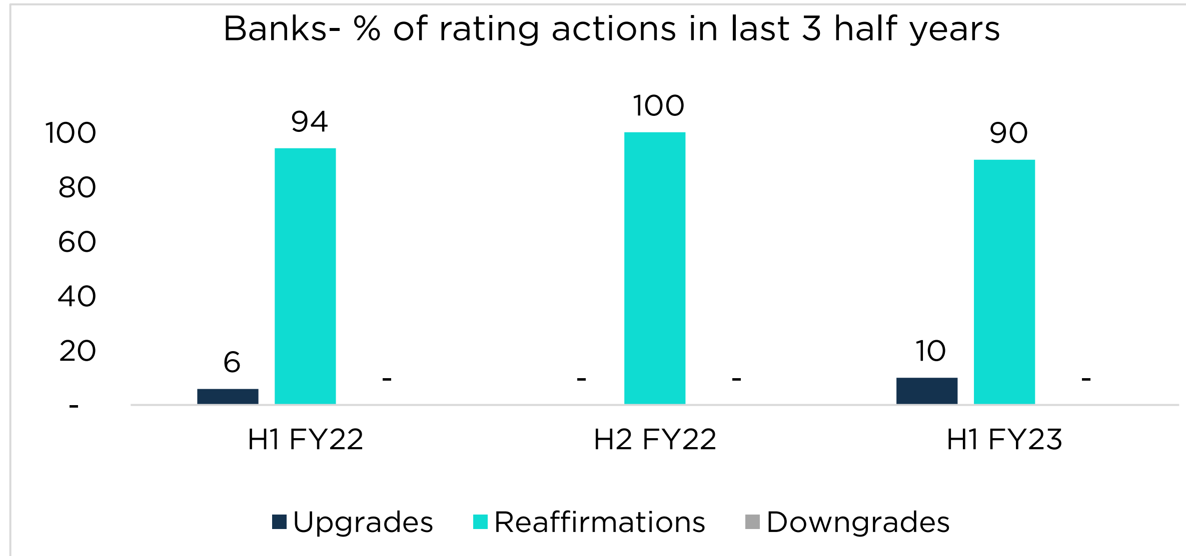
NBFCs and HFCs saw major upgrades in the BFSI sector. Higher proportion of upgrades in H1FY23 attributed to:

- Proven resilience in business and asset quality, despite liquidity crisis and Covid impact, especially for NBFCs funding mortgages and other secured assets.
- Significant fund infusion by promoters and marquee private equity players.
- Scaling up of operations and asset base supported by liquidity and restricted leverage.

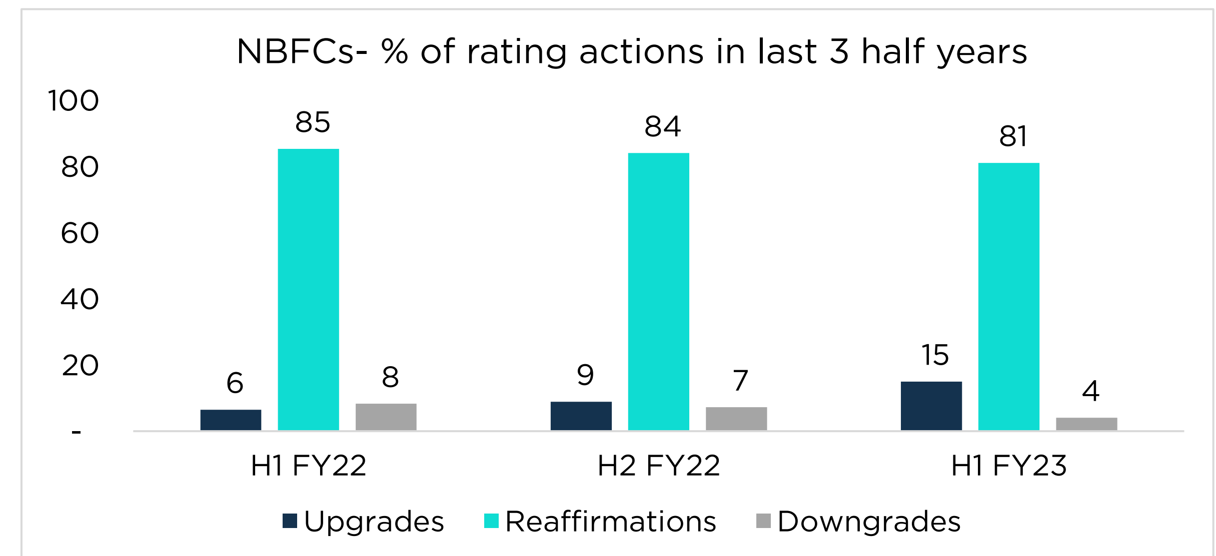
CareEdge RATINGS

# NBFCs to drive growth in BFSI sector

Outlook: Stable




Source: CareEdge Ratings




Source: CareEdge Ratings

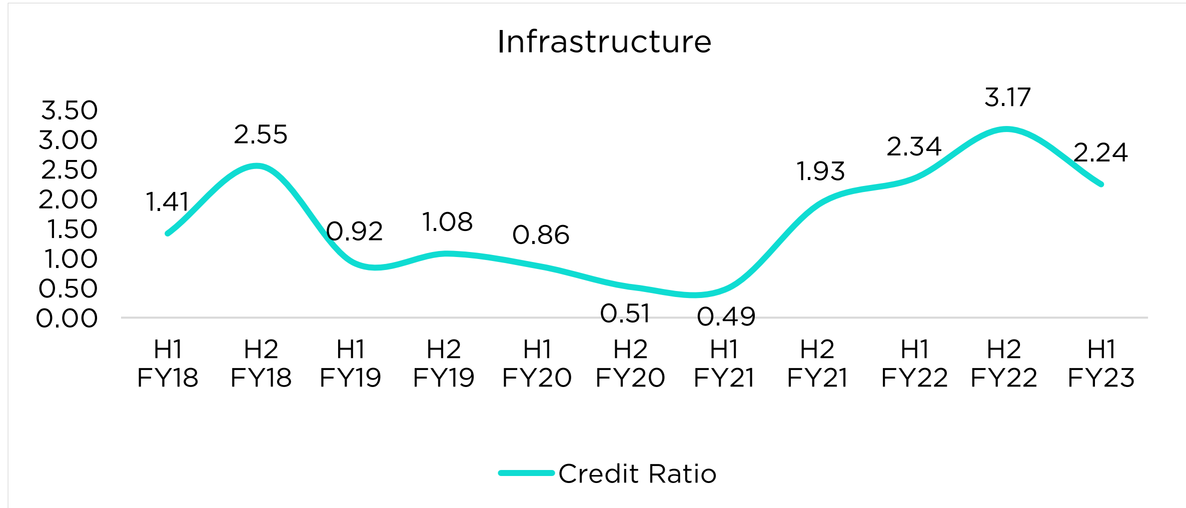
- The credit outlook is expected to be stable for Banks and NBFCs with scaling up of operations.
- Banking sector has seen significant turnaround with cleaning up of balance sheets after years of credit quality issues post Asset Quality Review (AQR) and idiosyncratic issues.
- The Gross NPA figures are likely to move to 5% or lower and move towards the pre-AQR figure of 4%. This has improved profitability of almost all banks.
- Overall, NBFCs/HFCs have shown significant growth in Q1FY23, which is likely to sustain for the rest of the year with improved access to equity and bank funding.
- Ability to access debt funding and rising interest rates are key monitorables. Rising interest rate is a risk to both profitability as well as to the ability of borrowers to repay.

CareEdge RATINGS

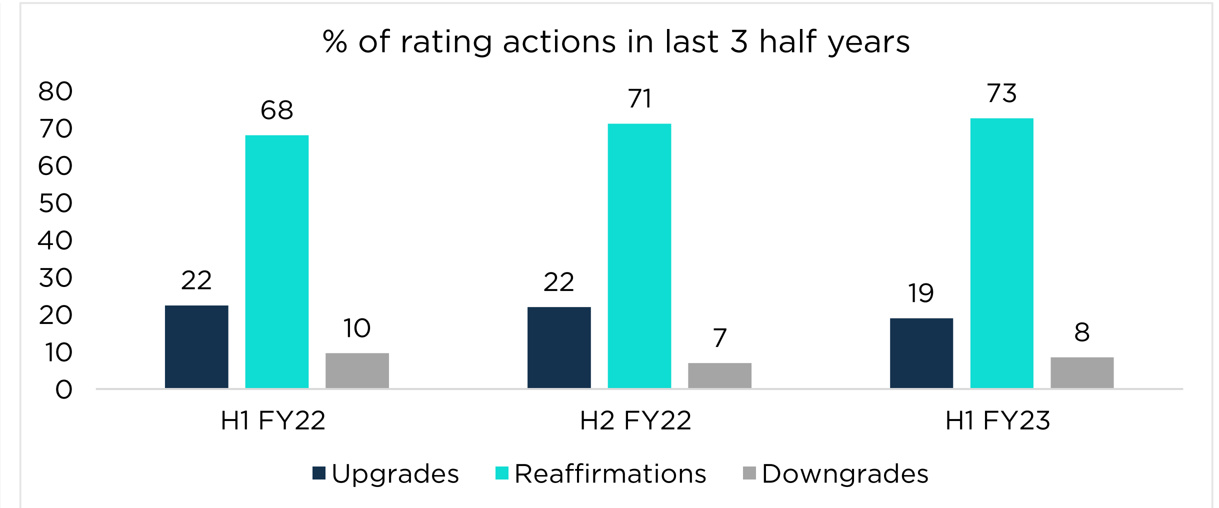
CareEdge
RATINGS
Infrastructure

# Infrastructure: Upbeat momentum with slight moderation

Outlook: Stable




Source: CareEdge Ratings




Source: CareEdge Ratings

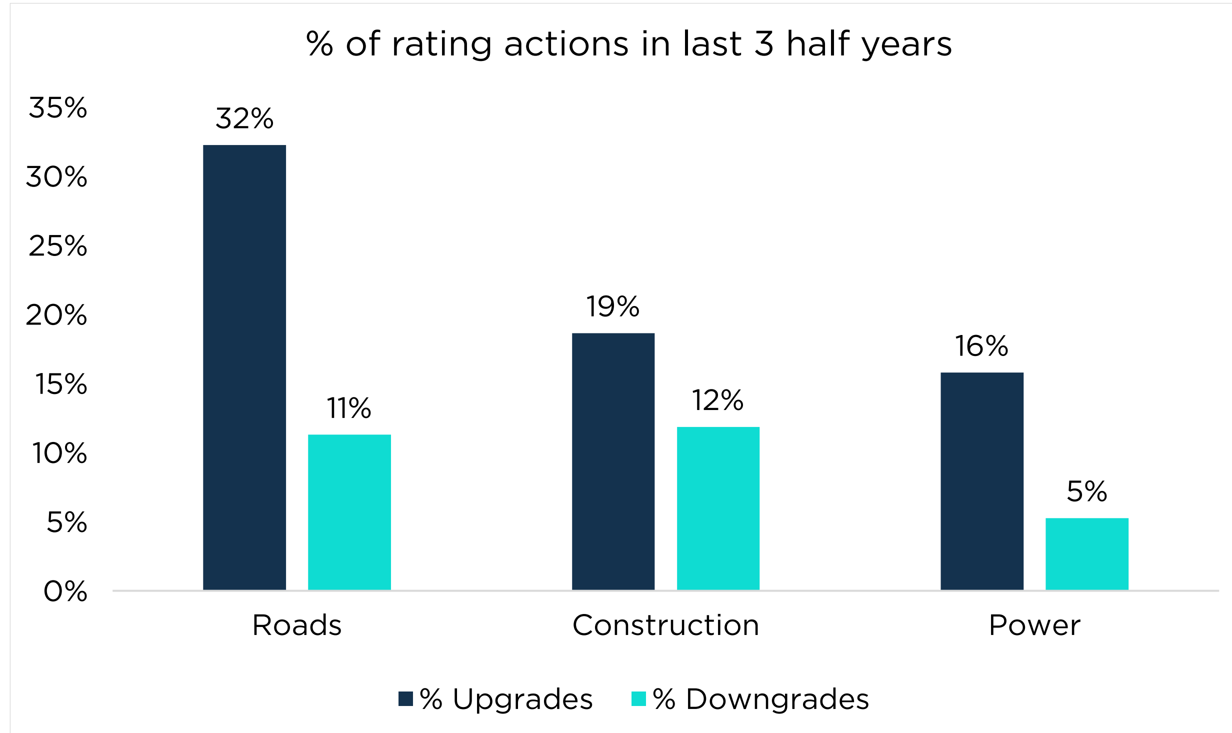
Credit ratio for Infrastructure continues to be upbeat – Roads, renewables are the front-runners followed by EPC segment.

**Key identifiable drivers**:

- Commissioning of projects, especially in the road Hybrid Annuity Model (HAM) segment & solar power generation space.
- Benefits of Atmanirbhar Bharat scheme providing a fillip to operating companies.
- Enhanced pace of execution along with strong order inflows.
- Operational projects viz. toll roads, ports, etc. recording robust revenue performance with opening up of the economy.
- Refinancing of projects at better financing terms and structured financing avenues like InvITs.

CareEdge RATINGS

# Roads to drive infra upgrades; Construction and power sector holds steady ground

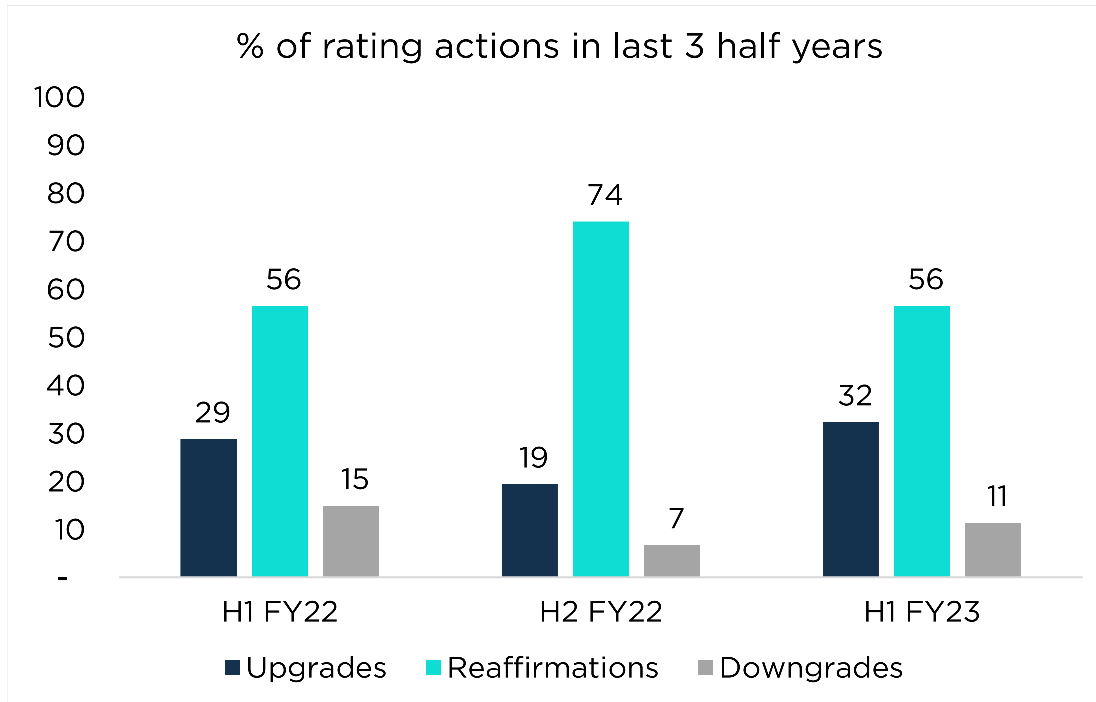



Source: CareEdge Ratings

**Outlook:**

- Continued healthy collection expected for GENCOS selling on merchant basis.
- Imported coal prices to remain high amid global uncertainties.
- Renewables tariff to rise but shall remain competitive.
- Revenue visibility enhanced with infrastructure push by the Government – Transportation segment to drive growth in awards.
- EPC Margins to recover from FY22 levels with addition of orders at new rates/reduction in commodity prices from peak level.
- Rising interest rates may impact the bottom line.

# Roads: Speeding well, strong operational performance leads the way




Source: CareEdge Ratings

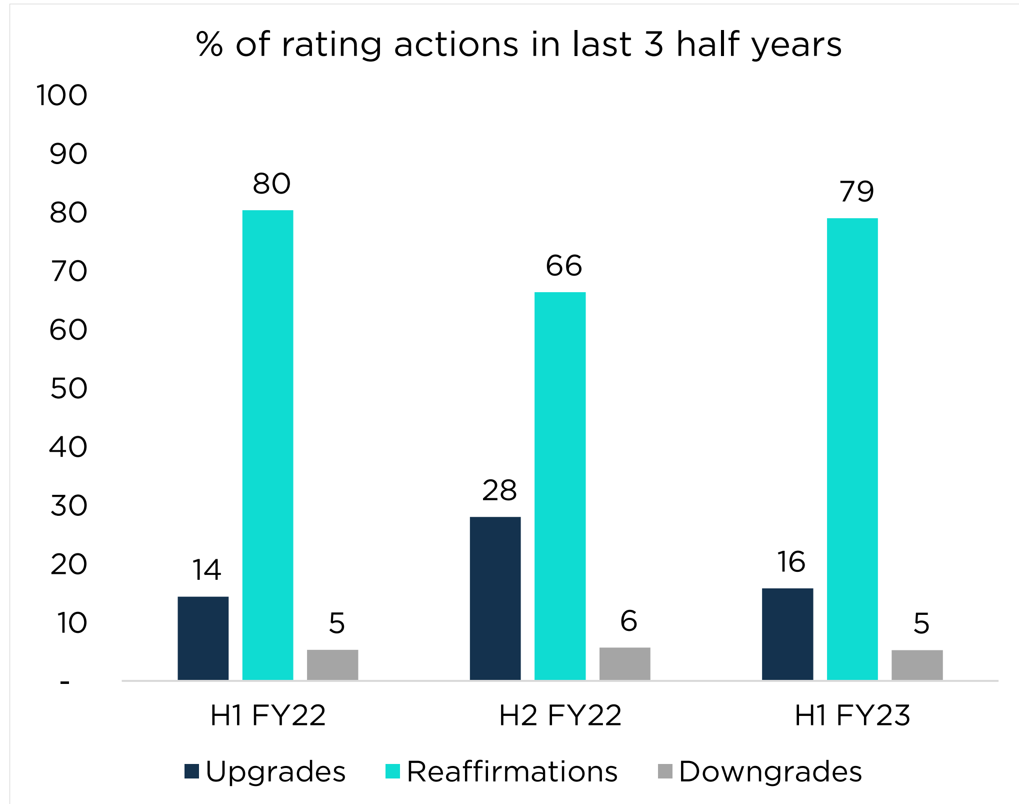
**Upgrades driven by:**

- Hybrid Annuity Model (HAM) Projects achieving Commercial Operations Date (COD).
- Significant reduction in finance costs with refinancing post receipt of annuities in completed HAM projects.
- Robust toll performance despite Covid.

**Outlook**:

- Project awards to be lapped up by large players as bidding appetite of midsized players to wane amid new bidding norms by NHAI.
- Hike in toll rates mirror higher WPI - To partially offset increase in borrowing costs.
- CareEdge Ratings estimates toll collections to grow by 16-18% in FY23 due to WPI linked hike in toll rates and traffic revival.

# Power : Release of dues from Discoms, lucrative merchant tariffs are key drivers




Source: CareEdge Ratings

**Upgrades driven by**

**Thermal/Hydro:**

- Surge in power demand pushing up spot prices leading to better realizations.
- Higher realization from Discoms bolsters liquidity and leverage profile.
- Additional tie up of power through medium term Power Purchase Agreement (PPAs).
- Commercialization/capacity ramp up of captive mine/unit – better operating efficiencies.

**Renewable**

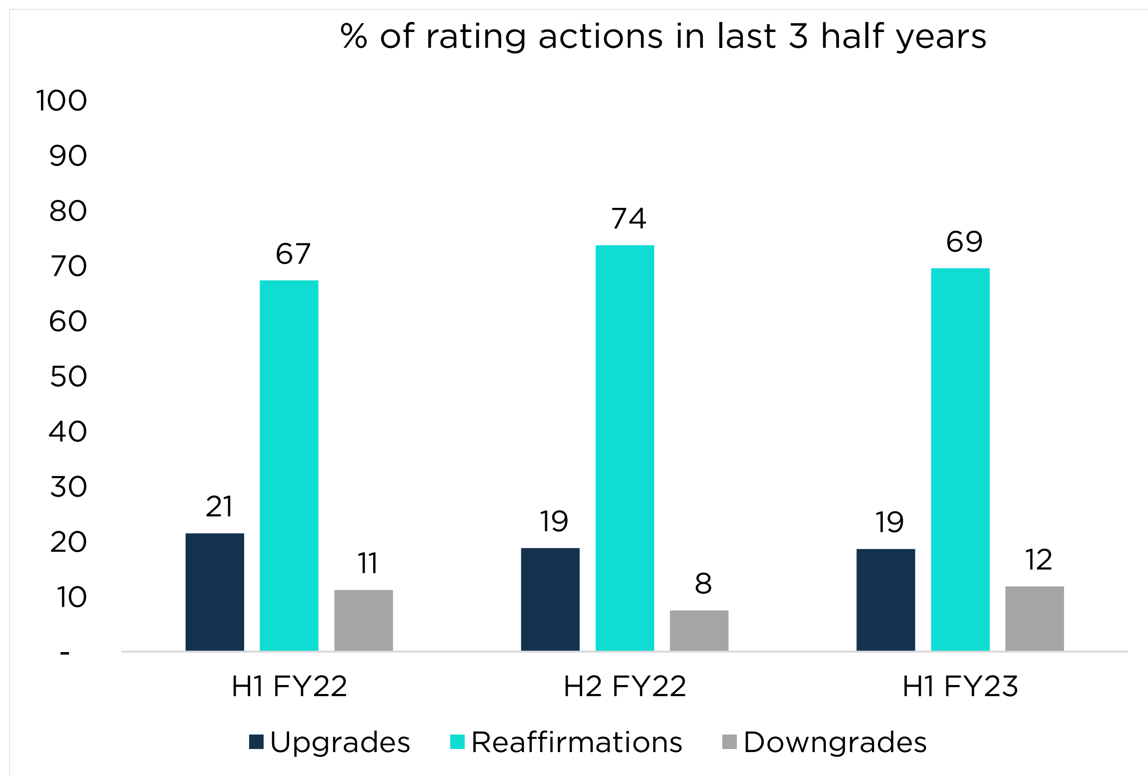
- Longer operational track record with better PLFs.
- Refinancing debt at better terms for commissioned projects.

**Outlook:**

- Strong power demand to ensure elevated merchant tariff rates.
- Imported coal prices to remain high amid global uncertainties; may witness improved domestic coal availability from Q3FY23 onwards.
- Continued healthy collection for Gencos selling on ST basis
- Gradual improvement in receivables from Discoms -Increased participation of Discoms to liquidate overdues as per EMI scheme launched by the Power Ministry.
- Renewables tariff to rise but shall remain competitive vis a vis conventional power.
- Interest rate increase to impact the bottom line of Gencos, more so for renewable companies.
- Persistent headwinds -Execution-related challenges, regulatory uncertainties in key states and increase in input prices.

CareEdge RATINGS

# Construction – Robust order inflows to rein sharp slip in PBILDT margins




Source: CareEdge Ratings

**Upgrades were triggered by:**

- Faster project execution led revenue recovery.
- Revenue visibility enhanced with infrastructure push by the Government – Transportation segment to drive growth in order book.
- Recovery of pending bills post Covid-unlock resulting in improvement in receivable days & liquidity profile.

**Outlook- Infrastructure led order book to continue**

- Margins to recover from FY22 levels with addition of orders at new rates/reduction in commodity prices from peak level.
- Rising interest rate may impact the bottom line.

# Credit Outlook: Stable with some hiccups

- Indian Corporates have shown strong resilience towards the global and domestic economic headwinds with an **all-time high Credit ratio** in H1FY23.
- Investment in the economy to get a boost from healthy Capex by the Central Government. Private capex is also expected to improve amidst rising capacity utilization level.
- With deleveraging of balance sheets and growth in domestic demand supported by Government initiatives, CareEdge Ratings expects the credit outlook to be stable going ahead.
- In this backdrop, CareEdge Ratings expects the credit ratio to remain strong in the medium term.

**Downside risks:**

- Impact of the Russia – Ukraine crisis, volatility in commodity prices, inflationary pressures, and rising interest rates are the key monitorables on credit risk.
- With weak GDP growth in US and EU, the fear of both the economies slipping into recession given the energy crisis, is seen to be a cause of concern.
- Also, with China's growth slowing down, World Bank has lowered China's GDP growth estimate to 2.8% for 2022.

CareEdge
Ratings • Advisory • Research • Risk Solutions

# Thank you

**Authors:**

| Name | | Designation |
|---|---|---|
| Sachin Gupta | I | Executive Director and Chief Rating Officer |
| Rajani Sinha | I | Chief Economist |
| Sanjay Agarwal | I | Senior Director |
| Padmanabh Bhagavath | I | Senior Director |
| Rajashree Murkute | I | Senior Director |
| Smita Rajpurkar | I | Director |
| Gurninder Aurora Bangera | I | Assistant Director |

**Media Relations :** Mradul Mishra I mradul.mishra@careedge.in I +91 9833070317

## About Us

CareEdge is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics and detailed research. CARE Ratings Ltd, the parent company in the group, is one of the leading credit rating agencies in India. Established in 1993, it has a credible track record of rating companies across multiple sectors and has played a pivotal role in developing the corporate debt market in India. The wholly-owned subsidiaries of CARE Ratings are (I) CARE Advisory, Research & Training Ltd, which offers customised advisory services, credible business research and analytical services (II) CARE Risk Solutions Private Ltd, which provides risk management solutions.

**CARE Ratings Limited**

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022

Tel. : +91-22-6754 3456 I CIN: L67190MH1993PLC071691

For queries / feedback write to us at: corp.comm@careedge.in

Connect