Assessment of Credit Quality of Rated Entities: FY21

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The credit quality of CARE Ratings' rated entities has remained moderate in FY21 primarily owing to the pandemic led disruptions. CARE Ratings' Modified Credit Ratio (MCR) i.e. the ratio of (upgrades and reaffirmations) to (downgrades and reaffirmations) was at 0.99 for FY21. Nonetheless, the ratio has seen a sequential improvement over the second half of the year. The MCR for H1FY21 was 0.92 which improved to 1.03 in the second half of the financial year. CARE Ratings upgraded 503 entities and downgraded 570 entities in FY21. The Modified Credit ratio for FY21 has seen the credit quality of most of the corporates across sectors being hit due to the pandemic-led lockdown for good part of the year. Although the unlock process has started, level of activity continues to be lower than the pre-lockdown period and the pace and extent of the same have been uneven and wavering. The index for Industrial Production (IIP) has also been in the negative territory for most part of the year. After registering a growth of 1.6% in December 2020, the IIP again witnessed a contraction of 1.6% in January 2021. The fear of a second wave and the restrictions imposed in some parts of the country could also impact the unlock process and recovery for some sectors may be slower than earlier expected.

The domestic economy had been reeling under a slowdown for the last three financial years with a downward trend in the GDP growth rate from FY17 onwards. FY20 saw a sharp decline in the GDP given the overall weakness in the global and domestic economy. This was further aggravated by the pandemic led disruptions towards the fag end of FY20. FY21 started with the lockdown and many businesses witnessed sharp deterioration in operations and liquidity. The deterioration in credit quality elicited downward pressure on ratings of entities, especially in the first half of FY21, with fewer upgrades. Due to appropriate measures taken by the Government in consultation with the Reserve Bank of India to induce liquidity in the system, like emergency credit lines and a 6 months moratorium on loan repayments from May 2020 to August 2020, the corporates received some respite on the liquidity front. The sequential quarters saw signs of improvement in the credit quality of businesses and consequential higher upgrades than downgrades. However, the downgrades for the whole year outweighed the upgrades and CARE Ratings' MCR was below unity at 0.99 for FY21. Going forward, the vaccination drive is expected to provide solace to the process of economic recovery.

The assessment of the MCR of entities rated by CARE Ratings in FY21 shows that:

- The credit quality of the rated entities although still stressed, has improved on a sequential quarterly basis in FY21.
- MCR based on rated debt of these entities was also below unity at 0.97 for the full year indicating that the quantum of debt downgraded was also higher than the debt upgraded in FY21.
- Majority of the entities (79%) saw their credit ratings being reaffirmed in FY21.
- The proportion of entities that saw their ratings being upgraded witnessed an improvement sequentially (as borne out in Exhibit 2 below).
- As entities below investment grade are more vulnerable to any unprecedented happenings, not surprisingly, the credit quality of entities with 'investment grade' ratings have been more stable than that of 'below investment grade' ratings. Around 58 % of total downgrades in FY21 were among the below investment grade entities.
- The credit rating downgrades in FY21 have been largely on account of Covid-19 led disruptions and lockdown for a major part of the year, thus reducing the scale of operations and impacting collections, liquidity and overall profitability of businesses.
- The sharpest deterioration in credit quality has been in the BFSI sector, hospitality, real estate, auto ancillaries, textiles and wholesale and retail trade.

- Although credit quality has been under pressure across sectors, the Banking and financial services (BFSI) have faced the highest proportion of downgrades than upgrades with the MCR being 0.93. MCR for the Manufacturing and services sector for FY21 was also low at 0.98 while the MCR for Infrastructure entities was above unity at 1.03. Upgrades in the infrastructure space have been mainly in the power generation sector led by renewables segment which was one of the lesser affected segments by the pandemic.

- The rating upgrades during FY21 have been mainly in the companies that have demonstrated strong resilience against the pandemic led disruptions and reported a favourable financial position in terms of scale of operations, liquidity situation, capital structure, debt servicing parameters along with other company and industry-specific factors.

- Sectors that saw improved credit quality include power generation, pharmaceuticals, chemicals, sugar and healthcare.

Modified Credit Ratio (MCR) – Concept and Trend

(i) Concept

The Modified Credit Ratio (MCR) is defined as the ratio of (upgrades and reaffirmations) to (downgrades and reaffirmations).

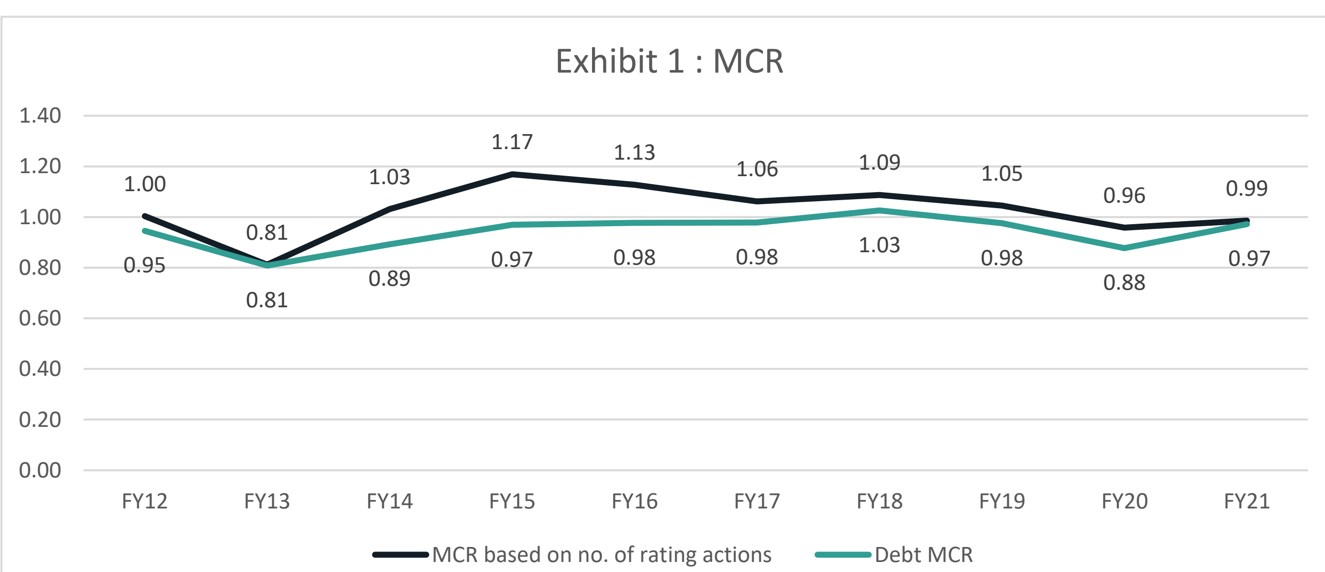
An increase in MCR denotes an increase in proportion of upgrades vis-à-vis downgrades, whereas a decrease in MCR shows the reverse. In other words, an increase in the MCR implies an improving credit quality of the rated entities while a decline in the same signals a deterioration in credit quality of the rated entities. An MCR closer to one indicates higher stability in the ratings, with a larger proportion of reaffirmations. **The MCR is calculated on a 4-quarter rolling basis.**

The movement of the MCR consequent to the periodic review of the credit rating of the rated entities (which point out the improvement, stability or weakness in the financial profile of these entities over time) not only helps measure mobility in ratings but is also seen as being reflective of the changes in credit quality in the system given the large quantum and diverse set of entities rated by CARE Ratings.

(ii) Trend in MCR

Exhibit 1 captures the movement in MCR on a 4-quarter rolling basis. Excluded here are cases where "Issuers are Not Co-operating".

The MCR for FY21 at 0.99 was an improvement, albeit marginal from the reading in the preceding year. The MCR in the first two quarters of FY21 (at 0.94) was the lowest since Q3 FY14 (0.92). The ratio has been below unity (1) from Q4 2019-20 denoting higher number of rating downgrades and lower number of rating upgrades of the entities whose ratings were reviewed during this period. MCR considering the quantum of debt upgraded and the debt downgraded was also low at 0.97. Nonetheless, on a full year basis, the MCR improved compared to FY20 and the improvement was majorly in the second half of the year that saw more upgrades than downgrades in line with the recovery shown in the economy. It may however be noted that the downgrades were limited in FY21 by the various measures taken by the government and the Reserve Bank of India like allowing moratorium, one-time restructuring, relaxing the default recognition norms and making available concession credit to the MSMEs under the emergency credit line guarantee scheme.



Source: CARE Ratings

Exhibit 2: Sequential movement in MCR in FY21

Quarter	MCR
Q1	0.88
Q2	0.96
Q3	1.01
Q4	1.03

(iii) Segment wise trend in MCR

The credit quality of entities in the below investment grade, has been moderate over the last two years i.e. FY20 and FY21 at 0.94 in both the years. The MCR of investment grade cases has however improved in FY21 and is above unity at 1.02. This proves the better resilience of the CARE Ratings' rated investment grade entities.

Exhibit 3: MCR- Investment Grade and Below Investment Grade Companies

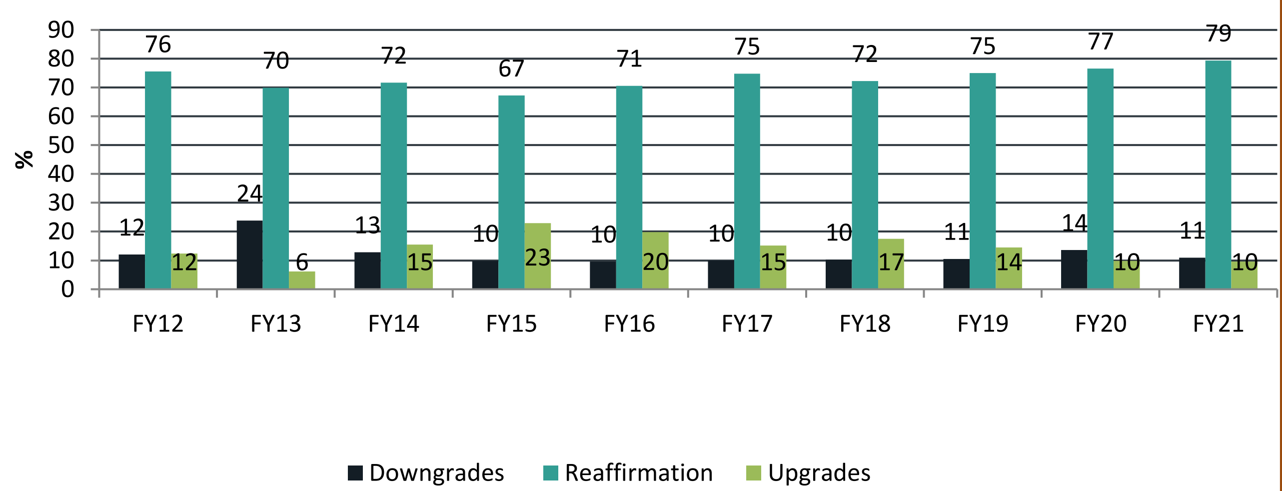
MCR	Investment Grade	Below Investment Grade
FY13	0.95	
FY14	1.00	0.97
FY15	1.21	1.06
FY16	1.26	1.04
FY17	1.16	0.95
FY18	1.14	1.01
FY19	1.10	1.00
FY20	1.01	0.94
FY21	1.02	0.94

Source: CARE Ratings

(iv) Proportion of Upgrades, Downgrades and Reaffirmations

Majority of entities saw their credit ratings being reaffirmed in FY21. 79% of the entities saw their ratings being reaffirmed. 10% of the entities reviewed witnessed rating upgrades, same as in the last year, while 11% of the entities saw a rating downgrade, lower than 14% in FY20. Essentially, proportion of downgrades reduced in FY21 vs FY20.

Exhibit 4: Percentage of Upgrades, Downgrades and Reaffirmations



Industry-wise Rating Movements

BFSI

MCR for the BFSI entities has been low for the last two years. Though MCR has improved slightly in FY21 from FY20, it is still low at 0.93 indicating higher downgrades than upgrades. MCR for banks improved marginally from 0.93 in FY20 to 0.94 in FY21 and the MCR for NBFCs/HFCs/Other Financial Institutions improved from 0.90 in FY20 to 0.93 in FY21. The downgrades in the banking sector were essentially because of deterioration in asset quality and reduced profitability of banks. However, it may be noted that the recapitalisation of banks and the liquidity measures by RBI have averted any significant deterioration in the asset profile of banks limiting the damage caused by the pandemic. NBFC sector which was already grappling with liability side issues and liquidity crisis in the last 2 years faced asset-side challenges in FY21 affecting collections due to moratorium allowed to its customers while no respite was provided towards its own obligations. Downgrades in FY21 were majorly due to asset quality and collection issues.

Infrastructure

MCR for Infrastructure entities improved to 1.03 in FY21 mainly aided by the upgrades in the power generation and construction sectors. The MCR for construction sector improved to 1.01 and the MCR for power generation was at 1.15 in FY21. Upgrades in the power generation sector were essentially in the renewables space, mainly triggered by commissioning of the plants eliminating the project execution risks, demonstration of healthy generation levels for the operational plants and also because of satisfactory payment track record of earlier defaulting accounts. Renewables was one of the lesser affected sectors in the pandemic. Upgrades in the construction sector were mainly in the second half of the year when the economy started opening up and showing signs of revival. The upgrades in the sector were mainly triggered by sustained growth in operations of the companies along-with a strong order- book position and revenue visibility.

Manufacturing/Services

MCR for industries like real estate, hospitality, auto, logistics, wholesale & retail trade and textiles was lower than one, largely due to the pandemic-led disruption in operations and the consequent impact on scale of operations, profitability, liquidity and debt repayment capacity.
Certain other industries like chemicals, healthcare, pharmaceuticals and sugar were resilient and the MCR for these industries was over unity in FY21.

Real estate

The real estate sector has seen a low MCR for all of the last three years. It had been grappling with several shocks with demonetisation, GST and RERA which has resulted in downgrades in the past. In FY21 as well, the sector witnessed low sales and bookings during initial months of the lockdown but recovered in the second half of the year. Downgrades in FY21 were due to low bookings and collections from customers.

Hospitality

MCR for hospitality, travelled from 1.03 in FY20 to sub-unity levels in FY21. The hotel industry is among the sectors that have been most severely impacted by the outbreak of the Covid-19 pandemic on account of its inextricable linkage with travel and tourism, especially foreign travel and tourism, which evidently bore the first brunt of the global crisis, reflected in the downgrades in the sector. Likewise, it may be among the last sectors to recover, considering that due to its nature, travel and tourism is a discretionary activity. Domestic leisure travel has started showing signs of recovery from September 2020, although demand from business segment has not picked up yet. Spike in Covid-19 cases in Q4FY21 and lean business season is expected to lead to subdued demand for hotels in H1FY22. However, demand is expected to gather momentum again from Q3FY22.

Automobiles

Since the onset of slowdown in third quarter of FY19, the total domestic automobile sales have been declining since October 2018. The ongoing pandemic added to the woes of the players, as domestic sales were near nil in April 2020 due to the nation-wide lockdown. However, the numbers improved every successive month and have shown an impressive recovery since then. The downgrades here have been largely in the auto ancillary segment due to subdued scale of operations in the first half of the year that affected the credit profile of players and hence a low MCR.

Wholesale and retail trade

Wholesale and retail trade were also impacted on contraction in consumer demand due to the pandemic on account of restriction in movement, social distancing and reduction in purchasing power of consumers. This affected the turnover and liquidity profile of players in the sector causing downgrades.

Textiles

MCR for textiles has deteriorated in the past three years and slipped to 0.97 in FY21. Downgrades in FY21 were mainly due to subdued demand and consequent stress on operations and profitability of the debt-laden textile sector. Both, domestic and export demand was affected due to the pandemic-led disruptions. In the medium to long term, some demand from the US and the EU markets is expected to shift (though gradually) from China to other major garment manufacturing countries like India, as the customers would like to decrease their dependence on China.

Rubber and plastic products

The industry saw rating upgrades majorly due to increase in the scale of operations and profitability. The industry was not affected by the pandemic.

Sugar

Sugar industry also saw an uptick in FY21 on increase in sugar exports by a sharp 50% to 5.7 million tonnes, aided by the export subsidy of Rs.10.4 per kg to sugar mills provided for certain expenses. Though domestic consumption increased by a marginal 0.8% to 25.7 million tonnes due to Covid-19 induced lockdown in March 2020, it augmented closing stock for the year. Upgrades in the sector in FY21 were triggered by higher sales and profitability of players. Overall, the outlook for sugar is stable, only supported by prevalence of the strict regulatory mechanism holding the domestic sugar prices and controlling the stock release.

Pharmaceuticals

Pharmaceuticals sector was the least affected by the pandemic. Infact, companies playing a role in the development of the vaccine were benefitted. With the increasing importance of healthcare, the sector saw upgrades in FY21, mainly aided by increase in scale of operations and robust revenue visibility, healthy profitability along-with strong leverage and coverage indicators.

Exhibit 5: Trend in Industry-wise MCR

MCR	FY19	FY20	FY21
BFSI	**1.04**	**0.90**	**0.93**
Banks	0.90	0.93	0.94
NBFCs/HFCs/Other FIs	1.06	0.90	0.93
Infrastructure	**1.00**	**0.95**	**1.03**
Power - Transmission and distribution	0.93	0.96	0.91
Roads	0.85	0.96	0.92
Construction	1.02	0.92	1.01
Power Generation	1.10	1.01	1.15
Manufacturing/Services	**1.05**	**0.96**	**0.98**
Real Estate activities	0.93	0.87	0.88
Hospitality	1.01	1.03	0.88
Auto	1.14	0.95	0.92
Logistics	1.03	0.92	0.92
Wholesale and retail trade	1.08	0.94	0.94
Textiles	1.02	0.98	0.97
Education	0.95	1.03	0.99
Gems and Jewellery	1.02	0.86	0.99
Food and food products	1.10	0.99	0.99
Iron and Steel	1.32	1.05	1.02
Paper and paper products	1.32	1.04	1.02
Chemicals	1.10	0.98	1.04
Beverages	1.24	1.22	1.06
Rubber and plastics Products	1.09	1.02	1.14
Healthcare	0.82	1.02	1.15
Sugar	0.97	0.96	1.18
Pharmaceuticals	0.98	0.94	1.26

Concluding remarks

The year gone by has seen a major disruption in operations of businesses across sectors which has got reflected in the credit quality of CARE Ratings' rated entities. Although the credit quality has been moderate for the year, there has been a sequential improvement every quarter of FY21, with the MCR for Q4 FY21 being above unity levels at 1.03, indicating higher upgrades than downgrades in the quarter. This is in line with the green shoots seen in the economic revival with the vaccination drive giving a boost to the business sentiment. However, the resurgence of the second wave of the virus has again raised uncertainty about the pace in recovery. CARE Ratings expects the recovery to be slow paced and thus estimates a stable MCR, closer to one for FY22.

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