Industry-wise impact of Covid-19

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The epidemic Covid-19 continues to take toll on global and domestic activities and economy. The number of infected cases is escalating each day with the first few cases being reported in China (in December 2019) now been recorded in almost every nation on the globe.

The severe spread of virus has halted domestic and trade activities across various economies which have disrupted routine activities of multiple nations bringing the countries to halt thus distorting their economic growth. Several countries across the world have been announcing travel restrictions, partial or complete lockdown to contain the spread of virus and to avoid the situation of crisis.

The Indian economy is also getting hit hard by Covid-19. The first case in India was reported on 30 January 2020. Post this, the number of cases have been on a surge with every state in the country facing the threat of virus. Subsequently, various transport facilities including trains and flights were suspended and several state governments started imposing lockdown across their territories third week of March onwards till 31 March 2020. Also, nation-wide lockdown of 21 days was announced 25 March 2020 onwards which is expected to hurt domestic operations in India.

With the virus now also affecting and disrupting global supply chains and economy for almost 3 months now, the situation is having a severe implication on the Indian economy as well. This is because India is dependent on global markets for exports and imports which has the potential to hit the Indian companies and, in turn, economy.

Here in this report, we assess the possible impact of Covid-19 on various industries in India. The industries that form part of our study are listed below:

1. Auto & auto ancillary
2. Aviation
3. Drugs & pharma
4. Education
5. FMCG
6. Hotels & Tourism
7. Media & Entertainment
8. Metals
9. NBFCs/HFCs
10. Oil & Gas
11. Paper & paper products
12. Textiles

1. Auto & auto ancillary

India's maximum dependence on imports especially for the two-wheeler and passenger vehicle industry component wise is in steering and braking systems, engine parts, alloy wheels and lighting systems. Also, most of the OEMs are dependent on Chinese supply chains for the BS-IV as well as BS-VI components such as fuel injection pumps. In the current scenario, with the overall slowdown in the Indian economy, shifting to other alternate countries (such as Germany, Japan, Korea) for supply may not be feasible in terms of both cost and time. Also, the gestation period and the huge investment requirements for the auto component industry remain the restricting factors for such immediate shift. In case of sub-segment tyres, the local industry is expected to benefit as cheap Chinese imports (about 25-30% of total tyre imports) are expected to drop. As per the industry experts, most OEMs were covered to continue sales and production operations till March – April 2020.

However, with the spread of the virus and at request of SIAM (Society of Indian Automobile Manufacturers) and ACMA (Auto Component Manufacturers Association of India), most of the OEMs and auto component players have initiated work from home for its non-manufacturing work staff and have announced temporary shutdown of manufacturing units and put local productions on hold. Also, the 2 main auto clusters in India, Pune and Gurgaon-Dharuhera have already been completely shut.

Table 1: Exports & Imports of Transport Equipment

USD Mn	India's Total Exports of Transport Equipment
FY17	21,645
FY18	21,702
FY19	24,643
USD Mn	**India's Total Imports of Transport Equipment**
FY17	19,072
FY18	18,675
FY19	20,302

Note: Transport equipment include Aircraft, spacecraft and parts, motor vehicles and parts, railway transport equipment and parts, ship, boat and floating structures, two & three wheelers, auto comps and parts and Bicycle and parts
Source: CMIE

India's exports of transport equipment to China account for a negligible share of about 0.5% of the total transport equipment exported from the country, however, US & Europe together account for about 80% share impacting the overall automotive component exports. In terms of imports of transport equipment, about 8.6% was imported from China during FY19, almost half of the equipment imported during the previous year. China is currently operating at below average capacities and given the conditions, is expected to fully recover only by Q2 FY21, provided the spread of Covid 19 is curtailed. Therefore, the Indian component industry is expected to witness supply chain disruptions in the domestic market during Q4 FY20 and Q1 FY21 to the tune of around USD 8,000 million (assuming 40% of FY19) while local sourcing is expected to increase going forward.

The investments of the industry have also been put on hold due to prolonged slowdown in the already existing subdued market during FY20. Auto component manufacturing firms such as Continental Automotive Components (India), Inovatiq Engineering, Lumax Auto Technologies, Safran Aircraft Engines, Varroc Lighting Systems and Wheels India are expected to complete their respective projects during FY21. (Source: CMIE)

During 9M FY20, net sales of the automobile OEMs witnessed a y-o-y decline of about 14% on a y-o-y basis vis-à-vis a growth of about 16% witnessed during 9M FY19 while auto ancillary players (including tyres) witnessed a decline of about 11.7% vis-à-vis a growth of 14.7% during 9M FY19. In terms of volume sales, industry witnessed a decline of about 13% y-o-y in FY20 (April – February). Industry profits declined by about 27% during 9M FY20 vis-à-vis a double digit growth during corresponding period previous year that can be attributed to weak sales booked along with various deals and offers and discounts given by OEMS during the festival season.

To conclude, with the already existing slowdown during FY20, the industry is likely to suffer huge losses going forward. Also, the employment of the industry is at risk as the contractual workers accounts for about 50% of the workforce in the industry. It is also to be noted here, that even if the pandemic is curtailed, the consumer sentiments are expected to be unfavourable and demand is expected to remain muted during H1 FY21 led by fluctuating and uncertain economic conditions.

Author: Darshini Kansara **Inputs By: Karthik Raj**

2. Aviation

With the spread of the novel coronavirus (COVID-19) to geographies beyond the epicentre of its origin in China and with Europe becoming the new hotspot of cases, the airlines industry has been beleaguered as countries all over are imposing travel restrictions and are going into complete lockdown. Indians too will not be traveling anywhere anytime soon as the government has imposed a 21 day lockdown which will restrict any passenger movement whatsoever and air transport services too have been halted for the time being (not applicable for cargo/freight transport).

Table 2: Passenger carried and passenger growth in respect to scheduled domestic airlines (Unit: in millions)

	Passenger Traffic	Growth (y-o-y)
2018-19*	129	15.1%
2019-20*	134	3.7%

Note: DGCA traffic information pertains data by various domestic airlines
Source: DGCA, CARE Ratings *April-February

Table 3: Air Traffic at all Indian Airports

	2018-19	2019-20	2018-192	2019-203
Aircraft Movement (in '000)	2,192	2,200	14.2%	0.4%
Passengers(in millions)	289	294	13.8%	1.7%
Freight(in 000' ton)	2,982	2,848	6.8%	-4.5%

Note: AAI traffic information pertains data by various airports domestic, international, custom, JV airports
Source: AAI *April-January

Concluding Remarks and Outlook for FY21

Even as the macros of the Indian aviation industry may be in favour of propelling its growth, the industry may not fully recover any time soon post the effects of the pandemic which has affected business operations, travel and tourism and economies world over. With most of the countries going under lockdown and banning/imposing restriction on entry of foreign nationals, airline carriers world over are mulling their operations due to lack of demand and are grounding their fleet due to which the aviation industry is in a fragile financial position.

Domestic scheduled airlines too have started facing severe cash flow pressures, considering airlines will not be functional at all till 14th April 2020 and this is also leading to trimming of employee salaries aside of the other issues being faced by the industry. Even post the nationwide lockdown, fares of airline operators is to be very low considering the lack of air travel demand which will also lead to scaling down of certain routes.

Going forward, there seems to be turbulence and stormy clouds for the Indian aviation industry as airlines will be operating on sub-par capacity which will result in low ticket booking, fall in revenues and low passenger load factor (PLF). **Passenger growth of airlines is to fall sharply and register a negative 20%-25% growth for FY21.** Passenger growth has been 13.7% during FY19 and 3.7% during FY20 (April-February).

- Even post the lift off the nation lockdown passenger growth will face a sharp contraction considering the inhibitions of travelling anywhere till the pandemic scare has been settled fully in the domestic regions and internationally especially on certain routes.
- Even with the containment of the virus, countries will not freely issue visas fearing the rise of any exigency with the entry of foreign nationals.
- COVID-19 has put a halt on major business operations and economies which means there will be a considerable fall in income which will also discourage incurring of discretionary expenses like traveling for leisure and tourism.

Given the fall in airline operations, **Airports are likely to operate at less than 20% capacity for the month of April and less than 50% till June.** Decline anywhere between 8% to 15% is expected for passengers handled (domestic and international) by airports.

Freight operations will add support to overall traffic movement but that is also likely to be subdued given the fall slowdown/shutdown of manufacturing units in most parts of the world and in the domestic economy due to the COVID-19 pandemic.

In terms of **capital expenditure** airlines will be deferring or scaling back on CAPEX given the expected fall in the top line and bottom line of carries which means purchase of airplanes or adding to the fleet sizes will not take place at least till 9M-FY21.

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3. Drugs & Pharma

The Indian bulk drug and formulation companies are primarily dependent on China for meeting the requirements of Key Starting Material (KSM) and Active Pharmaceutical Ingredient (API). Considering this dependency, the Indian pharma companies had already stocked the input needs for Q4FY20 as China observes holidays on account of New Year. Thus, the extension of holidays due to coronavirus outbreak is unlikely to have an impact on Q4FY20 of the Indian pharma industry.

Also, most of the large formulation companies that have their backward integration for APIs and the bulk drug companies that have started backward integration for KSM post disruption faced during 2018 after pollution control issue in China are likely to see limited impact during Q1FY21 due to extension of holidays.

With reducing number of new cases being registered in China, the factories have now started operations though with limited capacity. Also, the Chinese bulk drug manufacturers (except Wuhan – the epicentre of virus) commenced operations albeit not with optimal capacity which poses a challenge for the supply chain of bulk drugs in India during Q1FY21 and may extend to Q2FY21. Nonetheless, the Indian pharma companies have started opting for other countries or

domestic sources for bulk drugs or also have started opting for backward integration to avoid the situation witnessed by India in 2018 due to shutdown of facilities in China on account of strict pollution norms.

It is to be noted that if the Chinese facilities fail to resume operations at optimum capacity then such a situation can create demand-supply gap which will elevate the prices of bulk drugs. **If the gap persists for next 3-6 months, it will affect the companies that have higher dependency on Chinese bulk drugs.**

Closure of markets is not just limited to the country from where the Indian pharma industry imports its bulk drug needs but has spread even to the industry's export destinations. India derives about 40% of the pharma export revenue from regulated markets, where the spread of corona virus is intensely pandemic leading to lockdown of some of the countries. This has constrained manufacturing operations in these countries and thus restriction on import of healthcare and related products from these countries appear to be unlikely which provides an opportunity to the Indian pharma market. While the Indian pharma companies may not be able to pass on the rise in input prices in the domestic market due to Drug Pricing Control Order (DPCO) 2013, the same is possible for them in case of exports.

To avoid any situation of shortage, India restricted export of 26 APIs and formulations in the face of the COVID-19 outbreak. Thus the pharma companies that have a high reliance on this portfolio are likely to face challenge in exporting these drugs. However this restriction will ensure that the supply of these drugs and formulations in India are unaffected with causing no disruption in their domestic supplies. It is to be noted that the export of these drugs are not completely banned and is subject to government approval.

With increase in number of cases being registered every day in India, the government has announced lockdown across nation for 21 days 25 March 2020 onwards. This is likely to have an impact on operations of small scale companies that have limited number of manufacturing facilities. Nevertheless, pharma facilities may operate at suboptimal capacity and the ones that have automated systems may not see significant impact of the lockdown thus avoiding any major disturbances in domestic supplies.

It is not only the global companies that are taking efforts to develop vaccine against Covid 19 but also Indian firms are working towards development of vaccine against the virus. However the development of any vaccine in general takes time of about 1.5 to 2 years even if the development is carried out on fast track mode. The reason being studies such as pre-clinical trial or animal testing and human clinical trial that takes about 6 months and 12-18 months respectively. Thus considering aforementioned minimum incubation period (i.e. of about 1.5 to 2 years) to commercialize a vaccine, the probability of making the same available to humanity is likely to take place any time during FY22.

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4. FMCG

Through news reports, we learn that Ecommerce platforms and local general stores witnessed sharp surge in sales of staples, daily necessities and personal hygiene products in the past few days of March, as India indulged in panic buying amidst fear of shortage of essential items. Though we do not have numbers to substantiate this, but latest production numbers for the month of January 2020 shows a jump in production of various consumer goods and food products.

One of the essential items in times of widespread covid-19 is organic surface active agents. This includes various products such as sanitizers, disinfectants, all-purpose cleaners, etc. which are used at homes, factories and offices. Output of such products grew by 61% YoY in the month of January 2020.

In addition to this, production of personal care products such as hair oil and shampoo grew 13% and 12% YoY respectively in January 2020. Detergents have also witnessed positive growth during the month.

Within food products, positive output growth was witnessed in bakery products such as cakes, pastries and muffins and biscuits/cookies. Edible oils such as groundnut oil, Soyabean oil, mustard and rapeseed oil have witnessed robust production growth during the month of 30%, 33% and 99% YoY respectively. Milling products such as gram flour (besan) have also witnessed positive growth in output.

Due to sharp surge in demand for essential commodities in February and March 2020, robust production numbers are expected in these months however, such growth shall be restricted to specific product categories.

Increased demand is a positive sign for FMCG sector which was witnessing soft demand since past few months of FY20. Depending on how quickly the lethal virus curtails in the country, robust production growth could continue in initial few weeks of Q1-FY21.

Author: Vahishta Unwalla

5. Education

In India, the impact of coronavirus pandemic is being felt more from March, 2020. Among the entities offering formal education services, including schools and colleges, fee collection, which forms major portion of their revenue, generally takes place at the start of month/quarter/half year/year. The shutdown of educational institutions announced by different state governments and subsequently 21 days lockdown announced by Govt. of India recently is not likely to have major impact on the operations of these institutions in the very short term since fee collection has already taken place for the running month/quarter/half year/year in the beginning of the period. However, the entities, where the fee is collected with some delay from students, are likely to get impacted to that extent as they can face challenges in meeting their staff expenses and debt servicing. Further, receipt of aid in the case of aided institutions and reimbursement of fees from Govt. under different schemes is likely to get delayed with shift in the focus of State Governments on controlling the pandemic. Hence, managing the finances and working capital requirement during this period will be crucial for these institutions. However, availability of additional liquidity either in the form of unencumbered liquid investments, financial support from resourceful promoters or unutilised bank limits would provide some cushion.

For some institutions, mostly schools, where the academic year starts from the month of April every year, the fee collection happens in the beginning of the period. The same is followed by summer vacations post which the session again commences from the months of June-July. However, these schools cannot reopen in the first week of April due to the lockdown. In case the lockdown continues for long period, the cash inflows of these entities are likely to get deferred which can put pressure on the finances of these entities in the short term. However, higher educational institutions where the admissions take place late in June-September period may not get affected during this period. While the final examinations of the current academic session in secondary and senior secondary classes and higher education institutions have been suspended for the time being, late scheduling of these examinations are likely to delay promotions/admissions to the next class which can lead to some delays in the commencement of new academic sessions.

In the case of entities in informal education sector offering coaching services or vocational education, the lockdown has led to temporary suspension of operations though the same is likely to have little effect on their cash flows in the very short term. However, in case the pandemic continues for a long time, the same can impact their financial position as any delay in conducting of various entrance exams will defer commencement of their academic sessions and ultimately their cash flows.

In the situation of delay in admissions they are unlikely to receive fee but would be required to incur expenses on teachers as well as service the debt. However, entities offering e-learning programmes are better off as they can continue to offer their services and charge for the same from students with availability of teachers on call.

Likely government intervention

Subsequent to announcement of 21 days lockdown, Ministry of Human resource development has written to different states and regulatory bodies to work on alternate academic calendar on account of uncertainty in commencement of new session in the light of ongoing pandemic crisis. The government may also consider the lockdown as a vacation period for schools and start the new session once the situation returns to normal.

The government may also work on a revised schedule of entrance exams like JEE and NEET. While Joint Entrance Exam (JEE) has been rescheduled as of now, new date has not yet been announced. Further, there has been no decision on the rescheduling of the National Eligibility and Entrance Test (NEET) for medical colleges in the country, even though the admit cards are going to be out by March 27th. Further, ICAI has also postponed CA exams.

Conclusion

Though the long term outlook for the sector remains stable, prolonged lockdown could impact the operations and the cash flows of the education sector entities in the short term as the income may get deferred for the time being. However, entities with liquidity backup and resourceful promoters are not likely to get affected much.

Author: Harsh Raj Sankhla

6. Hotels & Tourism

a. Hotels

COVID-19 has already impacted the Jan-March 2020 and as the lean season seeps in for both business and leisure segments from April, the hotel players will have some time to realign themselves (cost rationalization, process improvement measures) before the next peak season. The operational parameters (Occupancy rates – ORs & Average room rates – ARRs) of the hotel players are expected to get adversely impacted for next couple of quarters. Though a medium term impact, this may lead to lower cash flows for the hotel entities and thus exert pressure on their profitability and liquidity.

FY19	OR (%)	ARR (Rs per day)	RevPAR (Rs per day)
Overall average	66.7%	5,973	3,981

Source: Hotelivate

We expect ORs to witness a decline of about 27% (2,700 basis points) to reach an overall average of about 40% during the year with maximum impact in H1 2020. Also, with weak demand, the ARRs are expected to decline by about 30 – 40% and reach around Rs 3,600 to Rs 4,200 per day. Consequently, the revenue per available room (RevPAR) is expected to decline by about 58 – 64% during the year to reach Rs 1,440 to Rs 1,670 per day. The existing room supply in the branded category for the country grew by 5.4% y-o-y in FY19 totalling to 133,359 rooms (as of March 31, 2019).

Hotel industry revenues stood at Rs 10,030 crore as of FY19 (3.5% y-o-y growth vis-à-vis FY18). Hotels which derives higher share of revenue from foreign passengers and food & beverages segment will be the worst affected. Cost-cutting measures are the need of hour. Hotel entities which will be quick in trimming down the unnecessary costs and implement various efficiency improvement measures will be able to cut down the damage better. Employee costs are one of the largest cost components of the hotels accounting for about 25-30% of the total expenditure.

Hotel sector is characterized by long gestation period. Hotel entities with recent expansions or groups with a higher portfolio of new assets compared to mature assets will face additional heat on their already weak financials. With high debt repayments and squeezed profitability, these entities may witness tightening in their liquidity and credit profile. Furthermore, hotels need to revisit their capex plans as the Covid-19 impact is expected to derail the future growth.

b. Tourism

Perhaps the most visible and immediate impact of Covid-19 is seen in the hotel and tourism sector in all its geographical segments - inbound, outbound and domestic and almost all verticals - leisure, adventure, heritage, MICE, cruise and corporate. Given various travel restrictions imposed by the Indian Government as well as Governments across the globe, forward bookings for various conferences and leisure travel bookings to foreign destinations have already been cancelled. In India, most of the summer holiday bookings have been cancelled (about 40-50% most of which was to states of Kerala, Rajasthan and Goa) impacting the domestic tourism. The impact on the inbound and outbound passengers is expected to be most severe in the next couple of quarters.

India's total foreign tourist arrivals (FTA) stood at 10.9 million and the foreign exchange earnings (FEE) stood at Rs 210,971 crore during 2019 with Maharashtra, Tamil Nadu, Uttar Pradesh and Delhi accounting for about 60% of FTAs. However, now with travel restrictions in India for over 80 countries and most of the flights of major airlines being suspended along with lockdown in states of India till March 31, 2020, the Indian domestic as well as foreign travel and tourism industry is expected to witness a sharp negative impact in 2020.

Assuming the impact to be about 50% during January and February 2020, while the impact being higher at about 70% during March 2020 post the suspension of international flights and about 100% during Q2 2020 (April – June 2020) on the overall foreign travellers with travel advisories being put out, the Indian tourism industry is expected to book revenues of Rs 69,400 crore during H1 2020, a y-o-y loss of over 30% during the period. During H2 2020, assuming the virus impact subsides, we expect FTAs to still be lower affecting the FEEs by about 50% to reach Rs 56,150 crore vis-à-vis Rs 112,300 crore during H2 2019. **Therefore, for the year 2020, the industry is expected to book a revenue loss of Rs 125,550 crore, loss of over 40% y-o-y**

Month	Foreign Tourist Arrivals (in Mn nos.)			Foreign Exchange Earnings (in Rs. crore)		
	2017	2018	2019	2017	2018	2019
January	1.0	1.0	1.1	16,135	17,755	18,079
February	1.0	1.0	1.1	15,790	17,757	17,912
March	0.9	1.0	1.0	14,667	17,222	16,125
April	0.7	0.7	0.8	14,260	15,620	17,061
May	0.6	0.6	0.6	12,255	12,753	13,541
June	0.7	0.7	0.7	12,971	14,398	15,963
July	0.8	0.8	0.8	14,796	16,976	18,191
August	0.7	0.8	0.8	13,811	16,492	17,817
September	0.7	0.7	0.8	13,840	15,150	16,791
October	0.9	0.9	0.9	14,213	14,701	17,043
November	1.0	1.0	1.1	16,528	16,584	19,831
December	1.2	1.2	1.2	19,381	19,474	22,617
Total	**10.1**	**10.6**	**10.9**	**1,78,647**	**1,94,882**	**2,10,971**
Growth rate (%)	14.8%	4.4%	3.2%	15.9%	9.1%	8.3%

Source: Ministry of Tourism, CARE Ratings

Author: Darshini Kansara **Inputs By: Nitesh Ranjan**

7. Media & Entertainment

The spread of Covid-19 in India shall have a definite impact on the media and entertainment sector, valued at Rs. 1,887 bn (estimated for CY2019). Segments such as digital media, online gaming, radio and Over The Top (OTT) platform shall benefit as individuals are forced to stay home and use such mediums as their only source of entertainment. However, large industries such as television, print, filmed entertainment, live events and out of home media shall take a hit on their revenues, which is explained below:

- **Television:** Television production activity has come to a virtual standstill to avoid large gathering of people on sets. With no new shows being produced, most General Entertainment Channels (GEC) have resorted to telecasting the old shows on repeat, to fill slots on their channels. Also, as most sports events scheduled in the months of March and April have been cancelled, viewership of sports channels shall drop. However, viewership of news channels is expected to augment during this period.

- **Filmed entertainment:** Film producers have decided to halt their shooting for few weeks and pushed the release of such films to a later date. This will create ripple effects as release dates of other movies that were expected to be released in the next 3-4 weeks shall also be postponed. Delay of movie releases shall impact box office collections not only in domestic market, but also abroad, as Indian movies have a large audience outside India.

  With film exhibitors across the country being temporarily shut, operating margins of such players shall take a hit, as salaries and maintenance costs are inevitable expenses. We expect a loss of revenue of Rs. 5,800 to 7,800 crore per month for film exhibitors. This includes revenue from sale of movie tickets, sale of food and beverages within the theatres and advertising income.

- **Live Events:** Multiple events including concerts and sports events were scheduled in the year 2020, including the Tokyo Olympics, Hockey Pro League, Asia Cup, UEFA Champions League, Cricket IPL, etc. While some are postponed, few are expected to be cancelled. In case of cancellation, there shall be heavy loss of revenue mainly from advertising and sale of tickets to audiences. Cancellation of a mega outdoor event - Cricket IPL season, is expected to lead to a loss of Rs. 120 – 150 crores on sale of tickets for 60 matches played across various stadiums in the country.

Advertising contributes ~45% to the media and entertainment sector's revenues. Such spends were already subdued in past few months of FY20, as top advertising industries like FMCG, automobiles, retail and fashion, gems and jewellery, telecom, etc. lowered their discretionary spends due to slowdown in the country. The outbreak of Covid-19 leading to cancellation of most events has worsened the situation further. With further drop in advertisement income, growth of media and entertainment sector for the year could be restricted.

Author: Vahishta Unwalla

8. Metals

Base metal prices which had just started to recover from the long-drawn US-China trade war have once again come under pressure due to the outbreak of the Coronavirus. Nickel prices have fallen the most among all the base metals. Nickel and zinc prices have plunged 30% and 27%, respectively since November 2019 levels. Copper prices have fallen 16% and aluminium prices by 8%.

In FY19, Nickel had outperformed all other base metals. While prices of all base metals (steel, copper, aluminium and zinc) declined due to the US-China trade war and global slowdown, Nickel prices rose by 15%. Nickel prices performed better than other metals due to supply worries from the world's largest nickel ore exporter, Indonesia. Prices rose after the country announced to ban export of nickel ore starting early January 2020. Indonesia had also imposed temporary restrictions on export of ore in October 2019 following which stocks at LME dropped sharply to 66.3 thousand tonnes in October from 152 thousand tonnes a month earlier. The ban was lifted towards the end of 2019 which moderated prices. Besides, output increase from competing countries like Philippines and New Caledonia also curbed the rally in prices.

Scenario of other base metals:

China is the largest producer and consumer of most base metals in the world. The country produces and consumes more than half of the total steel, copper and aluminium of the world. Therefore, China plays a major role in the global demand-supply of base metals, having huge potential to disrupt the equilibrium.

The trade war between US-China had battered base metals in 2019. Commodity prices remained depressed in most of 2019. The trade war between the two large economies and uncertainty related to Brexit had slowed down the pace of global economic growth in 2019.

Prices had only started to pick-up around mid-October when the two countries announced phase-1 trade deal however prices again went on a downward spiral due to the outbreak of Coronavirus.

The demand and production from China was severely hit as the city of Wuhan which has more than 500 factories and is also the largest steel manufacturing hub in China became the epicentre of the crisis and had to be put under lockdown. India initially expected to witness increased domestic demand due to pick-up in domestic manufacturing activity and slowdown in imports from China. However, the Covid-19 virus which first came to light in China has now spread to more than 190 countries and has become a worldwide problem. US, UK, Middle East and India have also come under the grip of

the virus. Many cities and countries are currently under lockdown mode to stem the spread of virus. Factories have either shut or are fast closing down due to restrictions on transportation, freight movements as well as lack of staff. Trade between countries have come to a standstill. Demand for metals has plummeted from all over.

In India, major automakers such as Maruti Suzuki, Mahindra & Mahindra, Fiat and Hyundai have announced suspension of operations indefinitely to contain the spread of the coronavirus. Auto sector accounts for 15-20% of steel demand in India. Construction activity has also come to a halt. Tata Steel has announced to shut down its downstream facility in Maharashtra and Uttar Pradesh. Many companies are also complaining of staff shortage as employees rush back to their hometown amidst the virus scare. Many factories are working at lower utilisation levels due to shortage of staff. Lack of demand, shortage of staff may impact domestic steel production in the coming months.

China has reported no new cases in a while and the Chinese economy is returning to normalcy. Factories are restarting operations in China. However, the situation outside of China is bleak. Globally, restrictions on transportation and lockdowns will have a bearing on production and demand. Demand from the European, Middle East and the US markets is likely to remain muted in the near term which will impact prices. ***Globally, in the short term (April-June 2020) steel prices are expected to hover around US$ 400-450 per tonne, aluminium prices around US$ 1,500-1,800 per tonne, while that of copper and zinc to be range bound around US$ 4,500-4,900 per tonne and US$ 1,700-1,900 per tonne, respectively.***

Chart 1: Nickel, LME (US$/tonne)

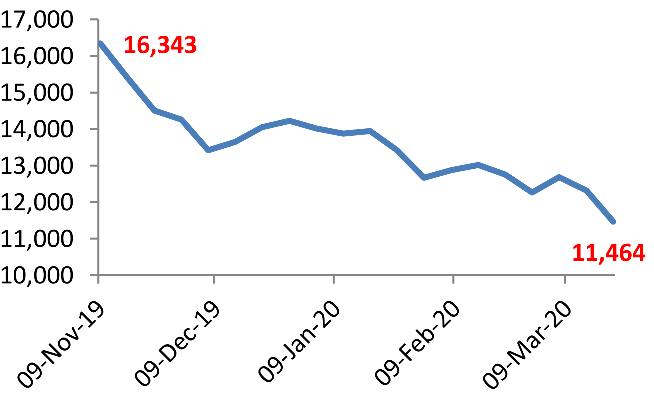


Chart 2: Zinc, LME (US$/tonne)

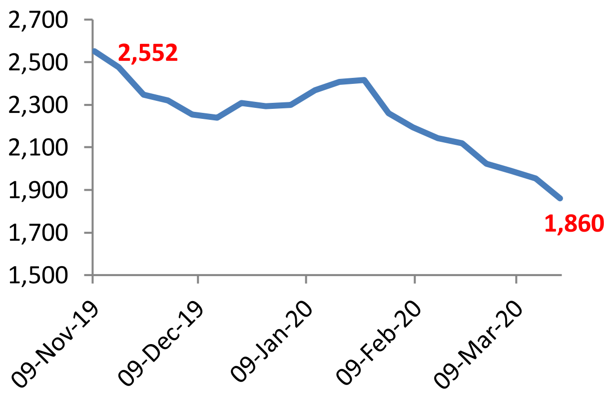


Chart 3: Primary aluminium prices, LME (US$/tonne)

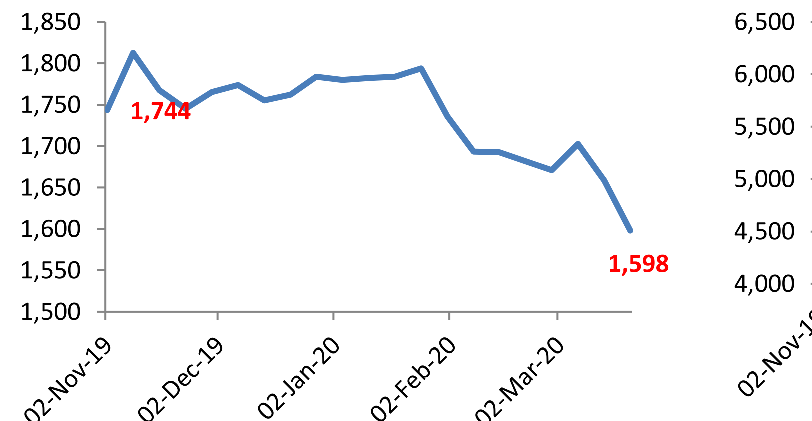


Chart 4: Copper Cathode price, LME (US$/tonne)

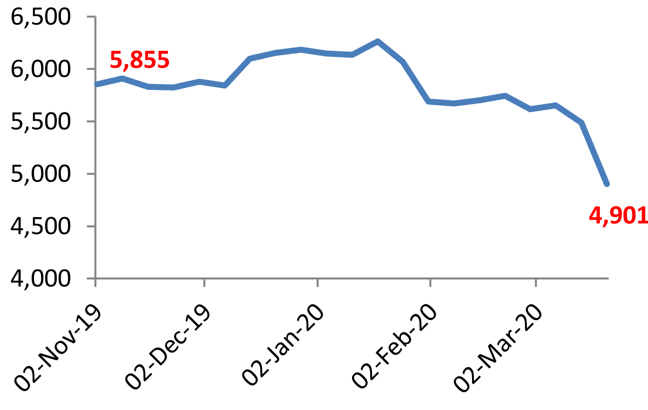
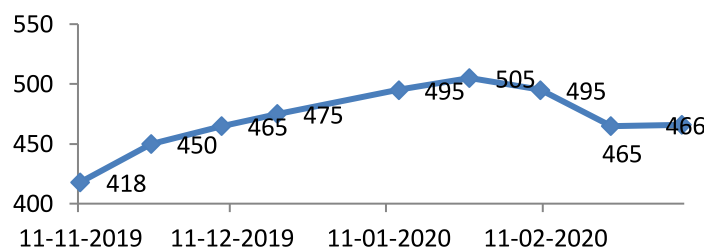


Chart 5: International steel prices, World export



Author: Rashmi Rawat **Inputs By: Hitesh Avachat**

9. NBFCs/HFCs

The Covid-19 situation is an emerging one in India with the Indian government along with the various state governments taking preventive steps to stop a large scale spread of the virus. With three week nation-wide lockdown, the impact on various businesses and the overall economy is expected to be adverse. At this stage, it is difficult to assess the time horizon till when the situation would come under control and normalcy will resume in global and domestic economic activity. Till then, it is certainly going to impact the livelihood of millions of people associated with trade and services. Though premature, we try and assess the impact on the NBFC & HFC sector which already has a relatively tight funding scenario. We look at the various asset classes and how these can be impacted in terms of delinquencies going forward.

The unprecedented and wide-reaching effects of the COVID-19 epidemic are likely to have economic impact across different strata of society. However, the lower income groups, typically labourers and daily wage earners are likely to be hit hardest. As a consequence, the microloan and MSME loan portfolios of NBFCs and MFIs would experience a significant increase in delinquency levels during the period. The effects would be seen in the urban and semi-urban portfolios before spreading to the rural portfolios.

To begin with, NBFCs were largely well placed in terms of ALM with an adequate buffer of treasury/investments assets and reasonably assurance of liability inflows to service business requirements. For most companies, this would provide margin to absorb delinquencies in the near term. Further, given the crisis in the industry during the past 18 months, the

companies have undertaken significant risk mitigation measures such as raising equity capital, developing liability relationships, cost rationalisation and where appropriate, limiting business operations. Hence, they would be able to tide over any short-term disturbances.

We believe that the RBI and the Government will take necessary measures to ensure that credit markets operate normally, and do whatever possible to support the banks & financial system if the situation worsens significantly from here.

- **Wholesale - Real Estate Lending:** In the residential segment, lower ticket-size inventory was witnessing traction, but luxury segment was under pressure with low sales velocity. Covid-19 impact may be seen for the developers focussing on the affordable housing segment as well which will experience reduced sale velocity in the near term. This will aggravate the pressure on the few real-estate focussed NBFCs who are already dealing with market risk aversion and difficulty in fund raising. Plans of such NBFCs/HFCs to monetize/off-load some wholesale exposures may also be impacted due to reduced investor risk appetite in the current scenario.
- **Microfinance:** Microfinance falls in the high risk category as, in the past; the sector has faced event risks including socio political interference, natural calamities, demonetization etc. which has led to sharp rise in delinquencies and higher level of end losses as compared to other NBFC asset classes. However, Covid-19 could have larger impact as earlier event risks were usually limited to certain geographies but this is going to impact across geographies. The impact might be higher in MFIs focussing on urban areas as the customer profile will involve small businesses or workers engaged on contractual basis losing man-days of work due to prevailing lockdown. If the duration of lockdown remains limited, the impact on rural MFI customers is likely to be limited.

  The impact may be mitigated due to the measures taken by RBI and the Government in terms of recognition of NPA and relaxation in capital adequacy norms. In the past RBI had introduced such measure during the AP ordinance act which impacted the NBFC MFIs operating in Andhra Pradesh. The relaxation helped the NBFC to a certain extent provided they already had comfortable capital adequacy and geographical diversification. Further, in the recent years, most MFIs have raised significant capital/built liability relationships to protect themselves against event risks.
- **Gold Loans:** Gold loan NBFCs cater to a high yielding segment where the customer profile is relatively riskier as they have small businesses or belong to lower income segment from the salaried class. The impact of Covid-19 will result in slowdown in the economy on account of which the NBFCs operating in the gold loan segment will face near term pressures on the asset quality and profitability. However, credit costs should be limited on account of gold as collateral but might witness near term rise in delinquencies.
- **Affordable Housing Segment:** Over the last few years, most financial institutions have looked towards affordable housing as their engines of growth within the housing sector. Majority of affordable housing loans are extended to Economically Weaker Section (EWS), Middle Income Group (MIG) and Low Income Group (LIG) segments in the rural and semi urban areas. However, the ability of these profiles of borrowers to absorb any economic shocks, has been less as compared to the others. COVID-19 is likely to impact the loan servicing of the borrowers in affordable housing since due to restricted scale of operations as well as limited digitalisation, the collection efficiency in this segment is likely to suffer more during the times of lockdown.
- **Loan Against Property/ Secured SME Loans:** The loans against property (LAP) extended to SMEs, has already been showing signs of some stress amidst cash flow pressure impacting the SME borrowers. While there has been some stress in the SME sector due to uneven performance and funding constrains, a prolonged disruption/lockdown of market activity will have material impact for the products/services offered by these set of borrowers. The slowdown in economic activity shall restrict the demand for the products, while the disruption in supply chain may increase the cost of raw materials which may negatively impact the cash flows. As a consequence, timely servicing of debt shall remain a key challenge in this segment. So far, the government has not announced any relief or policy changes. However, the government seems to be considering offering tax breaks for SMEs and easier loan repayment options. Such a move

would follow countries such as Germany, Australia, and Indonesia who have already taken similar steps to combat the impact of COVID-19 on their respective economies.

- **Commercial Vehicle Loans:** Slowing GDP growth will accentuate the impact on heavy commercial vehicle segment while the Covid-19 outbreak can disrupt the small & mid-sized CV operators also. Apart from the severity of the virus contagion, the time span of the disruption would determine the ultimate effects across asset classes. With reports of disruption being experienced across supply chains already being witnessed, there is every likelihood of stress in the performance of small and light commercial vehicle loans (SCVs & LCVs) to begin with. The CV sales have already been affected due to economic slowdown and the transition from BS-IV to BS-VI. The COVID-19 pandemic would further dampen the demand and in turn the financial viability of small transport operators.
- **Unsecured SME Loans:** Financiers who provide unsecured loans to SME units generally tend to rely on assessment of the estimated (surrogate) cash flows with high yield. Lock downs, disruptions in supply chain and impact of large industries loans would increase immediate delinquencies in this segment.
- **Personal loans:** Personal loans are largely unsecured and financiers whose customers include high yield and relatively large ticket-size with high proportion of self-employed or unorganised salaried customers are expected to see stress on asset quality in the near term if disruption of economic activity and restriction on movement of people and goods is prolonged as low income group people may lose wages.

In conclusion, the actual impact would depend upon the time frame in which the Covid-19 situation is expected to come under control and the various relief measures which the government is expected to roll out. The NBFC/HFC sector which has managed to sustain amidst challenging funding scenario by taking various mitigating steps, will now have to weather the Covid-19 disruption. While the sector remains fairly well-capitalized, the trend in delinquencies retail asset classes will be a key parameter to monitor for the sector over the next few quarters along with resource raising capabilities of the NBFCs/HFCs.

Authors: Abhijit Urankar, Aditya Acharekar, Mitul Budhbhatti, Ravi Kumar Dasari, Saurabh Bhalerao and Sriram Rajagopalan

10. Oil and Gas

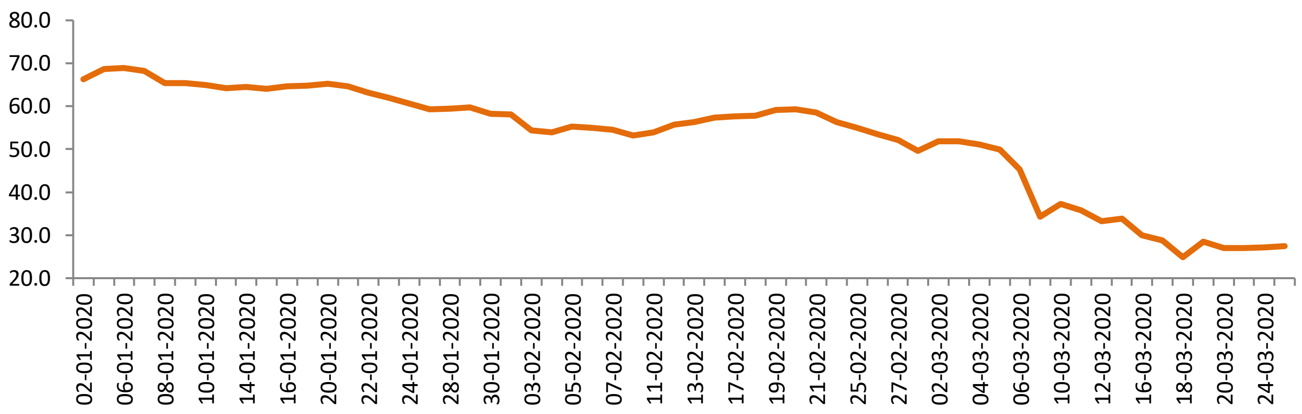
Pandemonium prevailed in the oil markets with the outbreak of the novel coronavirus (COVID-19) which has shaken the entire global economy. Oil prices have fallen by 58.7% since from the start of the calendar year till date and now with the fallout of Russia with OPEC (and with Saudi Arabia and UAE escalating a price war by declaring an increase in oil production April 2020 onwards), and dampened demand prospects of the commodity, oil prices are posed to fall even further now. The macros are in favour for the Indian considering economy considering we import more than 80% of our import requirements.

Table 4: Oil and Gas operational indicators (Unit: Million Metric Tonnes)

	2018-19*	2019-20*	2018-19*	2019-20*
Crude Oil				
Production	31.3	29.5	-4.0%	-5.8%
Consumption	234.7	233.2	1.7%	-0.6%
Imports	207.3	207.1	2.6%	-0.1%
Refinery Products				
Production	239.5	240	3.1%	0.2%
Consumption	193.7	197.6	3.3%	2.0%
Exports	55.6	59.7	-9.6%	7.4%
Imports	29.7	39.4	-8.6%	32.7%

Source: PPAC *April-February

Chart 6: Prices of Crude Oil since December 2019 (Unit: USD/bbl)



Source: Bloomberg

Outlook for FY21

Crude oil production for FY21 is to fall by -7.3% given the sharp fall in oil prices, crude oil explorers will be dissuaded to carry on with exploration. Domestic production has fallen by 4.2% during FY19 and 5.8% during FY20 (April-February).

- With the outbreak of COVID-19 crude oil prices has fallen by more than 50% which is far below the breakeven price for domestic explorers.
- Oil prices have been ranging between USD27-USD30/bbl which will also impact the realizations of E&P players.
- Domestic oil fields output has been dwindling since FY11 due to aging and maturing of oil fields. Now with the verdict to suspend production from the Cauvery delta fields in Tamil Nadu as well it will further add pressure on the domestic oil production.

Consumption of crude oil is to fall by 2.3% during FY21 as processing of crude oil activities undertaken by refiners is to fall in the light of subdued demand for consumption of petro-products given the world over fall in demand.

- With the spread of the contagion in the Indian economy, even post the 21 day lockdown period Indians will be sceptical to travel anywhere any time soon, thus laying less impacting the need for the auto and aviation transportation fuels.

- Uncertainly so as to how long the COVID-19 pandemic will last may also add onto the curtailment of refinery activities. There are chances the government will extend the 21 day lockdown period as well.

Imports of crude oil are to fall by 5.1% during FY21 given the lack of demand of crude oil by Indian refiners.

Author: Urvisha Jagasheth **Inputs By: Nitesh Ranjan**

11. Paper and paper products

The **paper and paper products industry** is largely domestic focused, however, imports continue to account for more than 20% of the overall annual demand, and more than 55% of newsprint demand (primarily from Russia and Canada). Further, the industry imports significant levels of pulp and waste paper due to lower domestic availability.

Category	China's share by volume	
	FY19	YTDFY20 (Jan- Dec)
Paper Imports	17.2%	19.0%
Paper Exports	17.7%	15.8%
Paper Products Imports	40.1%	43.0%

Source: CMIE, CARE Ratings Calculations

Subdued and diverse trading conditions caused by geopolitical uncertainties including the global coronavirus pandemic are expected to adversely impact the overall demand. Demand in the packaging paper & board segment is expected to remain ahead, while other segments are expected to either grow slowly or remain at similar levels.

In the beginning of 2020, even as coated paper prices increased due to slowdown in Chinese imports, other prices held steady. If the outbreak persists, the prices could increase further, however, global macro-economic headwinds and demand conditions would limit the upside.

Pulp prices had come off their highs and waste paper prices had declined further, however, pulp prices have already started to harden as the global trade has slowed. This in turn is expected to result in paper prices moving up. Cheaper Imports into India have also declined. Larger players maintain plantations and an ability to source raw materials efficiently; however, MSME companies could face raw material supply disruptions, impacting their ability to meet their supply contracts especially in the packaging material requirements

Margins of the players are expected to be affected by subdued market conditions, lower realizations of finished goods, and the upcoming summer season (impacts water availability). Credit profiles of companies which have either high leverage or larger dependencies on the overseas market implying lower bargaining power (especially MSMEs) could weaken indicating larger working capital requirements and lower liquidity levels.

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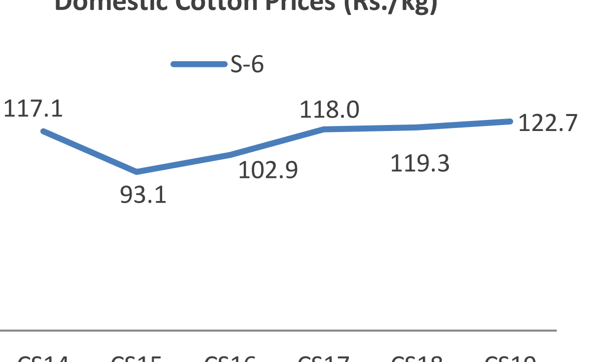
12. Textiles

Indian Textiles and Apparels (T&A) industry accounts for approximately 4% of the global T&A market. The T&A industry is one of the largest and the most important sectors for the Indian economy in terms of output, foreign exchange earnings and employment. The industry contributes approximately 7% to industrial output in value terms, 2% to the GDP and 15% to the country's export earnings. It also provides direct employment to over 45 million people and is the second largest provider of employment after agriculture.

Category	China's share in India's Trade (by volume) in FY19
Cotton Yarn Exports	35%-40%
VSF Exports	19%
PSF Imports	55%
PFY Imports	43%
VFY Imports	96%

Source: CMIE, CARE Ratings Calculations

The Covid-19 pandemic is primarily expected to adversely impact exports and with second order impact on the domestic markets with both exports as well as domestic sales falling



Demand from China was subdued primarily due to availability of cheaper yarn from Vietnam and Pakistan. As the Covid-19 pandemic originated in China's textile hub of Wuhan, Hubei, it has significantly impacted the Chinese textile industry in China with boarded up factories, Indian yarn exports have dried up and therefore yarn exports are expected to show a fall.

Cotton prices would remain largely range bound and average at Rs 122 – 125 per kg for CS20 due to higher production and subdued demand.

As per the WTO, India is ranked as 5th largest exporter of RMG in the world. As the Covid 19 pandemic has also affected the majority of India's export market (the US and EU together constitute for approximately, 60% of the total apparel exports from India in value terms), causing order cancellations/deferral of order leading to inventory build-up and expectation of slower realisation of export receivables leading to higher working capital requirements. Apparel exports are expected to fall due to drying up of order in the last quarter of FY20, working capital issues and lack of clarity on the duties and incentives especially when exporters from Bangladesh, Sri Lanka and Vietnam receive preferential access.

Additionally, domestic consumption is also getting impacted due to all India closure. New store openings have stopped and even domestic stores are facing an inventory build-up due to apparel sources for the upcoming summer season, Further, domestic prices could be negatively impacted if exporters dump their inventories in the domestic market leading to even reduced margins. This could lead to short term blips such as reduced employment of casual labour (factory closures and people moving back to their home towns) and reduced consumption.

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