
# CareEdge Ratings
# Credit Quality Assessment
# H2 FY22

# Pandemic decisively behind, Credit Ratio at decadal high

- CareEdge Ratings projects a GDP growth rate of 9.1% for FY22 amid rapid economic recovery and easing pressures on the financial sector.
- CareEdge Ratings has clocked a **decadal high Credit Ratio* at 2.64 times in H2FY22** which points towards a positive credit outlook. The uptrend was contributed by upgrades in both, the Infrastructure and Manufacturing/Services sectors. The Credit Ratio for the BFSI segment moved above unity for the first time since the NBFC crisis.
- In H2 FY22, CareEdge Ratings upgraded ratings of 468 entities and downgraded ratings of 177 entities.
- The sectors which witnessed high upgrades in H2FY22 were power, roads and construction within the infrastructure sector and steel, chemicals, gems & jewellery and pharmaceuticals in the manufacturing/services sector.
- The uptrend in the credit quality can be attributed to higher demand with the economy opening up, releasing of pent-up demand, lower tax regime, lower cost of capital, better realisations, and improvement in profitability, as well as significant deleveraging by India Inc.
- Government spending on infrastructure and schemes such as Atmanirbhar Bharat, Production Linked Incentives (PLI), etc, as well as the impact of the China + 1 strategy aided the recovery to a large extent.
- While the domestic companies have shown resilience and exhibited a sharp recovery, the global turmoil of the Russia-Ukraine crisis, sharp rise in commodity prices (especially oil), inflationary pressures and Covid restrictions imposed in some parts of the world are expected to have a bearing on some sectors going forward.
- The credit outlook is expected to be positive for India Inc. with the domestic economy on a recovery path.



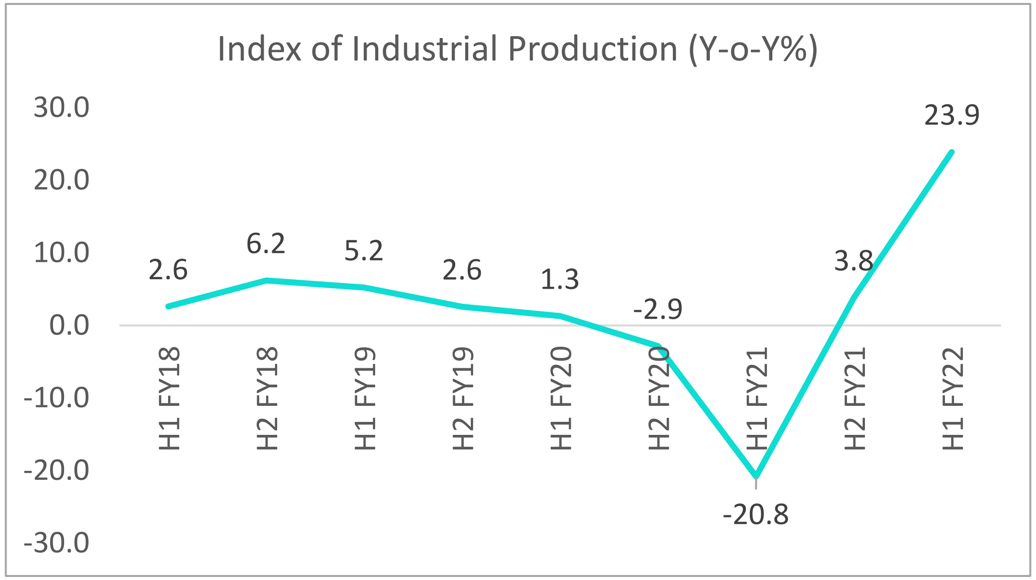
*ratio of upgrades to downgrades

# Economy

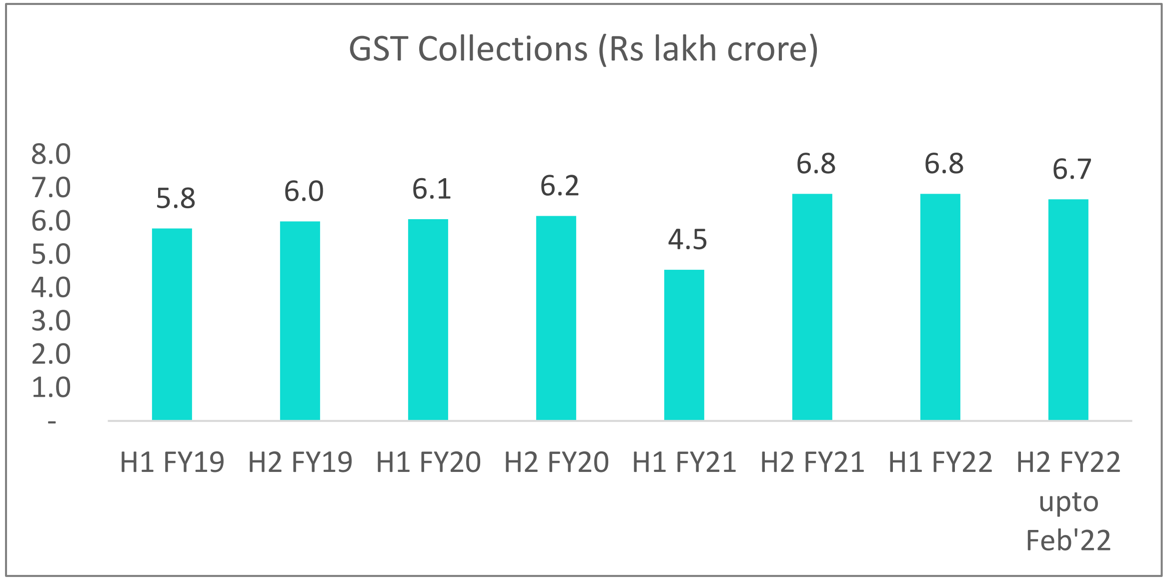
# Economy Outlook

- GDP growth expectation for FY22 retained at 9.1% with a downward bias of 10 bps.
- Infrastructure spending and rebound in the services sector to fuel economic growth in FY23.
- The downside risks to economic recovery: Geopolitical uncertainties and resurgence of Covid cases on account of new variants of the virus.
- CareEdge Ratings expects a rise in policy rates in FY23. This, coupled with a higher borrowing programme next fiscal, is likely to push the yields up. CareEdge Ratings expects the 10-year G-sec yield to remain elevated through the year in 7.00% -7.25% range.
- The outlook for bank credit growth is expected to be in the range of 8.0% to 9.0% for FY22 with a low base effect, economic expansion, rise in government and private capex (specially, capex for renewables and production linked incentive (PLI) schemes), extended ECLGS support, and retail credit push
- Strength in US Dollar relative to other currencies owing to expectations of aggressive tightening by Fed and investor risk aversion could pressurize the developing countries' currency.

# High Frequency Indicators exhibit Recovery




Source: MOSPI




Source: Ministry of Finance

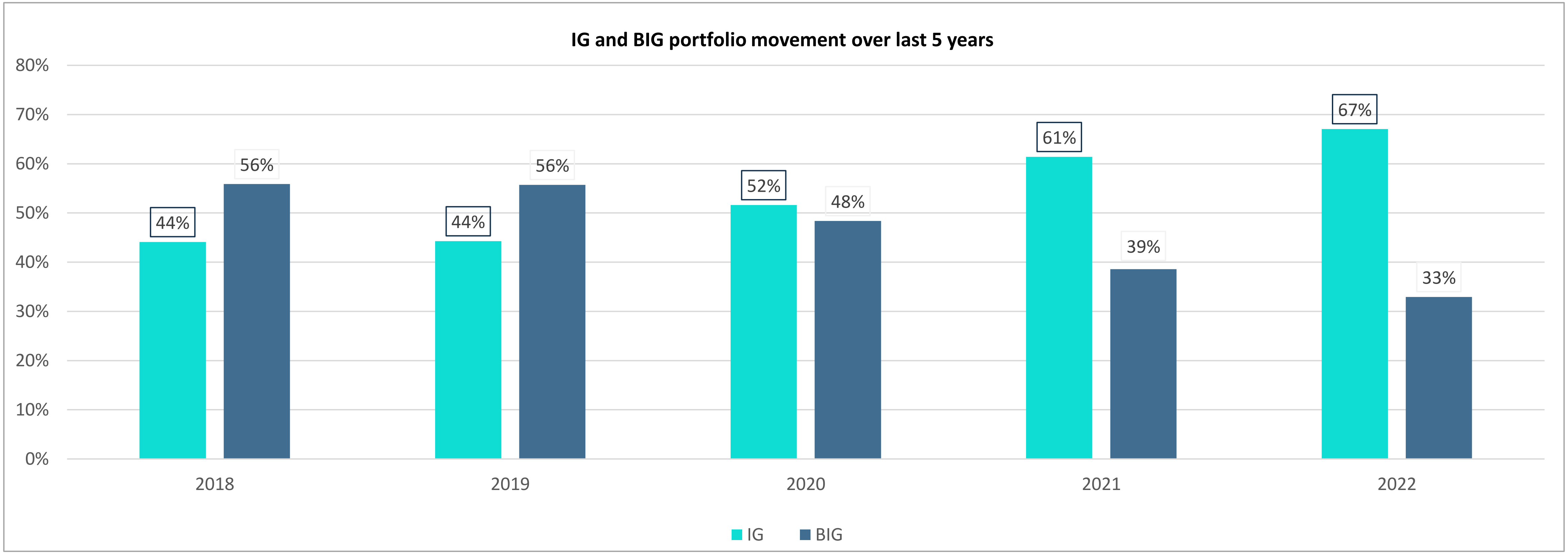
- Industrial growth picked up in H1-FY22 aided by a negative base, momentum in vaccinations and a return to economic normalcy.
- GST collections have been robust during the second half of FY22: Increased formalisation of the economy and better compliance has broadened the tax base.
- Bank credit growth shows signs of improvement: Incremental credit growth from April-21 to February-22 was 6.2% compared with 3.9% recorded the last fiscal, for the comparable period. Retail Credit has been the key driver for the total credit off-take.

# Ratings Portfolio at a Glance

# Share of Investment Grade Ratings on the Rise

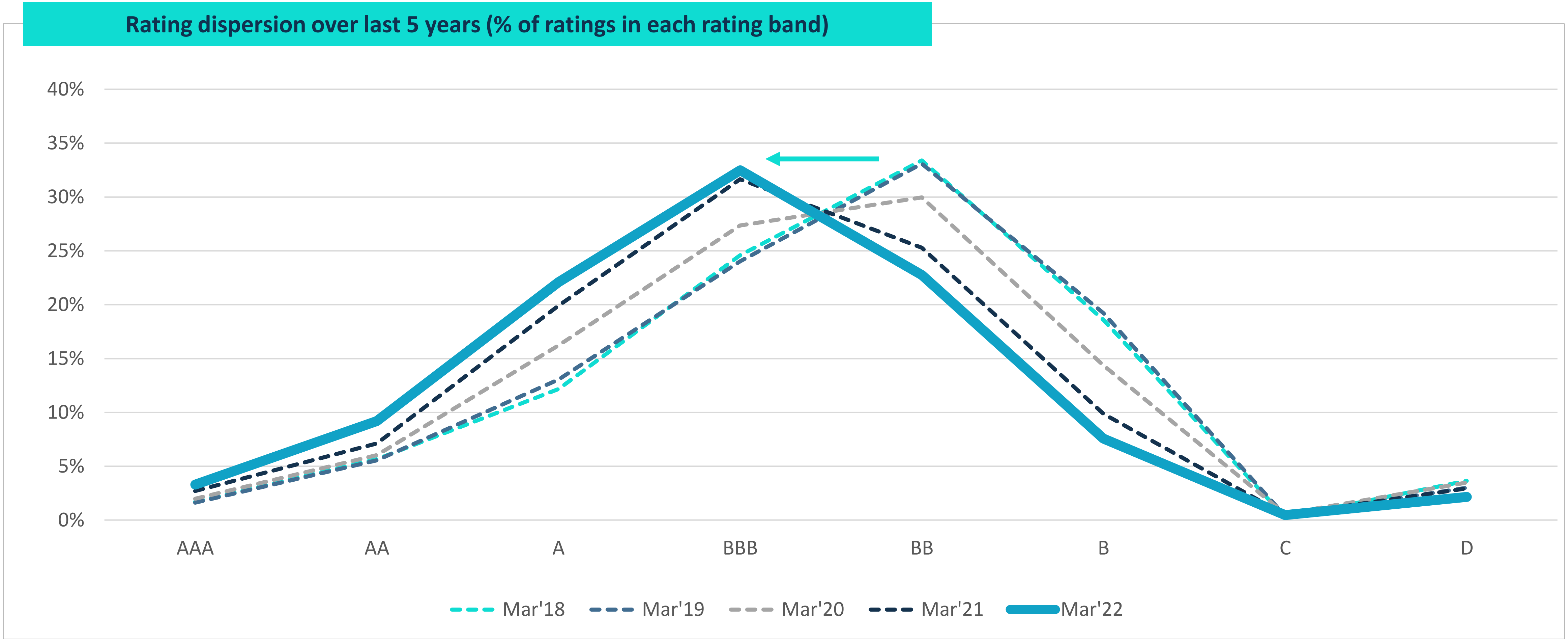
The proportion of investment grade (IG*) ratings in our portfolio has increased over the last 5 years from 44% in March 2018 to 67% in March 2022.

This shift cannot be attributed to rating movements from below investment grade (BIG) to IG across CareEdge Ratings' rated portfolio. Rather, in the past two years, a large proportion of lower-rated entities have turned into Issuer Not Cooperating (INC).




* Investment Grade (IG): CARE BBB-/CARE A3 or higher ratings. Below Investment Grade (BIG): CARE BB+/CARE A4+ or lower ratings.

# Median Rating continues at BBB Category




The median rating of CareEdge Ratings moved from BB category till FY20 to BBB in FY21 and continues to be there in FY22.

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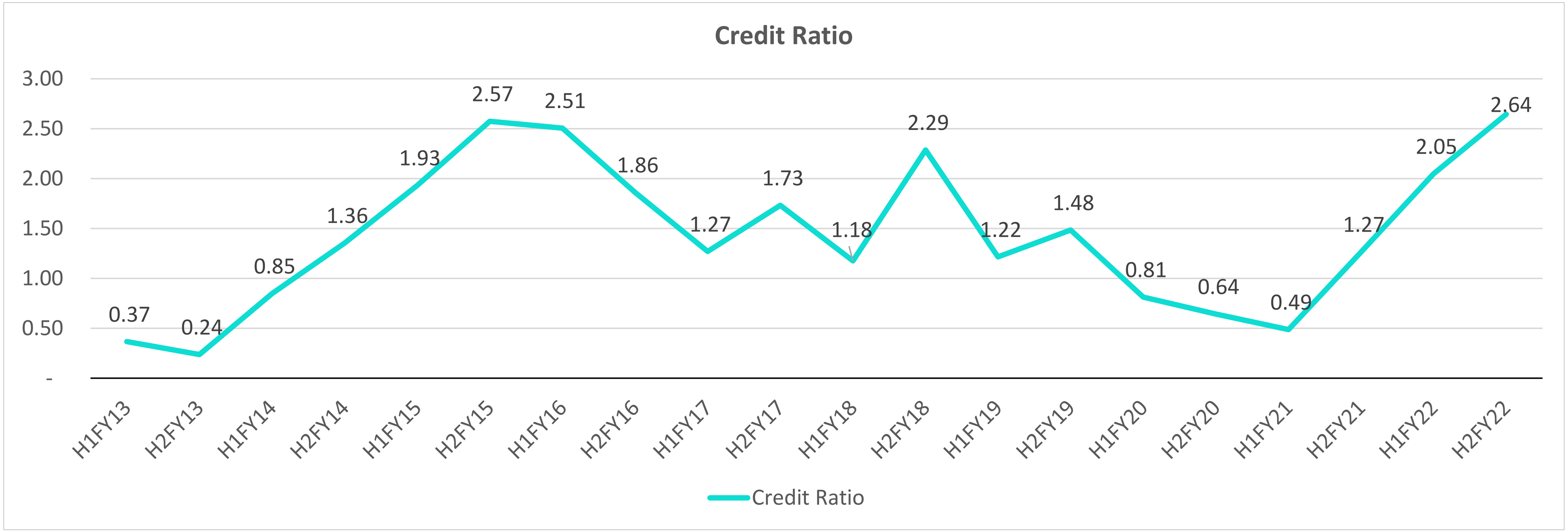
# Credit Ratio

# Credit Ratio at Decadal High

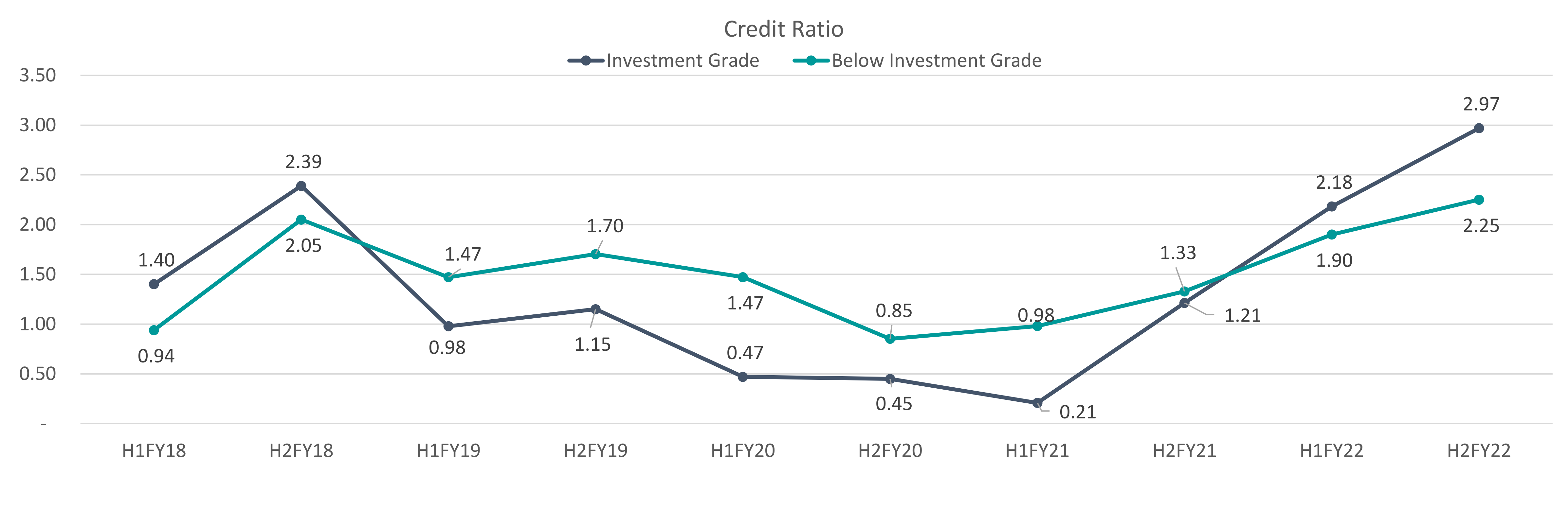



**Credit Ratio = Upgrades/Downgrades -** A ratio higher than unity denotes more upgrades than downgrades. An increase in ratio as compared to previous periods denotes an improvement in the credit quality of rated entities and vice versa.

Credit ratio was at a low of 0.49 in H1FY21 due to the onslaught of Covid but showed a steep recovery since then, riding on the improving sentiment with the vaccination drive, unlock process, government push and deleveraging efforts by the corporates.

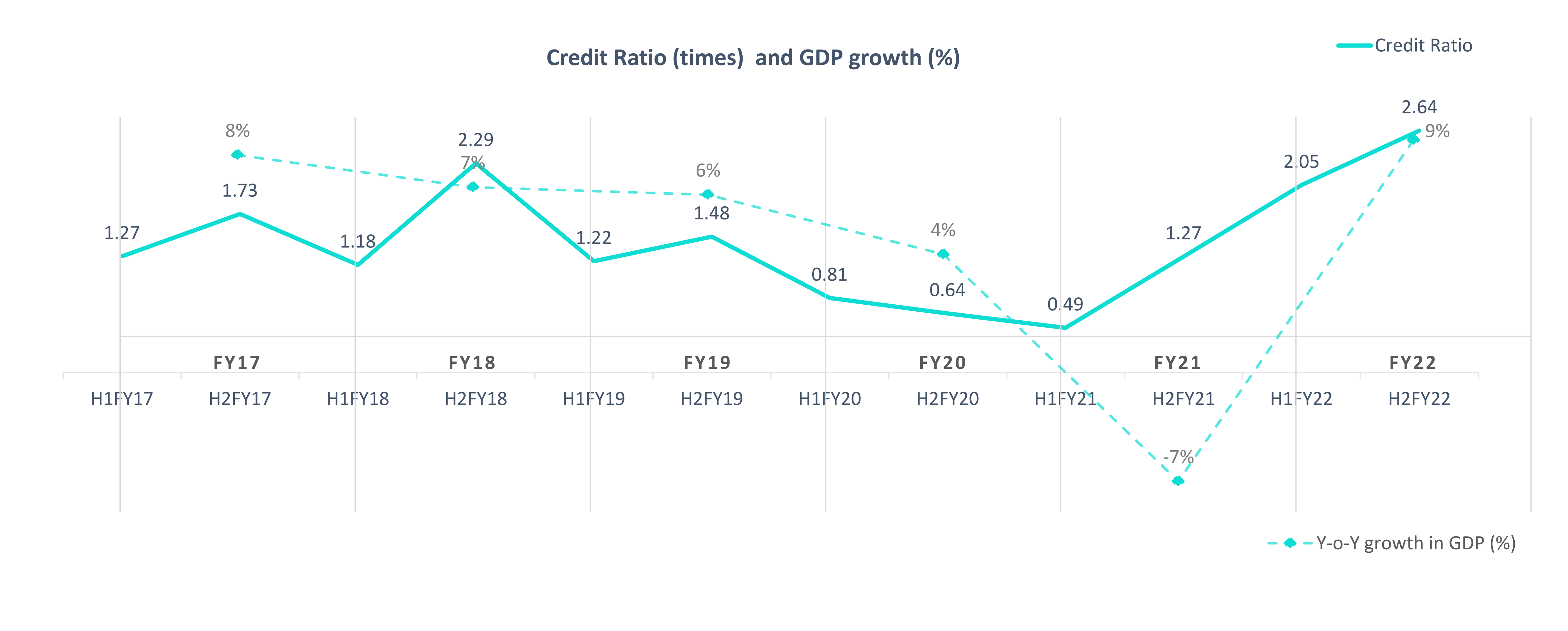
The jump up in the overall credit ratio in H2FY22 can be attributed to five-year high CRs in the Infrastructure segment (3.17) and Manufacturing/ Services segment (2.69).

# Credit Ratio driven by Upgrades in IG

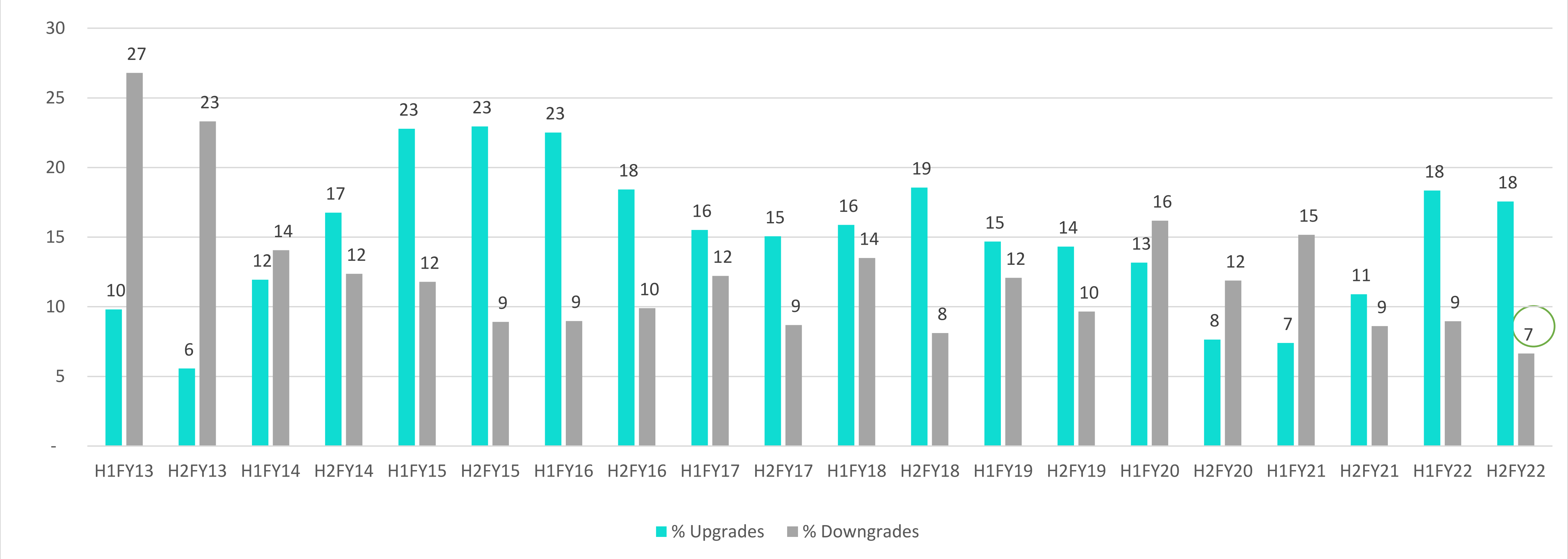



The credit ratio of both, Investment grade (IG) and Below investment grade (BIG) entities for H2FY22 is at its highest as compared to last five years.

# Superior Credit Ratio mirroring GDP Growth



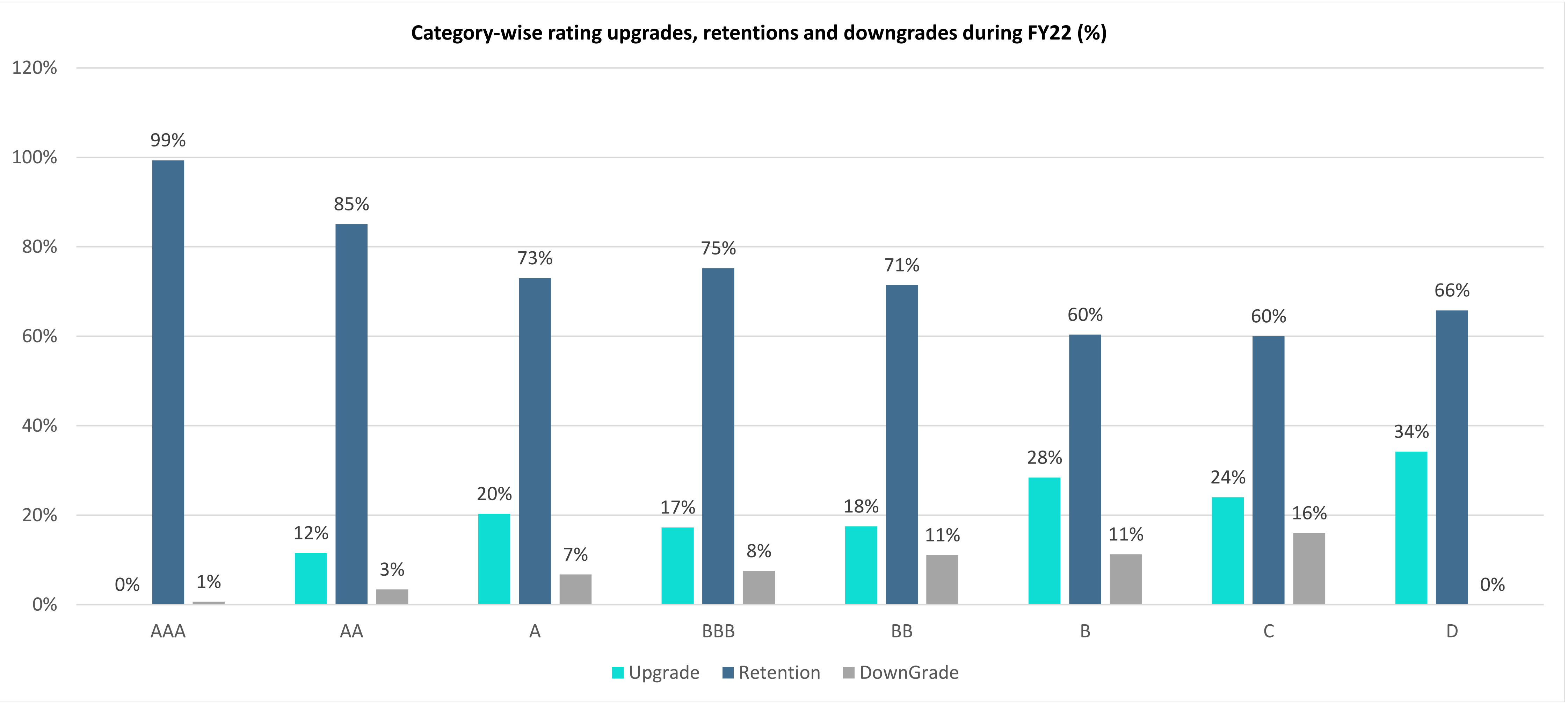
# Lowest % of Downgrades in the Past Decade




CareEdge Ratings downgraded 7% of its portfolio companies in H2FY22, the lowest proportion of downgrades in the past decade.

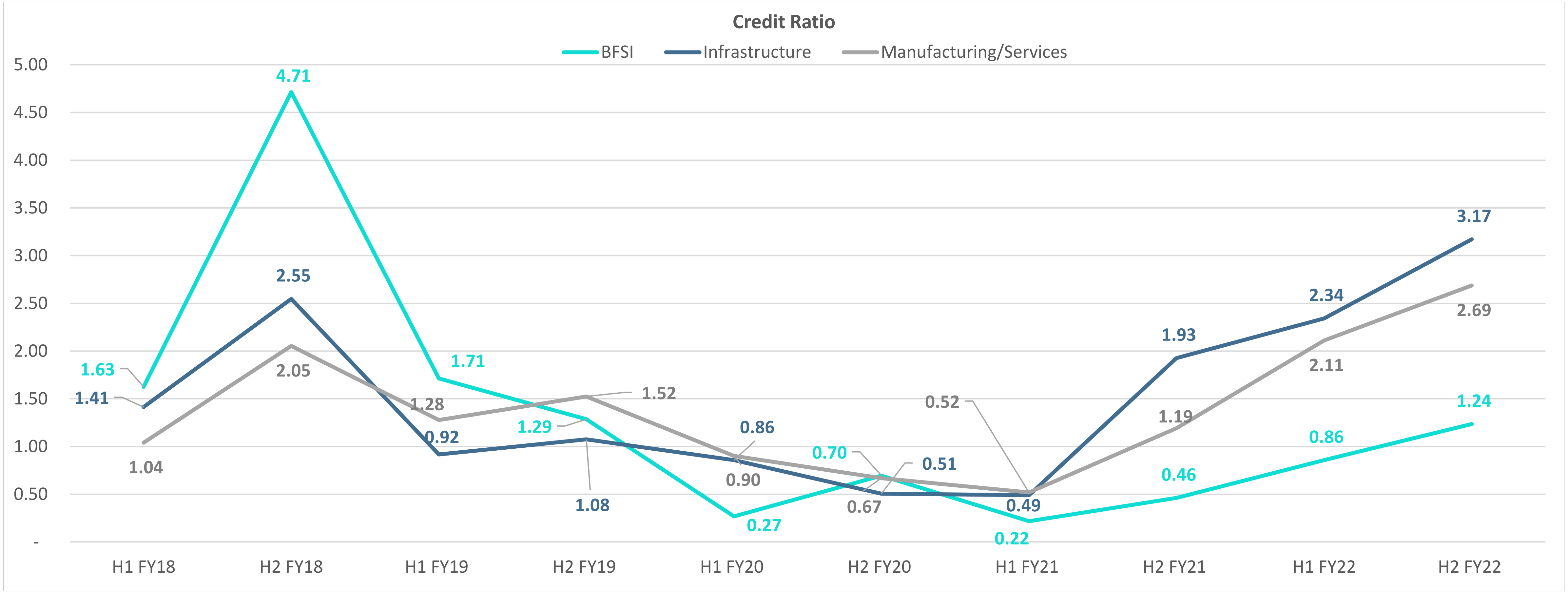
**Lower downgrades suggest a reduction in stress on the credit quality of companies**.

# Upgrades spread across Rating Categories in FY22



# Sector Trends in Credit Ratio

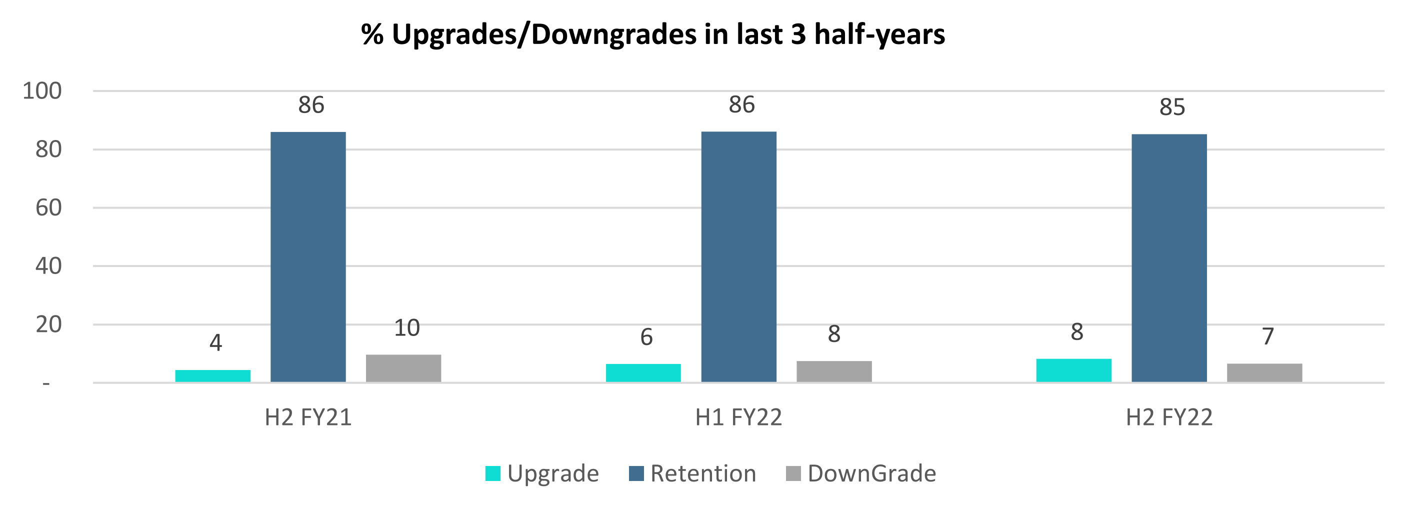
# Sectoral Credit Ratios

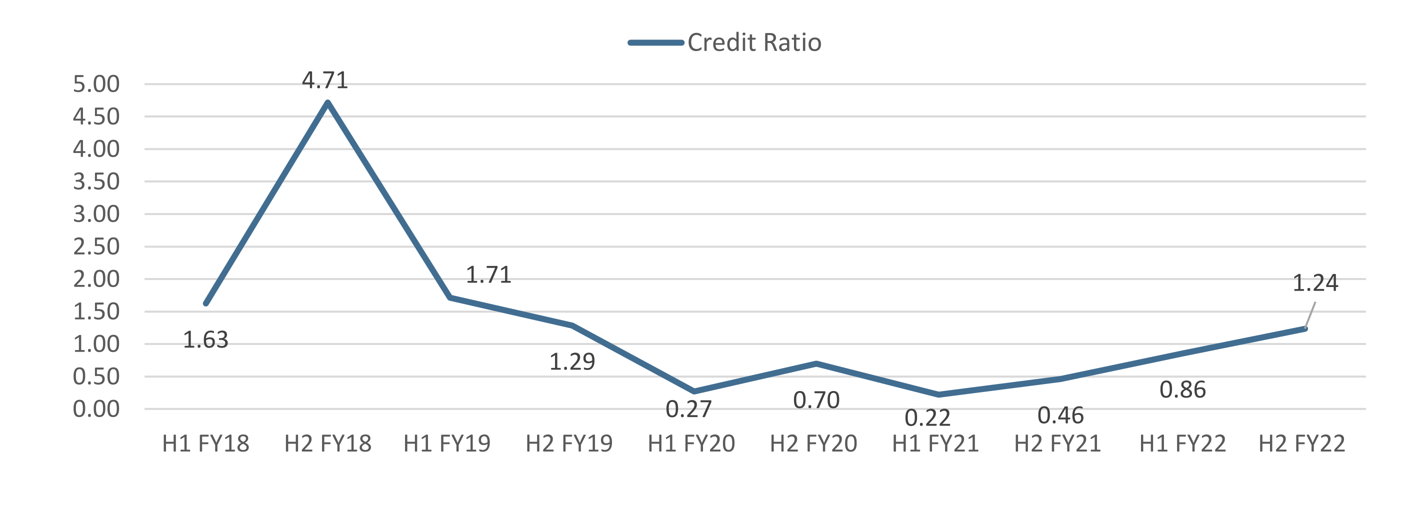



Infra and Manufacturing led the upswing in the Credit Ratio; BFSI Credit Ratio moved above unity for the first time since the NBFC crisis.

# Banking and Financial Services

# BFSI Credit Ratio: Inched above Unity after 3 years



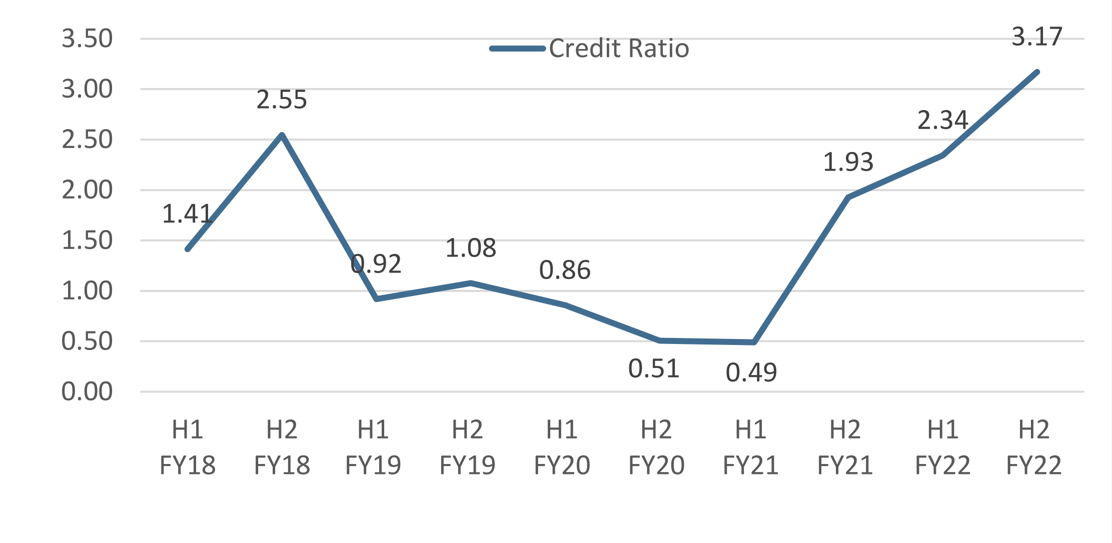



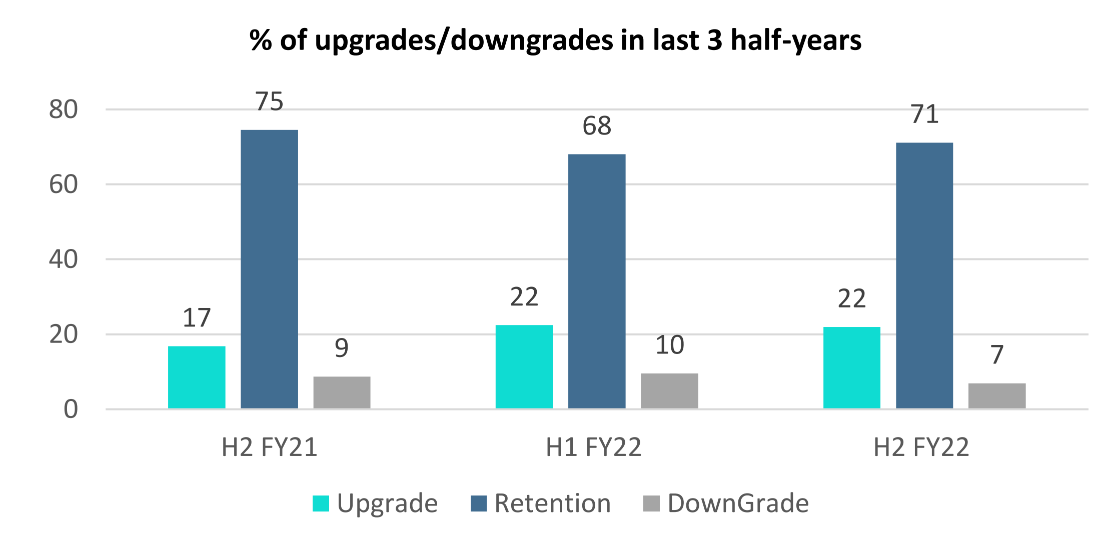

The higher proportion of upgrades in H2FY22 can be attributed to:

- ✓ Easing of asset quality concerns post-Covid.
- ✓ Regular capital infusion (debt+equity) leading to stable capital adequacy ratios.
- ✓ Upgrades in the PTC transactions driven by improved performance with collections almost reaching pre-Covid levels and rundowns of the pools.
- ✓ Banks overcoming the Asset Quality Review (AQR) hump in provisioning and hence exhibiting higher profitability.

# Infrastructure

# Infrastructure: Credit Ratio at Multi-year High



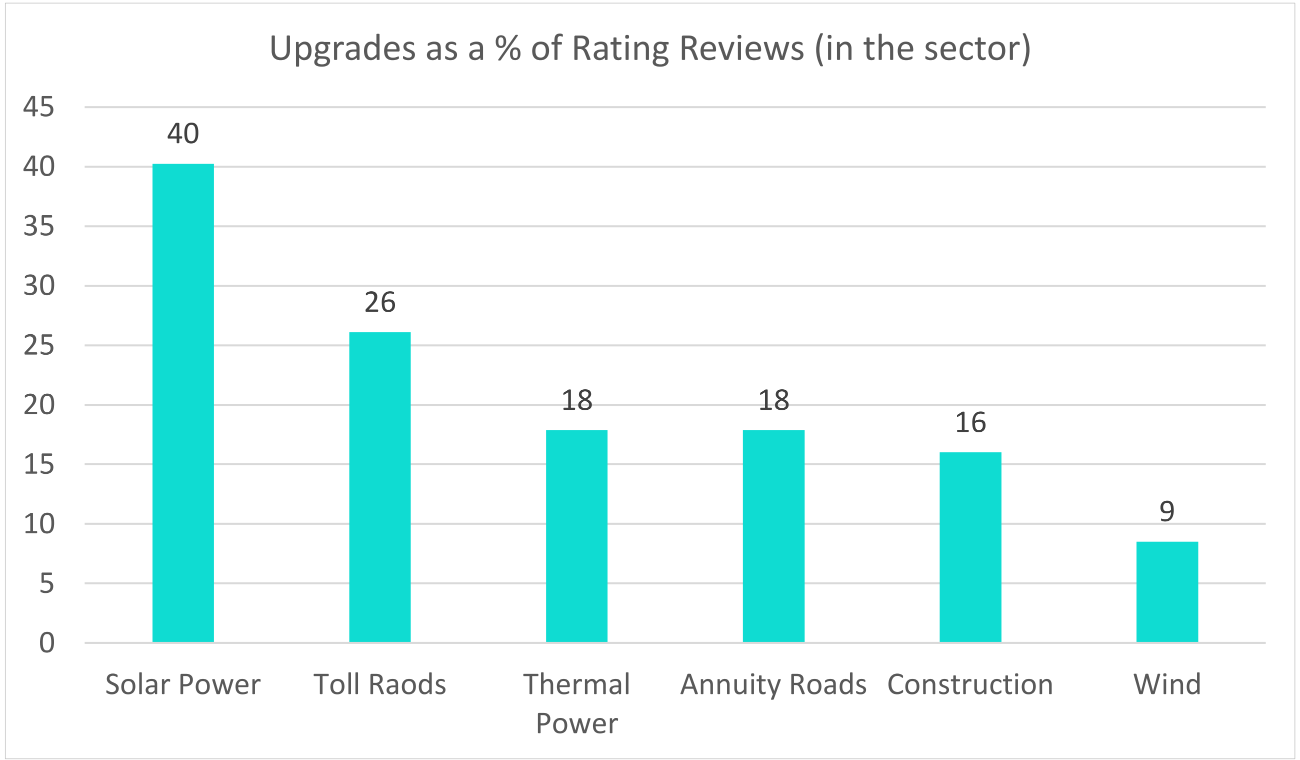



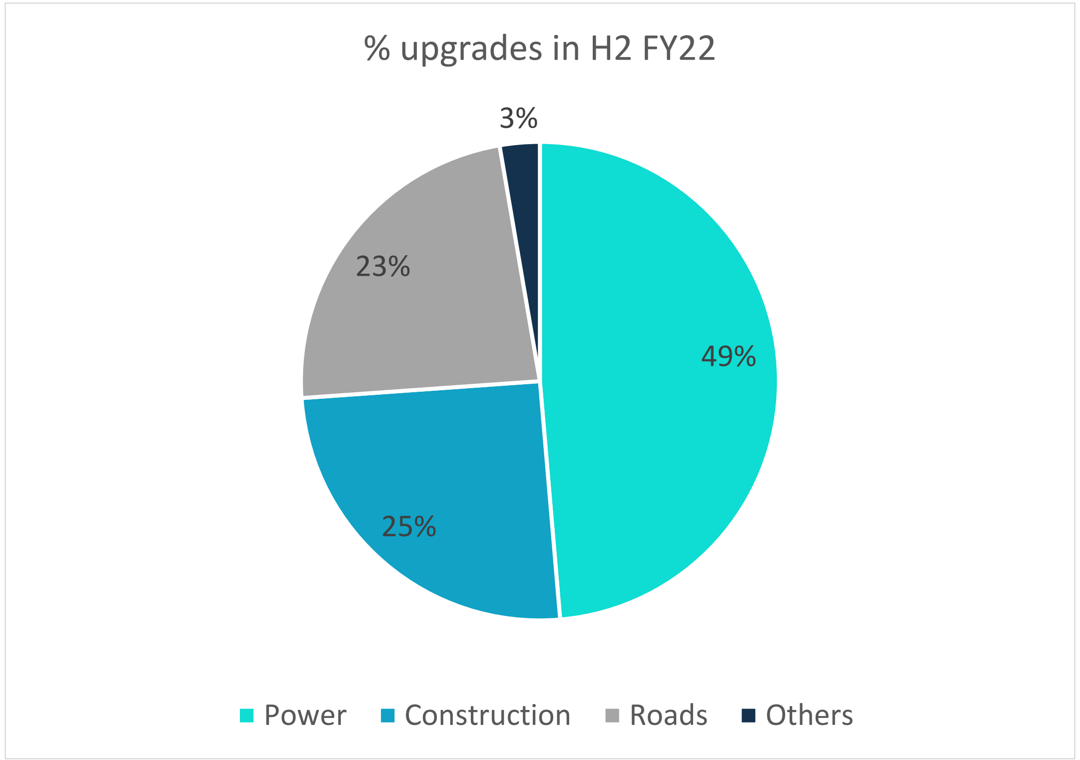

Upgrades in Infrastructure are driven by the Power sector, accounting for 49% of the total upgrades.

The upgrades in the Infrastructure segment can be attributed to:

- ✓ Commissioning of projects, especially in the solar power generation space.
- ✓ Benefits of Atmanirbhar Bharat scheme providing a fillip to power generation companies.
- ✓ Pace of execution picking up along with robust order inflows.
- ✓ Operational projects, especially toll roads, demonstrating robust performance with the opening up of the economy and hence better toll collections.
- ✓ Refinancing of projects at better financing terms and structured financing avenues like InvITs.

# Infra Sectors ruling in Upgrades

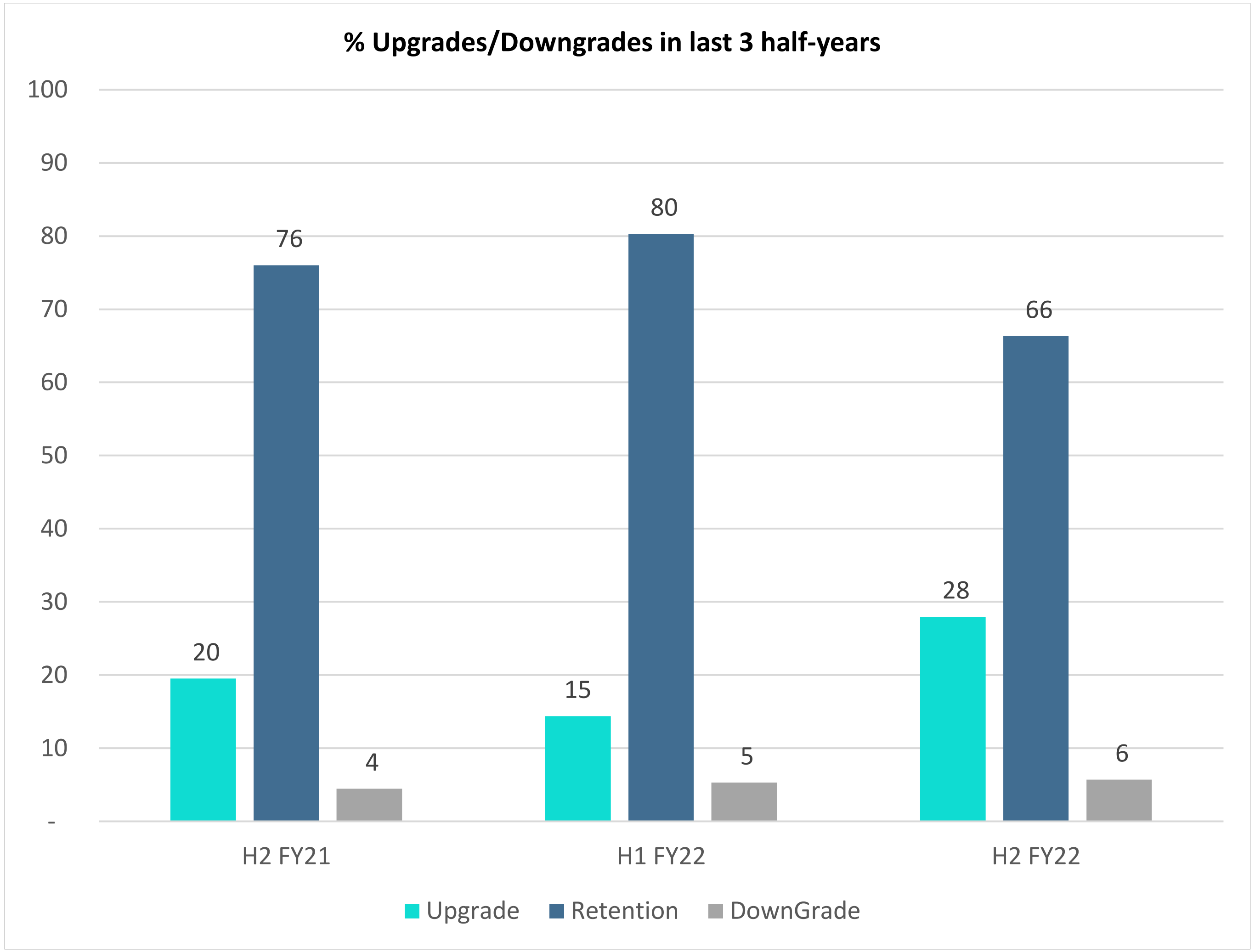



High upgrades in Solar power and Toll roads.

Power sector accounts for 49% upgrades in all infra entities.

# Power – Going Strong

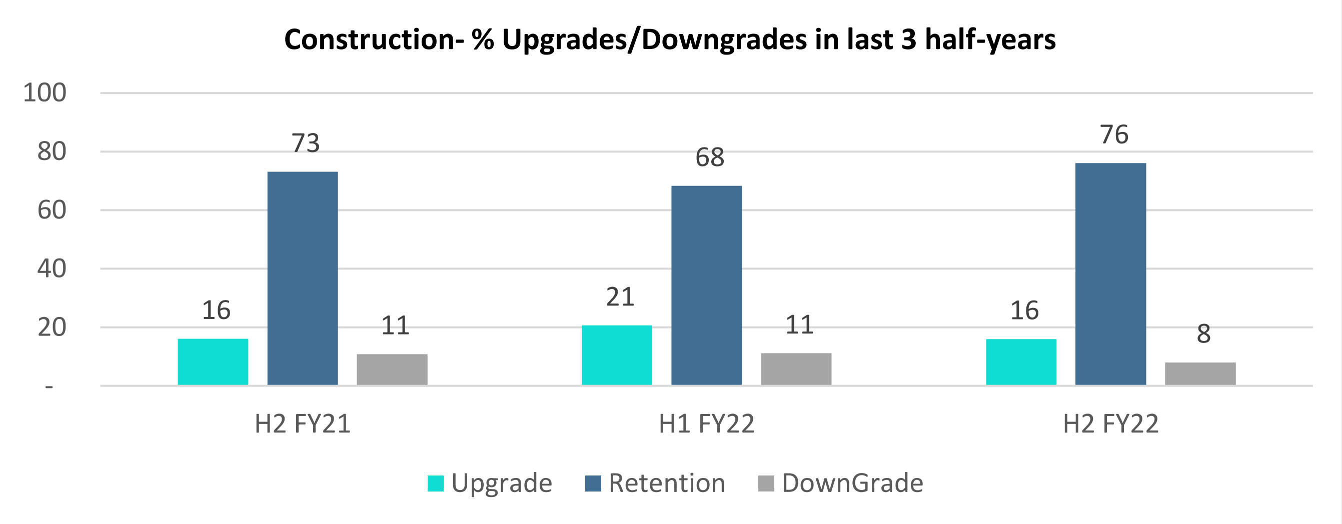


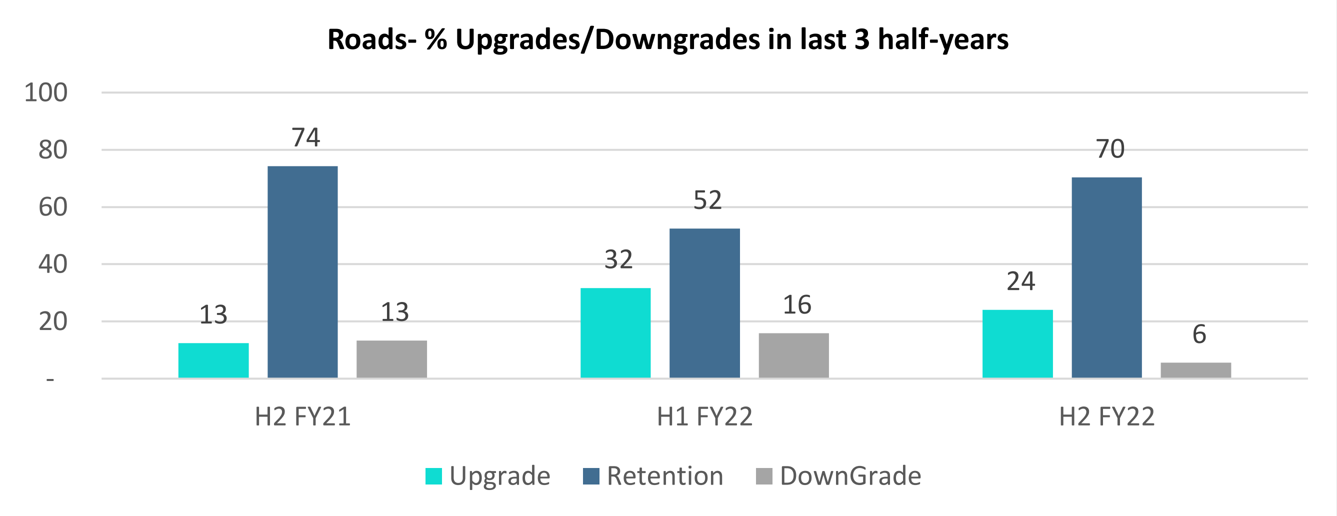

In H2FY22, 30% of upgrades in Infrastructure were in the Solar power generation companies.

Upgrades in the sector triggered by:

- ✓ Robust generation track record with generation levels above P90 estimates.
- ✓ Improvement in operating performance of utilities above regulatory parameters with a conducive regulatory environment.
- ✓ Operationalisation of projects.
- ✓ Capital infusion by strong investors.

# Construction and Roads – Normalcy Returns




Construction: Sector took a hit during the pandemic but revived in H2 FY22 due to:

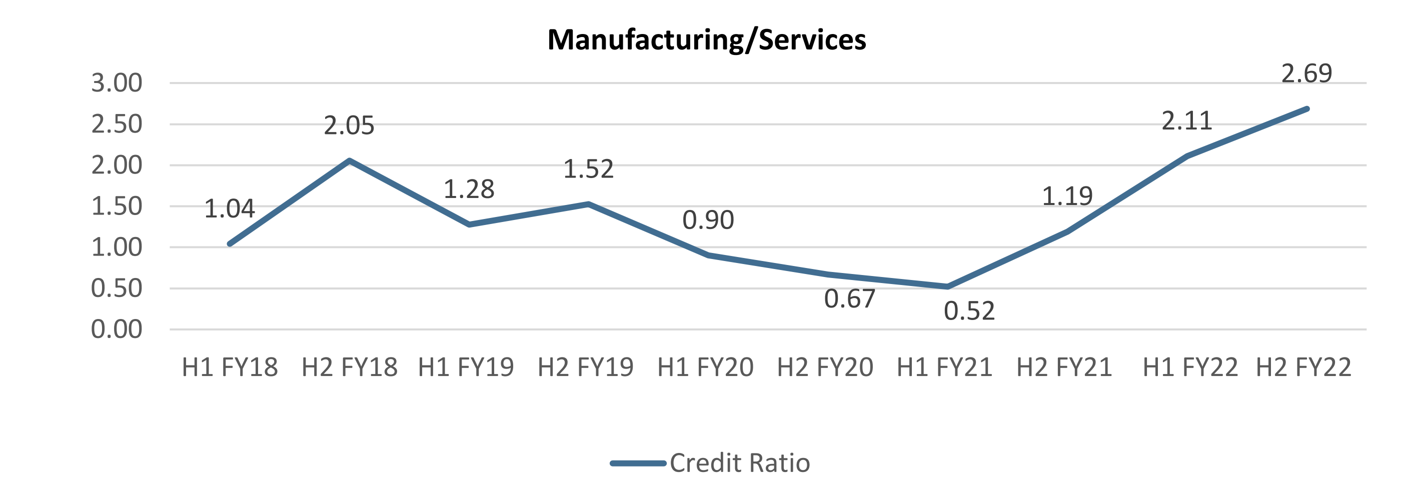
- ✓ Faster project execution leading to revenue recovery.
- ✓ Revenue visibility enhanced with infrastructure push by the Government spending.
- ✓ Recovery of pending bills post-Covid unlock.
- ✓ Improvement in profitability.
- ✓ Going forward, margins remain tepid due to the commodity price rise impact.

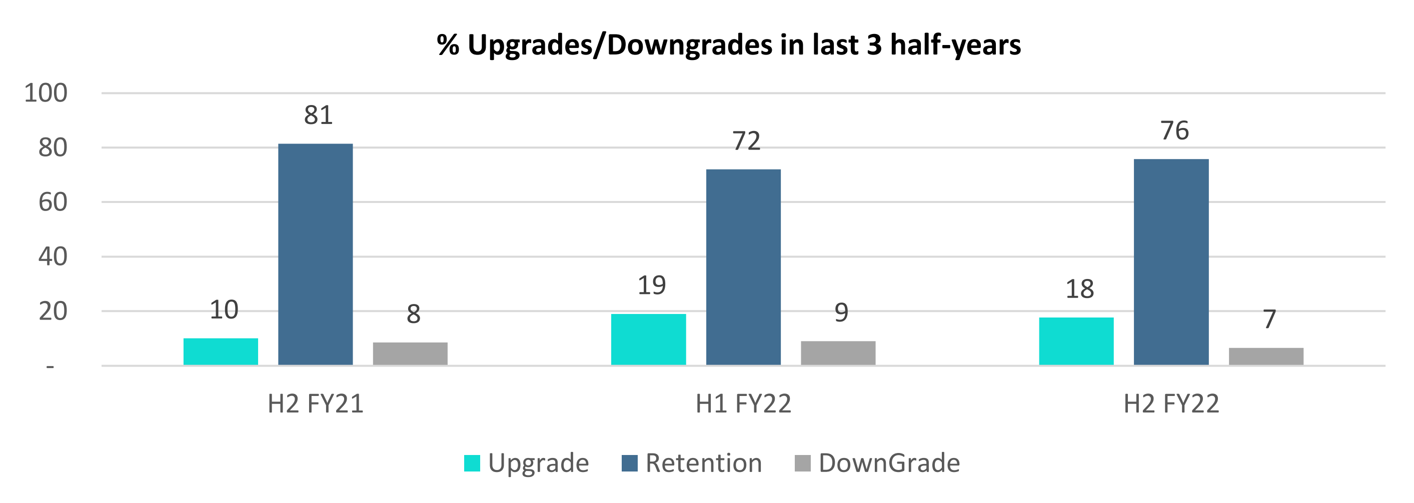
Roads sector upgrades were triggered by:

- ✓ 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.
- ✓ Demonstrated track record of toll collections for mature toll roads despite Covid. CareEdge Ratings estimates toll collections to grow by 10-12% in FY22.
- ✓ Strong sponsors/private equity players taking a stake and infusing equity in projects.

# Manufacturing/Services

# Manufacturing/Services : Credit Ratio at its Peak

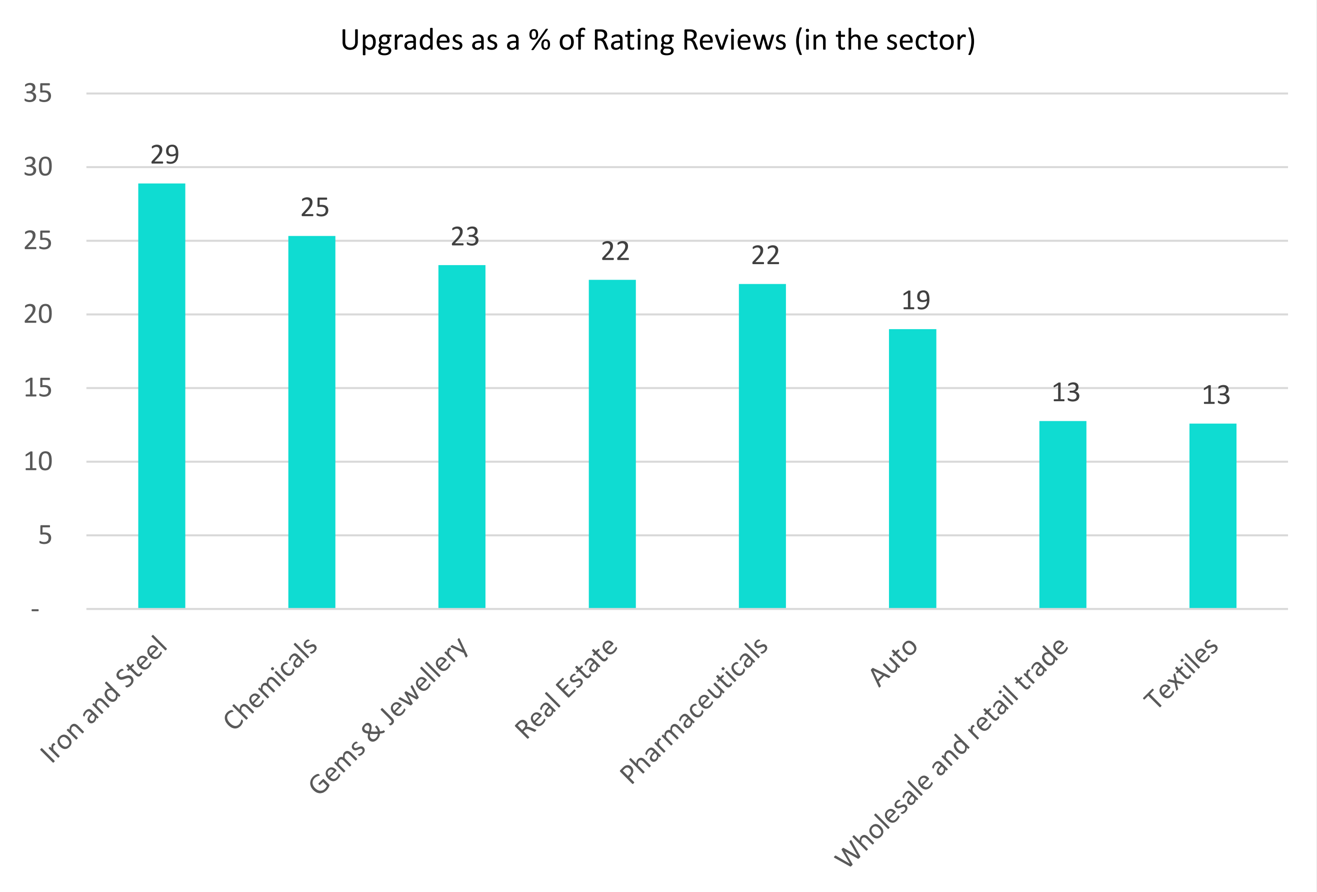


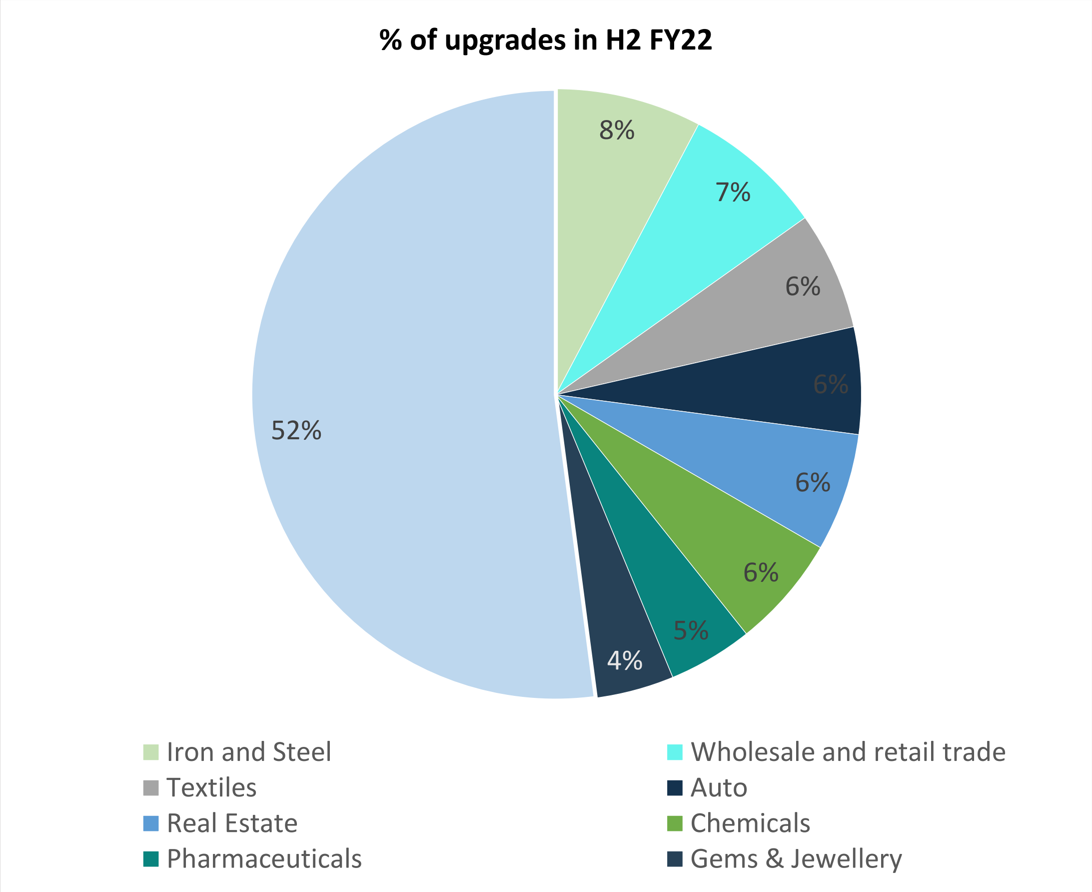




Credit Ratio for manufacturing/services highest in the last 10 half-years. The higher proportion of upgrades in H2FY22 can be attributed to :

- ✓ Demand growth post unlocks, both domestically and globally.
- ✓ Government initiatives like Atmanirbhar Bharat, Emergency credit lines, PLIs giving a boost, mainly to MSMEs.
- ✓ Higher turnover supported by both volumes and realisations.
- ✓ Credit quality supported by deleveraging efforts of corporates.

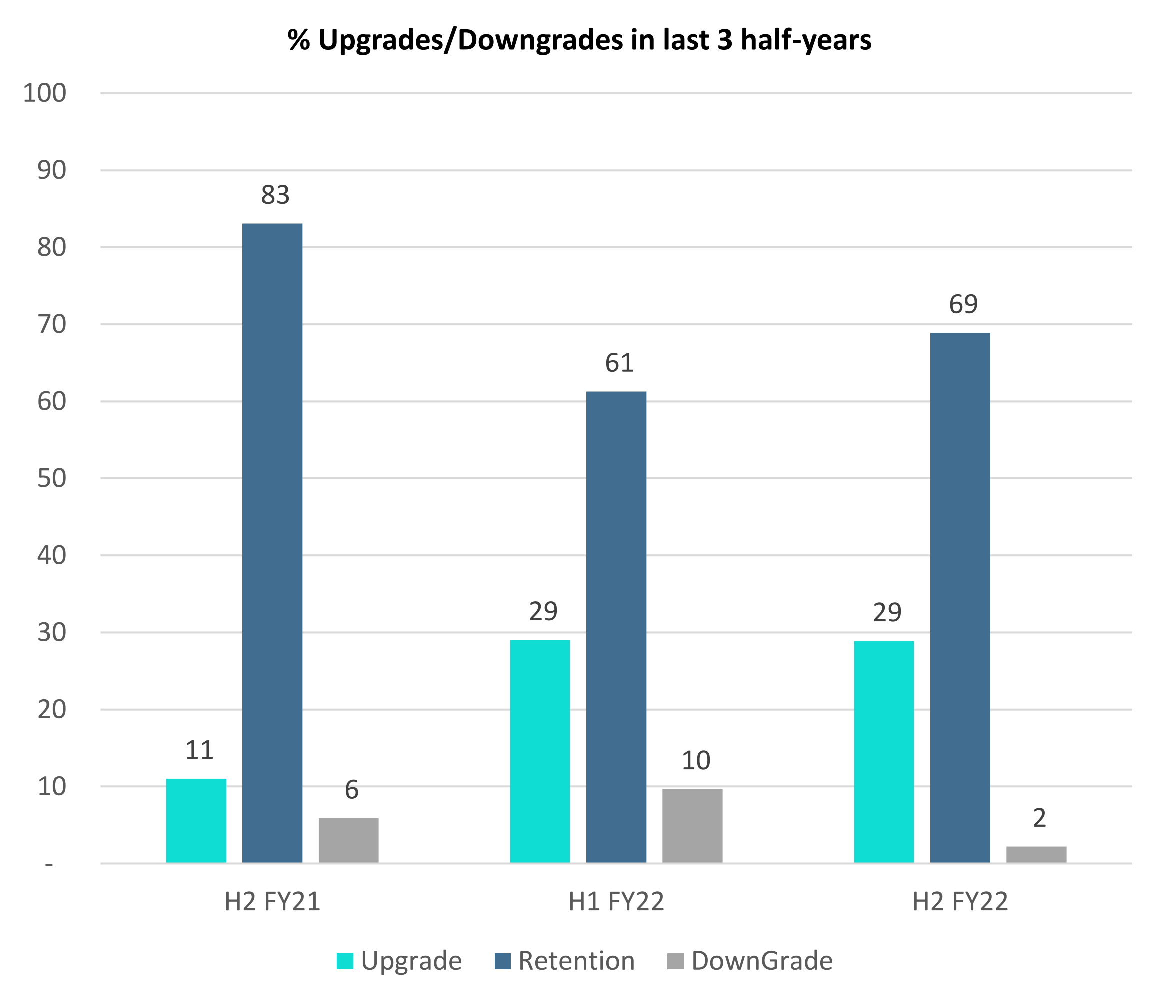
# Manufacturing/Services Sectors ruling in Upgrades




Iron and Steel, Chemicals and Gems & Jewellery leading the pack; these sectors also account for 18% of total upgrades across sectors.

# Steel on an Upcycle



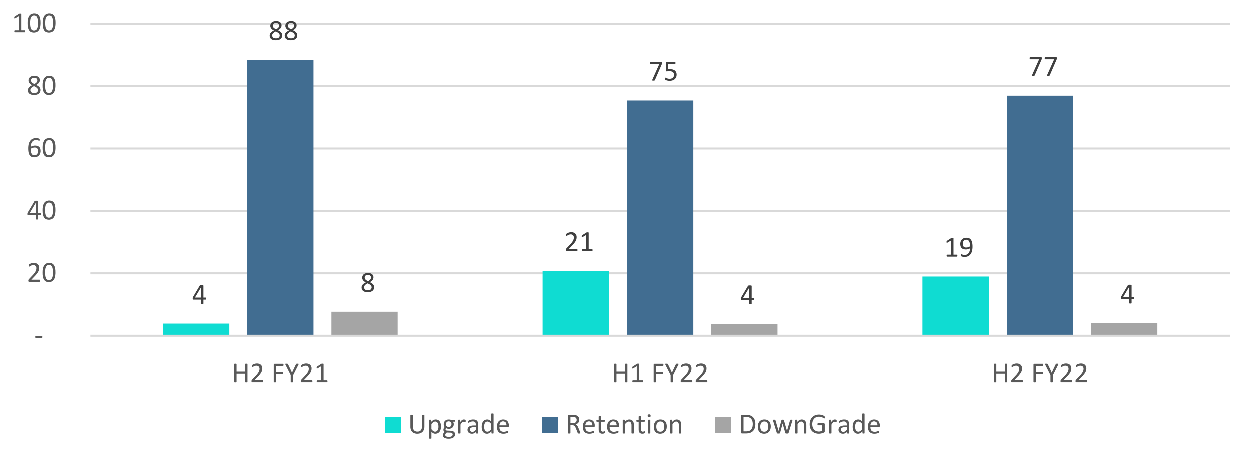

**Steel** industry witnessed a recovery in demand post-Covid.

Upgrades triggered by:

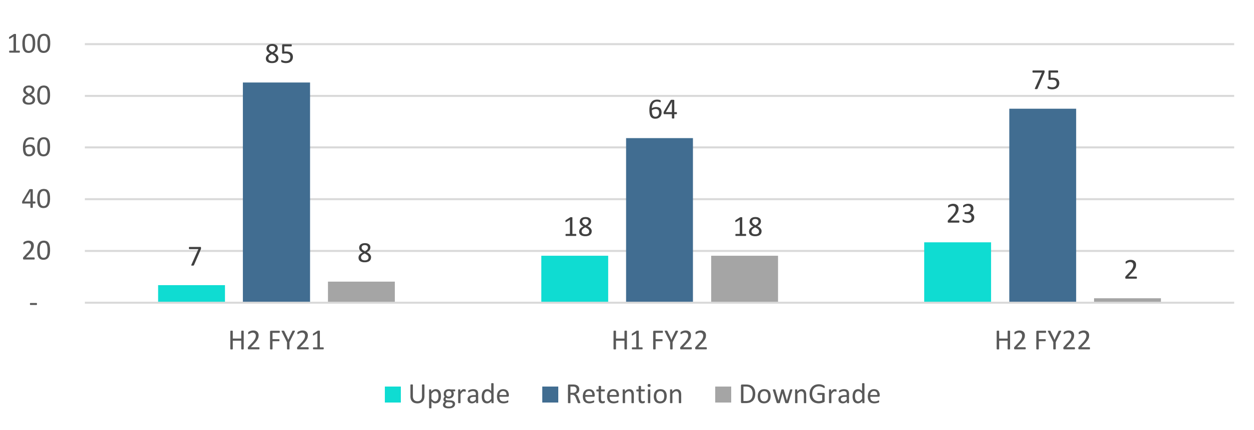
- ✓ Recovery in volumes in the current fiscal on a low base of FY21. Domestic steel production and consumption are expected to jump by 15% and 12% in FY22.
- ✓ Robust sales realisations backed by a strong uptrend in prices.
- ✓ Expansion in margins supported by healthy realisations.
- ✓ Substantial deleveraging and expectations of comfortable financial profile in medium-term notwithstanding fresh Capex.
- ✓ With strong demand backed by govt spending on infrastructure and Capex, fewer capacities coming up onstream in the near term & limited imports, steel prices are poised to remain elevated in foreseeable future.
- ✓ Profit margins of steel players shall remain healthy although they shall get adversely impacted due to a sharp jump in coking coal prices amidst the ongoing geopolitical situation.

# Chemicals: Showing Uptrend
# Gems & Jewellery: Recoups Lost Glitter

**Chemicals - % Upgrades/Downgrades in last 3 half-years**




**Gems & Jewellery - % Upgrades/Downgrades in last 3 half-years**



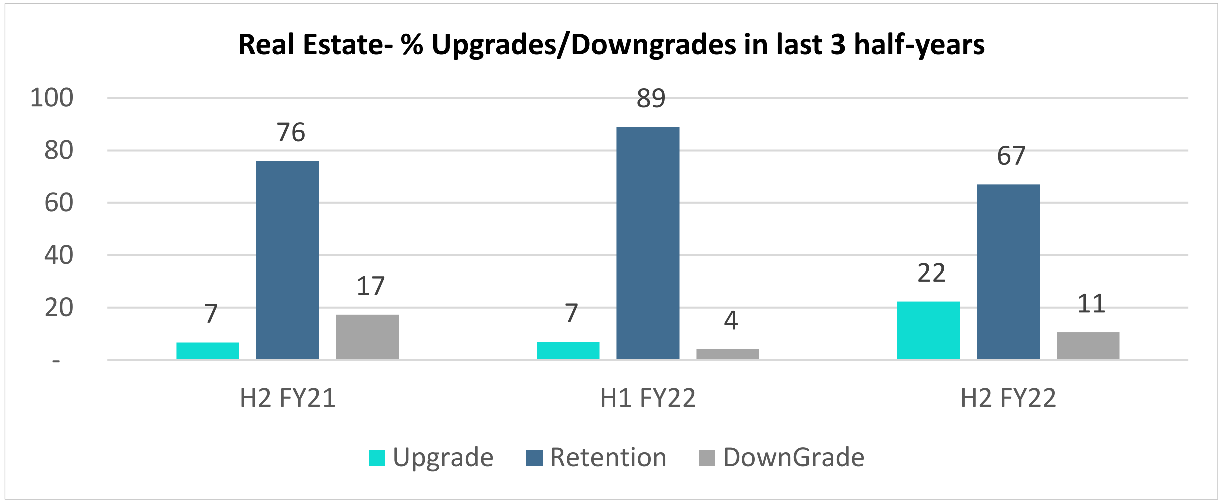

Upgrades in the **chemicals** sector triggered by:

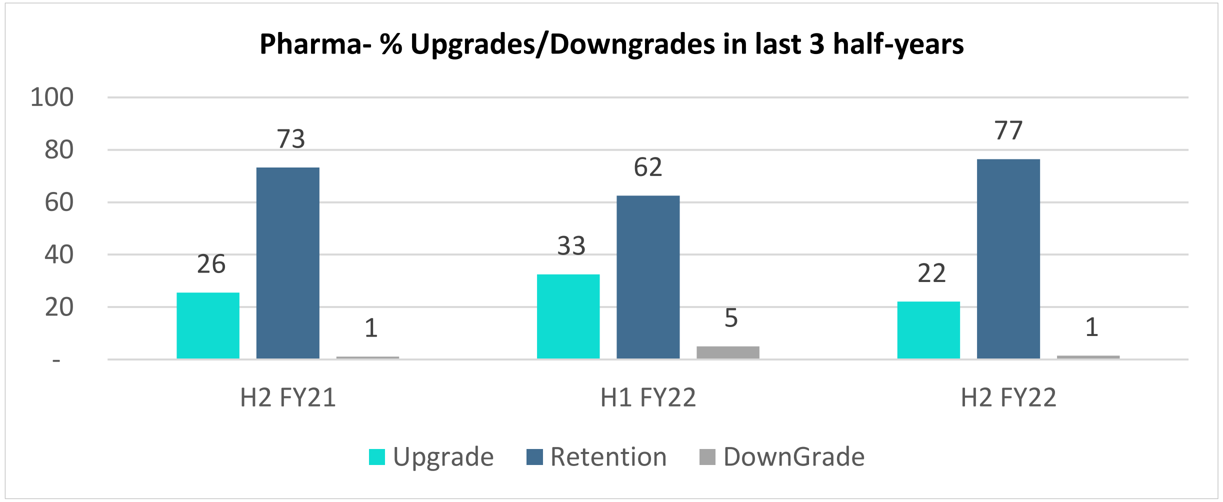
- ✓ Supply chain disruption in China and China+1 strategy of vendors.
- ✓ Improved realisations with high demand from domestic end-user segments.
- ✓ Cost-plus pricing model of Indian players to protect against a sharp increase in raw material prices. However, a rise in crude prices and derivatives may impact profitability in the sector in the future.

Upgrades in **gems & jewellery** were triggered by :

- ✓ Cut and Polished Diamond (CPD) segment: Faster than expected recovery in demand from key consuming nations due to stimulus from government and lack of other spending avenues. Overall exports of CPD have crossed pre-Covid levels.
- ✓ Gold Jewellery: Demand almost doubled in CY21 with pent-up demand, higher disposable income and an increase in weddings. It crossed pre-Covid levels to achieve a six-year high in CY21.
- ✓ Conservative debt policy resulting in improvement in capital structure and debt coverage indicators.

# Real Estate: Mixed Bag
# Pharma: Upgrades Continue




**Real estate**: Upgrades were triggered by :

- ✓ Pick-up in sales momentum and collections.
- ✓ Reduced unsold inventory.
- ✓ Regularisation of debt servicing.

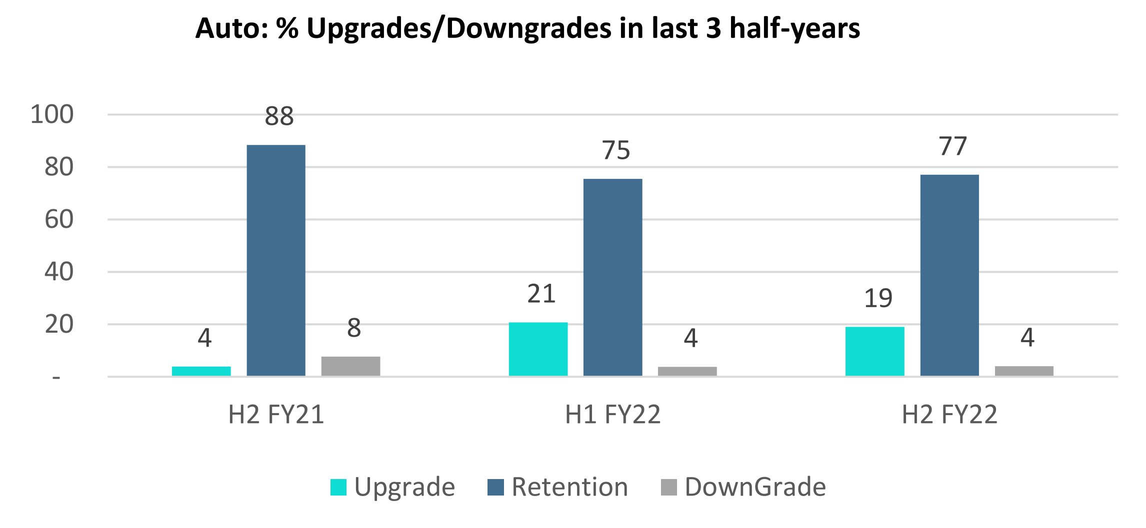
Downgrades in the sector were driven by:

- ✓ Lower occupancy in commercial real estate for LRD transactions.
- ✓ For smaller developers, non-realization of committed receivables on sold inventory.

Upgrades in **pharmaceuticals** triggered by:

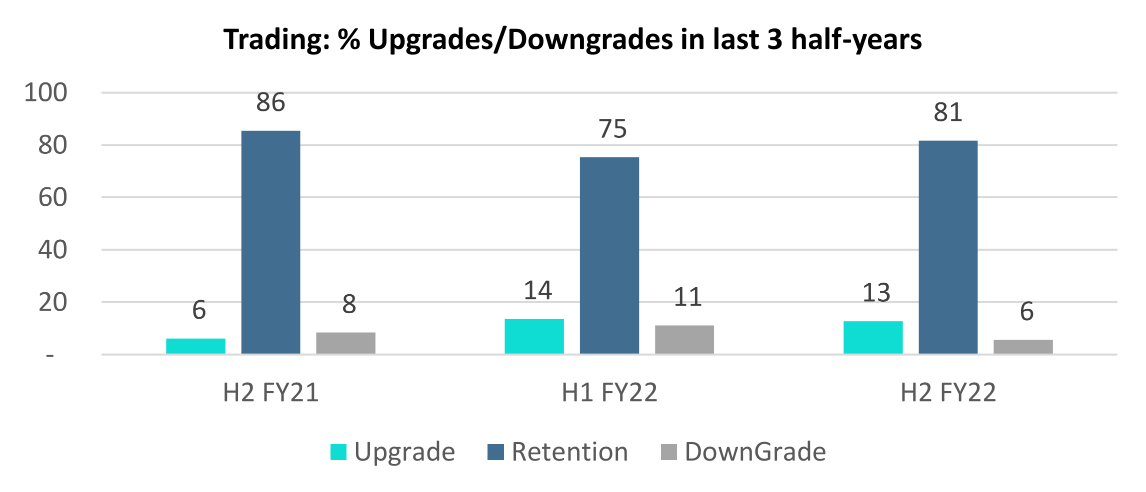
- ✓ Growth in lifestyle diseases and increase in demand.
- ✓ Increased scale of operations, profitability and revenue visibility with significant deleveraging.
- ✓ Increasing government spending under the Ayushman Bharat scheme and support by way of the PLI scheme.
- ✓ Diversification of sourcing base by global pharma companies.
- ✓ Efforts to reduce import dependency by Indian pharma players via backward integration into Key Starting Material (KSM) and Active Pharmaceutical Ingredients.

# Auto: Upgrades driven by Ancillaries & Dealerships
# Wholesale and Retail Trade: Staging Recovery




Upgrades in the **auto** segment supported by:

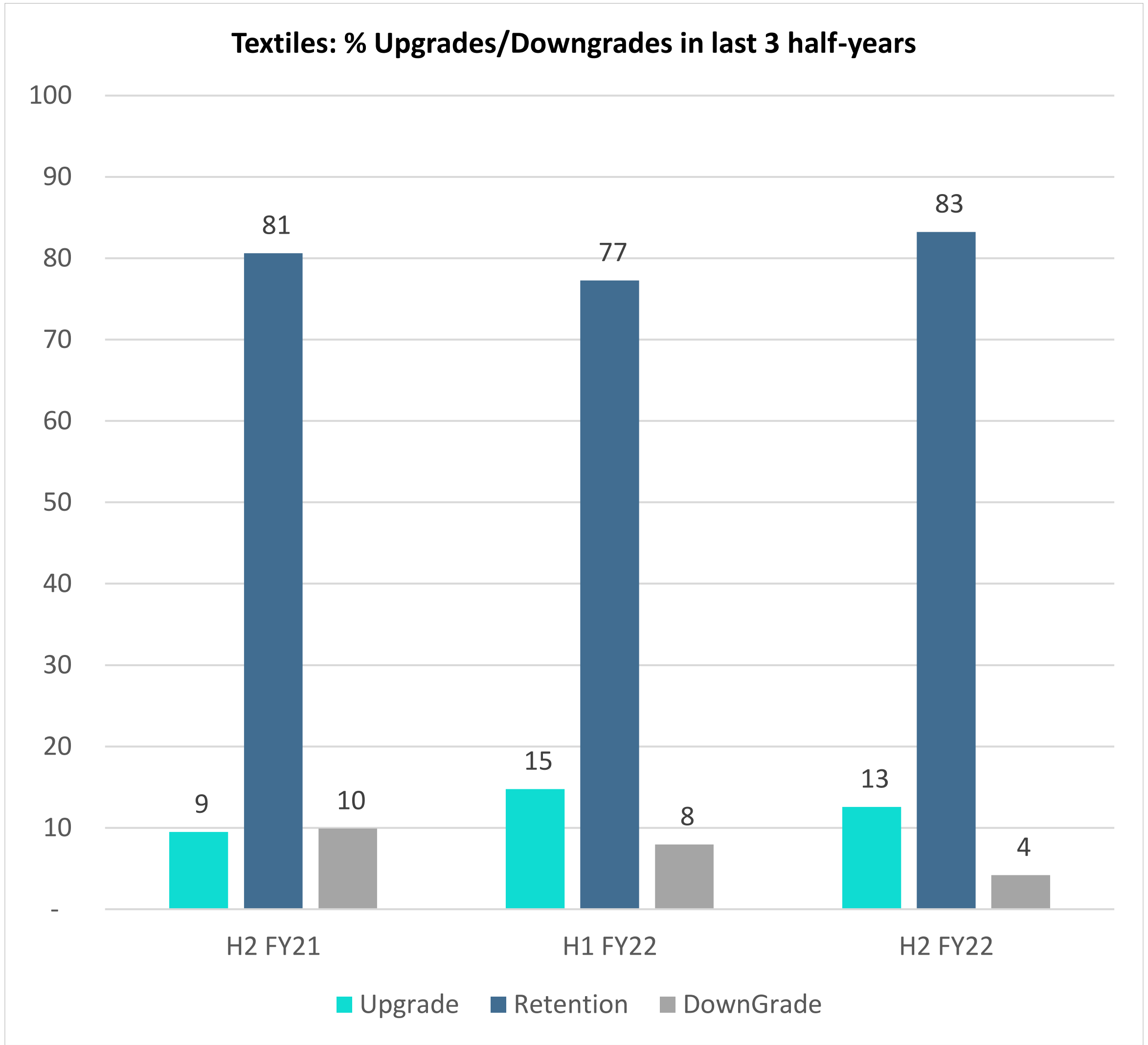
- ✓ Surge in demand with pent-up demand post the pandemic and new launches across vehicle categories.
- ✓ Auto ancillary segment seeing healthy demand from Original Equipment Manufacturers (OEMs), both in domestic and export markets.
- ✓ Auto dealer segment experiencing a revival in demand due to re-opening of showrooms and stabilisation of operations.
- ✓ The demand is expected to remain robust with a low base effect, improving demographics, continued focus on personal mobility, and economic recovery driving Commercial Vehicles (CV) demand with increased infrastructure expenditure. Rising fuel, commodity prices, and resurfacing of the semi-conductor shortage are key monitorables.




**Trading, especially retail trade** was one of the most affected sectors by the pandemic. Upgrades triggered by :

- ✓ Improvement in turnover with opening up of showrooms and streamlining of the supply chain.
- ✓ Improved demand post resumption of business and aided by festive and wedding season.
- ✓ Improved leverage position and liquidity with the capital infusion.

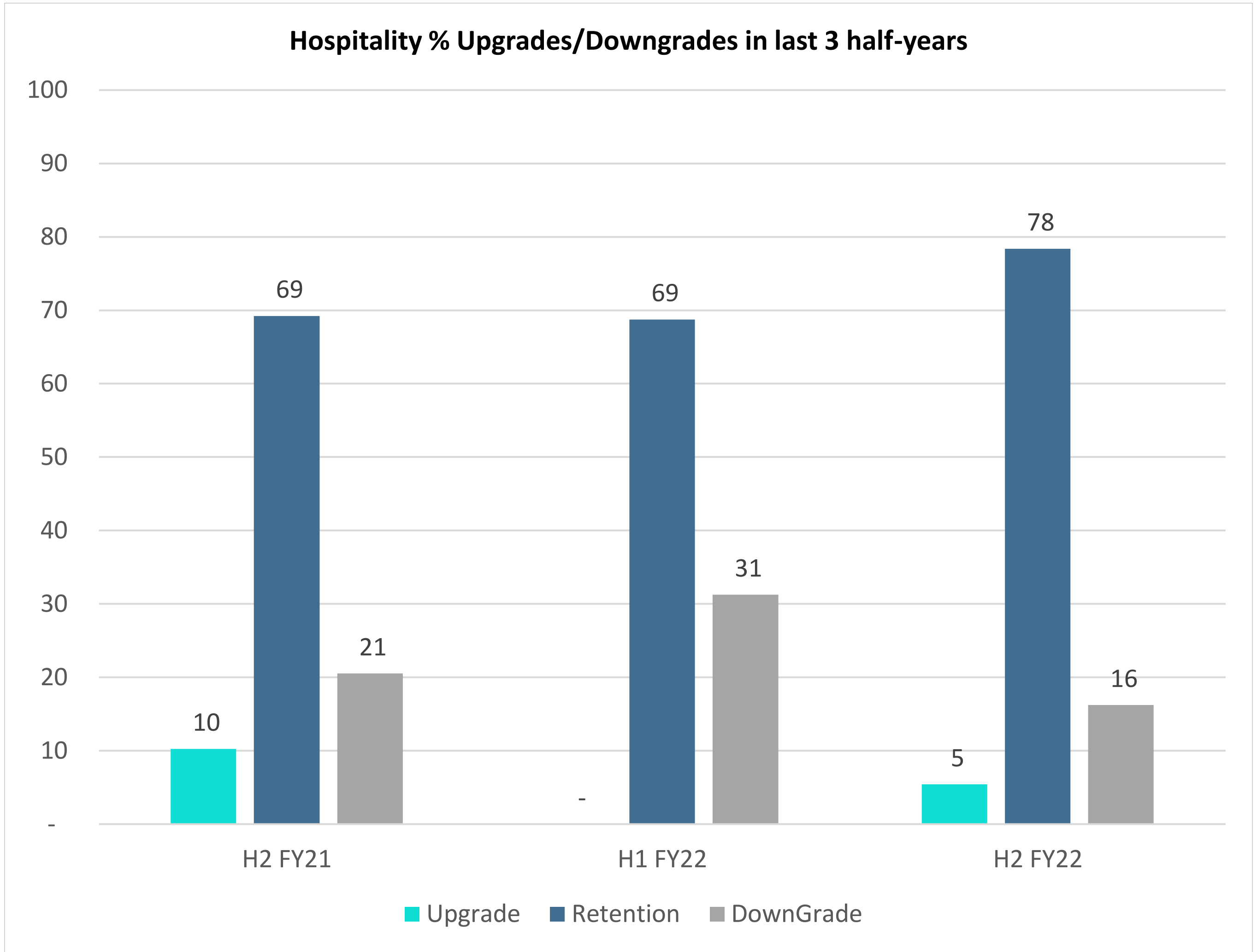
# Textiles : Recovery mode




Upgrades in the **textiles** sector were for the following reasons:

- ✓ Strong sales growth witnessed post the pandemic, aided by festive and wedding season and favourable progress on the vaccination front.
- ✓ Indian exporters derived benefit from the China+1 strategy and sourcing restrictions of Xinjiang (China) cotton.
- ✓ Strong cash flows and debt repayments, improving leverage position.
- ✓ The Government has also announced various schemes like Remission of Duties and Taxes on Export Products (RoDTEP), PLI and PM Mega Integrated Textile Region and Apparel (PM MITRA) which are likely to improve competitiveness and give impetus to the textile industry.
- ✓ Demand momentum is expected to continue in FY23 due to the waning effect of the pandemic and the gradual reopening of malls, schools, and offices.

# Hospitality: Hit Hard




**Bumpy road to recovery**

- Downgrades in the **hospitality** sector mainly triggered by:
  - ✓ Slower than expected recovery in most segments post the pandemic. Leisure destinations witnessing faster recovery than others, domestic tourism being the driver.
  - ✓ Business travel is yet to pick up with changing work patterns and virtual meetings.
  - ✓ Demand pick-up in Q3FY22, tempered by a fresh wave of Omicron which saw booking cancellations and lowers occupancy leading to low revenue per available room (RevPAR).

# Outlook

- The Indian economy has weathered the pandemic with a sharp recovery in FY22. Credit quality across sectors witnessed an uptick with **a decadal high credit ratio**.
- The PM Gati Shakti scheme with its seven engines to steer infrastructure development and catalyze investment.
- CareEdge Ratings expects the benefits of government programmes such as PLI, Atmanirbhar Bharat, etc. and the capex spending to augur well for the companies in FY23.
- The leverage indicators for India Inc. are currently at comfortable levels and we expect this to be generally maintained going forward.
- The credit ratio is expected to moderate in FY23 from the highs witnessed currently, as the portfolio has seen high upgrades in the year gone by and is now expected to remain stable.
- Impact of the Russia – Ukraine crisis, rise in commodity prices, rising covid infections in some parts of the world, inflationary pressures, and rising interest rates are the key monitorables on credit risk.

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**Contact:** Corporate Communications | corp.comm@careedge.in

**Authors:**

Sachin Gupta | Executive Director and Chief Rating Officer
Revati Kasture | Senior Director
Sanjay Agarwal | Senior Director
Padmanabh Bhagavath | Senior Director
Smita Rajpurkar | Director
Rajashree Murkute | Director
Sudhir Kumar | Director
Bhanupriya Khandelwal | Analyst
Akanksha Bhende | Associate Economist

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

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022 Phone: +91-22-6754 3456 I CIN: L67190MH1993PLC071691


**About:**

CareEdge (CARE Group) is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics capability and detailed research methods. CareEdge (CARE Ratings Limited) is one of the leading credit rating agencies in India. It has an impressive track record of rating companies for almost three decades and has played a pivotal role in developing the corporate debt market in India. CareEdge provides near real time research on all domestic and global economic developments. The wholly owned subsidiaries include CareEdge Advisory & Research arm focused on providing advisory and consultancy services and CareEdge Risk solutions a platform that provides risk management solutions