CareEdge RATINGS

FORESIGHTS

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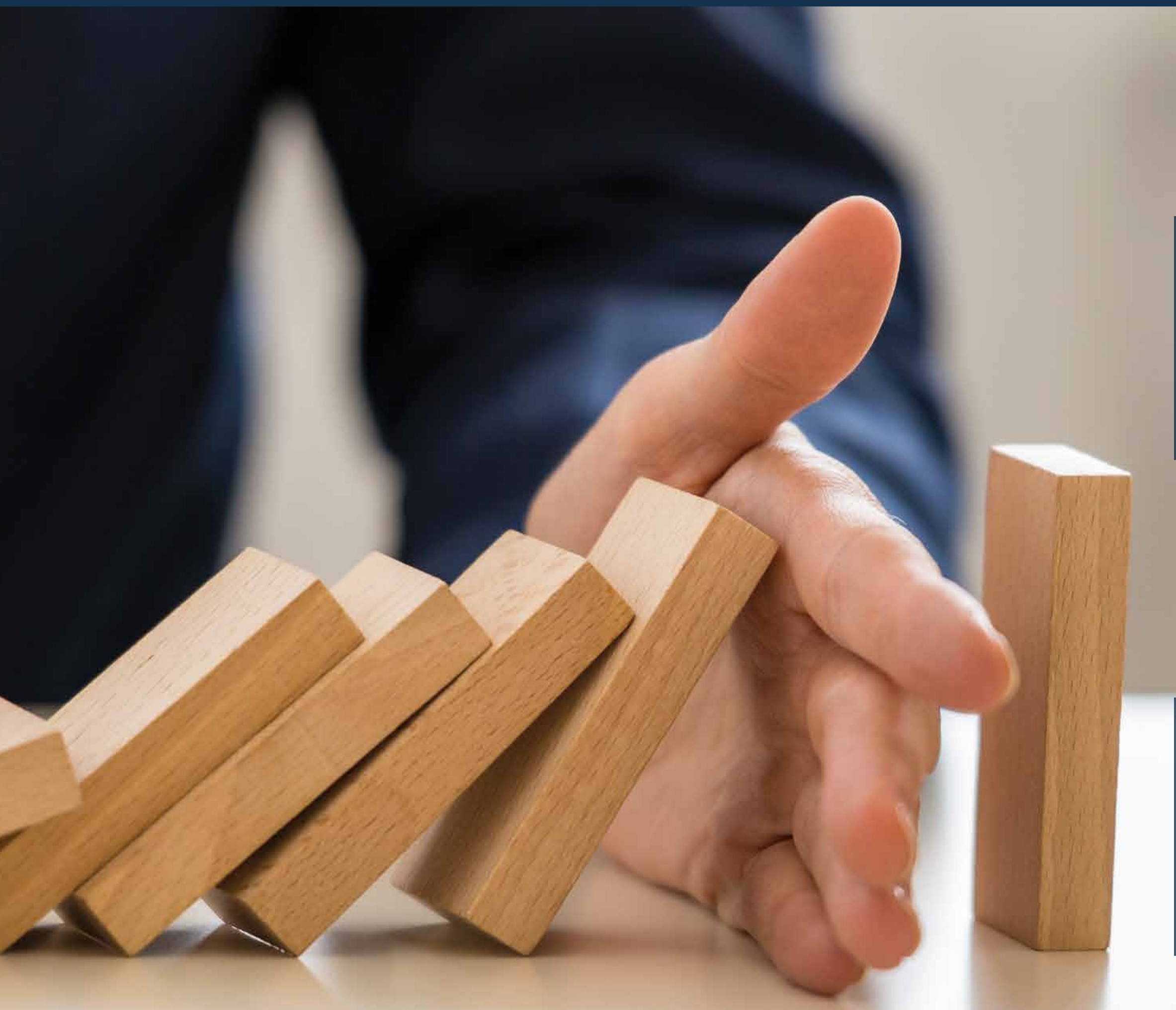


Union Finances Report Card - H1 FY23

Wind Assets' Performance on a Gloomy turn, Solar Sparkles

Fertiliser Subsidy Budget may Fall Short by ₹ 35,000 Cr.

DEMAND REVIVAL KEY TO BEATING GLOBAL TURMOIL

The Indian economy has been seeing relatively healthy growth in midst of the global turmoil. In the past, we have seen that India gets adversely impacted by the global slowdown and the linkages are only getting stronger with the entwining of trade and investment. However, unlike previous crisis scenarios, this time around there are some macro factors in favour of the Indian economy and that has been providing optimism on the ability to weather this global storm.

FOREWORD

SACHIN GUPTA

Chief Rating Officer
& Executive Director

As we bring out the second edition of Foresights, I must admit I was extremely humbled by the feedback we got on our first edition. I look forward to receiving your continued suggestions and comments to further enhance this offering with our top-notch insights and analyses.

The global business environment continues to be edgy. High inflation, sharp interest rate hikes by the US Fed (the fourth continuous 75 bps hike was done in early November), no end in sight of the ongoing Russia-Ukraine war and the weak demand outlook for most large, developed economies are keeping businesses on tenterhooks.

The impact of global upheavals on the Indian corporate sector can be broadly categorised across three levels.

First – The demand impact on the corporates due to slowing external demand. This will be felt by businesses that have a significant dependence on exports. Some of these sectors include Gems and Jewellery, Textiles (especially readymade garments), Vehicles and Capital Engineering goods.

Second – Financial impact on corporates that are exposed to unhedged dollar-denominated debt. While in general, the Indian corporate sector is well aware of the hazards of unhedged dollar debt positions, there could very well be some adventurous companies that have indulged in those. Also, companies that are looking at refinancing their forex debt are facing headwinds, both on the pricing and availability of the funding.

Third – Cost pressures impact on the operating margins. This is already visible in the latest quarterly results of large steel and cement companies. In general, the cost pressure is likely to keep the margins muted for most of the sectors this year. Some of the sectors that are facing the heat include Cement, Steel, Real Estate, Tyres and Pharma. Only companies that have very strong pricing power or have regulatory protection will be able to hold on to their margins. Overall, we expect most businesses to take a beating on margins.

Against the backdrop of the risks, I would like to also point out the stability provided by the robust GST collections. Steadily improving GST collections (over ₹ 1.5 lakh crore reported for October) and healthy auto sales provide confidence in domestic demand recovery. Also, the gross fiscal deficit for the first half year at 37% of the full-year target vs 35% for the same period last year, is somewhat reassuring on the Central Government's finances.

Overall, we do not yet see any systemic risk on account of global factors. But we are very closely monitoring credits, especially the ones that have a strong dependency on export revenues or the ones whose liabilities are dollar-denominated and need refinancing.

INDIA IN MIDST OF GLOBAL TURMOIL

NOTE FROM RAJANI SINHA

Chief Economist

The Indian economy has been recording relatively healthy growth in midst of the global turmoil. However, with global recessionary fears escalating there are concerns about India's economic recovery. IMF and World Bank have lowered India's GDP growth to less than 7% for FY23, with forecasts of further fall in GDP growth in FY24. While there is no denying that the global slowdown will have an adverse impact on the Indian economy, the crucial aspect is the severity of this impact.

In the past, we have seen that India gets adversely impacted by the global slowdown and the linkages are only getting stronger with the entwining of trade and investment. However, unlike previous crisis scenarios, this time around there are some macro factors in favour of the Indian economy and that has been providing optimism on the ability to weather this global storm. With deleveraging over the last few years, the balance sheets of corporates are in a healthy condition. The median gearing ratio (Total Debt/ Equity) for the top 1000 companies as per market capitalisation has reduced to 0.29 in FY22 from as high as 0.65 in FY13. Our credit ratio (number of upgrades/ number of downgrades) has improved to an all-time high of 3.74 in H1 FY23 as against 1.48 in the pre-pandemic period of H2 FY19. The banking sector is in good health, with the gross NPA ratio having fallen to 5.8% from a high of 11.5% in FY18. The strong fundamentals of the corporate and banking sector are providing resilience to the Indian economy in midst of the global turmoil.

The other supporting factor has been the strong forex reserves of more than US$ 640 billion that India had built up by the end of 2021. This has helped India withstand the sharp deterioration in forex reserves as witnessed by other emerging economies too in the last few months. India's forex reserves have fallen by a sharp US$ 105 billion in the year so far, pulling down the import cover to 8.9 months. While the import cover is higher than the 6.7 level touched during the taper tantrum (2013), there is a need for caution. The fall in forex reserves could get very disruptive going forward.

The sharp strengthening of the US dollar is causing havoc in other economies in the form of imported inflation and increased external debt servicing burden. India has relatively low external debt, with external debt to GDP at 20% and short-term debt to forex reserves at a comfortable ratio of 0.2. However, corporates with unhedged forex exposure are at serious risk in these turbulent times. As per RBI, around 44% of India's ECB (External Commercial Borrowing) is unhedged. However, this would include borrowings by entities that have a natural hedge in the form of dollar earnings. RBI is taking all precautions and has recently announced new guidelines that require banks to do additional provisioning for risks arising from unhedged forex exposure.

With global liquidity tightening and forex inflows to emerging economies reducing, India is also feeling the pinch in the form of a tighter domestic liquidity scenario. Domestic interest rates are rising at a time when there is strong retail credit demand (20% YoY), while credit demand growth from large industries remains low (6% YoY). The rise in interest rates will be an impediment to retail loans including housing loan demand. However, as far as the industrial sector is concerned, their investment plans would be more contingent on economic stability, and demand scenarios and will not be dented- severely by rising interest rates. This is mainly because interest rates are rising from low levels and are not expected to rise sharply from here on.

With global growth slowing, India's economy will definitely feel the pain of lower external demand. India's exports which contribute around 20% to India's GDP are already reflecting the pain. Data shows a contraction in India's non-oil and non-gems & jewellery exports in the last two months. With export growth slowing, India's average monthly trade deficit has widened to US$ 25 billion in the current fiscal year as against a monthly average of US$ 16 billion in FY22. India's trade deficit is estimated to widen to 8% of GDP in FY23 as against 6% in the previous year. Moreover, with capital inflows slowing due to FII outflows, the Balance of Payment will be in the deficit zone in FY23. This in turn will have a bearing on India's forex reserves. So, there are concerns over what lurks on India's external front.

In a nutshell, there are global challenges in the form of slowing external demand, volatile commodity prices, rising interest rates and volatile currency markets. While India is relatively better placed in this recovery cycle, it will feel the pinch of the global turmoil. In midst of all these global uncertainties, the most crucial requirement would be the healthy recovery of domestic demand and pick-up in the private investment cycle.

The above views were also published in Mint, issue dated November 1, 2022.

ECONOMICS

UNION FINANCES REPORT CARD - H1 FY23

The fiscal position of the Central Government has been fairly comfortable during the first half of the current fiscal despite global headwinds. The Central government's fiscal deficit up to the first six months of FY23 stood at ₹ 6.2 lakh crore, at 37.3% of the budget estimate. This was slightly higher compared to 35% in the same period last year. Buoyancy in tax revenues coupled with encouraging disinvestment proceeds helped offset the moderation in non-tax revenue receipt. Lower receipts from dividends and profits were the main drag on the non-tax revenue receipts. The government's expenditure policy so far in the current fiscal has been centred on asset creation and revenue rationalisation.

Snapshot of Central Government Finances (₹ lakh crore)

	H1 FY22	H1 FY23	% Change
Total Receipts	**11.0**	**12.0**	**9.5**
Revenue Receipts	10.8	11.7	8.2
Non-Debt Capital Receipts	0.2	0.3	88.7
Total Expenditure	**16.3**	**18.2**	**12.2**
Revenue Expenditure	14.0	14.8	6.0
Capital Expenditure	2.3	3.4	49.5
Fiscal Deficit	**5.3**	**6.2**	**17.7**

Source: Controller General of Accounts (CGA)

GOVERNMENT RECEIPTS – H1 FY23

- Gross tax revenue collection during H1 FY23 increased by 17.6% compared to last year on account of higher revenue from all major tax heads except customs and excise duty. Net tax revenue has risen by 9.9% during the same period.
  - o Encouraging performance of the corporates is reflected in the healthy corporate tax collections (up by 21.6%). Centre's GST collections have risen by an upbeat 28.3% supported by economic recovery and enhanced tax compliance. Moreover, elevated inflation levels also boosted the GST collections.
  - o Collections from customs and excise duty comprising of 16% share in the gross tax collections recorded de-growth of 6.9% and 18.5% respectively. The

government's decision to slash/suspend the customs duty on select items (such as steel, plastic, edible oil, and cotton) and lower the excise duty on petrol (by ₹ 8 per litre) and diesel (by ₹ 6 per litre) in May 2022 weighed on the collections under these heads.

- The non-tax revenue has been lower by 1.7% from the same period a year ago. Receipts from dividends and profits which is a major head (with a share of 33.7%) in the non-tax revenue were lacklustre at 47% of the budgeted amount as against 102% last year. For the current fiscal, the RBI has announced a surplus transfer of ₹ 30,307 crore to the Centre, sharply lower than the ₹ 99,122 crore transferred last fiscal.
- On the capital receipts front, disinvestment proceeds were at ₹ 24,560 crore achieving 38% of the budgeted target for FY23 (as against 12% in the same period last year). The government has already garnered ₹ 20,560 crore through LIC IPO. The proceeds from disinvestment will inch closer to the target of ₹ 65,000 crore with the likely receipts of ₹ 38,000 crore from stake sale in Hindustan Zinc Limited.

Revenue Receipts (₹ lakh crore)

	H1 FY22	H1 FY23	% Change
Tax Revenue (Net)	**9.2**	**10.1**	**9.9**
Gross Tax Revenue	**11.8**	**13.9**	**17.6**
Income Tax	2.7	3.4	25.7
Corporate Tax	3.1	3.8	21.6
Customs Duties	0.9	0.9	-6.9
Excise Duties	1.7	1.4	-18.5
CGST	2.7	3.4	28.3
GST Compensation Cess	0.5	0.6	26.0
Non-Tax Revenue	**1.6**	**1.6**	**-1.7**
Interest Receipts	0.1	0.1	21.1
Dividends & Profits	1.1	0.5	-49.9
Total Revenue Receipts	**10.8**	**11.7**	**8.2**

Source: CGA

GOVERNMENT SPENDING – H1 FY23

- Revenue expenditure grew by 6% mainly on account of higher spending towards fertilisers, defence and interest payments. On the contrary, spending was lower towards agriculture, food & public distribution, transfers to states, rural development, petroleum & natural gas. Expenditure rationalisation to adhere to the fiscal consolidation path has translated into lower spending towards these sub-heads.
- The twelve main heads of revenue expenditure constituted 81.4% of the government revenue expenditure in the first half of the current fiscal.
- Outlays towards food subsidy comprised 58% of the total subsidy allocation. Outlays towards petroleum subsidy were notably lower by 25.6% compared with the last fiscal.
- Capital expenditure recorded a growth of 49.5% (Y-o-Y). The monthly average capital spending so far in the current fiscal has been at ₹ 57,000 crore. The monthly average capex must rise to the tune of ₹ 68,000 crore to meet the all-time high target of ₹ 7.5 lakh crore in FY23.
- The six main heads of capital expenditure constituted nearly 87.3% of total capital expenditure in H1 FY23. Infrastructure-intensive sectors such as road transport and railways account for a major part (around 61%) of the total capital expenditure.
- Total expenditure during H1

FY23 as ₹ 18.2 lakh crore was modestly higher by 12.2% from a year ago level. The government spending so far has been focused on asset creation with the ratio of capital spending to total expenditure rising to 18.8 for the six-month period, the half-yearly highest in the last nineteen years.

Twelve Main Heads of Revenue Expenditure (₹ crore)

	H1 FY22	H1 FY23	% Change
Interest Payments	3,65,207	4,36,682	19.6
Defence	1,82,726	1,99,648	9.3
Food & Public Distribution	1,37,780	1,16,290	-15.6
Fertilizers	48,409	81,742	68.9
Rural Development	81,972	75,881	-7.4
Transfers to States	1,16,769	73,879	-36.7
Police	51,271	58,624	14.3
Agriculture	58,697	47,870	-18.4
Education (School & Higher Education)	31,757	41,336	30.2
Pensions	34,313	37,241	8.5
Health and Family Welfare	36,697	34,403	-6.2
Petroleum and Natural Gas	3,168	1,876	-40.8
Total Revenue Expenditure	**13,96,666**	**14,80,708**	**6.0**

Source: CGA

Six Main Heads of Capital Expenditure (₹ crore)

	H1 FY22	H1 FY23	% Change
Road Transport and Highways	73,787	1,21,893	65.2
Railways	46,262	88,548	91.4
Defence	63,646	64,075	0.7
Food & public distribution	2,570	9,732	278.7
Housing and Urban Affairs	13,429	9,121	-32.1
Transfer to States	5,669	5,854	3.3
Total Capital Expenditure	**2,29,351**	**3,42,889**	**49.5**

Source: CGA

CAREEDGE FISCAL DEFICIT PROJECTION – FY23

Buoyant Tax Collections, Windfall Fuel Tax, and 5G Spectrum Dues to Support Revenue Receipts

The repercussions of the Russia-Ukraine conflict on the global supply chains and commodity prices continue to pose a challenge for the fiscal math in FY23. Though tax collections have remained buoyant, the cut in fuel excise duty and suspension/reduction in customs duty on select items (such as steel, plastic, edible oil, and cotton) are estimated to have a revenue implication of around ₹ 1 lakh crore. However, this revenue foregone would be partially offset by the additional revenue to the tune of ₹ 40,000 crore from the windfall tax imposed on petroleum and crude products. Factoring the revenue shortfall from excise and custom duty cuts, additional revenue from windfall fuel tax and assuming a tax buoyancy of 1.1, we expect gross tax revenue to exceed the budgeted target by ₹ 3.5 lakh crore. Revenue from dividends and profits which is a big-ticket component in non-tax revenue is expected to witness a moderation owing to lower dividend transfer from the RBI. The cost to RBI in terms of higher interest payments on variable reverse repo auctions to withdraw excess banking system liquidity infused during the pandemic resulted in a significantly lower dividend transfer of ₹ 30,307 crore in FY23. However, the Department of Telecommunication (DoT) could garner additional revenue of around ₹ 10,000 crore due to the higher mop-up from the first annual instalment of 5G spectrum dues. This additional revenue could help partially offset the lower dividend & profit transfers translating into a non-tax revenue shortfall of around ₹ 13,000 crore. In a nutshell, we expect the net revenue receipts to exceed the budget expectations by ₹ 2.2 lakh crore.

Expenditure to Overshoot the Budgeted Target

Against the backdrop of volatility in global commodity prices and elevated domestic inflation, the Government stepped up measures to ease the burden of surging prices adding to the fiscal pressures. The Pradhan Mantri Garib Kalyan Ann Yojana (PMGKAY), the free food grains program has been extended twice during the current fiscal having an additional outlay of ₹ 1.25 lakh crore in addition to the budgeted amount of ₹ 2.07 lakh crore. The budgeted fertiliser subsidy of ₹ 1.05 lakh crore has been already enhanced to ₹ 2.15 lakh crore. However, owing to the elevated prices of key raw materials, natural gas and depreciation in the rupee, CareEdge expects a shortfall of ₹ 35,000 crore in the fertilizer subsidy budget for the current fiscal. Assuming that the government further supports some part of this shortfall in the current fiscal, we expect the fertiliser subsidy pay-out to be at ₹ 2.35 lakh crore for the current fiscal. The other additional expenditure items include LPG subsidy, hike in Dearness Allowance to Central Government employees and Dearness Relief to pensioners, interest subvention support on short-term agriculture loans and one-time grant to three PSU OMCs. The increased allocation towards the subsidy pay-outs (food, fertiliser and LPG) constitutes a major share of 86% of the ₹ 3 lakh crore additional outgo.

Additional Expenditure (₹ crore)

Head	Amount
Extension of PMGKAY	1,24,762
Fertiliser Subsidy	1,30,000
LPG Subsidy	6,100
Interest Subvention Support	11,619
One Time Grant to Three PSU OMCs (IOC, HPCL, BPCL)	22,000
Hike in Dearness Allowance and Dearness Relief	8,568
Total Additional Expenditure	**3,03,049**

Source: CGA

The central government has pegged the fiscal deficit at 6.4% of the GDP in FY23. Based on the assumption of 13.6% nominal GDP growth (higher than the budgeted 11.1%) and given the possibility of additional expenditure being partially offset by higher revenue realisations and no shortfall in the disinvestment proceeds we expect the fiscal deficit to rise slightly to 6.5% of the GDP .

Fiscal Deficit Projection FY23 (₹ lakh crore)

Additional Revenue Receipts (Net Tax Revenue + Non-Tax Revenue)	2.19
Additional Total Expenditure	3.03
Slippage in Fiscal Deficit	**0.84**
Fiscal Deficit (As % of GDP)	**6.5**

Source: CGA

INDUSTRY RESEARCH

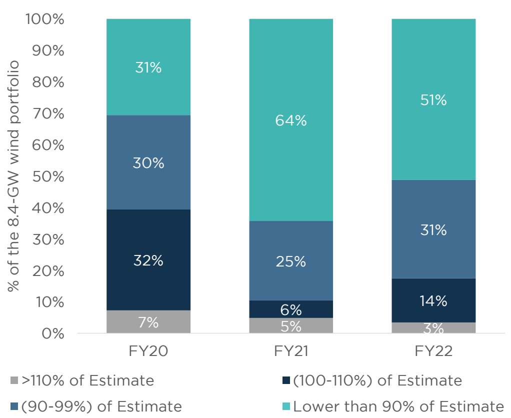
WIND ASSETS' PERFORMANCE ON A GLOOMY TURN, SOLAR SPARKLES

CareEdge has analysed the generation performance of its monitored operating portfolio comprising 8.4-GW wind assets and 14.5-GW solar assets, which is reflective of the country's overall operative renewable energy portfolio. The actual PLF for FY20, FY21 and FY22 from these assets have been compared with the designed estimate of the respective assets

- The generation performance of wind assets has witnessed a significant decline over FY20-FY22, in contrast to the steady performance put up by solar assets.
- In FY22, 6.9-GW (82%) of the monitored wind assets reported underperformance vis-à-vis the designed estimates while the corresponding figure was 7.0-GW (49%) of the monitored solar assets portfolio.
- Further over the three-year period, ~53% of the 8.4-GW wind assets could not achieve the designed estimates as against only ~31% of solar assets (out of 8.3-GW assets operating for all the three years).
- Extent of underperformance vis-à-vis designed estimates has remained lower than 3% for solar assets as against the 4-15% range for wind assets.
- Higher underperformance of wind assets has been witnessed in Andhra Pradesh and Tamil Nadu, followed by Maharashtra and Karnataka.
- Given the higher risks for wind plants even post-commissioning, CareEdge Ratings believes it is incumbent for a wind project to possess stronger debt coverage metrics and higher liquidity reserves than a solar project to cunterbalance such concerns. This is critical as the majority of the operational wind assets principally rely on weak counterparties, i.e., state discoms who often stretch the payment cycle.
- The credit profile of entities in the sector has been supported by the availability of adequate liquidity in the form of debt service reserve accounts (DSRA) and cash balances coupled with healthy financial flexibility and strong parentage.

Operational Performance of Monitored Wind Power Projects

Exhibit-1: PLF of Monitored Wind Portfolio vis-à-vis Designed Estimate



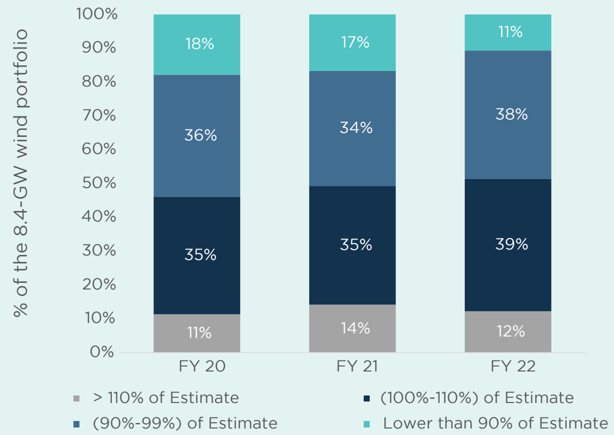
Source: CareEdge Ratings

- Wind power generation for only 11% and 17% portfolio was above the designed estimate in FY21 and FY22, respectively, whereas 39% capacity exceeded the designed estimate in FY20.
- It is noteworthy that around 4.5 GW out of the 8.4-GW monitored portfolio could not achieve the designed estimates in any of the three years under review.
- Underperformance is majorly attributable to:
  - o Lower wind speeds and grid curtailments in some of the key wind-rich states.
  - o Operating issues for projects with certain original equipment manufacturers (OEMs) resulting in lower machine availability.
- Within CareEdge Ratings-monitored portfolio, 49% of the capacities in Madhya Pradesh, 45% in Rajasthan and 15% in Gujarat performed at PLFs better than the designed estimates. Most of the capacities in the balance states performed below the designed estimates in FY22.

Operational Performance of Monitored Solar Power Projects

CareEdge analysed the operational performance of solar portfolio of around 8.3 GW, 13.1 GW and 14.4 GW in FY20, FY21 and FY22, respectively. The significant increase in the monitored portfolio capacity for solar assets has been due to the growth in installations over the last few years.

Exhibit-2: PLF of Monitored Solar Portfolio vis-à-vis Designed Estimate



Source: CareEdge Ratings
* % on the left axis represents proportion of 8.3 GW, 13.1 GW, and 14.4 GW solar capacity in FY20, FY21 and FY22, respectively

- The operational performance of solar projects has been relatively stable as compared to wind projects. Solar power capacity for around 50% of the portfolio was above the designed estimate in the last three years.
- On the other hand, a negative deviation of more than 10% from the benchmark level was observed only in 11% of the portfolio in FY22 as against 17%-18% previously, indicating stabilization of the underlying assets.
- It is noteworthy that 2.6 GW out of the 8.3-GW capacity, which was operational for FY20-FY22, could not achieve the designed estimate generation in any of the three years.
- Relatively high proportion of capacities in Andhra Pradesh and Rajasthan have achieved generation levels in-line with designed estimates, whereas capacities in Madhya Pradesh, Tamil Nadu and Punjab have underperformed.

CareEdge View

“As observed from the various data points, wind assets have significantly underperformed, whereas solar assets have shown steady performance. On a portfolio basis, the deviation of underperformance vis-à-vis designed estimates have remained lower than 3% for solar assets as against the 4-15% range for wind assets. Given such extent of variation in the performance between two asset types in the RE sector, the stakeholders from a debt perspective shall demand stronger coverage metrics from wind projects along with necessary provisions in the form of working capital and liquidity reserves as necessary safeguards. The need for such safeguards shall increase if the said plant has weak state discoms as an off-taker, which further leads to receivable-related risks.”

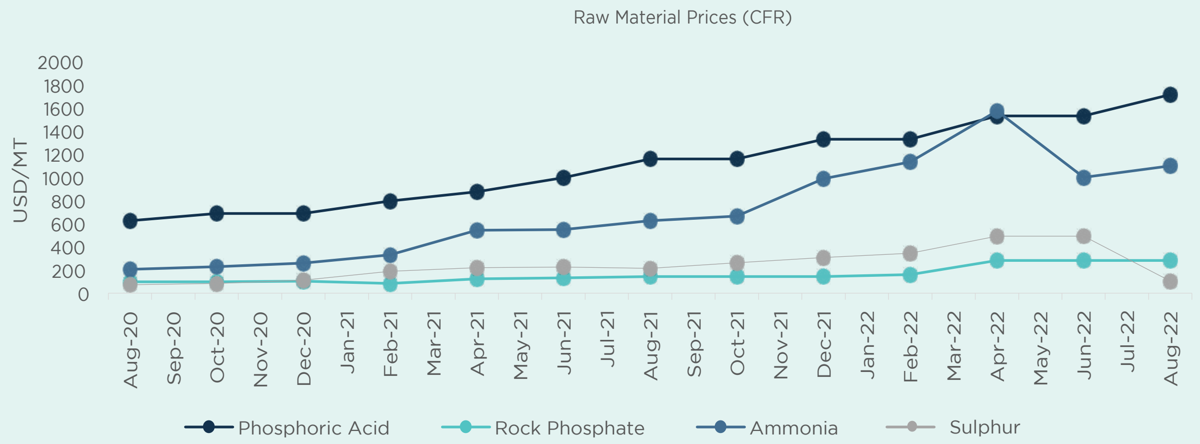
“Notwithstanding the issues around delays in receipt of invoices from the counterparties (especially state distribution utilities), the entities in the sector have been supported by the availability of adequate liquidity in the form of DSRA and cash balances coupled with healthy financial flexibility and strong parentage. Moreover, consolidation and refinancing on account of benign interest rate cycles has aided companies in maintaining their credit profile” said Rajashree Murkute, Senior Director.

CareEdge’s outlook on the RE sector remains stable, driven by adequate availability of resources, the government’s strong policy support and the presence of creditworthy central nodal agencies as intermediary procurers. However, some of the headwinds for the sector pertaining to regulatory uncertainties in key states, exposure to interest rate risk given the hardening of yields and poor health of most of the ultimate distribution utilities.

INDUSTRY RESEARCH

Subsidy Budget May Fall Short by ₹ 35k cr on High Input Costs

The already enhanced fertilizer subsidy budget of ~₹ 2,15,000 crore for FY23 is likely to fall short by around ₹35,000 crore as prices of a majority of the key raw materials for the production of fertilizers remain elevated on the back of the Russia-Ukraine war. Apart from natural gas, most key raw materials for the production of fertilizers include Ammonia, Phosphoric Acid, Rock Phosphate and Sulphur. In this, other than Sulphur, the prices of all key raw materials were elevated in H1FY23.



Source: Dept. of Fertilizers; CFR: Cost and Freight

After experiencing low natural gas prices for FY21 & FY22, prices of domestic natural gas surged significantly in H1FY23. The prices of domestic natural gas were further increased by nearly 40% w.e.f. October 01, 2022, for H2FY23. Also, prices of imported natural gas in the spot market stood much higher than domestic natural gas. Very high natural gas prices are likely to result in higher subsidy requirements for FY23.

Out of India's total consumption of fertilizers, urea constitutes 55% to 60% wherein Ammonia is the key raw material. Further, as retail prices of urea are capped by the government, there is a large subsidy pay-out with respect to the consumption of urea in India. Accordingly, urea subsidy comprises a very large part of India's total fertilizer subsidy budget wherein prices of Ammonia have a crucial role. Ammonia prices, though moderated a bit, remained at an elevated level of USD 1,100/tonne in August 2022. Further, nearly one-third of the domestic urea requirement is being met through imports wherein depreciation of the rupee would further add to the subsidy budget.

For manufacturing complex fertilizers, apart from natural gas, Phosphoric Acid, Rock Phosphate, Potash and Sulphur are among the key input materials whose prices also remain at an elevated level, except for Sulphur prices, which have corrected over the last three months. India has a very high import dependency for Phosphoric Acid, Rock Phosphate and Potash wherein apart from their elevated prices, depreciation of rupee would require a higher subsidy budget to keep the retail prices for farmers at an affordable level.

Although there is some moderation in the prices of urea from its peak level, it remains at an elevated level, whereas prices of DAP continued to remain at an elevated level till August 2022 on the back of elevated raw material and gas prices.

Historically, the subsidy budget used to be in the range of ₹ 70,000 crore to ₹ 80,000 crore p.a. during FY17 to FY20. The total subsidy outlay increased by 58% during FY21 to ~ ₹ 1,28,000 crore mainly due to additional allocation under the Atmanirbhar package of ~ ₹ 62,600 crore targeted towards clearing previous subsidy backlogs.

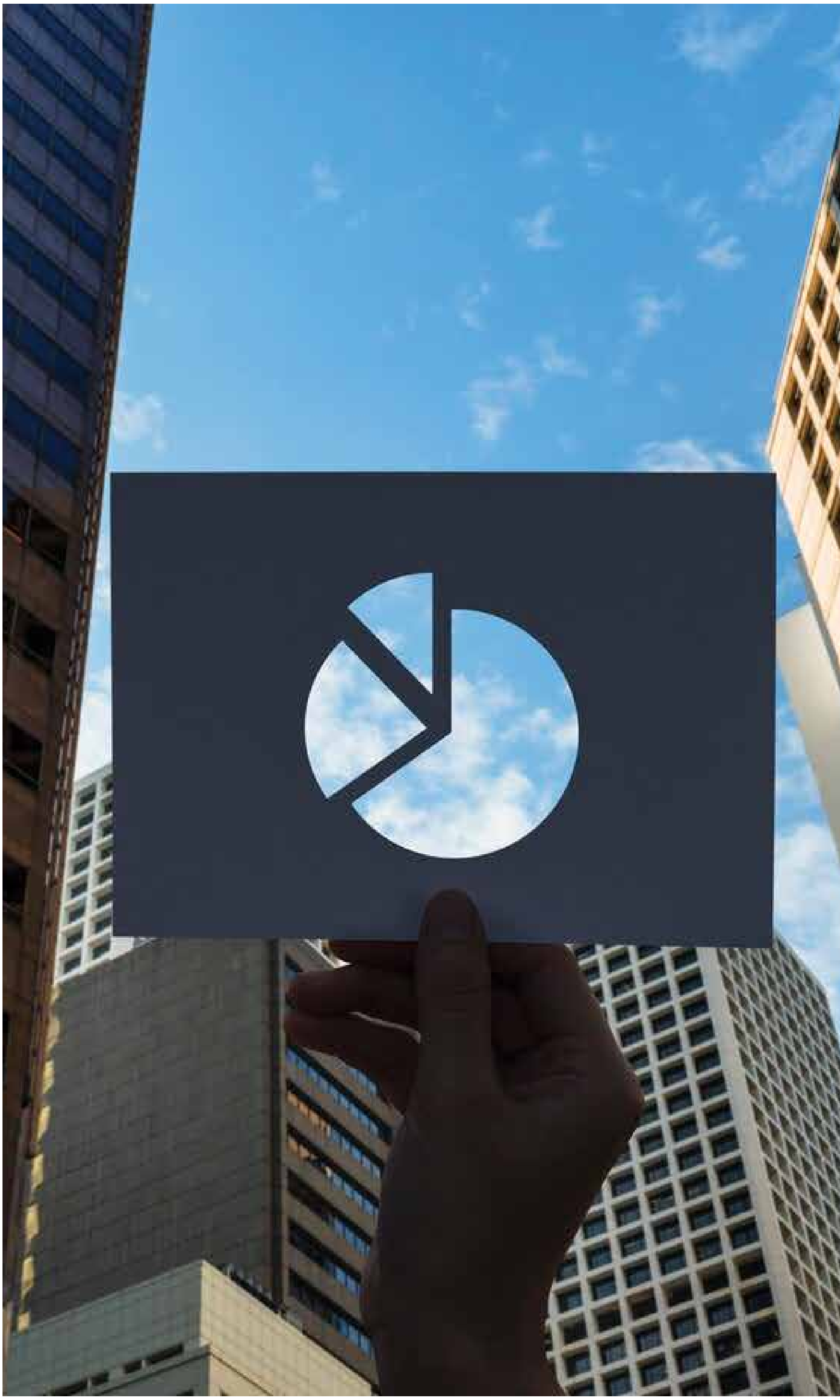
Subsidy pay-out increased further to ~₹ 1,58,000 crore in FY22 with an increase in gas prices leading to a higher subsidy for urea whereas an increase in raw material prices led to a high subsidy for complex fertilizers during the year.In the budget for FY23, the government had initially provided for a total subsidy of ₹ 1,05,000 crore, which was subsequently enhanced by another ₹ 1,10,000 crore, looking at the elevated level of raw material and gas prices taking the total subsidy budget for FY23 to ₹ 2,15,000 crore.

As prices of key raw materials remain elevated and natural gas becomes expensive too, CareEdge believes the double whammy along with the rupee's depreciation could lead to a shortfall of ₹ 35,000 crore in the fertilizer subsidy budget.

"Notwithstanding the issues around a raw material and natural gas prices, there has been a timely release of fertilizer subsidy by the government till now, which has resulted in lower receivables for fertilizer companies and consequent lower utilisation of working capital limits with adequate liquidity buffers in place. Moreover, the government has shown its intent to further enhance the subsidy budget for the upcoming Rabi season in case input costs remain elevated. However, if the fertilizer subsidy budget is not enhanced, then subsidy receivables of fertilizer companies could increase towards the end of FY23, which in turn would hurt the sector," said Hardik Shah, Associate Director – Corporate Ratings.

INDUSTRY RESEARCH

Hotel Occupancy in FY23 Set to Cross Pre-Covid Levels at 67-69%

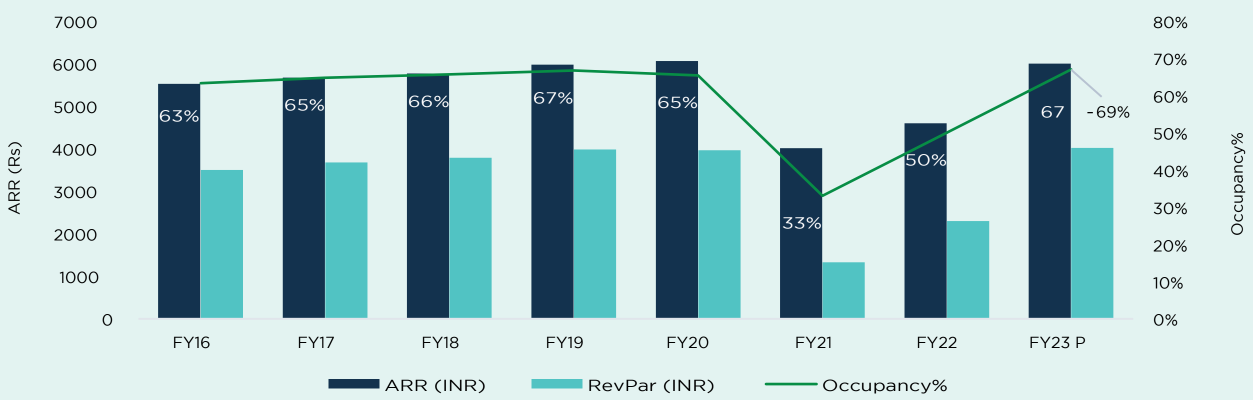


One of the biggest victims of the pandemic, the hospitality sector is seeing a reversal in its fortunes. Not only did it make a steady recovery in FY22, but H1 FY23 was also a record-breaking summer for the sector. With the sector entering its seasonally stronger second half, the demand rebound which was sharper than envisaged is expected to hold. The same will be aided by strong demand from the wedding segment and visible traction in corporate as well as a surge in Meetings, Incentives, Conferences and Exhibitions (MICE), direct segments and pick up in foreign inbound travel.

As per industry data available, ARR has been able to sustain over the pre-pandemic levels in Q1FY23. In Q2FY23, the industry ARRs were 7-9% higher than Q2FY20 levels at ₹ 5,750- 5,850. The overall average occupancy is expected to decline by approximately 300 bps in Q2FY23 to 62% vs. 65% in Q1FY23. Hence, the industry is expected to report RevPARs of ₹ 3,500- 3,600 in Q2FY23 leading to 6% decline Q-o-Q due to the second quarter being a lean or weaker quarter from a season perspective along with pent-up demand and events like the IPL driving up RevPARs in Q1FY23. The average occupancy in Q2FY23 is still at par with pre-pandemic levels when compared to a similar period.

As demand aligns with the pre-pandemic levels, H2FY23 looks promising. Factors such as festivities and wedding season and a likely pickup in foreign inbound travel and MICE activity will also support demand. Soaring international airfares and longer waiting times for travel approvals/visa amid rising inflation may limit outbound travel from India, and thereby enhance domestic demand in the medium term.

Occupancy on the Rise



Source: CareEdge, HVS Anarock, Industry data.

Though inbound foreign travel has increased in the recent past, it is still far from the pre-Covid levels. Pent-up demand and a weak Indian rupee, however, are likely to provide a fillip to the segment in H2FY23. Considering the narrowing gap between supply and demand, occupancies are expected to witness improvement, thereby leading to better pricing power with the players. For FY23, pan-India average hotel occupancy is expected to be at 67-69% which shall surpass the pre-Covid levels and ARR at ₹ 5,800-6,000.

Given the buoyant demand, CareEdge has revised its expectations up from the last estimated occupancy of 65-66% and ARR of ₹ 5,400-5,500 in June 2022. All the players are likely to record pre-Covid levels of revenue in H1FY23 with some to even surpass the same.

Operating Margins to Grow in FY23

Sustenance in fixed cost-saving initiatives undertaken by all the players in the industry in the last two years and better operating leverage will be the building blocks to help them register growth in operating margins in FY23. With the rise in occupancies, costs for all the players have though inched up, but still remain lower than the pre-covid levels aiding margin growth for the industry. As revenues improved in the past few quarters amidst the realignment of the cost structure done by players, the industry has been able to post profits at the operating level since Q2FY22. With the industry's focus intact on tight cost control measures, players are expected to record margin expansion in FY23. The industry registered its best-ever operating profit in Q1FY23 and profitability remained strong at the net level as well. The sample set of players as taken for analysis have reported 25.5% profitability at the operating level in Q1FY23 as against losses of 23% in the year-ago quarter.

Maintaining a stable outlook for its rated entities, CareEdge expects the hospitality sector to report a stronger second half in FY23. For the full fiscal, we expect most of our portfolio to perform nearly around pre-Covid levels. This growth would primarily be driven by domestic tourism, corporate activities and inbound international travel.

The strong rebound in occupancies and sustenance of higher ARRs shall lead to growth in the sector's revenue profile and drive the sector's profitability up by 200-250 bps in FY23. The debt-to-equity ratio though shall improve on a year-on-year basis but continue to be weak for the sector (over 1x) as companies have resorted to additional debt in the last two years to support their operations and incurred losses that have a bearing on the net-worth position.

"With a sustained recovery in operating leverage, the sector is expected to report healthy operating margins thereby leading to improved coverage and leverage indicators for the players compared to the past two years. The sector may witness some impact of the headwinds on account of rising inflation, higher labour and borrowing costs due to rising interest rates which will weigh on the profitability for the sector in H2FY23, nevertheless with the strong demand and the average room rates for the sector inching to the north of pre-Covid levels, the credit profile for players is expected to improve," said Ravleen Sethi, Associate Director – Corporate Ratings.

INDUSTRY RESEARCH

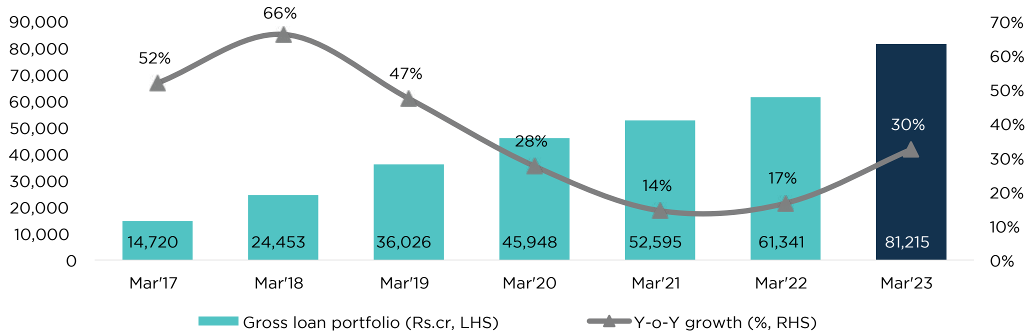
THE MICRO IMPACT: MFIS' CHANGING GEARS

Non-banking financial companies - microfinance institutions (NBFC- MFIs) in India registered a growth of 17% y-o-y in gross loans in FY22, shrugging off the negative loan book growth witnessed in Q1FY22 owing to the Covid-19 pandemic. With a resurgence in demand for micro-loans, especially from Tier-III cities, CareEdge Ratings expects the loan book to grow at around 30% y-o-y in FY23.

With an improving macroeconomic environment along with the rising loan base, the PAR 90+ for the NBFC-MFI industry is expected to improve. That said, for some NBFC-MFI players who carry a substantial amount of restructuring book coming out of moratorium, the headline asset quality metrics and credit costs may remain elevated for the coming few quarters. Also, NBFC-MFIs with a high share towards flood-affected states such as Assam, Bihar, and Telangana, among others, may witness an increase in delinquencies in the near term.

Pick-up in Loan Book Growth for NBFC-MFIs

Growth in loan portfolio of NBFC-MFIs*



*Source: Data from CareEdge Ratings' sample of NBFC-MFIs; based on CareEdge Ratings' estimates; March 2023 figures as per CareEdge Ratings' estimates.

Operating Margins to Grow in FY23

In FY22, the gross loan portfolio for CareEdge Ratings' sample set of NBFC-MFIs registered a 17% y-o-y rise, supported by strong disbursements in the latter part of the fiscal, shrugging off negative growth and the halt in business operations witnessed in Q1FY22 owing to the second wave of the Covid-19 pandemic. Although disbursements in Q1FY23 were impacted by revised regulations, CareEdge Ratings expects NBFC-MFIs to record a healthy loan growth of around 30% y-o-y in FY23.

Joint liability group (JLG) loans continued to dominate the loan book profile, however, with the growing ticket size across loan products and the new RBI guidelines, which deregulate the maximum cap on interest rates and lower the minimum required share of MFI loans in the portfolio to 75%, the share of individual and the micro, small, and medium enterprises and other non-MFI loans may gradually increase in the portfolio mix in the medium term.

The RBI, in March 2022, announced a revision in the regulations applicable to NBFC-MFIs and other regulated entities (RE) operating in the microfinance paradigm. Key features of the revised regulations are given below:

The said revision in regulations by the RBI, making standard applications for all MFI lenders, is expected to foster growth for NBFC-MFIs, as well as result in improved margins for these companies.

Post the exacerbating impact of the Covid-19 pandemic on the income profile of low-income groups of the economic society and the resultant rise in delays in debt servicing by the end borrower, asset quality stress spiked for the sector. The PAR 90+, ie, the loan delinquent for more than 90 days for CareEdge Ratings sample set increased to 4.82% as on March 31, 2022, as compared with 2.07% as on March 31, 2020. However, supported by a resurgence in economic activity post Q2FY22, the collection efficiency for micro-loans improved substantially, with the average collection efficiency rising from 75% during Q1FY22 to 92% during Q3FY22 and further to 96% during Q4FY22.

Going forward, CareEdge Ratings expects the recovery trend to continue, although, for some of the NBFC-MFI players, headline asset quality metrics and credit costs may remain elevated in the near term, owing to a substantial part of a restructuring or top-up book coming out of moratorium. Also, players with a high share in the states affected by floods may see higher delinquencies in the near term.

Margins to Improve; Profitability may Remain below the Pre-Covid Levels

As on March 31, 2022, CareEdge Ratings' sample set of NBFC-MFIs witnessed improvement in profitability, with a return on average assets of 1.01% vs 0.49% in FY21, which in turn, was severely impacted by a rise in credit and provisioning costs in FY21. The net interest margins (NIMs) compressed to around 8.5% in FY21 as compared with the pre-Covid level of 9.5-10% due to interest rate reversals caused by a sharp rise in delinquencies and excess liquidity maintained by most of the entities. The NIMs, although slightly improved in FY22, continued to remain low at around 8.7%. With the removal of the interest cap regime in the revised regulations stated by the RBI and the improved collection efficiencies, the average yield on advances is slated to improve gradually, leading to a margin boost, albeit will continue to be impacted by the rising interest costs on borrowings.

The operational expenses for the industry will continue to remain elevated (FY22: 5.6% of the average assets). The credit costs, after increasing significantly in FY21 to 4.1% of the average assets, continue to remain high at 3.5% in FY22. Overall, small improvements in margins along with reduced credit costs led to an improvement in the profitability indicators, with a return on average assets of 1.0% in FY22 (vs 0.5% in FY21), although it continues to remain below the pre-COVID level of a return on assets (RoA) of 2-3%. Going forward, profitability is expected to improve with higher margins and improved collection efficiency, however, with a substantial restructured book coming out of the moratorium, the profitability is likely to remain lower than the pre-COVID level in FY23.

Adequate Capitalisation Profile

Despite the rising borrowing level requirement of NBFC-MFIs, the overall leverage profile of the industry has remained comfortable for the last four fiscal years, supported by two consecutive years of substantial equity and preference capital infusion, i.e., in FY19 and FY20, respectively, and relatively lower disbursements in FY21 and FY22. However, going forward, with disbursements picking up and equity-raising plans still being in the pipeline for major players, the leverage may increase, although it is expected to remain at manageable levels.

ECONOMY DASH BOARD

HEAT MAP AND PROJECTION TABLE

		Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22
PMI-M	Unit	54.0	54.9	54.0	54.7	54.6	53.9	56.4	56.2	55.1	55.3
PMI-S	Unit	51.5	51.8	53.6	57.9	58.9	59.2	55.5	57.2	54.3	55.1
GST Collections	₹ lakh crore	1.4	1.3	1.4	1.7	1.4	1.4	1.5	1.4	1.5	1.5
E-Way Bill	Crore	6.9	6.9	7.8	7.5	7.4	7.4	7.6	7.8	8.4	7.7
Air Passenger Traffic	Crore	1.5	1.8	2.4	2.4	2.7	2.5	2.4	2.5	2.5	
Railways Passenger Traffic	Crore	34.5	41.4	48.4	45.6	50.1	50.1	51.6	54.0	54.8	
PV Sales	Lakh	3.0	3.1	3.4	3.0	3.1	3.3	3.5	3.4	3.6	
2-3 Wheeler Sales	Lakh	15.7	14.8	16.1	16.1	16.6	17.4	17.8	19.1	20.8	
Tractor Sales	Lakh	0.6	0.6	0.8	1.0	0.9	1.1	0.7	0.6	1.3	
IIP	y-o-y%	2.0	1.2	2.2	6.7	19.7	12.7	2.2	-0.8		
Core Sector	y-o-y%	4.0	5.9	4.8	9.5	19.3	13.1	4.5	4.1	7.9	
Power Consumption	y-o-y%	1.1	4.5	5.9	11.5	23.2	16.2	2.3	0.6	11.3	0.5
Petroleum Consumption	y-o-y%	2.3	5.4	6.5	9.6	23.7	17.9	6.1	16.3	8.3	3.4
Outstanding Bank Credit - Total	y-o-y%	8.2	7.9	8.6	11.1	12.1	13.2	14.5	14.3	15.3	
Capital Goods Import	y-o-y%	24.6	14.5	18.8	17.1	17.2	18.6	27.4	26.5	17.8	
Merchandise Exports	y-o-y%	27.9	34.5	26.4	29.2	20.9	30.4	8.2	1.6	4.9	

Note: Data for some Indicators are high in April-June quarter due to base effect

Indicator	FY18	FY19	FY20	FY21	FY22	FY23 Forecast
Gross Domestic Product (y-o-y%)	6.8	6.5	3.7	-6.6	8.7	6.9
CPI Inflation (y-o-y%)	3.6	3.4	4.8	6.2	5.5	6.8
Fiscal Deficit (as % of GDP)	3.5	3.4	4.7	9.2	6.7	6.5
Current Account Balance (as % of GDP)*	-1.8	-2.1	-0.9	0.9	-1.2	-3.6
Rupee (USD/ INR) (Fiscal year-end)	65.0	69.2	75.4	73.5	75.8	81-83
10-Year G-Sec Yield (%) (Fiscal year-end)	7.3	7.5	6.1	6.3	6.8	7.5-7.75

* Note: (-) Deficit / (+) Surplus

ABOUT US

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

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