ICRA

PERFORMANCE OF ICRA-ASSIGNED RATINGS

Credit quality on the mend, but risks remain

APRIL 2021

Highlights

- On a full-year basis, both FY2020 and FY2021 marked a sharp rise in the proportion of entities downgraded by ICRA (vis-à-vis the historical averages), but the rating action trends since November 2020 suggest that **incremental downgrade pressures have ebbed**.
- The **proportion of rating upgrades also has been on the rise** over the past two quarters.
- **Since November 2020**, the **Credit Ratio** of ICRA-assigned ratings, defined as the number of entities upgraded to that downgraded, has **consistently remained upwards of 1.0 time each month**. Prior to that, the Credit Ratio had remained consistently below 0.6x in each month since May 2019.
- Select sectors that experienced a healthy Credit Ratio in FY2021 include **Power, Pharmaceuticals, Healthcare,** and **Chemicals**.
- Sectors that experienced a high downgrade rate and a Credit Ratio of less than 1.0x in FY2021 included **Hospitality, Textiles, Real Estate, Construction,** and **Automobile Dealerships**.
- There were **only 44 defaults in ICRA's portfolio in FY2021**, compared with 83 in the previous year. Lesser number of defaults was largely an outcome of the relaxation provided by the regulators to the credit rating agencies (CRAs) in terms of default recognition, besides the timely alternative funding availed by entities from the lending institutions to manage their liquidity.
- While uncertainties relating to the sustenance of the recovery remain, stoked further by the second wave of Covid infections, our base case assumptions suggest that the **overall credit quality of India Inc. is on the mend.**

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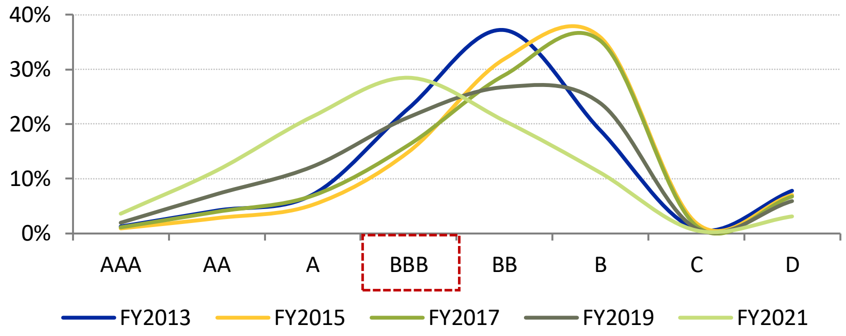
ICRA PORTFOLIO ATTRIBUTES

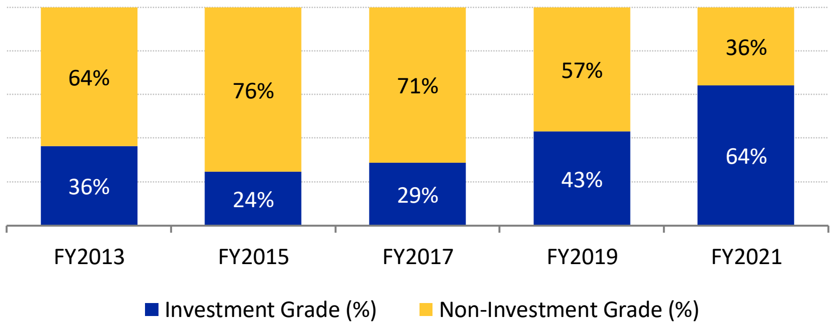
Median credit rating in ICRA's rated universe is hinged at the [ICRA]BBB category

Exhibit 1: Trend in the Category-wise Distribution of ICRA-assigned Ratings



Source: ICRA

Exhibit 2: Investment Grade versus Non-Investment Grade Entities in ICRA's Rated Portfolio



Source: ICRA

- After having remained in the [ICRA]BB category for eight years until the beginning of FY2019, the median credit rating of ICRA's rated universe had shifted upwards to the [ICRA]BBB category at the beginning of FY2020 and remained so at the beginning of the just-concluded fiscal.

- The composition of ICRA's rated universe has been undergoing a change over the years with the percentage of investment grade entities rising to 64% as at the beginning of FY2021 from 36% as at the beginning of FY2013.

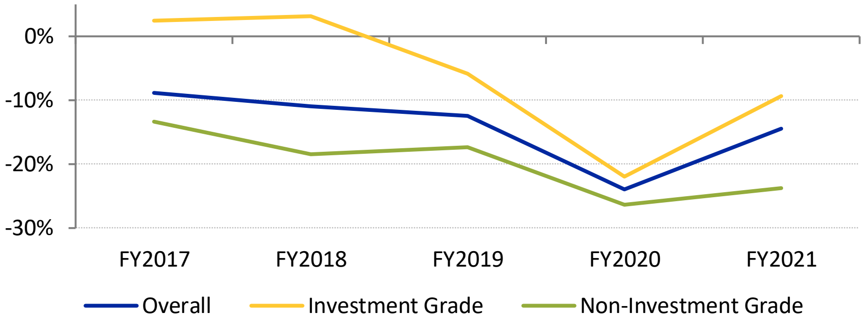
- The above is attributable not to the general improvement in the credit quality of the rated entities, but to the discontinuation of ICRA's rating coverage on a large number of lower rated entities owing to such entities' lack of cooperation in terms of sharing information with ICRA.

NOTE: Data in the above charts reflects the rating distribution as at the beginning of the various years mentioned

RATING MOVEMENTS

Rating drift remained negative in FY2021 but lesser compared with previous fiscal

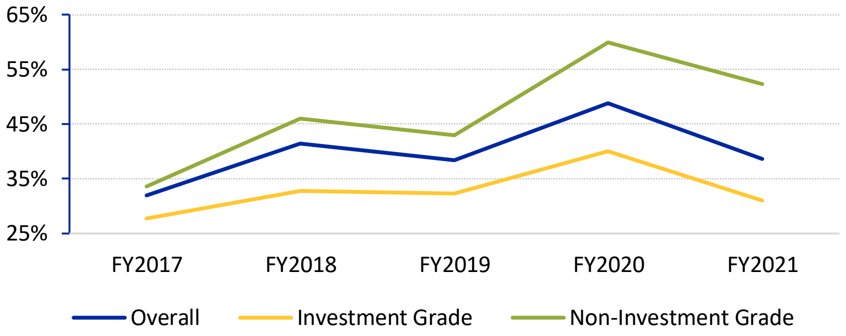
Exhibit 3: Rating Drift = (Notches Upgrades - Notches Downgrades)/ Rated Entities



Source: ICRA

- The rating drift of ICRA-assigned ratings remained negative at -14% in FY2021, but was significantly less negative compared with the previous year figure of -24% (past five-year average of -13%).
- While continuing high downgrade pressures caused the rating drift to remain at a negative in FY2021, a relatively lesser number of defaults during the year contributed to the sequential improvement.

Exhibit 4: Rating Volatility = (Notches Upgrades + Notches Downgrades)/ Rated Entities



Source: ICRA

- For the overall portfolio, the rating volatility stood at 39% in FY2021—lower than the volatility figure of 49% seen in FY2020, but in line with the past five-year average.
- The relatively lesser instances of downgrades to the default category also contributed to a reduction in the rating volatility in FY2021 compared with the previous year.

Volume of total debt downgraded down in FY2021 from the highs seen in FY2020

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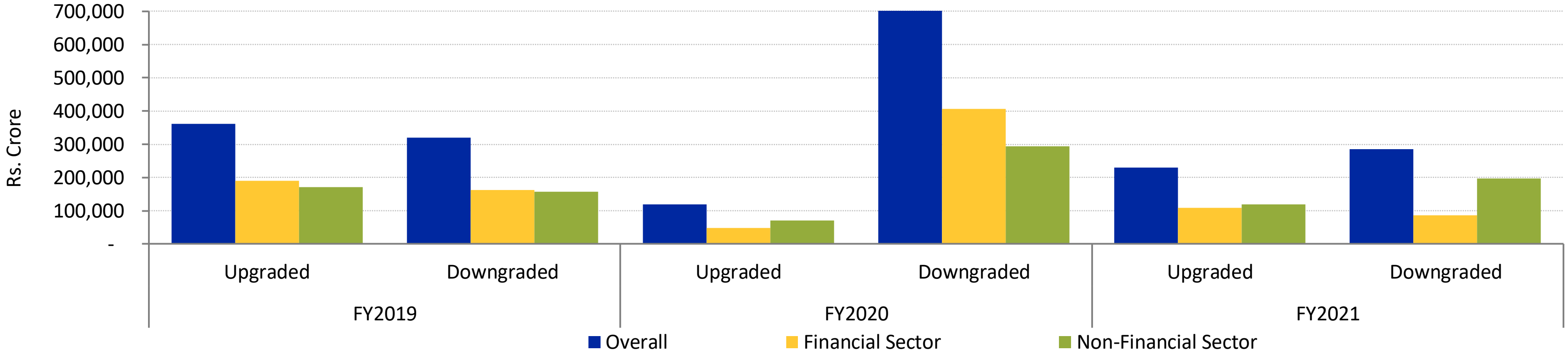
Exhibit 5: Trend in the Volume of Debt Upgraded and Downgraded

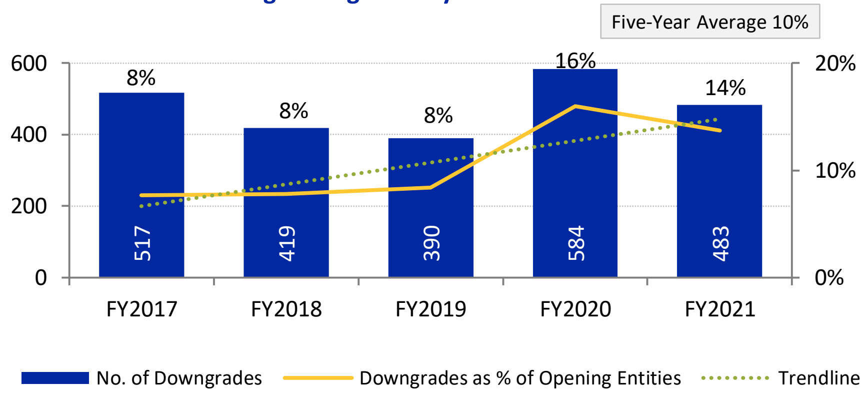


Source: ICRA

- ICRA downgraded the ratings of an aggregate debt of Rs. 2.9 trillion in FY2021, against the total debt of Rs. 7.0 trillion downgraded in FY2020. It is worth highlighting that FY2020 was a year in which several financial sector entities, besides entities in a few debt-heavy sectors, had experienced a downgrade resulting in the figures for the aggregate debt downgraded to touch a multi-year high. Of the aggregate debt downgraded in FY2021, around 31% was attributable to the financial sector (58% in FY2020).
- Among the corporate sectors, the largest contributors to the volume of the debt downgraded in FY2021 were **Construction, Power, Engineering** and **Petrochemicals & Polymers**. In comparison, the largest contributors to the debt upgraded were **Power, Ferrous Metals, Real Estate** and **Consumer Durables.**

Downgrade pressures have been high over the past couple of years

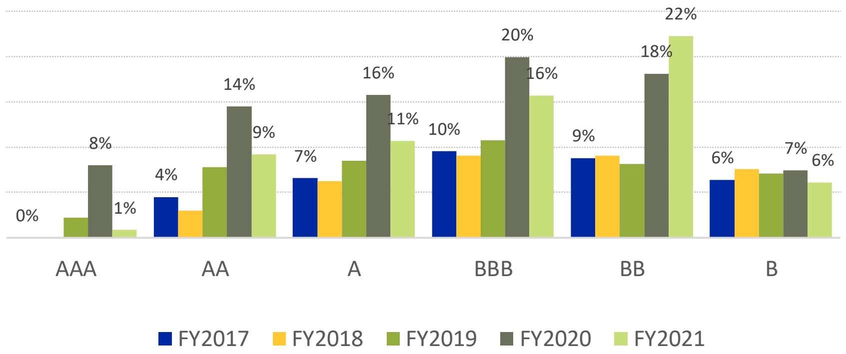
Exhibit 6: Trend in Rating Downgrades by ICRA



Source: ICRA

- ICRA downgraded the ratings of 483 entities in FY2021 reflecting a downgrade rate of 14%, coming on the heels of an even higher downgrade rate of 16% seen in FY2020.
- The proportion was much higher than the past five-year average of 10%, reflecting the elevated credit pressures seen in the past two years.

Exhibit 7: Downgrades as % of Opening Entities in Corresponding Investment Grade



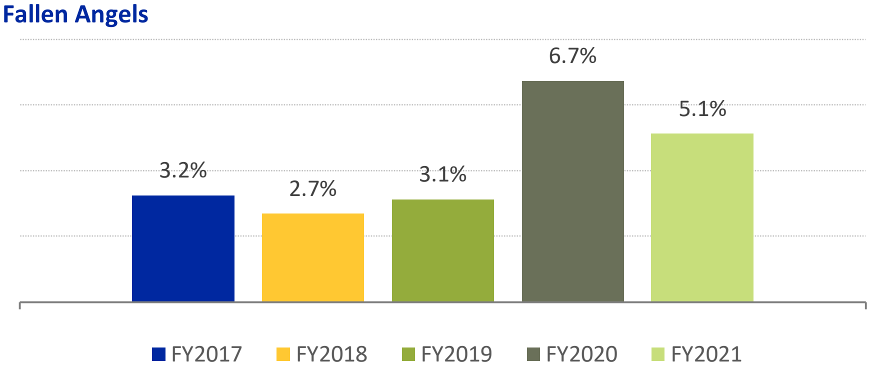
Source: ICRA

- The proportion of downgrades across rating categories largely exhibited ordinality, implying that the progressively lower-rated entities experienced a higher proportion of downgrades in view of their less resilient credit profiles.
- The ratings of a large proportion of entities rated in the [ICRA]B category remained unchanged as they were already weakly positioned on the rating scale.

NOTE: Past five years means the period of five years until FY2021

Proportion of fallen angels fell in FY2021 but remained high overall

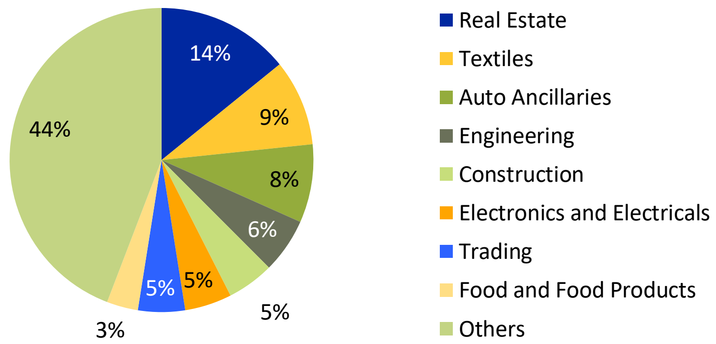
Exhibit 8: Percentage of Investment Grade Entities Downgraded to the Non-Investment Grade



Source: ICRA

- Aligned with the trend in the elevated proportion of overall downgrades, the proportion of fallen angels—the entities downgraded to the non-investment grade from the investment grade—remained high over the past couple of years.
- 91% of the fallen angels were rated in the [ICRA]BBB category prior to the downgrade in FY2021 (88% in FY2020)

Exhibit 9: Sectoral Break-up of Downgrades to the Non-Investment Grade in FY2021



Source: ICRA

- A large proportion of fallen angels in FY2021 belonged to the **Real Estate, Textiles, Auto Ancillaries, Engineering** and **Construction** sectors.
- The high contribution of the above five sectors to the pie of fallen angels was not only because of their higher share in ICRA's rated portfolio, but also because of the elevated credit pressures faced by the entities in these sectors in FY2021. Around 4-7% of the ICRA-rated entities in these five sectors ended up being fallen angels in FY2021.

Despite high credit pressures in FY2021, instances of defaults were lower

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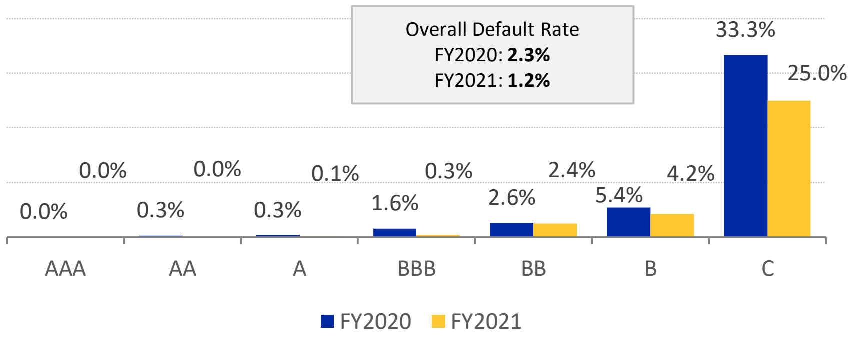
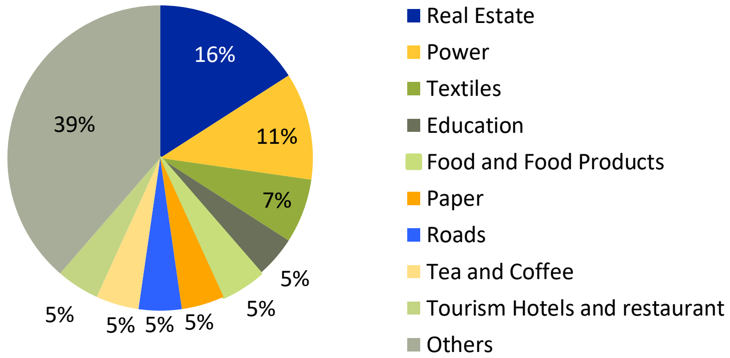
Exhibit 10: Downgrades to the Default Rating Category as a Percentage of Opening Entities in Corresponding Rating Category



Source: ICRA

Exhibit 11: Sectoral Break-up of Defaults in FY2021



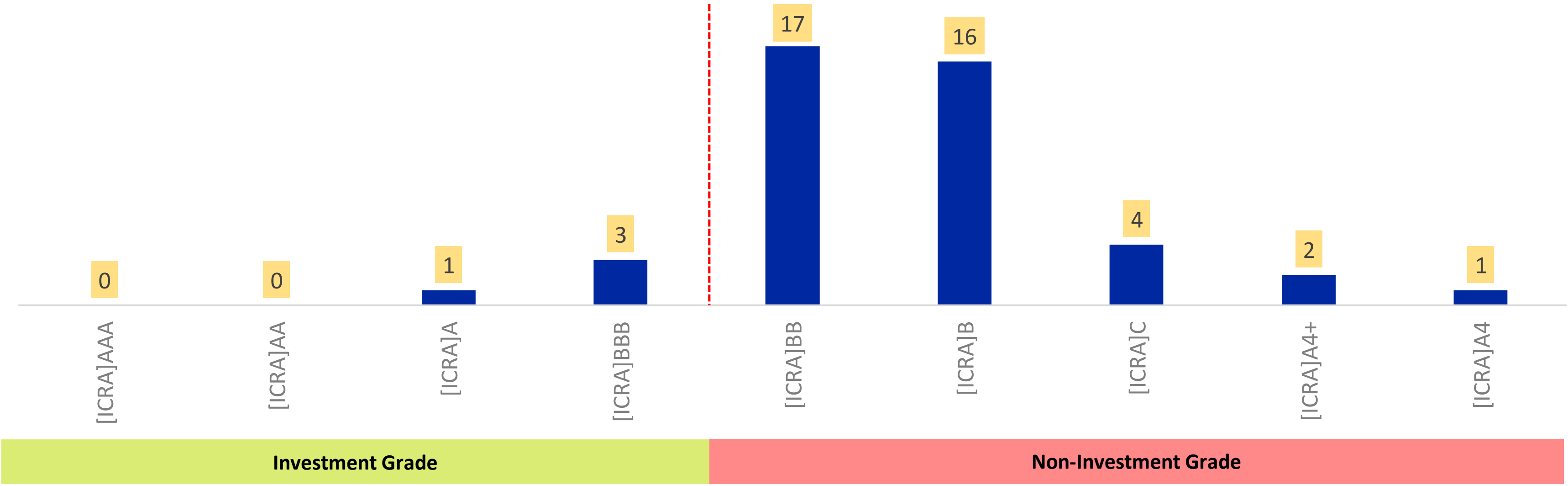
Source: ICRA

- Instances of defaults were lower in FY2021 supported by the moratorium on loan payments available to the borrowers between March and August 2020 and other liquidity support lines/ loan restructuring reliefs availed. The low default rate was also because of the relaxation provided by the regulators to the rating agencies in terms of default recognition.

- There were only 44 defaults in ICRA's portfolio across the rating spectrum in FY2021, compared with 83 in the previous year.
- **Real Estate, Power, Textiles, Education** and **Food & Food Products** were the top five sectors in which ICRA-rated entities defaulted in FY2021.

Rating category-wise defaults in FY2021

Exhibit 12: Mix of Defaults in FY2021



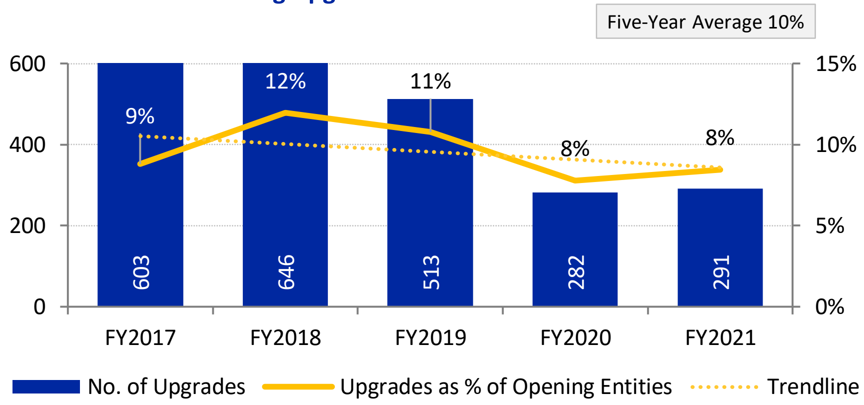
Source: ICRA

- There were a total of **44 defaults** in FY2021, of which **four** were investment grade defaults—defined as default by an entity that had an investment grade rating outstanding at the beginning of the fiscal. The four investment grade defaults were: **MVP Group International Inc., Amaravathi Textiles Private Limited, Pride Hotels Limited,** and **Bengal Shapoorji Housing Development Private Limited.**

NOTE: The rating in the Exhibit above reflects the level that was outstanding at the beginning of FY2021 before the entity slipped into the Default category during the year

Upgrade rate remained dim over the past couple of years

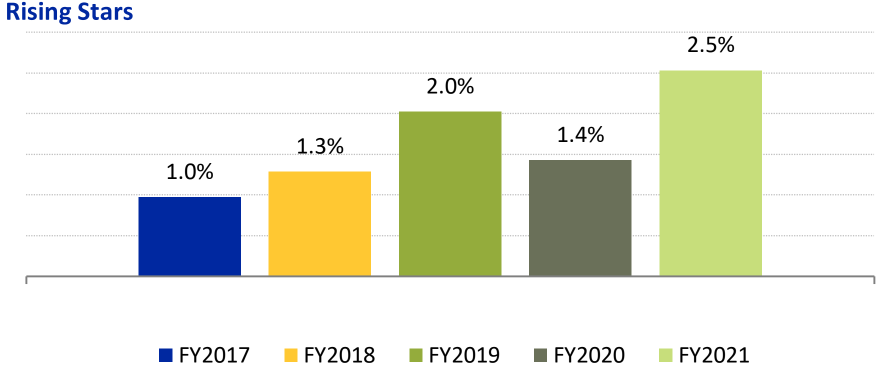
Exhibit 13: Trend in Rating Upgrades



Source: ICRA

- The ratings of 291 entities were upgraded by ICRA in FY2021. These accounted for 8% of the portfolio entities, a proportion similar to that seen in FY2020. This, however, stood lower than the past five-year average of 10%.

Exhibit 14: Percentage of Non-Investment Grade Entities Upgraded to the Investment Grade



Source: ICRA

- The ratings of 33 entities were upgraded from the non-investment grade to the investment grade. These entities, designated as rising stars, represented 11% of the total upgrades in FY2021.
- Effectively, 2.5% of the non-investment grade entities graduated to the investment grade categories in FY2021 (1.4% in FY2020). These were straddled across multiple sectors and the reasons were attributable to certain entity-specific favourable factors.

NOTE: Past five years means the period of five years until FY2021

Lately, however, rating movements have begun to tilt towards upgrades

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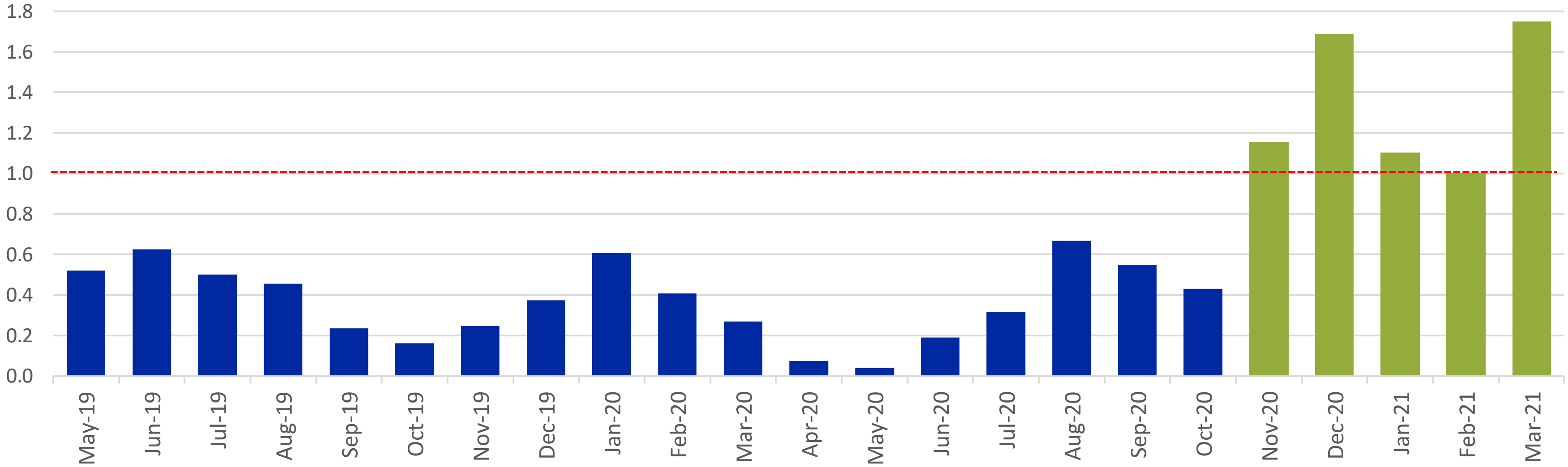
Exhibit 15: Monthly Trend in the Credit Ratio



Source: ICRA

- The rating action trends since November 2020 suggest that incremental downgrade pressures have ebbed. At the same time, the proportion of rating upgrades has been on the rise over the past two quarters.
- Since November 2020, the Credit Ratio of ICRA-assigned ratings, defined as the number of entities upgraded to that downgraded, has consistently remained upwards of 1.0 time each month. Prior to that, the Credit Ratio had remained consistently below 0.6x in each month since May 2019.

Sector-wise rating movements | Weak versus Resilient

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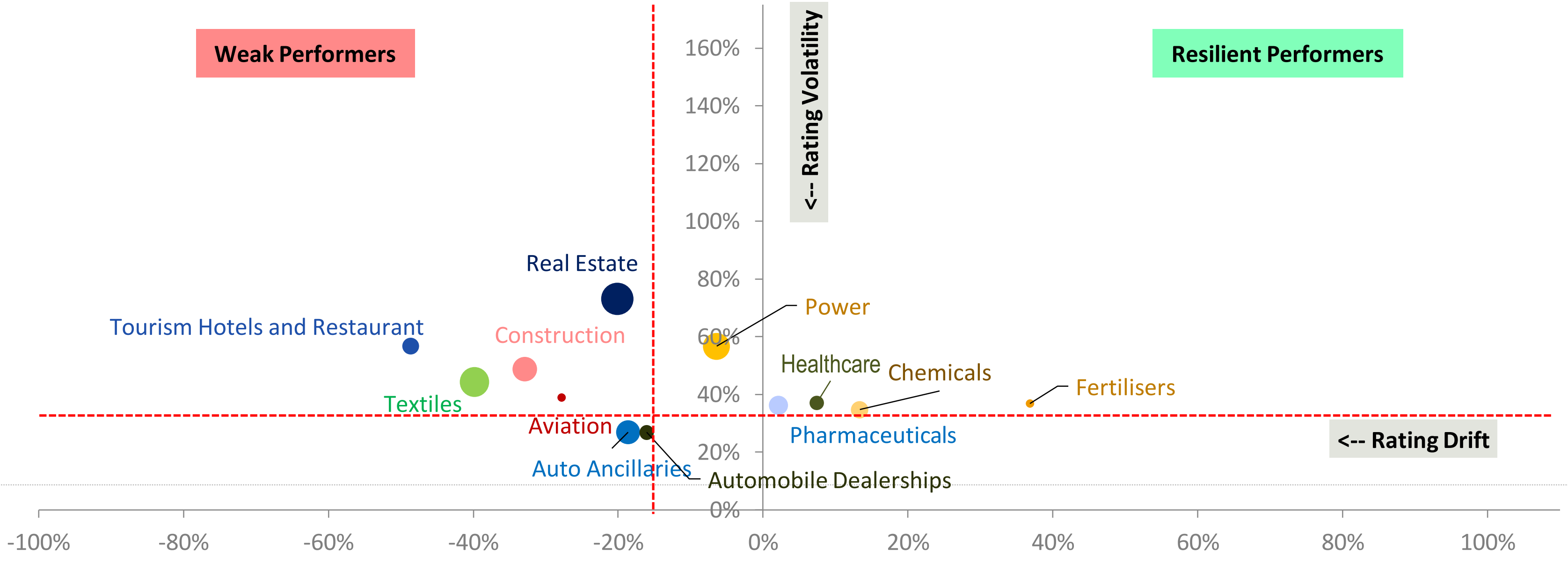
Exhibit 16: Sector-wise Rating Drift and Rating Volatility in FY2021



Source: ICRA

NOTE: Size of the bubble for a given sector is scaled based on the number of entities in ICRA's rated portfolio; the dotted red lines (vertical and horizontal) represent ICRA's Portfolio Average (*for Rating Drift and Rating Volatility*)

Sector-wise rating movements | Drivers

Weak Performers

Weak Credit Ratio FY2021

Hospitality
Facing among the most stressful periods of demand destruction caused by the pandemic

Textiles
Export-oriented entities and apparel players bore the most number of downgrades

Real Estate
Oversupply situation in several key markets, besides funding challenges faced by smaller entities

Auto Dealerships
Small and mid-sized dealers less able to cope-up with the demand and supply-side challenges

Resilient Performers

Healthy Credit Ratio FY2021

Renewable Power
Alleviation of project risk, improvement in PLF and availing of longer tenor loans

Chemicals
Favorable demand-supply dynamics for some specific chemicals and increased outsourcing orders

Pharmaceuticals
Healthy organic business growth and cost containment measures

Healthcare
Resilient revenues and profitability of select entities, despite a challenging operating environment in FY2021

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NEAR-TERM RISKS

Near-Term Risks

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- The span of Covid infections and the attendant demand and supply-side disorders that it may engender
- Movement in commodity prices which would have contrasting credit effects on the producers and the consumers
- Substantial likelihood of a rise in interest rates in view of the large Central and state government borrowing plans for FY2022
- Trajectory of the commodity prices and the borrowing costs would in turn have a bearing on the capital expenditure budgets and the viability of infrastructure investments, ongoing and in the pipeline
- The trade cycle, if not the domestic capex cycle, may see an upturn—supported by the large dose of fiscal stimulus planned in the US
- Funding environment has eased significantly for the financial sector entities, but a sustained improvement in asset quality and collection efficiencies will be the key to improvement in credit profiles

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Thank You!