Performance of ICRA-Assigned Credit Ratings

Update for H1 FY2021

October 2020

Corporate Ratings

Anjan Ghosh
+91 22 6114 3407
aghosh@icraindia.com

Jitin Makkar
+91 124 4545 368
jitinm@icraindia.com

Pratik Singhania
+91 124 4545 801
pratik.singhania@icraindia.com

Performance of ICRA-Assigned Credit Ratings in H1 FY2021

Negative rating actions rise amid a turbulent operating environment

October 2020

Overview

The business disruption and the fall in economic activity induced by the COVID-19 crisis has led to a weakening in the credit profile of a large number of entities. This is reflected in the sharp increase in negative rating actions taken by ICRA in the just concluded half-fiscal[1]. In H1 FY2021, ICRA took 582 negative rating actions, which on an annualized basis accounted for 32% of its rated portfolio, compared with the proportion of 23% in FY202

0. Around half of the negative rating actions were downgrades. As downgrades rose, the annualized downgrade rate[2] touched a high of 17% in H1 FY2021 compared with the past five-year average of 10%. At the same time, instances of upgrades were unsurprisingly sparse. ICRA upgraded the ratings of only 94 entities in H1 FY2021, reflecting an annualized upgrade rate of a mere 5%, compared with the past five-year average of 9%. This is hardly surprising considering the severity of the crisis and the synchronized impact it has had on economies, both domestic and global.

In H1 FY2021, the top five sectors—in terms of the count and the proportion of entities in the sector—that faced a negative rating action included Textiles, Real Estate, Hospitality, Auto Ancillaries and Construction. All these sectors (barring Hospitality) were already facing a demand slowdown prior to the onset of COVID-19 and the pandemic-induced disruption further amplified the adverse effects. While negative rating actions in these sectors and the overall portfolio in general were high, there were lesser instances of defaults. Only 11 defaults were observed in ICRA's rated universe in H1 FY2021 compared with 83 defaults seen in FY2020. To a large extent, this is because many entities in ICRA's rated portfolio (27%) availed a moratorium on payments on their bank loan facilities as permitted by the RBI alleviating default risk during the period of moratorium. Even in the remainder of the fiscal, instances of defaults are expected to remain low as the stressed entities would likely seek a restructuring of loans from the lending institutions which may involve, *inter alia*, the pushing ahead of loan payments.

While credit quality pressures have remained elevated, the situation could have been worse without the interventions seen on the fiscal, monetary and regulatory fronts. The mitigating effects of these measures manifested favourably in the broader financial markets as well as some specific sectors. For instance, the Reserve Bank of India (RBI) supported both a system-wide as well as a targeted improvement in liquidity conditions in specific sectors such as Non-Banking Finance Companies and Microfinance Institutions. Other relief measures included permitting the lending institutions to grant a moratorium on loan payments to borrowers for six months, and the subsequent allowance to carry out loan restructurings. These measures did and will likely work to alleviate liquidity stress, providing businesses more time to recover from demand and supply shocks. Further, liquidity support to the extent of Rs. 900 billion for state power distribution utilities, through PFC and REC[3], have eased cash flow concerns, for now, across the power sector value chain. Yet, amid the continued economic uncertainty and public health concerns, aggregate consumption and investment demand is likely to remain dull in the near term. Weak growth impulses, both in terms of domestic and export demand, would likely be the predominant risk factor causing continued pressures on credit quality, going forward. Vulnerabilities of the financial sector and weak fiscal health of the Centre and the State governments would add to the pressures.

ICRA has recently further slashed its GDP growth forecast for FY2021 to -11.0%, from -9.5% earlier. As banks and non-banks in general face elevated asset quality pressures, and public sector banks in particular face capital constraints, credit growth is expected to fall to low single digits in FY2021 which would both be a cause and an effect of weak economic activity. A prolonged weakness in the financial sector would likely restrict the credit quality of the real sector from improving materially. While entities in many sectors may not see a further deterioration in credit quality as economic activity improves sequentially, the recovery period is expected to be both long as well as uneven.

Overview

In responding to the severe and extensive shifts in the operating environment, the current ICRA-assigned ratings and outlooks capture the near-term and medium-term credit risks stemming from the pandemic, as well as the mitigating effect of policy support. Our ratings continue to reflect our expectations for medium to longer-term performance and are not predisposed solely to the credit quality weakness being seen in the extant period, unless an entity has inadequate liquidity buffers and weak financial flexibility that warrants an immediate and a relatively sharper rating change. As the situation evolves, our rating reviews will continue to incorporate emerging developments and new information.

ICRA'S PORTFOLIO OF RATED ENTITIES

Category-wise Ratings Distribution

Owing to a change in the rated portfolio mix, the median rating of ICRA's rated universe has gradually shifted upwards over the years, but has remained hinged to the [ICRA]BBB category over the past couple of years

The median credit rating of ICRA's rated universe continues to hinge at the [ICRA]BBB category

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 (See *Chart 2*). At the same time, the median credit rating of ICRA's rated universe has also been shifting upwards. 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 shifted upwards to the [ICRA]BBB category as at the beginning of FY2020 and remained so as at the beginning of the ongoing fiscal. The tilt in the proportion of entities rated in the investment grade and the upward shift in the median credit rating 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. Aside from the "median", the "mode" of ICRA-rated universe has also remained in the [ICRA]BBB category for the past couple of years, in comparison with the mode having been in the [ICRA]BB category as at the beginning of FY2019.

Chart 1: Category-wise Distribution of ICRA-Assigned Ratings

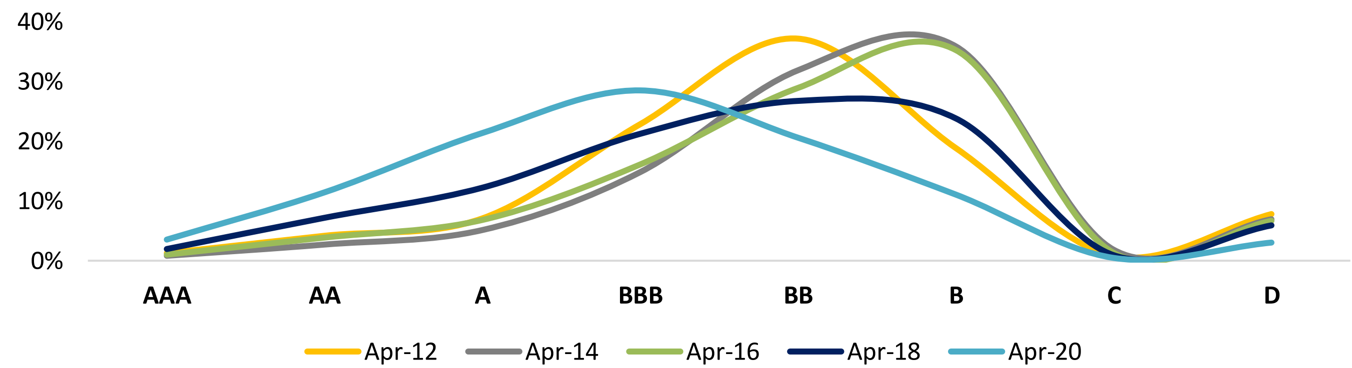
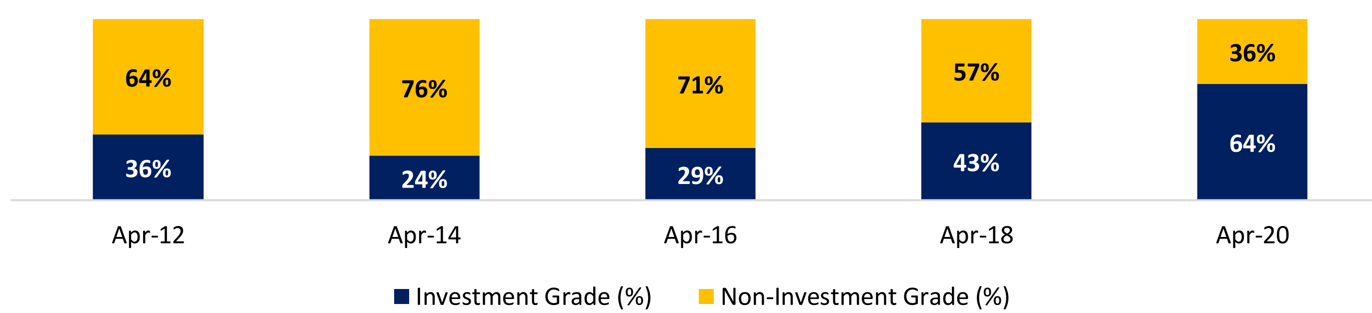


Chart 2: Investment Grade versus Non-Investment Grade Entities in ICRA's Rated Universe



Source: ICRA

Note: The data in the above chart and elsewhere in the document excludes the entities that were non-cooperating at the beginning of the year

TRENDS IN RATING DRIFT AND RATING VOLATILITY

Rating Drift and Rating Volatility

Rating drift remained significantly negative in H1 FY2021 in view of the large number of downgrades seen during the period, even as this was an improvement over the previous year because of lesser instances of downgrades to the default category

Rating drift remained significantly negative for both investment grade and non-investment grade entities

The rating drift of ICRA-assigned ratings, calculated as the average upgraded notches per rated entity, minus the average downgraded notches per rated entity, stood at -19% (annualized) in H1 FY2021. While this was an improvement over the rating drift of -24% seen in FY2020, it remained much worse than the past five-year average of -14% (See *Chart 3*). The apparent improvement over the previous year was mainly because of the significantly lower instances of defaults in H1 FY2021 compared with FY2020. Excluding the downgrades to the default category, the rating drift in H1 FY2021 worsened to -17% (annualized) in H1 FY2021 compared with -12% in FY2020. Also, the rating drift for investment grade entities continued to remain negative for the third consecutive year, being -17% (annualized) in H1 FY2021 (-22% in FY2020).

Further, for the overall portfolio, the rating volatility, which is measured as the average upgraded notches per rated entity, plus the average downgraded notches per rated entity, stood at 36% (annualized) in H1 FY2021—lower than the past five-year average as well as the volatility seen in FY2020. Even for investment grade entities, the rating volatility was lower in H1 FY2021 (at 33%--annualized) compared with FY2020 (at 40%), but in line with the past five-year average. While both upgrades and downgrades had contributed to the rating volatility in the past, the rating volatility seen in H1 FY2021 was predominantly attributable to downgrades with upgrades being much limited in proportion. In effect, both the sparsity of upgrades as well as limited instances of downgrades to the default category made the rating volatility numbers appear lower in H1 FY2021 compared with those observed in the past few years.

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

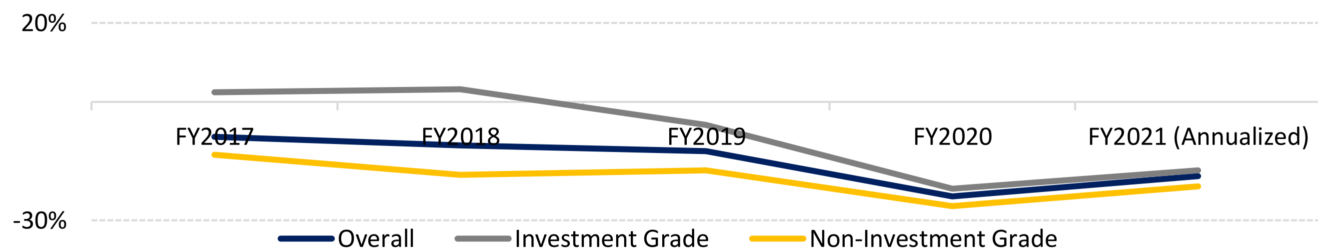
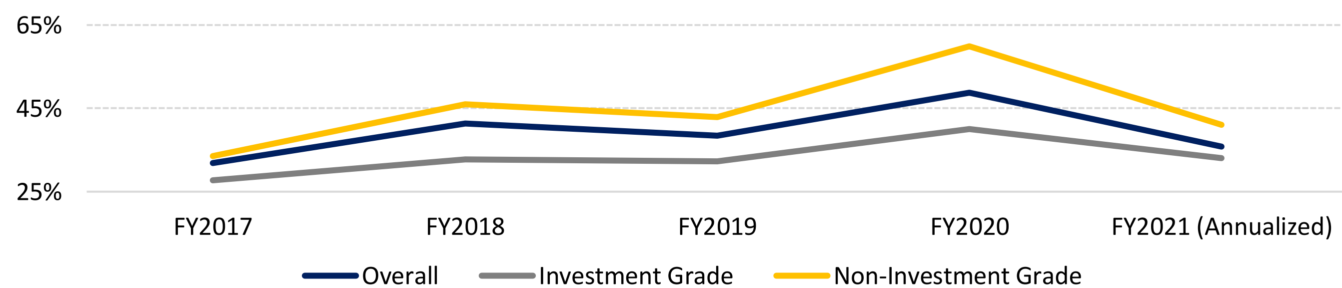


Chart 4: Rating Volatility = (Notches Upgrades + Notches Downgrades)/ Rated Entities



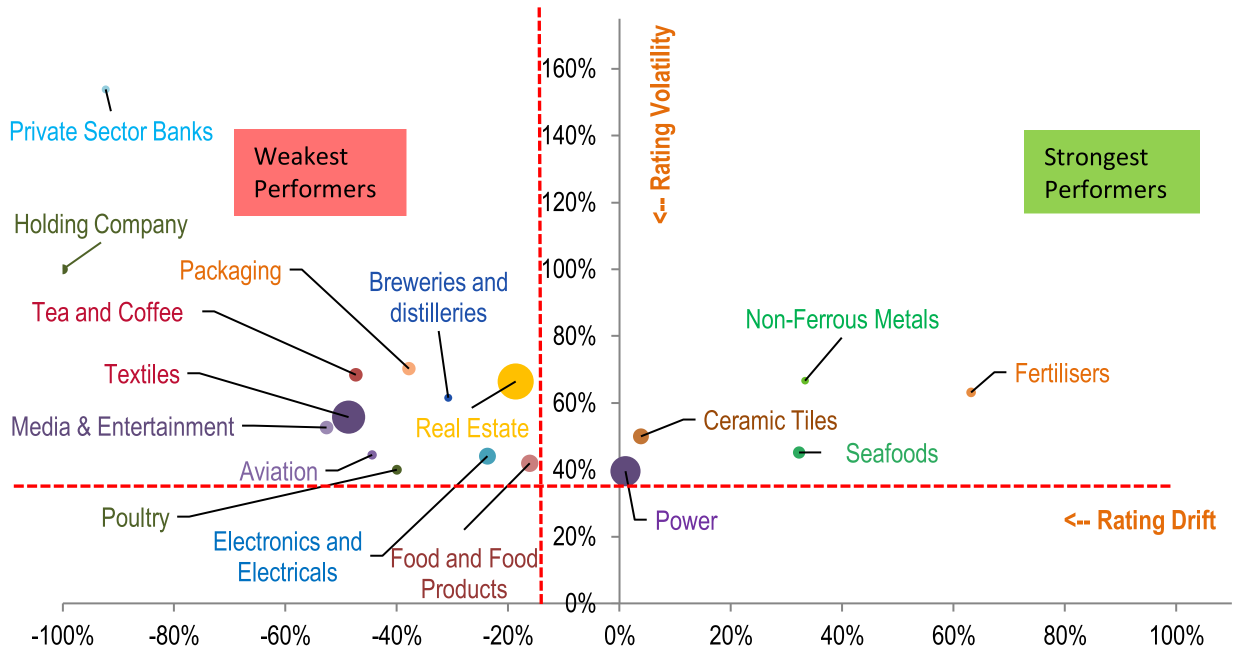
Source: ICRA

Rating Drift and Rating Volatility

Select sectors where the Rating Drift was positive and where the Rating Volatility in H1 FY2021 was higher than the historical portfolio average: **Ceramic Tiles, Fertilisers, Power** and **Seafoods.**

Select sectors where the Rating Drift was negative and where the Rating Volatility in H1 FY2021 was higher than the historical portfolio average: **Aviation, Electronics and Electricals, Media & Entertainment, Packaging, Real Estate, Textiles** and **Retail**.

Chart 5: Sector-wise rating drift and volatility in H1 FY2021 (annualized)



Note: The size of the bubble reflects the relative number of entities in ICRA's rated portfolio; The red dotted lines (vertical and horizontal) reflect the average Rating Drift and the average Rating Volatility of ICRA-assigned ratings over the past five years

Source: ICRA

Volume of Debt Undergoing a Rating Change

While the aggregate debt volumes downgraded in H1 FY2021 remained high overall, these remained much lower than the peak seen in FY2020

Volume of the total debt downgraded comes down in H1 FY2021 from the highs seen in FY2020

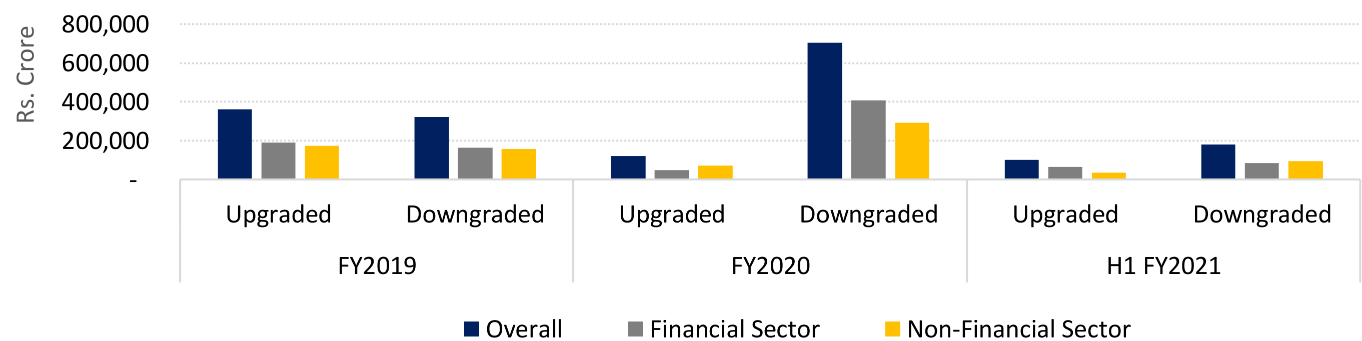
Upgrades

- While the number of entities upgraded in H1 FY2021 were significantly lower compared with the previous period, the volume of the debt upgraded by ICRA in H1 FY2021 (at Rs. 1.0 trillion) stood close to the debt volume upgraded in the full year FY2020. Three entities viz., IDBI Bank, Yes Bank and Lalitpur Power Generation accounted for around three-fourths of the total debt upgraded in H1 FY2021, implying that the data relating to the aggregate debt volumes upgraded was heavily influenced by the upgrade in the ratings of a select few entities.
- The share of the financial sector in the total debt volumes upgraded was at 65% in H1 FY2021 compared with 40% in FY2020. Here again, an increase in the above proportion is far from a reflection of a broad-based improvement in the credit quality of financial sector entities but rather represents an improvement in the credit quality of a mere five entities because of certain firm-specific factors.

Downgrades

- In H1 FY2021, ICRA downgraded the ratings for an aggregate debt of Rs. 1.8 trillion, 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 H1 FY2021, around 47% was attributable to the financial sector (58% in FY2020). In H1 FY2021, ICRA downgraded the ratings of 20 financial sector entities (of which 10 belonged to the same sponsor group), for reasons including asset quality pressures pertaining to the wholesale book and funding challenges faced. Among sectors, the largest contributors to the volume of the debt downgraded in H1 FY2021 were Construction, Finance and Banking, Petrochemicals & Polymers and Power
- At a portfolio level, the contribution of the debt downgraded to [ICRA]D to the total debt downgraded decreased to 3% in H1 FY2021, from 12% in FY2020.

Chart 6: Trend in the Volume of Debt Upgraded and Downgraded



Source: ICRA

ANALYSIS OF RATING DOWNGRADES

Number of Rating Downgrades

Number of rating downgrades as a proportion of rated entities remains elevated in H1 FY2021, maintaining the sharp increase seen in FY2020

» In H1 FY2021, the ratings of 297 entities were downgraded (266 in H1 FY2020). Overall, the number of downgrades as a proportion of opening entities remained high at 17% (annualized) in H1 FY2021, compared with 16% in FY2020 and against a much lower past five-year average of 10%.

» The downgrade rate of investment grade entities too stood at 17% (annualized) in H1 FY2021, similar to the previous full year, and being the highest since FY2013.

» Among the investment grade entities downgraded in H1 FY2021, about 52% of the ratings were in the [ICRA]BBB category, 28% in the [ICRA]A category, 15% in the [ICRA]AA category and none in the [ICRA]AAA category; about 6% were entities rated only on the short-term scale.

Chart 7: Trend in Rating Downgrades by ICRA

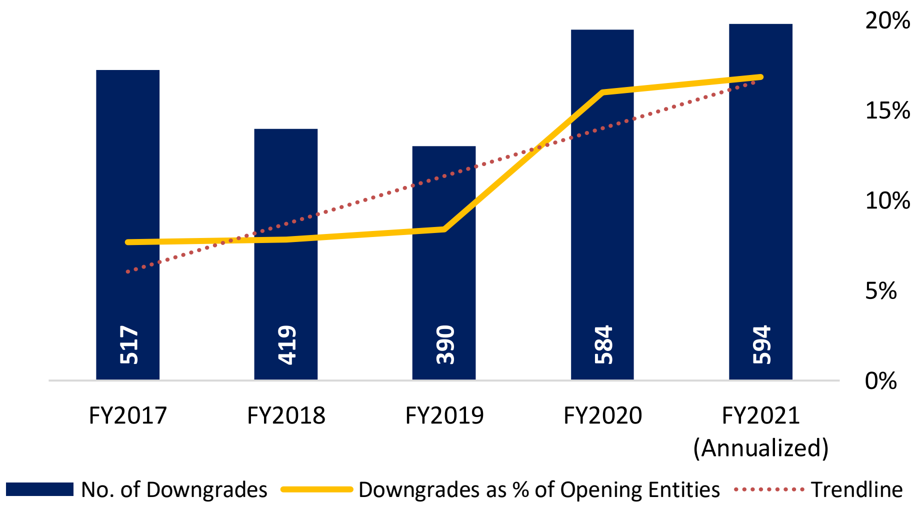
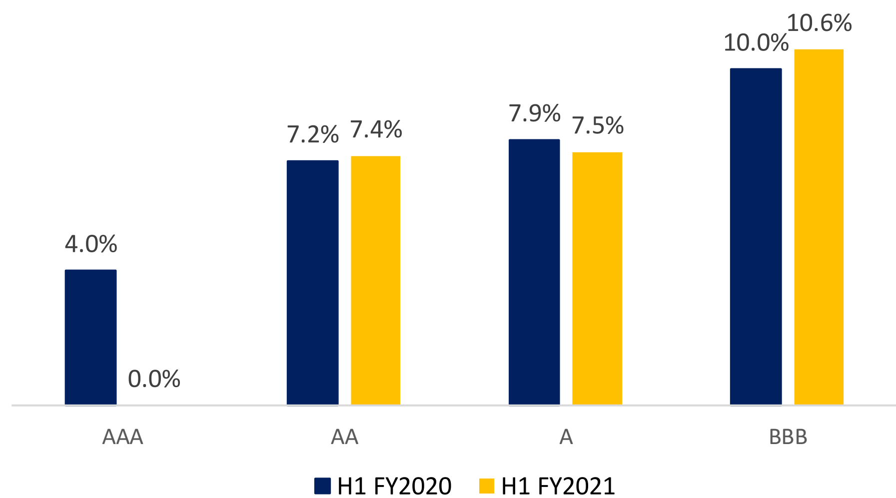


Chart 8: Downgrades as % of Opening Entities in Corresponding Investment Grade



Source: ICRA

Rating Movement from the Investment Grade to the Non-Investment Grade

The proportion of fallen angels in H1 FY2021 maintains the multi-year high experienced in the previous fiscal

- In H1 FY2021, the percentage of fallen angels i.e. the number of entities that were downgraded from the investment grade to the non-investment grade as a proportion of the total opening entities in the investment grade was 6.7% (annualized), similar to the level seen in FY2020 (See *Chart 9*). This remained as the highest proportion seen since FY2013. Around 94% of the fallen angels were rated in the [ICRA]BBB category prior to the downgrade in H1 FY2021 (88% in FY2020).

- In H1 FY2021, among the fallen angels, the outlook on the long-term rating post the downgrade was Negative for 30% of the entities, compared with 34% in FY2020.

- *Chart 10* presents the sector-wise breakup of entities whose ratings were downgraded from the investment grade to the non-investment grade categories during H1 FY2021. As can be observed from the chart, a large proportion of entities downgraded in H1 FY2021 from the investment grade to the non-investment grade rating categories belonged to the **Real Estate, Textiles, Electronics and Electricals** and **Trading** sectors.

Chart 9: Percentage of investment grade entities downgraded to the non-investment grade

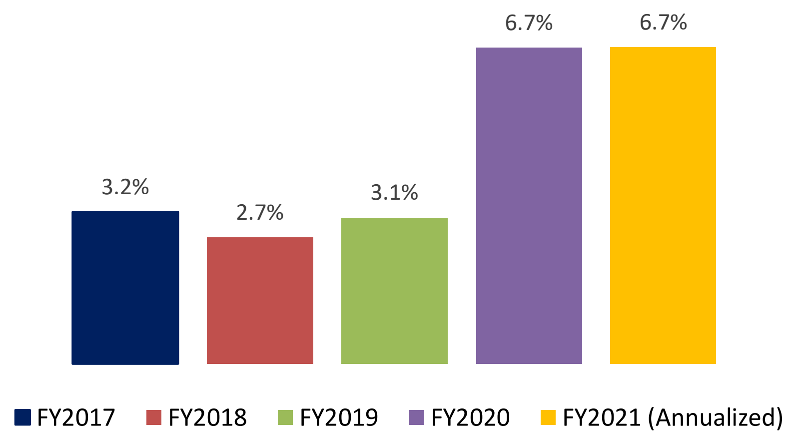
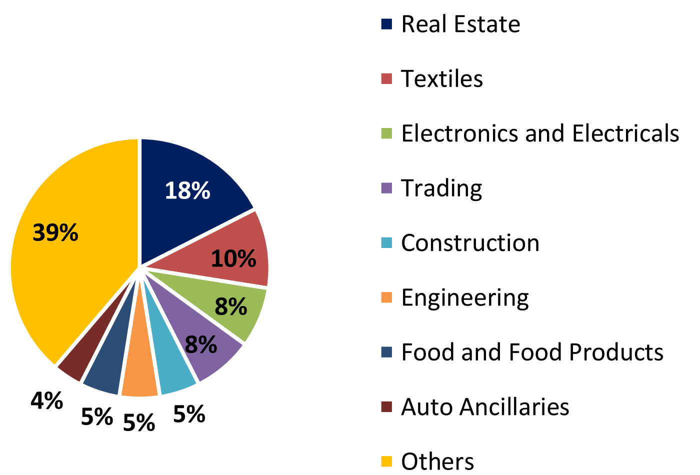


Chart 10: Sectoral Break-up of Downgrades to the Non-Investment Grade, H1 FY2021



Source: ICRA

Movement to the Default Rating Category

Despite rise in credit quality pressures, overall one-year default rate stays steady

- The default rate of ICRA-assigned ratings dropped to 0.6% (annualized) in H1 FY2021 from 2.3% in FY2020 and against the past five-year average of 2.5%. Only 11 defaults were observed in ICRA's rated universe in H1 FY2021 compared with 83 defaults seen in FY2020. To a large extent, this is because many entities in ICRA's rated portfolio (27%) availed a moratorium on payments on their bank loan facilities as permitted by the RBI, alleviating default risk during the period of moratorium. Even in the remainder of the fiscal, instances of defaults are expected to remain low as the stressed entities would likely seek a restructuring of loans from the lending institutions which may involve, *inter alia*, the pushing ahead of loan payments.

- *Chart 12* presents the sectoral count of defaults in H1 FY2021. As can be observed, the defaults were few and far between and straddled across diverse sectors.

Chart 11: Downgrades to Default Rating Category as Percentage of Opening Entities in Corresponding Rating Category (H1 FY2021)

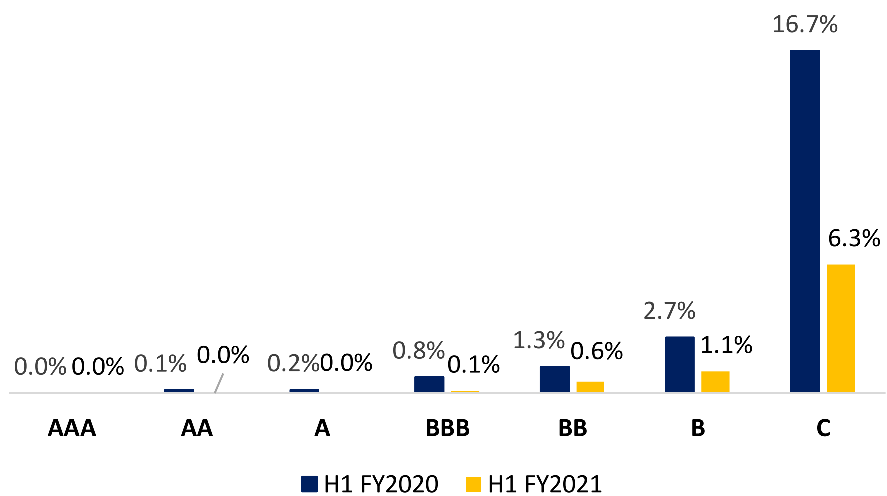
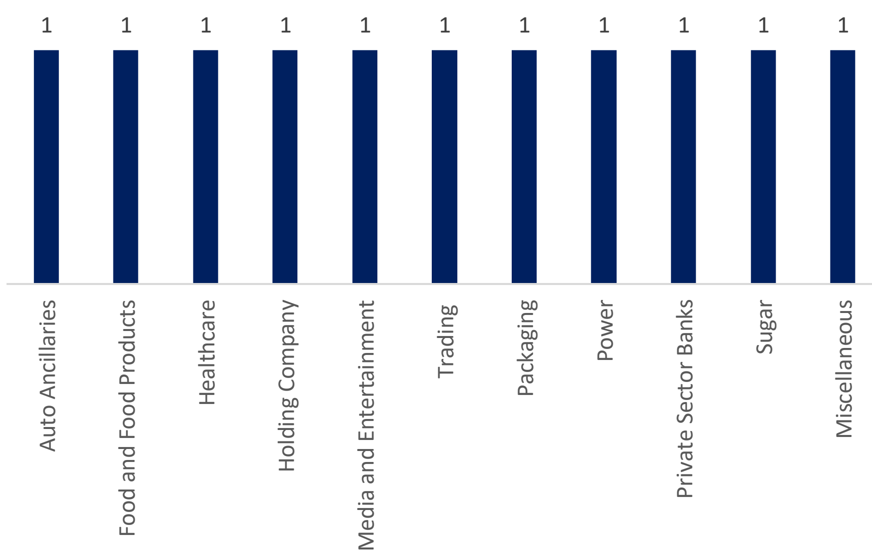


Chart 12: Sectoral Count of Defaults in H1 FY2021



Source: ICRA

ANALYSIS OF RATING UPGRADES

Number of Rating Upgrades

Upgrade rate loses traction in H1 FY2021

- In H1 FY2021, the ratings of 94 entities were upgraded by ICRA, compared with 170 in H1 FY2020. Overall, the number of upgrades as a proportion of opening entities ebbed to 5% (annualized) in H1 FY2021 compared with 8% in FY2020 and against the past five-year average of 9%.

- Of the total of 94 entities whose ratings were upgraded in H1 FY2021, for 9 entities (10% of total), the ratings moved out of the Default category (7% in FY2020).

- Also, in H1 FY2021, the ratings of 12 entities were upgraded from the non-investment grade to the investment grade. These entities, designated as rising stars, represented 13% of the total upgrades in H1 FY2021, higher than the percentages observed in FY2020 (9%) and FY2019 (11%). Effectively, 1.8% (annualized) of the non-investment grade entities graduated to the investment grade categories in H1 FY2021 (1.4% in FY2020) (See *Chart 14*).

Chart 13: Trend in Rating Upgrades

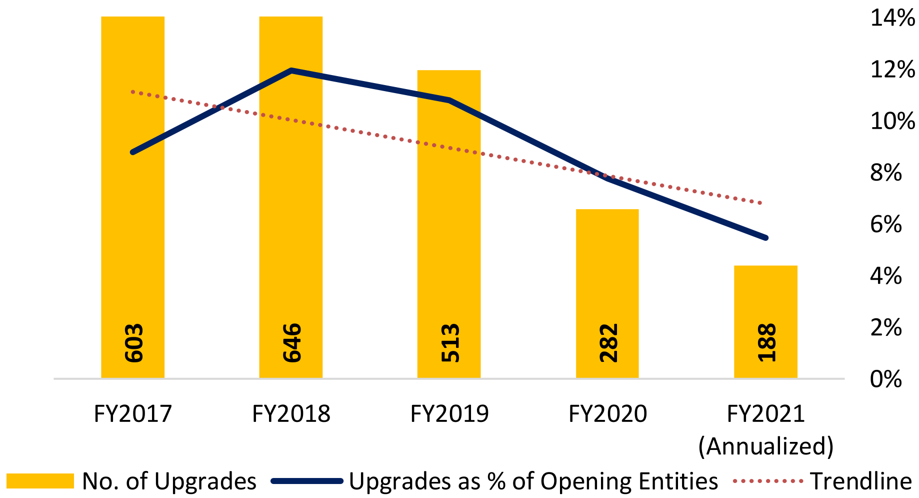
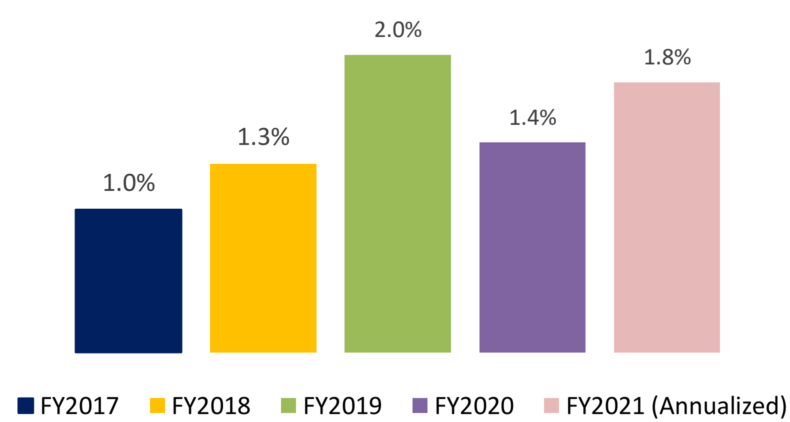


Chart 14: Percentage of non-investment grade entities upgraded to the investment grade



Source: ICRA

Endnotes

[1] Negative rating actions refer to rating downgrades, change in outlook to Negative from Stable, and change in outlook to Stable from Positive.

[2] Downgrade Rate (Upgrade Rate) is defined as the number of entities downgraded (upgraded) in the period of analysis as a percentage of the total number of rated entities as of the beginning of the period. The calculation of the downgrade rate excludes the [ICRA]D rated entities. The calculation of the upgrade rate excludes the [ICRA]AAA and the [ICRA]A1+ rated entities.

[3] Power Finance Corporation and REC Limited

Note: The data in this report relates to the performance of financial, non-financial and public finance ratings. It does not cover the performance of structured finance ratings. Further, the data included in this report excludes the entities that were non-cooperating at the beginning of the year

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Branches

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

907 & 908, Sakar – II,
Ellisbridge, Opp. Town Hall,
Ahmedabad - 380 006
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B,
Unit No. 1004, 10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch,
Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor, FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg, Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony, S. No. 210
CTS 3202 Range Hills Road, Shivajinagar,
Pune - 411 020
Tel: +91 20 2556 1194

Email: info@icraindia.com
Helpdesk: 124 3341580
Website: www.icra.in/ www.icraresearch.in